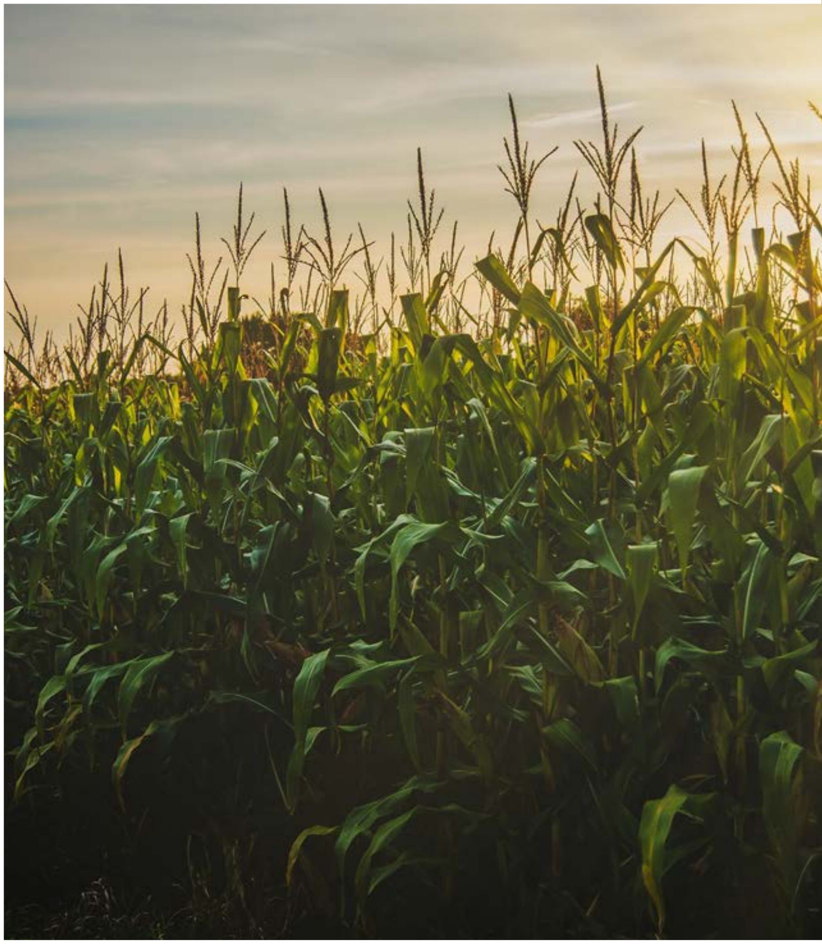
The Global Economy: Commodities Crisis



GPF | GEOPOLITICAL FUTURES

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Two wars are being waged that are dramatically affecting the geopolitical system: Russia's invasion of Ukraine, and the U.S.-led economic response to it. In some ways, the latter will be the more consequential.

The global economy was in a precarious place before the invasion, thanks to the COVID-19 pandemic. The sanctions against Russia, including the removal of many Russian hydrocarbons from the global market, and the blocking of traditional trade routes severely disrupted economic recovery.

Accordingly, there will be – and indeed there already have been – social crises that will become political crises throughout the world. This will, in turn, necessitate a worldwide economic restructuring that includes quotas on traded goods, diversification of trade partners, and near-shoring projects and initiatives to increase self-sufficiency through increased domestic production.

New structures create new definitions of what it means to be vulnerable and secure, and thus creates new sources of conflict. At the heart of all this is economic warfare.

Enclosed is a compendium of analyses that chronicles our coverage of it. It will provide an overview of the many dimensions and factors in play in this incredibly complex battlefield.

Allison Fedirka

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Director of Analysis

Analysts contributing to this special report

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Rising Food Prices Will Shake the Middle East and North Africa

By Allison Fedirka
March 10, 2022

Russia's invasion of Ukraine came at a time when global agriculture and food supply chains were already fragile.

Rising Food Prices Will Shake the Middle East and North Africa

The war in Ukraine is exacerbating preexisting problems with global grain supplies and prices. Although higher prices will be felt by all, North African and Middle Eastern countries along the Mediterranean will be more directly and severely affected. Sudden spikes in food prices are directly linked to increased social unrest and conflict. Further, instability in this region could put fertilizer supplies at risk, which would put only more upward pressure on food prices.

Terrible Timing

Russia's invasion of Ukraine came at a time when global agriculture and food supply chains were already fragile. A drought in 2021 across the U.S. and Canada, two of the world's largest producers and exporters of wheat and other grains, reduced crop yields. Dryer weather also hurt major agricultural exporters in the Southern Hemisphere, reducing the volume of some grains, such as corn, on the market. Smaller producers like Syria and Iraq also suffered from droughts, reducing their output and increasing import demand. And Russia, the world's largest wheat exporter, cut its export quota for 2022 to secure domestic supply. Even before the war, the U.S. Department of Agriculture's 2021-22 global outlook for critical goods like wheat, corn and select oilseeds projected lower supply, higher demand and reduced stocks at the end of the year.

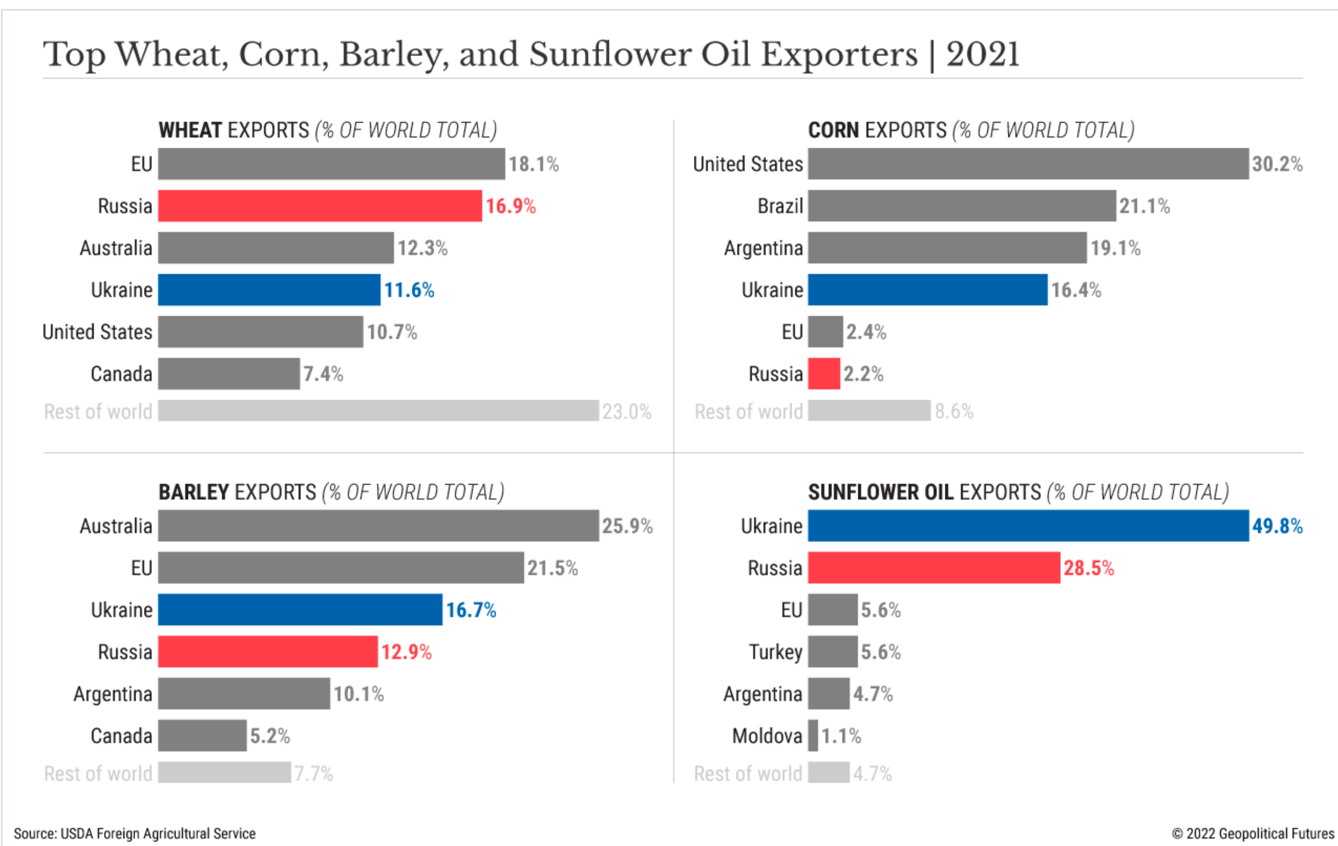
Higher fertilizer prices since the second half of last year were also starting to bite. Russia's decision at the end of the year to prohibit the export of nitrogen fertilizer until April made things worse, as did China's move to ban exports of phosphate fertilizer until at least June. The high cost and scarcity of fertilizers at the end of 2021 led many farmers, including those in Ukraine, to plant fewer hectares for the coming season than they had planned. It also affected decisions about which crops to grow – for example, farmers were averse to planting fertilizer-intensive crops such as corn.

The effects of the pandemic on energy and logistics cannot be overlooked either. Restarting economies in 2021 generated higher industrial activity, which pushed up energy prices. This, in turn, pushed up the cost of shipping goods. Additionally, prolonged logistical bottlenecks increased input prices of final products, including food. Although agriculture and food processing labor shortages were much improved in 2021 compared with 2020, there were still production interruptions and calls for higher wages. Simply put, there have been far more factors pushing up food prices than the reverse.

Market Uncertainty

The Ukraine conflict contributes to these price pressures by knocking two major producers of grains, oilseeds and other commodities out of the market and inserting enormous levels of market uncertainty. Together, Russia and Ukraine account for 28.5 percent of global wheat exports, 18.7 percent of corn exports, 29.6 percent of barley exports and 78.3 percent of sunflower oil exports – staples in the human diet and animal feed.

From the first days of the war, Black Sea ports have been closed while Russian warships patrol the area. Then on March 9, Ukraine's Cabinet passed a resolution banning the export of rye, barley, buckwheat, millet, sugar, salt and meat



for the rest of the year. Even before that decision, large shares of Ukraine's 2021 agricultural production were still awaiting transport: approximately 30 percent of its wheat, 45 percent of its corn and a quarter of its barley and sunflower oil. Now, those goods will not make it to the market in 2022.

Russia is encountering problems of its own. Though Russian ports and shipping lanes are open, Western sanctions have spooked potential buyers, shippers, insurers and so on. Finding enough shipping containers, shipping companies, ports for entry and buyers of any Russian goods has become increasingly difficult – even more so for the commodity trade, which is overwhelmingly conducted in U.S. dollars. Speculation about future sanctions targeting container ships would further jeopardize grain exports. This leaves grain and oilseed importers vulnerable.

Affected Countries

The countries most immediately affected are those that meet two conditions: They are heavily dependent on imports of grains and oilseeds, and they have as their leading suppliers Russia and/or Ukraine. Mediterranean countries in North Africa and the Middle East are first in the line of fire. Egypt and Turkey have suffered the most to date. Turkey relies on imports for 40 percent of its wheat and 33 percent of its corn. Russia and Ukraine combined provide Turkey with 75 percent of its wheat imports and 50 percent of its corn imports (as well as 51 percent of its sunflower oil imports). Similarly, Egypt depends on imports for approximately 60 percent of its wheat and corn consumption, and it gets 86 percent of its wheat imports and 40 percent of its corn imports from Russia and Ukraine combined.

Turkey was already battling severe inflation, and demonstrations related to the price of basic food goods have occurred. The country's Agriculture and Forestry Ministry assured the public that grain supplies are secure through the next harvest, but even if that is the case, Ankara has proved unable to tame inflation and stabilize the lira. In other words, it has not found a way to shield the public from higher food prices, particularly those related to imports.

Egypt has already canceled two orders of wheat, citing overpricing in one case

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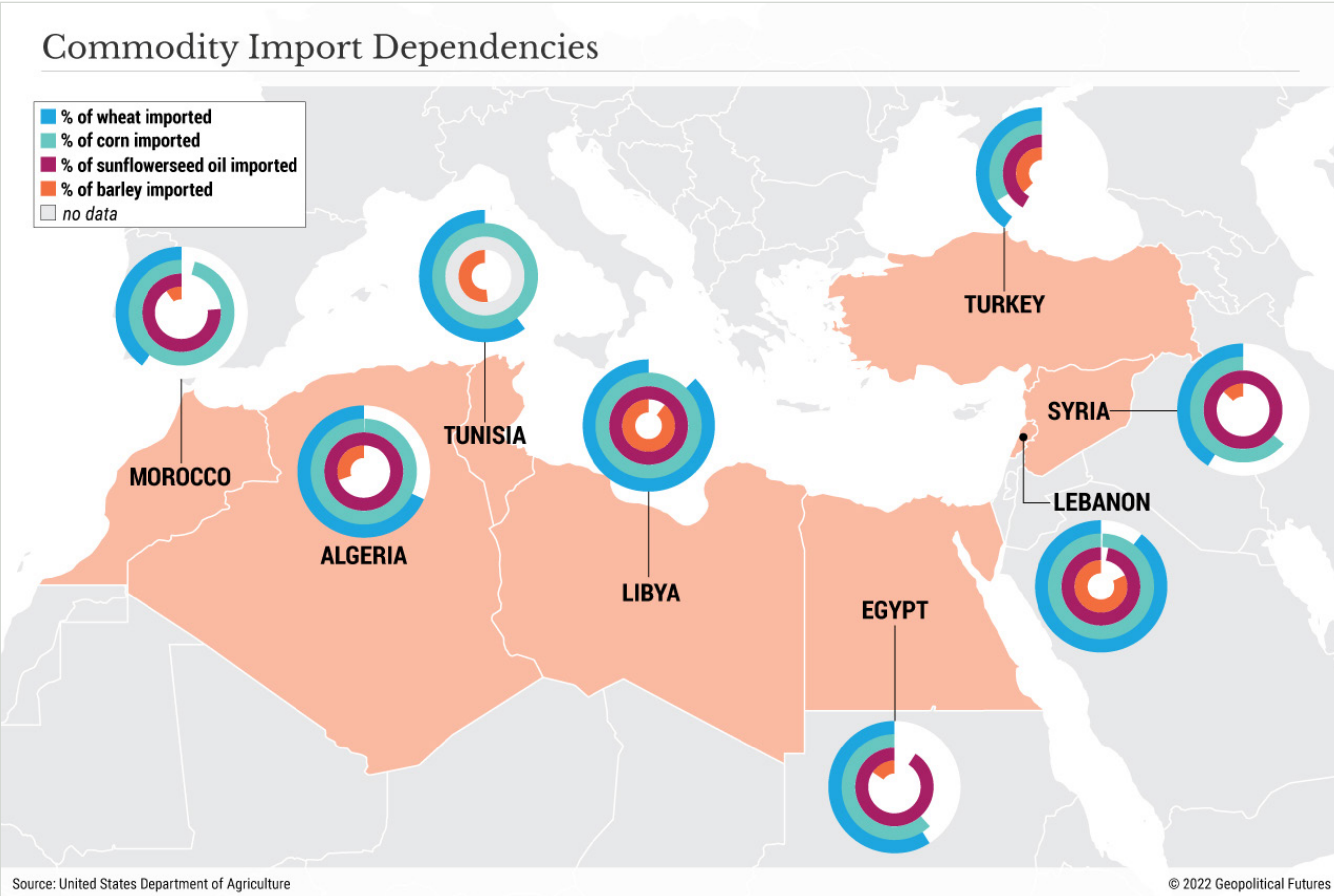

and a lack of sellers in the other. The Egyptian government heavily subsidizes wheat products, and previous attempts to curb these subsidies triggered mass unrest. Cairo will face the same choice again in the coming months.

Instability in either of these countries would be alarming given their significance in regional affairs. And neighboring North African and Middle Eastern countries are not faring much better:

In Morocco, severe drought increased Morocco's dependence on imports, especially of wheat and cooking oil, over the past couple of years. Morocco has a relatively lower import dependence for wheat of about 40 percent, but it relies on imports for nearly all of its corn. Ukraine and Russia provide Morocco with 20 percent of its wheat imports and just under 10 percent of its corn. In late February, a group called the Moroccan

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Social Front led nationwide demonstrations against rising food prices.

Tunisia relies on Russia and Ukraine for about half its wheat imports and 60 percent of its corn imports. The Tunisian government is now unable to pay for incoming wheat shipments because of drastic price hikes. Widespread shortages of grain products have been reported.

Lebanon gets approximately 45 percent of its cereal imports from Russia and Ukraine. In the past two years, imports have been even more critical for the country. The 2020 Beirut port explosion destroyed most of the country's primary grain silos, and authorities have been working ever since to compensate for a predicted wheat shortage.

Syria also has a relatively lower dependence on grain imports (approximately 50 percent), but Russia and Ukraine figure prominently in that supply. The two countries provide 61 percent of Syria's wheat imports, 42 percent of its barley imports and 20 percent of its corn imports. Syria has already started rationing wheat products.

Under these circumstances, and with no sign of improvement in the short term, mass unrest is nearly inevitable.

Future Crops

The conflict in Ukraine could also hurt the production of future grain crops – though the extent to which it will depends on how long the war lasts. The most obvious factor is the destruction of productive farmlands on which the fighting is taking place. Military movements across these areas will not only damage existing crops but could interrupt the planting for next season's crops. Pesticide and fertilizer application to wheat is supposed to start in March, while tilling resumes late March and early April. The barley harvest runs from March to April. Corn planting takes place in April and early May. If fighting persists for just a few more weeks, it risks disrupting these production processes and jeopardizing future crop production.

