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ASF Boosts Chinese Chicken

EPA Biofuel Plan

China Market Update

What the Trade Deficit Says About U.S. Economy

WORLD PERSPECTIVES: AG REVIEW

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WPI POLLING

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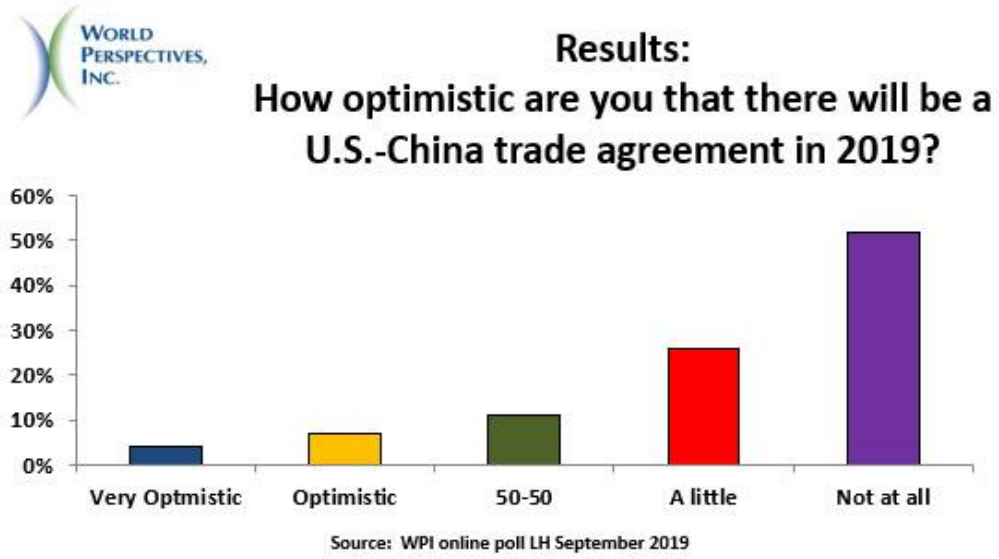
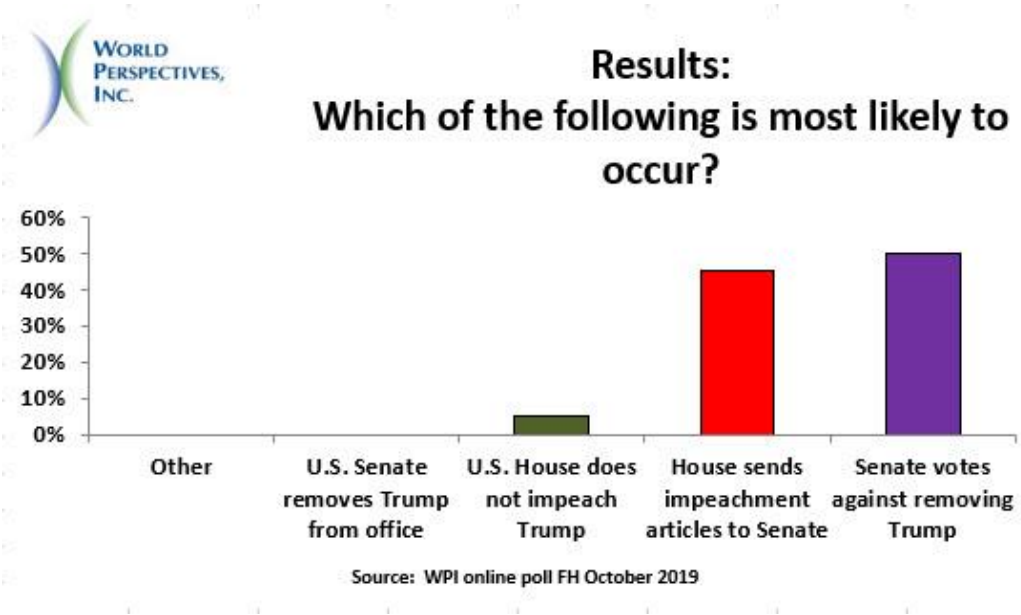




FROM THE WPI TEAM

By Matt Herrington

Change is seldom easy but almost always necessary. You might notice that the June, July, and September 2019 issues of *Ag Review* look and read a little differently than issues of the past few years. We've streamlined our approach to deliver the most pertinent information as seamlessly as possible while keeping reader costs low.

