

Can the side effects of sanctions and energy inflation trigger the disintegration of the international monetary regime?

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Abstract:

This article aims to discuss the impact of the energy crisis exacerbated by the Russo-Ukrainian war on the general macroeconomic performance and income distribution of the Eurozone. We consider the restrictive monetary policies induced by the return of inflation, their declared and implicit objectives, and the contradictory consequences for the economic system. We analyse the impact of Western sanctions on the Russian economy, and discuss the long-term consequences of sanctions and political strategies on the de-dollarisation of global markets.

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How to cite this article:

Lampa R., Oro G. (2023), "Can the side effects of sanctions and energy inflation trigger the disintegration of the international monetary regime?", *PSL Quarterly Review*, 76 (306):225-242.

DOI: <https://doi.org/10.13133/2037-3643/18249>

JEL codes:

F51, E32, F44

Keywords:

euro crisis, inflationary processes, post-war economic development

Journal homepage:

<http://www.pslquarterlyreview.info>

Fifteen months after the sudden onset of the Russo-Ukrainian war, we have already observed several changes in the global economic outlook triggered by the conflict on multiple planes.

At a regional level, the war has led to an exogenous shock on energy prices in Europe since European energy goods were (and still are, largely) primarily imported from Russia. This external turmoil has had severe consequences in at least two areas.

First, the sharpening of imported energy material inflation further amplified the crisis of the international supply chains, which dated from 2019 and was re-ignited by the Covid pandemic. The most relevant consequence was the abrupt interruption of the positive trend in the Eurozone trade balance, previously gained during the years of deflationary policies, which also implied a sudden stop to the competitive devaluation of the euro, particularly against the U.S. dollar. From a financial market perspective, the U.S. dollar has always been considered, in times of economic crisis, a haven 'as good as gold'. The resolute intervention by the Fed, and its restrictive monetary policy, has therefore attracted all those European capitals fleeing from imported inflation and devaluation towards the dollar currency area.

In addition, the increase in the cost of energy commodities and the forced end of the privileged Russia-Germany relationship (summarised by the sabotage of the Nord Stream 2 gas pipeline) has, in fact, implied the end of Agenda 2010. Indeed, the program desired by Prime Minister Gerard Schroeder is often linked to trade union agreements and Hartz's concept of labour market reforms. However, it should not be forgotten that the second pillar was precisely the privileged and competitively priced supply of Russian gas and energy raw materials. As a result, Germany entered a recession in the first two quarters of 2023. Added to the change in U.S. trade policy and the return of protectionist measures (which had already pushed Germany into recession in 2019), the conflict has probably caused a mortal blow to the German neo-mercantilist policy at the origin of the brilliant economic performance that the country had in the first 15 years of the new century (Halevi, 2023). However, the uncertain prospects of the German economy can potentially undermine the growth of the entire European Union, particularly of the economies closely integrated into the regional supply chains of Eastern Europe.

At a North-Atlantic level, the return of inflation after the 30 years of the Great Moderation implied a radical change in economic policy. If the Covid crisis had coincided with the return of expansionary fiscal stimuli, accompanied by an accommodative monetary policy, the flare-up of inflation led to the abrupt return to fiscal consolidation and monetary tightening.

As a result, European governments, the European Central Bank (ECB) and the Federal Reserve introduced new restrictive fiscal and monetary policies to contain the general price increase and thus prevent the depreciation of currencies and capital flight.

Compared to the highly conservative monetary policy during the 1973-1975 U.S. recession, the current monetary tightening is undoubtedly modest in absolute terms. However, comparing the two scenarios also shows that the discount rate is growing faster today than in the 1970s. This evidence has substantial implications when it comes to analysing the possible future developments of the crisis.

In addition, it is worth reflecting on the consequences of the increase in interest rates. On the one hand, higher interest rates affect aggregate demand, particularly new investments and indebted consumption, and they therefore lead to a reduction in profits. On the other hand, by changing the distribution of income, monetary tightening increases the cost of financing, thus reducing the ability of indebted businesses, workers and governments to repay their debts, which eventually results in greater financial instability.

Finally, at a global level, it is worth discussing the impact of the sanctions against Russia and their implications for the international economic and financial order. Since the 2014 Crimea referendum, sanctions against Russia have been implemented. However, in 2018, the Trump administration wilfully applied them blandly and ineffectively, even allowing Russian bonds to be issued in euros and dollars. As soon as the war broke out, further sanctions were promptly introduced, affecting Russian economic and financial activities. However, the effects of recession and isolation from international trade on the Russian economy have proved weak.

First, Russia has been implementing a "technologically regressive import substitution", which avoided the most detrimental effects of supply shortages of investment and consumption goods.

Second, financial sanctions have been absorbed by Russia's ability to quickly realign its trade and financial channels towards Asia, the Middle East and Africa.

From this perspective, we can ask ourselves if such new economic relations between Russia and several developing countries can accelerate the broadly discussed process of de-dollarisation of global financial markets.

The tendency to de-dollarisation has been recently linked to the increase in the share of transactions denominated in Chinese renminbi on total global exports, even if there are still many doubts regarding a possible replacement of the monetary system based on the dollar with one based on China's yuan, both for existing institutions and for the structural characteristics of the United States economy, which together defend the dollar hegemony. Alternatively, we can explore the possibility that one of the long-term consequences of the Russo-Ukrainian military escalation might be the rise of an international monetary system based on multiple hard currencies as a reflection of the emergence of new and differentiated currency areas, within which national economies will be conducted, as a natural consequence, to a return to the system of flexible exchange rates.

In light of this premise, in the next section we will discuss the impact of the energy crisis exacerbated by the military conflict on the general macroeconomic performance and income distribution of the Eurozone. In the following section, we evaluate the restrictive monetary policies, their declared and implicit objectives, and the contradictory consequences for the economic system. In the subsequent section, we analyse the impact of Western sanctions on the Russian economy. In the fourth section, we discuss the long-term consequences of sanctions and political strategies on the de-dollarisation of global markets. Concluding remarks follow.

1. The acceleration of the European energy crisis

The sharp rise in the prices of energy commodities was the first trigger of the inflationary flare that hit European households and businesses, reaffirming the centrality of the energy sector in the general trend of the economy. However, it is essential to point out that the increase in energy prices had already started in the second half of 2021. The Italian case, in this sense, appears particularly significant given that, in the fourth quarter of 2021, electricity and gas bills had increased by 50% annually (ENEA, 2021). The reasons for this surge were many. On the one hand, the rise in oil prices, the increase in international LNG quotations influenced by supply bottlenecks, and the strong growth in the cost of shipping following the pandemic combined with the increase in post-pandemic global demand. On the other hand, speculative movements on the main financial markets for the quotation of commodities played an important role.

