MARKET COMMENTARY

20 December 2022

The cost of supporting Ukraine – so far, just money!

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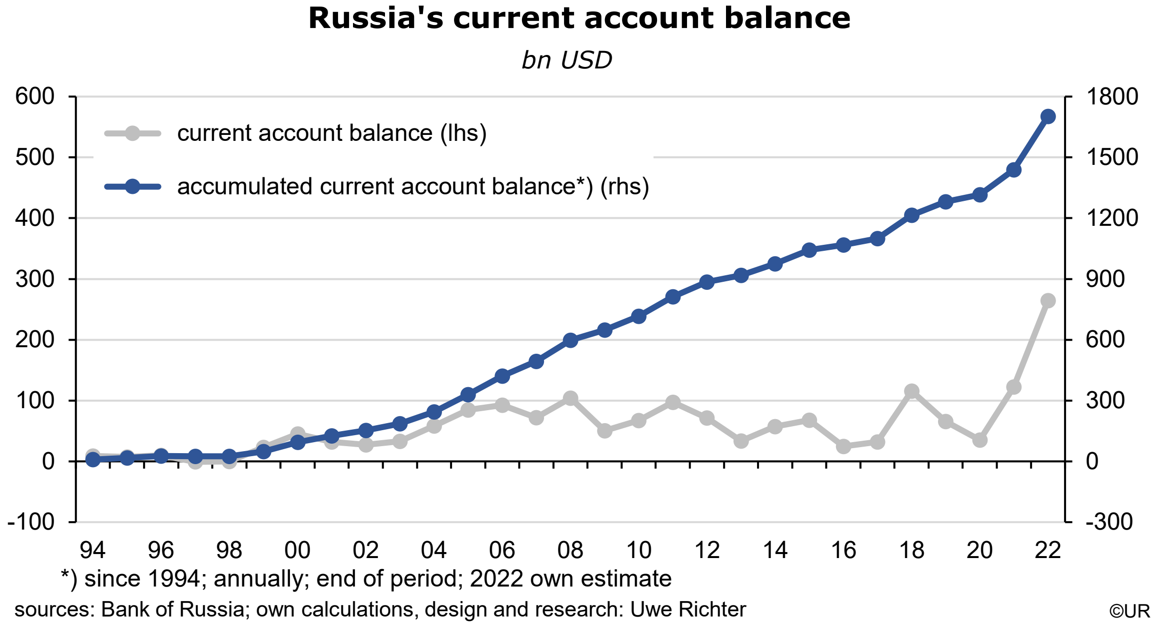
As of the end of November, support promises by governments and international organizations for Ukraine's defense against Russian aggression, its government expenses and the future reconstruction of the country have been about 129 billion euros. This is in the order of 0.3 per cent of the combined nominal GDP of the US and the European Union. By now, the EU and EU countries have made commitments of €51.8 bn, compared to America's €47.8 bn. For the donor countries, contributions do not all occur this year or next but over a longer period of time – I estimate that they will reach, as a maximum, 0.15 per cent per annum. For comparison, NATO military spending had recently been in the order of 2.6 per cent of member countries' GDP. The support for Ukraine is, and is planned to be, rather small and could easily be boosted by a factor of five or more, without a significant impact on living standards. The West has by no means entered a war economy. We are just freezing a little and are driving and flying less.

Europe's freedom is at stake in Ukraine. If the country were to be annexed for good by Russia, the three Baltics, Moldova, Georgia and even parts of Poland might be next, as Putin tries to re-establish the former Soviet Union. Under all circumstances the West must not get tired of the Ukraine issue and stop supplying the military equipment and financial support needed to fend off the aggressor. Since the Russian economy is nine times bigger (2021), the war's outcome would almost inevitably the defeat and annexation of Ukraine. To avoid this, the country must not be left to fight on its own.

According to the IMF, Ukraine's nominal GDP had been USD 199.7bn in 2021, the year before Russia's invasion. There are no statistics about the value of the capital stock, but I am certain that it has been less than ten times bigger than GDP, ie, at most USD 2 trillion. Assuming that by the end of the war a quarter of these assets will be destroyed by Russian attacks and that half of that will be financed from internal sources, Ukraine needs net capital imports of about USD 50 billion per year, for five years, to renovate its capital stock. The earlier the war ends, the lower will be the financial burden for western donor countries. In the present situation, thriftiness would not be a rational strategy.

Some of the above numbers are admittedly simple guesses and could be totally wrong. But I have tried to be conservative with regard to the likely cost of future recovery programs. 50 billion dollars are about one eighth of one percent of NATO's GDP and are thus almost negligible from a macro point of view, given the risks of the war from a Western European perspective. It is important that the burden of rebuilding Ukraine is shared fairly among the group of donor countries. This will probably require the establishment of a recovery fund. It is not easy to determine in which form the money should be distributed, whether as grants or loans. To make the program politically acceptable in the West, loans would be the better alternative – but they must be long term, with a grace period of several years, and at low interest rates.

A future peace treaty has to address the question to which extent the aggressor must participate in the recovery. Over the course of the war, Russia's net foreign assets have hugely increased. In 2022, the surplus in the balance on current account (a proxy for changes in net foreign assets) has reached no less than about 260 billion dollars, the result of the steep increase of oil and gas prices and the reduction of imports in the wake of Western sanctions.



It will not be easy to make Russia pay for the damage it caused. Only a small part of the reserves will have ended up on bank accounts in the US or Western Europe, the bulk will have been directed by creative accountants to Dubai, Qatar, Singapore, the Caribbean and similar places. If the US would put their mind to it, they could force these countries to reveal the beneficiary owners of all accounts in their jurisdictions. In the past, all such attempts have come to nothing.

The problem is that Russia cannot and will not lose the war – and cannot be forced to pay up. For this reason, the present sanctions against Russia will probably remain in force and may actually be tightened further. Only a meaningful change of government in Moscow will improve the situation. For the time being, there is just one positive effect of the Russian invasion: oil and gas prices will remain high and thus help to accelerate the global transition to renewable energies.

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About Wermuth Asset Management

Wermuth Asset Management (WAM) is a Family Office which also acts as a BAFIN-regulated investment consultant.

The company specializes in climate impact investments across all asset classes, with a focus on EU "exponential organizations" as defined by Singularity University, i.e., companies which solve a major problem of humanity profitably and can grow exponentially. Through private equity, listed assets, infrastructure and real assets, the company invests through its own funds and third-party funds. WAM adheres to the UN Principles of Responsible Investing (UNPRI) and UN Compact and is a member of the Institutional Investor Group on Climate Change (IIGCC), the Global Impact Investing Network (GIIN) and the Divest-Invest Movement.

Jochen Wermuth founded WAM in 1999. He is a German climate impact investor who served on the steering committee of "Europeans for Divest Invest". As of June 2017, he is also a member of the investment strategy committee for the EUR 24 billion German Sovereign Wealth Fund (KENFO).

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