

TITLE OF REPORT: Impact of situation in Russia and Ukraine

REPORT OF: Mike Barker, Strategic Director, Corporate Services and Governance

SUMMARY

This report informs the Committee on the impact of if the situation in Russia and Ukraine on areas relevant to its remit.

Background

1. On 24th February 2022, Russia began a military invasion of Ukraine in a major escalation of the Russo-Ukraine conflict that began in 2014. This is the largest military conflict in Europe since the second world war and its repercussions can be felt across Europe and the world.
2. This report will focus on what is currently happening across the world in terms of trade sanctions, and how those trade sanctions together with the war itself are impacting regionally, locally and on the Council's commercial activities and resource implications. It is important to note that the wider contextual issues including COVID-19, Brexit, and other recent world-wide events are cumulating in material shortages, price instability and huge rises, and further challenges to already strained supply chains and commissioned services.

WORLDWIDE ISSUES

Trade Sanctions

3. Sanctions are penalties imposed by one country on another to stop it acting aggressively or breaking international laws. They are among the toughest actions nations can take, short of going to war.
4. A wide range of sanctions have been imposed on Russia by the UK, the EU and the USA including:

Sanction	By whom
Ban on the exporting of luxury goods including vehicles, high end fashion and art to Russia	UK and EU
35% tax on some imports from Russia including vodka	UK
Ban on the export of goods used by Russian firms	UK, EU, USA and others

including dual-use goods (items with both a civilian and military purpose (chemicals and lasers)	
All Russian flights have been banned from US, UK, EU and Canadian airspace. (The UK has also banned private jets chartered by Russians)	UK, EU, USA, Canada
The G7 (an organisation of the seven richest nations) is stripping Russia of its “most favoured nation” status which means it will lose many trading benefits	G7 comprising Canada, France, Germany, Italy, Japan, UK, and USA
Ban on all Russian oil and gas imports	US UK will phase out by end of 2022 EU will switch from Russia before 2030 Germany put on hold permission for new gas pipeline

5. The individual sanctions are impacting individual markets but when considered together culminate in shortages in global supply chains.

Freight and transportation

6. The formal sanctions highlighted above are being supplemented by unexpected issues that crop up as a direct result of the conflict. For example, some 20,000 workers at 29 ports on the West Coast of the USA said they would not load or unload any Russian vessels or Russian cargo. In addition, the destruction of Antonov Airlines giant cargo jet and the grounding of the rest of Antonov’s fleet of large jets impacts on the shipments of bulky items like generators, refining equipment, satellites and aerospace components. This will impact on supply shortages further. Suspension of air freight on Russian air carriers will stress an already tight air cargo market. Overall, average flight times are rising as airlines avoid airspace over the region, again, impacting on supply chains.

Action by Companies

7. Over 400 international companies have announced their withdrawal from Russia to varying degrees and the list of those companies and their actions can be found [Expanded List - Mar 18 - Detailed v5.xlsx | Powered by Box](#). A number of companies are also blocking access to software applications which will impact on Russian companies ability to trade.

REGIONAL ECONOMY

8. Work has been undertaken at a regional level by the North East Regional Enterprise Partnership to determine the impact of the war on Ukraine on the local economy. The local economy is not facing huge direct detrimental impacts, however individual sectors or organisations will be hit harder than others and

knock on impacts on the global supply markets will impact the local economy. They estimate that over the last 4 quarters:

Trading with Russia

- North East good exports and imports to Russia account for 1% of the North East total, but 29% of North East petroleum and related products imports;
- North East exports to Russia were valued at £154M. This was 1.3% of the North East's total exports;
- North East imports from Russia were valued at £121M. This was 0.94% of the North East's total imports;
- 8% of England's exports to Russia were from the North East while 2% of England's imports from Russia were to the North East;
- 33% of the North East's exports to Russia were classified as power generating machinery, 12% as road vehicles;
- 52% of imports were classified as petroleum products and related materials. This was 29% of the North East's total petroleum imports;
- 16% of England's imports of petroleum were from Russia.

Trading with Ukraine

- North East goods exports to Ukraine were minimal but Ukraine accounts of 1.4% of imports including 43% of North East iron and steel imports;
- North East imports from Ukraine were valued at £176M. this was 1.4% of the North East's total imports;
- 7% of England's exports to Ukraine were from the North East, while 27% of England's imports from Ukraine were to the North East;
- 66% of the North East's exports to Ukraine were classified as road vehicles;
- 97% of the North East's imports were classified as iron and steel. This was 43% of the North East's iron and steel imports;
- 5% of England's imports of Iron and Steel were from Ukraine.

