

Delphi Economic Forum VII: New realities

In-depth analysis and forecasting from
the Oxford Analytica Daily Brief



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Foreword

As the world is becoming more and more uncertain, we persistently rely on expert analysis and top-tier intelligence to navigate through the complex problems and emerging new realities in government, business and geopolitics. This is the essence of the Delphi Economic Forum and the underlying reason we invest time and energy to put together an event of such calibre every year.

In this spirit, we have partnered with one of the world's most prominent analysis and advisory firms, Oxford Analytica.

We are happy to be able to share their first-class insights and commentary with guests and speakers of the Delphi Economic Forum. Going through this document, we hope guests can find a short synopsis of the general themes and issues we will be exploring together in the next few days. We sincerely hope we can build on this partnership and keep bringing you more outstanding content in the future.

We hope you have an enjoyable read and wish you a great experience in the Delphi Economic Forum VII.

Yiannis Thomatos,

Executive Vice President, Head of Strategic Initiatives,
Delphi Economic Forum



Yiannis Thomatos
Executive Vice President,
Head of Strategic Initiatives,
Delphi Economic Forum

Introduction

2022 was supposed to be a year marked by the waning of the COVID-19 pandemic, with economies fully reopening and policymakers focused on managing debts and dealing with rising inflationary pressures.

For Europe in particular, Russia's invasion of Ukraine reset the outlook overnight. Concerns over the cost of living have been exacerbated by spiralling energy prices and the near-term prospect of a permanent rupture in relations with Russia, heretofore Europe's main external energy supplier. The unprecedented sanctions on Russia complicate the situation of many EU companies and increase the threat of a recession later this year. The Union now faces an agonising reappraisal of its security policy, defence posture and approach to relations with Moscow—and Kyiv. A refugee crisis is well underway. While many European states have opened their doors to Ukrainian refugees, it would not be a surprise if burden-sharing soon became an issue between them.

The risks on which we were all focused until late February have not gone away. Central banks that for years struggled against deflationary pressures now face a battle to tame inflation rates last seen in the 1980s, without choking off the recovery or making life more difficult for households facing rising prices. In emerging markets, some countries and many more companies will struggle to pay their debts as interest rates rise globally.

The pandemic exacerbated global inequality and left the poorer, the less well-educated, women and minorities at a disadvantage. Dramatic action is also needed, in this decade, to decarbonise economies if the world is to have any chance of capping the rise in global temperature from pre-industrial times at 1.5 degrees Celsius.

Russia's war on Ukraine reframes some of these challenges; it threatens to reduce the attention that can be given to others. Yet it could also, possibly, provide a powerful catalyst for decisive action.

If you have any questions arising from any of the articles included here or would like to know more about our services at Oxford Analytica, please get in touch with us at oxan.to/delphicontact.

Nick Redman,

Director of Analysis, Oxford Analytica



Nick Redman
Director of Analysis
Oxford Analytica

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Mid-war, Russia sets near-impossible peace terms

Friday, March 18, 2022

The Russian president has reiterated maximalist demands while daily negotiations inch towards an agreement

Ukrainian and Russian negotiators are expressing cautious optimism about a possible agreement that could end the war. Although the substance is being kept confidential, both sides have outlined some of the areas being discussed. Notably, Kyiv is willing to renounce NATO accession. However, irreconcilable differences remain on many other points. The talks have had no effect on the level of violence: Russian aircraft and artillery continue to bombard civilian areas.



A Kyiv resident carries his belongings after his apartment block was damaged in a Russian strike, March 18 (Felipe Dana/AP/Shutterstock)

What next

The likeliest area of compromise is on Ukraine's NATO aspirations, but this will not be enough. There is no evidence that Moscow will honour a peace agreement, if one emerges. Even if Russia's negotiators are acting in good faith, their leaders may be using the process to gain more time for troops to regroup, rebuild and continue the invasion. President Vladimir Putin seems determined to pursue his war.

Subsidiary Impacts

- Russian troops do not appear to be advancing, and continued losses will make even a standstill unsustainable.
- Unless a Russian onslaught forces a surrender, Zelensky has gained a level of popularity that should ensure his political longevity.
- Indiscriminate attacks on civilians will consolidate lasting hostility towards Russia, undermining its chances of future governance.

Analysis

Bilateral talks were mooted soon after the Russian invasion started on February 24. It took until February 28 to convene a first round. Despite Kyiv's initial reservations, three rounds took place in Belarus before moving to video-conferencing (see [RUSSIA/UKRAINE: Talks optimism belied by realities - March 14, 2022](#)).

Separately, Ukrainian Foreign Minister Dmytro Kuleba met his Russian counterpart Sergey Lavrov in Turkey on March 10, but this produced nothing, not even the 24-hour ceasefire that Kyiv requested (see [RUSSIA/UKRAINE: Shift in Russian tone offers slim hope - March 10, 2022](#)).

Diverging positions

Negotiators have agreed not to comment on preliminary outcomes or even the issues being discussed, so little is known about the substance.

Nevertheless, the starting positions are fairly clear: Ukraine wants an end to the Russian troop presence and indiscriminate attacks, and Russia has a clear (though slightly shifting) menu of core demands.

In an address late on March 15, Zelensky said negotiators seemed to be adopting "more realistic" positions.

The terms of a deal are confidential but there are no real surprises

The Financial Times on March 16 quoted people involved in the talks as saying there was "significant progress" on a 15-point plan.

Ukraine's lead negotiator and presidential adviser Mykhailo Podolyak said the Financial Times report referenced only a draft reflecting Russia's demands. "The only thing we confirm at this stage is a ceasefire, withdrawal of Russian troops and security guarantees from a number of countries," he said.

Putin called Turkish President Recep Tayyip Erdogan on March 17 and outlined Russia's demands. Erdogan's spokesman Ibrahim Kalin told the BBC the main demand is neutral status for Ukraine; others cover past ground including a renunciation of Kyiv's claim to its sovereign territory in Crimea and eastern Ukraine.

Russian withdrawal

Podolyak told the Financial Times that the terms of a peace settlement would require Russian troops to withdraw from territory occupied since the invasion began. This is the foundational issue under discussion.

Humanitarian issues

Kyiv has been trying to steer the talks towards discussing an immediate ceasefire and humanitarian corridors.

This has largely failed: agreed safe routes out of besieged cities have been repeatedly attacked by Russian forces.

Neutrality

Formal neutral status for Ukraine, with no NATO accession, is the one point on which there seems to be clear agreement. Zelensky has effectively conceded this. Speaking to Western military officials on March 15, he said: "We have heard for years that the doors were open, but we also heard that we couldn't go in there. That is the truth and it has to be recognised."

Kremlin spokesman Dmitry Peskov said on March 16 that neutral status could be modelled on Austria or Sweden.

Neutrality will not be popular in Ukraine, and Zelensky will suffer opposition criticism.

'Demilitarisation'

According to the Financial Times report, Ukraine would retain armed forces but would not host foreign military bases (which it has never done).

If agreed, this would address one of Moscow's initial demands, for 'demilitarisation', but presumably not in the way the invasion plan envisaged -- the destruction of most or all military hardware and infrastructure.

Security guarantees

In return for neutral status outside NATO, Ukraine would get security guarantees from Western governments.

Designing these Western security guarantees will be problematic. They would need to be stronger and more substantial than promises made in the 1994 Budapest Memorandum on Security Assurances, which prohibited military action against Ukraine and which Moscow has so patently flouted.

Podolyak speaks of a "Ukrainian model" which would require specified guarantor states to intervene immediately in the event of a future foreign incursion.