From this angle, the subsequent outbreak of war in Ukraine (February 24, 2022), besides reinforcing the pressure on prices, triggered a reconfiguration of oil and gas flows at an international level, highlighting the widening gap between the Atlantic and Asian blocs, a harbinger of significant shifts in the global balance of power, with potentially persistent impacts on energy prices (Floros, 2023). Although the risk of overall gas shortages at the European level was averted for the winter of 2022-2023, the change in supply flows could prove to be much more problematic for next winter, when European countries will have to fill the gas stocks without the substantial contribution of Russian supplies.

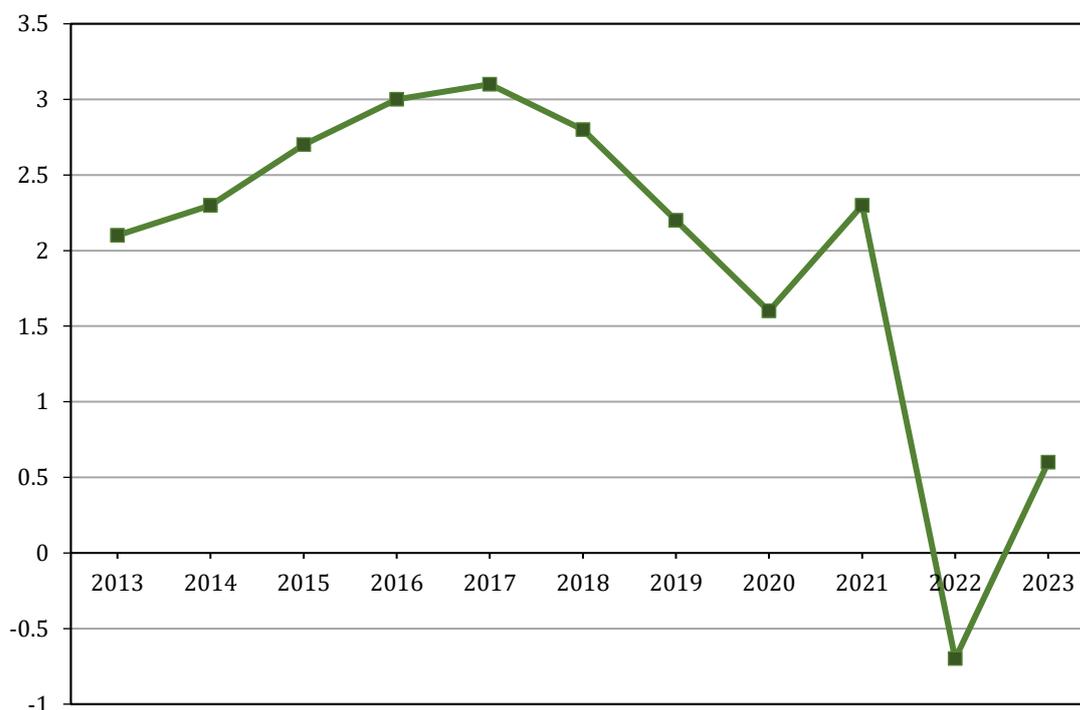
In light of this premise, the impact of the energy crisis that began in 2021 and accelerated after the military escalation of the Russo-Ukrainian conflict immediately represented a double fracture in the EU economic situation.

On the one hand, the crisis of imported energy materials rapidly translated into an internal inflationary process: where they were able to do so, large energy and food companies endowed with significant monopoly power on the market maintained, if not even increased, their profit margins as a reaction to the rising costs of energy resources (Weber, 2021; Bivens, 2022; Reich, 2022; Cucignatto et al., 2023).

Consequently, if we disaggregate the main components of the harmonized index of consumer prices (HICP) in the EU for 2022, we note that the item “Housing, water, electricity, gas and fuels” increased by 18% against an overall 9.2% HICP increase (Eurostat, 2023).

On the other hand, inflation has caused an external imbalance (see figure 1): the increase in the prices of imported goods in the absence of domestic production to replace them (as in the case of natural gas and oil) has led to an increase in production costs, while domestic inflation reduced the competitiveness of domestic goods on foreign markets, compromising the volume of exports. Therefore, the two imbalances resolved in the general increase in prices and the new current account deficit.

Figure 1 – Current account (% current GDP), Eurozone (2013-2023)



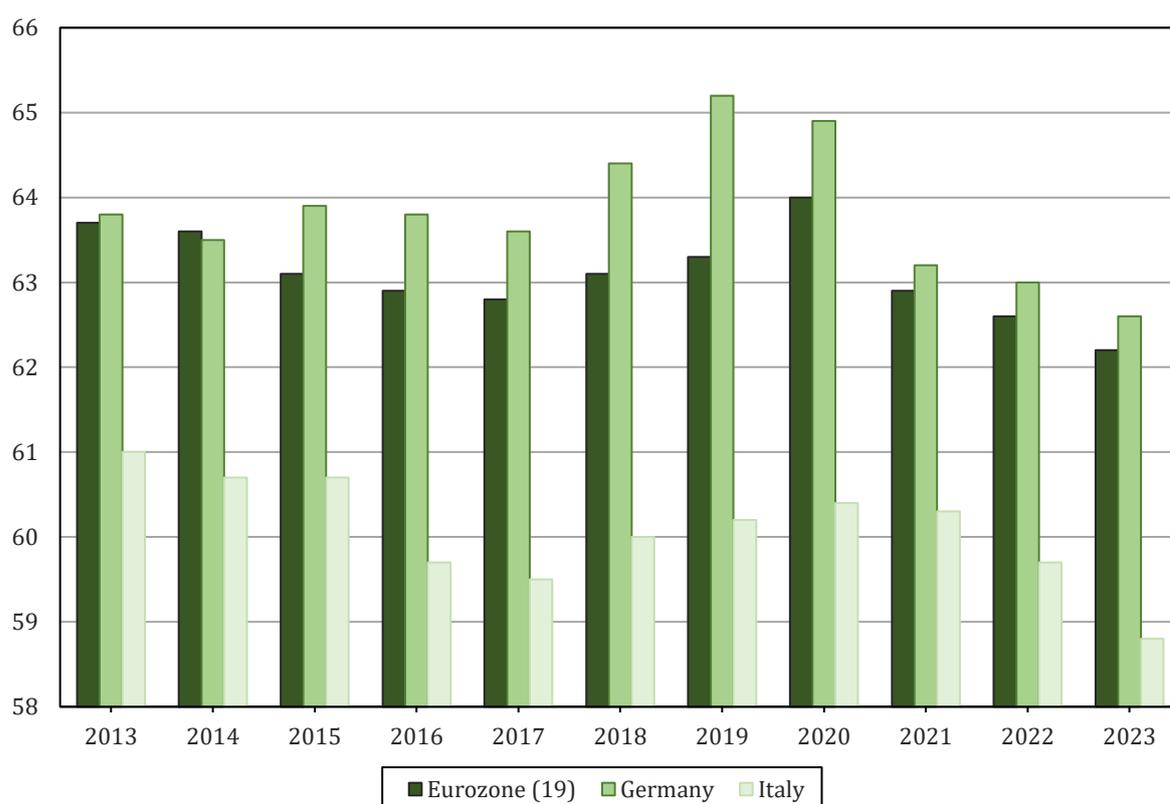
Note: Elaboration based on IMF online database, available at https://www.imf.org/external/datamapper/BCA_NGDPD@WEO/EURO

