

# The Coronal Virus and Challenge to Our State Organizations

Part 14

Friday April 24, 2020

Month	World Virus Cases <sup>i</sup>	World Virus Deaths
January 31	10,017	120
February 7	30,000	700
February 14	65,000	1,400
February 21	77,000	2,250
February 28	84,000	3,000
March 6	101,000	3,408
March 13	136,000	5,000
March 20	250,000	10,000
March 27	550,000	25,000
April 3	1,010,000	54,000
April 10	1,615,000	96,000
April 17	2,200,000	150,000
April 24	2,800,000	192,000

## Cases In Texas<sup>ii</sup>

Date	Cases	Deaths
March 19	173	3
March 27	1,662	23
April 3	4,900	77
April 10	11,426	222
April 17	16,700	410
April 24	22,500	600

## Path of the Virus

As we noted last week we are now in the depths of the viral pandemic that began less than 4 months ago, sometime in January.

**Limiting human movement and contact** is the major strategy to controlling the spread of the disease and overwhelming medical and hospital resources. How long the effort will take and the number of people killed and damaged is not known. Data are beginning to appear that suggest the rate of spread is declining based on efforts to reduce contact among people.

## The Bigger Story

The greater issue becoming ever more apparent is not the virus but the economy. Various items are appearing in news suggest a reali-

zation of the passing of the paradigm since the Kissinger era that was an emphasis on **globalization** of trade, education, travel and even identity. Kissinger as the Secretary of State and National Security Advisor in the Nixon and Ford Administration led efforts to build ties with China as well as much of the world. Kissinger felt a world with global connections and interdependencies would be a more peaceful and prosperous world.

Today that pattern is changing and it is helpful to think about supply chains to see the advantages and disadvantages of the globalization promoted since 1970. This is a Texas example of the creation of a supply chain.

### **Early Supply Chain**

After the Civil War in 1865, the economy of the South including East Texas collapsed. The significant export from East Texas and the other states of the South was cotton. It was a labor-intensive crop requiring hand planting, weeding and harvesting using much slave labor. The cotton including the bolls (seeds) was shipped from ports on the Gulf to states in New England and England for weaving into fabric. This market collapsed from the Civil War.

Not many years after 1865 and the end of the Civil War, some farmers and ranchers in Central and South Texas using horses began to round up longhorn cattle that roamed the prairies and the brush country in large herds and drove the herds north through Texas then Oklahoma to railroad junctions that had reached western Kansas. The cattle were herded into large wooden pens and then loaded into cattle cars on the railroad. The cattlemen were paid for their herds by meat processing houses in Kansas City, St. Louis and Chicago. The largest meat processing houses were in Chicago where cattle were slaughtered, processed, packaged and then the beef was refrigerated and sent via railroads to markets to the East. As urban populations increased so did the demand for

these packaged meats of beef, hogs and sheep coming from Texas and soon then from other states of the Middle West.

The elements of this early application of supply chains were herds of longhorn cattle living on the open range in Texas. The second step was rounding the cattle up and driving them to a railroad junction in western Kansas, mainly Abilene. Cattle cars carried the animals to processing plants in Chicago. Railroads and some Great Lakes shipping then moved the packaged beef to wholesalers, butcher shops and customers in the increasing urban areas of the eastern United States.

The keys to this development of these long distance supply lines are ample supplies, in this case of beef, dependable modes of transport to processing plants and then to the final markets that mainly were urban. Similar processes began in Japan in 1697 to bridge steps between growers of rice and customers and then creating the first futures exchange. Similarly developments began among American farmers to move corn, wheat, cotton and soybeans from farms to customers that involved storage, grain elevators, processors, packing and shipping, etc.

