

UKRAINE'S GRAIN DEAL: IMPLICATIONS & POSSIBLE FORWARD SCENARIOS

Exploring Ukraine's unwavering efforts to ensure global food security as Russia's aggression continues

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On top of the enduring, unthinkable human tragedy, Russia's invasion of Ukraine has also triggered a series of economic and humanitarian crises felt across the globe, not least that concerning global food supplies. As part of their efforts to crush Ukrainian independence and exert pressure on Kyiv's international supporters, Russia has blocked and mined Ukraine's pivotal Black Sea, disrupting grain exports crucial to ensuring global food security. Ukraine is one of the most important suppliers of various agricultural and food items necessary to ensure global food supplies, particularly in African and Middle Eastern countries.

With the Kremlin actively using the threat of mass starvation and a new migration crisis to improve its political and military positions, the recent landmark agreement aimed at protecting the export of Ukrainian wheat, corn, barley, sunflower oil, other food products and fertilizers onto the world market is seen as a crucial step in staving off a major global crisis.

Indirectly signed between Ukraine and Russia with Turkish and UN mediation on 22nd July, the "Grain Deal" has been hailed as a remarkable achievement by the UN as it looks to ease key supply risks on the global food market and avoid a major humanitarian catastrophe. However, with no end to the war in sight, it is yet to be seen whether Russia will honour the deal's provisions and make it a reliable instrument for global food security.

Below, Aretera provides further insight into this landmark deal, Ukraine's global significance as a food producer, potential post-agreement scenarios as the Russian aggression continues and implications for international businesses.



This memo will cover:

- Ukraine's role in international food security and the global food market,
- the immediate consequences and mid-term effects of Russia's invasion,
- key takeaways from the Grain Deal,
- possible short- and mid-term scenarios and implications for international investors.

UKRAINE – A KEY FOOD PRODUCER ON THE GLOBAL STAGE

Due to its exclusively fertile land and vast areas under crops, Ukraine has long been a large producer of agricultural goods, mainly of grains and oil seeds. Starting from the 2010s, when the country started to visibly cope with post-Soviet economic hardships, attract investment and new technologies, agricultural production and efficiency improved considerably, with Ukraine becoming a large supplier of grains, oil seeds, vegetable oil and other food items to the global market. The growth in the agricultural and food sectors came as major agricultural companies secured ownership of 100,000+ hectares of arable land in Europe's largest country, where agricultural land amounts to 41 million hectares.

In 2021, Ukraine collected the largest harvest of grain and oil seeds in its history: 106.6 million tons (MT) compared to 42 MT in 2001. Of this figure, the exports of grains and oil seeds was expected to be 70 MT, sufficient to feed over 400 million people.

Some countries, such as Bangladesh, India, Sudan, Egypt, Somalia, Yemen and numerous African states are also critically dependent on supplies from Ukraine, as is the United Nation's World Food Programme for developing countries.

COUNTRIES MOST DEPENDENT ON WHEAT IMPORTS FROM UKRAINE

Country	Share of Wheat Imports from Ukraine (%)
Moldova	92
Lebanon	81
Qatar	64
Tunisia	49
Libya	48
Pakistan	48
Indonesia	29
Malaysia	26
Egypt	26
Bangladesh	25

(Source: UN FAO 2020 data)

With the major importers being in Asia, Africa and the Mediterranean region, the logistics of Ukrainian grain, oil seeds and oil supplies was constructed with an emphasis on maritime shipments and storage infrastructure in the ports on the Black Sea and the Sea of Azov.

Supplies by rail, for instance to the EU, were limited, due to differences in railway track width, a shortage of grain-hoppers and higher prices compared to sea shipments. At the same time, storage infrastructure lagged behind the growing harvests, essentially creating the conditions for a logistics crisis in the event of any major disruption of exports by sea.

UKRAINE'S SHARE IN GLOBAL FOOD SUPPLIES

Food Item/Facility	Ukraine's Global Share (%)
Corn	16
Wheat	10
Barley	6.5
Sunflower Oil	45-50
UN World Programme (WFP)	40

(Source: UN FAO 2021 data)

RUSSIA'S INVASION – IMMEDIATE DAMAGE & LONG-LASTING IMPACT

Russia's invasion of Ukraine, which began on 24th February, is largely seen as an attempt to crush Ukraine's Euro-Atlantic aspirations and conquer more Ukrainian land, especially on the Black Sea coast. However, seen through an economic lens, Russia's invasion of Ukraine also enabled Moscow to eliminate a competitor in crucially important economic sectors, including food supply and metallurgy.