Finally, the unequal impact of inflation across households enhanced its contractionary effects.

In most countries, lower-income groups, whose consumption basket is mainly composed of essential goods, have been most affected by the increase in prices. The poorest households suffered a rise in prices of 2 to 5 percentage points higher than the wealthiest households (Villani and Vidal Lorda, 2022; Claeys and Guetta-Jeanrenaud, 2022; Lokshin et al., 2023).

The real effect on income distribution has been significant. The energy and food inflation that hit the Eurozone has affected labour income, deepening the effects of pre-pandemic deflation (see figure 2). Money wages have been stagnant for three decades, especially in the countries of the southern periphery of Europe, where the high levels of unemployment and the absence of a mechanism for indexing the nominal wages to inflation prevent any wage adjustment to the price growth. Furthermore, these latter factors, taken together, confirm that the rising inflation does not come from any of the mechanisms affecting the labour market, such as, for example, a “wage-price spiral”, as wage growth has been smaller than the general increase in prices even in the post-pandemic period, a fact that was confirmed by the International Monetary Fund (Alvarez et al., 2022). Thus, the price increase has led to a real reduction in labour incomes against a real profit increase deriving from companies’ monopoly positions.

Figure 2 – *Adjusted wage share (% current GDP), Eurozone, Germany and Italy (2013-2023)*



Note: Elaboration based on AMECO online database, available at https://dashboard.tech.ec.europa.eu/qs_digit_dashboard_mt/public/sense/app/667e9fba-eea7-4d17-abf0-ef20f6994336/sheet/f38b3b42-402c-44a8-9264-9d422233add2/state/analysis/.

After the pandemic and, above all, the energy crisis, the Eurozone emerged from a decade of persistent external surplus, which was the effect (and the declared objective) of the restrictive fiscal policies imposed on peripheral economies. The long phase of competitive devaluation of the euro against the dollar and the effect of the expansionary monetary policies by the ECB, such as the post-2011 quantitative easing programs and the negative interest rates, were aimed at balancing the current account positions of the member countries of the European Monetary Union (the North with a persistent surplus and the South with a persistent deficit). The drastic reduction in aggregate demand has achieved the expected results; indeed, it could not fail to do so. However, with the new imported inflation, the countries of the North, such as Germany and the Netherlands, began to experience a deterioration of their positions towards foreign countries, which consequently compromised the exports of the South. In summary, the changes in the distribution of income in favour of monopoly profits and the reduction of the trade surplus caused by inflation led to recession, so much so that some economic analysts (Andersson et al., 2022), already at the beginning of the increase in energy costs, were able to speak of the return of stagflation.

Finally, Germany deserves a separate analysis. As highlighted by Halevi (2022, 2023) and Tooze (2022), China is Germany's largest trading partner. Between 2005 and 2021, and using the UN Comtrade database, the value in dollars of Germany's world exports of goods has grown by 67%; towards China, it has increased by 4.5 times. The German industrial circles have intended to create synergies between China, Russia, Kazakhstan, Ukraine and, therefore, Europe and Germany. That is to say, synergies between countries and large areas integrating logistics, energy production and exports (Russia, Ukraine, Kazakhstan) and imports of industrial goods from China and Germany. Therefore, it is only from the German relations with Russia and China that it is possible to concretely imagine the launch of the new export-led growth necessary to stave off German decline and stagnation (Halevi, 2022). From this angle, it seems superfluous to underline how the substantial distance between Germany and Russia caused by the war still represents the main threat to a new edition of German neo-mercantilism.

However, once we take note of the German crisis, we have to ask ourselves what the consequences will be for the rest of the European countries. From this point of view, the worst consequences are expected for Eastern Europe, whose economies are firmly integrated, in a subordinate way, with the German economy.

In this sense, the adverse economic shock of the war on Eastern countries has been visible already during the third quarter of 2022. Runaway inflation has reduced real incomes and thus private consumption, previously the most important pillar of Eastern economies' growth after the pandemic. One of the most critical factors at the origin of this change in the economic scenario is the weakening German economy (WIIW, 2022).

Given the high exposure to the German economy, which entered recession in the first quarter of 2023, the Visegrad countries, North Macedonia, and Slovenia were severely hit since exports to Germany exceeded 15% of their GDP. If the German outlook worsens – for instance, assuming a certain degree of energy rationing and the temporary closure of some plants in the next winter – those countries will be severely impacted (WIIW, 2022).

Therefore, the final result will shock the regional supply chains, amplifying the recessive effects of the Ukrainian war on Europe.

2. The return of the monetary hawks

The conservative reaction of central bankers took place in this context.

The Fed promptly raised the interest rate in the United States, bringing the Effective Federal Funds Rate (Fed funds) from 0.2% in March 2022 (the beginning of the war) to 5% in May 2023.

The figure is not particularly significant if we consider that the Fed funds were at the same level in August 2007, i.e., before the collapse of Lehman Brothers and AIG. From this point of view, Fed funds have eventually returned to traditional values after the long season of extraordinary monetary policies and quantitative easings. However, the judgment changes if one compares the current situation with the Yom Kippur crisis of 1973 (the closest historical antecedent to the current crisis) and the Federal Reserve's response to that occasion. On the one hand, we can observe how the 1973 oil crisis caused the Fed funds to reach a significantly higher level than the current one, equal to 13% in July 1974. On the other hand, however, it should be noted that the rate of growth of Fed funds is significantly higher today than in 1973: from October 1973 (the beginning of the Yom Kippur War) to July 1974 (Fed funds' peak), the rate increased by three percentage points, well below the current five percentage points.