One of the most notable changes is that *Ag Review* will now hold true to its name and offer a synopsis of the past month's market and policy activity. We've taken a "best of" approach and will be publishing reader's favorite articles from the past month for three categories: Market Analysis, International Analysis, and Policy Analysis. Within each of these sections, you'll find information previously published in a WPI report that readers and WPI staff deemed especially interesting or pertinent.

We hope you enjoy the revised *Ag Review*. As always, WPI's commitment is to provide unique, actionable information and analysis to our readers. If you have any feedback or further suggestions for this (or other) publication, we always appreciate hearing readers' thoughts!

WPI MARKET ANALYSIS

ASF Boosts Chinese Chicken

By Gary Blumenthal

China is emphasizing larger, better capitalized hog production facilities that can deploy better disease management practices. Chinese farmers are taking pigs to larger size before slaughter to capture a better return in the current high-priced market. However, there are potentially permanent changes in what the Chinese eat as a side effect of the disease problem.

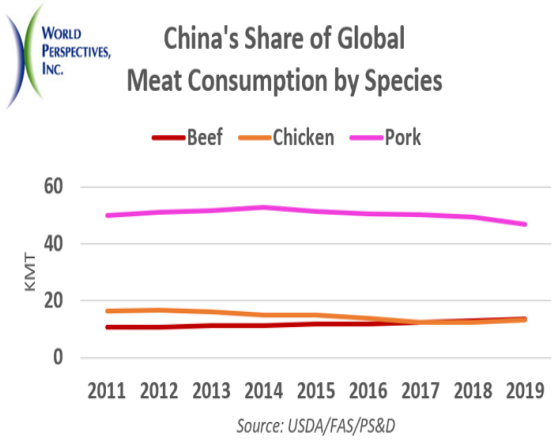
The Chinese constitute roughly 19 percent of the world's population and consume nearly 30 percent of the world's beef, chicken and pork. However, that is largely due to the country's out-sized consumption of pork. Pork disappearance in China reached its peak in 2014 and its share of global pork consumption had begun to decline before the outbreak of ASF.

China's consumption of beef has been increasing but the country's share of global chicken demand had been decreasing until ASF came along. Because chicken meat is both low in cost and quicker to expand in production, the disease is forcing the Chinese to more strongly consider poultry in their diets.

The lag point has been a shortage in breeding stock, but this will be resolved in due time. The question is how permanent will be the conversion from pork to beef and chicken?

China has long wrestled with domestic outbreaks of avian influenza (AI), and its restriction against imports from countries with even low-pathogenic AI contributes to the breeding stock shortage. Meanwhile, beef has too high of a cost and length in production cycle to be a large enough replacement in the total animal protein demand equation.

Consuming chicken at a rate closer to that of other countries would greatly reduce feed costs and have a reduced environmental footprint relative to pork. ASF seems destined to at least temper China's out-sized consumption of pork and increase the per capita intake of poultry.



What the Trade Deficit Says About the U.S. Economy

By Dave Juday

USDA released its weekly sales report in early October with some mixed news, but another trade report, the August international trade report from the Department of Commerce, has some interesting insights into the overall economy.

The U.S. trade deficit in all goods and services was $54.9 billion in August; that compares to a deficit of $54 billion in July. Exports increased $500 million in August (0.2 percent), but imports rose faster at $1.3 billion (0.5 percent).

The most important economic indicator from this is that the total volume of trade increased. Indeed, from an economic perspective, the total volume of trade is an important indicator as it reflects the trend in overall economic activity. August exports of goods were up for most

categories except for civilian aircraft, which was down $1.3 billion.