LOCAL AND COUNCIL IMPACTS

9. Council Services have been asked to consider all risks associated with this conflict and put in place any mitigations, and the Council's corporate risk register has been updated with appropriate actions.

Supply chain and commissioned services

10. The Council does not have any first-tier contracts with Russian organisations, however this report demonstrates that we are all dependent on a global supply market, and there will inevitably be disruption to supply chains and commissioned services impacting the Council, and its businesses and residents. Estimating the length of time the impact will last is difficult as much will depend on what happens in the conflict and how long it continues. Economists predict that if the conflict were to end tomorrow, its implications would continue for the next 12-18 months at least.

Financial Measures

11. The Council has no direct links to Russian banks or financial institutions.
12. The UK, EU and USA has also imposed sanctions on hundreds of members of the Russian regime and wealthy business leaders (known as oligarchs) who are considered close to the Kremlin.
13. We have been provided by our Bank (Barclays) with a list of Companies and individuals who have been subject to UK Sanctions and the Council does not make or receive payment from any individual or organisation on that list.
14. Western countries have frozen the assets of Russia's central bank to stop it using its foreign currency reserves. Other international measures include
 - Suspension from the Bank for International Settlements (the central bank for central banks)
 - The USA, EU and UK have banned people and business from dealing with it
 - Some Russian banks are being removed from the international financial messaging system Swift which is used to transfer money from across borders. (This will delay payments to Russia for energy exports).
 - Other UK sanctions include:
 - Major Russian banks have been excluded from the UK financial system
 - All Russian banks have had their assets frozen
 - The Russian state and major companies are not able to raise finance or borrow money in the UK
 - There is now a limit placed on deposits Russians can make at UK banks.

Energy

15. Prior to the 24th February, 2022, the UK was already in the midst of a global energy crisis due to record market high gas prices set by international markets. The conflict situation caused prices to surge by 60% within a day. The UK is not as dependent on Russian gas supply as our single largest source of gas is from the UK Continental Shelf and the majority of gas imports come from other European countries such as Norway. There are no gas pipelines directly linking the UK with Russia and imports from Russia typically make up less than 4% of the UK gas supply. Countries who import gas from Russia are trying to seek alternative sources and this is adding to the market pressures.
16. The Council's energy suppliers, Corona Energy, the Gateshead Energy Company, and EDF have confirmed that they have no trading or any other relationships with Gazprom or any of the Russian oil and gas producers. The Gateshead Energy Company also procures energy that it requires from Corona Energy.
17. The Council buys most of its energy through the NEPO contracts and NEPO have worked with the regional Directors of Resources Group comprising Finance

Directors to develop a 2-year purchasing strategy to ensure that any risk exposure is minimised.

18. The energy markets are more volatile than they have ever been and regular information is provided by NEPO to inform budget setting and management. Prices are changing on an extremely frequent basis but at the time of writing this report, energy market prices have reduced slightly and for example for example, gas prices have reduced from their peak around the start of the conflict 13-16p/kWh to around 7-8p/kWh for year ahead purchasing
19. This reduction will have minimal impact on the overall supply market increases that are likely to be in the region of 383% for Gas in the summer and 191% for gas in the winter and 94% for electricity. The Council will see lower increases due to the NEPO purchasing strategy and the contracts entered into by the Gateshead Energy Company.

Liquid Fuels

20. There is currently a huge price increase in the cost of petrol and diesel, hitting historic highs. Prices were already rising before the situation in Russia and Ukraine and they have continued to rise due to concerns around supply, and increases to the global cost of oil. There is also the possibility of fuel shortages on garage forecourts if the public begin to panic buy (as we saw during COVID).
21. In terms of Council requirements, we have been assured by our supplier that importers have guaranteed that they will be able to deliver contracted volumes to the authorities that participate in the NEPO contract, providing that the Councils all stick to their usual buying patterns. Any unusual ordering activity will be questioned and potentially refused to ensure continuity of supply to all authorities.
22. Our usual pricing arrangements for the purchase of liquid fuels has moved from a weekly pricing mechanism to a daily mechanism due to the current market volatility. Prices will be based on the cost on the actual day of delivery impacting fuel budgets, and at the time of writing this report fuel price increases have added an extra £9,000 per month to the Council's liquid fuel bill, and potentially could rise further.
23. The Council's supplier has also confirmed that they and their importers are avoiding any supply from Russia, and this is adding to the concern around supply shortages as most of the world importers of Russian fuel are also trying to source alternatives.

