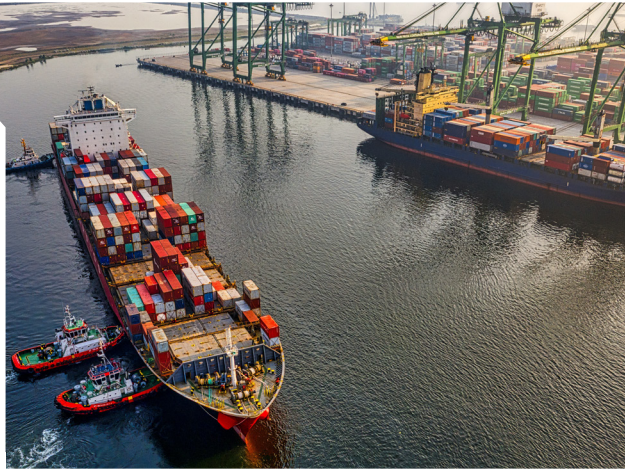


A New Economic Reality



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Introduction

Soaring inflation and heightened geopolitical tensions are making the news every day. The global economy seems to be in the most precarious place in years and many talk about a recession like the one the 2008 financial crisis triggered. The Russian invasion into Ukraine followed by the Western sanctions against Russia and the repercussions of the COVID-19 pandemic have accelerated the global polarization, leading to a restructuring of the global economy.

Therefore, we will continue to observe – as we have already – how transformation in the global economy will lead to socio-political crises throughout the world. This process will turn into a general worldwide realignment, creating new definitions of what it means to be secure and what it means to be vulnerable.

Fear and change stand at the heart of the process. Enclosed is a compendium of analysis that chronicles our coverage of what makes economic fear and what drives change in the global economy. It provides an overview of the many sectors and dimensions that are currently in play within the restructuring process that the global economy, and with it, the world is going through.

Antonia Colibasanu
Chief Operations Officer

Analysts contributing to this special report



[George Friedman](#) is the founder and chairman of Geopolitical Futures and author of such best-selling books as *The Next 100 Years*, *Flashpoints: The Emerging Crisis in Europe*, and *The Next Decade*. His most recent book is *The Storm Before the Calm: America's Discord, the Coming Crisis of 2020s, and the Triumph Beyond*.

[Antonia Colibasanu](#) is Geopolitical Futures' COO and a senior analyst. She is the author of *Contemporary Geopolitics and Geoeconomics 2.0 - A Method for Analyzing Global Trends and Contemporary Geopolitics and Geoeconomics*. She is also a lecturer at the Romanian National University of Political Studies and Public Administration and associate professor for the Carol I National Defense University in Bucharest, Romania.



[Allison Fedirka](#) is the director of analysis at Geopolitical Futures. Ms. Fedirka has a bachelor's degree in Spanish and international studies from Washington University in St. Louis and a master's degree in international relations and affairs from the University of Belgrano, Argentina. She is fluent in Spanish and Portuguese.



[Hilal Khashan](#) is a Senior Analyst at Geopolitical Futures and a Professor of political science at the American University of Beirut. He is a respected author and analyst of Middle Eastern affairs and author of six books, including *Hizbullah: A Mission to Nowhere*. (Lanham, MD: Lexington Books, 2019.)

[Ekaterina Zolotova](#) is an analyst for Geopolitical Futures. Ms. Zolotova has a specialist degree in international economic relations from Plekhanov Russian University of Economics. In addition, Ms. Zolotova studied international trade and international integration processes. She speaks native Russian and is fluent in English.



Russia Hits Europe in the Bread Basket

By Ekaterina Zolotova
September 21, 2022

When it comes to fertilizers, Europe has no good alternatives.

Russia Hits Europe in the Bread Basket

It's autumn in Europe, which for European farmers means it's time to start placing orders for fertilizer for the spring. Of course, prices have been much higher recently. World nitrogen prices are up significantly since the start of 2021, driven by elevated demand for agricultural produce and pandemic-related supply disruptions. European prices of natural gas – a factor in nitrogen-based fertilizer production – since the second half of 2021 have shot up by even more. And the elevated price of nitrogen fertilizers has already pushed purchasers toward phosphorus or potash fertilizers, bringing their prices to multiyear highs as well. Then, in February 2022, Russia's invasion of Ukraine was added to the mix.

Higher energy and fertilizer prices means higher food prices, without a fanciful surge in output or state intervention. This will increase the risk of social unrest in Europe, a major concern for European governments and the European Union. It's clear that Europe must do something, but the most important factors in the soaring costs are the war in Ukraine and – indirectly, in the case of fertilizers – Western sanctions against Russia. For Moscow, one of the world's largest producers of natural gas and

nitrogen fertilizers, this is crucial leverage, which it will use to try to extract significant concessions on sanctions. Europe's next best alternative – finding supplies somewhere else in the next few months – is unlikely to pan out, and it may eventually have to give the Kremlin some of what it wants.

Disruptions, Real and Imagined

Put a large market with lots of manufacturing capacity next to a treasure trove of natural resources, and you get interdependence. Over the years, infrastructure and commercial linkages, made possible by proximity and circumstance, have tied the European and Russian markets together. In addition to being a massive natural gas exporter, Russia supplies approximately 45 percent of the world's ammonia nitrate fertilizers, 20 percent of potash fertilizers and just under 15 percent of phosphate fertilizers. Most of this production goes to Europe. Russia receives a constant influx of foreign currency, reinforcing the regime's stability. Europe, most of the time, receives a cheap, steady flow of critical inputs: About 40 percent of its gas imports and, for example, about a third of its ammonium for the production of fertilizers.

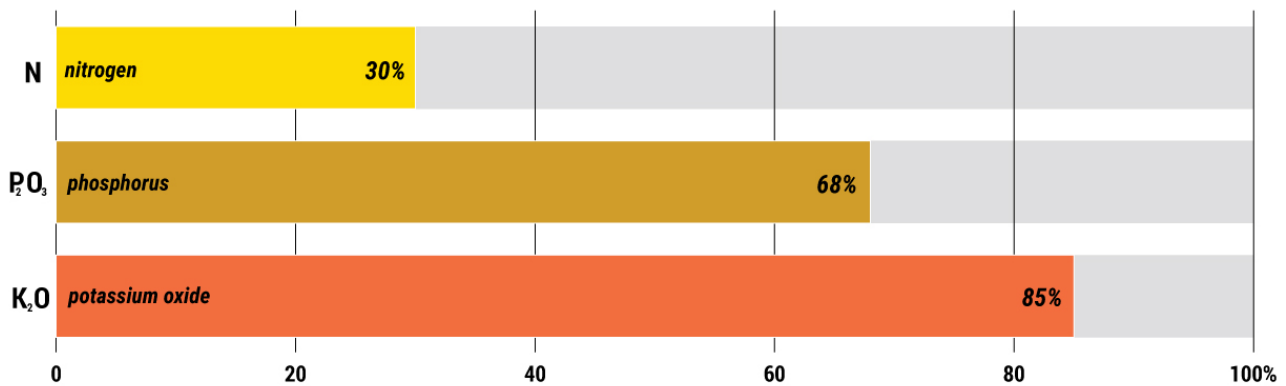
Russia Hits Europe in the Bread Basket

Roughly a quarter of Europe’s fertilizers are imported from Russia, and together with Belarus, a Russian ally, provides more than half of Europe’s potash fertilizers.

Since December 2021, the Kremlin has had quotas in effect on exports of nitrogen and compound nitrogen fertilizers

to states outside the Eurasian Economic Union, but those quotas have been gradually relaxed without spurring a significant increase in Russian fertilizer exports to Europe. Western sanctions do contribute, but not directly. There are sanctions in effect that target individuals who run Russian fertilizer companies, but no measures target the fertiliz-

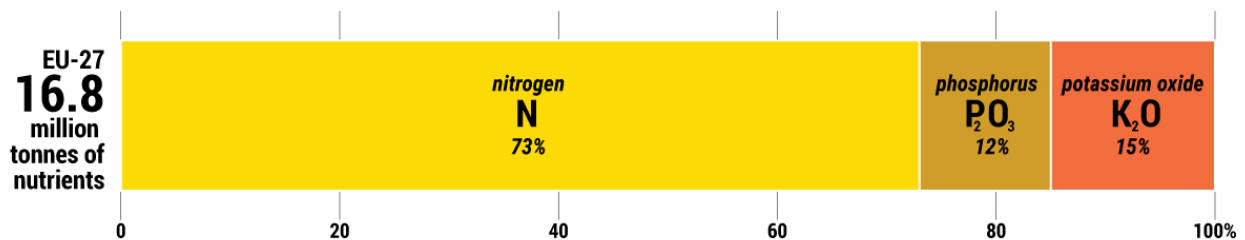
Fertilizer Nutrients and Imports' Share in EU Consumption



Sources: Fertilizers Europe, Eurostat

Graphic redesign by Geopolitical Futures

EU Fertilizer Production by Nutrient, 2019



Sources: Fertilizers Europe, IFA

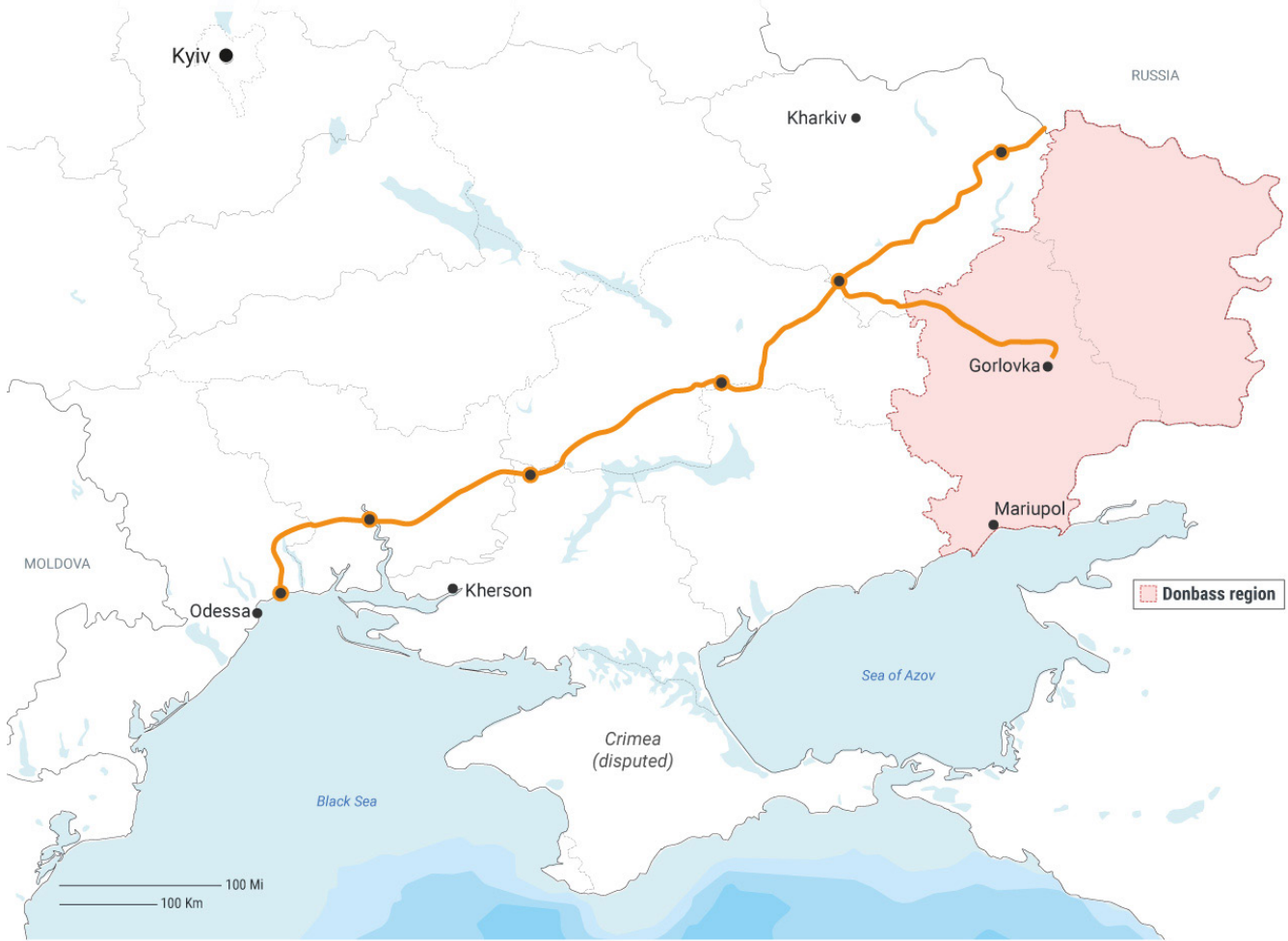
Graphic redesign by Geopolitical Futures

Russia Hits Europe in the Bread Basket

ers themselves. The European Union did adopt a quota on the import of Russian potassium fertilizers for one year, but the quota limit is very close to typical trade volumes. Instead, the effect of Western sanctions is mostly transmitted through logistics and finance.

In terms of logistics, Baltic ports that usually receive shipments have become less accessible to Russian producers. Buyers have encountered difficulties chartering large bulk carriers, forcing them to rely on smaller vessels and raising transport costs and delivery times. Financially, some Russian banks are blocked from using SWIFT, the domi-

Togliatti-Gorlovka-Odessa Ammonia Pipeline



Russia Hits Europe in the Bread Basket

nant messaging system for interbank transactions. As a result, payments are more complicated, and some potential buyers are avoiding Russia entirely for fear of blowback. In total, nearly 300,000 tons of fertilizers are reportedly blocked from European ports and can't reach the buyers.

With respect to ammonia specifically, the war in Ukraine is a direct obstacle to the delivery of supplies. The 2,500-kilometer (1,550-mile) Togliatti-Gorlovka-Odesa pipeline is capable of transporting 2.5 million tons of ammonia per year from Russia's Volga region to the Ukrainian Black Sea port of Yuzhny, near Odesa. But it also happens to traverse the parts of Ukraine witnessing the most intense fighting, including Kharkiv. And since ammonia is highly toxic and corrosive, the war is a problem.

Europe's Options

An additional problem for Europe is the lack of alternative suppliers. Domestically, the nearly 30 percent increase in natural gas prices put a damper on Europe's own fertilizer production. As much as 15 million tons of European ammonia capacity has been shuttered

or is at risk of it, equivalent to almost a third of Europe's annual output. Producers of nitrogen fertilizers face significant competition for scarce natural gas from other industries as well as households. And Europe lacks the capacity to significantly raise production of other types of fertilizers. Ideally, Europe would try to develop homegrown resources – preferably not nitrogen, whose processing for fertilizers requires lots of natural gas. Mines in east Germany have started test-drilling for potassium, but again, it would take time to spin those up to meaningful production levels.