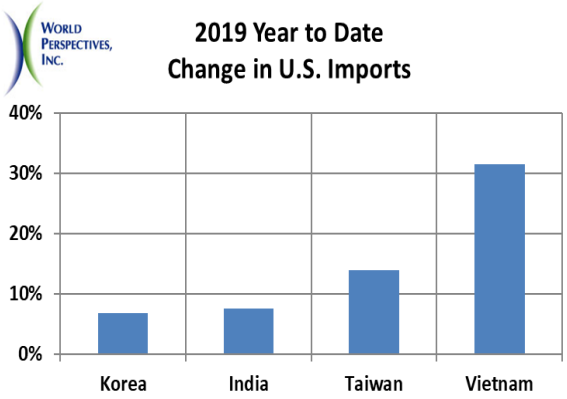
The August trade numbers weren't a fluke. For the three months ending in August, imports of consumer goods were up $1.9 billion, including cell phones and other household items. Recall, these are the types of products (cell phones, laptop computers, some electronic toys and certain types of footwear and clothing) that the Trump Administration did not want to impose additional tariffs on if coming from China as the season for Christmas shopping was getting under way.

Looks like retailers and distributors are bullish about holiday retail activity this year. Similarly, the import of capital goods, like semi-conductors and industrial machines were up, which can be construed as a positive sign. Total capital goods imports were up $1.9 billion. Manufacturers don't buy more inputs when they have no plans to use them.

Tempering that on the downside was the drop in imports of other industrial supplies and materials, but the silver lining there was that imports of petroleum products were down accounting for half of the drop, largely due to the exports of fuel oil from the U.S. Fuel oil exports were up $800 million while total petroleum products imports were down $700 million and crude oil imports were down $500 million (by the way, 55 percent of all crude oil imports into the U.S. in 2019 have been from Canada, and adding in Mexico, that increases to 63 percent).

In other words, the energy supply in the U.S. is plenty large and is relatively cheap, and that goes double for North America. In fact, the U.S. trade deficit in petroleum energy in August at $321 million was the lowest on record, and only the second time under $1 billion (the other time being January of this year at $971 billion). September's trade numbers for petroleum will be interesting to watch, since the attacks on Saudi oil facilities occurred about mid-month in September.

With the trade war, Chinese imports into the U.S. year to date were down 13.2 percent from last year. But imports from other key Asian markets were up, which is generally a good sign for building markets for U.S. ag exports. Beef exports to Korea were at a record in 2018 and are up 8 percent year to date. Vietnam and Taiwan are potential growing ag export markets and U.S. exports to India are up 30 percent so far this year.



The soy market should remember that Chinese purchases of U.S. soybeans do not change the world supply/demand outlook for soybeans. It will simply change the trade flow. The U.S. would fill a part of China's demand that Brazil/Argentina would otherwise cover. The latter will compete for other buyers that the U.S. would have covered had Chinese buying of U.S. soybeans not occurred.

It is also reported that Chinese buyers were inquiring about prices and availability of U.S. pork, but we cannot confirm that there have been any actual purchases. However, the spread between high domestic pork prices prevailing currently in China and U.S. pork prices appears wide enough to cover the 25 percent tariff. If the Chinese government allows it, there likely will be new purchases of U.S. pork if there have not been some already. China needs to import a lot of pork to help offset the lost domestic production due to African Swine Fever.

China's need to import U.S. pork appears to be much greater than their need to import U.S. soybeans. But political decisions will control what happens in both cases.

WPI INTERNATIONAL ANALYSIS

China In-Country Analysis
02 October 2019
By Williams and Liu

President Xi's Fleeting Rural Dreams

With China's National Day Holiday celebrations in full swing this week, questions have risen as to whether President Xi's economic strategy is helping or hurting the country.

Without question, the trade war with the U.S. came at a challenging moment when Beijing was making efforts to diversify its domestic economy. Specifically, the leadership wants to move away from the export of lower value consumer goods and assembled components to higher value technologies and a larger service sector. Similarly, China's central government, keenly aware of the shaky ground of its shadow banking sector, implemented several policies to curtail capital outflows and restrict speculative borrowing and investment.