Food

24. Russia supplies about 20% of world wheat exports, and Ukraine about 10%, according to the Food and Agriculture Organization (FAO) of the United Nations. Together, they account for approximately 13% of total global wheat production. Sanctions on Russia will further impact on supplies, and Russia may also retaliate with measures of its own to reduce supplies to the west. The grains produced are used to make cereals, flour and therefore a wide range of food products including bread, cakes, and pasta will be impacted.
25. Ukraine has some of the most fertile soil in Europe and is the third-largest exporter of corn. It is also a primary exporter of sunflower oil, barley, corn, rice, and potatoes. It is therefore inevitable that there will be a disruption of supplies of specific foodstuff together with rising prices due to the shortages.
26. Poultry shortages are being reported as live birds are in short supply, partly due to Ukraine no longer able to supply them, and more generally animal feed is also in short supply (due to the grain shortages mentioned above), and this is leading to huge price increases too.
27. The shortage of food and unprecedented price rises impact directly on Gateshead residents, and it is also greatly impacting on the Council's School Catering service. The School Catering service has previously been dealing with significant price increases linked to COVID-19, Brexit, and rising costs in packaging, energy and distribution; and the issues with the war in Ukraine are further exacerbating the situation.
28. The Council's food contracts used to be based on a fixed price per term, however they are now being revised monthly with price rise applications being received on a weekly basis. The service is at a point where they are no longer able to mitigate this as there are only so many changes to the menu that can be made, and there are no foodstuffs that are not affected by the unfortunate culmination of events. The price of school meals have been increased, however this may not be enough to cover the continuous increasing costs.
29. It has been noted that the private sector providers are walking away from some school meal contracts and drastically reducing quality and portion sizes of other, and this does not help those children who depend on school meals.

Fertiliser

30. Russia and Ukraine are significant suppliers of fertilisers world-wide and these supplies will be disrupted too.

Electronic chips and semiconductors

31. A chip shortage, (also referred to a semiconductor shortage) occurs when demand outstrips supply. There has been a chip shortage since 2020 when COVID-19 caused disruption in supply chains and a 13% increase in global demand for PC due to a global shift to a "work from home" economy. Lead times for chips extended to 22 weeks in April 21 and this was compounded further by droughts in Taiwan during the summer of 2021.

32. Ukraine is the world's largest neon exporter which is an essential component in the production of chips/semiconductors, and this is likely to have a huge impact on a wide range of markets including IT and electronic products, vehicles, plant and fleet, electric and electronic equipment used in construction.

Paper

33. A number of paper suppliers have informed the Council that the conflict is causing huge price hikes on paper prices as their energy supplies have increased in price and the market is also trying to avoid using Russian paper mills. This is leading to price increases but also shortage of supply, and in some cases specific types of paper are being rationed by suppliers.

Vehicles, Plant and Fleet

34. Russia produces 40% of global palladium supplies which was in short supply before this latest conflict. The risk associated with supply of palladium is becoming too costly for the automotive industry and other metals are being considered for use in catalytic converters, however only between 25 and 50% of palladium can be routinely substituted with platinum in diesel catalytic converters and Russia is also the second largest producer of platinum.

35. Electronic chip/semiconductor shortages (see above) have resulted in several car factories in Germany closing down.

36. This will impact on the Council's ability to replace vehicles and plant that were scheduled to be replaced this year, and the shortage of supply of some vehicles will lead to global price rises. An example of this is that Ford have announced that the order bank for all of their Commercial Vehicles, excluding E-Transit, has been closed with immediate effect starting 22nd March 2022. This temporary closure will enable Ford to review emerging supply and production challenges to ensure their lead time guidance is realistic.

IT Equipment

37. One of the Council's largest suppliers of IT hardware, Dell, have informed the Council that

"Due to a global surge in demand, multiple-industry component shortages and geopolitical disruptions, we are seeing an industry-wide increase in certain component costs.

Given macro-economic and supply-related factors impacting the industry today and in the coming months.

1. While we do everything we can to mitigate cost increases; we expect price increases in Q2 (After 30th April 2022) and the second half of this year due to:

- Rising oil prices*
- Increased logistics costs*
- Expected cost increases coming on several commodities*

2. *We are doing everything in our power to provide you with the best value with minimal disruption. We're seeing industry-wide supply chain constraints, including the need for alternative shipping routes in some parts of the world. Dell has proven our ability to outperform the competition, minimizing these changes to protect your business. Getting orders in early will help ensure the best availability of supply.*
3. *The semi-conductor industry continues to experience supply constraints along with long lead times on integrated circuits.*
4. *Our supply chain speed, agility and flexibility has enabled us to meet customer needs in this dynamic environment and as we navigate supply uncertainty.*

38. Dell have not yet provided an indication of the level of price increases to expect, but this correspondence illustrates quite effectively the issues faced by IT hardware manufacturers.