Fertilizers are also a major concern. The market for fertilizers – especially nitrogen-based fertilizers – is already outpricing certain crops for production. Russian sanctions didn't affect fertilizer exports simply because they were

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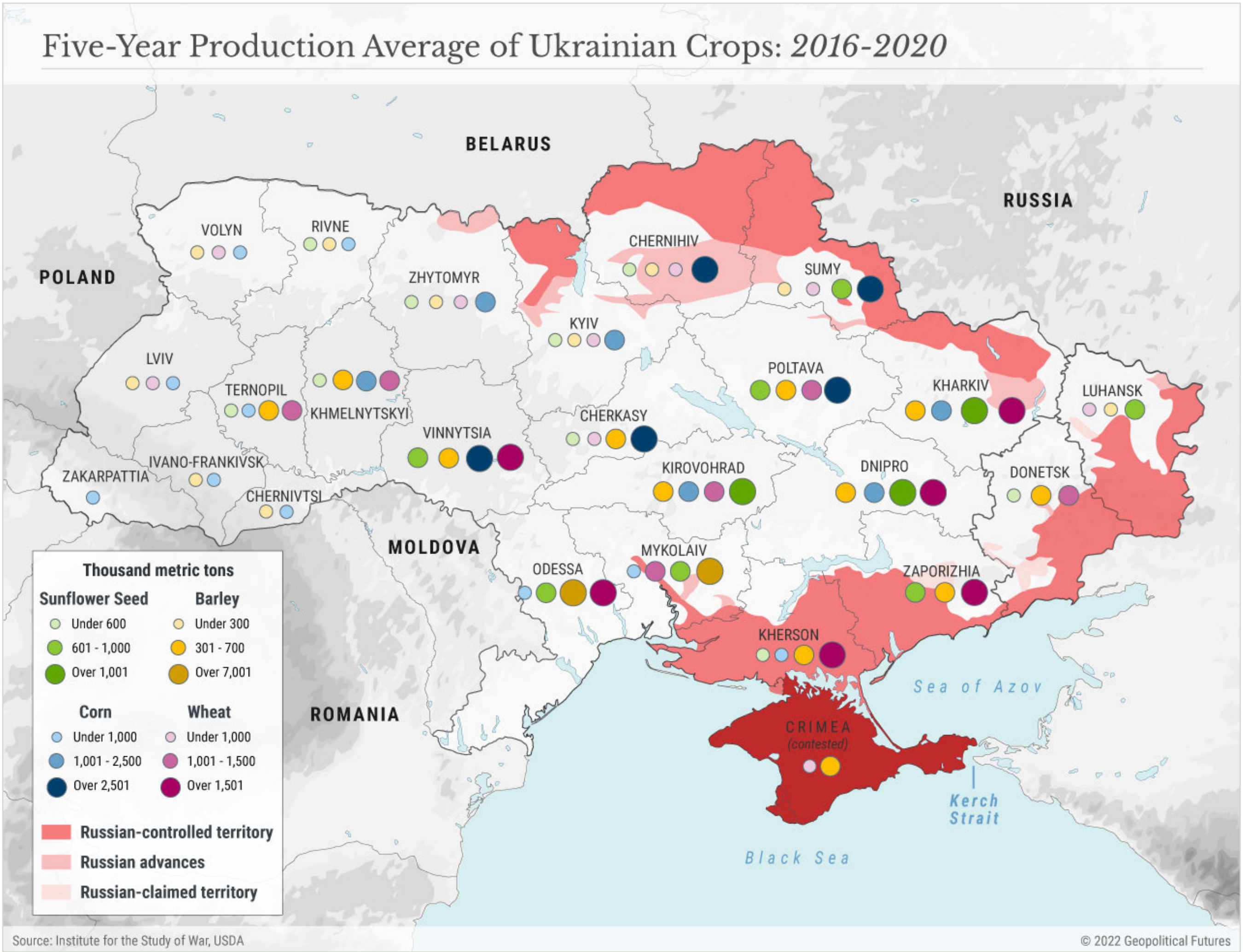

already off the market as of the end of last year, and there was no guarantee even absent a war that Russia would resume exports come May.

New sanctions have, however, dealt a major blow to fertilizers through Belarus, which provided 17 percent of the world's potash fertilizer exports. Adding Russia to the mix brings that figure up to 30 percent of potash fertilizer that is no longer available on world markets. And while Russia continues to export gas to Europe, major cuts in Russian gas supply to buyers like Germany, Poland, Lithuania, the Netherlands and Belgium, which together account for 16 percent of nitrogen fertilizer exports, will likewise threaten the market.

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Alternative Suppliers

It's extremely difficult to increase global supply when a major player is taken offline. Grain production, for example, depends on multi-month crop calendars that cannot be rushed. (Governments around the world have strategic grain reserves, but most of them are earmarked for emergency domestic use.) Fertilizer production depends heavily on resource extraction and infrastructure development; a country can't produce raw materials it doesn't have, and even if they do, it takes years to develop the facilities to process and export them.

Even so, alternative supplies to grains, oilseeds and fertilizers do exist. For wheat, corn and other grains, the best candidates are the U.S., Canada, Australia, Kazakhstan and Argentina. (Australia had a particularly strong wheat crop to help compensate some supply losses.) And because prices are so high and supplies so low, even smaller producers like Romania, France and India are becoming more competitive. But just because a country can export does not mean they will. Hungary has already banned grain exports to ensure domestic supply, while Argentine wheat farmers have stopped selling their wheat over confusion about pricing and uncertainty.

Fertilizer alternatives are trickier. Many of the countries at immediate risk of instability over food supplies are the same ones that can cushion fertilizer markets. Egypt and Algeria, for example, supply the world export market with 9 percent of nitrogen fertilizers. Algeria is also a major producer of natural gas, a key ingredient for nitrogen fertilizer but one that requires necessary infrastructure. Egypt and Morocco supply over 30 percent of potassium fertilizer exports for the global market. Given the state of the fertilizer market and supplies, stability in these countries becomes increasingly important. Any disruptions to their fertilizer export activity would hit fertilizer markets at a highly vulnerable time.

If there were any doubts over continued high food prices, the war in Ukraine put those doubts to rest. How long the spike will last depends entirely on how long the war lasts. So far, North African and Middle Eastern countries along the Mediterranean have borne the brunt. In turn, this creates the risk of instability in a region where governments were already on weak footing. For the rest of

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the world, now's a good time to consider going gluten-free.

How the Ukrainian Battlefield Redefines the World

By George Friedman
March 22, 2022

How the Ukrainian Battlefield Redefines the World

The war in Ukraine is a humanitarian tragedy to be sure, but that's not why it has commanded the world's attention. After all, there are humanitarian crises taking place in Yemen, Syria and other countries as I write this. From a geopolitical perspective, the war is potentially a watershed moment – that is, if European politico-military unity endures, creating a new model of Europe and redefining the functioning of the global system. A secondary issue is whether China's view of the world will change too as it either seeks a new understanding with the United States or becomes more estranged from it.

The Russians have fought a surprisingly poor war so far in Ukraine, especially when you consider their goals: to secure Ukraine as a buffer from the West, and to demonstrate Russian power as a force to be reckoned with. So far, the war has done the opposite. In some cases this is surmountable: In Afghanistan, Iraq and Vietnam, for example, the United States failed to impose its will and was seen by some as a power in decline. The difference is that those countries were not essential to American security. Ukraine is vital to Russia's.

So now Russia is looking for reinforcements from Syria, Belarus, the Wagner Group, and so on. Even if Moscow finds willing participants, it takes time to transport troops, familiarize them with the battlefield, and insert them in the combat structure. And even if Moscow succeeds in doing all these things, it still portends a long and drawn-out conflict. To many observers, the need to recruit foreign troops indicates a failure of Russian commanders, a weakness in training and motivating troops, and logistical problems.

If Russia wanted to create a sense in Europe that it could invade at will – something it likely would not have done, but something that would have potentially caused Europe to find an accommodation with Moscow or reconsider its relationship with the U.S., just in case – it has failed. For now at least, it has brought the United States and Europe closer than before. The continued combat and the brutality that Russia now seems to think are required to defeat Ukraine only galvanize it more. It's hard to think of an outcome for Russia, short of using weapons of mass destruction, that leaves the West worried about Russia as a major threat.

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And that's not just because of Russia's poor performance on the battlefield. Great power status is partly military and partly economic. Russia's gross domestic product in 2001 was $1.6 trillion, ranked 11th in the world just behind South Korea. Since then, Russia has limped along from volatile energy prices, the 2008 financial crisis, the COVID-19 pandemic, and now crippling sanctions in response to its invasion. In other words, it can no longer be thought of as an economic power either. And this changes our understanding of the world where Russia was considered a great power, due to its military force, accepting a weak economy.

Weeks before the war began, China sought an alliance with Russia because it needed friends in the face of the massive U.S. alliance structure running from Japan to India. As I have mentioned, China has no significant allies, save Pakistan. China knew it could not provide economic support to Russia – it has its own problems to manage – but at the very least, China needed some relief, which it hoped to achieve by harnessing Russian military power to force the United States and Europe to recalculate the threat that sanctions against it poses.

Aside from the military aspect, Russia benefitted from the possibility of financial support from China, or at least the impression to lenders that China was backing the Russian economy. It was obvious that Russia's ability to contribute significant force to a Chinese battlefield was limited, as was China' willingness to adopt a weak Russian economy. The alliance had the power of instilling fears in those whom they wanted to be afraid.

The alliance is still rhetorically there, but the possibility of actual support is not. Russia has already been damaged by economic actions from the United States and its allies, and China, at this economic juncture, cannot afford to be caught in the trap Russia is in. Any military support would run afoul of sanctions. Put simply, Russia is a liability for China.

Beijing's decision to announce its alliance with Russia, I suspect, was based on knowledge of Russia's invasion. This made an alliance attractive to China when it believed Russia was capable of a quick and easy victory, one that would, in theory, force the West to reconsid-

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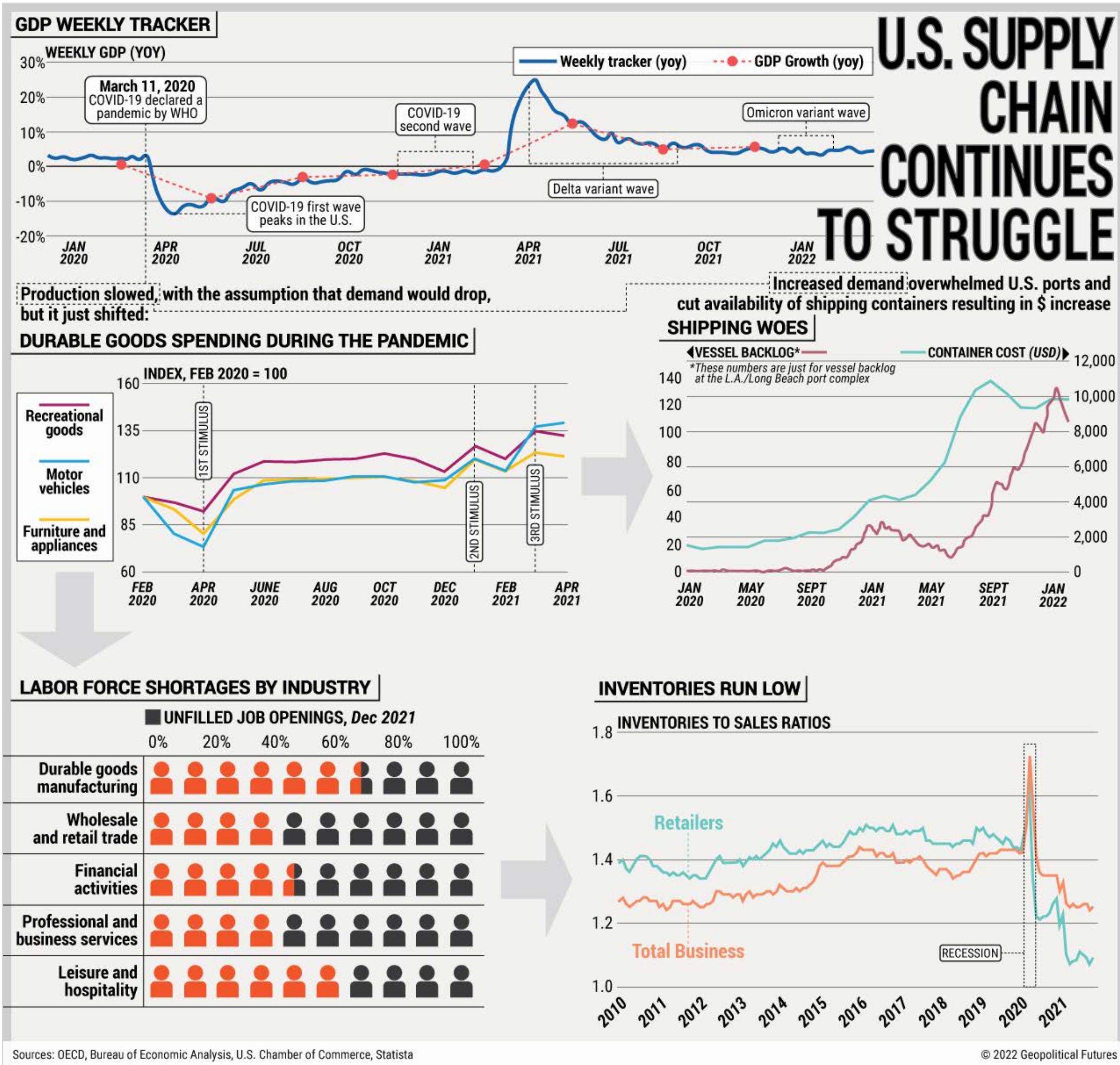
er their position on a China that could, maybe, replicate the Russian strategy.

Russia's incompetence has forced China to do everything it can to recoup, and thus it needs to reconsider its relationship with the U.S. It is in a severe economic downturn. Its alliance with Russia hasn't borne any fruit, nor is it likely to. The United States and Europe have developed a model of economic warfare that, if applied to China, would seem to be extremely damaging. China's short-term strategy, then, is to appear confident, maintaining its rhetorical support for Russia and criticizing the U.S., while it considers its next move.

Notably, Taiwan isn't the next move. China has seen firsthand that wars can go wrong and thus that an invasion of Taiwan is something to avoid for now.

If we think about the great powers of the world, we normally list the United States, Europe and Russia. Russia will have a problem claiming something like that unless it does something startlingly effective. Europe is a great power if it sticks together militarily and economically. It is doing that now, but as fear of Russia dissipates, old tensions will emerge. China is still a great power, albeit one with an untested military and a troubled economy. For now, the United States alone remains great economically and militarily.

America's Broken Supply Chains



Shipping backlogs, labor shortages and low inventories are persistent issues.

America's Broken Supply Chains

More than two years after the world first learned of COVID-19, U.S. (and other) supply chains are still experiencing severe problems. Prolonged public health interventions, repeatedly loosened and then tightened with each subsequent variant of the virus, disrupted the movement of finished goods and raw materials, seriously hampering manufacturing. With production slowing significantly, many experts expected demand would also decline. Instead, demand for services shifted toward durable goods like motor vehicles, recreational equipment and furniture. This overwhelmed U.S. ports and strained the availability of shipping containers, driving up freight rates.

Shifting demand patterns also stretched the labor market to its limits. Lingering fears about the virus, inflation and heightened economic uncertainty, a bump in early retirements, disruptions to family life, frustration and fatigue among many in the hospitality sector, and myriad other factors combined to slow the economic recovery.

Russia and the First Economic World War

By Antonia Colibasanu
April 11, 2022

The Kremlin has prepared for decades to confront the West and its socio-economic model.

Russia and the First Economic World War

As momentous as Russia's invasion of Ukraine is, the most strategically important event in recent weeks was the global economic war between Russia and the U.S. and its allies. Russia, however, has been preparing to confront the West and challenge the Western socio-economic model for a long time.

The Putin Era to the Pandemic

Russia's strategic interests in Ukraine are well-known. The geography and history of Russia compel its leaders to create and preserve a buffer between Moscow and the major powers in Western Europe, and to ensure access to the Black Sea. Ukraine is crucial to both goals. But beyond Ukraine, the Kremlin perceives the eastward expansion of Western influence, including into Russia, to be a modern invasion by stealth that threatens the Russian regime.

It is not Western organizations like NATO and the European Union that challenge the Kremlin, but the socio-economic model that enabled the West to win the Cold War and that enticed Eastern Europeans to want to join the West. When he became president of Russia in 2000, in the wake of the Soviet Union's collapse and the economic crisis of the 1990s, Vladimir Putin inherited a broken country. Many Russians contemplated joining the European Union, hoping that alignment with the West would bring a better life.

The priority for the Russian establishment was to stabilize and rebuild the country. Putin just wanted to survive politically. Following the example of past successful Russian leaders, he centralized power. Knowing he needed stability and growth to slow the rate of emigration and address Russia's poor demographics, he sought to make Europe economically dependent on Moscow. And looking back at history and the current power balance, he identified Germany as the lynchpin of his strategy of dependence.

Russian ties to Germany were key to establishing ties to the European Union more broadly, but this was only the beginning of Russia's strategy in Europe. Russia opened up its economy to Western investment, established links throughout the Continent and tried to understand the inner workings of EU bureaucracy. It established close business ties with Italy, France and later Hungary,

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and built a political network that would help expand its influence in Europe. For Moscow, learning about European vulnerabilities was just as important as building up its economy and growing Russia into a stable economic power.

The Kremlin also campaigned to join the World Trade Organization to establish deeper relationships with the world's biggest economic players. In the process, it benefited from foreign investments in Russia and learned how the global economy works, building partnerships with not just Western economies but also other economic powers. The only problem was that China, its major ally against the West, was not seeing the accelerated growth it hoped for and was still very much dependent on the U.S. market, giving Beijing limited ability to counter U.S. interests in the world and forcing Russia to keep its focus on Europe.

Average Russians saw improvements in their standard of living under Putin. In major Russian cities, life was similar to that in the West. However, when it became a major player in the energy market, Russia also increased its exposure to global economic cycles. The European economic crisis of the 2010s sent shivers through Moscow. Russia's economy remained fragile overall, and the gap between urban and rural areas remained dangerously high, potentially threatening Putin's control.

At the same time, the West offered an attractive model to rival Russia's. It wasn't so much the growing Western influence in Russia's buffer zone that bothered the Kremlin, but the fact that ordinary Russians might look at Eastern Europe and see a better model for political organization and economic growth.

Then the pandemic hit. The Russian president apparently feared that the economic insecurity wrought by COVID-19 could threaten his country's economic security and stability. As the worst socio-economic effects of the pandemic faded, action against the West became urgent. From the Kremlin's point of view, this was a unique moment. The U.S. has been trying to reduce its presence in Europe and instead focus on the Indo-Pacific and domestic problems. In other words, from the Kremlin, the trans-Atlantic alliance and the European Union appear weak. Most important, Russia's leaders believe they have gained sufficient knowledge of the way the West works and can fight it effectively.

Preparing for War

Russia has been preparing to confront the West since at least the early 2000s. Besides stockpiling foreign reserves, Moscow constructed trade blocs and deepened relations with projects like the Eurasian Economic Union. In Europe, it enticed Germany to become dependent on Russian natural gas, which as is clear today made it extremely difficult for Europe to cut off Russian energy imports. Shifting from gas would require Europe to build new infrastructure – a costly, time-consuming process.

The close German-Russian partnership also benefited the Kremlin's Europe strategy in other ways. To give a practical example, the EU had plans to make the Danube fully navigable through the establishment of additional canals, increasing Central Europe's connection with the Black Sea. This would have given Europe more leverage against Russia at the moment, when the war in Ukraine has forced the rerouting of commercial flows from the Black Sea to much more expensive land routes. Instead, positive relations with Moscow made the project seem unnecessary, and it faded away.