This led to an organization in Chicago in 1864 to provide funding to growers by creating a futures market. The function of the futures market is to let growers sell a futures contract say in wheat as a promise to deliver 5,000 bushels of grain in October for a specific year. The grower, the farmer if wheat is selling for \$1 a bushel, will receive \$5,000. This promise to deliver puts funds in the hands of the farmer to harvest, then secure seeds, plow the land and prepare for the next seasonal crop. The funds for the farmer come from companies that will need the crop and they buy a futures contract that is a promise they will receive 5,000 bushels of wheat by a specific date in the futures contract. Additional funds in the market come from speculators who bet that prices at the market some months ahead will be higher or lower than those currently existing.

Thus futures/commodity exchanges are “middle men” between the producers and then consumers and come into being to facilitate long delivery chains like for meats and grains in the United States or even longer chains like for oil, metals, etc.

## **The Collapse of Oil Futures Contracts on April 21, 2020**

An event that had never occurred on any oil futures exchange occurred this week on Tuesday. That event was the collapse of a futures contract for the month of May of WTIC (West Texas Intermediate Crude), the oil that the United States produces. What this collapse means is that there was no one to buy and take delivery of oil. The entire supply chain for oil that dates back to the early years of the 20<sup>th</sup> Century just collapsed.

The reason for the collapse was the precipitous drop in the consumption of oil coming from “lockdowns” created to control the Covid-19 virus as well as the collapse of economic activity in many countries including China, and higher levels of oil production coming from Saudi Arabia and Russia. Oil production increases and decreased oil consumption caused a collapse of the chain and prices went negative. **That means that the oil producer did not get paid for the product but would be charged for storing a product that had no buyers!**

## **An Earlier Version**

This event echoes back to the 1980’s when Saudi Arabia punished members of OPEC for producing oil beyond the agreed upon levels. Back then the Saudi’s cost of production was perhaps as low at \$.50 a barrel. In contrast for Texas, it was \$9.50. Oil prices peaked in 1980 near \$40 a barrel and then collapsed under high production from the Saudi’s to \$10 or lower in 1986! This decline in oil prices in turn collapsed much of the Texas economy, first bankrupting oil producers, refiners and shippers then banks and then much of real estate. The oil bonanza of the late 1970’s and early 1980’s promoted speculation in Texas first in oil, then banking and then real es-

tate. The oil bust cratered the Texas economy and out of state buyers picked up Texas banks, as an example, for pennies on the dollar. The FDIC chronicles the collapse with over 400 banks failing in Texas alone.<sup>iii</sup>

### **After a Decade and a Half, Texas Rebounds**

By the 1990's the Texas economy was beginning to diversify to international agricultural exporting and manufacturing including booming joint manufacturing along the border with Mexico in the new NAFTA plants. Initially electronics but soon equipment like refrigerators, motors, trucks and autos were built with Mexican labor than averaged less than a dollar an hour but with American managers and engineers that lived on the American side and traveled to work in Mexico each morning returning in the evening.

Building on innovations like integrated circuits, Texas Instruments and other groups began to create companies, educational research institutions and supplies for electronics. Accompanying this was companies providing software and with the advent of the Internet, an explosion of new businesses.

However oil prices did not start to recover until beginning in 2004 about 20 years from their early 1983-84 peak. As prices rose beyond \$50 a barrel, it became economically feasible to use a variety of methods to extract oil from fields that had been pumped dry now drawing oil from geologically "tight" regions where it could be obtained but at much higher costs than simply drilling a well into an existing pool of oil. This created an industry of oil production in Texas through Oklahoma into Canada designed to acquire higher cost oil, the "fracking" industry. It made possible the boast that the United States no longer needed to import oil but was self-sufficient with domestic reserves.

## The Collapse In Texas

This all changed in April! The twin forces of sharply **declining oil demand** and the **increased production** from Saudi Arabia and Russia have collapsed prices on the futures exchange and all oil storage is filled. This has never happened before in oil! It is part of the deep economic decline being experienced across the world but particularly sharp in the oil producing regions of North America. Greater increases in unemployment are occurring in West Texas, the major oil-producing region and in Houston, the location of the nation's major oil refining and shipping companies.