Early in the war, Russian forces established a remote military blockade of Ukrainian ports in the Odesa and Mykolayiv regions, using long-range cruise missiles, which could be potentially launched from ships, submarines and aircrafts. The ports on the Sea of Azov were also all captured in the first weeks of the war. In addition, Russia has conducted numerous missile attacks on the ports, as well as on the grain and oil storage infrastructure, to limit Ukraine's existing export capabilities.

By seizing and blockading Ukraine's sea ports, Russia has looked to secure political and military leverage against Western governments to lift sanctions against Russia and stop supplies of weapons to Ukraine – two crucial elements of the Western support for Kyiv.

The Russian threat created by the blockade of Black Sea ports has contributed to the surge in inflation, already fuelled by an evolving energy crisis, and had the potential to provoke political crises and increase migration pressure from Asia and Africa over the fear of mass starvation. Furthermore, any ongoing blocking of food exports, together with the destruction of grain storages and machinery and the burning of crops in war-affected regions of Ukraine, would have deprived Ukraine of its major export income sources (over 40% of total export revenues in 2021).

The blockade has exposed the limitations of alternative exports routes (rail, road, river) and Ukraine's critical dependence on its Black Sea ports. This in turn has raised the issue of the insufficient capacity and low number of workable land borders with the EU. In effect, the war has become a stimulus for

searching ways to reduce the dependency on shipping, including such measures as solving the differences in railway track width.

IMMEDIATE CONSEQUENCES OF RUSSIA'S ACTIONS

- considerable material damage to Ukrainian agriculture, which analysts say will need at least a decade to recover;
- the reduction of arable land, which together with financial losses and this year's drought, will considerably reduce harvest and export supplies (by an estimated 30%) this year;
- the destruction of storage facilities and difficulties with exports will see a large part of this year's crops unharvested and reduce sowing plans for the next year;
- an increase in food prices on the world market, further fuelling inflation;
- export limitations in numerous countries, for instance in India, to prevent the shortage of critical commodities;
- the growing deficit and prices of nitrogen fertilizers, which Ukraine is a large producer of;
- massive uncertainty on global food markets.

MEDIUM-TERM EFFECTS

- reduced supply of Ukraine's major crops (corn, wheat, barley, sunflower) to key markets, including the EU, which together with this year's significant drought in Europe may considerably increase food prices and the need for further social spending by EU governments;
- continuing efforts to restructure Ukraine's food logistics to reduce dependence on ports, which will necessarily involve Ukraine's neighbours (Poland, Hungary, Slovakia, Romania) and other (coastal) countries (Lithuania, Croatia, Montenegro, Greece, Italy, etc.);
- investment into Ukrainian areas affected by the relocation of existing food processing companies and the creation of new food processing firms, as well as of the establishment of storage and logistics facilities;
- a further need for strengthened partnerships with agricultural and food companies affected by the war, as the industry will need capital inflows to maintain and/or restore operations.

THE LONG ROAD TO THE GRAIN DEAL

The risks of the food crisis were obvious from the first days of war, when several commercial vessels of third countries were attacked off the Ukrainian coast. Russia also captured Snake Island close to Ukraine's naval border with Romania, temporarily taking the north-west Black Sea under their control.

This triggered the first, unsuccessful attempt at talks with Russia on the part of Ukraine's Western allies. Having a firm military position at the time, Russia insisted the ports could be unblocked only when Ukraine de-mines its shore, a condition unacceptable to Ukraine given the threat of Russian troops landing in the Odesa region.

The situation changed dramatically after Russia suffered severe military losses, including the sinking of the Moskva cruiser and withdrawal from Snake Island, considerably impacting any chance of a successful landing operation. Furthermore, the growing sanctions pressure on Russia and the risk of

worsening relations with its partners in Turkey and the Middle East due to potential mass starvation and a migration crisis, have brought Russia to the negotiating table.

The readiness of Western countries for a soft deal (no further sanctions plus the lifting of some in exchange for the unblocking of Ukrainian ports), and the efforts of the Turkish leadership have also contributed. The UN has also played a role, albeit a largely symbolic one. Given the widespread distrust towards Russia over its actions in Ukraine, representatives of Kyiv and Moscow signed separate but identical documents with the UN and Turkey on 22nd July.

The Grain Deal itself consists of two parts. Firstly, it includes a Turkish-Ukrainian agreement on the safe passage of vessels, protected by the Turkish Navy and subject to multilateral exports control by a special commission, from the ports of Odesa, Pivdennyj and Chornomors'k.