It is no coincidence that after 2012, the first full year that Nord Stream 1 was operational, Europe became much more reluctant to adopt policies that could be seen as anti-Russian. There was simply no interest in Germany to carry them out. It is also no coincidence that relations between the U.S. and Germany have cooled down over that time. The U.S. needed Germany to lead Europe, or at least maintain neutrality, to prevent Russia from expanding its influence in Europe as the U.S. drew back. The fact that Russia joined the World Trade Organization in 2012 gave it even more leverage in the world economy.

It is also worth noting that the Kremlin used personal relationships to shore up its influence. Former German Chancellor Gerhard Schroeder was tapped to lead Nord Stream 1. Nord Stream AG also hired former Finnish Prime Minister Paavo Lipponen as a consultant to speed up the permit process in Finland. Former Italian Prime Minister Matteo Renzi served on the board of Delimobil, a Russian car-sharing service. Former Finnish Prime Minister Esko Aho was on the board of Russia's largest bank, Sberbank. Former Austrian Chancellor Christian Kern resigned from the board of Russia's state-owned railway company in the early days of the war in Ukraine, while another ex-chancellor, Wolfgang Schussel, remained on the board of Russia's Lukoil. This is just a short list of top politicians, all of whom had at least some influence over their country's foreign policy discussions. They have certainly been useful to Russian economic growth and the advance of Russia's economic strategy in Europe.

Working closely with Europeans for the past two decades has enabled Russia to learn what is important for the stability of their countries. It has also helped the Kremlin better understand their political agendas and support causes that work to its advantage. For example, Russia enthusiastically supported many green policies, like Germany's decision to give up nuclear power – which translated into greater reliance on Russian gas. And Russia has openly supported populist parties throughout Europe and effectively used information warfare, all in an attempt to destabilize and ultimately divide Europe.

Globally, Russia has maintained close relations with traditional enemies and competitors of the West. Joining the WTO gave it a stronger position on the global stage, which is used to advance the influence and interests of emerging global players, including the BRICS countries, which also include Brazil, India, China and South Africa. Though the results were modest, Russia promoted the group as an alternative to the West and continued to focus on building ties to China and India, establishing links that it hoped would withstand in a potential confrontation with the West, which we're seeing play out today.

To counter the current sanctions, it has looked to China for help. The Eurasian Economic Union gives it proxies for continuing to do business with the world. At the same time, Russia's presence in the Middle East and parts of Africa helps it keep the price of oil high – high enough that it can keep paying its bills. Influence in the Middle East and the Sahel, two highly unstable but resource-rich areas, also gives Russia more leverage over the world economy.

In building its network, Russia has tried to focus on economics and enhancing

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weaknesses in the global network. It expanded its influence abroad, making sure the dependencies it was encouraging were strong enough to give it leverage but loose enough to allow its withdrawal when necessary. Russian strategy certainly has its weaknesses, but Russia has options in countering the West during the current global economic war. Supporting EU fragmentation through its economic ties in Europe and using the knowledge of European politics that it's gained over the years are likely the most important elements of its strategy. The moment European citizens feel the repercussion of Western sanctions is when the bloc will become more fragile, which will allow Russia to exploit the EU's weaknesses.

The world is witnessing its first economic world war of the modern era. The rules are undefined, and the global economy is complex, meaning collateral damage is unavoidable and frequently unpredictable. Slowly, we are becoming aware of the repercussions the sanctions on Russia are having on the global economy. Less clear are the instruments that Russia can employ against the West. How this will change the world is a mystery. All we can do is look back at what Russia has prepared for – and guess what could come next. This is only the beginning.

China Struggles to Balance Zero-COVID and the Economy

By Antonia Colibasanu
April 20, 2022

Beijing's inability to admit the shortcomings of its pandemic strategy is threatening growth and may push it closer to Moscow.

China Struggles to Balance Zero-COVID and the Economy

Shanghai, China's largest city and financial center, has been under strict lockdown since April 1 to contain an outbreak of the COVID-19 omicron variant. Although the government is considering relaxing restrictions in the city starting this week, other parts of China are likely to introduce severe restrictions soon as the virus spreads across the country. Guangzhou (a southern transportation hub), Suzhou (an eastern industrial city), Shenzhen (a southern tech hub) and Xiamen (a port city in the southeast) are all rumored to be next.

Perhaps most significant, there's some indication that Beijing could also soon impose a lockdown. Locals have already started stockpiling food, and the director of the Beijing Municipal Health Commission was put under investigation on April 16 for allegedly violating unspecified rules, possibly indicating that authorities believe the virus is spreading into the capital.

The lockdowns are increasing the pressure both on China, where frustration with the restrictions is growing, and on the world economy, which has already seen massive supply chain disruptions over the past two years. To understand why Beijing is reacting the way it is, we first need to understand the unique constraints the government is facing.

Limitations of Zero-COVID

It might seem odd that the Chinese government is imposing strict lockdowns at a time when the rest of the world is opening up. But with infection numbers rising and health services becoming overwhelmed, Beijing has backed itself into a corner. It previously touted the success of its strict zero-COVID strategy, using this as an indicator of the government's ability to manage the crisis better than other countries, and it can't abandon the policy now.

However, as the virus spreads to more and bigger cities, the government's fidelity to this strategy is turning into a political burden. The public's expectation that lockdowns will protect the population from the virus has contributed to a low vaccination rate among elderly Chinese. Over half of Chinese citizens aged 65 or above – more than 92 million people – still have not received three vaccine doses. About 20 percent of the population aged 60 and older, and more than 40 percent of those older than 80, hasn't

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received their first dose. Many believe that the side effects of the vaccine are worse than getting COVID-19, while others believe that the vaccine isn't effective anyway.

Indeed, the Chinese Sinovac-CoronaVac vaccine is not as effective as other vaccines. And with the emergence of omicron, a COVID-19 variant that was considered mild in the West, this has become an even bigger problem. In Hong Kong, the first omicron wave generated the highest COVID-19 mortality rate in the world. What happened in Hong Kong was proof not only that the low vaccination rate poses a high risk for the Chinese health system but also that the vaccinated population is poorly protected against the coronavirus. Thus, having refused to buy the more effective, Western-made vaccines, both the Chinese health system and the Chinese leadership are facing enormous challenges with the emergence of omicron.

According to the World Health Organization, Sinovac-CoronaVac offers 51 percent efficacy against symptomatic SARS-CoV-2 infection and about 49 percent efficacy against delta variants. Its efficacy against omicron is unknown. By comparison, lockdowns have a 50 percent efficacy rate globally – which explains why they were imposed so readily early in the pandemic before vaccines were available.

China now has two choices. The first is to keep imposing strict lockdowns, as it's currently doing. The second is to import the Western vaccines – thereby admitting the Chinese vaccine isn't as effective – and begin another mass vaccination campaign. Considering that China wanted to position itself as a pharmaceutical leader and export its own COVID-19 vaccine to other countries, the second option is unlikely.

Beijing is between a rock and a hard place. The 20th National Party Congress, where President Xi Jinping is expected to secure his third term, is set for the second half of 2022. And although the government doesn't want to introduce unpopular restrictions, especially right now, lockdowns are the only way to keep cases from spreading and the health care system from collapsing.

But keeping a city three times larger than New York under lockdown is tough, to say the least. For starters, delivering

China Struggles to Balance Zero-COVID and the Economy

food to all the residents locked in their homes is difficult. This is one of the issues that has caused anger among residents in Shanghai. Then there's the limited availability of health services. And so, with the growing frustration comes protests and civil unrest. Some demonstrations have already been held in Shanghai. These factors all make zero-COVID increasingly unworkable.

Economic Considerations

More concerning for Beijing than protests is the increasing economic problems China is facing due to lockdowns. On April 17, Shanghai authorities provided some guidance on measures firms should take to restart production in the city, such as stocking up on medical supplies and submitting COVID-19 prevention plans for their factories. China's industry regulator identified more than 650 companies in the semiconductor, automobile and medical sectors as priority firms that should resume production.

However, just three weeks under severe lockdowns – plus varying levels of restrictions in other regions such as Jilin, a major tech and agricultural hub – have caused problems in supply chains. On April 18, Vice Premier Liu He ordered the introduction of a nationally recognized COVID-19 test pass for truck drivers so that they can deliver goods between provinces without having to undergo screening at every stop. And in the aggregate, experts predict China's April lockdowns have already taken between 3 percent and 5 percent off China's monthly gross domestic product – an acceptable cost for the government. At the same time, Chinese analysts point out that actual local monthly income will drop by more than 50 percent, which could pose further problems for China's leadership.

China's leaders spent two years saying that China's lower COVID-19 deaths proved the superiority of the Chinese political model. The omicron variant challenges those claims and could eventually destabilize the Chinese economy. And Xi's position is more tenuous than normal right now. He needs enough elite support going into the National Congress later this year to head off rumblings of dissent or the emergence of potential challengers.

China Struggles to Balance Zero-COVID and the Economy

What's more, this comes at a time when China is already facing challenges on other economic fronts. The first – and probably the most worrying for the government – is the potentially explosive crisis in the real estate sector, embodied by property giant Evergrande. Beijing's plan to let the massively indebted company fail slowly to contain market panic and contagion risks is threatened by the lockdowns and resulting economic instability. Evergrande's woes may spread deeper and faster into the real estate market, potentially causing a financial crisis.

The second major problem is an energy crunch. China is the largest producer, consumer and importer of coal, which provides more than 60 percent of the country's electricity needs. No other energy source is more important to China, considering its large industrial base. The country needs cheap energy to maintain price competitiveness. Although China is committed to reducing its coal use from 2026 and reaching carbon neutrality by 2060, it is likely to be more cautious after coal shortages caused blackouts and factory shutdowns in 2021 following a Chinese ban on Australian coal. Another of China's major suppliers, Indonesia, banned coal exports for a month in January.

At the moment, the lockdowns are keeping production and energy consumption down. In fact, although China's ports haven't been fully locked down, the situation resembles the 2020 supply chain crisis, with factory closures and driver shortages. As a result, the volume of goods shipped from Shanghai dropped 26 percent between March 12 and April 4, while the volume of goods leaving the port by truck fell 19 percent, according to FourKites, a Chicago-based company that tracks supply chain data.

At the same time, the International Energy Agency said on April 13 that it had cut its forecast for global coal and oil demand because of China's imposition of lockdowns since March. The price of oil and other fuels has also fallen off since its explosion in late February when the war in Ukraine started.

China's temporary shutdowns will buy time for the government to tackle the energy problem. The government has increased domestic coal output since last year's blackouts. But expanding mining takes time and investment, and China

China Struggles to Balance Zero-COVID and the Economy

will have to compete on international markets in the meantime. Therefore, Beijing may be using the lockdowns in part to negotiate with global coal suppliers, one of which is Russia.

The lockdowns are also certainly pushing the Chinese government to think about its priorities and shifts in the global economy. During the National People's Congress and Chinese People's Political Consultative Conference in Beijing in March, it was made clear that a key government concern is lower foreign demand for Chinese products. Global consumption shifted toward goods during the pandemic, but now it's rebalancing back toward services. Many countries have begun considering facilitating local production for basic goods in order to secure their demand. If Chinese lockdowns continue, the shift away from Chinese goods may persist. Beijing is aware of the risk but can do little about it without abandoning its zero-COVID policy.

Global Economic Warfare

Russia's invasion of Ukraine isn't doing China any favors either, but there is little China can do about it. The war has increased uncertainty in already unstable commodities markets. It also pushed up already high energy and food prices, a trend that is likely to continue in the coming months. These higher input prices challenge China's ability to maintain production and exports. At best, if it plays its cards right, Beijing could use the economic war between Russia and the West in its favor.

Hoping to make the most of the war, China has not joined Western sanctions against Russia, even as it ensures it doesn't risk secondary sanctions on itself. In the run-up to the war, with Moscow anticipating sanctions, the Kremlin worked to increase trade with Beijing. According to Chinese customs data, turnover in Chinese-Russian trade from January to February reached $26.4 billion, an increase of 38.5 percent compared with the same period last year. The 2021 figure was itself a 35.8 percent increase on 2020 numbers.

Moreover, with Western sanctions blocking Russia from using the dollar and the SWIFT payment system, China and Russia renegotiated contracts to denominate them in renminbi. Previously, only 17 percent of bilateral trade was settled

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in the Chinese currency. The lockdowns have surely caused a slowdown for Russian exporters who have encountered logistical problems in shipping their merchandise into China. But the renegotiation has facilitated the restoration of Russian energy deliveries to China, with coal shipments scheduled to be the first to arrive, followed by crude deliveries.

Maintaining access to cheaper Russian commodities will be crucial to Chinese efforts to balance exports and economic growth with its zero-COVID policy. At the same time, Moscow needs partners right now and thus has its own interest in preserving good relations with Beijing. However, it will take more than cheap Russian imports to keep Chinese products competitive in Western markets. China also runs some reputational risk from its close relationship with Russia. Ironically, reduced demand for Chinese exports and the consequent weakening of the Chinese economy could push Beijing and Moscow closer together in an effort to stabilize their economies and, while doing so, counter the West. China's existing economic model would need to fail for Beijing to consider such a strategy – and from the looks of it, China is fighting hard to avoid that outcome. The West – and the U.S. in particular – is currently most important for China.

Can Africa Replace Russian Energy in Europe?

By Ekaterina Zolotova
April 25, 2022

Moscow isn't too worried, but neither is it taking any chances.

Can Africa Replace Russian Energy in Europe?

Unsurprisingly, the economic war against Russia has created tensions in European energy markets, which are scrambling to find alternate sources from what is still their largest supplier. Italy, for example, has already reached agreements to increase natural gas supplies from Algeria and Angola. However, Russia isn't all that concerned – it figures the internal problems endemic to the region, the recent OPEC+ deal and the competition for energy in the European Union will conspire to keep Europe fairly dependent on its own exports. But neither is Moscow taking any chances. It sees what Europe is doing and will take all appropriate steps to maintain its position in European markets by increasing cooperation with African states.

Hopes

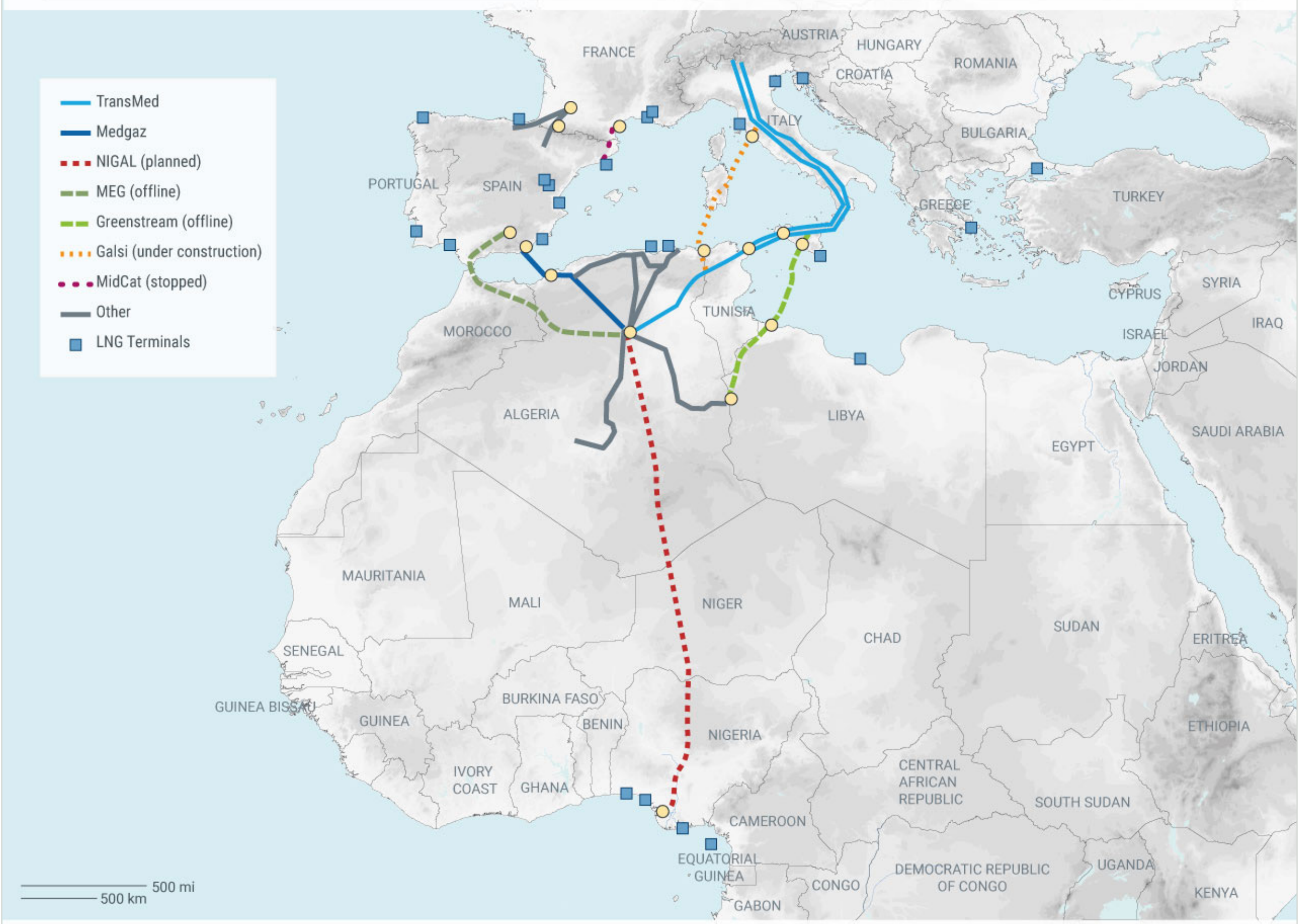
The debate over abandoning Russian gas for other suppliers, particularly in Africa, isn't new. U.S. President Ronald Reagan encouraged Europe to do so as far back as 1981, right around the time the Urengoy-Pomary-Uzhgorod gas pipeline – the primary conduit for Russian exports to Europe via Ukraine – was being built. The idea was to weaken the Soviet Union, which, like Russia today, relied heavily on oil and gas revenues. Washington set a ceiling for Western Europe – allies could buy only up to 30 percent of their total gas consumption from the Soviet Union – and banned the General Electric Corporation from exporting technology and equipment to the Soviet Union under the threat of sanctions. Europe ultimately went its own way: West Germany and the Soviet Union had important oil and gas infrastructure contracts that neither wanted to abandon, and other countries had too few options for ginning up their own production.