## The Growing Challenge In Mexico

The consequences are more severe in Mexico where the economy is more narrowly based on jobs from travel and tourism, oil exports, border (NAFTA) manufacturing and money sent back to Mexico from citizens working in the United States (remittances). The Mexico of today is not the nation of forty years ago that was largely rural and families were self-sufficient raising for themselves most of the food consumed. It is an urban population of approximately 130 million. Today at least 60 percent of the jobs Mexicans hold are service jobs such as working in hotels, restaurants and street retail markets. The jobs do not have unemployment or health benefits and workers do not have savings. Unlike the lives of their parents and grandparents that had the land, some chickens, pigs and a cow or goat that provided food and thus safety in hard times, this generation has only the job!

The capability to test and treat for disease is far lower in Mexico than in the United States, but Mexico is more capable than other countries in Central America. Observations from Ecuador are suggestive of how the virus may be being handled in Guatemala, El Salvador, Honduras as well as in South America. Ecuador's population is 17 million, young and largely rural. Health services are limited mainly to urban areas including the ability to test and track

for all disease. The nation's experience with the corona virus is disturbing as in the month of March to April 15, there were 7,600 deaths more than seen for that period of time in an average year. Yet, Ecuador reported only 503 deaths related to the virus. Reports from the country indicated overwhelmed hospitals and mortuaries with dead bodies in streets, hallways and stored in paper boxes.

“The death toll in Ecuador during the outbreak was 15 times higher than the official number of Covid-19 deaths reported by the government, according to an analysis of mortality data by The New York Times. The numbers suggest that the South American country is suffering one of the worst outbreaks in the world.”<sup>iv</sup>



Much of South America and Central America including Mexico have populations and economies similar to Ecuador. News reports from El Paso and San Diego indicate rapidly growing cases of the virus and high death rates in Juarez and Tijuana.

This economic recession and the growth of very violent and powerful cartels are fueling the highest number of homicides in history in Mexico.<sup>v</sup> Mexico is now averaging about 100 people murdered a day while the United States averages about 50 a day. Mexico's population is less than half of the United States. Inflation is rising, the government oil monopoly, PEMEX teeters on bankruptcy and social disorder is spreading. **As the largest customer of Texas' exports, and with a joint border of over 1,200 miles, Mexico's challenges affect Texas directly.**

## Resources in Texas

The critical meaning that must be drawn from this week's **total collapse of oil prices** is that our greatest challenge is not the clearly formidable virus but our economy. The challenge is far more than just getting people out traveling, shopping and working. We have long supply chains that are proving brittle and undependable. We have most of our jobs as service jobs, but lockdowns to slow virus spread has collapsed the economy with unemployment rising higher than 20%<sup>vi</sup> Most Americans are not substantially different than Mexicans. Most live not so much day-to-day but week or month to the next week or month. Few have substantial savings to exist unemployed for weeks or months. Unlike three or four generations ago, they are not living on farms where most of what they eat, they raise!

But unlike many states in the country Texas maintains highly fertile agricultural resources that meet all of the needs of the population and provide exports to other states and countries like Mexico. Oil is the state's greatest export, but its recovery costs are higher than areas like Saudi Arabia. It was the Saudis that demolished

Texas oil businesses in the 1980's by oversupplying and pushing oil prices below the levels that were profitable for Texas' companies. The Saudis again and the Russians are the actors this time.

Like concerns of the source of the Covid-19 virus, there is some reason to worry about international actors. International conflict is rising and there are many ways to vector threats into our communities. Whether it be the price of oil, or the availability of pharmaceuticals or parts for a car or computer, globalization with its vulnerable supply chains strongly advises building a more independent and resilient economy!