Crimea, Donetsk and Luhansk

According to Russia's chief negotiator Vladimir Medinsky, speaking on March 16, one of Moscow's key concerns is for Kyiv to recognise Russian sovereignty over Crimea, annexed in 2014, and acknowledge the independence of the Donetsk People's Republic (DNR) and Luhansk People's Republic (LNR), which declared autonomy in 2014 and which Putin recognised as sovereign states on February 21 (see [RUSSIA/UKRAINE: Invasion may follow eastern occupation - February 22, 2022](#)).

A further complication is that Putin recognises the DNR and LNR as having the borders of the entire Donetsk and Luhansk administrative regions, rather the smaller area held by the rebel forces prior to February 24.

Russia wants Ukraine to approve its illegal land grabs

Ukraine has not indicated it is prepared to move on this issue. It is just possible these obstacles could be put aside temporarily: Podolyak says these territories are "a separate case" from the overall Russian withdrawal issue.

Politics

Almost in passing, Medinsky mentioned another core demand, 'de-Nazification', which Putin had cited (with 'demilitarisation') as justification for the invasion (see [RUSSIA/UKRAINE: Offensive looks like all-out invasion - February 24, 2022](#)).

It is unclear what Moscow now means by this: coercive regime change; a Russian say in government formation; or something else.

Another point raised by Medinsky offers more scope for compromise: improved status for the Russian language and the "position of the Russian-speaking population". The former is possible; the latter is more difficult to define than Moscow believes: many native Russian-speakers count themselves as fully Ukrainian, and language identification does not equate to pro-Moscow sentiment.

Outlook

There is muted optimism and an apparent readiness to negotiate on both sides. Putin told Erdogan he would need a face-to-face meeting with Zelensky to finalise a deal. The Ukrainian leader has previously called for such a summit.

In the real world, it is almost inconceivable that core differences can be resolved in a consolidated document. Russia is unlikely to concede on its major demands, and is half-way through a war which has its own momentum (see [RUSSIA/UKRAINE: Campaign failures stem from errors - March 11, 2022](#)).

If a document does emerge, it is difficult to believe that Moscow will honour it. A full troop withdrawal is an essential component, and that will look like defeat if it is patently evident that Putin's justifications for war -- 'demilitarisation' and 'de-Nazification' -- have not been achieved.

Putin's mood appears to be worsening. At a March 16 meeting he made it clear a war was taking place at home, too -- an existential struggle to "remain Russia" fought between true patriots and "national traitors" (see [RUSSIA: Putin uses single law to kill off free media - March 7, 2022](#) and see [RUSSIA: Kremlin tries to shut out dissenting voices - March 2, 2022](#)).

That is not the mindset of a leader considering the difficult and messy compromises needed to end his Ukrainian incursion.

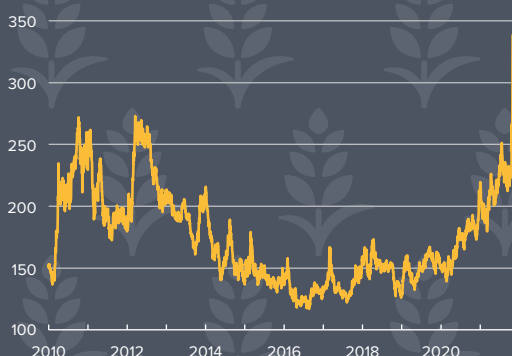
March 8, 2022

Persistently high food prices may spark social unrest

Cereal grains such as wheat provide essential sustenance to humans and animals; price surges raise risks of food crises

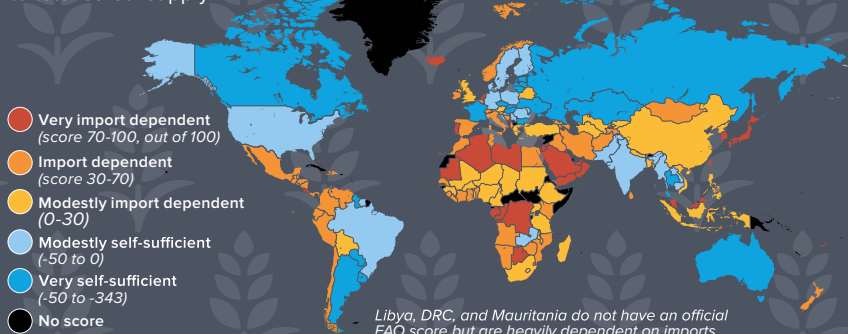
The Middle East and North Africa (MENA) are especially vulnerable to soaring cereal prices

S&P Goldman Sachs wheat price index for three months ahead



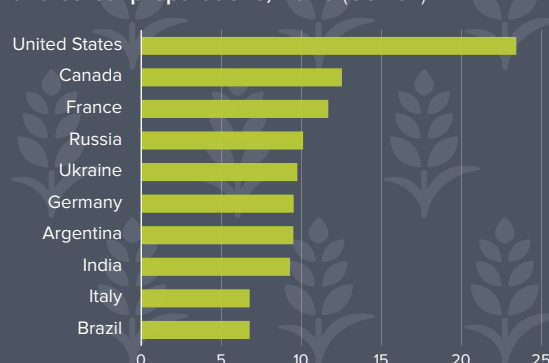
Cereal import dependency ratio, 2020

The ratio of cereal imports to total cereal supply

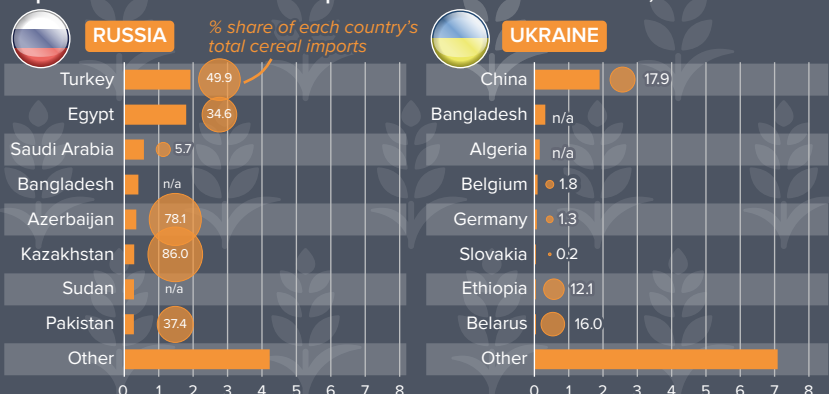


Russia and Ukraine are among the top five exporters of cereals, especially to MENA, China and Central/South Asia

Top ten exporters (including re-exports) of cereals and cereal preparations, 2020 (USDbn)



Top destinations for cereal exports from Russia and Ukraine, 2020



Prices of cereals will jump in March, having risen by 3.0% month-on-month and 14.8% year-on-year in February, according to the UN Food and Agriculture Organization.

Russia and Ukraine are among the top five exporters of cereals. The invasion will disrupt planting in Ukraine, cut exports and greatly disrupt the harvest. Russian output may also be affected, if economic sanctions reduce available credit or restrict the ability of farmers to buy essential inputs and make or receive payments.

MENA, China and Central and South Asia buy substantial quantities of Russian and Ukrainian cereals. Research on food and political stability shows that rising prices of staples such as bread can spark political unrest.