Today's tension is somewhat similar. It's true that curbing Russian imports would hurt the government in Moscow. It generates more than a third of its budget with oil and gas sales, with Europe importing about 85 percent of all Russian gas. Which is why the European Commission has accelerated a plan to reject Russian carriers. If implemented, the EU could reduce its demand for Russian supplies by as much as two-thirds by the end of 2022, its supplies offset by increases in imports from the Arabian Peninsula, Central Asia, Africa, Azerbaijan and Norway, as well as the U.S., which is supplying liquified natural gas.

Can Africa Replace Russian Energy in Europe?

But in the context of the current economic war, African countries occupy a unique place for a couple of reasons. First is the sheer amount of natural gas resources – about 455.2 trillion cubic meters, according to British energy firm BP. Second is proximity. The legacy of colonialism has left many African regions oriented toward trade with Europe, with gas pipelines and LNG terminals to boot. Third is the simple fact that countries such as Algeria and Nigeria already supply a not-insignificant amount of gas to Europe. (Algeria accounts for almost 12 percent of European consumption, while Nigeria accounts for about 3 percent.)

Gas Pipelines from Africa to Europe



Source: DW

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Can Africa Replace Russian Energy in Europe?

More important is that African countries have the potential to increase production and supplies without dramatically reorienting global supply flows. Stimulating production and discovering new deposits will be a much more effective method of energy warfare than the reorientation of existing trade flows. After all, if the European Union prefers countries that already have a developed infrastructure for production, processing and transportation, and already have customers and occupy a sizable market share, then these countries will most likely have to abandon their current markets to cover European demand. (Think Azerbaijan, Qatar and Norway.) This will almost certainly result in Russian oil filling the gaps. Goosing production in Africa sidesteps that problem.

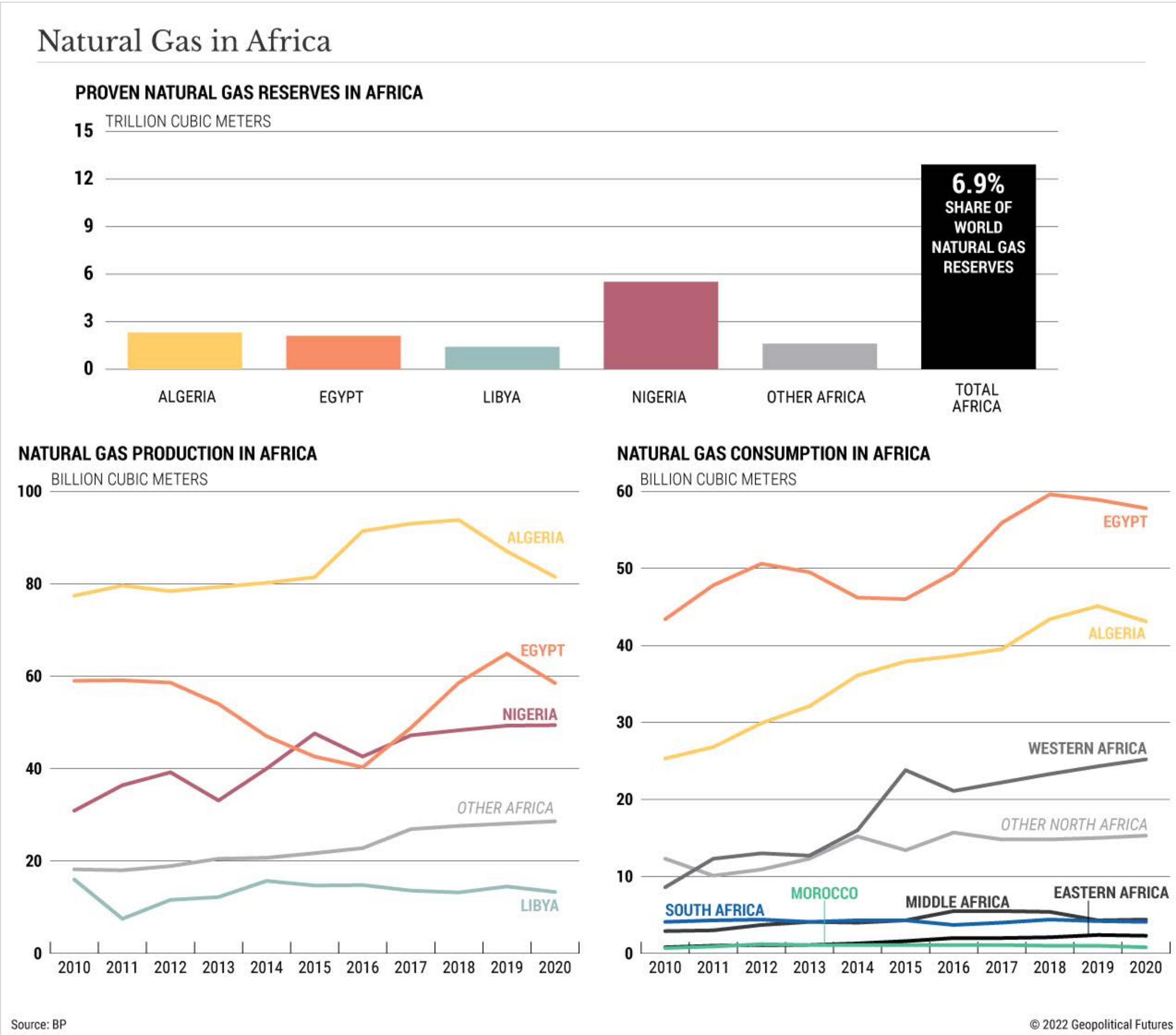
Doubts

All this is easier said than done. Just about every EU country is trying to accomplish the same thing but on a bilateral basis. What may benefit one country may well come at another's expense. Moreover, EU members that go it alone will have a harder time marshaling the huge amounts of resources needed to boost African production enough to offset the loss of Russian supplies.

Indeed, it's hard to overstate how difficult it will be to build up the necessary infrastructure in the short term. It's not that there aren't any pipelines. Transmed, a natural gas pipeline from Algeria via Tunisia to Sicily and thence to mainland Italy, delivers some 30 billion cubic meters of gas per year. And Medgaz, the main gas pipeline connecting the largest gas field in Algeria with Spain, has a design capacity of 8 billion cubic meters per year. It's that existing pipelines either have far too low a capacity to replace Russia or have been rendered inoperable by construction or regional conflicts. (Such is the case with the Maghreb-Europe Gas Pipeline in Algeria.) This is to say nothing of the difficulty in constructing new pipelines through the Mediterranean Sea, which is often too deep for modern technologies to accommodate.

And even if new infrastructure were completely operable, it ignores the fact that gas producers tend to start consuming more of their products. In Algeria, for example, gas consumption increased from 25.3 billion cubic meters in 2010

Can Africa Replace Russian Energy in Europe?



to 43.1 billion cubic meters in 2020. In Egypt, it jumped from 43.4 bcm to 57.8 bcm, while in West Africa it jumped from 8.6 bcm to 25.2 bcm. That means Algeria consumes nearly half of what it produces, Egypt nearly all of what it produces, and West Africa roughly two-thirds of what it produces.

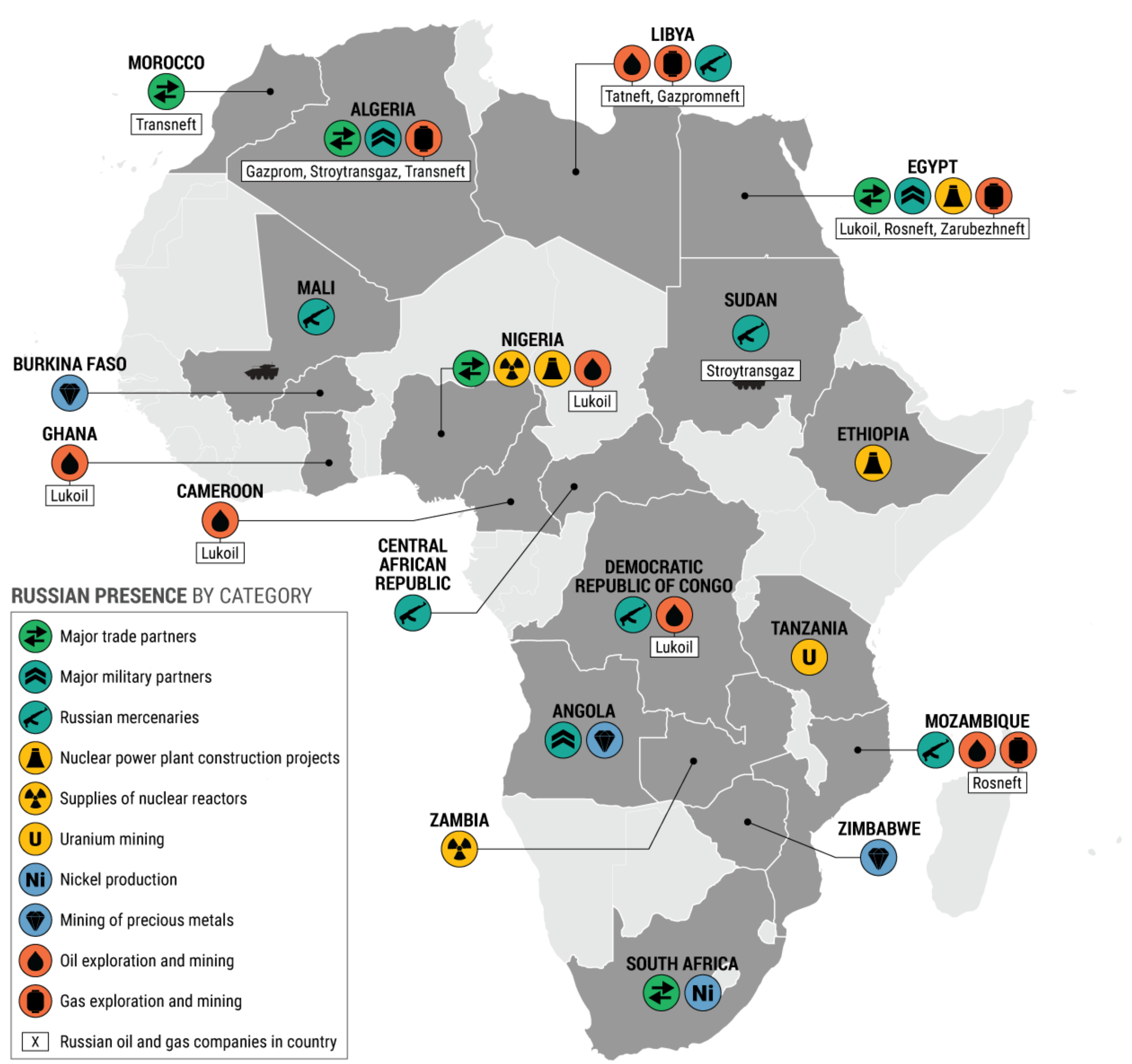
Production is typically incommensurate with increased consumption for a variety of reasons. International oil companies began to reduce investment in response to falling oil prices. In Algeria, the development of new potential exploration zones, most of which are new shale gas deposits, becomes unsustainable due to the lack of water resources necessary for hydraulic fracturing. In Nigeria, gas production depends on oil production, and oil production is limited by the OPEC+ agreement. In Angola, production has fallen by more than a third because Western operators simply do not want to invest any more money in perpetually unstable economies. And it goes without saying that redirecting needed gas supplies to Europe will be sure to upset the local populations, potentially leading to bouts of unrest.

Meanwhile, Russia has significantly strengthened its position in the region. Lukoil, Gazprom, Rosneft and others are directly or indirectly enhancing energy relations with many African states. For example, Lukoil entered the offshore deepwater project on the Tano block of the Ghana shelf in West Africa, where there are two gas fields. Lukoil also acquired a 25 percent stake in the Marine XII hydrocarbon production project on the shelf of the Republic of Congo, where Litchendjili gas condensate is being produced. Rosneft acquired a 30 percent stake in the Zohr offshore gas field in Egypt. Gazpromneft has projects in Libya and offshore fields in Equatorial Guinea and Angola through its subsidiary, NIS. Gazprom is participating in exploration and production operations at El Assel, Algeria, in which it has a 49 percent share. Russia also participates in maritime transport, as evidenced by a delivery to Spain from Cameroon on a Gazprom-chartered tanker.

For Europe, then, finding new partners is possible but difficult. Finding new deposits is expensive and time-consuming. And redirecting existing flows risks creating more markets for Russia. Even if things proceed without a hitch, it's unlikely that Africa can replace the Russian energy that Europe wants to forgo – namely, about 40 percent of what it consumes every year – any time soon. Moscow will therefore bank on the ineffectiveness of Europe's current African project in the short term, while continuing to enhance its market share in the medium term. Given the lack of investment and technology and the rather friendly attitude of African states toward Russia and their nonaligned sanctions policies, the future may still be bright for Russia.

Can Africa Replace Russian Energy in Europe?

Russia's Presence in Africa



Sources: RBC, SIPRI, Russia's Ministry of Energy

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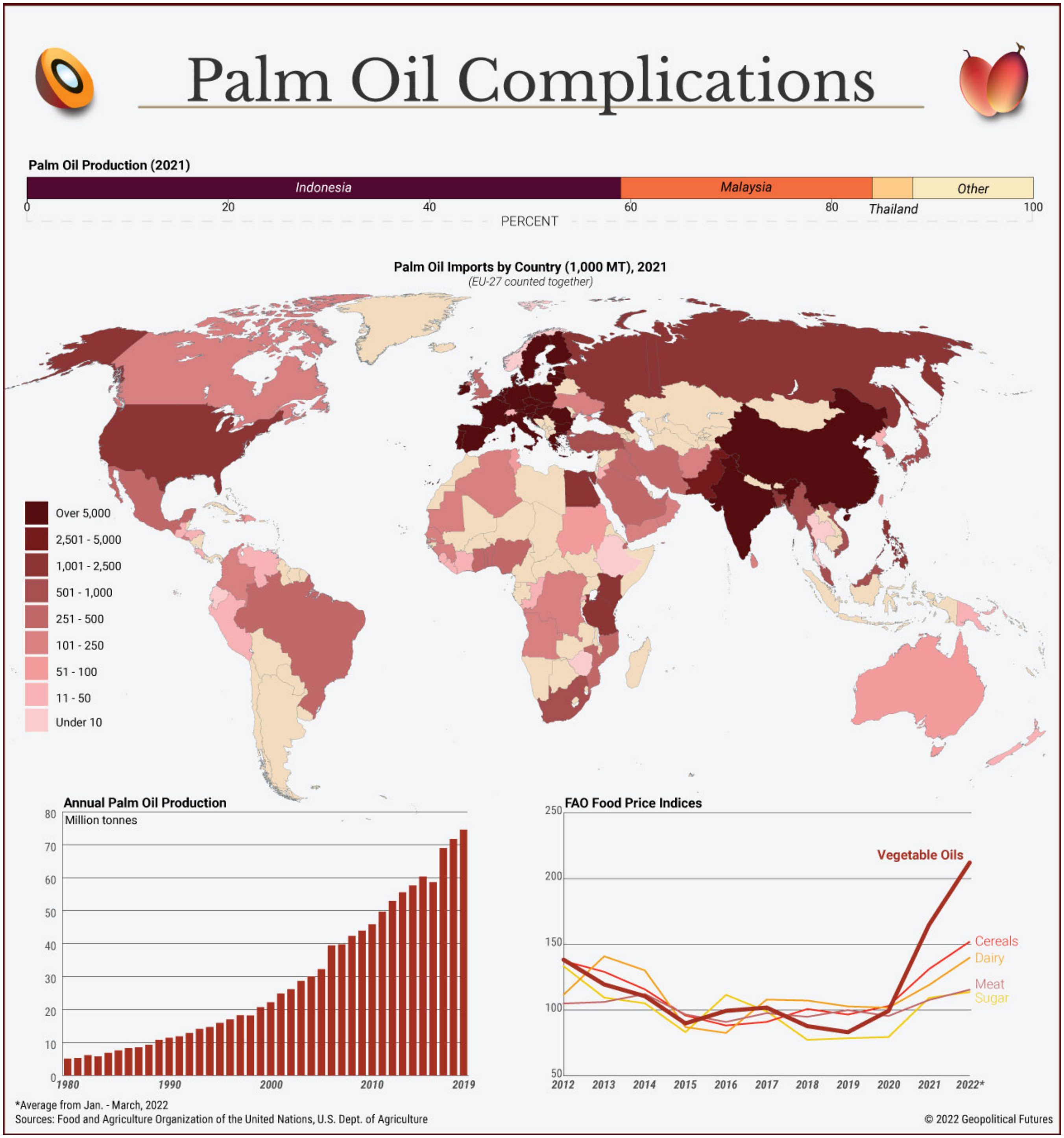
Indonesian Exports and Palm Oil Prices



After a spike in domestic prices led to shortages and unrest, Jakarta expanded its restrictions on palm oil exports.

Indonesian Exports and Palm Oil Prices

Palm oil is an essential good all over the world. It is used not only in cooking but also as an ingredient in food manufacturing, detergents, cosmetics and biofuel. Earlier this week, after a spike in domestic palm oil prices led to shortages and unrest, the Indonesian government expanded its restrictions on palm oil exports to include crude palm oil, RBD (refined, bleached and deodorized) palm oil, and used cooking oil. Jakarta even deployed its navy to prevent illegal exports of palm oil.

Like other food prices, palm oil prices have been rising since the COVID-19 pandemic began. Export restrictions in Indonesia, the largest palm oil producer, will directly contribute to higher food prices globally. This will especially affect African countries, which use palm oil in local cuisine and are extremely vulnerable to price fluctuations. Food expenses in sub-Saharan Africa already account for 40 percent of households' consumer spending, so it will be difficult to absorb the extra cost. Advanced economies like the U.S. will also see higher prices, notably in processed food products and things like soaps and makeup.

China's Role in Sri Lanka's Economic Crisis

By Victoria Herczegh
May 4, 2022

Beijing's ability to come to its allies' aid is hampered by its own domestic problems.

China's Role in Sri Lanka's Economic Crisis

Over the past several weeks, Sri Lanka has been experiencing an economic crisis that has brought the country to the brink of bankruptcy. Nearly $7 billion of its $25 billion in foreign debt is due for repayment this year, meaning the country is low on cash at a time when it's also experiencing the fallout of government mismanagement of the COVID-19 pandemic. To address the crisis, Sri Lanka will need outside financial help. One option is an International Monetary Fund loan, which would require the country to ensure it can manage its debt by, for example, restructuring existing loans. This is unlikely, since one of its major lenders, China, prefers not to engage in IMF-backed processes. Another option is to reach out to regional economic powers for more credit. Though this would only increase its total debt, at least it would be able to avoid default.