European buyers have reached out to other gas and fertilizer producers in the Middle East, North Africa and Canada. The bloc is discussing natural gas with Algeria and fertilizer with Morocco, which already provides 40 percent of Europe's phosphate imports and contains more than 75 percent of proven world reserves of phosphorite. But Europe faces obstacles here as well. Gas-producing countries are already taking advantage of their access to cheaper gas and running fertilizer plants producing nitrogen at near full capacity. Quickly raising production of other fertilizers is even more difficult. Lastly, importing more fertiliz-

Russia Hits Europe in the Bread Basket

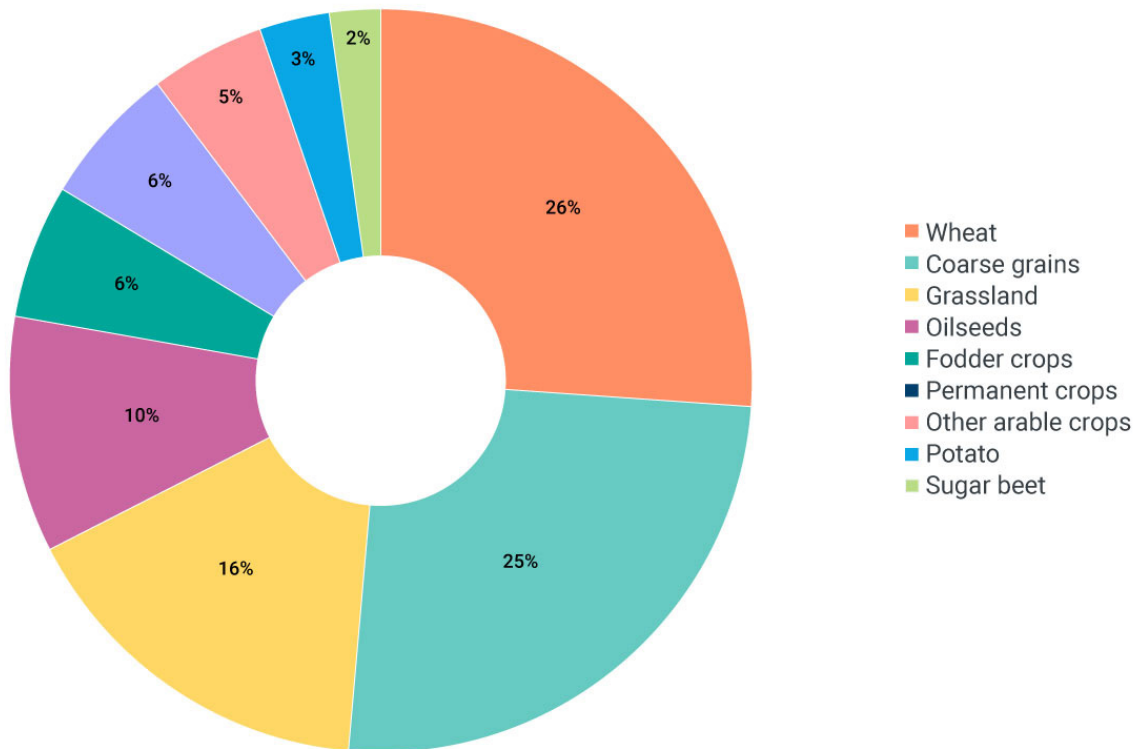
ers does nothing to help domestic fertilizer firms stay afloat.

reform will take more time than Europe has – and possibly more unity too.

Then there are the long lead times. Although fertilizer is usually applied a couple of months before planting season (February-March), farmers usually order fertilizer between September and November. The European Union is working on a strategy to increase domestic fertilizer production, protect and create jobs, and diversify supplies, but such a

This leaves Europe with two options: muddle through, or compromise with Russia. Already, there are indications that Europe is investigating the latter. According to U.N. Secretary-General Antonio Guterres, the West is discussing increasing ammonia nitrate supplies through the pipeline in Ukraine. Ukrainian President Volodymyr Zelenskyy has al-

European Fertilizer Consumption by Crop



Note: Due to rounding, figures may not add up to 100%
Source: Fertilizers Europe

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Russia Hits Europe in the Bread Basket

ready given his support to the idea. And the United Nations proposed that gaseous ammonia owned by Russian fertilizer maker Uralchem be piped to the border with Ukraine, where U.S.-based trader Trammo would buy it.

Compromised

But Russia is aware that Europe does not have many options, so Moscow is in no hurry to respond to appeals to make better use of the Togliatti-Gorlovka-Odesa pipeline. The Kremlin intends to squeeze Europe to, for instance, ease restrictions on logistics or payment for Russian goods. Russian President Vladimir Putin recently called on Europe to ease restrictions on port access for fertilizer shipments bound not just for Europe but for non-European markets as well. Several ports, including Rotterdam and Finland's Kotka, have responded

positively to proposals to make exceptions for Russian fertilizers. However, Brussels is nervous that simplifying logistics or otherwise easing up the pressure will restore maritime or rail connections and give Russia more access to foreign currency and trade.

Given the likely shortages of fertilizers for the spring, the prospects for Europe's 2023 harvest are murky but downbeat. Moscow can use the situation to promote its interests and seek favorable contract terms. It will delay restoration of pipeline supplies for as long as possible under various pretexts, from unexpected repairs to retribution for refusal to pay in rubles. Therefore, food prices are unlikely to stabilize by next summer, and prices in the EU as a whole will remain elevated, heaping more pressure on the bloc.

Immigration, the Economy and the Italian Election

By George Friedman
September 27, 2022

Immigration, the Economy and the Italian Election

Italy elected a hard-right party in parliamentary elections held over the weekend. The result indicates that Italians are unhappy with the country's reality. Italy has the third-largest economy in the European Union, after Germany and France, and its economic and social realities are very different from the Continent's other top-tier countries in the sense that its economy is less productive and generates more debt. Italians believe, with some reason, that the European Central Bank is pursuing monetary policies that benefit Germany, which wants to maintain the value of the euro as a net creditor. Italy favors a very different policy of cheap money, a reasonable preference considering it's a net debtor. A single European bank can't serve both interests, nor can it readily split the difference. But given Germany's size, its economic performance is a massive component of Europe's financial well-being, meaning the ECB must support the German position.

Logic dictates that Italy would elect a hard oppositional government that sees the ECB as a threat to Italian prosperity. It has long been our position that the tension between Italy and Germany over monetary policy would represent the

largest threat, perhaps a lethal one, to the European Union. Given the coming winter, European politicians will be protecting the interests of their own voters, and therefore following divergent policies. The ECB will not be able to harmonize the economies of Europe, and if the Russian embargo persists, competition between nations will be intense. The EU was created to ensure peace and prosperity, as its motto proclaims. Peace is shaky, and prosperity is slipping away. The Italian election signals a crisis.

Meanwhile, there was another issue that loomed over the election: illegal immigration. This issue has been facing Europe since 2015 when massive numbers of Muslim migrants came to the Continent. At the time, relatively open immigration was the EU's policy, but the opposition was substantial. Proponents of the policy believed that member states had a moral obligation to admit migrants. But opponents argued that member states were expected to let in too many migrants, and that the bloc and its supporters, particularly those from wealthy countries, were strutting their moral superiority without footing the bill.

Immigration, the Economy and the Italian Election

To understand these issues, I would insert my experience as a young immigrant to the United States, something I have done before. I'm an immigrant and certainly don't oppose immigration. At the same time, I understand the stresses immigrants put on the system and the fear over immigration. That fear cannot be dismissed as simply racism. The cost of immigration is borne by groups that find the burden difficult to carry. However, the problem is not just financial. When immigrants arrive in a country, they do not live among the wealthy. Instead, they are channeled to live among the poorest of society, where an apartment might be barely affordable.

Immigrants are also foreigners and often don't understand the host country. The parents often go off to work in menial jobs, and their children are left to fend for themselves. Lacking parental supervision, immigrants from the same country huddle together and wars break out – between Jews and Puerto Ricans, Irish and Black people, Italians and Dominicans, to provide a sample of ethnic groups I grew up with. Crimes were committed, and residents were mugged and robbed in their apartments.

The point is that immigration is a brutal experience for the young and an even more horrible influence on the residents who had settled there years before. It was particularly a nightmare for the elderly. Anyone who could fled. Anyone who couldn't stayed indoors. This was the experience of immigrants, and it was also the experience of the working class and retired. It was not the fault of anyone really, save those who championed the policy without understanding what large-scale immigration meant and made no attempt to mitigate the crisis it caused.

I noticed a pattern in New York that I see in Europe and elsewhere. The most passionate advocates of immigration do not live in the neighborhoods in which immigrants settle, nor do they have any sense of what the collision of cultures will result in or what unsupervised teenagers do. If none of this happens in their neighborhoods, it's not that they are indifferent to the chaos; it's that they simply can't fathom it.

The rise in hostility to immigrants in Europe will surge when the immigrants are sent to the poorest neighborhoods in the poorest countries. Do not mistake

Immigration, the Economy and the Italian Election

me for an opponent of immigration. I am here in America as an immigrant. But I am also aware that there is no memorial containing the names of those who paid for it.

The immigration issue exists in all countries. But in Europe, it's more divisive. America is a nation of immigrants, and all of us have an ancestor who came here or was brought here, save for the Native

Americans, who were the ones who paid for the first wave. But I understand the Italian position on immigration, which can be summarized as: "Let them all go to Germany." And this is where the economic and the immigration issues meet, creating a powerful new problem fueled by the contempt hurled at those who oppose immigration by the moral upper classes. The EU will be torn by these issues, and so will other countries.

On Geoeconomics: Systemic Challenges

By Antonia Colibasanu

October 10, 2022

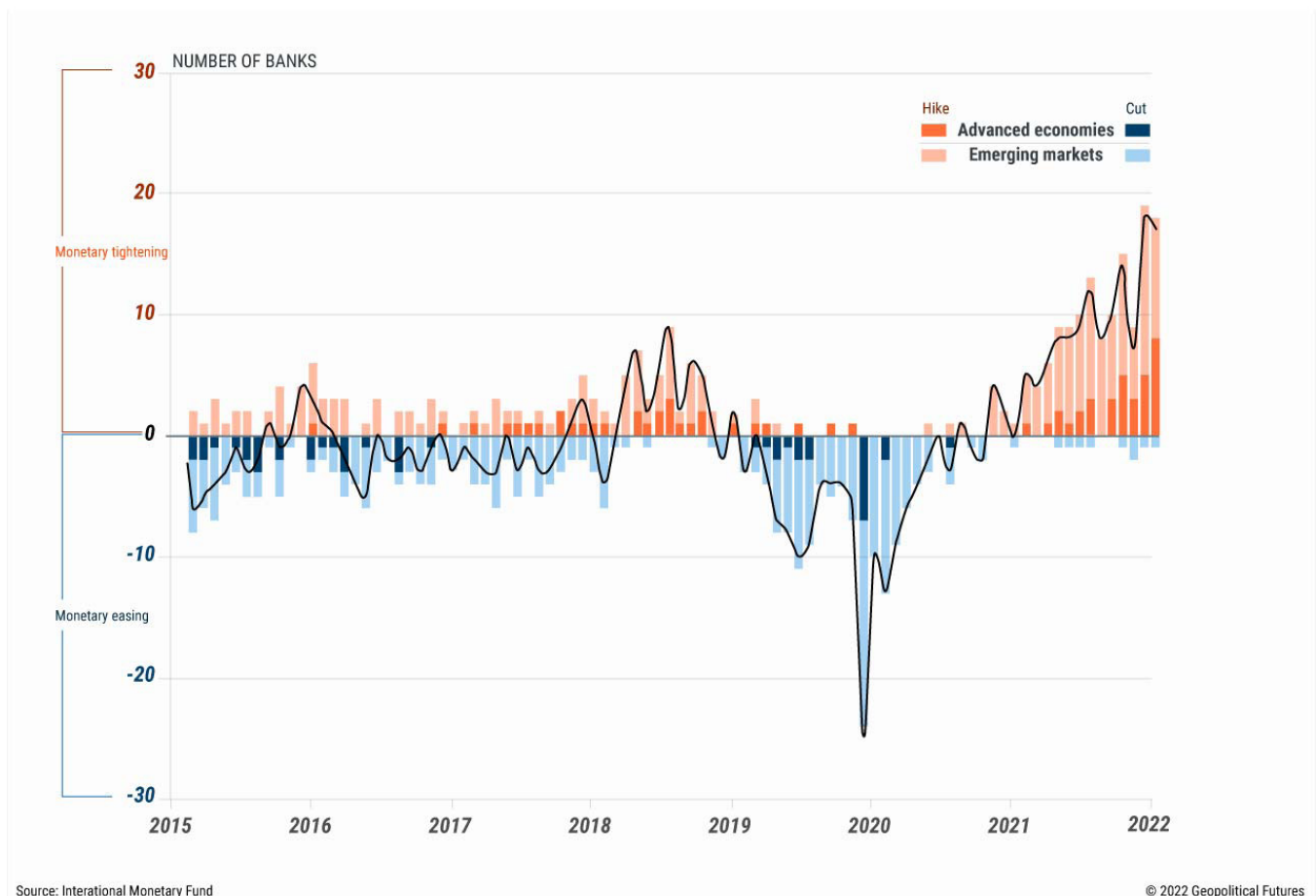
State actors are starting to behave like aggressive investors in a more deglobalized environment.

On Geoeconomics: Systemic Challenges

It's no secret that central banks and governments the world over are dealing with rising inflation and economic uncertainty, both of which need to be addressed head-on if they want to maintain internal stability. To do so, they are starting to consider measures outside the usual monetary toolkit and that address geopolitical events by stimulating national investment more creatively.

The British government, for example, proposed a deficit-financed expansionary fiscal policy while the Bank of England raised interest rates and reduced its balance sheet to fight high inflation. The same week, Japan's Ministry of Finance spent 2.84 trillion yen (\$19.5 billion) to slow the slide in the currency – the first such intervention since 1998. The two countries are the world's third- and fifth-largest economies, as well as

Number of Central Banks Hiking Interest Rate



On Geoeconomics: Systemic Challenges

key U.S. allies in their respective regions. Such news frames the next phase for the global economy, giving several hints to understand how different countries will seek to restructure their economies, a trend that we have written about since 2021.

