Global Counsel

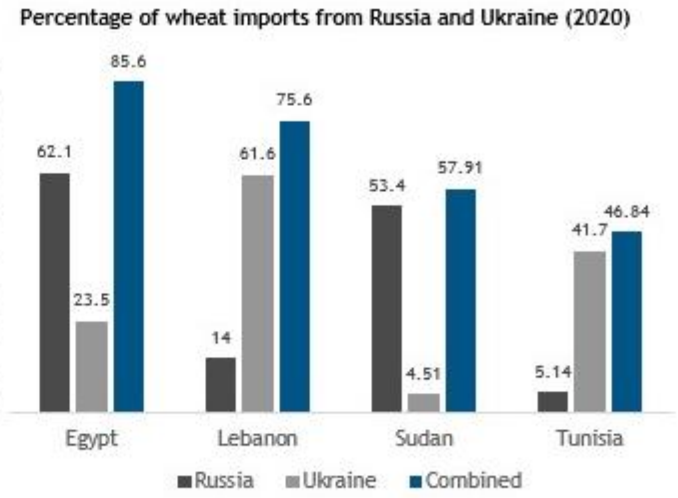
The Russia-Ukraine war threatens the MENA’s food security

Blog post by Practice Director Ahmed Helal – 20 December 2022

As the world’s largest grain-importing region in the world, the Middle East and North Africa (MENA) has felt acutely the impact of the Ukraine conflict’s disruption to global food production and exports. The MENA is an agro-ecologically diverse region, ranging from the Gulf, where there are no permanent rivers or lakes and minimal rainfall, to Egypt and Iraq, where river systems have supported agriculture for millennia. However, the region overall is the most water-scarce in the world, driving high levels of food import dependence. Gulf states, for instance, import between 80-90% of all the calories they can consume, and in some food categories, like cereals, they import 100% of their needs. Fiscal disparities between the region’s oil exporters and net energy importers are equally marked, with oil-rich Gulf states enjoying far greater purchasing power than their peers in North Africa and the Levant.

The heterogenous fiscal and agricultural profiles of MENA states explain their varying degrees of vulnerability to this year’s food and energy crises. High energy prices have generated a windfall for oil-rich Gulf states, largely cushioning them from historic spikes in the price of food commodities. Saudi Arabia, the largest oil exporter in OPEC, has this year recorded its first fiscal surplus in 10 years, while LNG heavyweight Qatar has seen its surplus jump 12-fold on account of record high gas prices. The financial health of Gulf states has allowed them to buy food commodities at any cost, without straining public finances.

In contrast, the region’s energy importers, such as Egypt, Lebanon and Tunisia, have seen their nascent economic recoveries from the pandemic derailed by a dramatic inflation in their food and fuel import bills. For two of the region’s most indebted countries, Egypt and Tunisia, an inflated food import bill has weakened their ability to finance debt service. The resulting pressure on dollar reserves has increased sovereign default risks, forcing both Tunisia and Egypt to turn to the IMF for bailouts. Lebanon had already defaulted on its debt in 2020 as the Beirut port blast and chronic economic mismanagement came to a head. With food inflation soaring above 300% in Lebanon this year, the World Food Programme must now provide food assistance to one in four people in Lebanon.



Source: OEC

The problems of Egypt, Lebanon, and Tunisia, moreover, are of both affordability and accessibility. Not only must they pay for dearer food imports, but their long-standing dependence on imports of wheat from Russia and Ukraine makes them especially susceptible to the collapse of food exports from the Black Sea region. Before the war, Egypt, Lebanon and Tunisia imported respectively 80%, 70% and 50% of their wheat needs from Russia and Ukraine. It was therefore no coincidence that the first grain-carrying ship to leave the Ukrainian port of Odesa in August (since the start of the war), under a UN-brokered deal, was destined for Lebanon and Egypt.

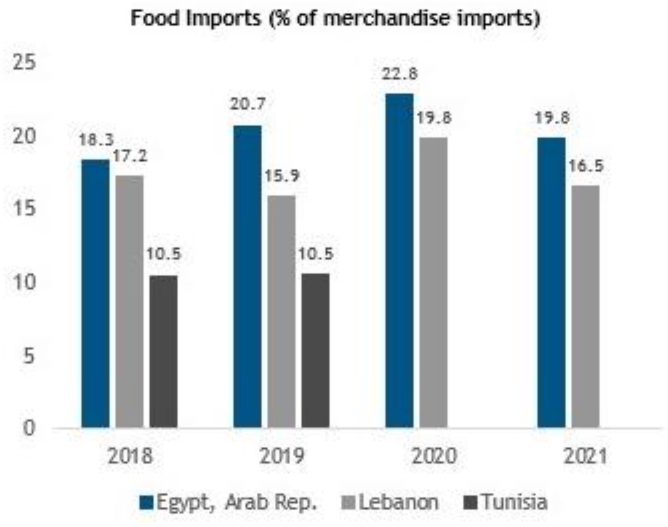
For Egypt, where hard currency earnings from the crucial tourism sector were just beginning to recover from Covid, the Ukraine-Russia food shock exacerbated a difficult economic context. As an emerging market, Egypt was impacted by the flight to safety of global investors that was sparked by Russia's aggression and major central banks' moves to fight inflation by hiking interest rates. Foreign portfolio investors have pulled some $22bn from Egyptian treasuries this year, sapping the country of a crucial source of budget financing.