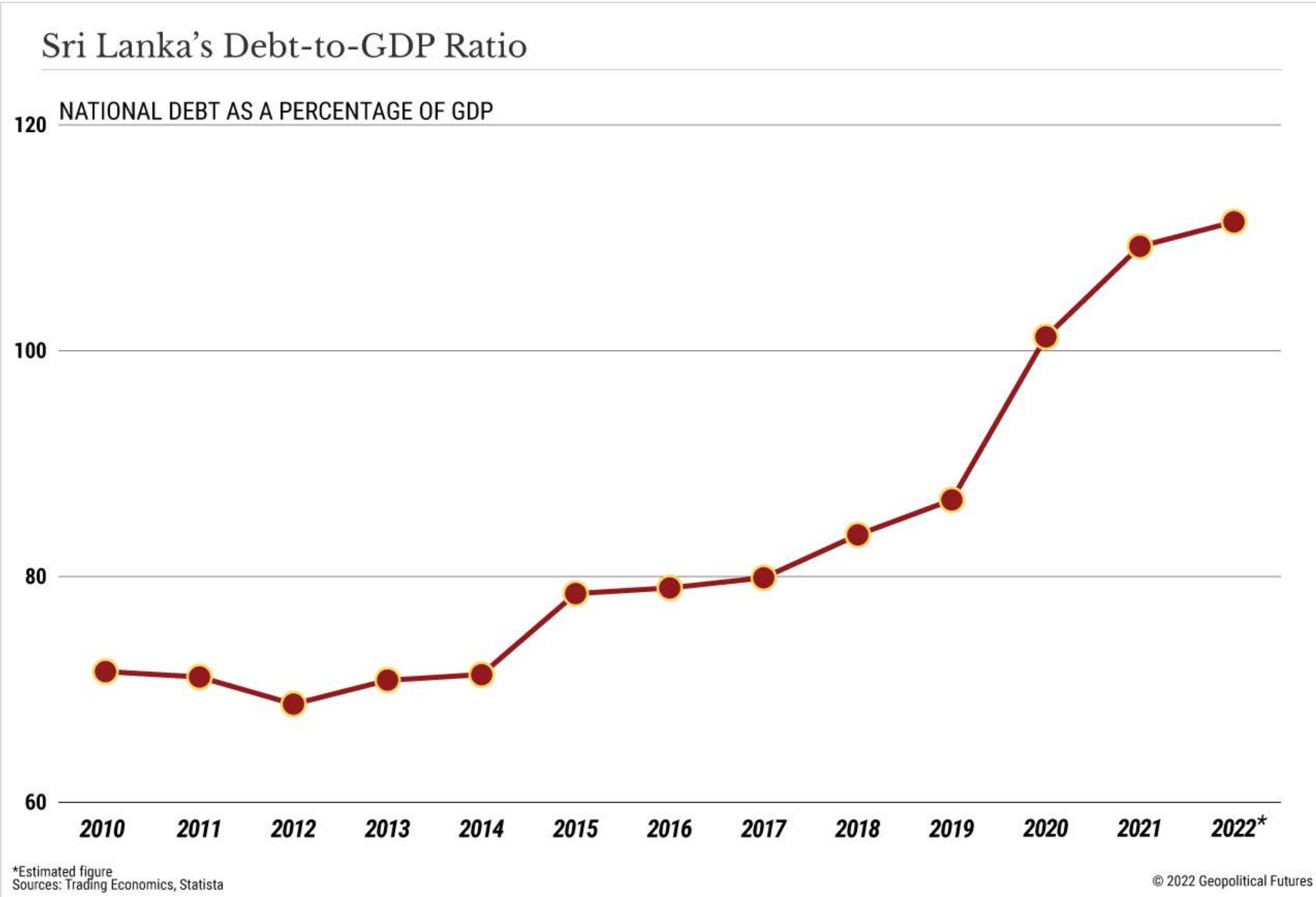
The most obvious choice is China, since Beijing has already invested heavily in many countries of the region, seeing this as a way to build its influence in strategically important locations. However, when these countries experience financial difficulty, as Sri Lanka is right now, they're likely to turn to Beijing for help. And the problem for China is that its own constraints – structural economic issues and its fight against the coronavirus – could prevent it from coming to their aid. Thus, China will increasingly struggle to maintain its influence in these countries and to keep rival powers out.

Strong Ties

China's growing investment in Sri Lanka has been strongly supported by the administrations of both current President Gotabaya Rajapaksa and former President Maithripala Sirisena. China is already Sri Lanka's fourth-largest lender after international financial markets, Japan and the Asian Development Bank. The ADB is a Japanese-led institution and reflects mainly Japanese and U.S. interests. Its Chinese-led counterpart, the Asian Infrastructure and Investment Bank, also finances significant infrastructure projects in Sri Lanka, like affordable housing and land redevelopment.

In recent decades, China has lent Sri Lanka over $5 billion for large-scale infrastructure projects as part of Beijing's Belt and Road Initiative. This money has gone toward funding roads, an airport

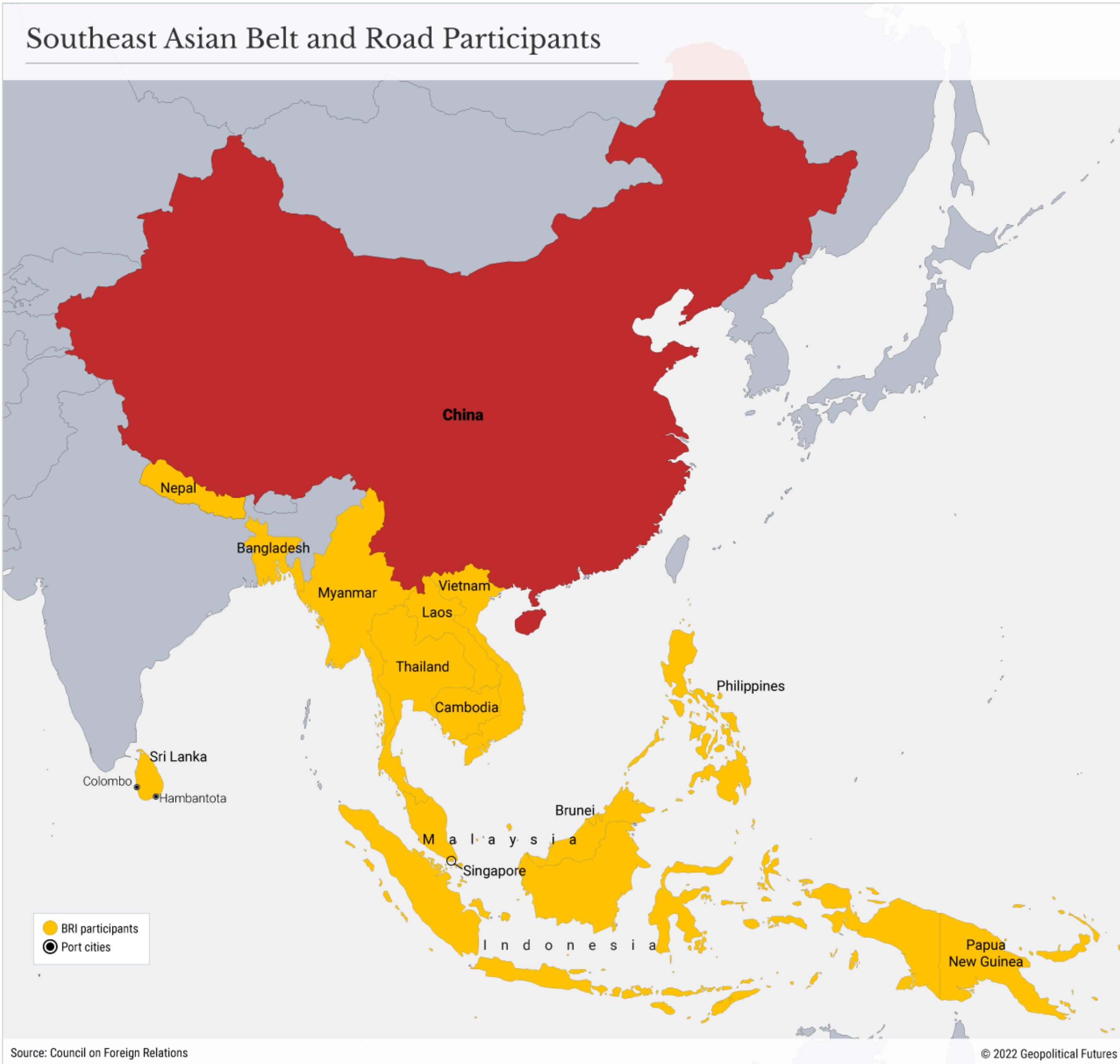
China's Role in Sri Lanka's Economic Crisis



and several ports. One of its most significant projects is the Colombo Port City, in which China's $1.4 billion stake is the largest single foreign investment in Sri Lanka's history. But the country is now heavily indebted to China, having taken loans at rates ranging from 3 percent to 6 percent compared to the 1 percent to 3 percent rates offered by the World Bank and IMF. Unable to pay them back, Sri Lanka has even had to ask China to swap some of the debt it owes for the country's own stocks.

China has the strongest influence in Sri Lanka of any foreign country, having supplanted India over the past decade despite India's proximity to the island nation. That's partly because its investments there have steadily increased since the early 2010s but also because Beijing has gradually built political ties and pulled Sri Lanka into its orbit. Sri Lanka's China-friendly political tilt, driv-

China's Role in Sri Lanka's Economic Crisis



en by the promise of quick and efficient economic and technical assistance, can be seen in both the Sirisena and Rajapaksa governments. China succeeded in winning Sri Lanka's trust because of its willingness to lend money to countries shunned by the international community for their poor human rights records. Indeed, their relationship strengthened after allegations emerged in Sri Lanka

China's Role in Sri Lanka's Economic Crisis

of state-sponsored human rights abuses during the Tamil Tigers-led insurgency in the country.

China's Motivations

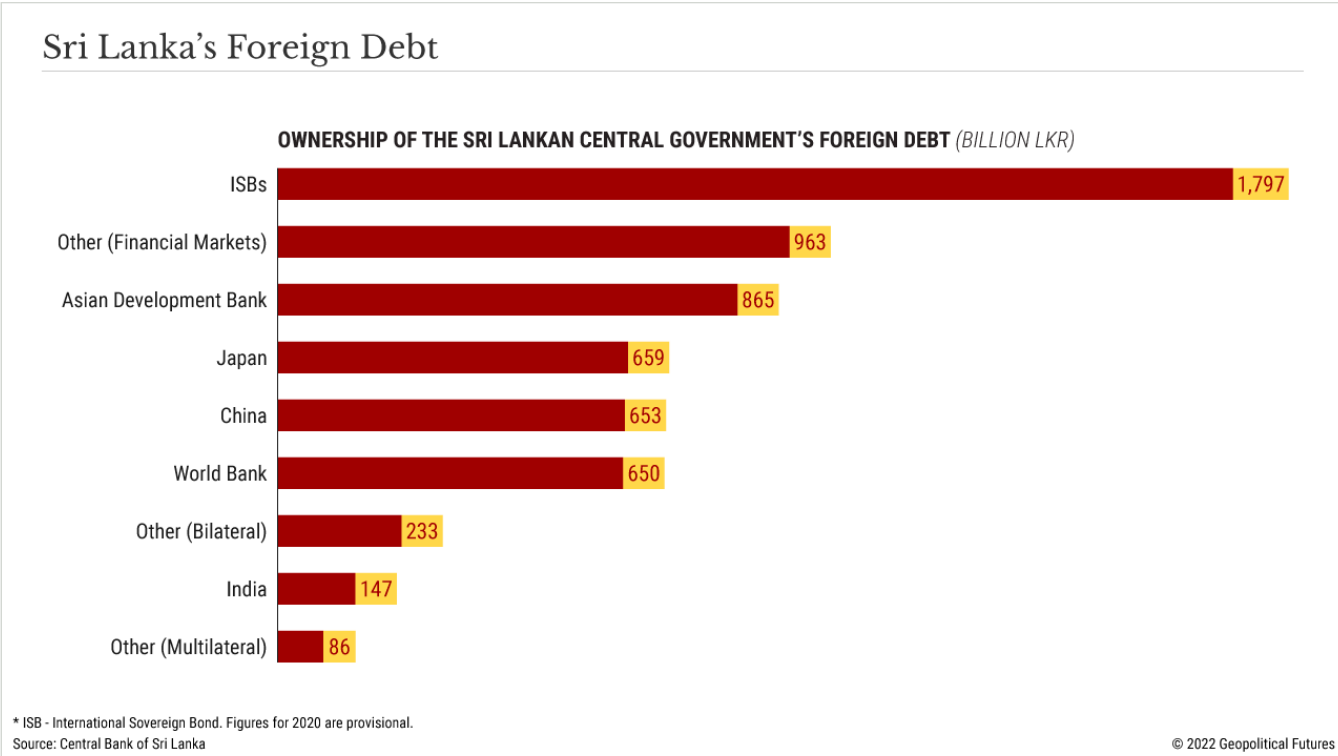
What's in it for Beijing? China has been investing massively in infrastructure and other projects in nearby countries, primarily because this helps guarantee its access to foreign markets through key regional maritime routes. These investments are a substantial source of Chinese influence in the region.

In addition, Sri Lanka is of major significance in China's "string of pearls" strategy in the Indian Ocean. The port of Hambantota, operated as a joint venture and currently leased to China for 99 years, straddles an extremely busy east-west shipping route. It offers a diversified range of transport and logistical services. China has a strategic imperative to gain immediate access to the Indian Ocean and control ports in the Asia-Pacific region, so that it can conduct trade and maintain strong relations with its numerous partners. Hambantota is close to major sea lanes, so building a port there could help Beijing guarantee access to international trade routes nearby.

However, China hasn't exactly been enthusiastic about coming to its ally's aid. It even refused to restructure Sri Lanka's debt when asked. India, on the other hand, was the first country to provide immediate help, with a $1.5 billion line of credit. A line of credit may not be ideal given Sri Lanka's situation, but right now it needs whatever help it can get. New Delhi's offer is clearly an attempt to pry the island nation away from Beijing – not surprising since India is trying to counter China in the Indo-Pacific region, where the two regional powers have competing interests. For India, wooing one of China's "pearls" would be a big step.

China's hesitancy in helping Sri Lanka is a result of domestic constraints. The East Asian country is facing its own structural economic problems and has been battling an outbreak of the omicron COVID-19 variant for months, which has led to partial or full lockdowns of major cities including its financial hub, Shanghai. Given that Beijing spent weeks considering whether to provide Sri Lanka with financial assistance, it seemed that

China's Role in Sri Lanka's Economic Crisis



China was either unwilling or unable to help.

On April 25, however, talks between the two countries began after Chinese Premier Li Keqiang said China was ready to provide much-needed assistance for Sri Lanka. But many in Sri Lanka see this as an empty promise – one that came too late and only as a response to Sri Lanka's talks with the IMF. Doubts about China's credibility aren't surprising given that Sri Lanka in the past has had to find new financing for BRI projects after China failed to come through with promised funds on time.

Waiting in the Wings

China's role in helping Sri Lanka resolve its economic crisis is important because it will set a precedent for other countries in South and Southeast Asia that may also face economic difficulties in the near future. Also, China's global image is in part based on its ability to assist and invest in smaller neighboring countries, so if Beijing fails to come through,

China's Role in Sri Lanka's Economic Crisis

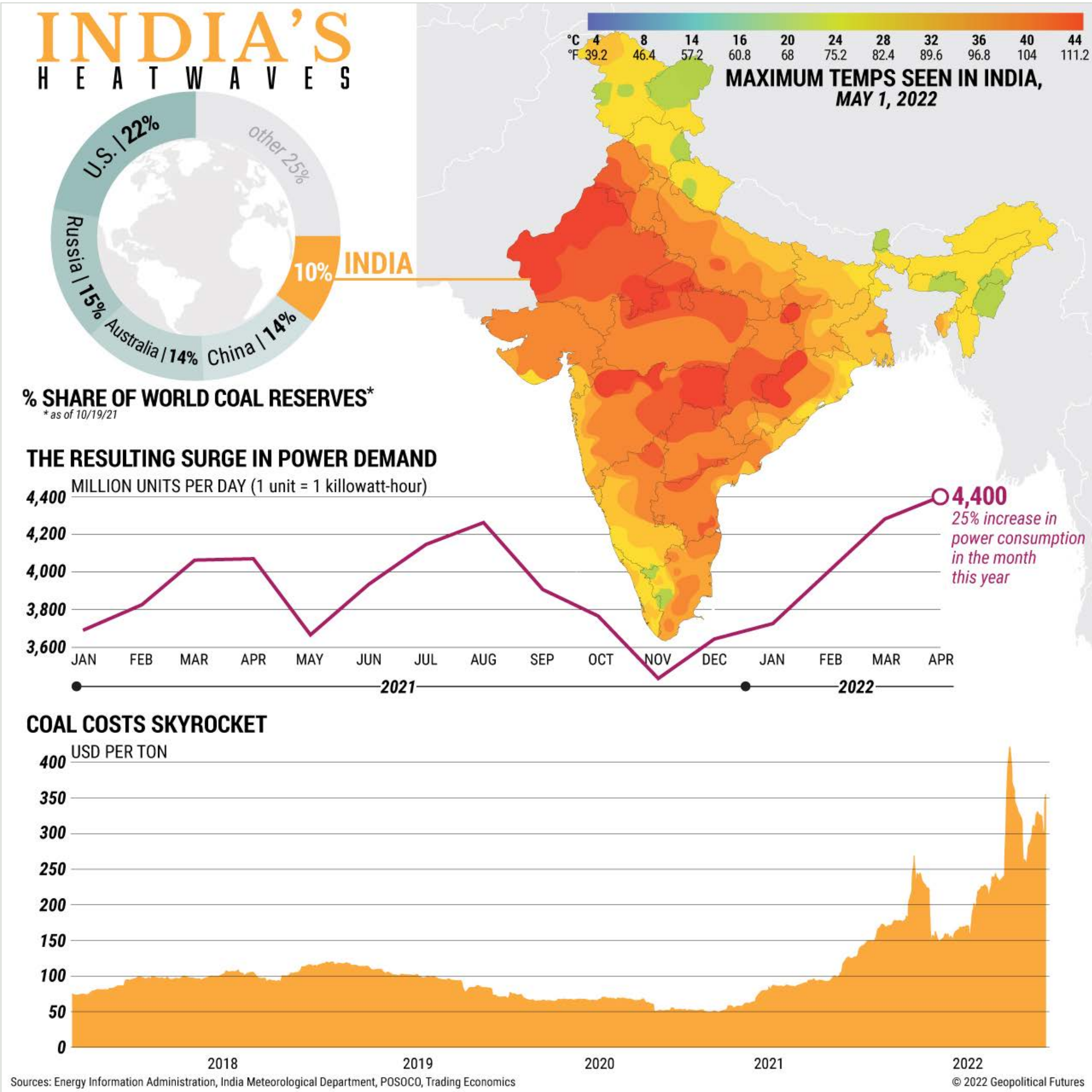
it could cast a negative light on its international standing.