In other words, state actors start behaving more like (aggressive) investors in financial markets as they defend their interests. This was common enough in the 1990s, before globalization tightly bound national economies to one another. But times have changed. World economies are less globalized than they once were, a trend accelerated but not started by the COVID-19 pandemic and made all the more apparent with the fall-out over Russia's invasion of Ukraine. Even so, existing trade and technological dependencies limit the extent to which central governments can defend their interests, and all measures they take will affect others faster than they would have before.

There are several systemic challenges the world is facing at once. The first and most consequential is the weaponization of economic ties. Global economic warfare continues, and the current ener-

gy crisis is just one of its major theaters. When Russia invaded Ukraine, few anticipated a long-term war, so few believed the global economic war would continue into the winter of 2022.

The sanctions imposed on Russia by the West were supposed to force Moscow into submission. Instead, they have balkanized the global economy. Before the imposition of sanctions, foreign-exchange reserves were thought to be untouchable. At the same time, the U.S. dollar, the world's reserve currency, was thought to be a sort of public good – as was SWIFT, the globally accepted mechanism for international financial exchanges. Curbing Russia's access to both was, in a sense, unprecedented – the West has done this before (to countries like Iran and Venezuela) but not to such an important economy as Russia's.

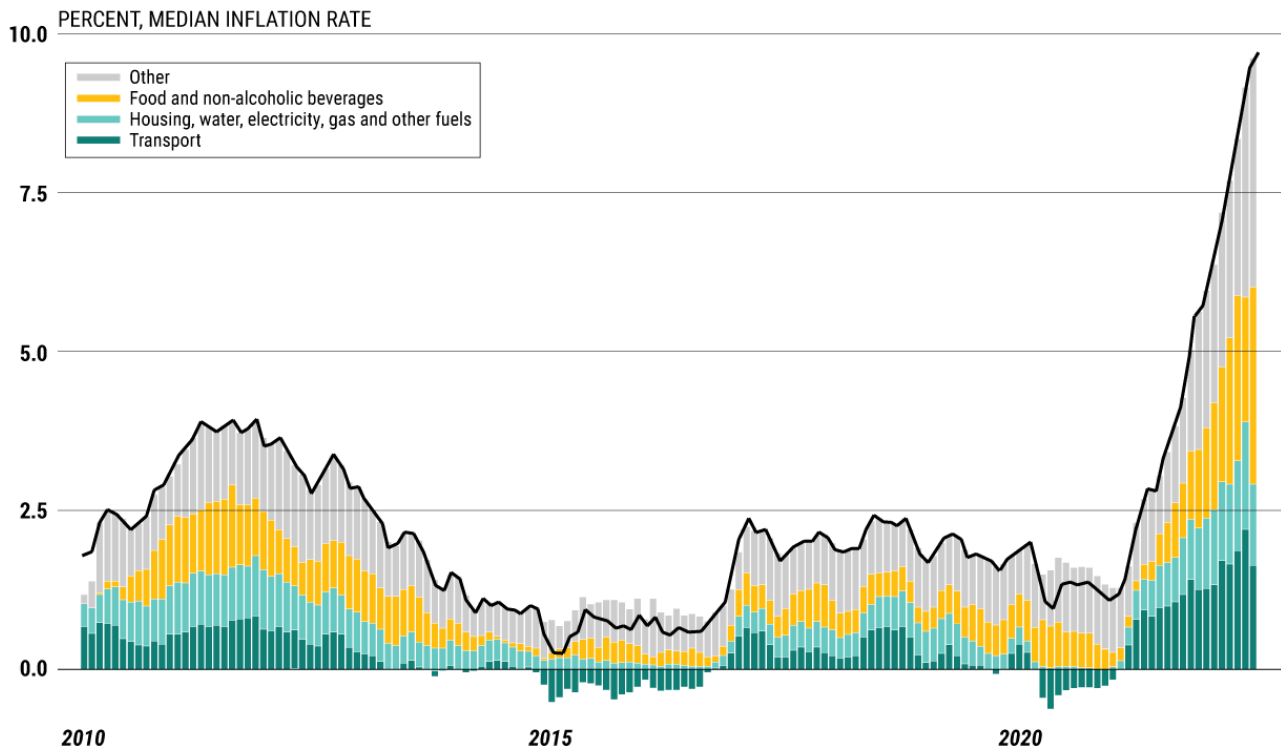
For the sanctions to succeed, Russia had to be caught off guard. It wasn't. The ruble initially collapsed, inflation skyrocketed, interest rates soared and output dwindled. But six months later, Russia's economy, though bad, seems to be performing better than expected. Russia had prepared itself for measures like these since 2014, when it invaded

On Geoeconomics: Systemic Challenges

Crimea and was thus subject to the first wave of Western sanctions. Since then, the Kremlin invested heavily in supporting national industry and campaigned internally for the need to increase Russian entrepreneurship and for Russian-made products. Russia's energy strategy toward Europe since the early 2000s, meanwhile, insulated it from punishment.

After the initial shocks, the world came to understand that both SWIFT and the U.S. dollar are conditional public goods. The West couldn't manage to secure alliances beyond the G-7 in a quick manner (which would have helped its rapidly winning the economic conflict against Russia), and though developed economies and the global north have coordinated their actions against Russia, the global south is largely undecided. In fact, most unaligned G-20 countries

Factors Driving Inflation



Note: Chart shows median total inflation and in select categories across 88 countries, including 28 advanced economies and 60 emerging and developing economies. Sources: IMF CPI database and IMF staff calculations

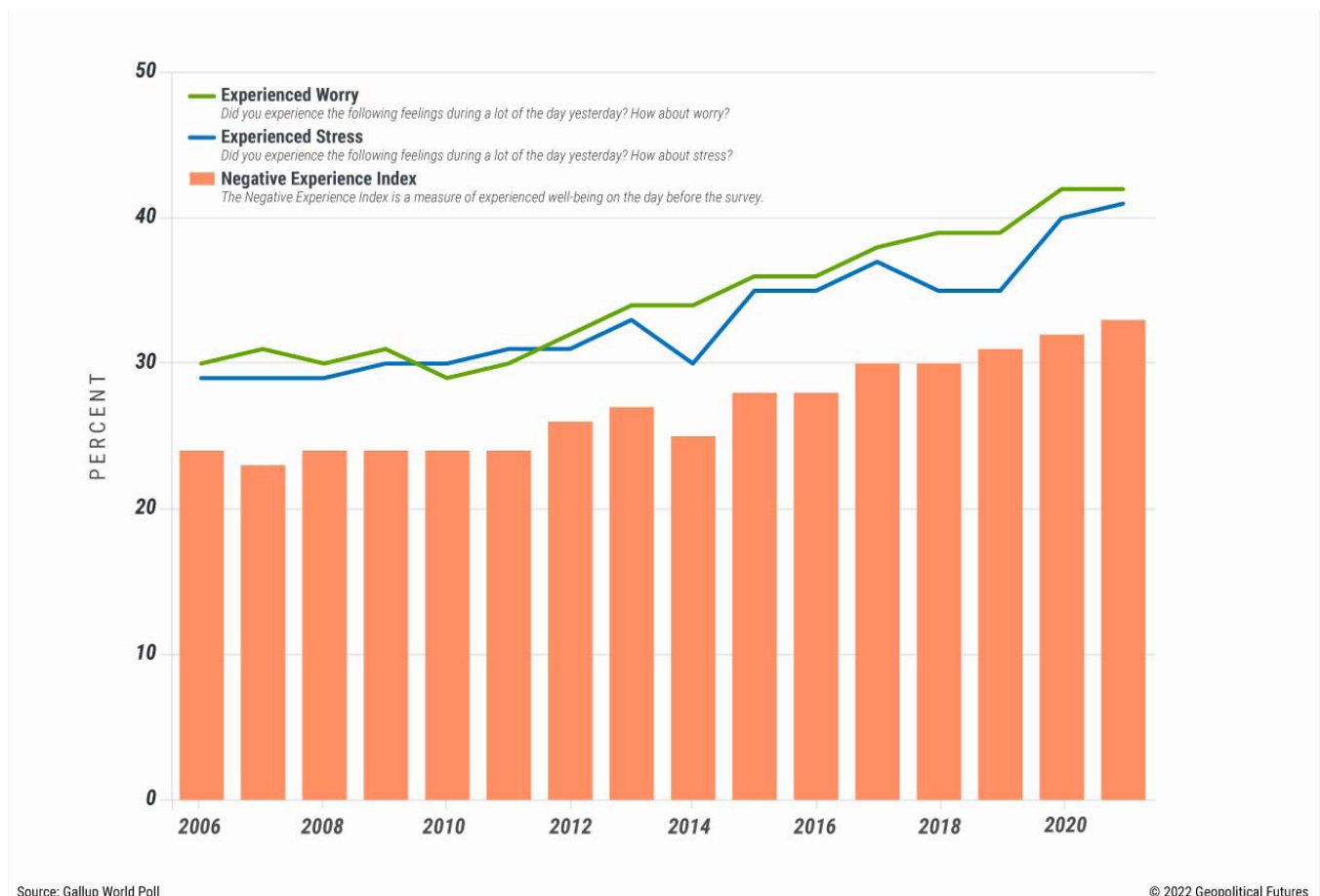
Graphic redesign by Geopolitical Futures

On Geoeconomics: Systemic Challenges

have more to gain from playing Russia and the West off one another. Still, some are trying to find alternatives to SWIFT, while others have found some already. Put simply, Western control over global financial markets is being challenged, and while alliances are still in the making, uncertainty continues to affect the global economy.

The second systemic challenge facing the global economy is post-pandemic uncertainty. Remember that the current energy crisis is not solely responsible for high inflation. In 2021, excessively loose monetary, fiscal and credit policies and supply shocks caused prices to surge. The war in Ukraine only made things worse, of course, but a dramatic decrease in consumption, more than anything, changed the inflation equation

Negative Experience Along with Stress and Worry



On Geoeconomics: Systemic Challenges

in 2022. With all polling data pointing to pessimism with regard to the future, consumption is unlikely to recover any-time soon. Those same supply shocks, meanwhile, are still distressing markets. Some industries such as shipping have slowly adapted to the new reality, but things like China's continued lockdowns of major ports have created new bottlenecks that are hard to cope with.

In fact, China's economic uncertainty is the third major systemic challenge for the world's economy. The country has been struggling, of course, but the way it handles its recovery is a point of major contention within the Communist Party of China, one so strong that there are rumors of viable opposition to President Xi Jinping at the upcoming National Party Congress. The relationship between China and the world, and specifically between China and the U.S., its most important customer, is dependent on Chinese politics and its socioeconomics.

The fourth systemic challenge is European fragility. An economically weakened China and Russia is bad for Europe, which depends on both in different ways. The European economy never really got over the pandemic, so it never

really found a way to mitigate the damage of Chinese supply chain shocks. The energy crisis is worse, politically and economically, and, with a cold winter coming, is likely to trigger more socio-economic consequences on the Continent. The key question is the degree to which German industry will be affected by the Nord Stream 1 supplies cut earlier this month – and thus the degree to which the European economy will be affected. But others to watch are France and Italy. Many have criticized Paris over its inability to launch a new reform agenda, while Italy just elected a new right-wing government. Central and Eastern Europe are mostly preoccupied with military threats from Russia, while not excepted from socio-economic troubles.

The last but likely most important systemic challenge is Washington's weaponization of the U.S. dollar. The U.S. Federal Reserve is using all the usual policies to force monetary supply and demand into better balance, focusing especially on interest rates. While inflation is high and the labor market continues to be tight, the Fed will likely keep tightening financial conditions to slow growth enough to cool the economy,

On Geoeconomics: Systemic Challenges

even though this makes for challenging and volatile markets.

The Fed's hiking rates to bring down inflation is having spillover effects for the rest of the world through the appreciation of and demand for the dollar. The problem is this kind of weaponization doesn't discriminate between friend and foe. When the global economy is stable, this may give countries like Germany, the U.K. and Japan a spark for increasing their exports to the American market. But the global economy is not stable – and all these countries are fighting back inflation and dealing with similar problems that the U.S. is.

Likewise, the European Central Bank, which is in charge of stabilizing the eurozone, has echoed the Fed policy of increasing interest rates. At the same time, it has delayed its quantitative easing and bond purchasing programs to make sure countries in Southern Europe like Italy and Greece have the flexibility they need to deal with rapidly changing market conditions. For them, high interest rates coupled with high debt levels would create poor liquidity in markets where businesses are still recovering from the last decade's economic crisis.

Keeping some monetary stimulus is still key for businesses to continue working in the European periphery, at least until inflation is under control.

The U.K. and Japan, as mentioned, are taking completely different paths. They're betting on expansive fiscal stimulus while ensuring funding for energy and critical infrastructure projects. Instead of increasing the interest rates, they are increasing the borrowing on the governments' part, looking to subsidize both consumption and investment. In essence, they are replacing the economic crisis with a currency crisis – which explains recent reports about the pound and the yen dropping to historical lows against the dollar. By doing that, they have a larger set of tools they can use to address economic imbalances, which are related to both the post-pandemic reality and the war in Ukraine. Specifically, they're looking at cyclical sectors like industrials and construction to support the rebound in economic activity.

Considering the systemic challenges that the global economy is facing, the coming winter will be difficult. With liquidity low and with credit expensive, a recession is likely around the corner. Re-

On Geoeconomics: Systemic Challenges

cession may be an old game, but deglobalization is not. That means that in the next few months we will start to see the first signs of the restructuring processes we've been anticipating since 2021. With many businesses cutting down on operations and with governments becoming more active in shaping the national economy, more government spending is up next. Since most of the developed world has an aging population and thus excess savings, spending on defense and energy infrastructure may come with still-low real interest rates for governments. But more government spending doesn't necessarily mean responsible spending or lower inflation. Expect more uncertainty and investor anxiety in the next months. Further shocks will determine whether (and how) states become more aggressive in protecting strategic assets and critical infrastructure. Protectionism will likely become a preferred trade policy, with all the populist and nationalist sentiment that comes with it.

Saudi Oil Policy: Between Retribution and Market Pricing

By Hilal Khashan
October 13, 2022

*Riyadh is pulling away from Washington but still
needs oil to fund its budget.*

Saudi Oil Policy: Between Retribution and Market Pricing

U.S. President Joe Biden visited Saudi Arabia last July hoping to convince Saudi King Salman and Crown Prince Mohammad bin Salman to do what they can to reassure markets and stabilize fuel prices. He also urged them to reduce cooperation with China, the dominant economic partner in the region.