Construction

39. Construction materials have previously been impacted by Brexit, Covid, the freight containers that were on the tanker that was grounded for several weeks, and they were already in short supply and at an all-time high in terms of cost.
40. Ukraine has one of the largest sources of titanium, magnesium and iron ore. This is leading to price rises of 12% for steel, 24% stainless steel, 90% nickel.
41. Existing construction projects will not always be able to sustain the financial models agreed at the start of the contract.

Inflation

42. The level of inflation within the UK is expected to continue to grow and at a faster rate leading to further budget pressures faced by the Council, its supply chains and commissioned services. Care is being taken to scrutinise all price increase requests to not only consider their relevance and applicability, but to also understand the risk to the supplier/provider if the price increase is refused.

Extra demand on services

43. The conflict will result in refugees coming to Gateshead, As a humanitarian response to the war in Ukraine, the Home Office have launched the "Homes for Ukrainians" sponsorship scheme, the scheme consists of two parts (1) Family Sponsorship and (2) a hosting scheme where people from across the UK can offer up a space in their homes to accommodate refugees. With the hosting scheme Councils will be expected to administer 'thank you' payments at the £350 per sponsoring household per month rate. The Government will allocate additional funding for these payments, but expect councils to cover administration costs within the tariff.

44. The government is also providing additional funding to councils to provide education services for children from families arriving from Ukraine under this scheme. The Department for Education (DfE) will allocate funding on a per pupil basis for the three phases of education at the following annual rates:

- Early years (ages 2 to 4) - £3,000
- Primary (ages 5 -11) - £6,580
- Secondary (ages 11-18) - £8,755

45. A number of services will see demand potentially increasing as a result of refugees settling in Gateshead, including but not limited to the migration team, safeguarding and property checking services (if families or households take in refugees), screening, surveillance and health protection/ GP registration (health checks, management of infectious diseases and ensuring that vaccinations are up to date) as well as a range of Advice and support linked to council services such as housing and homelessness, benefits, education, early help as well as translation services.

46. The mental health of the refugees is likely to have been affected due to the significant trauma they have faced. This may be more prevalent in children and young people and it may also lead to higher rates of health harming behaviours (e.g. smoking or alcohol abuse). There will also be the language barriers to overcome. Government have confirmed that there will be a payment of £10,500 per refugee for the first year, however funding for future years will be reviewed in due course. Some of the services may be required for many years

Additional Cyber Security Risk

47. Following Russia's attack on Ukraine, IT Services have undertaken additional activities in order to bolster the Council's cyber defences. Recognising that even the most robust technical controls can potentially be circumvented by an unsuspecting user IT Services have distributed a user communication to all colleagues which informed of the current heightened risk and explained how users can do their part to help us through these worrying times.

48. The following additional technical and procedural controls have been reviewed, updated and implemented;

- We have initiated a programme to confirm ALL accounts are Multi-Factor enforced. Microsoft suggest that using MFA blocks 99.9% of account hacks.
- We have brought forward our elevated user account review with the aim of minimising the number of user accounts with higher level of permissions. Implementing least privilege not only reduces the likelihood of a breach occurring in the first place, but it helps limit the scope of a breach should one happen.
- IT Services have prioritised the updating of the Cyber Security Incident Response Plan. Again, to try and limit the scope of a breach should one happen.

- Reviewed and updated the Council's firewall ruleset and increased the frequency of future reviews
- A recent IT Health check has recently been performed against our network and attached devices, including all internet facing services. IT Services along with colleagues from across the Council are currently working on the resulting remedial action plan.
- Data backup success is confirmed on a daily basis by the appropriate team within IT Services and 'air gapped' offline copies are maintained where required.
- IT Services have implemented Safe Links and Safe attachment features within Microsoft Defender for Office 365. This is part of the council MS365 environment offering extremely useful added protection against phishing attacks.

49. Members of the Council's Cyber Security Team have liaised with neighbouring Council's to confirm that we're all following the expected tasks and sharing best practice in order to mitigate these risks.

Recommendation

50. It is recommended that Corporate Resources Overview and Scrutiny Committee:
- i. consider the impact of the situation between Russia and Ukraine as outlined in this report on the areas relevant for this committee;
 - ii. identify any areas, they feel they require more detail about, that could be covered in a Members Seminar.

Contact: Andrea Tickner

Ext: 5995