Moreover, as seen with India, other powers are waiting in the wings to fill the void left by Beijing. China's failure to act opens the door for other nations that want to counter Chinese influence in the region. And Sri Lanka has no other choice but to rely on its largest creditors, many of which have an interest in curbing China's regional influence.

India, as mentioned, is one example, but Japan is another potential source of financial assistance. It has historically been a major source of development aid for Sri Lanka and offered help during the country's last economic crisis in 2016. The U.S. has also provided financial assistance to countries of the region and may welcome an opportunity to undermine China here. Furthermore, Sri Lanka expects to receive $500 million as emergency aid from the Asian Development Bank and World Bank – two institutions affiliated with countries that have an interest in countering Chinese influence – in the next six months.

A lot depends on how China chooses to manage Sri Lanka's economic crisis. Its hesitation has already given an opportunity for several other players to step up. These actors have a common intention: to chip away at China's foothold in South and Southeast Asia. Whatever China chooses to do, it'll have to give up something significant – money or influence – in the process.

India Powers Down



Energy disruptions are threatening the country's economic recovery.

India Powers Down

Although India has some of the world's largest coal reserves, its massive power consumption means that it also must import coal to meet its energy needs. India is facing a two-part coal conundrum: supply shortages and rising prices. Oil and natural gas prices were already rising as economies across the globe came back online from the pandemic. Between the recovery and the price hikes provoked by Russia's invasion of Ukraine, many countries turned to cheaper energy alternatives, including coal. This, in turn, pushed up coal prices.

The situation is concerning for the Indian economy on several fronts. April's power demand was well above peak consumption last summer, and power plants are now in a weaker position to meet upcoming summer demand. Coal shortages and slumping inventories have created electricity shortages in major Indian cities, including New Delhi, where hospitals have been affected. Sixty percent of households in India have already experienced some level of daily power cuts. The government is making plans to increase domestic coal output and reduce coal supplies to the non-power sector. The supply cuts will affect aluminum smelters, steel mills and other industrial activities, risking the country's economic recovery.

Arab Food Insecurity and Political Failure

By Hilal Khashan
May 12, 2022

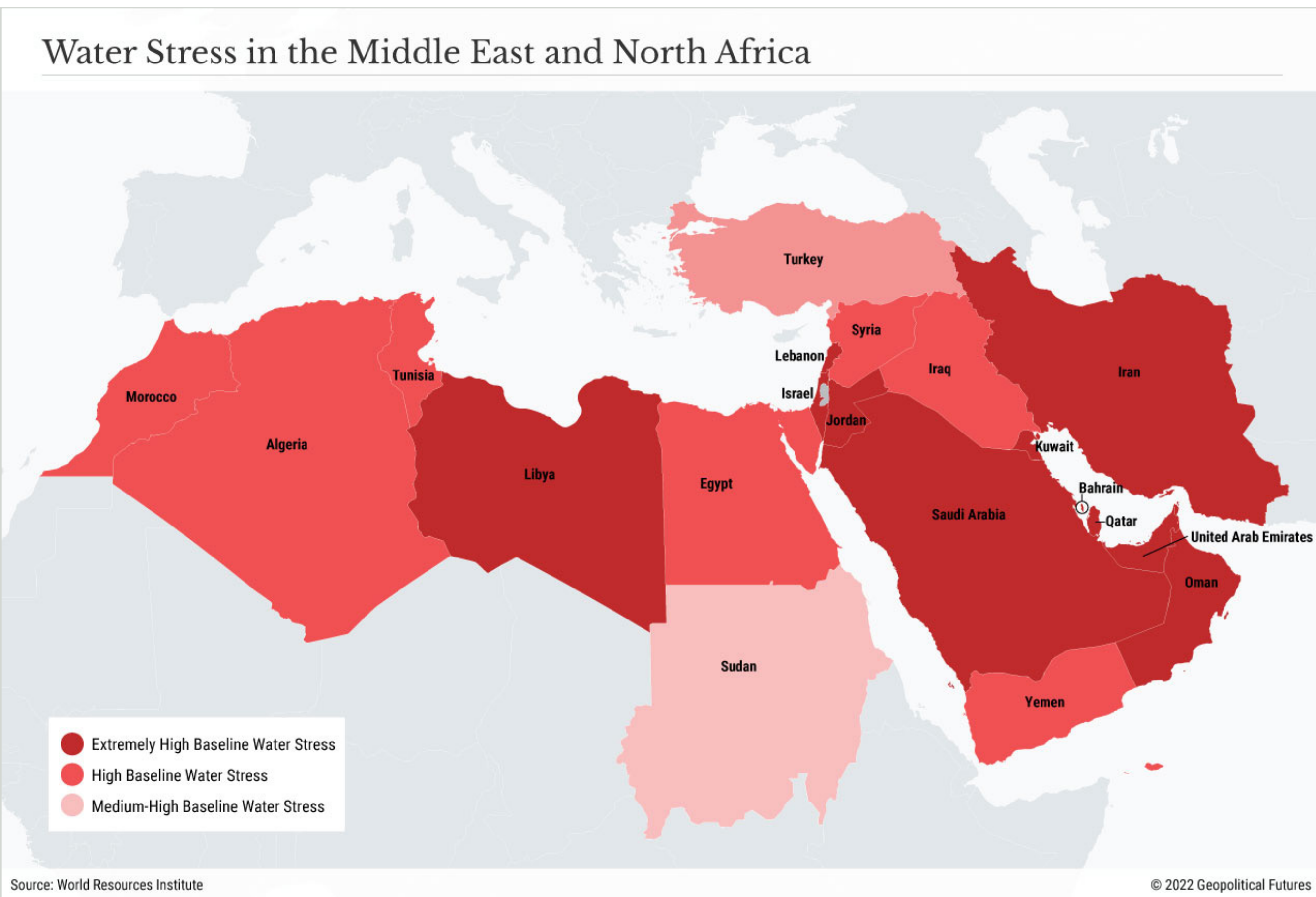
Current disruptions in the food supply chain highlight long-standing problems for Arab countries.

Arab Food Insecurity and Political Failure

The Arab region, extending from the Persian Gulf in the east to the Atlantic Ocean in the west, faces severe shortages of several staple foods. Given that at least 65 percent of people in most Arab countries are poor or vulnerable to poverty, it's little surprise that hunger and malnutrition are prevalent in the region. Even in oil-rich Saudi Arabia, conservative figures place at least 20 percent of the population below the poverty line. Poor government planning, demographic changes, water scarcity, climate change, the COVID-19 pandemic and unresolved conflicts all contribute to the problem. And today, the war in Ukraine is revealing the extent of these vulnerabilities, which will continue to plague the region long after the war's conclusion.

Water Scarcity

Of the world's 17 most water-stressed countries, 12 are in the Middle East and



Arab Food Insecurity and Political Failure

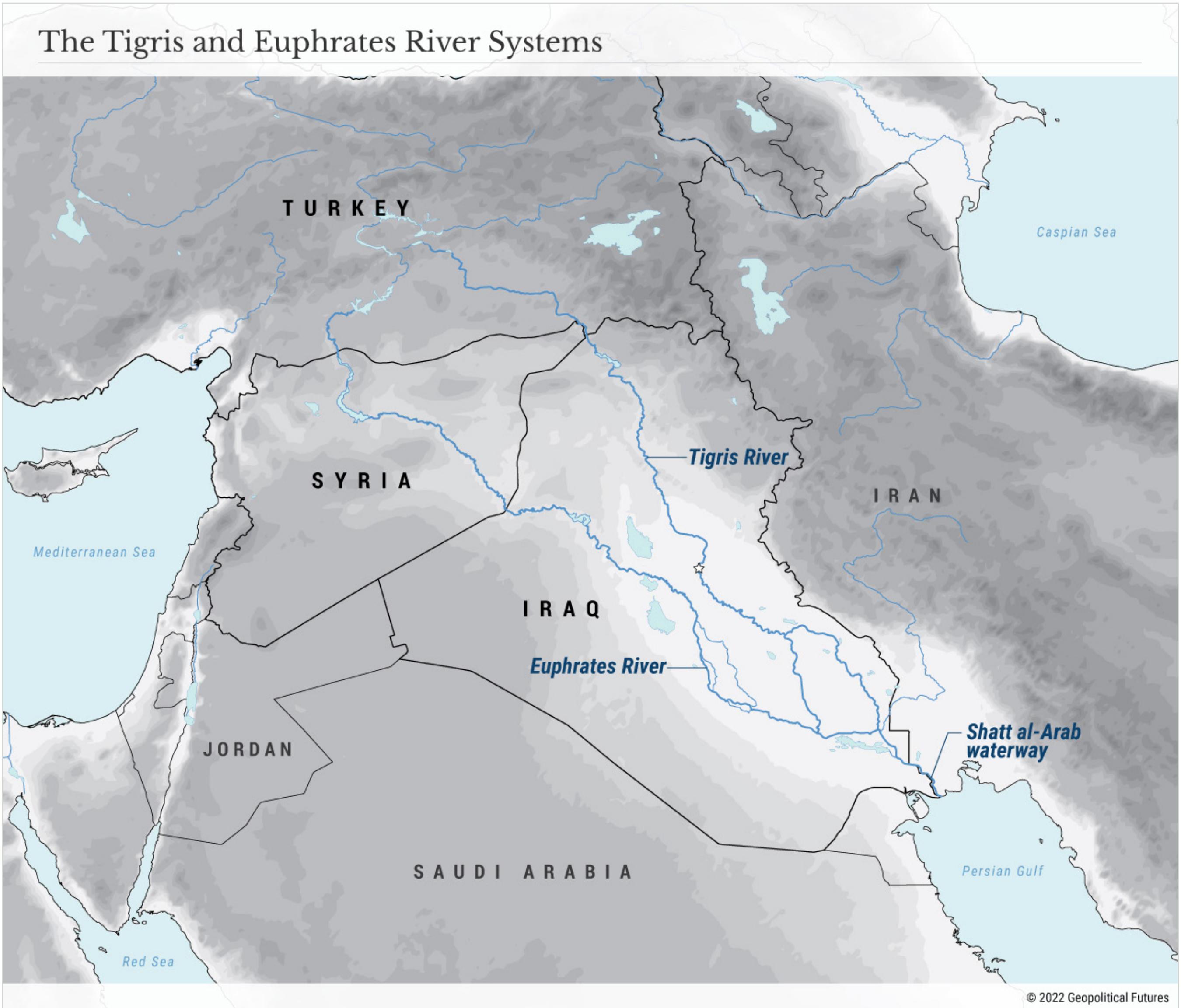
North Africa. Even though the Arab region includes 5 percent of the world's population, its share of the world's freshwater is less than 1 percent. Arab countries import more than half of their food supplies, spending 5 percent of their gross domestic product on these imports.

These problems have affected countries in different ways. In Iraq, drought, sandstorms, high temperatures and external restrictions on water flows have led to 60 percent water loss. Turkey's and Iran's aggressive dam construction policies have hugely aggravated water supply problems in both Iraq and Syria. In Egypt, Addis Ababa's Grand Ethiopian Renaissance Dam has deprived the country of 25 percent of its Nile water supply. Israel's virtual monopoly of the Jordan River system has further worsened Jordan's severe water scarcity.

In Syria and Iraq, where 12 million people have lost access to water, wheat production is collapsing. Land under cultivation shrank by half last year in Iraq, where the population will double by 2050 but potable water will decrease by 20 percent because of declining precipitation, which constitutes 30 percent of the country's water supply. The Iraqi Ministry of Water Resources says that unless Turkey releases more water into the Euphrates and Tigris rivers – which flow into the Shatt al-Arab waterway south of Baghdad – they will dry up in 20 years. In Syria, around 60 percent of the water flow comes into the country from Turkey, which has used the resource as a political weapon to increase its influence in Syria. It typically releases more water into Syria in the winter, when dams reach maximum capacity, threatening their structural integrity. During the dry summer season, reduced water flows can cause immense economic losses in agriculture and fisheries.

Saudi Arabia has already depleted its underground aquifers, having used annually 5 square miles of its nonrenewable fossil water on farming. Even though Saudi Arabia and other Gulf Cooperation Council countries have nearly 900 water desalination plants, farming remains unviable, with more than half of the plants' output going toward household use. In Algeria and Morocco, where water shortages are rising, agriculture depends heavily on rainfall, which is unpredictable.

Arab Food Insecurity and Political Failure



Outdated Technology

Water scarcity isn't the only problem, however. The lack of agricultural productivity is also a result of outdated technology and cultivation techniques, as well as poor planning and management. Inefficient irrigation systems such as flood irrigation consume 40 percent more water than sprinkler or drip irrigation. Agricultural cooperatives are scarce, and Arab governments do not provide incentives for expansion, resulting in the perpetuation of small, fam-

Arab Food Insecurity and Political Failure

ily-owned lots that are not suitable for modern irrigation and mechanized cultivation. Agriculture also lacks sufficient fertilizers and pesticides. These issues lead to low yields, averaging 1.3 tons per hectare, compared to the world average of 3.6 tons per hectare. High birth rates – around 2 percent compared to the world average of 1 percent – complicates the situation.

The region's arable land totaling 70 million hectares, 30 percent of which are in Sudan, would be sufficient to meet its agricultural needs. What Arabs lack is a workable irrigation system and the ability to work together. But corruption and personal politics often stand in the way. In Iraq, the government doesn't seem to take the water situation seriously. In 2018, it allocated $15 million, about 0.2 percent of its budget, to address water issues. Iraq needs to invest at least $180 billion in dam construction and irrigation projects to tackle its acute water scarcity over the next two decades. Syria's water issues predate the 2011 uprising. Metropolitan Damascus, with a population of more than 4 million inhabitants, frequently experiences water cuts that last several weeks. Half of Syria's water treatment facilities are inoperable because of the war, reducing available drinking water by 40 percent over the past decade and causing sewage water to contaminate supplies.

Government Failures

Arab countries are the world's leading grain importers, but Russia's war on Ukraine has revealed the vulnerability of the region's lack of self-sufficiency. Even though Russia and Ukraine export only 12 percent of the world's food, their proximity to the region makes their products substantially cheaper and more competitive than those of other food exporters. The conflict has been especially disruptive to Arab countries because of the importance of bread in Arab diets. Around 35 percent of caloric intake in Arab nations comes from bread alone. Some countries, such as Iraq, Yemen and Lebanon, import more than 70 percent of their wheat.

Shortages of food staples, including bread, cooking oil and legumes, are common, notably in Egypt, Algeria and Morocco, and have forced the ruling elite to take steps to avoid possible revolts. For years, Algerians have complained about food scarcity and inflated prices, as their purchasing power dropped by 40 percent over the past six years. The cash-strapped government's detachment from the crisis and decision to reduce imports have increased the level of public frustration. In Egypt, the country's 20th century irrigation policy, which culminated in completion of the Aswan High Dam in 1970, did not lead to an agricultural revolution. Instead, the gap between local food production and imports has increased, reaching an alarming rate in recent years. Domestic grain yields totaled 69 percent in 2000, but local production decreased to 45 percent in 2018. During the same period, its locally grown legumes declined from 56 percent to 37 percent, and the downward trend has continued.

Arab regimes are more concerned about security than food independence. For example, Egypt, Algeria and Morocco spend five times, 12 times and 25 times more on defense than on agriculture, respectively. Some in the Arab region proposed, all the way back to 1956, establishing a common Arab market in preparation for launching an economic union – but the idea never materialized. The 2005 Arab League summit in Algiers and the 2007 summit in Riyadh presented a strategic vision to achieve Arab food security by developing an economically efficient agricultural sector, properly managing environmental resources and enhancing farmers' quality of life. Arab agriculture ministers approved the summits' recommendations during the 2008 meeting of the Arab Organization for Agricultural Development in Bahrain. The recommendations included developing modern agricultural techniques and encouraging investment in agricultural processing. They also called for improving farming competitiveness and investing in human resource development.

But Arab regimes ruined the prospects for launching a successful agricultural revolution. They rejected possibilities to cooperate, preferring to import food that annually costs the Arab region more than $100 billion and exposes it to price fluctuations and import disruptions due to foreign conflicts. Arab dictators willfully contributed to wasting their countries' meager water resources. In 1992, Iraqi strongman Saddam Hussein ordered the drying up of the Mesopotamian Marshes in southern Iraq, where insurgents sought shelter, destroying its agriculture, fisheries and unique biodiversity. In the early 1990s, Syrian President Hafez Assad diverted sewage water to the Barada River, which crossed through Damascus and provided the capital with water for domestic and agricultural use. He also rerouted its canals away from his palace for security reasons. His son, Bashar, changed the direction of the river mouth to flood rebel areas outside Damascus.

Impact on Public Health

According to the Food and Agriculture Organization, the number of people who go hungry in the Arab region has risen by more than 90 percent over the past two decades, exceeding 69 million in 2020. One-third of the region's 420 million people suffer from malnourishment. More than 20 percent of children under five suffer from stunted growth. Eight percent are underweight, and 11 percent are overweight, primarily because of poor diets, which exceeds the international average by 5 percent. In Yemen, 45 percent of adults suffer from hunger, and 60 percent of young people are anemic. In Sudan, more than 20 percent of the country's 45 million people suffer from severe hunger, which could double under its military-controlled government. These figures are particularly stark given that Sudan could feed most of the Arab region if it was able to meet its full agricultural potential.