The trade war with the U.S., which has helped to push down China's GDP growth rates to their lowest level in a decade, has derailed many of those objectives. With worldwide economic growth beginning to wane, even the country's ambitious Belt and Road Initiative (BRI), which seeks to connect other developing nations through infrastructure investment and trade alliances seems a long way off.

An article posted on *The Atlantic's* website, discussed several challenges confronting China's BRI and noted that many projects have targeted areas, which previously limited commercial value, and the huge sums involved have opened the door to rampant fraud and abuse.

This progress or lack thereof, is notable, when it comes to looking a China's domestic agricultural policies and practices. In 2015, when the central government began launching a series of rural reforms (changing its domestic corn subsidy policy, implementing new environmental regulations on livestock production, and improving the commercial competitiveness of Chinese farmers), President Xi was quoted as saying, "Agriculture cannot be ignored; we cannot forget farmers, we cannot be indifferent to the countryside."

To that end, his proposals advocated collective ownership of rural land; promoting farmer cooperatives and increasing access to capital, technology, and government subsidies. What has materialized in the four years since President Xi gave that speech, is simply a continuance of the prior history he sought to correct.

In September, several articles appeared on various Chinese news outlets pointing to rising farm operator defaults on rent payments to rural village cooperatives. With individual landowners unable to sell or directly own their land and rural migration reducing the number of laborers in the countryside, many small farmers who managed their own small plots turned their acreage over to the village cooperative to lease out. The village cooperatives then took their aggregated total and leased them out to enterprising investors and/or well-off families with the means to undertake large-scale operations.

In addition, these entrepreneurs have generally had a much easier time accessing bank loans, government production subsidies, and crop insurance. The transformation of land ownership is reflected in Anhui Province, where in one

community nearly 62 percent of the farmland has been leased out to large-scale operators.

The problems of nonpayment for rents to the cooperatives have risen as down years due to weather issues resulted in massive crop losses, or as in the case of wheat this year, a large crop pushed down sharply cash prices. At the same, village cooperatives have held their rents at relatively high levels. In Anhui, the average has been above RMB 1000/mu or $865/acre. That translated to more than 50 percent of the average cash price for wheat. Add in the costs of fertilizer, seed, fuel, and labor and many operatives were finding themselves in the red.

In a decent year, a farmer in Anhui might net about $85/acre on his or her wheat operation. In the past couple of years, farm operators have lost an average of $130/acre. That has proven unstainable, and as a result, some farm operators have simply abandoned the land and their obligations to the rural cooperative landholders. In one notable case, village landowners in a northern community in Anhui province reportedly blocked a farmer from completing her harvest saying that she owed the cooperative, fertilizer dealers, and other input providers about RMB 2 million or about $283,000 in unpaid bills.

Some of the articles discussing the situation clamored for even more subsidies and government support to resolve the problems. However, a local government official in Anhui astutely noted that the real issue is inexperienced "farmer entrepreneurs" jumping into the industry in order to benefit from government "awards" and then pivoting away to something else when it turns out the supports were not enough to make ends meet.

In returning to President Xi's goal of restoring harmony to the countryside, these developments are another example of how Beijing's grandiose, top down initiatives often fail to address practical challenges at the local and provincial level. They also reflect a tendency to take shortcuts for the sake of bureaucratic expediency rather than address longer term problems, such as helping rural farmers become better at what they do and how they do it.

As with the case of African Swine Fever (ASF), a dearth of skilled veterinarians, laboratory technicians, and animal health inspectors at the provincial level cannot be overcome with simple decrees and directives from the major ministries in Beijing.

Livestock

China's Live Hog Price Soars in September

Through the third week of September, China's national average live hog price has reached RMB 27.15/kg ($3.83/kg) or RMB 12.32/lb. ($1.74/lb.). Since the end of August, the average price has climbed by RMB 2.46/kg ($.35/kg) or RMB 1.12/lb. ($.16/lb.). This nearly 10 percent increase in just three weeks will push China's monthly food inflation figure well into double digits for the month of September.