This aspect must be carefully considered to establish whether the response of the U.S. monetary authorities has been physiological or whether we are observing an excess of zeal, which could configure an overkill of current inflation.

After an initial valuation difference, which led it to leave interest rates unchanged until July 2022, the ECB embarked on a path very similar to that of the Federal Reserve, moving from -0.5% in July 2022 to 4% in May 2023. This evidence suggests that the pace of interest rate growth, and therefore of monetary tightening, has been even more robust in Europe than in the United States, even though the current discount rate is one percentage point lower.

It is interesting to ask what theoretical analyses central bankers – together with their prominent reference economists – have developed to justify such increases in interest rates.

As in the United States and also in Europe, the idea of raising interest rates to contain inflation has been based, initially, on the hypothesis that the price increase is the consequence of an increase in aggregate demand (resulting from fiscal stimuli in response to Covid crises), which rebounded from a relatively rigid supply of goods, matched with the post-2008 extraordinary monetary expansion, which created a mass of liquidity ready to push prices up as soon as fiscal policy would have turned expansionary. According to this hypothesis, inflation would be nothing more than the unwanted effect of the expansionary fiscal and monetary policies pursued by governments and central banks to face the post-pandemic recovery.

This thesis has been supported by several top economists, such as Paul Krugman (2022) and Lawrence Summers (2022), and rapidly became the standard reference for central bankers.

Indeed, we observed that the levels of employment of the workforce and the utilization of plant capacity have rapidly returned to the levels recorded before the pandemic, both in Europe and the United States; however, they did not go beyond those levels. In December 2022, the capacity utilization rate was 78.8% in the United States and 81.4% in the euro area (Lampa and Oro, 2023), far from the scenario of excessive warming of aggregate demand described by monetarists. Furthermore, the increase in the price of imported goods has a depressive effect on national income. For these reasons we could assert that, whatever the complex dynamics behind the return of inflation, the Taylor mechanism of interest rate hikes may be considered an inappropriate measure when the goal is to “cool down” an economy that was already

severely affected by a recession due to the increase in energy costs, on both the production and the consumption sides.

The board and the president of the ECB have explicitly recognized the weakness of such a position in the face of empirical evidence. In the ECB's bulletin of 30 June 2023 (ECB, 2023), the European monetary authorities propose an analysis that has the causes of the current inflation completely reversed. It was profits, not wages, that generated a spiral that fuelled the price rise. Furthermore, the pressure of unitary profits has reduced the wage share, which is at the origin of the current slowdown of the European economy. However, the policy implications remain unchanged: only a strong monetary tightening, through the recession, will be able to push entrepreneurs to accept a wage recomposition, given that the alternative would be to lower prices. Even in this case, however, there are well-founded doubts about the possibility that profits will fall *motu proprio* and, above all, the role that the increase in market concentration (resulting from high profits in a context of stagnant demand) could imply for price dynamics.

On the other hand, the tight monetary policy makes much more sense from a financial market perspective. Because the U.S. dollar has always been considered, in times of economic crisis, a haven 'as good as gold', net of any intervention by the Fed, the policy introduced by the latter attracted all those European capitals fleeing from imported inflation and devaluation towards the dollar currency area. The scale of the financial inflow to the United States caused an appreciation of the U.S. dollar to the extent that, for the first time in 20 years, the euro fell below parity (0.95 dollars per euro in September 2022). Now we understand how the ECB was forced to intervene, in turn, on interest rates. However, this happened not so much to control the ongoing inflationary process as to avoid the fall in the value of the euro (promptly brought back to 1.05 dollars per euro in March 2023); this, in turn, in a global market where energy materials are mainly evaluated in dollars, has amplified the negative effect of imported inflation. In this way, the Eurozone could compensate for the current account deficit by means of a surplus in the financial account generated by those savers who decided to keep securities denominated in the euro (capital movements and monetary variables are reported in table 1, figure 3 and figure 4).

While the ECB's policy, therefore, appears to be linked, as regards the prevention of capital movements, to the Fed's strategies, the public and private sectors of both areas risk being exposed to financial instability due to both inflation and the same restrictive monetary policy decisions aimed at containing the latter.

The new high interest rates can cause other distortionary effects within income distribution that risk changing internal financial relations. Imported inflation, by causing all domestic prices to rise, also causes the prices of industrial products to rise. As long as the firms turn to bank credit to make new investments, inflation also increases their indebtedness (the annual change in loans requested from the banks). If we consider the indexing mechanism of the interest rate as proportional to the inflation rate, which is systematically practised by almost all central bankers (the Taylor rule), the nominal cost of financing can double the inflation. At the same time, in real terms, there may be a reduction in net profit instead of an increase in bank interest proportional to the inflation rate.

Therefore, on the one hand, the high cost of money, as well known, delays the trend of new investments and indebted consumption by depressing aggregate demand and monetary profits. On the other hand, it may cause debtor subjects (businesses, workers and governments) to reduce their ability to repay their debts to financial institutions. We must also consider that, in a context in which the trade surpluses of the Eurozone have been worn down by inflation and the consequent loss of competitiveness, the increase in the cost of debt