See also: [Rising power prices raise risk of economic instability](#) -- February 21, 2022
[Pandemic to deepen food insecurity beyond 2020](#) -- May 13, 2020

- More spending on costlier but essential food and energy will hit purchases of discretionary goods and services, cutting global GDP growth.
- Russia and Ukraine supply many nations bordering the Black Sea; they will pay more to import their cereals from other suppliers.
- The US Department of Agriculture planting report at end-March could plan more planting to boost supply, though farmers' costs will rise too.
- Food trade protectionism will rise; Indonesia, Turkey and Hungary have introduced policies to give them more control over local produce.

Ukraine conflict alters the role of cyberspace in war

Wednesday, March 23, 2022

Western governments are on high alert since President Biden's warning that Russia may be preparing to attack US targets

On March 21, US President Joe Biden advised US businesses to shore up their cyber defences in light of "evolving intelligence that Russia may be planning a cyberattack" against US targets. Biden and other Western officials have not made any specifics public. Nonetheless, the advice underlines the risks to global geopolitical stability from cyberspace, an unstable domain of security competition. Lessons from previous military wars or from the nuclear era do not readily translate into the cybersecurity domain.



US President Joe Biden (Shutterstock / Ron Adar)

What next

Western public and private sector organisations must prepare for three key scenarios: in descending order of likelihood, Russian cyberattacks to disrupt Ukrainian governmental and civilian infrastructure, cyberattacks against Western targets by Russian state or non-state actors in retaliation for economic and financial sanctions, and cyberattacks against Russian targets by the United States and its allies seeking to impose non-military costs for the war.

Subsidiary Impacts

- Ukrainian government systems, energy facilities and transportation networks face the greatest risk of Russian cyber disruption.
- Western financial systems are likely to be prime targets for Russian retaliation.
- Russian internet services that orchestrate Kremlin's propaganda are likely targets of any Western cyber action.

Analysis

Most major cyberattacks during the last decade or so have occurred outside conventional war scenarios. One important exception is the Russia-Georgia war of 2008, where Russian distributed denial of service (DDoS) attacks interrupted government communications and the Georgian national bank.

Consequently, there are few empirically tested models of the strategic and tactical consequences of cyber campaigns undertaken in tandem with military campaigns -- especially one involving a large and technologically aggressive actor such as Russia, with a highly capable offensive cyber capacity and a proven willingness to use it abroad.

Limits of historical lessons

Policymakers will not be able to rely strongly on past experience of maintaining geopolitical stability amid rising tensions between nuclear-armed states. The experience of the nuclear weapons era shows that preserving stability and preventing escalation under the conditions of a technological revolution has three main conditions:

- a small number of relevant actors;
- shared objectives among them -- particularly in preventing a spiralling conflict; and
- the opportunity to build stable expectations of behaviour through iterated interactions.

None of these conditions holds strongly true in cyberspace, which is an inherently unstable domain of security competition even while it offers states non-violent options to pursue foreign policy or financial goals.

Unique characteristics of cyberspace

As long as cyber actors ensure their actions do not cause loss of life or significant destruction of physical property or civilian infrastructure, they escape the severe retaliation that the use of physical force among nations ordinarily elicits.

Yet 'weaponisation' of cyberspace is increasingly a force for instability in international affairs:

- For example, the Stuxnet malware -- probably spread by US and Israeli governments in 2009 -- destroyed elements of Iran's suspected nuclear weapons programme.
- The Shamoon wiper virus spread by Iran in 2012 incapacitated tens of thousands of workstations at Saudi Aramco -- the oil giant of Saudi Arabia, Iran's main regional adversary and a regional ally of the United States.
- Russian state-linked cyberattacks against US political infrastructure in 2016 profoundly destabilised US politics and undermined US electoral integrity, and had the effect of undercutting US power projection abroad.

Although cyber activity can sometimes replace conventional military force -- the Stuxnet operation possibly averted an Israeli airstrike against Iranian nuclear facilities -- it also invites its own risks.

If Russia-linked actors attack major Ukrainian or Western targets in the coming weeks, geopolitical instability will increase sharply. Moreover, the avenues for restoring stability or de-escalation would be complicated due to the distinct characteristics of cyberspace as a unique security domain.

Three of cyberspace's characteristics are especially important.

Diversity of actors

Cyberspace has diverse state and non-state actors

Unlike the military domain, cyber space is populated by a large number of relevant threat actors.

States operating in cyberspace must contend not only with other states, but also with private actors. These actors include politically motivated 'hactivists' such as the Anonymous community, members of transnational terrorist networks, and even 'lone wolves'.

Consequently, the potential for misattribution of the location of threat actors and for misinterpretation of their motives and objectives is higher in the cyber domain than in other security realms.

At times, private actors operate as proxies under the direction of, or with the consent of, their home government, though not always. In January 2022, an independent US hacker switched off many North Korean websites (internet access is available mainly to the country's small elite) through unsophisticated DDoS attacks.

The attack was politically motivated: the man promised to exploit other North Korean vulnerabilities in an effort to deter hacking against Western targets.

The effects of this incident on international stability was limited because it was a standalone incident. However, amid a diplomatic or a military crisis, a similar action could destabilise the dealings of states if it prompted a government to respond offensively.

Diversity of motives

Cyber actors have geostrategic and financial motives

Cyber actors operate with multiple motivations, not all of them geostrategic.

Some actors -- both governmental and private -- use cyberspace for subversive ends. Their actions could intensify rather than de-escalate a conflict.

North Korean hacking activity illustrates the problem. Leading cyber powers such as the United States and the United Kingdom have exercised self-restraint in the use of offensive capacity in order to establish norms of responsible state behaviour.

By contrast, hackers tied to Pyongyang have defied them. In particular, the 'Lazarus Group' -- the North Korean military's chief hacking unit -- has destroyed the computer assets of multinational companies such as Sony Pictures Entertainment, stolen large funds from the Bangladeshi Central Bank and hacked into cryptoasset exchanges in South Korea. The motivations of these actions have been both geopolitical leverage and financial gain.

Among non-state actors, operatives of terrorist groups such as Islamic State have hacked into US military databases and top-secret UK government email systems. They sought to acquire destructive capabilities to attack Western public infrastructure (so far without notable success). Their aim is the instigation of conflict, not its avoidance.

More recently, members of the Anonymous collective took the Kremlin's website offline to protest against the invasion of Ukraine. While not damaging, such an incident could prompt Russian retaliation against computers and servers located abroad, thereby instigating a spiral of responses and counter-responses.

Asymmetric learning

Strategic learning in cyber space is difficult

Difficulties of attributing the identity and location of threat actors muddle the pool of cyberspace actors, making strategic learning for policymakers even more difficult.

Actors often deny authorship of an operation, such as when Russian hackers breached Democratic Party emails during the 2016 US presidential election -- a denial that former US President Donald Trump subsequently repeated.

In such cases, even when authorship can be technically ascertained with high confidence, the failure to acknowledge it by the relevant parties hinders the mechanism of strategic learning and adopting norms of appropriate state behaviour in future.

Scenario 1: Russian attacks against Ukraine

The ongoing Ukraine war has increased the risk of cyberattacks -- against Ukraine and NATO-linked targets.

Some have already materialised:

- As a prelude to the invasion, Kremlin-linked hackers infiltrated the Ukrainian interior ministry and activated data-wiping malware that destroyed information relevant to domestic intelligence and police activities.
- When Russian forces moved into Ukraine on February 24, serious interruptions to civilian internet access were reported in the country. For example, a severe disruption in the city of Kharkiv occurred almost simultaneously with a series of explosions on the ground.
- A few days into the invasion, internet service degradation became evident more widely, including in Kyiv.

Thus far, Russia has not launched catastrophic cyberattacks against Ukraine or NATO targets (see [INT: Cyberactivity in Ukraine signals Russian limits - March 4, 2022](#)). No major destruction of civilian infrastructure has been reported on the same scale as previous attacks (such as the interruption of energy provision in the Kyiv region in 2015).