For the same week one year ago, the average live hog price stood at RMB 14.19/kg ($2.07/kg) or RMB 6.44/lb. ($.94/lb.), which translates into an annual increase of 91.3 percent. By comparison, China's Ministry for Agriculture and Rural Affairs (MARA), said through the third week of September the wholesale pork price was up year-on-year by 81 percent.

China Feed Industry Data Show Piglets and Sows Down Sharply

Newly released data from China's Feed Industry Information Network, show feed for productions for piglets and sows fell in the first half of 2019 by nearly 25 percent from the first half of 2018. Feed production for piglets came in at just under 12.6 MMT, while for sows it totaled roughly 4.8 MMT.

By contrast, feed production for finishing hogs was up slightly to almost 16.6 MMT, a nearly 1 percent increase from a year ago. High pork prices and an overall meat shortage has pushed the expansion of other animal protein sources. Feed output for the broiler meat poultry and egg layers was up by 12.4 percent and 10.5 percent to 32.8 MMT and 13.03 MMT, respectively. Feed production for ruminants also saw steady growth through the first half of 2019, rising to just over 4.4 MMT for annualized increase of 4.9 percent compared to the first six months of 2018.

MERCOSUR Regional Analysis – 21 October 2019

By WPI Staff

After several weeks of uncertainty, the soybean market is starting to realize that the trade war won't find a short-term solution. The Chinese purchases that U.S. exporters were waiting for never appeared and suddenly the Chinese have started looking for more Brazilian soybeans. Sport offers started to trade again with more demand for October and November positions, showing Chinese crushers' need to cover nearby positions as no more U.S. soybeans were traded. This supported Brazilian basis for November positions, which traded last week at 189X CNF, 8 cents higher than prior sales.

Brazil

October Brazilian soybean exports will probably exceed September volumes, showing a changing trend after 6 straight months of declining volumes. This shows that the Chinese need to rush and cover their shorts in the Brazilian market. Argentina will also likely export a higher volume in October than it did in September.

Now, the market is almost empty of sellers for nearby positions. Trading houses are sensitive on originating old crop soybeans with farmers having sold about 93 percent of the crop already, meaning available volumes are small and it seems risky to pay high premiums to originate, since demand can quickly change if there is a U.S.-China trade agreement. Consequently, traders are preferring to just stay out of it.

For the 2019/20 campaign, however, the situation is much different. Brazilian basis is way cheaper than the U.S. and it's clear China will simply buy Brazilian soybeans. Basis has been dropping in Brazil due to the weaker real that accelerated farmer selling. That was bad for exporters who kept origination volumes buy were forced to sell it was basis below that they paid farmers a few months ago. Therefore, the industry, which is long about 15-18 MMT of soybeans, is suffering from the falling basis.

Nevertheless, this week is opening with good demand from China. This morning, soymeal basis rallied in China, giving Chinese crushers opportunities to hedge purchases at good margins ($28/MT), so crushers decided to buy several positions.

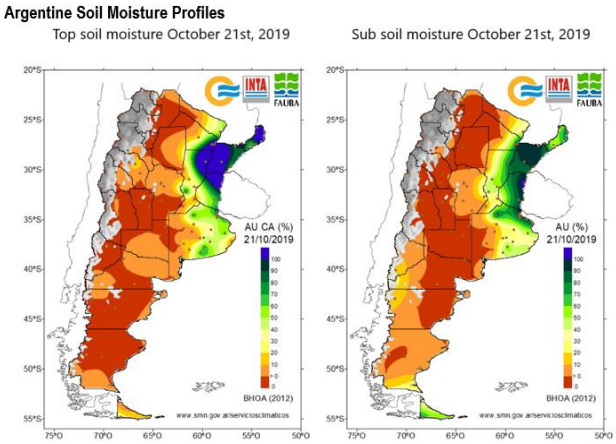
Last week, there was significant movement for April, May, and June positions again, at very aggressive levels. For the moment, these traded values are the cheapest of the year. April traded at 115K, May at 120K, and June at 113N, all CNF China. All these levels sound like they will be the bottom for the market. It's estimated that some 20-25 vessels were traded last week from Brazil to China, almost all new crop.