Portfolio outflows, combined with unwieldy food and fuel costs, complicate the government's ability to pay for the $5.5bn in food subsidies that keep the price of food, especially bread, within the reach of Egypt's poor. Egyptians consume 150-180 kilograms of bread per capita, more than double the global average of 70-80 kg, making Egypt consistently the world's largest importer of wheat. Egypt, therefore, is particularly sensitive to the outsized role that Russia and Ukraine play in the global supply of wheat (together they account for 30% of global trade in wheat). Maintaining the affordability of the traditional flatbread known as eish baladi, Egypt's food staple, is a bedrock of regime stability. Food prices that shot to 50-year highs in 2011 drove food inflation of 19% in Egypt that year, helping fuel mass protests that ultimately ended the 30-year rule of Hosni Mubarak.

Soaring costs for food staples have threatened household-level food security in import-dependent MENA countries like Egypt, putting people's resilience at a "breaking point," as the UN's World Food Programme has put it. In Egypt, this is especially true for the 70mn Egyptians who depend on the government's subsidised bread programme for their sustenance. The impact on macroeconomic stability has been equally pronounced. Given that food imports represent around 20% of Egypt's overall imports, the country's level of foreign exchange (FX) reserves expressed as months of import coverage is a good proxy for the sustainability of Egypt's external balance, especially as it relates to food security. In September 2022, Egypt's FX reserves stood at 3.7 months of import coverage, down from 4.9 months in January. While Egypt's reserves have not fallen below the IMF's "rule of thumb" level for emerging markets of three months of imports, Egypt's falling reserves have weakened the government's ability to fund debt service – highlighting the economic fallout of the food crisis.

Simultaneously, higher interest rates have increased Egypt's debt-servicing burden, putting further pressure on its dollar reserves. Thus, Egypt's sovereign debt has traded at distressed levels this year, defined by yields more than 10 percentage points above that of similar-maturity US Treasuries – indicating investors' belief that default is a real possibility. Egypt has avoided this scenario, which would have been reminiscent of Sri Lanka's first ever sovereign default in April, thanks to $22bn in support it has secured from its Gulf allies Saudi Arabia, the UAE and Qatar, as well as a $3bn loan from the IMF.

Egypt is representative of what its food import-dependent peers across the MENA are experiencing (the oil-rich Gulf is an exception). Tunisia and Lebanon are both also in fraught talks with the IMF to secure bailouts from the Washington-based lender. With the global food crisis set to worsen in 2023, there is no reprieve in sight for the region's weaker economies. The prices of fertiliser and other farm inputs remain elevated and the destruction of Ukrainian farmland as a result of Russia's aggression will undercut supply from a key global breadbasket. The impact on this year's planting season means that today's crisis of affordability could next year evolve into a crisis of availability. The instability of export channels from the Black Sea, as demonstrated by the latest setbacks in implementing the UN grain export deal, compounds the situation.



Source: World Bank

With the recent memory of food prices contributing to the Arab Spring uprisings, the region's governments sense the urgency of adopting drastic measures to address food inflation at its roots. The economic fallout of this year's food crisis has shone a light on the dangers of the region's food import dependence. As climate variability plays havoc with agricultural systems the world over, the Russia-Ukraine crisis demonstrates that MENA governments should prepare for the spectre of multiple breadbasket failures. In the first instance, this will require diversifying away from a concentration of grain imports from any single region, notably the Black Sea.

A more fundamental point is diversifying away from wheat-based diets that drive the region's massive wheat imports; incentivising the cultivation of local species of grains would promote biodiversity and improve nutritional outcomes while helping diminish the world food system's overdependence on wheat. Food loss and waste (FLW) in the Arab world is less frequently discussed, but a potent threat to food security in the region. Policies need to address FLW across the entire value chain, from the early stages (production, handling, processing, and distribution), to the consumer and retail levels. Reducing food loss and waste would help replace expensive food imports, freeing up fiscal resources to fund a social safety net for the region's most vulnerable households.

In parallel with domestic measures, MENA governments need to remain engaged in international food trade and diplomacy through multilateral bodies like the World Trade Organisation (WTO) and Food and Agriculture Organisation (FAO). Maintaining the multilateral food trading system and avoiding the kind of export restrictions that occurred during the 2007/08 global food crisis will prevent artificial shortages of key food commodities – crucial to the food security of the MENA region.