



POLICY BRIEF(er)

March 2022

THE GOOD NEWS: COVID APPEARS UNDER CONTROL. BUT...

Two years of contending with a global pandemic, anti-everything protests spreading throughout the world, and now a brutal war in central Europe. Just as the last wave of COVID wanes, another crisis wells up. Is this the violent and tumultuous 20th century repeating itself, or, as some have put it, history rhyming?

Looking back, we were so innocent in March 2020. Chaos has been a staple ever since. RIP 'normal' as the embodiment of stability and predictability. It was great while it lasted.

While hope for a repeat of the roaring 20's is something to cling to it is hardly a clear-eyed perspective on reality. So what is the near future likely hold?

END OF THE "WASHINGTON CONSENSUS"

No more Canada/Russia hockey series, for one.

Since the collapse of the Soviet Union in 1991, Russia has moved slowly, imperfectly, but steadfastly towards economic integration with the western world. And then the unthinkable occurred. Within a week's time of Russia's decision to invade of Ukraine, trade, investment, higher education, even sports ties, that took decades to forge,

have been severed, perhaps irreparably, for the foreseeable future.

The integration of the former Soviet Union into the international order over the past few decades (think the symbolism of the first McDonald's outlet opening in Moscow) has been unraveled with breakneck speed. Crippling sanctions imposed by most of the western world has frozen Russian assets and induced major western corporate players to halt Russian business dealings to minimize liability or salvage reputation and brand. Even the big oil companies — BP, Shell, ExxonMobile — have decided to jump ship after more than two decades of work and billions invested in Russia.

Unsurprisingly, the value of the Russian ruble has since plummeted and the Moscow stock exchange has severely restricted operations. With the Russian Central Bank no longer able to access most of its \$640 billion in foreign currency reserves, the country's economic forecast is bleak. As the sanctions intended.

But this fiscal contagion is unlikely to remain contained, as Russia works with China and India to evade western sanctions and re-establish the

gold standard (in defiance of the current global financial practice of recognizing the US dollar standard). There will be a ripple effect as global commerce adapts to the new realities. To add to market unpredictability, both the US and EU are scrambling to lessen their dependence on Russian oil and gas - with significant potential ramifications for Canada.

On the diplomatic front, once an aspiring superpower, Russia has become an international pariah. Russian aggression has galvanized and re-energized NATO. Finland and Sweden now favour membership, whereas before any threat posed by their eastern neighbour seemed distant. The German defence minister (from the Green Party, no less) recently announced US\$110 billion in new German military expenditures, reversing the country's pacifist policies adopted since the end of WWII. All western countries have pledged to supply updated military hardware to Ukraine to reinforce its defence posture.

Within a month, Russia has identified itself as the preeminent global threat around which all western nations have rallied. This spells the dawn of a neo-Cold War, as an Iron Curtain again separates eastern and western Europe. Vestiges

of international collaboration are now shuttered or on tenterhooks — from Russian membership in the G20 to joint administration of the International Space Station.

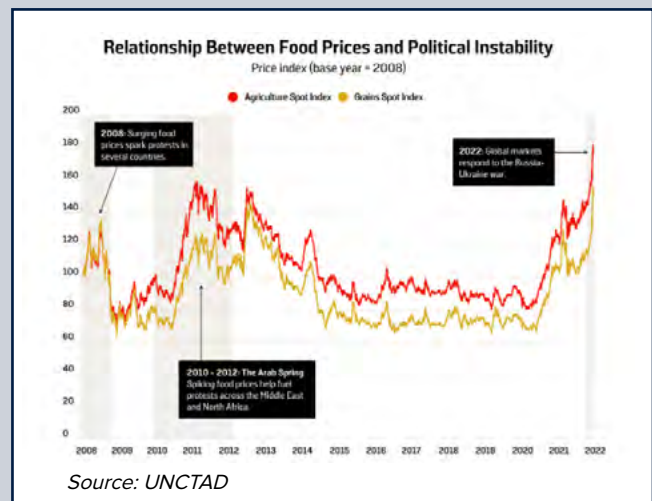
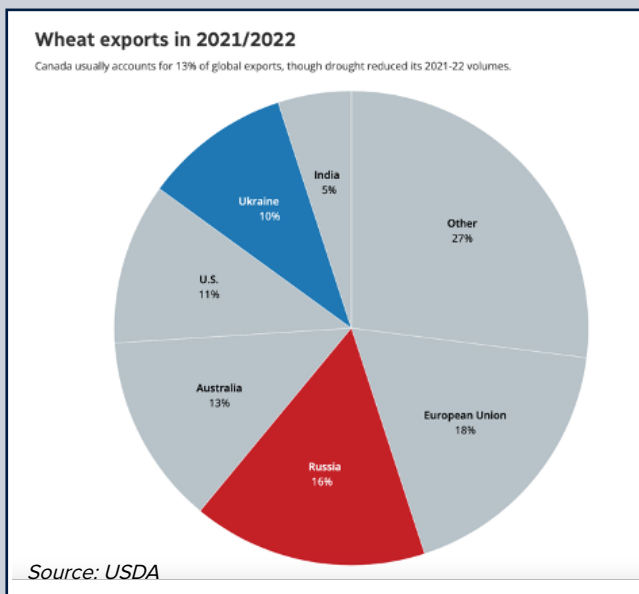
The Canada/Russia hockey series was emblematic of a now contestable theory that nations that trade (and play) together will tend towards peace and stability within a mutually beneficial international rules-based order. One of the first casualties of the invasion of Ukraine was this belief that markets will always trump politics.