It is unlikely that serious disruptions of infrastructure have occurred but not been reported in the public domain. The effects of cyber disruption -- especially in vital infrastructure such as power grids -- are difficult to hide.

Yet complacency would be ill-advised. It is impossible to rule out attacks such as:

- a repeat of the power grid disruptions -- an important risk to public health especially during colder months; or
- another attack with cascading disruption within private industry -- especially in cities and areas of the country that are beyond the control of the Russian military.

It is likely that Russian hackers have penetrated Ukrainian communication systems, transport systems, power grids, financial institutions (such as the National Bank of Ukraine), and other essential infrastructure to lay the ground for future disruptions, depending on military developments. Disruption to such infrastructure could tactically benefit the invasion campaign, as was the case during Russia's invasion of Georgia in 2008.

Scenario 2: Russian threat to NATO targets

The Ukraine war also increases significantly the risks of cyberattacks by the Kremlin and its proxies against Western targets. The United States, the United Kingdom, the EU and other actors have imposed stringent economic and financial sanctions on Russian interests.

These penalties include sanctions against the Russian central bank (which impede its access to foreign currency reserves) and the exclusion of several Russian banks from the SWIFT interbank payments system. Western measures are not only punitive; they also involve the arming of Ukraine's resistance to the invasion. For example, on February 27, European Commission President Ursula von der Leyen announced that the EU -- for the first time ever -- would finance and facilitate the delivery of weapons to a country under attack.

Despite the harsh rhetoric from President Vladimir Putin, who has heightened the level of nuclear readiness, all foreign parties in the crisis want to avoid a direct military clash. Cyberspace offers Russia retaliatory options that avert fatal consequences:

- There is a risk that Russian state-linked hackers will attempt to disable the operations of North American and European banks or stock trading platforms to mirror some of the effects of economic and financial sanctions against Russia (see [UNITED STATES: Corporate cybersecurity is improving - March 9, 2022](#) and see [EUROPE: Hacking of energy firms cements new dynamic - February 8, 2022](#)).
- The conflict might also prompt pro-Russian 'patriotic' hackers to launch a broad spectrum of cyberattacks, such as DDoS attacks, against the online services of Western governments and businesses.

The risk of these actions taking place increases in direct proportion to Russia's military and political setbacks on the battlefield.

Scenario 3: Western counter offensives

Rising Russian-Western tensions over the Ukraine war also elevate the prospect of counter cyber offensives by US, UK and other Western state-linked hackers against Russian targets.

One goal of such activity could be denial -- helping Ukraine defend of its governmental, military and civil society functions. Another could involve curtailing Russian social media information campaigns. There are precedents for such actions: for example, during the 2018 mid-term elections in the United States, US Cyber Command disabled the servers of the Russia-based Internet Research Agency.

Cyberspace also gives Western partners of Ukrainian President Volodymyr Zelensky's government non-military options for imposing further costs on Moscow for its invasion.

Punitive activity could go beyond the denial of Russian attacks and might include, for instance, the disruption of Russian banks to compound the effects of economic sanctions or interruption of the servers of Kremlin-backed news services.

Outlook

If major cyber incidents were to materialise during the war in Ukraine, cyber risk modelling of Western and other cyber-capable actors would evolve dramatically.

Over the medium term, important lessons will centre around two key issues:

- the tactical effect that disabling the financial institutions of a targeted country has on its ability to procure military equipment from foreign powers or internally; and
- the effects of disrupting communications systems -- including access to social media channels -- on the targeted country's ability to coordinate its war response and counter disinformation operations.

However, the lack of sufficient models means that in the immediate future, policymakers would struggle to mount an effective and proportionate response to a major Russian cyberattack against civilian infrastructure in Ukraine or NATO countries.

The response will be especially difficult if non-state actors are involved on either side, or if malware targeting Ukraine accidentally triggers cascading failures beyond the country's borders.

Climate risks on course to intensify globally

Tuesday, March 8, 2022

The IPCC has released a new report looking extensively at climate impacts, adaptation and vulnerability

Working Group 2 (WG2) of the Intergovernmental Panel on Climate Change (IPCC) last month published the second part of the Sixth Assessment Report synthesising recent research on impacts, adaptation and vulnerability. The publication outlines threats posed by climate change to human wellbeing and natural systems, arguing that there is a brief, closing, window in which to avoid the worst effects.



Protesters in France stress the urgent need for climate action. Toulouse, November 2021 (Alain Pitton/NurPhoto/Shutterstock)

What next

Some irreversible climate damage has already occurred, and each increment of future warming locks in additional consequences. Tension will grow between developed and developing countries on issues of loss and damage this year, culminating in difficult negotiations at the COP27 climate summit, in Egypt in November. Alongside increased concerns around European energy security, this report could galvanise efforts to decarbonise energy systems.

Subsidiary Impacts

- After the global pandemic, the Ukraine crisis presents a further potential distraction from climate action.
- Any move by developed states away from their climate goals to address energy concerns would further damage Global North-South cooperation.
- High oil and gas prices will increase the temptation to boost extraction.

Analysis

Published on February 28, the "Impacts, Adaptation and Vulnerability" section of the IPCC's Sixth Assessment Report outlines how climate change has widespread impacts on societies, economies and ecosystems across every inhabited region of the world. Over 40% of the global population, or 3.3-3.6 billion people, live in areas that are highly vulnerable to climate change.

3.3-3.6bn
People living in highly vulnerable areas

The report outlines how numerous irreversible impacts, such as species extinctions, have already occurred, and the approaching irreversibility of other effects. While it argues that warming of 1.5 degrees above pre-industrial levels will bring about unavoidable increases in climate hazards, it also warns that limiting warming to near 1.5 degrees will not eliminate all projected losses and damages.

Building on Working Group 1's publication last year (see [INTERNATIONAL: Report will boost climate action calls - August 27, 2021](#)), the report reinforces pressure on governments and businesses to take immediate climate action. It emphasises economic imperatives, with projected estimates of global net economic damage increasing non-linearly, each increment of warming leading to ever-increasing costs.

Moreover, scientists argue that any delay in global action will miss a rapidly narrowing window to facilitate "climate resilient development", the IPCC's term for integrated mitigation and adaptation which supports sustainable development.

There was much political wrangling over the report, with pushback on wording from countries such as the United States prompting significant tweaks. The term 'loss and damage' for example, is particularly sensitive politically as it is associated with demands for financial compensation. It was replaced with 'losses and damages'.

A similar compromise at the COP26 saw the establishment of the Glasgow Dialogue on Finance for Loss and Damage after a more ambitious plan for a 'Glasgow Loss and Damage Facility' was blocked by developed countries. Given frustration among developing countries, loss and damage will be among the most contentious issues at the COP27 (see [INTERNATIONAL: Climate tensions may undermine progress - December 2, 2021](#)).

Wide-ranging impacts

WG2 discusses climate change impacts across several societal and natural systems, identifying 127 risks, and noting that in the medium-to-long term (2041-2100) risks across the globe will be multiple times higher than they are currently.

Human risks relate to issues ranging from the economic to those in the realm of health and wellbeing.

Industries such as insurance face substantial financial implications. By 2100, under the medium scenario outlined in the report, between USD7.9tn and USD12.7tn of assets will be within one-in-100-year coastal floodplains. Liabilities are closely related to the magnitude of warming; flood damages are projected to be 1.4-2 times higher at 2 degrees of warming, and 2.5-3.9 times higher at 3 degrees, than at 1.5.

