Oxford Analytica

Public Webinar – Middle East and North Africa's looming food crisis

Introduction

Rising food prices, caused partly by higher energy and fertiliser costs, were stoking food insecurity even before Russia's invasion of Ukraine. That geopolitical shock has pushed prices still higher, and it raises the spectre of physical shortages in the Middle East and North Africa (MENA), one of the major destinations for Russian and Ukrainian grain exports. Rising prices and potential shortages of food will have a global impact but could be felt most forcefully in the MENA states. It could destabilise governments and tear at the fabric of societies, as was the case in the run-up to the Arab Uprisings and drive further migration to Europe. Given MENA's anchoring role in the global energy markets, massive destabilisation in the region would have global impacts. In this webinar, we ask our panel to analyse the drivers of rising food insecurity, to consider how the crisis is likely to manifest in different ways across the region and to explain why instability in the region could have a global impact.

Elizabeth Rust, Senior Analyst, Global Economics at FrontierView

According to the Food and Agricultural Organisation of the United Nations (FAO), food prices are currently at an all-time high. Following a trend over the past few years, prices rose throughout 2021, continuing in early 2022, following the reopening after the first COVID-19 lockdowns. The rapid reopening and sudden acceleration in global economic growth pushed up the demand for food commodities. The expectation of war in Ukraine also drove prices up, and the invasion on February 24 prompted an unprecedented surge. Weather disruptions are another significant factor behind the price rises. The FAO index reflects the prices of global commodities, but also how much consumers actually pay for their food; these prices are up 23% on the year. This underscores how food is feeding into high inflation globally. There is a risk that high food prices could lead to more social unrest, as food can be a high share of household consumption, particularly in low-income countries.

One of the reasons why the war in Ukraine drove up prices is because Russia and Ukraine account for a large share of food production in the world—they export 10% of global calories. The war has also disrupted planting cycles; Ukrainian exports are at a standstill. Russia and Ukraine account for one-fourth of globally traded wheat. They export large volumes of sunflower oil, and the export disruptions caused upward pressure on other vegetable oils because of the substitution effect. Global commodity markets are tight, meaning that any disruptions, even minor, can push prices up. Going forward, the outlook depends partly on the weather, which was poor at the beginning of the harvest season in North America. There is also some uncertainty regarding food export bans. When India imposed a wheat export ban, it sent a strong signal to the market and prices rose further. Regarding rice, the outlook is a bit more optimistic, with harvests in India and Thailand—top exporters of rice—are good so far.

The situation is also complex for fertiliser prices. Immediately after the start of the war, fertiliser prices increased. There are two main drivers: Russia and Belarus account for one-third of globally traded potassic fertilisers, and the impact of the war on energy prices led to a decline in fertiliser production in Europe. However, there is reason for optimism as benchmark prices have fallen because those products are not under sanctions. Nevertheless, geopolitical uncertainty means that the situation could change again.

Martin Keulertz, Environmental Management Lecturer, University of West England, Member of the Oxford Analytica Expert Network

The FAO food price index shows a similar picture to the situations in 2008 and 2011 in the MENA. A series of crisis means that the region was already struggling with food supply. Lebanon has been hit hard with an inflation rate of 200%, for instance. The correlation between increasing food prices and social unrest is strong. When prices rose in 2008, population discontent grew in Egypt, Somalia, Tunisia, Yemen, etc. In 2010-2011, it was even worse, and even though food insecurity cannot be entirely held responsible for the Arab Uprisings, it certainly contributed to social unrest.

The region is heavily dependent on the global market, especially as wheat is a key component of dietary habits in the region. In many countries, wheat is subsidised by the government. The region cannot grow its own wheat and predominantly imports it from Russia and Ukraine—in Egypt, 86% of wheat imports come from these countries and in Lebanon 96%. Russia and Ukraine are essential to global food production, because they have the right land—black soils—and water to produce wheat. Russian exports also played a big role in President Putin's strategy to gain influence in the region.

The region has already faced economic difficulties and is now confronted by a 'perfect storm' type of situation. The population is also quickly growing—it gained 85 million people since 2011. Growing food insecurity could also lead to more migration, particularly to Europe.

David Butter, Associate Fellow, Middle East and North Africa Programme, Oxford Analytica Region Head

The region is indeed very dependent on wheat imports, but there is some local wheat production. However, many countries have had a bad year in terms of harvest—Iraq has had bad weather and will need to import more. Some countries may be advantaged in terms of being able to bid in a global market where prices are soaring. Gulf states are in a strong position in that regard. Algeria is also heading towards a good wheat harvest and will be able to cut back on imports. Morocco is a big producer of phosphate, which is in high demand at the moment, so even though their oil and wheat import bill has increased, their revenues from phosphate and fertiliser exports have also risen.