China is actively looking for offers, but basis has rebounded following good margins in China. This will likely be an active week for trading.

Argentina

Argentine farmers have sold 35 MMT of old crop soybeans from total production of 56 MMT (62 percent). The total volume of soybeans loaded to far in 2019 is roughly 7 MMT. Last week saw daily origination volume of roughly 80,000 MT/day with FOB replacement levels still near 30X and local gross crush margins at $10/MT.

Last week's rains offered good coverage, though with various intensities. The situation has certainly improved for the soybean region, though there are some places in Cordoba, as well as others, where more rains are needed. Planting has just started in the northern Argentina and is advancing southwards.



In the FOB market, there were some exporters looking for November demand with the market heavy amid little demand for spot positions as the Chinese were waiting on clarity on the U.S.-China trade war. November positions are offered at 30X FOB.

Farmers have already sold 5.5 MMT of new crop soybeans, roughly 6 percent of the estimated 53 MMT crop. New crop FOB offers were at -30N last week, though this week have moved higher to -25N. Demand was bidding -30N this week and there are a few rumors of cargoes traded for May shipment already.

Uruguay

Good rains fell last week and will permit the start of planting. There were a few old crop offers but nothing for the new crop.

Paraguay

Commercials and farmers are looking at what will happen with Argentina's presidential elections and how that will influence economics for Paraguayan farmers. Argentina is important to Paraguay's markets as a large share of the Paraguayan crop is sold to Argentine crush plants. Planting in Paraguay has already reached 90 percent.

Macroeconomics

Argentina's general elections will take place Sunday, 27 October and to win, a candidate needs 45 percent of the votes in the first round or over 40 percent of the vote with a 10 percent difference in the second one. The Fernandez-Fernandez *dupla* received 45 percent of the votes in the primary election, so if they repeat that performance, they will be the next President and Vice President. Otherwise, there will be November runoff election.

Last week saw huge volatility in forex and equities and the same might occur this week. Restrictions on buying U.S. dollars pushed parallel markets higher, with the spread between the official and parallel dollar market rising to 10 percent – the highest level in many years.

Even though the Macri administration had many bad economic policies, the administration did positive things (even with higher export taxes) for agriculture. When Cristina Fernandez was president, the export surplus increased sharply for commodities that were affected by government intervention. During the past two years (the Macri administration), Argentina has actually produced and exported corn and wheat.

Everyone knows that farmland needs crop rotations to avoid soil degradation and favorable economic policies increased corn and wheat areas during the current administration. Hopefully, the next government will continue these policies, otherwise Argentina will shift to a soybean-only cropping system (soybeans have the cheapest investment, lower risk, and better economic returns in terms of revenue per invested dollar).

Wheat

With the rains received two weeks ago plus what was received last week, most agricultural areas recovered their soil moisture, with only some areas in Cordoba and Santa Fe receiving insufficient rains.

The 21-21.5 MMT of production discussed at the beginning of the wheat campaign is no longer reachable, but thanks to recent rains, losses will be minimized. Trading houses are now working with 18 -20 MMT of production, with most estimates averaging near 19 MMT.

In the very northern part of Argentina (Salta and Formosa) the harvest is slowly moving with yield slightly above the historic average. The North of Santa Fe and Cordoba crop is in the grain filling

stage and is coming along well, and similar progress is observed in Entre Rios. In the South of Santa Fe and Cordoba, the situation is different, where crop conditions are below average, and yield will be smaller than expected. That same situation holds for western Argentina as well.

These dynamics are having large impacts on the FAS and FOB markets with farmers selling good volumes each week but now at better prices. For November/December delivery, the market is $6-7/MT higher than a week ago ($170/MT versus $163-164/MT) and $10-20/MT higher than two weeks ago.