In terms of health, WG2 sets out how water insecurity, extreme events, vector-borne diseases and hunger have all increased human mortality and morbidity. It also outlines, for the first time, how mental health will be affected by the impacts of increasing temperatures, considering trauma from weather and climate events, and losses of livelihoods and culture.

Regionally, pictures are complex, particularly when adaptation is considered. For instance, while most European countries are predicted to see a drop in agricultural production, Northern Europe will see some modest increases, though not enough to offset the overall regional decline. Irrigation can serve as an effective adaptation, but temperature increases may restrict water availability.

WG2 is equally pessimistic about nature. Creatures in areas currently classified as biodiversity hotspots are twice as likely to become extinct at 2 degrees of warming than at 1.5 degrees and ten times more likely at 3 degrees than at 1.5. Half of the species assessed are already migrating to higher elevations or latitudes in response to warming.

This has profound implications for efforts to preserve 30% of the Earth's surface by 2030. The report indicates this target may need to rise to 50%, a challenge considering that in 2020 only 17% of land and 8% of marine environments were protected.

Conflict and energy policy

With Russia's invasion of Ukraine having dominated world news since February 24 (see [RUSSIA/UKRAINE: Offensive looks like all-out invasion - February 24, 2022](#)), both the report's publication and immediate reactions to it have been largely overshadowed. The crisis affected talks on finalising the publication, with Ukraine's delegation reportedly forced to withdraw from negotiations, its members sheltering from attacks.

An apparent apology and condemnation of the invasion by the Russian delegation was not made in public, but suggests concerns within the scientific community over possible disruption to Western-Russian climate cooperation.

Beyond the report, the invasion has refocused Europe's attention on imported hydrocarbons. Germany has halted the certification process for the Nord Stream 2 gas pipeline (see [RUSSIA: Kremlin may not have expected sanctions range - March 1, 2022](#)) and a sense of urgency has arisen across Europe surrounding the need to develop renewable energies quickly, to break EU dependence on Russian gas import and ensure European energy security.

In the medium-to-long term the situation could supercharge Europe's green transition, though in the short term it will lead to further energy price increases and could tempt governments to resort temporarily to increasing dirty coal power generation, or at least slowing phase-out efforts.

The conflict could also reopen debates about fracking and nuclear power, the latter of which could prove particularly contentious given the contrast between the technology's clean energy potential, and perceived threats of nuclear disaster, especially in the context of fighting around Ukrainian nuclear plants.

In the near term, violent conflict and migration patterns will continue to be driven primarily by socioeconomic and governance issues rather than climate change. However, the report notes that in the medium-to-long term displacement will increase due to weather extremes and, increasingly, sea level rise.

Climate governance

Regarding climate governance, the report sets out the risks of maladaptation and the adverse effects of poorly designed emission reduction measures. With climate finance forecast to reach USD100bn per year by 2023, there will be increased scrutiny of bodies such as the Green Climate Fund which implement adaptation projects.

USD100bn

Forecast funding for climate adaptation by 2023

WG2, for the first time, directly addresses climate scepticism, noting that, despite scientific certainty, vested interests are attempting to delay action. The report specifically identifies the role of misinformation in the United States.

Despite the report's dismissal of the potential of geoengineering as a technological solution, its prominence in discussions will grow. As inaction continues, NGOs and some scientists will advocate greater consideration of 'technofixes', an approach which, the IPCC warns, risks hitting tipping points in the Earth system.

EU trade tool carries risks for international trade

Friday, March 25, 2022

The EU's new trade tool would give the Commission new powers to take trade action against third countries

The European Parliament (EP) is considering a proposed EU anti-coercion instrument (ACI) to empower the Commission to take punitive action against non-EU entities that threaten or impose economic sanctions on member states. The ACI seems mainly to target China but could also apply trade sanctions on Western and other partners. It represents a significant development of trade policy to defend the EU's interests.



European Trade Commissioner Valdis Dombrovskis (Julien Warnand/EPA-EFE/Shutterstock)

What next

The ACI will likely be approved by member states, though it could take several years before it enters into force. The Commission hopes that the ACI will deter coercion against member states, but it might first have to establish that the instrument can be used despite potential divisions among member states. Although it could strengthen the EU in trade tussles with China and the United States, it risks triggering an escalatory dynamic globally.

Subsidiary Impacts

- Coercive trade behaviour by a third country against an EU country could hurt other EU countries that have close trade ties with the target.
- Given the growing opposition to China in the West, Beijing may have fewer inhibitions about using coercive trade measures.
- China could threaten trade restrictions to curb European trade with Taiwan.

Analysis

The EU's proposed text for the instrument, published by the Commission on December 8, is clear and relatively short with only 17 articles.

Article 1 establishes the ACI's purpose: "the effective protection of the interests of the Union and its Member States where a third country seeks, through measures affecting trade or investment, to coerce the Union or a Member State into adopting or refraining from adopting a particular act."

Article 2 clarifies further that the ACI seeks "to prevent or obtain the cessation, modification or adoption of a particular act" and that this should be influenced by factors such as a pattern of behaviour, intensity, willingness to resolve the issue, and whether there is a widely recognised legitimate concern.

The remaining articles describe the process that the EU will follow, including engagement with the country concerned, international cooperation, choice and duration of measures, termination, review, and an associated committee of member states. EU action could be taken without member state approval, though given the potential impacts there would probably be extensive discussion and cooperation.

Annex 1 contains the list of measures that the EU may take in the case of coercion. These include tariffs; new or increased restrictions on trade in goods and services; restrictions on investments, particular new ones; and the exclusion of a target state or entity from public procurement.

Rationale and implementation

The definition of coercion, and the kinds of measures which will justify use of the ACI, are not clearly defined.

It is widely assumed that the main target of the measure is China, whose economic coercion against trade partners has escalated in recent years. In designing the proposals, experts cited various examples of Chinese coercive behaviour including:

- China curbing imports from Australia in response to Canberra's call for an enquiry into the origins of COVID-19 (see [AUSTRALIA: Canberra proves Chinese coercion has limits - December 15, 2020](#));
- China boycotting European products after the EU imposed sanctions against Chinese officials over human rights violations in Xinjiang; and
- Chinese trade curbs against Lithuania (and businesses in other European countries that source Lithuanian supply-chain components) to punish Vilnius for supporting Taiwan (see [CHINA: Pushback from the West will increase - October 12, 2020](#)).

The ACI is a response to growing concerns over Chinese trade aggression

Other non-EU countries have used mechanisms which could also fall into the category of coercive behaviour. Examples include threats from the United States to impose trade sanctions over European proposals for a digital tax, Russia using public health concerns to ban imports of agricultural produce from Poland in 2014, and threats by Turkish President Recep Tayyip Erdogan to boycott French-made goods following France's crackdown on political and radical Islam (see [FRANCE: Terrorism response carries risks - November 5, 2020](#)).

When considering implementation, it is likely that the Commission would take particular note of the gravity of the coercion and likely damage to the EU, the question of whether this is part of a wider pattern from the country concerned, and the swiftness with which action would be needed. This will require a dedicated analysis and implementation team, presenting member states with detailed information about the coercion and the likely consequences.

The Commission hopes that the very existence of the ACI will act as a deterrent to other countries in their use of coercive measures. However, for that to be effective, the EU will need to show willingness to take action, which is where extensive discussion is likely. In particular, officials and policymakers must confront difficult debates including whether to take action, and how to match the impact of the coercive measure imposed by the non-EU country.

