The Price of War

By Laurence Boone, OECD Chief Economist and Deputy Secretary-General.

The world is set to pay a hefty price for Russia’s war against Ukraine. A humanitarian crisis is unfolding before our eyes, leaving thousands dead, forcing millions of refugees to flee their homes and threatening an economic recovery that was underway after two years of the pandemic. As Russia and Ukraine are large commodity exporters, the war has sent energy and food prices soaring, making life much harder for many people across the world.

The extent to which growth will be lower and inflation higher will depend on how the war evolves, but it is clear the poorest will be hit hardest. The price of this war is high and will need to be shared.

The global economy is set to weaken sharply in our projections. We estimate world growth to be 3% in 2022 – down from the 4½ per cent we projected last December – and 2¾ per cent in 2023. Inflation projections now stand at nearly 9% in OECD countries in 2022, twice what we were previously projecting. Elevated inflation across the globe is eroding households’ real disposable income and living standards, and in turn lowering consumption. Uncertainty is deterring business investment and threatening to curb supply for years to come. At the same time, China’s zero-Covid policy continues to weigh on the global outlook, lowering domestic growth and disrupting global supply chains.

Real GDP growth projections

G20 economies, % change, year-on-year

	2021	2022	2023		2021	2022	2023
World	+ 5.8%	+ 3.0%	+ 2.8%	G20	+ 6.2%	+ 2.9%	+ 2.8%
Australia	+ 4.8%	+ 4.2%	+ 2.5%	Argentina	+ 10.3%	+ 3.6%	+ 1.9%
Canada	+ 4.5%	+ 3.8%	+ 2.6%	Brazil	+ 5.0%	+ 0.6%	+ 1.2%
Euro area	+ 5.3%	+ 2.6%	+1.6%	China	+ 8.1%	+ 4.4%	+ 4.9%
France	+ 6.8%	+ 2.4%	+ 1.4%	India	+ 8.7%	+ 6.9%	+ 6.2%
Germany	+ 2.9%	+ 1.9%	+ 1.7%	Indonesia	+ 3.7%	+ 4.7%	+ 4.7%
Italy	+ 6.6%	+ 2.5%	+ 1.2%	Mexico	+ 4.8%	+ 1.9%	+ 2.1%
Spain	+ 5.1%	+ 4.1%	+ 2.2%	Russia	+ 4.7%	- 10.0%	- 4.1%
Japan	+ 1.7%	+ 1.7%	+ 1.8%	Saudi Arabia	+ 3.1%	+ 7.8%	+ 9.0%
Korea	+ 4.0%	+ 2.7%	+ 2.5%	South Africa	+ 4.9%	+ 1.8%	+ 1.3%
United Kingdom	+ 7.4%	+ 3.6%	+ 0.0%	Turkey	+ 11.0%	+ 3.7%	+ 3.0%
United States	+ 5.7%	+ 2.5%	+ 1.2%				

Source: OECD Economic Outlook, Volume 2022 Issue 1

With risks biased to the downside, the price of war could be even higher. The conflict is disrupting the distribution of basic food and energy, fuelling higher inflation everywhere and threatening low-income countries in particular. European economies are struggling to wean themselves off Russian fuel. But because alternative energy sources may not be easy to ramp up quickly, there is a risk of higher prices or even shortages. If the war escalates or becomes more protracted, the outlook would worsen, particularly for low-income countries and Europe.

Limiting Russia’s ability to finance the war, as is intended by an embargo on Russian oil exports, is essential for speeding up an end to this devastating conflict.

Meanwhile, we must minimise the humanitarian, economic and social consequences.

The first urgency is to avoid a food crisis. Today, the world is producing enough cereals to feed everyone, but prices are very high and the risk is that this production will not reach those who need it most. Global cooperation is needed to ensure that food reaches consumers at affordable prices, in particular in low-income and emerging-market economies. This may require more international aid as well as cooperation in the logistics of shipping and distributing to countries in need. The flaws of global vaccine distribution are still fresh in our memory. Let’s not repeat them.

Second, inflation has strong distributional effects. It will help drive down debt, including public debt, but it is also eroding real income, savings and purchasing power. At the same time, it may affect firms’ profits and capacity to invest and create jobs. Inflation is a burden, which must be shared fairly among people and firms, between profit and wages. Governments also have to play a role through support targeted to those most vulnerable to rising food and energy inflation.

Next, monetary and fiscal policy need to adjust to these extraordinary circumstances.

Globally, the elevated levels of inflation and employment today suggest there is no longer a need for monetary policy accommodation. However, in many regions inflation is driven by food and energy. If monetary policy cannot address such supply shocks, it can send signals that it will not allow inflation to rise or spread further. Removing accommodation is therefore warranted across the globe, but with particular caution in Europe where supply-driven inflation dominates. Conversely, wherever inflation is driven by over-buoyant demand, as in the United States, monetary policy can tighten faster to reduce such excess.

Fiscal policy management is particularly complex. Because of the current levels of growth, employment and inflation, the need for economy-wide income support has disappeared and should be replaced by better targeted measures. The war in Ukraine has raised the need for higher public investment in defence and for greater urgency in the transition to greener energy. This comes on top of other investment needs like health, digitalisation, ageing and education, and as public debts remain high. This conundrum can only be resolved with a stronger focus on prioritisation from governments. In Europe, the integration of the region and high exposure to the war calls for more solidarity in defence and energy spending.

The war has exposed how energy security and climate mitigation are intertwined. Governments need to shift gear to accelerate the energy transition. The emergency response to an energy crisis has turned out to be a stark scramble for alternative sources of fossil fuels and an increase in coal use. This can only be temporary as it is the opposite of what the world needs, which is a rapid increase in investment in, and consumption of, cleaner energy. But clean energy requires inputs, minerals and intermediate materials which come from all over the planet. Put simply, the cleaner the energy, the larger and the more geographically diverse the value chains will have to be. There will be no climate mitigation without open trade and resilient global value chains.

The world is already paying the price for Russia’s aggression. The choices made by policymakers and citizens will be crucial to determining how that price will be distributed across people and countries.

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