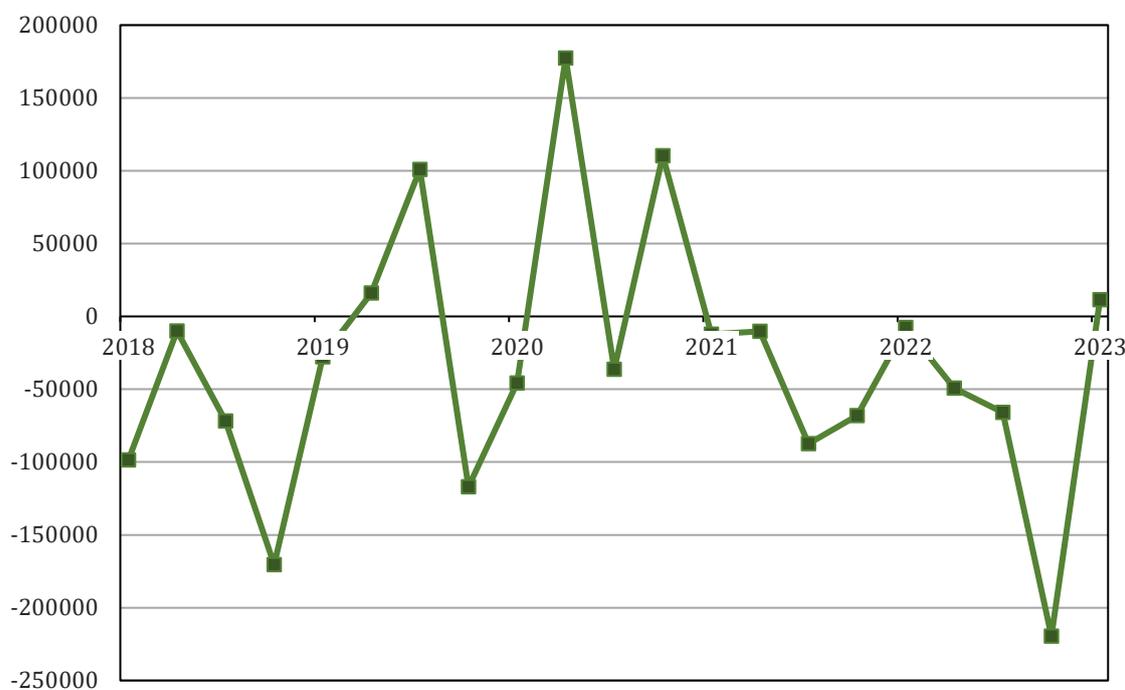
servicing could also have severe repercussions for the sustainability of the public debt, which depends on, among other things, the net foreign position. For all these reasons, some commentators argue that the Fed faces a dilemma between fighting inflation and ensuring financial stability (Smith, 2023). On the one hand, the contractionary effects of higher interest rates might result in an increase of non-performing loans (at a firm level) and sovereign debt defaults. On the other hand, monetary tightening can even be ineffective, if energy prices rise abruptly, driven by speculative and predatory conducts on the financial markets.

Table 1 – *Evolution of net financial account, policy interest rate and inflation rate, Eurozone (2021-2023)*

	Financial account (net) (EUR mln)	ECB interest rate (%)	Inflation rate (%)
2021-Q4	25,519	0	4.4
2022-Q1	4,907	0	6
2022-Q2	-43,946	0	7.2
2022-Q3	-7,980	0.5	8.9
2022-Q4	-49,970	1.25	10.6
2023-Q1	62,375	3	8.5
2023-Q2	-	3.75	7

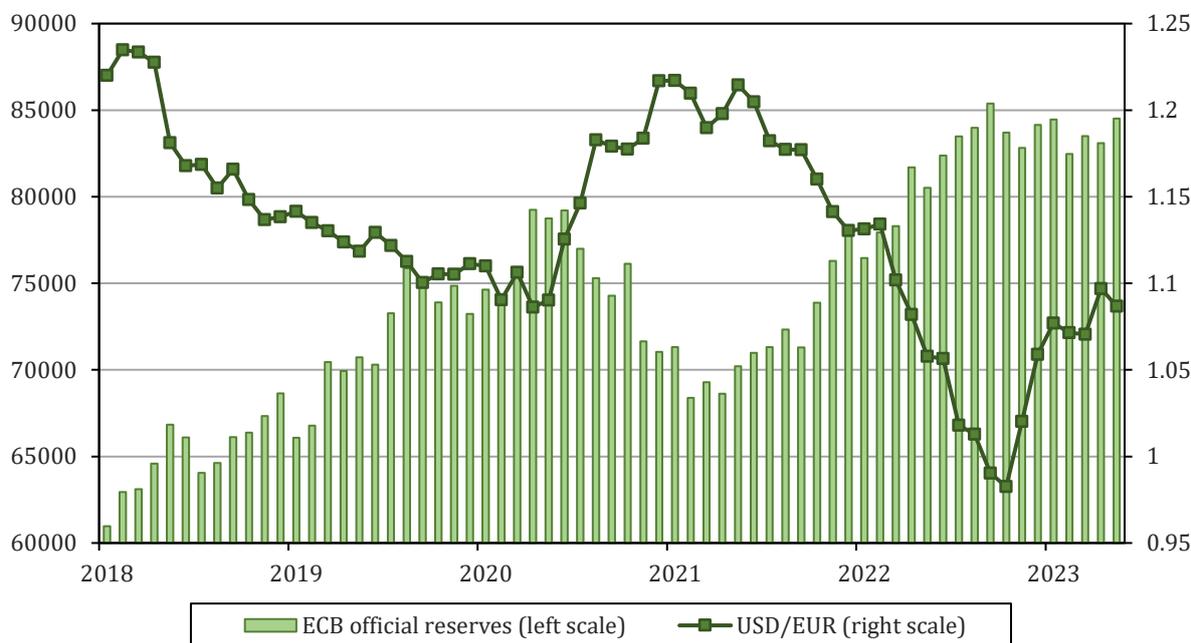
Note: Elaboration based on Eurostat and ECB online database, available at <https://data.ecb.europa.eu/data/datasets/BP6>

Figure 3 – *Foreign direct investment (net inflows) (EUR mln), Eurozone (2018-2023)*



Note: Elaboration based on ECB online database, available at <https://data.ecb.europa.eu/data/datasets/BP6>

Figure 4 – Official reserves (EUR mln) and USD/EUR nominal exchange rate, Eurozone (2018-2023)



Note: Elaboration based on ECB online database, available at <https://data.ecb.europa.eu/data/datasets/BP6>

3. Sanctioning and boycotting Russia: a weak strategy

The effect of the sanctions and boycotts against Russia that followed the military intervention in Ukraine should now be considered. The most relevant aspects of the sanctions introduced by the European Union concern: the ban on accessing the European financial markets; the unprecedented freezing of Russian reserves held by European credit institutions; the exclusion of the leading Russian banks from the SWIFT payment system; the ban on the export of hi-tech products to Russia and a blockade of air transport; and, finally, the ban on Russian foreign investment, which includes the blocking of imports of Russian energy materials. The EU also extended sanctions against Belarus, as a nation involved in the invasion of Ukraine, and Iran, as a supplier of drones.

In addition, we should consider the amplifying role of sanctions played by the Western sabotage¹ of the Nord Stream 2 pipeline, the network of gas pipelines that conveyed Russian gas to Germany; this definitively closed the economic and financial relations of the Euro-Atlantic countries with Russia, thus implying a reduced inflow of hard currency to Russia.