The Saudis apparently were not convinced. Despite Biden's calls to refrain from cutting oil production, OPEC+ energy ministers announced following a meeting in Vienna earlier this month that output would be slashed by 2 million barrels per day. The unexpected decision triggered congressional demands to punish Saudi Arabia. It also stunned the Biden administration given that all previous Saudi administrations had avoided embarrassing Washington, even during turbulent times in their relationship. U.S. Secretary of State Antony Blinken said his country would consider options to respond to the move, which he described as short-sighted and disappointing. He also said the U.S. would not act against its own interests, alluding to a demand by members of Congress to withdraw important U.S. military assets stationed in Saudi Arabia and the Unit-

ed Arab Emirates – an indicator of the tough choices facing Washington today.

Gulf Oil in U.S. Foreign Policy

U.S.-Saudi relations have experienced several periods of friction that have played out on the oil issue. During the October 1973 Arab-Israeli war, Saudi Arabia imposed an oil embargo on the U.S. because of its support of Israel. By the time the embargo was lifted in March 1974, oil prices had quadrupled, exacerbating the economic crisis facing the United States at the time. That crisis included a recession, inflation and the Watergate scandal. Recently declassified British documents indicate that President Richard Nixon had considered invading Saudi Arabia to control oil prices but decided instead to rely on the shah of Iran to discourage the Gulf states from trying to destabilize the global economy again.

Iran's 1979 revolution and its hostility to the U.S. led to the adoption of the Carter Doctrine in 1980, which was meant to ensure that there would be no more oil embargoes or Soviet intrusion into the Persian Gulf. The doctrine considered any attempt by a foreign power to gain

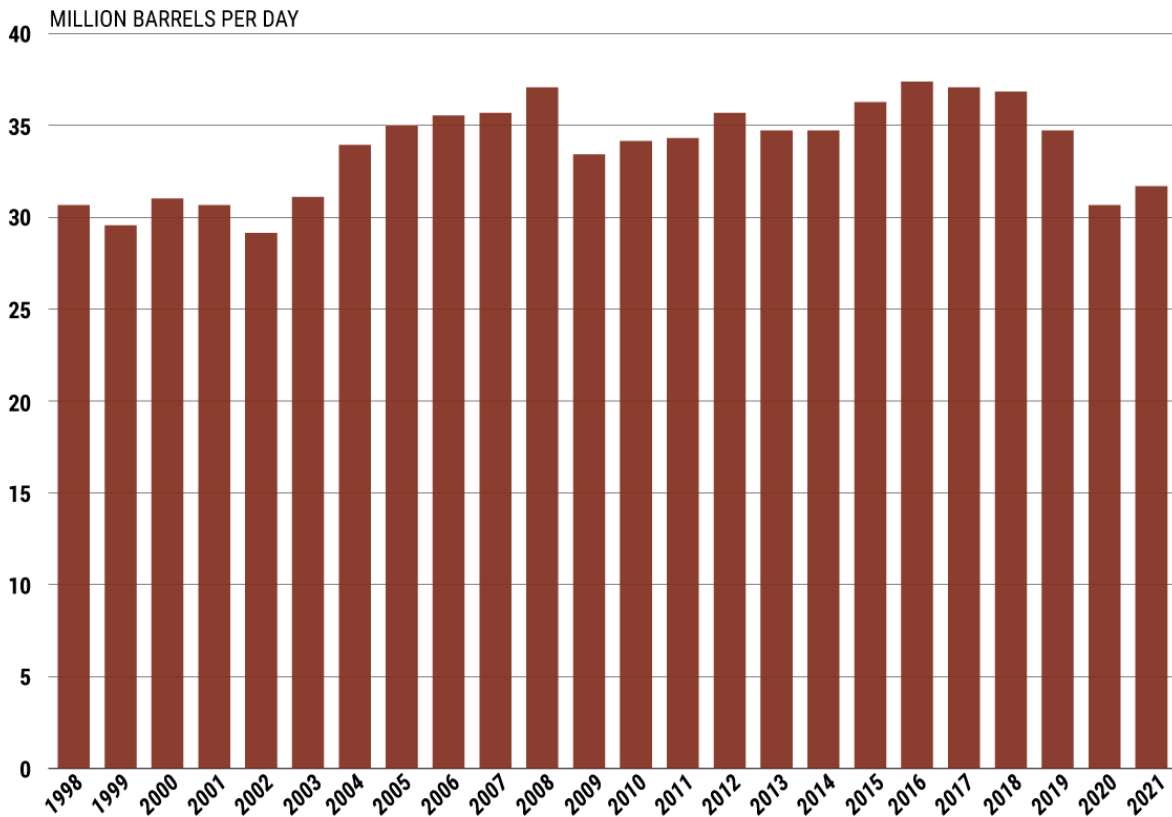
Saudi Oil Policy: Between Retribution and Market Pricing

control of the Gulf region as an attack on vital U.S. interests. It established the Rapid Deployment Force that, in 1983, integrated with U.S. Central Command, organizing regular military exercises codenamed Bright Star involving several countries. These drills, which are Central Command's most significant, focus on desert combat skills, training troops to maintain their equipment in harsh com-

bat conditions and communications between troops.

Today we are again seeing cracks in the relationship between the U.S. and Gulf producers. After OPEC+ decided to reduce production, some Americans demanded Washington end Saudi Arabia's special status and even launch a military strike against it. Others denounced Washington's disingenuous affection for

OPEC Crude Oil Production



Source: Statista

Graphic redesign by Geopolitical Futures

Saudi Oil Policy: Between Retribution and Market Pricing

Riyadh. The U.S. Congress is now considering the NOPEC (No Oil Producing and Exporting Cartels) bill, which would allow the Department of Justice to sue OPEC countries and their allies under the pretext that the organization is a monopoly conspiring to raise oil prices. U.S. National Security Council spokesperson John Kirby said Biden is dissatisfied with the Saudi position and will coordinate with Congress to determine the shape of the future relationship with Riyadh. OPEC Crude Oil Production

Biden and MBS

One of the reasons for Biden's distrust of the Gulf states generally, and Saudi Arabia specifically, is the absence of democracy in the Arab region. Last year, he hosted the Summit for Democracies to reaffirm the United States' commitment to democratic values in its foreign policy. The only Arab country invited to the summit was Iraq, which the U.S. hopes will eventually transition into a pluralist democracy. Even by Arab standards, Saudi Arabia would rank at the bottom of the democratic continuum in the region.

Before Russia's invasion of Ukraine, Biden seemed to believe that applying consistent pressure on the Saudis would help bring an end to the conflict in Yemen and tame MBS with minimal damage to Washington's relationship with Riyadh. Biden ended U.S. military support for the Saudi-led coalition in Yemen and removed the Houthis from the U.S. list of terrorist organizations. But MBS seems to believe that the Houthis' place in post-war Yemen should be up to him.

Biden was also disturbed by the assassination of Saudi journalist Jamal Khashoggi, for which he holds MBS personally responsible. He even allowed the partial publication of the secret U.S. intelligence report on the Khashoggi case. Biden sees MBS as an authoritarian and ruthless leader, a description confirmed by various personal accounts of interactions with the crown prince. A former Saudi intelligence officer who was for years MBS' right-hand man said the crown prince likened himself to Alexander the Great and wanted to become the most powerful man in the world.

Biden didn't want to shake hands with MBS when he visited Saudi Arabia in

Saudi Oil Policy: Between Retribution and Market Pricing

July, preferring to greet him with a fist bump instead. Prior to the trip, Biden avoided communicating with MBS, in contrast to the way previous American presidents have dealt with Saudi royals. Some senior U.S. officials also avoided visiting Saudi Arabia when they toured the Middle East.

There's little doubt, however, that the Saudi crown prince has used his country's oil resources to gain recognition from the Biden administration as the true ruler of the kingdom. King Salman recently appointed him as the new prime minister, an unprecedented move by a sitting Saudi monarch. He continues to resist U.S. pressure to pump more oil and, in coordination with Russia, led the OPEC+ decision to slash production by 2 million barrels per day, to Washington's chagrin. MBS says in private meetings that Biden knows his number and can call him directly to discuss the matter.

Logic Behind Oil Cuts

Saudi Arabia has rejected accusations launched by the Biden administration that it is favoring cash-strapped Russia by keeping prices high. It insists that oil production was cut for technical rea-

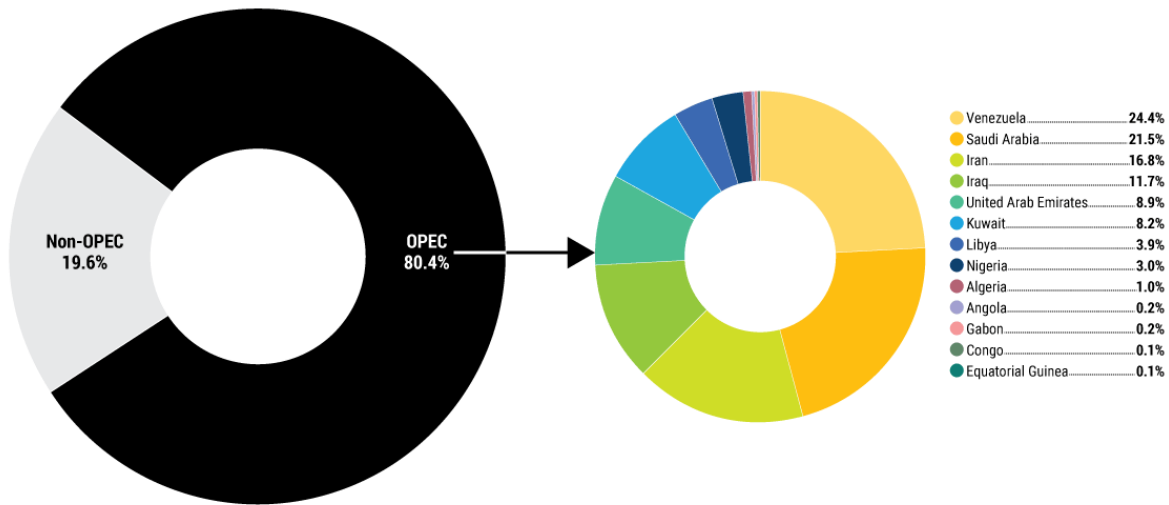
sons, to stabilize prices and to ensure energy security, especially considering the state of the global economy and the decline in demand for oil. Oil is the primary source of revenue for the Saudi budget, and thus an essential political tool in a country with a severely underdeveloped taxation system. Over the past four months, oil prices have dropped from more than \$120 per barrel to \$80, and fearing that the downward trend will continue because of the looming recession, the Saudis seem to have determined that lower production would stabilize prices.

Still, the Saudi-Russian rapprochement has reached new, concerning heights for Washington. At the G-20 summit in Buenos Aires in 2018, Russian President Vladimir Putin greeted MBS warmly, shaking his hand while most other leaders ignored him because of the fallout from the Khashoggi case. Putin wanted to help MBS deliver a diplomatic win. More recently, the Saudis helped mediate the release of foreign prisoners captured by the Russians in the Ukraine war.

Saudi Arabia and the United Arab Emirates did not join the sanctions imposed

Saudi Oil Policy: Between Retribution and Market Pricing

OPEC Share of World Crude Oil Reserves, 2021



Source: OPEC Annual Statistical Bulletin 2022

Graphic redesign by Geopolitical Futures

on Russia. They questioned U.S. motives for punishing Moscow with tools such as capping the price of its oil exports, fearing that, in the long run, it would shift the power to price oil from producers to consumers. The rule that governs the U.S.-Gulf partnership – oil for security – no longer holds, as reflected in the struggle to define the rules of global oil pricing. From a Saudi-Emirati perspective, the U.S. has lost its ability to determine its partnership priorities. The Democrats have tried to strike a balance with the Saudis, refusing to give an American cover for MBS’ domestic policies while working with him on urgent

issues such as oil and the normalization of relations with Israel.

Implications for Saudi Arabia

The Saudis reacted angrily to U.S. criticism of their decision to slash production and to the calls to punish Riyadh. Saudi activists circulated a statement by the late Saudi Foreign Minister Saud al-Faisal, in which he said: “We in the Kingdom of Saudi Arabia do not break a promise just as we do not accept a threat.” In Saudi Arabia and the UAE, Biden is dealing with a new generation of leaders less confident in partnering with the U.S. and more determined to

Saudi Oil Policy: Between Retribution and Market Pricing

take an independent foreign policy approach after years of distrust. They believe that the Democrats are working to weaken them, despite the recent warming of relations thanks to the need for oil.

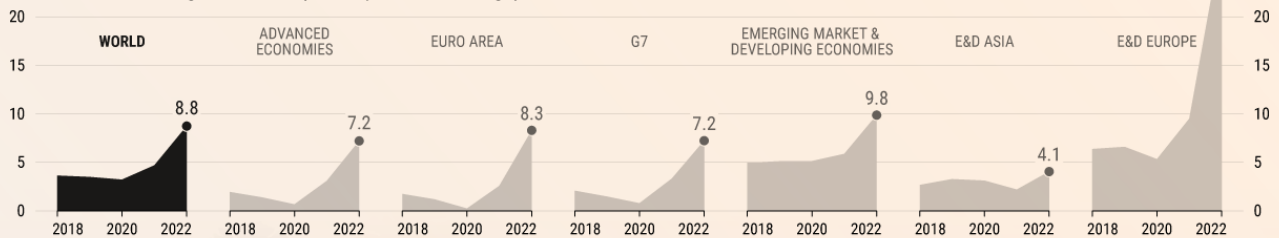
But while the chasm between Washington and Riyadh is deepening, the

Saudis will continue to maintain close economic and political ties with China and Russia, which, unlike the U.S., don't raise concerns over human rights. MBS has been charting Saudi Arabia's foreign policy orientation for years. He believes his country's future lies with China, Russia and emerging economies, not with the U.S.