INFLATION: THE POLITICS OF ECONOMICS

Global food production was already at issue, contending with flooding, drought, and disease. Now, throw war into the mix. The Russian invasion of Ukraine impacts the very heart of the fertile European 'bread basket'.

Together, Russia and Ukraine account for nearly 30 percent of global wheat exports, 17 percent of corn, 32 percent of barley, and 75 percent of sunflower seed oil (an important cooking oil in some parts of the world). Almost 30 countries depend on Russia and Ukraine for more than half their wheat imports.

With the war in central Europe projected to severely impact production, commodity prices



have jumped. Wheat prices have increased by 60 per cent since the start of February; corn prices by 36 percent; barley 82 percent.

Add to this a dramatic spike in oil and gas prices. Energy is at the heart of the food supply chain — from farm production to transportation, processing, packaging, storage, distribution and retail.

Simultaneous disruptions to global fuel supplies, fertilizer production and 2022 crop plantings all point to a perfect storm: food inflation. In the coming months, the UN Food and Agriculture Organization estimates that food prices will surge as much as 20 percent, possibly igniting a global hunger crisis.

The last time basic food prices spiked (wheat and rice in 2007/08), food riots broke out in almost 40 countries and led to the Arab Spring uprisings. The marked relationship between food shortages and political unrest is well documented, - the Flour Riots of Versailles [1775] and New York [1837]; Bread Riots of Richmond [1863] and Cairo [1977]; Arab Spring, Egypt [2008-2010] - leading to the observation that all revolutions start with bread. Or rather, lack thereof; signs signal more rhyming.

IMPLICATIONS FOR CANADA

The federal government will be forced to be more diligent about border security issues — such as territorial claims in the Arctic and NORAD. We often forget that Canada is effectively a border state with Russia.

As such, the federal government will be under greater pressure domestically and internationally to elevate its military spending priorities, as well as those attached to Canadian membership in international institutions and alliances. This translates into stronger resource commitments to support Canadian international obligations, competing for attention with domestic policy priorities. The recent Liberal/NDP accord may give the federal government some short-term

political runway within which to consider these hard choices.

Canadian businesses, for their part, will need to contend with ongoing (and escalating) supply chain challenges, as global commerce adapts and transitions to an unpredictable trading environment in this redux version of the Cold War. Growth aspirations that included Russia, China and perhaps India may need rethinking.

Similarly, with the lifting of pandemic restrictions came an expectation of a return to more robust economic activity as businesses re-opened and consumers acted on pent-up demand. The uncertainty and instability borne of a brutal war in central Europe, the uncertain future of a co-operative and rules based world order, and escalating consumer pricing may severely dampen those projections.

Instead, it may be necessary to recalibrate those pre-pandemic expectations for enduring and extraordinary prosperity (admittedly uneven and worsening pre-pandemic) that Canada and much of the world enjoyed for the past several decades. A difficult “re-shoring²” discussion must take place, particularly in key strategic sectors like energy, medical supplies and food. While a return to regional trade blocs does not necessarily undermine long-term economic prospects, it most certainly will mean an intensification of near-term inflationary pressures and continued pressure on national fiscal capacity as, for example, energy and food supply chain infrastructure is adapted and rebuilt. While there continue to be countervailing forces working against the “re-shoring” logic (e.g. wages and other input costs in developing nations) the imperatives regarding domestic resiliency and geo-political security must be considered in a stark new light.

For those hoping to witness the imminent ‘rhyming’ of the Roaring 20’s, *Sweet Georgia Brown* doesn’t look like it’s on the playlist just yet.