The results of the sanctions were quite different from the objectives the institutions had set themselves (international isolation of Russia and a consequent recession of its economy). After an initial devaluation of the rouble following introduction of the new sanctions, which went from 80 to 130 roubles per dollar in the first quarter of 2022, the Central Bank of Russia

¹ An investigation by Pulitzer Prize winner Seymour Hersh (2023) blames NATO countries (notably Denmark) and the U.S. administration for sabotage. Other sources (Entous, Barnes and Goldman, 2023) explained the Ukrainian responsibility alternatively.

(CBR) intervened through a large sale of dollar-denominated assets that managed to stabilize the currency; the rouble returned to 80 roubles per dollar in the second half of 2022 and recorded a value of 77 roubles per dollar in the first quarter of 2023 (CBR's official reserves amounted to 640 million dollars in January 2022, just before the military intervention, and fell to 541 million dollars by October 2022, CBR). Meanwhile, the Russian current surplus, which exploded with energy inflation, began to decline at the end of 2022 due to the boycott of the trans-Baltic gas pipelines, but it remained above the levels recorded before the military intervention (see figure 5).

Overall, Russia ended 2022 with an annual GDP growth rate of -3.7% , after many forecasts (IMF, World Bank and OECD) had estimated that the sanctions would result in a growth rate on the order of -10% .

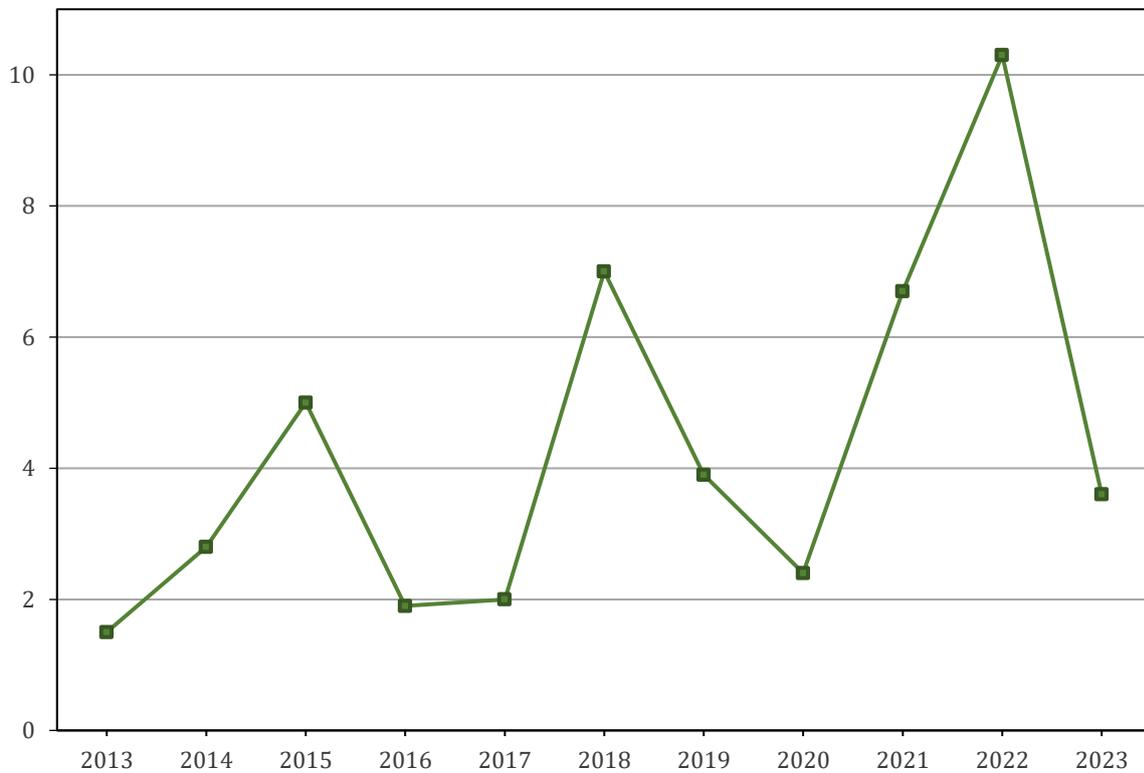
In other words, sanctions and boycotts have caused a slowdown but not a total freeze of the Russian economy, let alone its international isolation. How can we explain such an ability of the Russian economy to absorb the impact of sanctions?

The economic sanctions that the Obama administration and the European Union imposed on Russia in July 2014 – after the plebiscite and the consequent annexation of Crimea – radically changed the Russian economic framework, giving way to a series of profound changes. Initially, the effects on the financial markets were robust, with the exclusion of Russia from the Visa and MasterCard payment circuits. Nonetheless, thanks to the change during the Trump administration, in 2018, Russia was able to place its treasury bills on international markets (the so-called Eurobonds), thus returning to finance itself in dollars and euros, albeit at an increased cost and a lower intensity (Andermo and Kragh, 2021). However, the simultaneous collapse in the price of oil – equal to -70% between July 2014 and the first quarter of 2016, making this fall one of the three main ones after the Second World War (Stocker et al., 2018) – brought down the rouble/dollar exchange rate from 0,03 to 0,013. This shock has forced a paradigm shift on the Russian government and central bank, inspired by the need to disengage, as much as possible, from dependence on the dollar.

First, the Russian authorities have started looking for alternative instruments to the dollar for their international payments. In October 2014, this process culminated with the signing of a trade settlement in local currency agreement with China, through which an increasing share of the bilateral trade between the two countries was de-dollarized and paid for with domestic currencies. As a result of this measure, bilateral transactions in dollars went from 90% in 2015 to 46% in 2020 (Stent, 2020).

Therefore, the post-2022 fraying of Euro-Atlantic relations with Russia has acted as a further incentive to twist the commercial, financial and energy axis from West to East. Indeed, as reported by the Chinese newspaper *Global Times* (2023), in 2022 the volume of bilateral trade deals between Russia and China grew by 34%; Chinese exports to Russia, which include industrial goods and hi-tech products, increased at the annual rate of 17.5%, while Russian exports to China, which mainly include energy raw materials, increased by 48.6%. These exports could surpass the primacy of the share of Chinese energy needs represented by Saudi Arabian supplies. In addition to the quantitative aspect, the relevant aspect is that these transactions were carried out in yuan and roubles instead of dollars. In this sense, Stognei (2023) reports the increase, starting from January 2022, of the share of transactions made in renminbi on the total of Russian exports against a parallel decrease in transactions made in dollars, especially those made in euros. Even the latest meetings between the Russian and South African leaders have gone in this direction.