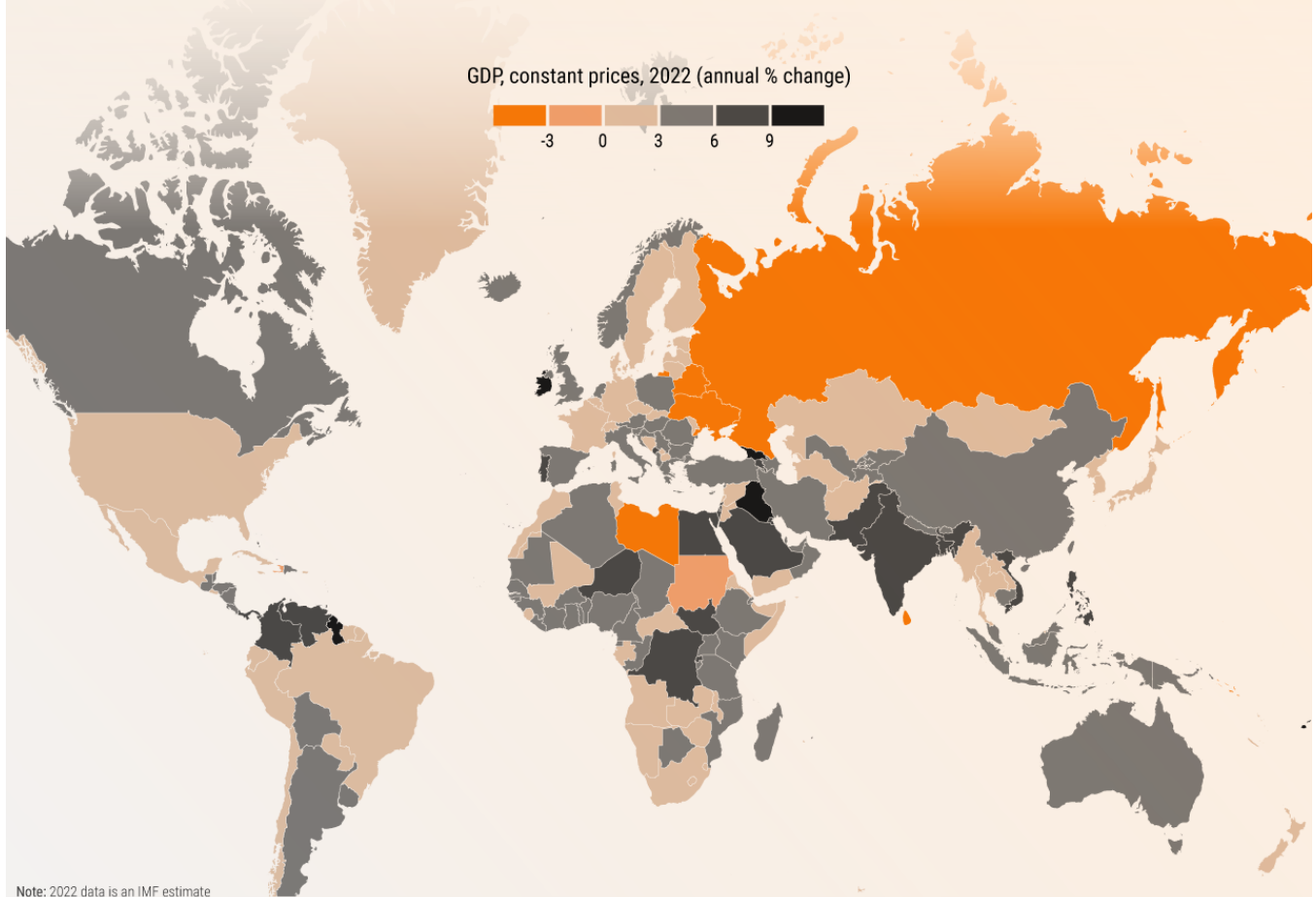
The Latest Global Growth Forecast

Global Economic Trends, 2022 | Inflation and Uncertainty

Inflation, average consumer prices (annual % change)



GDP, constant prices, 2022 (annual % change)



Note: 2022 data is an IMF estimate
Source: IMF World Economic Outlook - October 2022

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The IMF's new economic forecast is gloomier than before.

The Latest Global Growth Forecast

In its new report on the outlook for the global economy, the International Monetary Fund confirmed a slowdown for 2022 and was pessimistic about 2023. In identifying the causes of the gloomier forecast, the IMF highlighted Russia's war in Ukraine, pandemic-related supply disruptions and high inflation expectations.

Stagnation, anxiety and rising prices are a recipe for social and political instability. Concern is especially focused on the European Union and whether the bloc can remain united as it confronts these challenges. In times of crisis, the incentives for zero-sum thinking will strengthen, and weak national leaders will be tempted to name scapegoats abroad.

An Opportunity for the US and Venezuela

By Allison Fedirka

October 17, 2022

The political costs of mending ties with otherwise estranged regimes have rarely been lower.

An Opportunity for the US and Venezuela

The COVID-19 pandemic, the war in Ukraine, the current energy crisis and the looming economic recession are disrupting the geopolitical world order, even in places like the Western Hemisphere that were once thought to be comparatively immutable. Driving the process is, unsurprisingly, the United States, whose interests there remain unchanged but whose strategy for pursuing them has become more flexible. Nowhere is this more apparent than in Venezuela. Rumors of sanctions relief are circulating among U.S. policymakers, think tanks and investors, and White House officials claim new policies are under review, even as they insist no changes are in the offing.

The U.S. understands that it needs to revitalize its relationships in the Western Hemisphere. Geography dictates that U.S. security and prosperity depend largely on the relative well-being of its neighbors, an interdependent system predicated on the notion that hemispheric stability enables Washington to project power globally. The inroads U.S. competitors such as China and Russia have made in Latin America over the past few decades threaten to upend that stability. The U.S. National Security

Strategy released last week acknowledged as much, so it only makes sense for Washington to reassess its ties with a country like Venezuela, which has been estranged from Washington for much of the 21st century and under the influence of China and Russia accordingly.

Incentives

Of course, Latin America has been experiencing political and ideological changes of its own. For a generation after the Cold War, the region was characterized by a fairly simple political alliance system: Democratic, free-market governments continued to align with the U.S. while governments with a more populist approach to governance and economic policy aligned with more autocratic regimes like Russia and China. Citizens and governments alike eventually concluded that this failed to meet their needs, so a new political blueprint emerged, one that allowed governments to pursue a more pragmatic economic policy and a foreign policy divorced from political ideology.

The circumstances within and without Latin America mean that the political costs for mending ties with otherwise

An Opportunity for the US and Venezuela

estranged regimes have rarely been lower, while the incentives for new partnerships are all in place: for the U.S., a weak China and Russia, a need to stem northbound migration, the urgency of near-shoring for supply chain security, and greater cooperation in energy and food security; for many Latin American countries, a strong strategic partner in these trying and potentially more difficult economic times.

Washington's success will depend partly on how flexible it is willing and able to be. For most of its history and especially since the end of the Cold War, the U.S. has approached Latin America ideologically, seemingly prioritizing things like democratic values and moral obligation – which has limited who it engages in the region and how it engages them. But a newfound sense of flexibility has opened for Washington and the Cuban regime to reengage on select issues of common interest, and there is evidence that something similar is slowly and measuredly underway with Venezuela. Earlier this year, certain sanctions were eased to facilitate Chevron's relationship with state-owned oil company PDVSA (even if nothing drastically changed Venezuela's access to and engagement

in international markets). In September, the Maduro government handed over wanted criminals to the U.S., while Washington cut a \$367 million check to the Maduro government to help aid migrant flows. But perhaps the most telling development came early this month, when Venezuela released seven imprisoned U.S. citizens in exchange for two Venezuelans held in the U.S. Their release occurred roughly three months after the president of Venezuela's National Assembly, Jorge Rodriguez, received a U.S. delegation that included its chief hostage negotiator, Roger Carstens.

Alignment

There are other potential areas of cooperation. One is the current energy crisis. The Maduro government needs to rescue its economy. It can't do that without rehabilitating its oil industry, it can't rehabilitate the oil industry without greater access to investment and international markets, and it can't get access to either if it is still an American adversary. The U.S. government needs more reliable energy partners down the road. Demand for oil isn't going down, and Washington has learned time and again the dangers

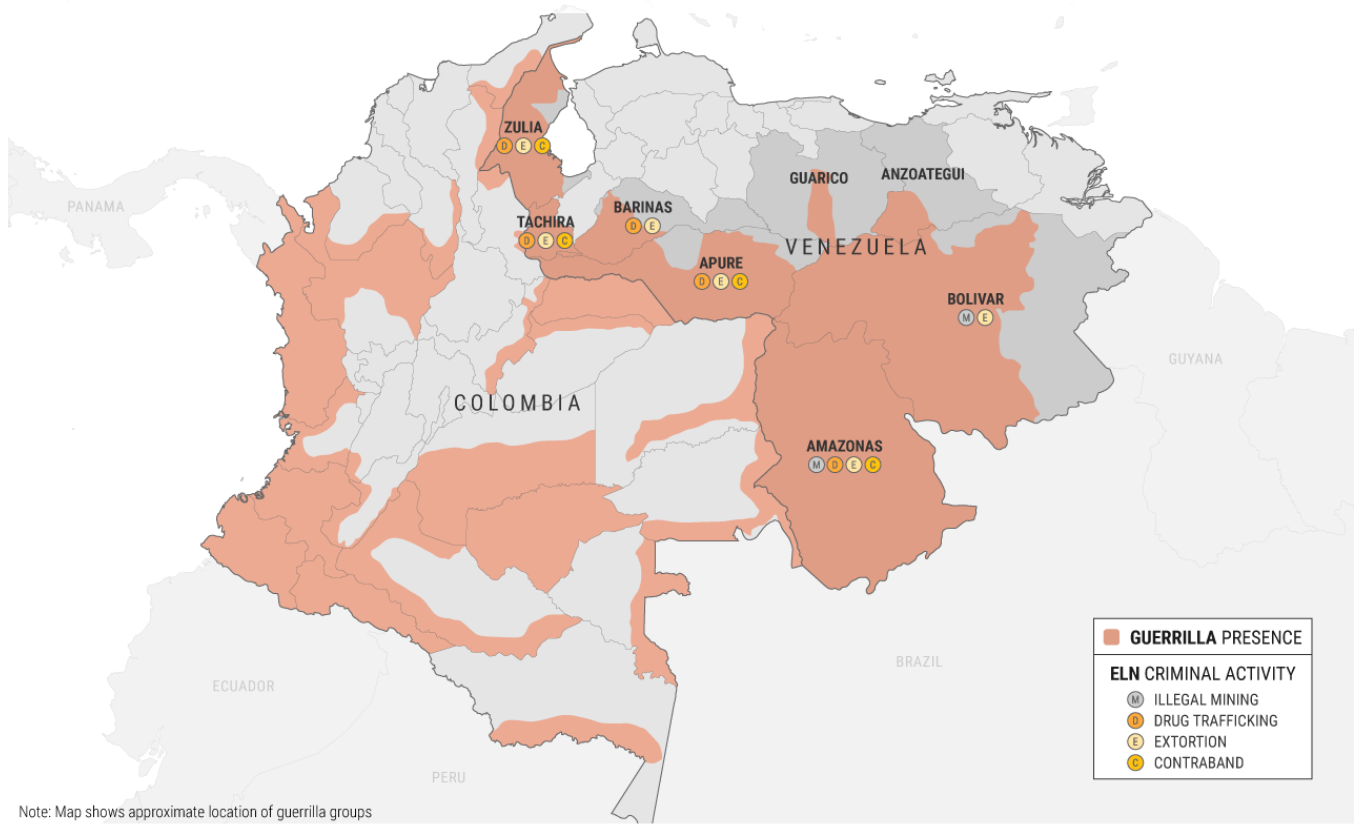
An Opportunity for the US and Venezuela

of having Saudi Arabia and Russia be the arbiters of energy markets.

Another is hemispheric security. Colombia – a stalwart U.S. ally in the region – figures prominently in U.S. hemispheric security, thanks to its location along the southern rim of the Caribbean basin. Colombia’s most pressing national interests – stemming the flow of Venezuelan migrants and reducing insecurity caused by guerrilla groups – require

the Colombian government to improve its relationship with Venezuela. Colombia thus reopened its border with Venezuela and requested President Nicolas Maduro to serve as guarantor in peace talks between Bogota and anti-government rebels. Maduro agreed. (Caracas’ buy-in is essential because Venezuela often shelters many of the rebel groups Bogota needs to make peace with.) Put simply, if the U.S. wants to maintain ties with Colombia, it needs to get on

ELN and Other Guerrilla Presence in Colombia and Venezuela



Note: Map shows approximate location of guerrilla groups
Source: InSight Crime

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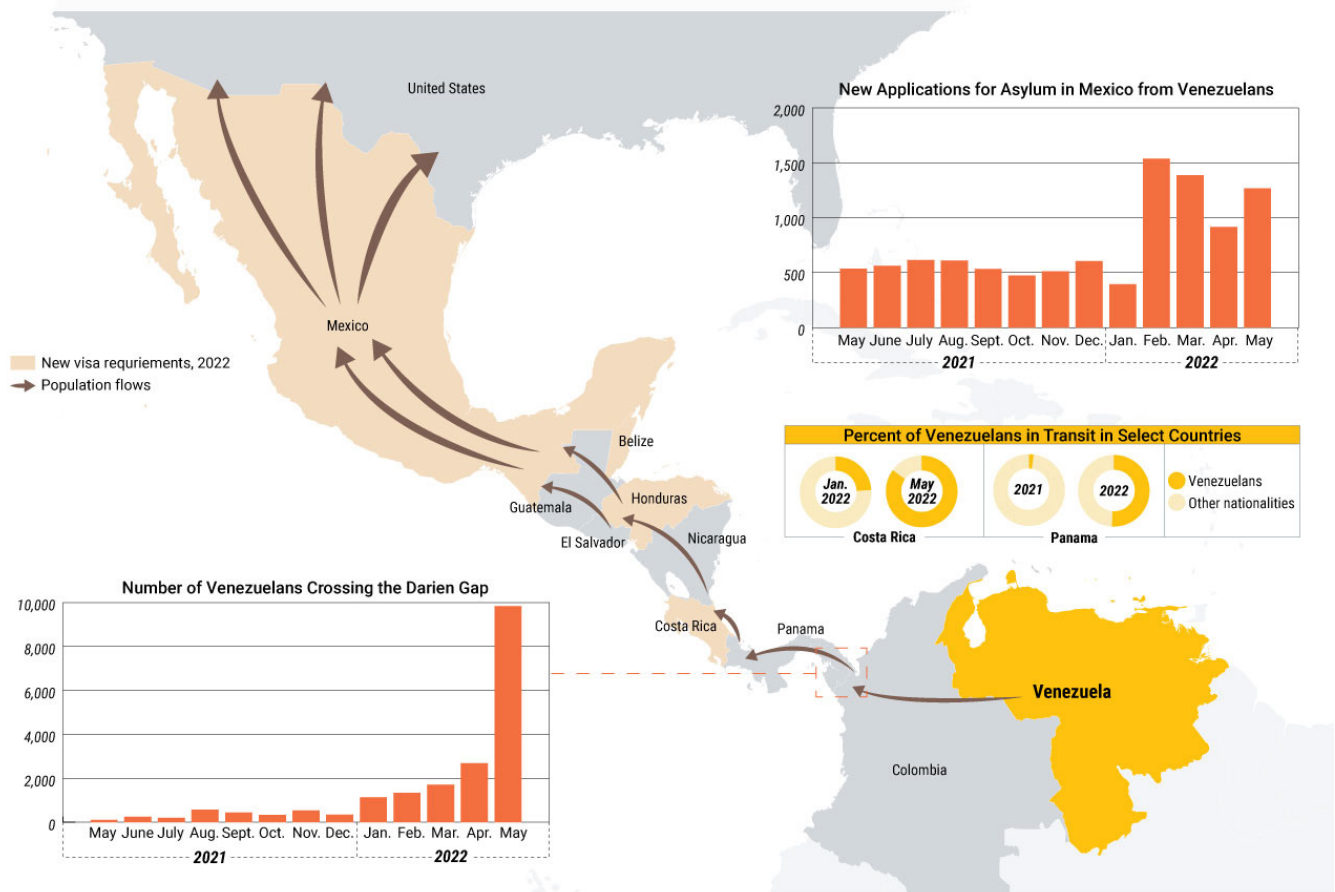
An Opportunity for the US and Venezuela

board with the Colombia-Venezuela rapprochement.