Risks

As seen in debates over Russian sanctions, taking steps against third countries comes with a risk of economic harm to the EU and member states (see [INTERNATIONAL: Russia and EU to suffer from sanctions - March 8, 2022](#)). While the level of unity has led to harsh measures being imposed in the case of Russia, it is unlikely that this would equally apply to cases of coercion against an individual member state. This underscores the potential for the ACI to create divisions within the EU.

Efforts to use the ACI risk leading to division among EU member states

Another significant risk is that the ACI leads to escalating disputes between the EU and trade partners (see [EU: CBAM risks international retaliation - November 1, 2021](#)). The instrument is only intended for use in the most egregious cases, but these are the ones where the other party is likely to be powerful and determined, and so not inclined readily to back down. Non-EU countries targeted by the ACI could adopt reciprocal measures, leading potentially to prolonged trade wars.

The Commission will argue that the ACI will keep markets open via deterrence. This is a gamble. If it fails, protectionism will increase globally.

Chances of approval

The legislative process for the ACI has only just started, with the International Trade Committee as the lead in the EP, with Chair Bernd Lange as the rapporteur. The EP requested such an instrument, so it seems likely that there will be majority support.

There also appears to be broad support among member states. However, as the EP Research Service notes, the Czech Republic and Sweden (which hold the next two presidencies of the Council) submitted preliminary comments on the ACI to the Commission in November 2021, arguing that "the use of the instrument must remain an exceptional and last resort solution".

They also believe that the ACI would have extensive foreign policy impacts and therefore "member states should be fully involved in the decision-making on this proposed instrument." Others may have similar concerns, though France and Germany are supporters.

Overall, it is likely that the instrument will be passed, but this may involve considerable discussion on the way it is used, and how the risks identified can be mitigated.

Russia and also Europe to suffer from EU sanctions

Tuesday, March 8, 2022

EU countries have agreed unprecedented measures against Russia in response to the invasion of Ukraine

The EU has applied extensive, debilitating sanctions on Russia since the February 24 attack on Ukraine. EU leaders accept that the measures will undercut EU growth and increase the risks of recession. They have less appetite than Washington for further sanctions, reflecting their greater exposure to Russia. The refusal of Germany and the Netherlands to back a US proposal to ban Russian energy imports underscores this.



A money exchange sign shows the value of the ruble plunging (Pavel Golovkin/AP/Shutterstock)

What next

EU leaders are likely to approve the European Commission's proposal to dampen the economic impact of sanctions and possible Russian counter-sanctions by fast-tracking the approval of state subsidies. There will be more resistance to raising new EU joint debt. Further sanctions are possible, but close energy, banking and investment links between some EU member states and Russia will make the bloc, and especially Germany, cautious.

Subsidiary Impacts

- EU firms will try to diversify their commodity supplies away from Russia, not only oil and gas but also metals used in industrial alloys.
- More states will join the EU's gas storage coordination and joint gas reserves purchases the European Commission initiated late last year.
- An extended conflict would hike the threat to vital Ukrainian and Russian grain supplies for states in the Middle East and North Africa.

Analysis

EU leaders adopted three packages of sanctions against Russia from February 24 to March 2.

Four types of economic sanctions are now effective:

- Capital market and financial restrictions on Russian banks.
- Export bans on dual-use goods, services and technologies in the defence, security energy, oil refining, aviation and space sectors. Also, Russian planes are banned from EU airspace.
- EU public organisations are banned from financing trade and investment in Russia and credit institutions are banned from taking new deposits above EUR100,000 (USD109,000) from Russian counterparts.
- Assets held in the EU by high-ranking Russian officials, including President Vladimir Putin and Foreign Minister Sergey Lavrov, are frozen.

Financial and capital markets restrictions

The most crippling measure for Russia's economy is the G7 decision to freeze the foreign assets of the Central Bank of Russia. As of February 1, the bank held nearly half its more than USD630bn in reserves (foreign currency and gold) in the form of non-Russian securities and nearly one-quarter as cash and bank deposits in foreign financial institutions. Access to around 70% of this total may now be closed off.

The freeze will reduce Russia's ability to pay for imports and investment abroad (see [RUSSIA: Invasion brings high economic costs - March 7, 2022](#)).

The second-toughest measure is the exclusion of seven Russian banks from SWIFT's financial messaging system from March 12. SWIFT is a Belgian-based company subject to EU law that facilitates 90% of international financial transactions. The ban hits many of Russia's leading banks:

- VTB, Russia's second largest bank;
- VEB, a state bank reconfigured as a development corporation;
- Promsvyazbank, which finances military procurement;
- Novikombank, controlled by defence industry group Rostec; and
- Otkritie, Sovcombank and Bank Rossiya, respectively the seventh-, ninth- and twelfth-largest banks by assets.

The EU has not banned Russia's largest and third-largest banks, Sberbank and Gazprombank, from SWIFT. Russia's oil and gas export revenues, 42% of total export revenues, are paid to these banks and banning them would have severed energy transactions.

Restrictions target 70% of Russia's banking system, according to the European Commission.

Sberbank and Gazprombank have had restricted access to EU capital markets since August 2014. EU financial institutions are prohibited from providing them with financing through bonds, shares and loans with a maturity of more than 30 or 90 days (depending on the debt instrument). The restrictions also apply to three other banks and six firms including Rosneft and Gazprom Neft. The EU has extended these restrictions until April 12 2022. Four additional banks and eight companies have been added to the list.

Research carried out for the European Parliament in 2017 estimated the cost for Russia's economy of EU sanctions since 2014 at between 0.2% and 2% of annual GDP. The military conflict and the sanctions since 24 February 2022 are likely to have a larger impact.

EU banking exposure to Russia

Although exposure has fallen since 2014, EU banks remain much more exposed to Russia than US banks are

Austria's Raiffeisen Bank International (RBI) subsidiary, Raiffeisenbank, is Russia's tenth-largest bank and has a subsidiary in Ukraine. RBI's EUR22.9bn of lending activity to Russia's corporate private sector makes it the most exposed European bank.

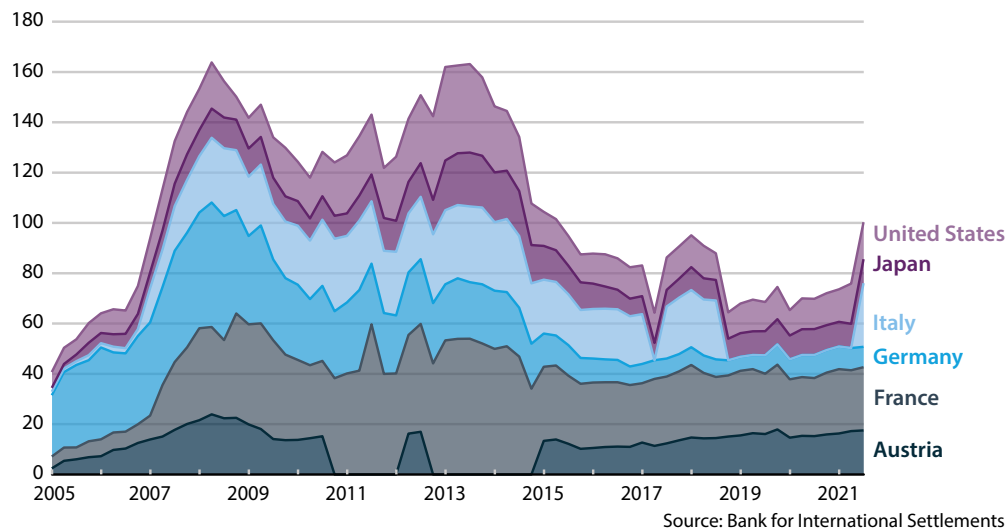
France's Societe Generale is the majority shareholder in Rosbank, Russia's twelfth-largest bank, while Italy's Unicredit is present in Russia through its subsidiary AO UniCredit Bank. These two have a regional exposure of EUR18.6bn and EUR14.2bn respectively through their retail bank lending.