Secondly, a Turkish-Russian agreement was signed and implemented on the safe passage of ships with food and fertilizers for at least the next 100 days. However, the absence of strict control over Russian vessels also allows Russia to export grain seized on the occupied territories of southern Ukraine (and essentially stolen from Ukrainian farmers) to pass via the straits. This issue could theoretically be addressed in later amendments to the deal.

A MAJOR RELIEF WITH REMAINING CHALLENGES

The practical implementation of the Grain Deal started on 1st August, when the first ship left the port of Odesa and safely reached Turkey, where it was inspected in accordance with a special procedure under UN supervision. As of 30st August, 61 ships have passed through safely, with several dozen more vessels heading to Ukraine.

According to the UN, exports of grain and other food items from Ukraine's southern ports have surpassed one million metric tons since the deal was agreed, decreasing the risk of global food shortage in Asian and African countries.

While the deal suffered a very early setback when the port of Odesa was struck in another Russian missile attack a day after the agreement was signed, giving further reason for Ukraine and the international community to be cautious about the Kremlin, the agreement can so far be judged as a significant success.

The resumption of food exports from Ukraine has had an immediate effect on commodity prices, which fell sharply. The absence of further Russian threats to exports gives some hope that prices will continue to stabilize and may reach pre-war levels. However, in the next commodity marketing year the obvious deficit of food due to the war and drought may still lead to price hikes.

The Grain Deal was also a huge relief for Ukrainian farmers and the Ukrainian state budget due to the resumed currency inflow. At the same time, Ukraine, still riven by the ongoing impact of the war, must also cope with the ever-increasing cost of managing the logistics behind its agricultural exports.

In less than 100 days, another round of negotiations will take place. These will coincide with the end of harvesting in Ukraine, when storages are at the limit of their capacity, thus weakening Ukraine's bargaining position. For this reason, export operations from Ukraine should be finalized by this date, if possible.

POSSIBLE FORWARD SCENARIOS

With the upcoming renegotiations in mind, the Ukrainian state and the private sector will continue to seek alternative export routes by developing storage and transport infrastructure in the western part of the country, closer to EU customers, as well as to the nearest ports. Many projects of this kind may be implemented in neighbouring countries. This may serve as an impetus for new investment into both Ukraine and nearby EU member states.

An important development in this regard will be the switching focus of the Ukrainian agricultural business from exports of raw material to processed goods in order to reduce their physical volume and to increase added value. This transformation is actively supported by the Ukrainian government, which made this national economic shift one of its key priorities, potentially creating further momentum for foreign investors to support the country's agricultural sector.

The chances for the deal surviving for and even beyond 100 days will depend considerably on the evolving situation on the frontlines, as well as on potential political and economic developments inside Russia. Should Russia's military position worsen significantly, the Kremlin could cancel the deal unilaterally. Under this scenario, the above-mentioned risks will again return, exacerbating the urgent need for Ukraine to diversifying its food export routes.

Fears of Russia breaking the agreement are also fuelled by the Kremlin's notorious track record of using non-military means to gain leverage in Ukraine, including Europe's still pressing dependence on Russian gas. Although not directly connected, it is important to note that Russian forces have actively used Europe's largest nuclear power plant in Zaporizhzhia for military purposes, essentially risking a nuclear catastrophe with devastating consequences.

The fact the Grain Deal is not a formal international treaty also leaves plenty of room for Russia to abuse it. Furthermore, Russia is Ukraine's main competitor on the grain market, which could push the Kremlin to launch a renewed Black Sea blockade to gain a strategic advantage over Kyiv as the war continues.

On the political level, although signed indirectly, the Grain Deal, which marks the first diplomatic agreement between Russia and Ukraine since the start of the Russian invasion, is also regarded by some as a pretext for an actual peace deal between Moscow and Kyiv. Turkish Defence Minister Hulusi Akar recently said the deal "lays the groundwork for a permanent peace environment."

However, there are fears that this would mean peace only on Russian terms, most likely with Ukraine potentially seeing the loss of crucial territories, unpunished Russian war crimes, the Kremlin not being held accountable for its actions in Ukraine and Russia remaining a security threat for Ukraine and the wider CEE region.

At the same time, neither side is ready to conduct peace talks at present, with Russian forces still waging on war on Ukrainian territory, while Kyiv has recently launched its first major counteroffensive to liberate the Russian-occupied territories.

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If you would like to schedule a discussion of this paper, please contact:
[Dominik Istrate](mailto:d.istrate@areterapa.com), Advisor for Central and Eastern Europe at **d.istrate@areterapa.com**



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