A third is immigration. The pandemic wreaked havoc on Latin American economics, and the return of almost-normal travel patterns resulted in an influx of migrants along the U.S.-Mexican border. Though the exodus of Venezuelans did not affect the U.S. initially, there has since been a notable increase in the

number of Venezuelans reaching U.S. borders, many by land routes through Central America and Mexico. From October 2021 to August 2022, U.S. border officials picked up over 150,000 Venezuelans, more than three times higher than in the previous year. Unsurprisingly, the status of Venezuelans has recently been integrated into U.S.-Mexico cooperation mechanisms for migration border enforcement. (Notably, Mexico has

Venezuelan Migration Through Central America



Source: Integrated Coordination Platform for Venezuelan Migrants and Refugees

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An Opportunity for the US and Venezuela

said easing sanctions on Venezuela would do more to fight immigration than mere border enforcement.)

Naturally, this apparent alignment of interests between the U.S. and Venezuela has called into question the standing of the Venezuelan opposition. Over the past four years, Washington has softly backed away from its support for opposition forces led by Juan Guaido. Since declaring a parallel government in early 2019, the opposition has failed to gain control of government institutions and economic centers and has lost the faith of many public supporters. These days, the U.S. has been dangling the prospect of sanctions relief to both the government and the opposition to encourage them to break their political impasse and find a way to hold free and fair elections. (This looser backing of the Venezuelan opposition also puts the U.S. in closer alignment with other regional players like Mexico, Argentina, Chile, Colombia,

Peru and to a lesser extent Brazil and Ecuador that do not support the inclusion of Venezuelan opposition groups in formal regional affairs.)

Immigration and hemispheric security may not be major concerns for Venezuela, but they are pressure points for the U.S. that could compel Washington to rethink its stance on Venezuela. There's also a clear shared interest on the energy issue and a common desire for improved economic conditions. One way of laying the groundwork for these conditions is by lifting sanctions, which would have an obvious economic benefit for Venezuela and, for the U.S., could discourage illicit activities and migrants from heading to its southern border. Given the alignment of interests and geopolitical incentives for both the U.S. and the Maduro regime, the prospect of the U.S. easing sanctions on Venezuela in the coming weeks or months is not unreasonable.

To Change the World, China Must Change

By Antonia Colibasanu

October 19, 2022

*The economic world war is heating up, and both
top contenders are in disarray.*

To Change the World, China Must Change

Over the past month, I have spoken at several conferences about the challenges that Russia's invasion of Ukraine and the subsequent economic war pose for the global economy and the Black Sea region, the area where I live. At each event, the audience set the debate topics. In Washington, the main topics were Black Sea shipping, the region's economic dependencies on Russia, European energy security and the likely European response to another economic crisis. The focus in Europe was slightly different. For instance, at the Clube de Lisboa (Club of Lisbon) – which gathered speakers from Europe, the U.S., Asia and Africa – discussions about the war in Ukraine were global in scope.

However, a common theme at every event was China – the challenges it faces, and what they mean for the world. The most urgent question was about the possibility of a Sino-Russian alliance against the West. The more interesting questions concerned this week's National Congress and Beijing's future economic model, which will determine its relationship with the West and Russia. The fact that China's problems are significantly shaping the global economy is not new; in fact, I previously listed

it among the world's major challenges in the coming months. But the model's continued ability to promote prosperity and internal stability, as well as how it is perceived in the rest of the world, are critical questions that will affect the whole world.

The Making and Breaking of a Global Order

China is under pressure not only because of its dependencies on the United States but also because of changes in its relationship with developing countries. Emerging economies in Africa and South Asia are no longer looking for help from more developed countries like China, the U.S. and others. Instead, they are biding their time and watching the global economic war evolve to ensure they do not overcommit to the losing side and make the best choice for their nations. For them, Washington's recently passed CHIPS and Science Act – intended to preserve U.S. technological leadership, including by restricting exports to China – is a reminder that conflict between the West and the East involves more than just Russia.

To Change the World, China Must Change

The first skirmishes in the economic world war started years ago as a U.S.-Chinese trade war. The two countries' mutual dependencies had created socio-economic problems for both. Protectionism gained favor in both countries. In 2020, the COVID-19 pandemic and subsequent supply chain crisis made these problems much worse. This year, the relationship broke beyond repair – or so it seems now.

The current struggle is not between two states but between two governing systems. Both originate in 1944, near the end of World War II, though both have transformed since then (and arguably need to change further to remain effective). One is the market capitalism model as articulated in "The Road to Serfdom," published in 1944 by Austrian economist and philosopher Friedrich Hayek. It asserts that central planning and public ownership lead to oppression, while free markets maximize profit and the general welfare. The other model was put forth in the same year by American-Hungarian economic historian and anthropologist Karl Polanyi in "The Great Transformation." Polanyi argues that capitalists exploit society through free markets, and a market economy imposes regulations

and politics on society that engender division and eventually crisis. Instead, he argues for a compromise between liberal economic policies internationally (such as free trade and economic openness) and domestic social stability, secured mainly through the welfare state. For Polanyi, the social agenda should set economic rules, not vice versa.

The West adopted Hayek's model of regulated but basically free markets and democracy, while China broadly followed Polanyi's "great transformation." China's system of governance aims at delivering benefits to most of the population while attempting to control most of its activities. The West, on the other hand, sets the rules of the market and defines individual rights, and then generally lets the market run itself, checked by electoral democracy.

Despite being completely different, these two systems complemented one another during the Cold War and early 2000s. China's model eradicated absolute poverty in the country and made it the economic powerhouse it is today. The U.S. played a critical role in enabling and sustaining worldwide trade and investment. The stable dollar, American

To Change the World, China Must Change

technology and U.S. military power increased global security, making it easier for China to use its low labor costs to become the world's cheapest manufacturer. Moreover, by engaging China directly, the U.S. won the Cold War against the Soviet Union. Both models succeeded, inspiring developing economies everywhere at the turn of the millennium.

While many of the former Soviet states and satellites in Eastern Europe adopted the Western capitalist model, Russia took up a hybrid of the two. At the same time, large emerging economies like Indonesia, Brazil and India have struggled to deal with the consequences of market failures, such as income and wealth inequality, and have tried to adapt Hayek's model to Polanyi's. In Latin America and Africa, the places most dependent on foreign investment for development, most states accommodated the economic model of their most generous investor. The explosion of trade and investment made it possible for the two systems to coexist peacefully.

The Race to Rewrite the Rules

The financial crisis of 2008 and the Great Recession marked the end of

their peaceful cohabitation. When global markets failed, states urgently needed to limit failures in their own markets, minimize harm, and generally fulfill the public's expectations of prosperity and security. They have not succeeded. The Western and Chinese systems had become too dependent on each other to provide unique answers to global problems while also protecting their publics. As societies and nations polarized, each state developed strategies to limit the fallout of future global crises.

In the process, cooperation between the U.S. and China – between Hayek's and Polanyi's models – was replaced by competition and confrontation. Though both talked of structural reform, neither model was actually updated. Instead, the pandemic-induced supply chain crisis accelerated implementation of protectionist measures, from reshoring or friend-shoring business investments to export restrictions. The Russian invasion of Ukraine and Western sanctions have further accelerated this process and, through the weaponization of media, finance and trade, made escalation and greater uncertainty inevitable.

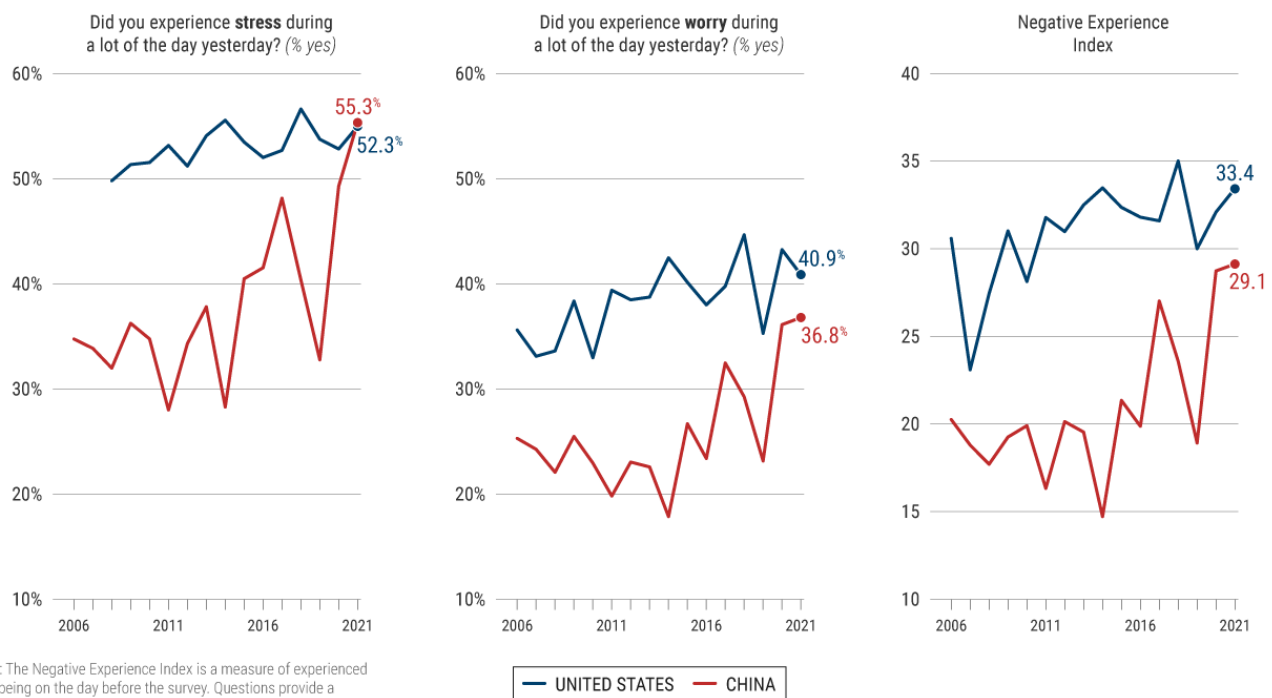
To Change the World, China Must Change

Both the U.S. and China are now scrambling to save and reform their governing models, the foundation of their development and their influence over the global economy. In fact, it is striking that Americans and Chinese are both experiencing very negative feelings about their personal well-being. (In China, negative feelings about personal well-being are at a record high.) Both are worried about the future, and confidence is broken. All of this indicates that their respective socio-economic models need to adapt. The West (especially the U.S.)

is experiencing high inflation and faces the prospect of an unprecedented energy crisis beginning this winter, given European dependence on Russian piped natural gas. The U.S., Europe and Japan are attempting to tackle their economic problems together, gathering in the G-7 and EU formats, which may serve as a basis for common solutions.

China, on the other hand, finds itself relatively isolated. The most urgent task of this year's party congress is to restore economic growth. But China depends

Stress, Worry and Negative Experiences in the U.S. and China



To Change the World, China Must Change

too much on the U.S. market to risk Western sanctions if it gets too close to Russia. At the same time, the U.S. is no friend either, recently tightening its grip on the semiconductor industry. The biggest obstacle to China's recovery is its zero-COVID policy, but because of its association with President Xi Jinping, it can't be openly questioned. In addition, the poor quality of China's COVID-19 vaccines and low vaccine uptake among the most vulnerable cohorts complicate re-opening. (Beijing may turn to even greater coercion to vaccinate the population, a potential threat to regime stability.)

While the U.S. (and the West generally) dumps military and financial aid into Ukraine and distributes money at home to address soaring energy prices, China is limiting its external funding to projects like the Belt and Road Initiative, the keystone of China's strategy to build up its influence in Eurasia and beyond. Xi unveiled his Global Security Initiative, a plan for a new global order, earlier this year, but it is heavy on principles and light on details about how to achieve them. Beijing can try to shape global and regional institutions to serve Chinese interests – by, for example, lobbying for more state sovereignty over the inter-

net – but it is not clear that its ideology would have the same appeal without massive funding to back it up.

The struggle between the American and Chinese socio-economic models will continue over the coming months as the global economic war intensifies. China understands the risks of a direct confrontation with the U.S., and so it will avoid it. In its attempt to rewrite the global rules, Beijing prefers subtlety (such as working within the United Nations) over Russia's more direct approach. For example, China successfully lobbied to have the U.N. Human Rights Council begin to prioritize collective rights, such as guarantees of economic subsistence, over individual liberties like freedom of speech and association. At the same time, China could look to ensure a greater role for itself in the Indian and/or Arctic oceans, where norms are more pliable than in the Atlantic or Pacific. In this way, China can set its own boundaries for international trade and investment, and thus for the global economy.