Estimates suggest that writing off SocGen and Unicredit business in Russia would reduce their consolidated common equity Tier 1 ratios by 0.35-0.40 basis points, leaving the ratios above regulatory buffer requirements.

SocGen and Unicredit could write off their Russian assets and still meet regulatory requirements

The French and Italian banking systems are the most exposed, according to the Bank for International Settlements, having lent just over USD25bn to Russia as of September 2021. German bank lending to Russia amounts to USD8.1bn, out of USD121.5bn total claims held by foreign banks.

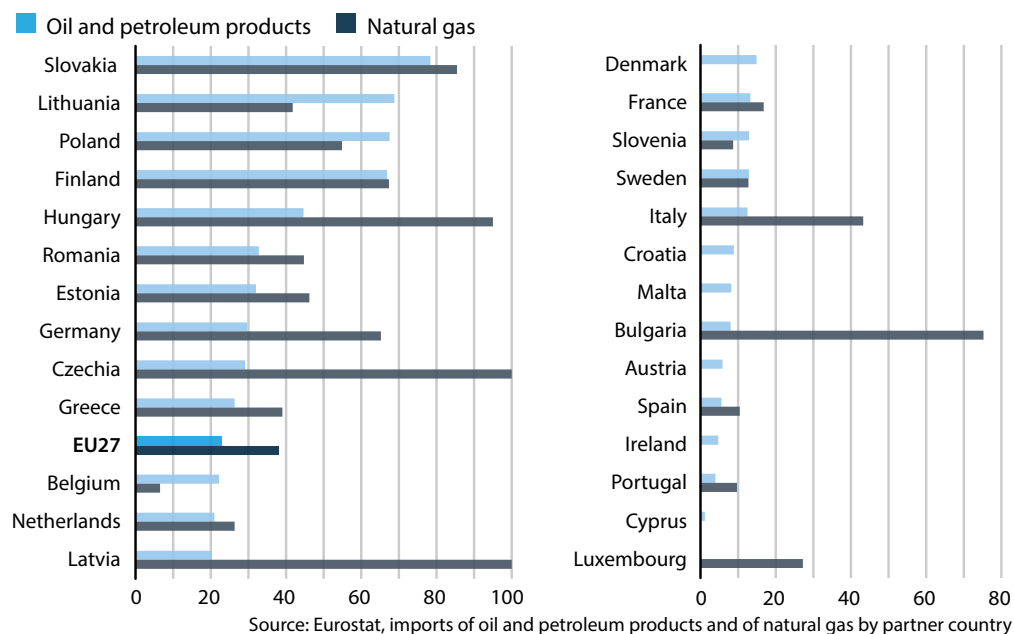
Total bank lending to Russia (USDmn)



EU trade exposure to Russia

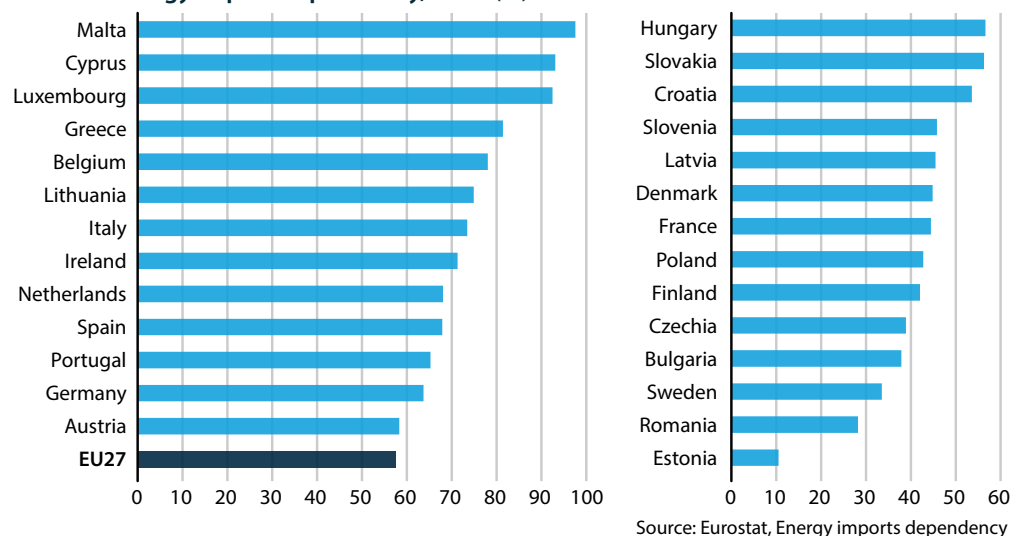
Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania and Slovakia are wholly or overwhelmingly dependent on Russia for their gas supply. In Germany and Finland, two-thirds of imported gas comes from Russia. Slovakia, Lithuania, Poland and Finland rely heavily on Russian oil delivered by overland pipelines.

EU: Economies, share of imported oil and gas from Russia in 2020 (%)



Total energy dependency, the ratio of energy imports minus exports to energy consumption, varies across the EU (see INT: High power prices raise instability risks - February 21, 2022). France and most of the post-2004 EU member states have a lower dependency than most of the pre-2004 member states. France's energy dependency is 44.5% while Germany's is 63.7%.

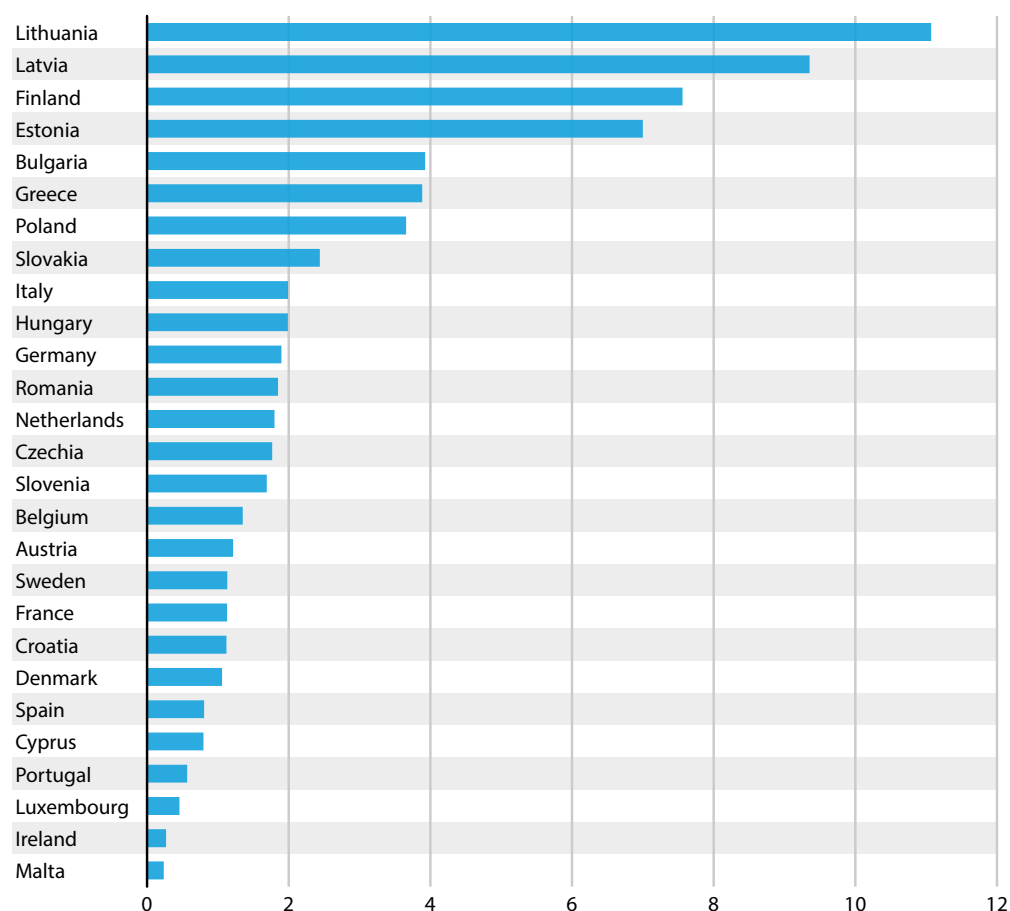
EU: Total energy import dependency, 2020 (%)