Looking at the FOB market, before the yield losses were reported, prices were $176-177/MT for December, with no demand. Now, last week ended with offers at $190/MT for December and $193/MT for January ($5/MT higher than the prior week).

Even at these prices, Argentina is still competitive to most destinations but demand has disappeared. WPI believes that buyers will reappear sooner or later, but it can take time for buyers to validate big price increases. It seems Argentine FOB prices for wheat are hitting the ceiling, at least relative to other international offers.

Farmers have already sold 7 MMT (30 percent) but a big problem for exporters is that 4 MMT of that was sold with prices "to be fixed". That means farmers are certainly enjoying the present bull market. Exporters, however, are working at counter margins and have already done programs for 3.5 MMT, which is part of the reason for the $15/MT rally in recent weeks.

Corn

Contrary to the wheat market, corn markets have been quiet with big vessel lineups that continue to exceed expectations. Presently, there are vessels waiting to load 1.5 MMT and October will probably see 3 MMT in corn exports, the highest in at least several years.

Due to the recent rainfall, the flow of trucks to ports has fallen sharply (from 1,500/day to 800/day). Between this and the big vessel lineup, exporters were forced to pay up in the local market to get corn with prompt delivery to ports. After several weeks with FAS corn at $130/MT prices went to $135-136/MT last week, leaving replacements at 10Z for spot and with a few cents carry for deferred positions. This is about 10 cents above the FOB market.

There is some demand from Latin American and the Middle East/North Africa, but buyers are not really ready to get close to asking prices. Exporters need to keep selling, but with big programs already done, small volumes of corn arriving to ports, and negative margins, they are not in a hurry to sell and have no need to discount offers.

Originating corn from the South of Argentina is still complicated. Many exporters need corn to fill panamax vessels, but that volume is not appearing. They are trying to get corn by paying as much as $20/MT higher than Upriver prices. Of course, they are paying it for their short covering as no fresh demand will validate such prices.

The new crop planting is progressing with the recent rainfall and 25 percent of the expected area is seeded so far (4.5 weekly progress). It is difficult to determine the real area that will be planted. We know that due to political uncertainty and lack of soil moisture, some farmers switched to soybeans. Some analysts estimate that in the corn agricultural regions, 5-10 percent of corn area will be switched to soybeans. For example, Cordoba was expected to increase its corn area versus 2018 but will now likely see a decrease.

For Argentina as a whole, the beginning of the campaign saw expectations of 6-7 percent corn area increase, but now the best-case scenario will be 2 percent. Production estimates are now 48-50 MMT.

WPI POLICY ANALYSIS

EPA Biofuel Plans Locks in E15

By Dave Juday

The Trump Administration rolled out its proposed reforms to the biofuels required volume obligations (RVO) today.

- EPA will project the amount of SRE's exempted in a program year by using as a reference the past three years' volumes recommended by the Department of Energy (DOE). EPA consults with DOE when considering SREs, but EPA makes the final decision.

- The three-year average of SREs granted by EPA would total 1.35 billion gallons, but the volume recommended by DOE is likely to be smaller. DOE can, and reportedly has, in some cases recommended partial waivers. EPA has only granted full waivers.

- EPA will project the number of gallons that will receive waivers and other refiners and blenders will be obligated to take up those gallons.

- Approaching it this way, EPA won't have to change the proposed 2020 overall RVOs, but they will increase the percent of biofuels to be blended by individual refiners.

The way the RVO works is EPA proposes a volume for the four RFS targets: cellulosic, biodiesel, advanced, and total. Biodiesel and cellulosic are nested in the advanced category, and the advanced is nested in the total renewable fuel category.