Figure 5 – Current account (% current GDP), Russian Federation (2013-2023)



Note: Elaboration based on IMF online data, available at https://www.imf.org/external/datamapper/BCA_NGDPD@WEO/OEMDC/ADVEC/WEOWORLD

Second, the leap in the international monetary paradigm has been associated with a specific industrial policy oriented towards import substitution.

Contrary to the common perception, Russia has a manufacturing sector of significant size and differentiation. In 2013, its share in terms of the added value of the global manufacturing sector was higher than that of India and Brazil and slightly lower than that of France (Connolly and Hanson, 2016). However, it is a non-competitive industrial system oriented towards the domestic market. As such, its ability to expand is inextricably linked to the performance of non-industrial exports. In 2015, through the VEB.RF development bank, the government provided subsidized credit at a rate of 5% (well below inflation, which is 15.55%) for 162 billion roubles (65 billion USD). The measure's purpose was to encourage investment and, in the future, reduce the consumption of dollars by the industrial sector (Lampa, 2022).

Milanovic (2022) has brilliantly defined this industrial policy line as “technologically regressive import substitution”, i.e., a process based on replacing products imported from the West with less advanced goods that can be produced in Russia, such as most of the components for industrial products. Being a regressive industrial reconversion, in the long-term, it certainly involves both the loss of economies of scale acquired over time through the international integration of trade and the over-qualification of the Russian workforce, which is generally trained to operate the most advanced Western machinery. These consequences may not

necessarily be problematic. However, in the short term such strategy has been effective: Russian imports of technological equipment from Kazakhstan and Turkey have grown to such an extent that, in total value, they have been able to return to the level of the period preceding the introduction of the new packages of sanctions (Ivanova and Seddon, 2022). Russian trade with the West has stalled, but trade with Asian, Middle Eastern and African countries has grown. This trend means that the low cost of energy materials guaranteed by the Russian extractive system has resulted in too significant a competitive advantage, especially in global energy inflation, to be completely isolated from international trade and eventually replaced with American energy supplies. Judging by the results that the Russian economy presents one year after the beginning of the military intervention in Ukraine, it seems that the circumvention of the most devastating recessionary effects of Western sanctions has proved, for the moment, to be rapid and effective.

4. The accelerating de-dollarisation: a threat to dollar hegemony?

The post-2014 economic sanctions on Russia prompted central bankers in developing countries to diversify their reserves, perceiving excessive exposure to dollar-denominated assets as a risk factor and external vulnerability. It was a complete reversal of the perspective during the previous five-year period, in which the dollar's centrality was strongly reaffirmed in a macroprudential function. In line with what Münchau (2014) predicted, making central bank reserve assets denominated in dollars liable to sanctions was equivalent to creating a perilous precedent that threatened the same ratio of the current international monetary system, eroding its foundations. From this point of view, the vicissitudes regarding the reserves of Venezuela in the same years (where the embargo went as far as the material appropriation of a billion dollars in gold bars deposited at the Bank of England in 2020), Iran and, more recently, Afghanistan have provided the best evidence of the risks to which developing countries were exposed in the event of a political, diplomatic or military dispute with the United States.

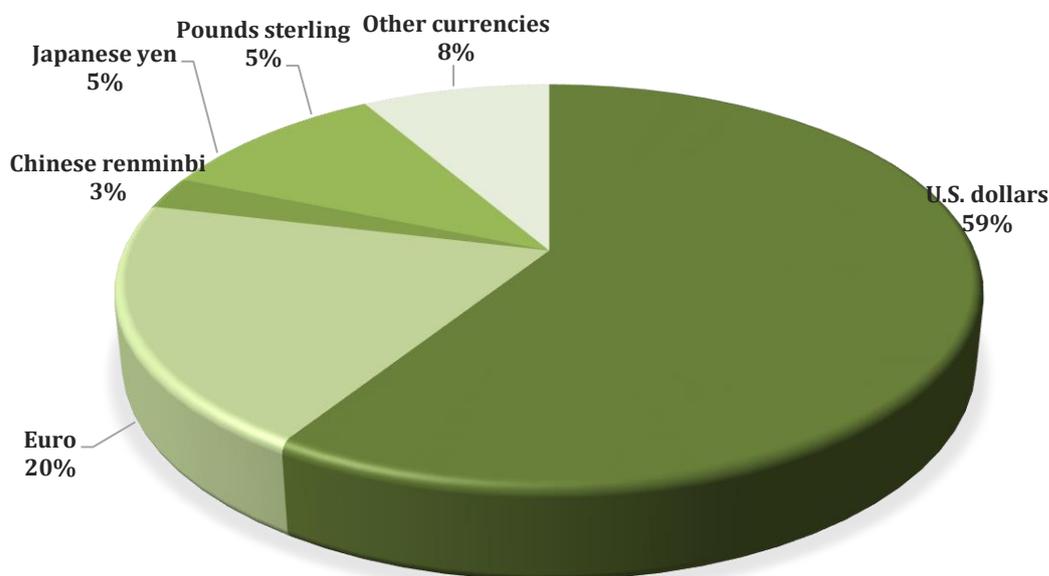
Therefore, it is not surprising that, following Russia's example, Iran has also entered into bilateral relations with the latter and China to offer a basis for evaluating goods independent of the accumulation of dollars. India has similarly introduced a rupee stabilization mechanism that will allow it to use the currency to exchange raw materials and manufactured goods. Meanwhile, China's project appears to be much broader. Pozsar (2022, 2023), an analyst at Credit Suisse, states that China, while increasing imports of oil and natural gas from all OPEC countries, has extended the use of the Shanghai Petroleum and Natural Gas Exchange to all BRICS countries to evaluate in terms of renminbi all exchanges of energy materials in the coming years; this could lead to the beginning of the first test of resistance of the petrodollar hegemony to a slow rise of the petrol-yuan.

Finally, during the August 2023 Johannesburg meeting, BRICS countries agreed to expand the bloc to six new members: Saudi Arabia, Iran, Ethiopia, Egypt, Argentina and the UAE. In addition, country members established that membership of the 22 countries that had formally requested to join the alliance will be discussed regularly in the future. As emphasized by the meeting's final statement, the most urgent issue to be addressed is the gradual de-dollarization of BRICS economies, matched with the creation of an international currency for inter-country payments whose value should be based on the basket of all the currencies from the countries involved (BRICS, 2023).