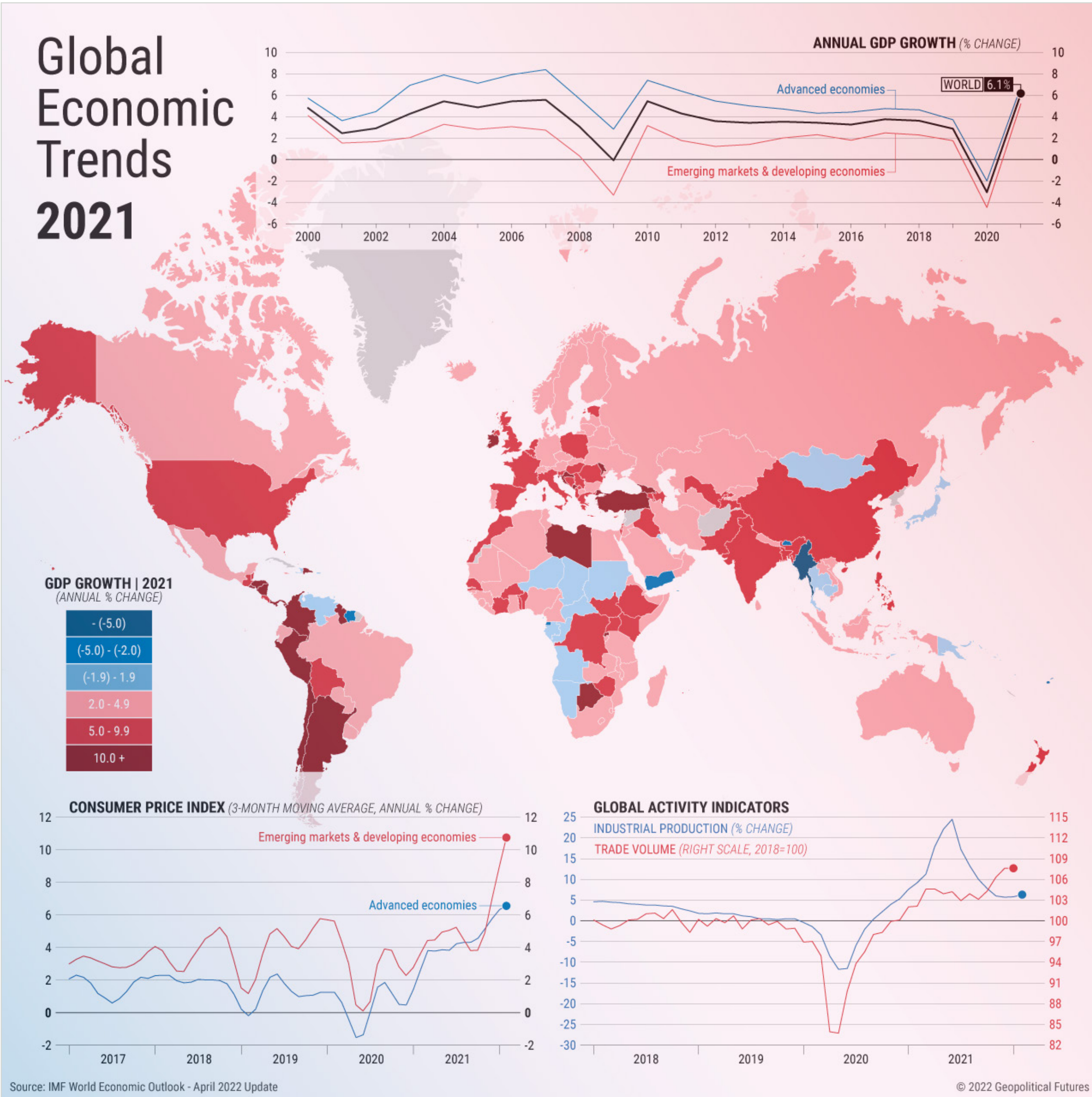
In wealthy GCC countries, however, overnutrition is a big problem. The Arab diet depends heavily on refined flour and rice, and variety in food consumption is either beyond most people's means or is not part of the traditional cuisine. In addition, government subsidies do not cover wholesome foods. Unhealthy eating habits have contributed to high rates of suffering from chronic diseases, especially diabetes. A quarter of adults in GCC countries will become diabetic by 2030. In Saudi Arabia, more than 50 percent of people over 30 are prediabetic. In Egypt, 21 percent of adults have diabetes, and an equal percentage are prediabetic.

The Arab region has failed to tackle the underlying causes of its food issues and thus is unlikely to overcome them in the near future. Achieving sustainable development requires resolving the endemic food crisis and exiting the vicious cycle of poverty. This process involves reprioritizing state objectives from defense to agriculture and revers-

Arab Food Insecurity and Political Failure

ing internal migration patterns that saw a massive population movement from rural areas to urban centers over the past half-century. These demographic changes weakened the agriculture sector yet failed to promote other productive industries. Arab rulers may be eager to develop their countries, but they are unwilling to abandon their fixation on regime stability and order.

The Global Economy Rebounds, Stumbles Again



The IMF's latest data would be encouraging if it had accounted for the war in Ukraine.

The Global Economy Rebounds, Stumbles Again

Economic data for the past two years – that is, the majority of the COVID-19 pandemic – has finally been processed and made available thanks to the International Monetary Fund, giving us a more clear picture of how the global economy is performing. Though the pandemic initially hit much of the world hard, most countries seem to have rebounded, as have their industrial production, both of which are leveling off this year.

Notably absent from the IMF Outlook, however, is the Ukraine war, which began after the data was published. This explains why its estimates are relatively rosy, if not quite as strong as the rebound in 2021. Data available in July will no doubt account for the Russian invasion, which has been yet another exogenous shock to aa system that had just barely started to recover from the pandemic. States that had hoped to turn the tide this year will likely find themselves waiting much longer than they expected.

Diesel Supplies and Food

By Allison Fedirka
June 6, 2022

At worst, shortages could shrink the global food supply.

Diesel Supplies and Food

Diesel supplies appear to be the next casualty of global energy disruptions. In fact, they started the year in a weak position, thanks to the COVID-19 pandemic. Inventories were tight, and global refining capacity dropped to 78 million barrels per day from 82.1 million bpd. Things got only worse after Russia invaded Ukraine. The United States, Russia and China have the three highest crude oil distillation capacities, while the U.S. and Russia are the two leading diesel exporters, accounting for 22 percent of global trade by value.

Supplies from Russia have been severely disrupted or have been taken offline entirely. Just under a third of Russia's refining capacity has been idled due to Western sanctions, and in April, Rosneft announced it would no longer export diesel. Consequently, market experts estimate that 1.3 million bpd from Russia will remain offline for the rest of the year, and Russian production is likely to stay down given its dependence on technology it no longer has access to so long as sanctions remain in place.

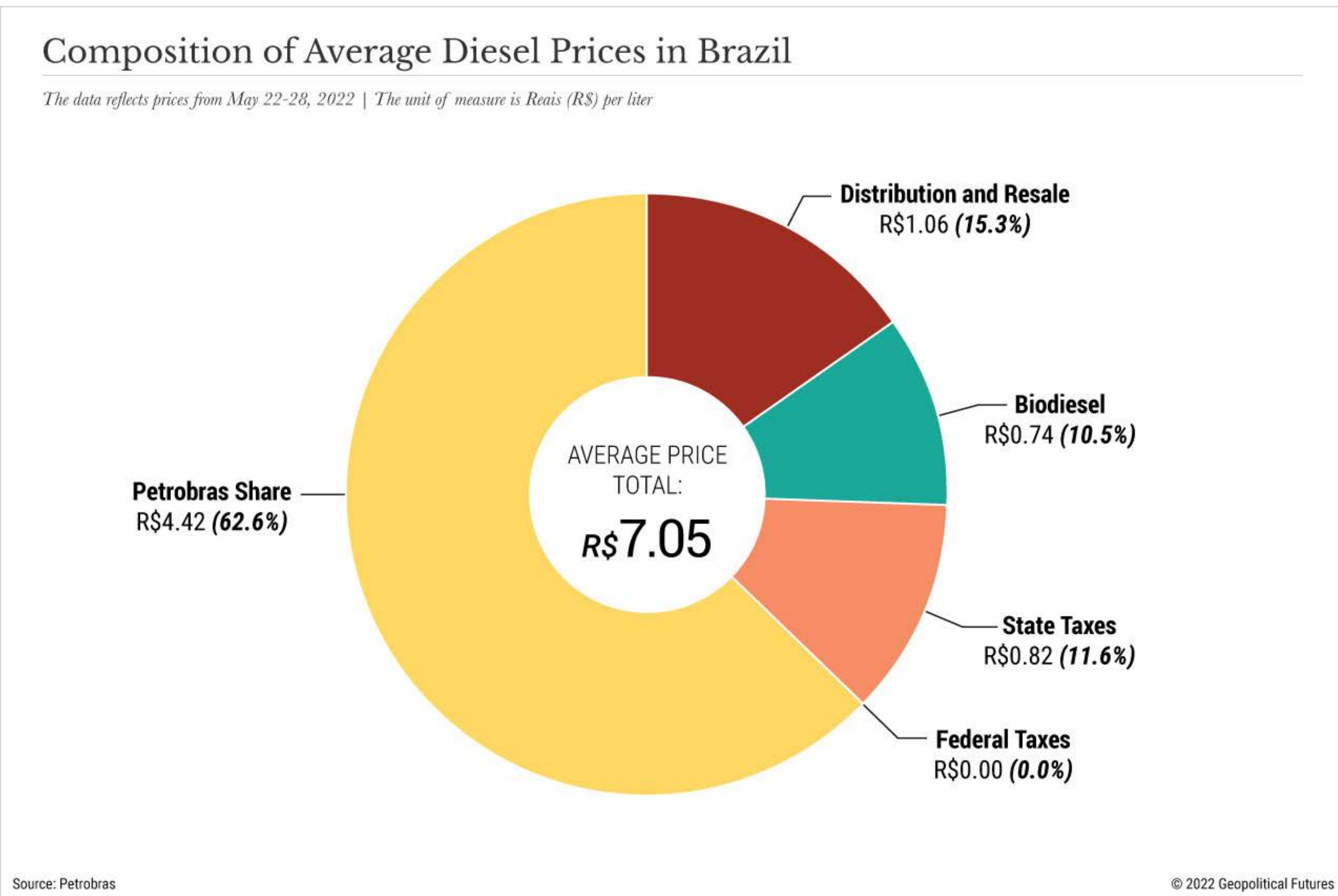
The biggest concern over potential diesel shortages is how they will hurt the agriculture sector, particularly in the Western Hemisphere. Diesel and gasoil – both middle distillates – are the primary fuels in Latin American freight transport and farming machinery. U.S. farming and trucking also use a ton of diesel because it's usually cheaper than gasoline. In other words, a threat to crop production and shipment is a threat to food supplies.

Three of the world's leading grain and oil seeds exporters – Brazil, Argentina and the U.S. – are especially vulnerable. Last year, the U.S. was the world's second-largest wheat exporter, Argentina the seventh. Together they accounted for a fifth of global wheat exports by value. The U.S. is the global leader in corn exports, Argentina is the second, and Brazil is the fourth. They account for nearly 63 percent of global corn exports. Brazil leads global exports in soybeans, while the U.S. ranks second and Argentina fourth. They dominate the global soy market, accounting for 87 percent of exports. Brazil and Argentina have already reported concerns over diesel supply and have warned of the impact it will have on their crops. The U.S. is better positioned but will find itself increasingly constrained when it comes to rising prices and distributing the diesel supplies it has available.

Brazil

For Brazil, the problem with diesel shortages is three-fold: high prices, import constraints and domestic political battles. If current trends hold, shortages will begin in September, according to state-owned oil company Petrobras, just in time for the seasonal spike in agriculture demand. These concerns have prompted some Brazilian farmers to reduce their sowing area for the upcoming season and have raised concerns about truckers' ability to distribute what crops are harvested.

Despite producing roughly 75 percent of its own diesel, Brazil has a hard time securing imports, which have risen as Brazil fails to increase refining capabilities. In recent weeks, Brazilian importers have reported a notable decline in the number of responses to calls for fuel



Diesel Supplies and Food

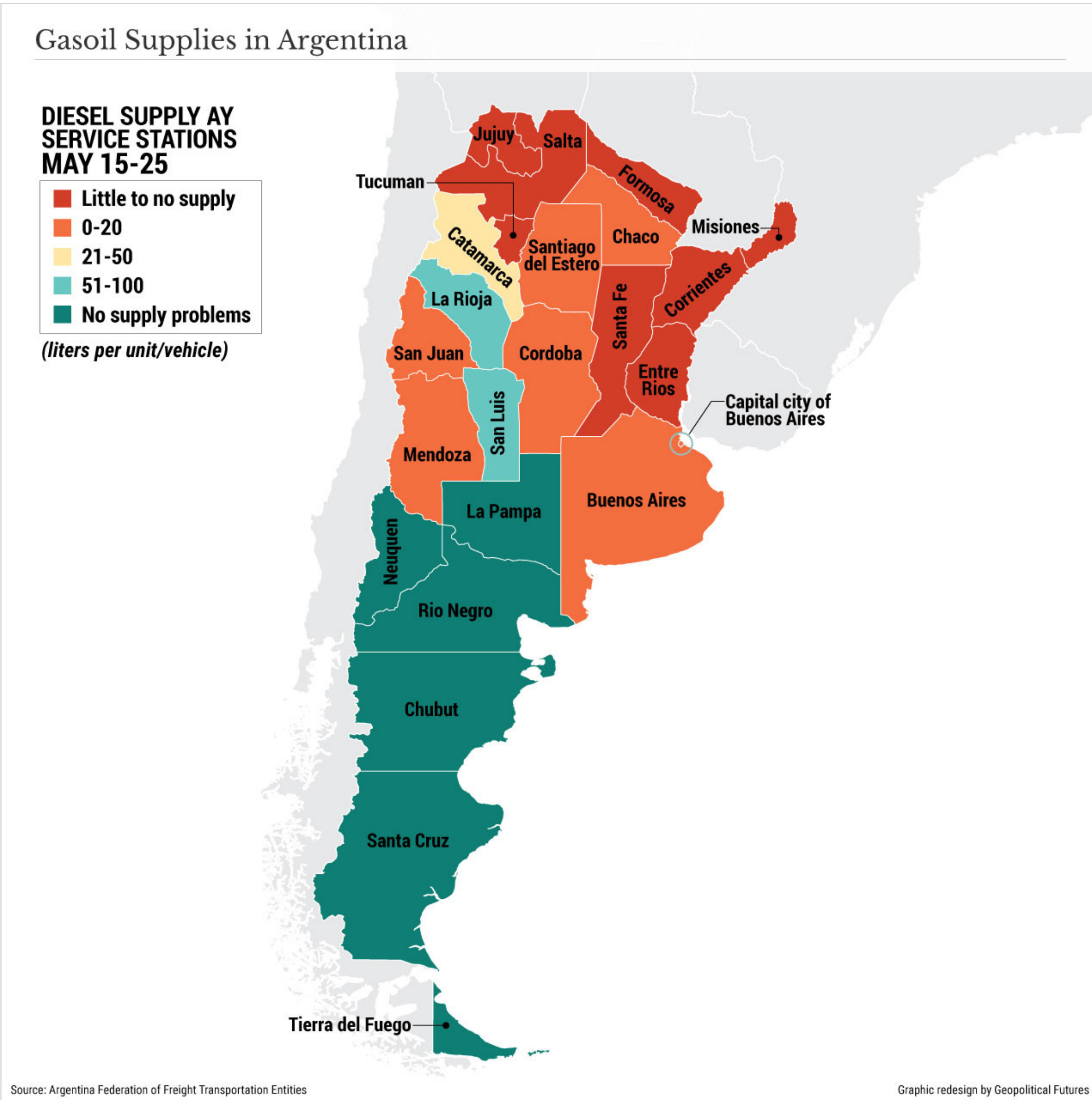
purchases. (Past calls would receive offers from about 20 ships; now that number is two or three.) About 80 percent of its imports come from the U.S., but Brazil isn't sure that it can count on Washington, which may experience its own shortages and has begun to look for other supplies in West Africa and India.

Either way, domestic political considerations will constrain Brazil's management of diesel shortages. Through Petrobras, the Brazilian government can set domestic fuel prices. The Petrobras pricing mechanism also affects imports. If the company imports fuel at a market price higher than the domestic price, it must absorb the difference so that the cost isn't passed on to consumers. This framework has discouraged Petrobras from importing diesel at its current price and has paralyzed the company from being able to raise prices. Containing food and fuel prices is paramount to the sitting government's strategy for reelection, and the government has therefore strongly resisted efforts to hike prices.

The government and Petrobras, however, are looking for ways to redress the issue. For one, they are calling on distributors to increase mandatory inventory levels, which currently stand at three to five days. Leading distributors such as Vibra have already started doing as much on their own and have set inventories at seven to nine days. A second option involves increasing the percentage of biodiesel in diesel from 10 percent volume to 12-13 percent. Last, the government is considering legislation that would allow private companies to use state-run terminals and pipelines, with the ultimate goal of reducing prices. Ultimately, Brazil's efforts to resolve the diesel crisis pit its interest in keeping fuel prices low against importing greater volumes of needed diesel.

Argentina

Argentina is no stranger to shortages. In fact, the government's economic intervention has played a notable role in the development of shortages. Demand for diesel fuel in Argentina has risen 17.7 percent this year. According to the Energy Secretariat, this is due to seasonal demand, increased economic activity and, most important, sales to vehicles crossing the border from Paraguay and Brazil. In Argentine provinces bordering those countries, diesel demand increased 37-57 percent. The spike in foreign purchases of Argentine diesel is a direct result of the government price controls that keep Argentine diesel much cheaper than diesel sold in neighboring countries. Argentine freight drivers have already reported difficul-



Diesel Supplies and Food

ties acquiring enough gasoil and diesel fuel. The latest survey by the Argentine Federation of Freight Transportation Entities showed that only a third of freight transporters can freely access fuel. The majority (57 percent) have some limitations or difficulties with acquiring fuel for their vehicles, while 10 percent reported no access at all.