Conventional ethanol is a residual category – i.e. the difference between total renewable and advanced. Those volumes are calculated into percentages by dividing each RFS target by the total estimated supply of renewable gasoline and diesel fuel for the year. For 2020, those percentages are:

2020 RVO Obligations		
Category	RVO	Percent Blending Obligation
Total Renewable Fuel	20.04 bln gal	10.92%
Advanced	5.04 bln gal	2.75%
Cellulosic	0.54 bln gal	0.29%
Biomass based diesel	2.43 bln gal	1.99%

Source: EPA, WPI

Those percentages are then applied to each obligated party's actual supply of gasoline and diesel fuel to determine its specific renewable fuel obligation for that calendar year. After those four categories are calculated, conventional corn ethanol is the residual category.

For the 2020 proposed rule, the conventional ethanol RVO is 15 billion gallons. The estimated volume of gasoline in 2020 is 143.49 billion gallons. So, under the proposed rule originally issued in July, refiners would have to blend ethanol at a rate of 10.45 percent,
or submit purchased or carryover RINs or receive an exemption.

Now, depending on how much EPA adds based on the reallocation of the past SREs, that percentage would increase. Since ethanol is about 75 percent of the total renewable RVO, it will also comprise 75 percent of the reallocated gallons. The table below shows a high and low range of potential blending obligations for the remainder of the refiners after the SRE reallocations.

Reallocated Ethanol	Blending Obligation
1.35 bln gal	11.16%
1.00 bln gal	10.98%
0.675 bln gals	10.81%

Source: WPI

So, at the end of the day, this plan would be much more like what EPA Administrator Wheeler described: a plan to net out conventional ethanol at 15 billion gallons compared to the President's comments that the RVO would be changed to 16 billion gallons.

A couple of takeaways: first, this should be bullish for RINs, which can be slightly bullish for corn. Should the corn supply and demand situation not be as rosy as the October WASDE painted, RINs prices have an increasing impact when corn prices are higher. They can be a catalyst to a bull corn market, as we have seen in past years.

Second, this plan creates a market-wide system for E15. By definition, E15 is any blend between 10.5 percent and 15 percent. This just locks in all refiners into making E15 which is something the biofuel industry has been after for a long time. It is also something the petroleum industry will resist. Stay tuned.

EPA will be holding a public hearing on the plan on 30 October. Then it will be open for comments for another 30 days. That means the 2020 final RVO rule will not be issued by the statutory deadline of 30 November, but the Administration is hopeful that it will be completed by the end of calendar year 2019.

Utopian Agriculture Irony

By Gary Blumenthal

Debating the future of the Common Agricultural Policy (CAP) will be a major objective for the new politicians in Brussels and the twists and turns ahead are fascinating.

First, there is the issue of crop protection. Chemophobia is in full swing with the demand to eliminate the use of chemicals in food production. Rational forces recognize this is a bridge too far and will cause productivity to fall too much for food security purposes. They argue that new breeding techniques that build protections into the plant itself is the future. This is especially true given the threats from climate change.

However, this means getting environmentalists to agree to remove the shackle of the Novel Foods Directive since it will excessively throttle that kind of innovation. Basically, the question now in Brussels is whether synthetic pesticides has become politically more dangerous than genetic modification. It would be great irony if in Europe a relatively benign herbicide like glyphosate has become more evil than GMO's.

Second, is the conflict between the environmentalists and the farm community over how CAP support is allocated. The environmentalists want to end direct payments, especially to large farms, and instead convert to predominantly green payments. Currently less than half the support is focused on agronomic practices and farmers say they cannot be internationally competitive if forced to forego income subsidies and incur ever more greening mandates. Ideally, the EU would convert the direct payments to crop insurance subsidies like the U.S., especially since climate change is making production riskier.

Finally, there is the issue of scale. Small farmers have always been the cuddly panda bears of European agriculture even though larger farms are more efficient. But boosting small and medium-sized businesses will be an over-arching goal in Brussels and small farmers are going to press for their "fair" share. Essentially, the political temptation as always is to subsidize the small and inefficient, be it farms or local digital technology firms, while punishing large, foreign competitors with taxes and carbon duties.


WORLD PERSPECTIVES
AT THE NEXUS OF POLICY & MARKETS