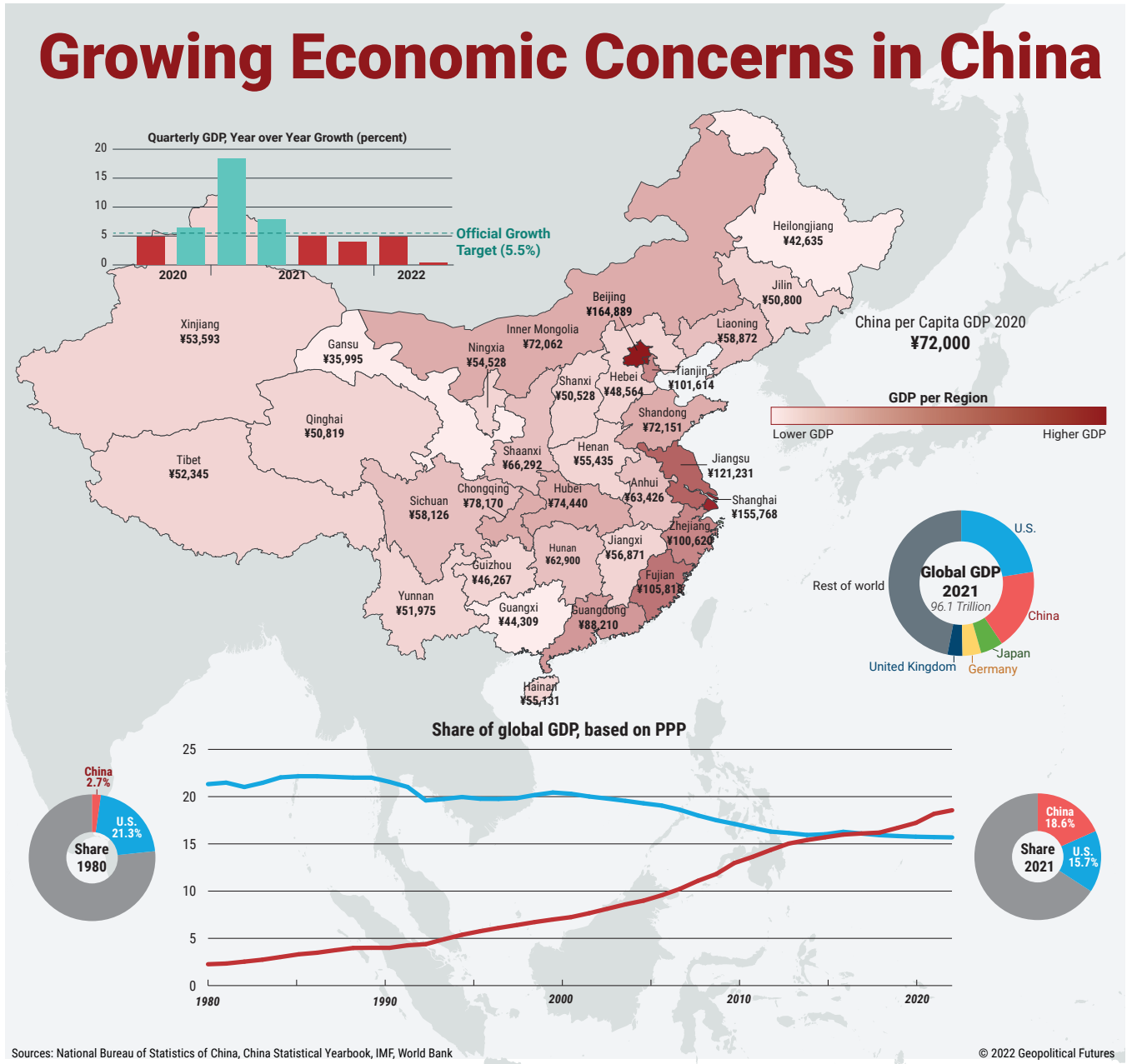
To succeed, however, China must remain stable internally, and that requires a reform of its Polanyi-style model. This is why the current Communist Party

To Change the World, China Must Change

Congress is important. Whoever China appoints as its leaders at the end of the week, the success of the party to reform the Chinese socio-economic model will determine the country's role in shaping the global system.

China's Missing Economic Data

Growing Economic Concerns in China



As China's growth has slowed, its statistics have become less transparent.

China's Missing Economic Data

China's third-quarter economic data, including gross domestic product figures, were due to be released Oct. 18. The day before the scheduled release, however, publication was delayed indefinitely. Indeed, over the past decade, as China's GDP growth has slowed, it has become less transparent.

Since late 2021, China's various economic issues, exacerbated by frequent and often abrupt pandemic lockdowns, have trapped Chinese GDP growth below the official target of 5.5 percent. For example, China grew by just 0.4 percent in the second quarter of 2022, despite strong growth in coastal provinces. Setting aside hopeful notes from President Xi Jinping and other top officials at this week's National Congress, China's Q3 data is still expected to paint a dire picture of the future.

UK Energy Costs Are Through the Roof

WINTER IS COMING...

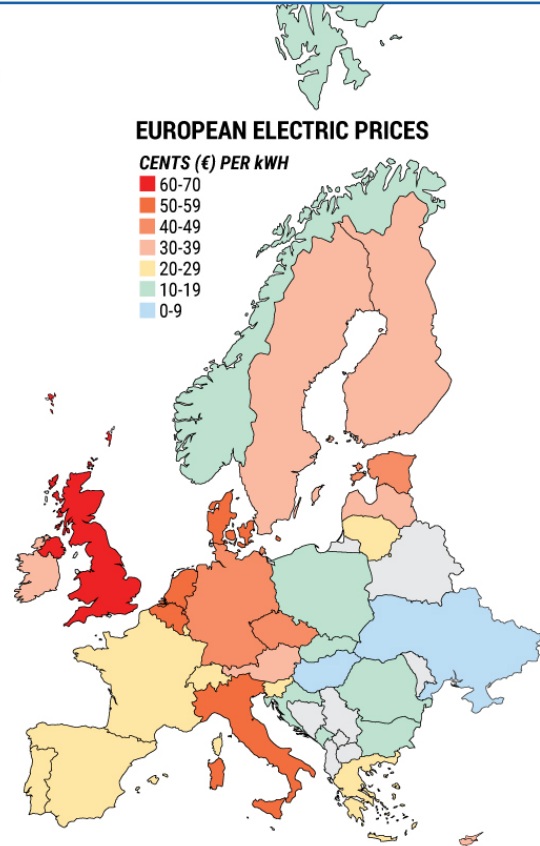
UK ENERGY RATES WINTER TO WINTER

	October 2021	April 2021	October 2022	Winter to winter, % change
Electricity unit rate, £/kWh	0.21	0.28	0.52	+148% ▲
Gas unit rate, £/kWh	0.04	0.07	0.15	+275% ▲
Electricity standing charge, £/day	0.25	0.45	0.46	+84% ▲
Gas standing charge, £/day	0.26	0.27	0.28	+8% ▲

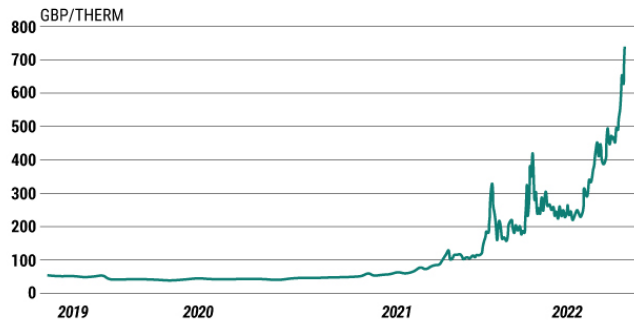
EUROPEAN ELECTRIC PRICES

CENTS (€) PER kWh

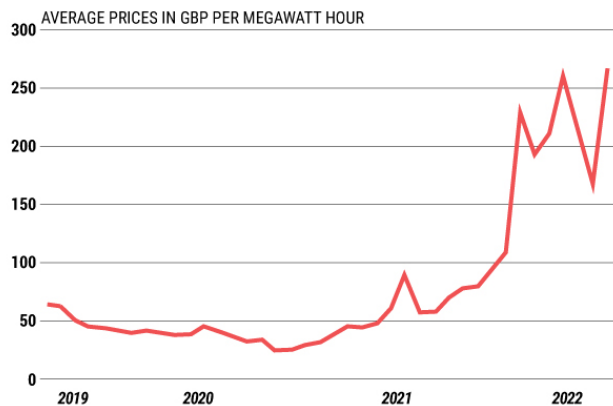
- 60-70
- 50-59
- 40-49
- 30-39
- 20-29
- 10-19
- 0-9



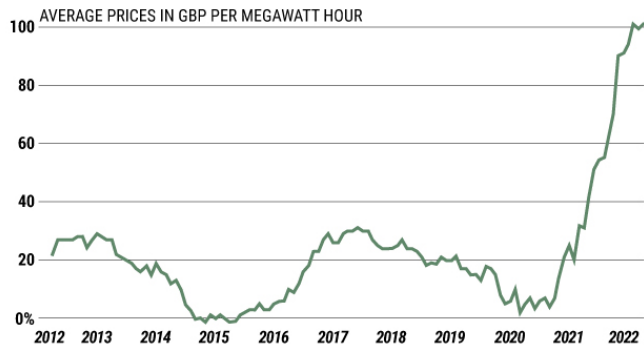
RECORD HIGH UK GAS PRICES



UK ELECTRICITY PRICES SPIKE



UK INFLATION HITS DOUBLE DIGITS



Sources: Household Energy Price Index (HEPI), Ofgem, ICE, Statista, Office for National Statistics

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A price cap is set to expire in April.

UK Energy Costs Are Through the Roof

Following the downfall of another prime minister and the British pound's collapse to its lowest level ever against the dollar, the U.K. urgently needs to tackle energy prices. In June, regulatory body Ofgem reported that more than 2.3 million British households are behind on their electricity bills and 1.9 million are behind on gas bills. Both figures are some 70 percent higher than at the end of 2020.

As part of her doomed mini-budget, the former prime minister, Liz Truss, introduced a bill to cap energy costs for consumers. Estimates of the program's costs ranged from 60 billion to 150 billion pounds (\$70 billion to \$175 billion). It was supposed to last two years, but the new finance minister said it will now expire in April 2023. With the U.K. already in an economic crisis, the government will have its hands full dealing with the social fallout when the price cap ends.

Good News and Bad News for the Russian Economy

By Ekaterina Zolotova
October 31, 2022

*Silver linings can't paper over nearly
irreconcilable costs.*

Good News and Bad News for the Russian Economy

Years before the Russian war in Ukraine – in fact, years before Russia was even under sanctions – authorities in Moscow faced criticism from their constituents for “selling” the country’s resources and companies to foreign interests. The concerns were well founded: Foreign chains entered the market, gradually gained popularity and eventually conquered their markets, however niche, oftentimes becoming the largest companies in their respective industries.

Today, many of these companies are leaving, sometimes selling their businesses. The silver lining for Russia is that this allows Russian entrepreneurs to fill the void, even as businesses can skirt sanctions by importing goods from third-party countries. And so, after eight months of war, Russia seems to be adapting to new realities but continues to face logistical difficulties and general uncertainty, as evidenced by slowing production indicators and scrupulous preparation of upcoming federal budgets.

Better Than It Looks

Russian sanctions have been in place since 2014, but rarely did they affect the

daily lives of ordinary citizens. The lone exception was agricultural products, which were replaced easily enough by domestic production and imports from Eurasian Economic Union countries. All the while, international companies continued to operate and even open new branches. Still, Moscow took steps to substitute imports of sensitive goods, knowing that the conflict in Donbas – which was largely responsible for the imposition of sanctions in the first place – was unresolved and any intervention in it could lead to tougher sanctions.

But the new sanctions levied after the invasion were much more severe in that they dramatically reduced what Russia could import. (Exports were comparatively less affected. In terms of value, they remain at high levels thanks to rising prices for raw materials and energy resources and to the pivot to Asian markets to offset losses in Europe.) According to preliminary estimates from Russia’s central bank, imports will fall by 32.6-36.5 percent by the end of the year. Meanwhile, foreign businesses took flight. By October, some 317 global companies left the Russian market, the most notable of which included Ikea, McDonald’s and Coca-Cola, which had

Good News and Bad News for the Russian Economy

a fairly large number of employees and some infrastructure and factories in Russia. Almost all major participants in the automotive industry have suspended operations at their production facilities. The disconnection of the SWIFT payment system, ideological disagreements with Moscow and, most important, logistical difficulties with the delivery of goods have called into question the prospect of conducting business in Russia henceforth.

It's not an ideal situation for Russia, of course, but it's not as bad as it may sound. For one thing, not all companies completely stopped their activities. Some either reduced investment and marketing programs, or temporarily froze operations until the dust settled. Many of those that have left have been replaced by Russian businesses. For example, Russian companies have replaced departed soft drink makers and restaurants, and Russian clothing brands have even found their way to the market. And naturally, these businesses employ workers the same way the old ones did. The formula for success seems to be to focus on the domestic market, shore up a little money, capitalize on good connections with countries

in the post-Soviet space and, as important, be creative.

For another thing, some companies that left the Russian market in 2022 are already returning, even if they must do so under a different name. Reebok, for example, has made its way back under the auspice of a Turkish holding company called FLO Retailing Turkey.

Finally, businesses have created parallel imports and have used them effectively. In fact, after sanctions were imposed there was a marked increase in exports with trade partners in Russia's near abroad. In the first half of 2022, exports from Armenia to Russia increased by 49 percent compared to the same period last year. Georgia increased trade turnover with Russia by roughly 50 percent while increasing exports to Russia by 11 percent. Imports from Kazakhstan rose by 30 percent. In other words, Russians can still buy an iPhone 14 or spare parts for their cars, and drink Coca-Cola, and fly out of the country using the services of other airlines.

*Good News and Bad News for the Russian Economy***Threats Remain**

Even so, Russian industry isn't out of the woods. In 2020-21 Russia recorded an increase in dependence on imports. The share of imports for non-food consumer goods such as clothes, shoes, appliances, cosmetics, etc. ranged from 40 percent to 90 percent, depending on the industry. (This ignores the fact there are simply no alternatives to some lost imports.) And there has been severe damage caused by the restriction to export products that Russia produces inefficiently: electronics, computers, components for the aerospace industry and other IT products. Even parallel imports cannot offset the damage. For example, because some foreign distributors have stopped cooperating with Russian partners, Russian companies have begun to import microchips through unofficial suppliers, often with poor results: As much as 40 percent of the microchips they receive from China are defective, compared with 2 percent before sanctions. (Anecdotally, this has prevented Russia from introducing a new 100 ruble banknote into circulation because only 20 percent of ATMs can accept them.)

Moreover, new Russian businesses have been unable to recoup all the jobs lost by departing companies, which created work throughout the entire production line, employing drivers, cleaners and so on. Decreased production will magnify these losses. McDonald's accounted for about a quarter of all taxes paid by the food services industry, and its share of local purchases of raw food materials, food products, packaging, and cleaning and detergents once reached as high as 90 percent, thus providing 100,000 jobs at suppliers' enterprises. Enough time has passed since the closing, sale and launch of the restaurant chain under a new brand to create trouble for those who worked directly or indirectly for the chain. Larger, more established companies like McDonald's can withstand things like decreased demand, declining real wages due to inflation, and consumer reluctance in the face of uncertainty better than their replacements can.