On these bases, it is possible to fully understand the position taken by Gita Gopinath, chief economist of the IMF (Wheatley and Smith, 2022). In an interview with the *Financial Times*, Gopinath highlighted the risks to the centrality of the US currency that arise from this new scenario. In her analysis, the economic sanctions affecting the Russian Central Bank have the paradoxical effect of showing the risks – rather than the opportunities – connected: i) to the use of international payment systems based on the dollar; and ii) to the accumulation of large international reserves in dollars, until recently considered the panacea for all possible crisis scenarios. In light of this premise, IMF researchers estimate that, in the future, there will be a growing diversification of international reserves, especially in emerging economies (Wheatley and Smith, 2022); in the medium term, this would be equivalent to the disintegration of the post-1971 monetary system and constitutes the main threat to the 50-year monetary hegemony of the dollar (Arslanalp, Eichengreen and Simpson-Bell, 2022; Fantacci et al., 2022)

In other words, the sanctions and global energy inflation would therefore have caused a push towards the process, already begun after the financial crisis, of de-dollarisation of international commercial transactions and elaboration of alternative payment systems to those dominated by the United States and its allies since the Second World War. Currently, the yuan accounts for only 3% of the composition of official foreign reserves, compared to the 59% represented by the dollar. Such a result marks the dollar's lowest level in 25 years, dropping by 12 percentage points, from 71 to 59 percent (IMF COFER database); the recent growth in the use of Eastern currency in the trading of energy commodities can be interpreted as an acceleration of this trend (see figure 6).

Figure 6 – World currency composition of official foreign reserves (2023-Q1)



Note: Elaboration based on IMF online database, available at <https://data.imf.org/>

However, according to Pettis (2022) and Setser (2023), it is unlikely that the yuan can replace the dollar as an international currency in the short term; the reasons discussed concern the fact that China, for the moment, is unable to replace the United States as the largest importing economy of the world, which is supported by substantial international flows of capital and by the military power at its disposal. The exorbitant privilege of the United States to sustain prolonged external deficits in its domestic currency makes its hegemony possible within all those economies that can compensate with an external surplus for the low domestic demand, which, in turn, is due to fiscal austerity and income distribution that reduces consumption and encourages savings. In summary, the global adoption of the dollar facilitates the process of export-led growth of European economies, which can, in this way, take advantage of the exchange of goods produced in excess (relative to internal demand), with the most varied financial and real estate assets from the rest of the global economy. In this sense, China should guarantee full mobility of international capital flows, which, according to the theory (the impossible trilemma of Mundell, 1963), would lead it to have to choose between maintaining an independent monetary policy and a fixed exchange rate system. Now, since the persistent and long-lasting appreciation of the national currency would have a negative impact more on the Chinese economy (led by exports) than on the American one (led by indebted consumption), it is convenient for China, for the time being, that the yuan remains flexible and depreciated against the dollar, rather than being stabilized to establish itself as the new unit of measure for international markets. Furthermore, it should not be forgotten that the United States is actively defending the dollar hegemony, both on the military side, with the supply of armaments and trainers to the Ukrainian army, and on the financial side, with the recessive intervention of the Fed oriented to the stabilization/revaluation of the dollar and internal deflation (even at the cost of sacrificing the Western economic system as a whole). The outcome of the monetary regime change will depend on the new international grabbing of energy resources and, above all, of the energy markets (Foroohar, 2023).

Therefore, for the moment, it seems reasonable to imagine that the development of the de-dollarisation trend will lead to a multipolar monetary system in which there is more than one hard currency, given the persisting hegemony of the US dollar. Suppose future international arrangements lead to a balance between Euro-Atlantic power and the Sino-Russian bloc with respective affiliated countries. In that case, the national economies can no longer be classified according to a rigid hierarchy, but conflicts will exist between the advanced economies and the respective areas' currencies. The significant implications of such an arrangement concern a return to exchange rate flexibility, which will be inevitable if total freedom of international capital movements is to be maintained. However, the flexible exchange rate regime could translate, for the national economies, into a loosening of the external constraint and a return of the currency policy aimed at reaping the benefits of exchange rate mechanisms in foreign markets. In general, this change in the currency regime could favour the development path of the economies of the global peripheries by easing the external constraint that would follow. In the specific case of the Eurozone, a system of flexible exchange rates would naturally lead to the reopening of the political discussion among member states on the introduction of coordinated currency and fiscal policies supported by the issuance of European debt securities. Once the military conflict is over, a multipolar monetary system could help open up some prospects for economic development.

5. Concluding remarks

The discourse developed in this article highlights some relevant consequences of the economic policies implemented in response to the Ukrainian War.

On a continental plane, imported inflation and the side effects of the sanctions imposed on Russia have interrupted the Eurozone's post-pandemic growth path, worsened its external position, and produced internal imbalances in distribution and finance. The counter-effects of the sanctions on the Eurozone economy were foreseeable, with Russia being the first supplier of energy materials in the European continent.

This change led to the end of the long phase of trade surplus that the Eurozone had conquered through austerity policies (the lowering of domestic demand and employment reduced the level of imports). However, the high prices of imported energy materials and the closure of commercial channels have not stimulated European governments to jointly implement an industrial and energy conversion plan aimed at replacing the raw materials affected by inflation and sanctions; instead, they have led them to exert a further depression of economic activity through new fiscal and monetary recessionary policies to escape the growing value of imports. Therefore, the attitude was that of sheltering from the contraindications of the sanctions rather than drawing from the war contingency and energy inflation the incentive for progress on the front of energy and trade policies.

On the North-Atlantic plane, post-war policies marked the return of monetary hawks: monetary tightening has been robust in Europe and the United States. However, the new high interest rates cause distortionary effects within the income distribution, loss of competitiveness, fewer investments, and decreased consumption; debtors experience a reduced ability to repay their debts to financial institutions. Finally, we were able to observe the first effects of the preference for liquidity induced by the increase in the cost of financing with the financial failures of Silicon Valley Bank, Signature and Credit Suisse, a sign of how the private sector is today exposed to the danger of insolvency due to the restrictive choices of governments and central banks.

Finally, on the global plane, Russia has decided to continue the military intervention in Ukraine and undertake a double paradigm shift, first through an import substitution-oriented industrial policy and then through international channels independent of the sanctioning countries. By doing so, Russia has completed its positioning within China's long-term plan to de-dollarize its economy, specifically by implementing a global market for energy resources independent of the dollar currency area within the BRICS countries.

In other words, the paradoxical effect of the sanctions was to affect the economy of those countries that promoted them and, simultaneously, to open the way to new markets for the countries that were targeted. The long-term consequences of the observed political and economic dynamics might even reshape the international monetary system.

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