Let us focus on Egypt. The country is the world's biggest importer of wheat, it consumes over 20 million tonnes of wheat per year, of which 12 million have to be imported. The basic use for wheat is bread, which is subsidised, and the price of bread has not been adjusted for a long time. This creates fiscal pressure when prices are rising. The government has been trying to maximise local wheat production for subsidised bread, but this is not in the farmers' interests, because they can get better prices selling their wheat on the non-subsidised market. Looking at Egypt's 2022-2023 food subsidy budget, it amounts to EGP90bn, accounting for 4.3% of total expenditure. Over half of the subsidy allocation is for the bread supply. Breaking down Egypt's bread subsidy, 8.6 million tonnes of wheat are needed to make the amount of bread they need. The government has increased procurement costs but not sufficient for farmers. In the budget itself, the allocation for bread subsidies was increased because of higher wheat import prices. However, this is likely to be an underestimate. The government has been talking about possibly increasing the price of bread, but during this crisis, with high inflation, it appears to be unwilling to do so; a decision with which the IMF agreed.

What also weighs on the budget is the accumulated public debt, and its cost of servicing. Egypt has maintained high interest rates. The budget totals around EGP2tn, of which EGP690mn is debt interest and it will continue to climb. Fuel subsidies are also going to be hit hard. Egypt cut fuel subsidies over the past years, but the government and the IMF agreed to index fuel prices. Diesel is still priced at 37 cents per litre, and this has not changed since 2019. Natural gas prices for industrial and electricity use are unchanged since early 2020 and fertiliser producers pay USD5.75/mmBtu.

There are several potential fiscal scenarios for 2022. It is likely that food subsidy costs will reach EGP150bn—50% higher than planned in the budget. The fuel subsidy costs could be four times higher than budgeted for, and interest payment costs could reach EGP800bn. The fiscal deficit could then reach 10% of GDP, rather than the 6.1% target. The deficit has been higher in the past, but the hard work that has gone into reforms over the past five years was supposed to improve the country's fiscal position. Egypt's good relations with the Gulf states, Europe and even Russia mean that it is probably able to pull through. Many other countries, such as Lebanon, will face much harder times.

Q&A

Will food prices will continue to go up exponentially, potentially by 50% by year end?

A 50% increase by year end is difficult to imagine. There could be more unexpected disruptions, but probably not something as drastic as the Russian invasion of Ukraine. So far, we are up 23% on the year, and there could be further increases in food prices, but not at same rate we have already been experiencing. We have not seen the full effects of the disruptions though, and a lot is still unfolding.

What are the prospects for food sovereignty or greater self-sufficiency?

Food sovereignty is popular in Lebanon, Jordan, Morocco, and many other countries in the region but the core problem is that farmers are so highly indebted that the only reason they stay is to pay back their debts. There is insufficient water. Cereals need to be imported in large volumes, which is normal, but the question is how much you want to import. Why is wheat so important to the region? A recent study showed that a sustainable diet in line with planetary boundaries by 2050 was very close to the Eastern Mediterranean diet. So, there is a need to address the food system to address food sovereignty, and it is important to return to traditional diets in the region, rather than use western dietary standards. This crisis may lead to further engagement on addressing food system change in MENA.

What sort of situation are Tunisia and Libya facing?

Tunisia has a similar profile to other North African countries, meaning it produces wheat, but that production only covers half of the country's needs. Both Tunisia and Libya are during chronic political crisis and instability. Libya can benefit from higher oil prices, but Tunisia is in a more vulnerable situation.

What is the role of speculation in current market turbulence? And what is the impact of the sanctions on Russia and Belarus?

All financial trading of commodities involves speculation about the future price of the underlying commodity, and that is particularly true for the food market, because it is traded in options and futures, not in spot prices. Speculation might be playing a role in driving up food prices, but the dominant effect is still the actual disruption. Regarding sanctions: Russia has been using this excuse, arguing that sanctions are preventing the country from bringing grain to the global markets. The idea is to scare European countries into lifting sanctions by talking about a potential migration crisis. Russia is likely overplaying its hand saying sanctions are the reason behind shortages, when truly, the country would be able to skirt sanctions and use loopholes to avoid sanctions. Food is not under any direct sanctions from the European Union or the United States. However, sanctions on shipping companies and banks make it harder for Russia. In any case, this is not the main factor driving prices up. A bigger factor would be the production being down by one-third in Ukraine and disruptions to Ukrainian exports.

How do you think the response to this crisis might have an impact on the Egyptian government's approach to governance and its agenda over the next couple of years?

The government has attempted to divert attention away from the crisis to attract large amounts of investment. This approach suited the Gulf states' role well, as they like to commit to long term investment. While some parts of the Egyptian economy are doing quite well (the Suez Canal is doing well, tourism will recover, money is coming in from remittances etc), high import costs and a current account deficit of USD20bn to finance mean that the fiscal and external financial situation remains precarious and will likely remain so coming into 2023. A large segment of the population is living under the poverty threshold and heavily rely on cheaply priced food, imposing costs on the state. This is a fragile balance, which means any disruption is something to be concerned about.

Where does Iraq get its food from? What is the food emergency legislation?

In 2020, Iraq procured most of its wheat from North America. Iraq has the interesting advantage of being close to Iran, a country which benefits from good relations with Russia. In global trade, it is common to see smuggling between countries where there is a scarce commodity. So, it is likely that the southern part of Iraq received some of its cereal's requirements from Iran. But Iraq is a challenging country to forecast, and whether the food emergency law will suffice is uncertain.