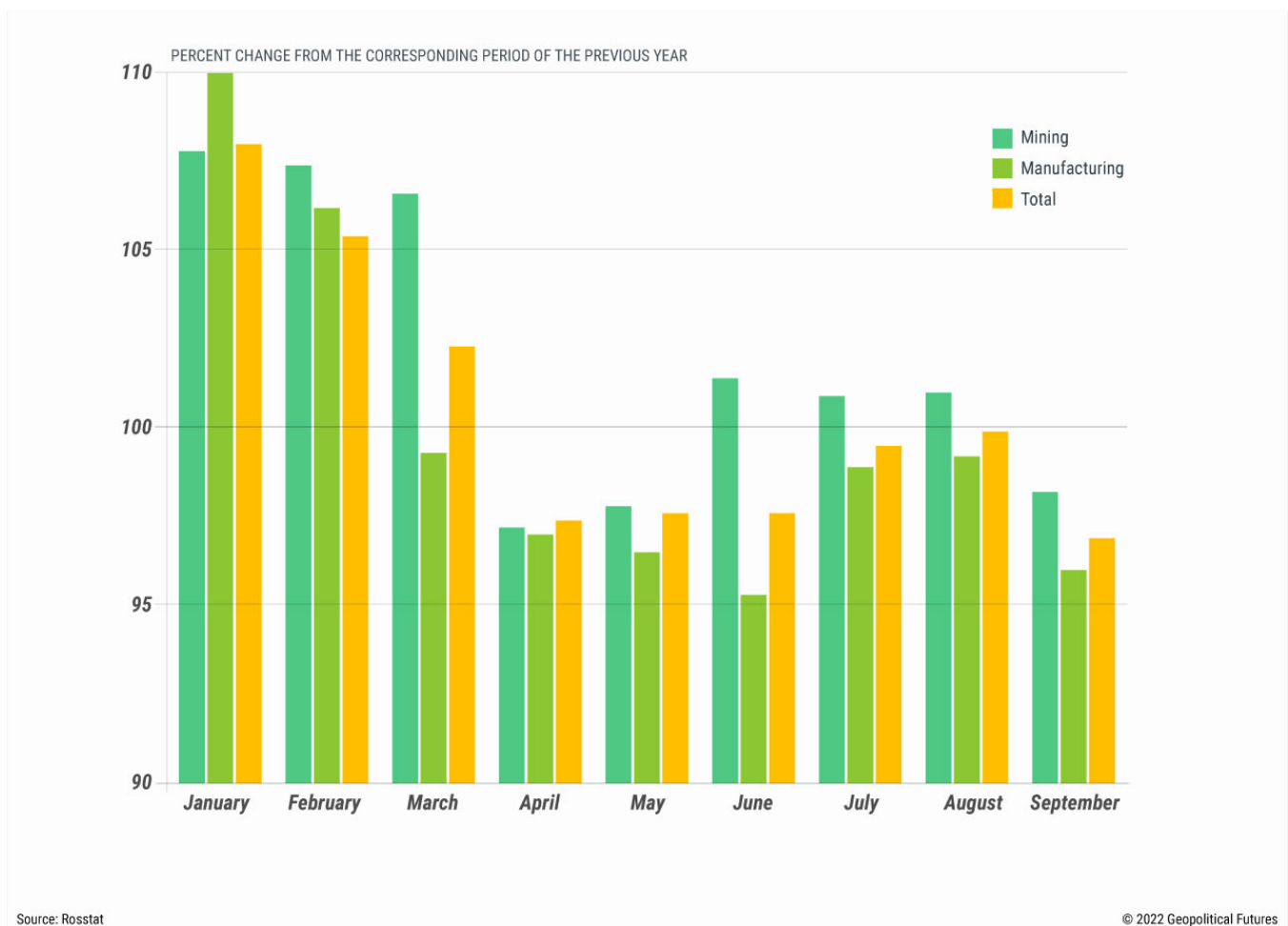
It's no surprise, then, that the threat of bankruptcy looms, even if it is not visible in state statistics. Bankruptcy growth rates decreased in January-September 2022 due to a moratorium on bankruptcy, but analysts nonetheless predict a wave of bankruptcies in 2023-24, includ-

Good News and Bad News for the Russian Economy

ing among large enterprises and even entire industrial groups. The cause: the general accumulated negative effects of the COVID-19 pandemic, the 2022 sanctions, the departure of an active and solvent population abroad, and the general drop in supply and demand in different markets.

This is reflected in the indicators of economic development. Industrial production decreased by 3.1 percent in September compared to September 2021 – the largest decline in two years. An even bigger decline was seen in manufacturing industries such as coal mining, metal ores, and even oil and natural gas production.

Russian Industrial Production Indices, 2022



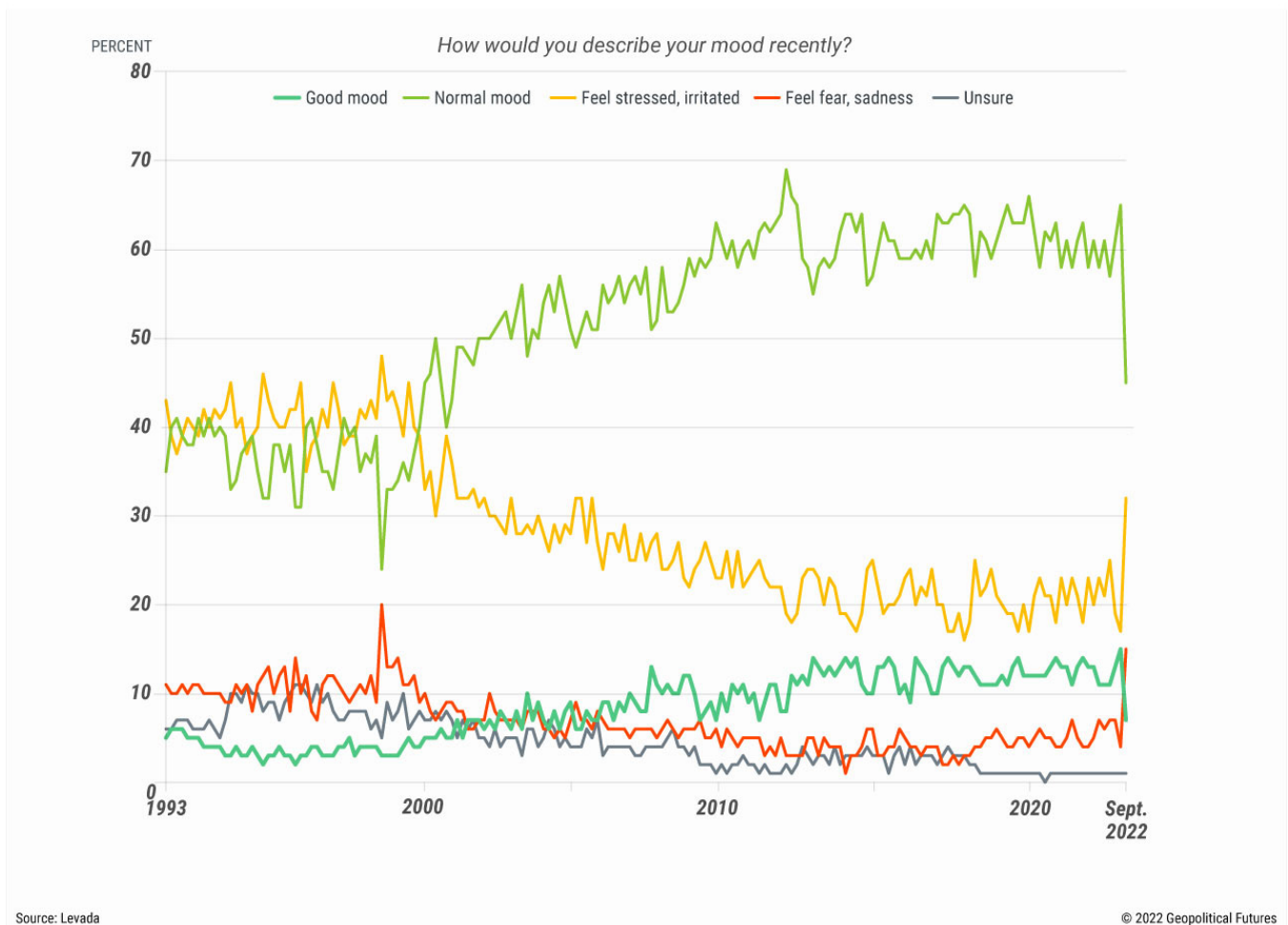
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Implications

The implications of Russia’s economic decline are many. One of Moscow’s most urgent geopolitical imperatives is to unify, as best it can, the largest landmass in the world, often redistributing income and subsidizing key industries to do so. The biggest threat to the Krem-

lin, then, isn’t NATO but the population itself. Russians remember all too well the economic calamity of the 1990s, and the fear of reliving it compels ordinary citizens to stock up on things like buckwheat and toilet paper, and to distrust banks and overreact to everything from a new wave of coronavirus to a possible nuclear attack, which puts even more

Russian Mood Score



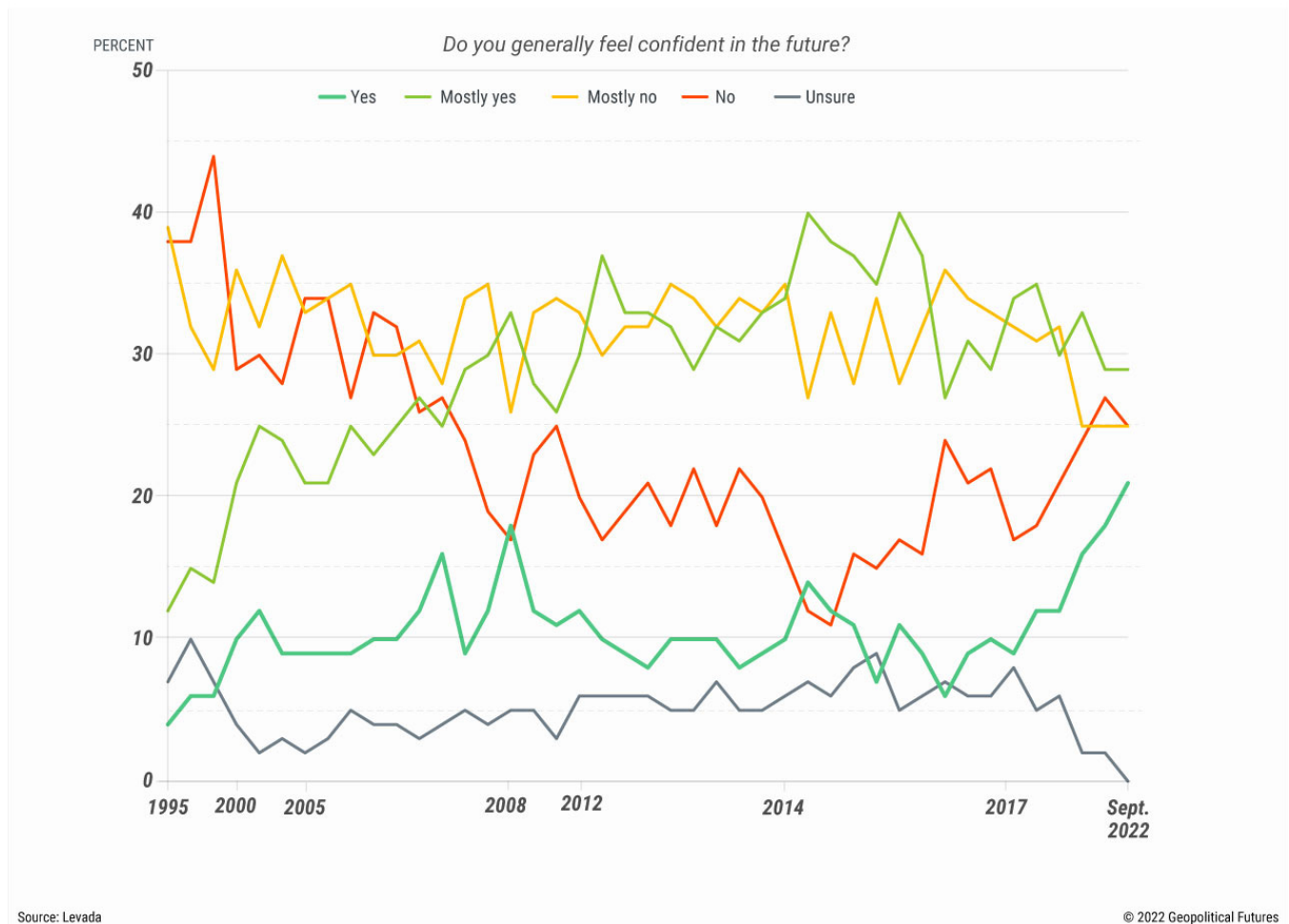
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pressure on the economy, government and infrastructure. According to a survey conducted by the Levada Center, public sentiment has deteriorated sharply. Tension, anger, fear and melancholy are rampant, at levels not seen since 2000.

This means that by the end of the year, the Kremlin will be facing three key chal-

lenges: completing a costly military operation that could damage, at least, the reputation of Russian leaders; coping with growing stress among the population and businesses alike; and diversifying exports. Each of these areas requires massive efforts and funding. The Kremlin understands that the Russian economy is entering a period of reces-

Russian Confidence in Future



Good News and Bad News for the Russian Economy

sion but expects it to be followed by a smooth exit, which will require investment and spending.

In the meantime, it faces the more immediate, more difficult task of planning the next few budgets amid a costly war, struggling businesses, an unhappy population and reduced imports.

There are many questions, and just as many opposing answers, about how to build the future economy. Some have proposed a State Defense Committee to lead all military and economic issues. But with a limited budget and the need to redistribute resources between

regions, save bankrupt industries and solve social issues, the militarization of the economy looks like an extremely expensive solution, not to mention the socio-economic consequences inherent in such an enterprise. The Kremlin has no choice but to make sure it has enough funds to overcome all three problems simultaneously. This is no easy thing, and obviously the Kremlin is in no hurry; it's biding its time, hoping the war in Ukraine tips in its favor. The most dangerous prospect will not be a budget deficit but an imbalance in all three areas, which will create an imbalance in the economy and in society.

MISSION STATEMENT

Geopolitical Futures understands the world through the rigorous application of geopolitics: the political, economic, military and geographic dimensions that are the foundation of nations. The imperatives and constraints contained in these define the nation. We study the past to understand the future. At its core geopolitics assumes, as does economics, that events are governed by these impersonal forces and not by individual whim or ideology.

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