Dependence on Russia is not limited to fossil fuels. The EU imports 40% of its palladium, 32% of its vanadium, 20% of its phosphate rocks and 17% of its aluminium from Russia, according to the European Commission.

The EU is Russia's largest trade partner, accounting for 36.5% of its imports and 37.9% of its exports. Russia accounts for 4.8% of the EU's trade in goods with non-EU countries, and for less than 4% of most EU member states' total trade, with the exception of Finland and the Baltic countries.

Russia's share in EU countries total trade* (%)



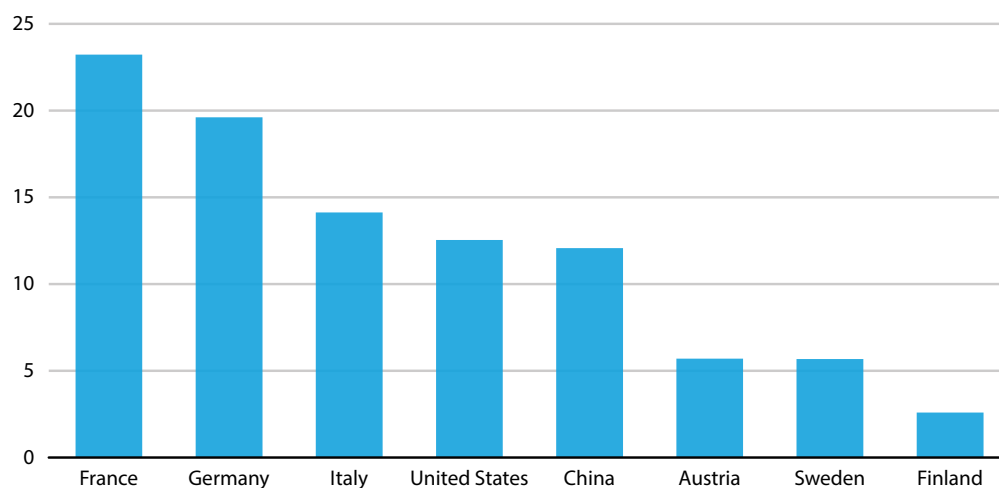
*exports and imports

Source: Eurostat, EU trade since 2017 by BEC/rev.5

EU investment exposure to Russia

Some EU countries are major investors in Russia. IMF data show that Russia's largest stock of foreign direct investment (FDI) comes from Cyprus, followed by the Netherlands. Much of this is offshore Russian investment; the profile of the Netherlands has risen since the 2012 Cypriot crisis.

Select countries' FDI positions in Russia (USDbn)



Source: IMF

After these two, the largest FDI providers are France, Germany and Italy. France is the largest foreign employer, with 160,000 employees in Russia. As many as 35 of the 40 companies listed on France's CAC40 stock market do business in Russia. Several EU companies have closed their business in Russia; others are reluctant to follow.

Next steps

On March 10-11, EU leaders will discuss the European Commission's proposal to dampen the impact on EU economies of the sanctions and possible Russian counter-sanctions through new debt issuance and fast-tracking the approval of state subsidies. The latter is likely to pass; but agreeing to raise new joint debt will be tricky.

Germany's refusal to target directly the oil and gas trade underscores the caution that will inform discussion of further sanctions, to ensure that the damage will fall more on Russia than the EU (see EU: Ukraine conflict will bring heavy costs - February 25, 2022).

March 3, 2022

Ukraine analogy has limited relevance for Taiwan

Russia's invasion of Ukraine has drawn comparisons with a potential Chinese invasion of Taiwan

Ukraine and Taiwan have relative advantages and disadvantages vis-a-vis their adversary					
Ukraine			Taiwan		
Vulnerability to invasion: HIGH 2,000km of land border with direct road links		Vulnerability to blockade: LOW Over 1,000km of land borders with friendly countries	Vulnerability to invasion: LOW 160km of rough seas; small number of suitable amphibious landing sites		Vulnerability to blockade: HIGH Island, within easy strike range of adversary, heavily dependent on imported food and fuel
Around 10% of world exports of wheat, barley and maize and nearly 20% of sunflower oil; diminishing role as transit route for Russian gas supply to Europe			World's largest producer of semiconductors; critical node in most international high-tech supply chains		
Eastern Ukraine since 2014			None		
None			United States (Taiwan Relations Act)		
EU, NATO			Japan		
Join NATO			Equip and train to defeat China without assistance		
Military budget USD4.2bn (2021 budget)	GDP USD181bn (2021 estimate)	FX reserves USD30bn (2022)	Military budget USD11.6bn (2020)	GDP USD670bn (2020)	FX reserves USD550bn (2022)
Separate political entity since 1991			Separate political entity 1895-present, with four-year hiatus (1945-49)		
Close bilateral military cooperation into 2010s			Preparing for war since 1949		
Democracy since 1991, often poorly functioning and corrupt, but fair elections since 2014; loss of control of Crimea and part of eastern Ukraine Freedom House rating: partly free 61 Transparency International's Corruption Perceptions Index: 122			Liberal democracy firmly established since 1996 Freedom House rating: free 94 Transparency International's Corruption Perceptions Index: 25		

Russia's invasion of Ukraine does not significantly raise the risk of China attempting to invade Taiwan. There are parallels, but Taiwan is a more formidable and much better prepared adversary in most respects, and China understands this.

However, Taiwan's relative geographical isolation creates vulnerabilities as well as strengths -- it is much more vulnerable than Ukraine to blockade. This is the least risky type of aggression for China: though increasingly well-equipped, China entirely lacks Russia's recent experience of actual warfare and has no reliable way to assess how its forces would perform in an invasion.

- **Taiwan cannot be caught off-guard: it has spent 70 years preparing for a Chinese invasion and has detailed plans for rapid mobilisation.**
- **The US defence commitment to Taiwan, while ambiguous, is firmer than any country's commitment to Ukraine, but Taiwan will not count on it.**
- **The Ukraine war will be watched closely in Taiwan; it will increase the sense of threat and bolster support for greater defence spending.**
- **China's objective, unlike Russia's, has never been ambiguous: to occupy Taiwan, strip it of all autonomy and subjugate its population.**

See also: [China could seize Taiwan's outlying islands](#) -- October 22, 2021

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HEAD OFFICE

5 Alfred Street, Oxford OX1 4EH
T +44 1865 261 600



FIND OUT MORE

Fivos Iliopoulos

Sales Director EMEA

Filiopoulos@oxford-analytica.com

T +30 6977 452323

www.oxan.com