Thankfully today Texas has a more complex economy with significant activities and human capital in manufacturing, particularly computer-related, software design and support, insurance, health, pharmaceuticals and banking. **These concerns and ones to be developed are the Texas economy of the future.**

### **Observations and Urgings from Last Time**

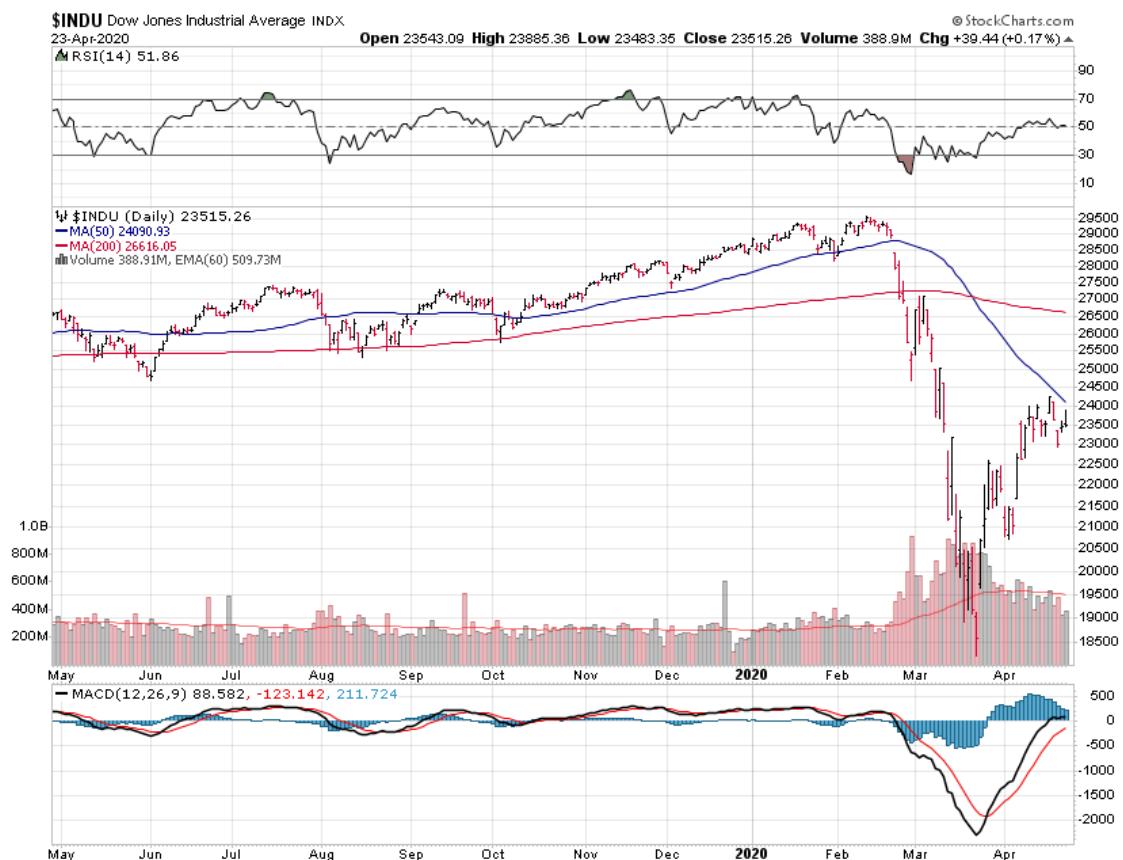
Our state agencies can provide continuity through these turbulent and frightening times by being aware of all of these issues, communicating clearly with colleagues and with all other organizations in every community. Be active in one's neighborhoods, business and professional associations, the public schools, religious organizations, helping develop greater resiliency and local competence. Remember the example of the **“neighborhood watch”** to expand police presence for neighbors by neighbors in times of challenge.

Knowing, trusting and working with others is termed **social capital**. It is the basis of building wealth including creating better organizations and new organizations. Our state agencies represent a huge store of social capital for the state. It is the largest store of such potential innovation in the entire state. Our challenge is to build a new economy less dependent on oil, distant, brittle supply chains and unpredictable events.

## Key Economic Indicators: Oil and Stock Market

West Texas Intermediate Crude is the oil the United States produces.





## References

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