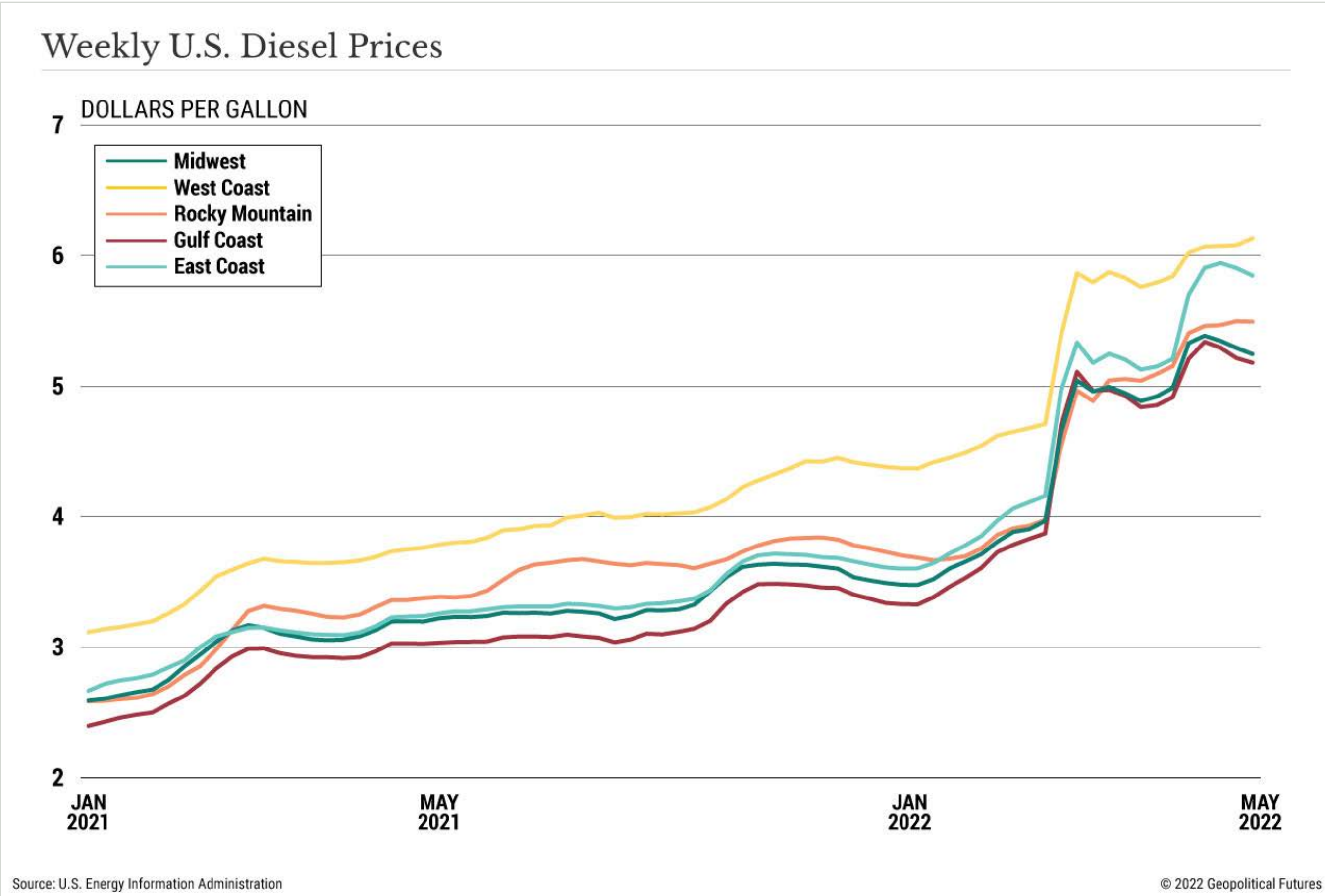
Argentina's diesel shortage overlaps with its agriculture production. The country's agriculture activity is concentrated in Buenos Aires, Cordoba and Santa Fe provinces. Agriculture activity also extends farther north to the Paraguayan border and the northeast, where fuel shortages are even more severe. The shortages started in late May, toward the end of soy and corn harvesting season, which runs from mid-March to early June. The lack of diesel supply and depleted inventories have already made farmers worried about harvesting what remains of current crops and about their ability to sow new ones in the coming months.

The government's options for managing diesel shortages are limited. State-owned oil company YPF plans to increase fuel imports in June and July from two or three ships to four. But unknown time frames and volumes cast doubt on whether incoming volumes can do much good. The country's larger macroeconomic problems, particularly revolving around U.S. dollar supply and debt, also put into question the government's ability to pay for increased energy imports. These financial constraints will limit the government's ability to import diesel, which will become increasingly more difficult as prices rise.

The United States

One of the shared challenges facing Argentina and Brazil is that their main supplier of diesel, the U.S., is dealing with diesel supply problems of its own. On the geopolitical front, the U.S. must support Europe as it reels from decreased energy supplies from Russia. Before the Ukraine war began, Europe relied on Russia for 45-50 percent of its diesel imports and Russian oil products to feed its domestic refineries. In an effort to offset these losses, the U.S. exported 1.47 million barrels of diesel and gasoil to Northern Europe in March, a significant rise compared to the 300,000 barrels in February. April and May ship-

Diesel Supplies and Food



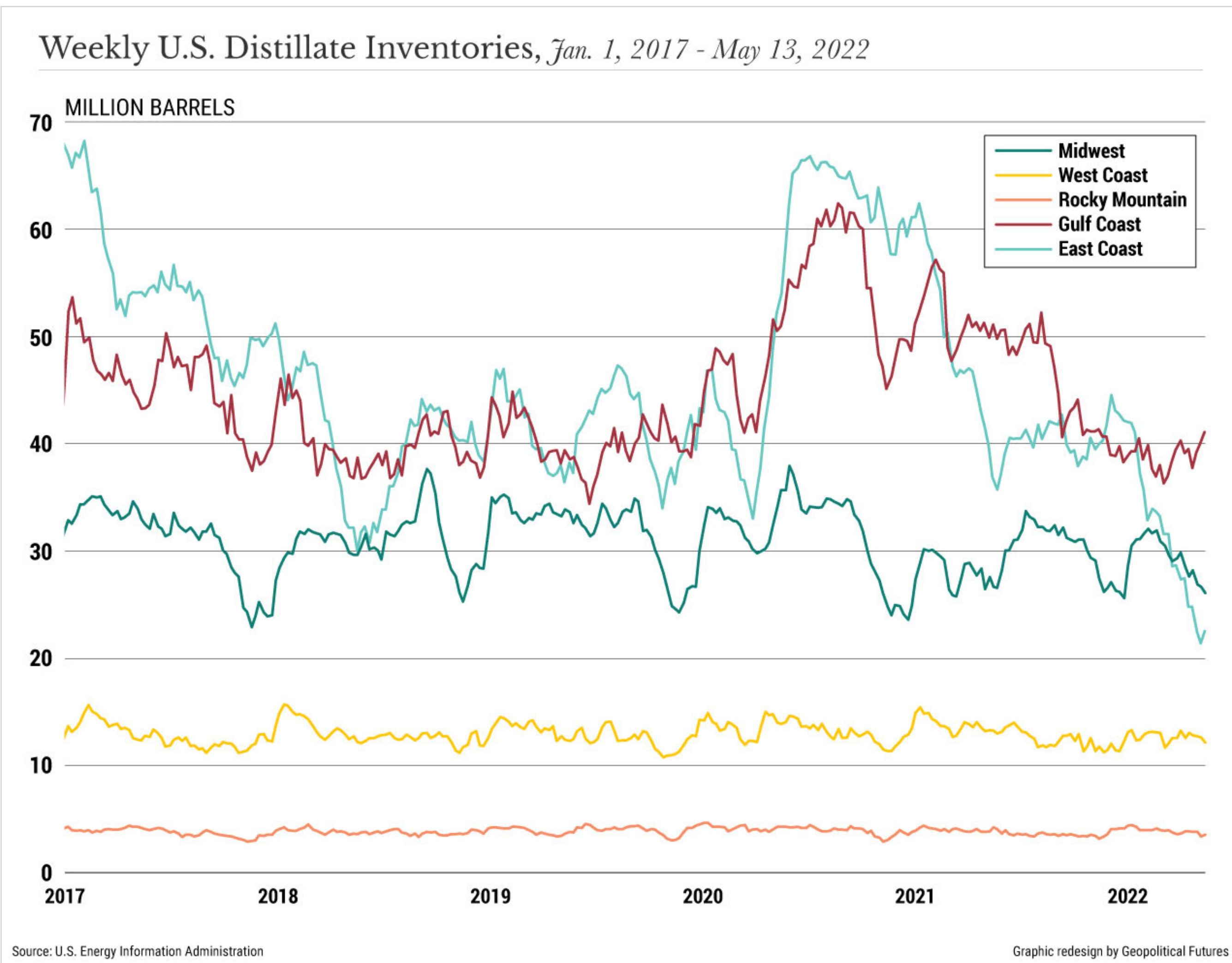
ments are on par with or higher than the March values.

The question, then, is how long the U.S. can sustain exports and meet domestic demand without prices skyrocketing. The U.S. Energy Information Administration forecasts diesel exports to average 1.3 million bpd this summer, a 38 percent increase from last summer. At the end of May, U.S. distillate stocks totaled 106.8 million barrels after reaching a 14-year low at the start of May with 104 million barrels. Current inventories are about 20 percent lower than the pre-pandemic five-year average and can last about 28 days. This decline has been most heavily felt on the East Coast, where inventories are the lowest since 1996 due in large part to declining refinery capability in the region. Select service stations like Pilot and Love's have started warning about diesel shortages at some East Coast locations. And with U.S. refineries

Diesel Supplies and Food

already running at 92-95 percent capacity, there's only so much Washington can do to goose production.

U.S. farmers are in a less dire situation than their South American counterparts but remain wary about the impact diesel prices and possible shortages may have on their crops. Most of the U.S. spring season has already been planted; the rest will be done by the end of the month. However, the harvesting season for most grains and oil seeds is in August and September. Diesel demand will dramatically increase at that time, further pressuring prices and supply. The White House is contemplating an emergency decree that would allow access to 1 million barrels of diesel in strategic reserves. Such a move could be a



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stop-gap measure for rising summer demand but falls short of solving any of the structural supply and production issues afflicting the country.

At the very least, the rising cost of diesel will jack up food prices at a time when they are already high. At worst, they could lead to material declines in vital food-exporting countries, which would strongly aggravate the food supply crisis.

Exerting Economic Influence in Latin America

China has become the top trading partner for certain countries but the U.S. is still the largest source of investment.

Exerting Economic Influence in Latin America

In recent years, the U.S. has leaned more heavily on using economic engagement and economic warfare to exert influence over other countries. In Latin America, Washington's marquee policies in that regard are the Cuba embargo and the running sanctions on Venezuela. But it also pursues a lower-profile, parallel strategy in the Western Hemisphere. Through the International Development Finance Corporation, the U.S. provides direct funding for various development projects and assurances to private U.S. businesses Washington would like to have more involved in the region. The primary purpose in this region is to foster the growth of small and medium-sized enterprises, as well as local-level infrastructure work.

Though the U.S. is Latin America's largest trade partner writ large, there are countries in which China has an edge. These include Brazil, Peru and Chile, where China has bought up soy, copper and ore. U.S. trade with top partners such as Colombia, Ecuador and Mexico consists more of manufactured goods, and while U.S. foreign direct investment into the region still surpasses China's. It's notable, however, that China used financing and loans to exert its influence in Latin America for much of the 21st century but in the past few years has started to focus more on mergers and acquisitions instead.

Economies and War

By George Friedman
June 14, 2022

Economies and War

The American economy, the largest and most dynamic in the world, is a geopolitical issue. And right now, it is in a predictable period of dysfunction. It's been compared – rightly, in my opinion – to the tumult of the 1970s. Unemployment reached 8.2 percent in 1975, inflation rates hit 14.4 percent in 1980 and interest rates were 11.2 percent in 1979. I bought my first house in 1978 at 19 percent interest. It was a hard time, and it was intimately linked to the Vietnam War.

Lyndon B. Johnson inherited that war and intensified it. The U.S. was facing an election in 1964 and another in 1968. By then, things in Vietnam were not going well. Arguably more important to Johnson was what he called the Great Society, a massive and very expensive attempt to wage war on poverty. He was faced with a choice between "guns and butter." A massive social program and a full-scale war were incompatible, but Johnson was ideologically committed to the social program and couldn't abandon the war. He decided to do both. It was at that point that the economic crisis that would erupt in the 1970s began.

Guns and butter meant either massive borrowing, or massive loosening by the Federal Reserve. Everyone wanted to join Johnson in having his cake and eating it too. The result was both money printing and borrowing, creating massive inflation and weakening of the dollar.

Richard Nixon was elected later, inheriting not only the Vietnam War but also an economy that seemed to be out of control. In August 1970, he did two things nearly simultaneously: He imposed a freeze on prices and wages for 90 days, and he abandoned the gold standard, which had been established by the Bretton Woods Agreement. That agreement obligated Washington to convert dollars to gold at $35 an ounce. The sudden freeze on prices immobilized the economy, and abandoning the gold standard made the dollar more volatile. Broadly speaking, it decreased in value and led to inflation.

The unemployment rate rose because laying people off was the only way to manage expenses. Interest rates and inflation rose. It appeared that everything was out of control, but the real blow was yet to come. In October 1973, with Nixon wallowing in the Watergate scandal, *Economies and War*

Egypt and Syria caught Israel by surprise in a stunning and unexpected attack. The U.S. held back from supporting Israel, but as Israel started to run out of artillery shells and other necessities, the U.S. began to airlift supplies in. Arab oil producers responded by placing an oil embargo on the United States and Israel's other supporters, particularly in Europe. It was a stunning blow to the U.S. economy, where oil prices not only rose but oil became unavailable. Gas stations that had fuel had lines of cars a half mile lined up. Oil was an essential commodity, and it was unavailable. Inflation surged. Unemployment soared as businesses closed. Interest rates rose as banks protected reserves. The oil embargo continued for months among some producers. It's not excessive to say that the American and other economies were heading toward meltdown. The political maneuvers that had impacted the U.S. economy over previous years now seemed modest.

What began with the Vietnam War accelerated with the Arab-Israeli War. The real pain did not come until the early 1980s, when a new political paradigm confronted the idea that inflation and high interest rates not only affected private life but drastically constrained investment and in turn opened the door to Japanese exports. A shift in the tax code that increased investment and decreased consumption solved the problems created first by war and then by politics. Ronald Reagan happened to be president and carried out policies that he had no choice but to carry out. What started with guns and butter ended in the capital that drove the technology boom.

It is easy to blame Johnson and Nixon, but they executed policies demanded by the public. The public wanted the problems solved at no cost to them. Since that was impossible, the political system generated the illusion of a solution. That illusion satisfied short-term public demands, the demands that frequently end in greater pain than they imagined.

In other words, war begat an unintended consequence. Another war imposed an extraordinary hardship but led to an upheaval in the political system. As I have written elsewhere, this is how our culture works. In our era, the end of the cycle began with COVID-19, which had the same disruptive effect as a war and created the same raging anger. This has been followed by another war, Ukraine, which is having a massive effect on the global economic system. Inflation is surging and interest rates rising.

If my model follows course, the political system will not be able to solve the problems before the end of the decade. We will of course blame the politicians for what happens, as that is an American tradition. The irresistible process creates the pain, and the miracles demanded by the public will make things worse. The politicians will be blamed. But it clears out the system and readies us for the future.

Checking in on the Global Economy

By Antonia Colibasanu
June 15, 2022

There are disruptions in energy, finance and trade underway that could alter the global order.

Checking in on the Global Economy

Let's check in on the global economy. The world is struggling with inflation, even as it continues to mend broken supply chains. The Japanese yen, the Indian rupee, the Chinese yuan and the euro have all slid against the dollar, prompting expectations that the Federal Reserve will raise interest rates again this week.

Energy prices are particularly worrisome. Gasoline prices have been on an upward trend ever since the COVID-19 pandemic fundamentally changed consumption patterns, but the Russian invasion of Ukraine, and the sanctions that followed, sent prices through the roof. The European economy is especially beholden to Russian energy. Natural gas imports keep households heated and industries humming. The longer the war goes on, the more volatile the energy environment in Europe will be. (This has prompted many European states to look for other suppliers, which could create new opportunities for oil-rich states that are looking for investments in their energy sectors.)

Meanwhile, Western sanctions against Russia have prevented producers there from accessing certain technologies to extract energy resources in places such as western Siberia and to refine the extracted products. For now, Russia is supplying most of its clients, but as the fallout from the war and sanctions continues, its ability to do so will likely diminish. Less Russian oil and gas on the global market would hurt both Russia and the global economy. Insufficient investment worldwide in projects over the past several years has only compounded the problem.

Meanwhile, the dollar, which most of the world uses to buy oil, is growing stronger in global financial markets. Risk-averse investors are less interested in betting on potentially high-reward projects than they are in investing in reliable, if low-return, opportunities. This means less money is going into new technologies and more is being invested in consumer products. It also means less money is being spent on developing economies than developed economies, of which the U.S. is the safest – hence why the value of the dollar has increased by more than 10 percent since the beginning of the year compared to most world currencies.

Checking in on the Global Economy

This comes at a time when the financial system was already under pressure. The retirement of the baby boomers was already driving a major restructuring, with a notable shift from saving to consumption of leisure goods and health care services. This transition will mean lower overall spending on high-tech, innovative sectors that have driven economic growth in recent years.

At the same time, the pandemic generated mass relocations in developed countries, adding pressure on the global credit market. This includes not only the baby boomers but also their children, the millennials, the second-largest generation in most developed countries. While the boomers are looking for cheaper housing in warmer climates, millennials want affordable single-family homes for raising families. This is causing demand pressures on credit markets and beyond. The demand for dollars is only growing.

A major trade dislocation is also in progress. The pandemic demonstrated the negative effects of interdependence. Most countries have experienced supply chain problems in essential goods, such as pharmaceuticals, or temporary food supply disruptions. In response, most countries are looking at ways to diminish their dependencies on other countries and better integrate production chains internally. In short, protectionism has grown.

The U.S. is no exception. Presidents Donald Trump and Joe Biden followed the same script on trade, making support for American production a priority. The war in Ukraine further bolsters the case for protectionism, as it exposes even more vulnerabilities. This week, the U.S. Congress will vote on the 2022 Ocean Shipping Reform Act, the largest overhaul of shipping regulations since 1998. In light of the government's desire to promote U.S. exports while reining in ocean carriers' market power, the bill would broaden the regulatory powers of the Federal Maritime Commission and set up a legal framework for the creation of vessel alliances. The goal is to secure the U.S. as the primary power controlling the ocean shipping industry.

At the same time, a decades-old trend is reversing. Since the 1980s, firms have expanded their production abroad and developed global supply chains. But in response to the pandemic and Ukraine,

Checking in on the Global Economy

which affected perceptions of the costs (resilience) and benefits (efficiency) of globalization, companies have started discussing reshoring or "friend-shoring." Reshoring means companies relocating supply chains within their national borders, something that's possible only for countries like the U.S. where there's enough resource diversity to cover most needs, albeit at higher prices. Friend-shoring – setting up production in nearby friendly countries – is more likely, since it still promises shorter supply chains.

All these firms' adaptation strategies involve adjustment costs and new investments. All will put pressure on governments to adjust and establish the necessary regulatory environments to protect their interests. This is one of the reasons the U.S. is revising the ocean shipping act. It's why pretty much all developed states are looking to secure supplies of food, key commodities and microchips.

But more important, this means some of the globalization of the past four decades will be cut back. Some of these processes were already underway, and the pandemic accelerated many others. The war in Ukraine only amplifies the trend. Energy dislocation, financial dislocation, and trade and investment dislocation will alter the global economic order. These changes won't happen overnight, and the actions governments will take are unclear. However, all this makes it more urgent for leaders to start rethinking economic models now, which in the end will affect their strategy and the global geopolitical model.

MISSON STATEMENT

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