

Agricultural Products. Russian Embargo and Import Substitution: Current Status and Trends

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A short history of Russian agricultural products embargo

- On August 7, 2014, the Russian government imposed an embargo on a range of agricultural and food products imported from the European Union (EU), the United States, Canada, Australia and Norway.
- On August 13, 2015 the countries which joined the anti-Russian sanctions as Albania, Montenegro, Iceland, Liechtenstein, since 1 January 2016, Ukraine were included into this list.
- Since August 2015 “sanction products” in Russia are subject to destruction.
- The EU Council extended anti-Russian sanctions until January 31 2017, and Russia extended its counter-sanctions until December 31 2017.

A short history of Russian agricultural products embargo

- The products covered include bovine meat, pig meat, processed meat, poultry, fish and other seafood, milk and milk products, vegetables, fruits and nuts.
- It was supposed that the countries fallen under the embargo will not be able to find a replacement for the Russian market and will suffer losses.
- Economists of РАНХиГС (Russian Academy of Public Economics and Government Service) say: the Russian share in agricultural exports of these countries in 2013 was about 4.8%.
- At the same time the dependence of Russia on imported agricultural products from these countries was high, import declined from 44% in 2013 to 24% in 2015.

A short history of Russian agricultural products embargo

Russia's imports of products affected by the ban, (US\$ mln), 2013

	From all sources	From banned countries	Share of banned countries in total, %
Beef	3164	276	8,7
Pork	2213	1570	70,9
Poultry	895	432	48,3
Fish and seafood	2895	1541	53,2
Milk and milk products	4653	1786	38,4
Vegetables	2930	946	32,3
Fruits	6434	1755	27,3

A short history of Russian agricultural products embargo

- ▶ The ban was a reaction to sanctions imposed by Western countries in the course of the political conflict over Ukraine, including the annexation of the Crimea by the Russian Federation earlier in 2014.
- ▶ It was not by accident that the Russian administration chose the agricultural sector as an arena for import restrictions
- ▶ Against the collapse of the domestic livestock herd after the dissolution of the Soviet Union, worldwide food price increases, and recurrent droughts in some of the main agricultural regions, self-sufficiency in food has become a key political goal of the Russian government.

A short history of Russian agricultural products embargo

The ban raises some important question:

- To what extent do the sanctions imply price increases and welfare losses for Russian consumers?
- Which previous exporters were hit most?
- To what extent and how fast will they be replaced by other sources?
- Will the ban be instrumental for boosting domestic productivity in agriculture?

Russian embargo impact on European agricultural sector

Share of exports to Russia in the value of exports of the affected product, by exporter, 2013

	Beef	Pork	Poultry	Fish and seafood	Milk and milk products	Vegetables	Fruits
USA	0	0,4	6,2	1,6	0	0,1	1,5
EU*	20,1	25,4	4,9	4,6	6,6	25,3	32,4
Canada	0	9,6	0	2,8	0	0,2	0
Australia	2,8	0	0	0	3,3	0	0,9
Norway	0	0	0	11,0	3,6	0	0

*Intra-EU trade is excluded

Russian embargo impact on European agricultural sector

- ▶ It is possible to identify the differential impact of the ban across countries reflecting the significance of the Russian market for their respective export trades.
- ▶ For example, Russia had been a key destination for cheese exports from the Baltic countries, representing more than 30% of Lithuanian, and some 83% of Finland's cheese exports went to Russia.
- ▶ Russia was a key destination for Finnish butter exports outside the EU, while for France, Russia represented 15% of its extra - EU exports.

Russian embargo impact on European agricultural sector

The biggest losers: Value of exports of the affected products in 2013 for exports over 100 mln USD

Country	Product	Exports to Russia, USD, mln	Total Exports, USD, mln	Share of Russia in total Exports, %
Canada	Pork	247	2556	9.6
	Fish and seafood	106	3364	2.7
Denmark	Pork	263	3393	7.8
Finland	Milk and milk products	336	691	48.6
France	Milk and milk products	132	8042	1.6
Germany	Pork	318	5290	6.0
	Milk and milk products	211	11217	1.9
Lithuania	Milk and milk products	211	774	27.3
Netherlands	Pork	101	2290	4.4
	Milk and milk products	443	11232	3.9
	Vegetables	115	7906	1.5
Norway	Fish and seafood	1109	10126	10.9
Poland	Milk and milk products	187	2091	8.9
	Vegetables	231	1168	19.8
	Fruits	451	1486	30.4
Spain	Pork	106	3171	3.4
	Fruits	210	9260	2.3
USA	Poultry	307	4982	6.2

Russian embargo impact on European agricultural sector

- ▶ In the case of Hungary, though its pork and poultry sectors were affected, the banned products in total represented less than 30% of Hungarian agricultural exports to Russia.
- ▶ According to the report of Norwegian Marine Data Centre, the volume of exports of Norwegian fish in 2015 was record over the past ten years. It amounted to 7.75 billion Euros, 8% greater than in 2014 and twice as much as a decade ago. The main buyers were Poland, Denmark, France.
- ▶ The direct effect of the ban on Czech exports is marginal, the country was affected more by the indirect impact of over-supply of agricultural products such as meat and fruit on the internal market. (Banned meat exports to Russia from the Netherlands, Belgium and Germany were imported to the Czech Republic at very low prices, which were hard for Czech farmers to compete with)

Russian embargo impact on European agricultural sector

- ▶ In the case of Poland, the Russian ban is considered as contributing to the collapse of apple prices in the country (about 40% of Polish exports went to Russia) and it also affected other sectors such as mushrooms and tomatoes. Its exports of cheese to Russia represented 43% of total cheese exports, equivalent to 4% of Poland's entire cheese production. Based on data from 2013, the ban covered 67% of Polish agri-food export to Russian Federation
- ▶ However, according to the Ministry of Agriculture and Rural Development, Poland almost immediately adapted to the changed conditions. Agri-food product exports income in 2015, is reached a value of ca. 22.5 billion Euro, and is 3% greater than in 2014. Exports of pork and beef was reoriented to the EU countries.
- ▶ The crash of cheese export to Russia resulted in the dairy industry increasing sales to Algeria and countries of Asia, which report demand mainly for milk and powdered whey.

Russian embargo impact on Russian Economy and agricultural sector

Russia is most heavily dependent on supplies of beef (according to some estimates, up to 62% of consumption), fish (50%), cheese and curd (48%) and fruit (45%).

Product	2015	2014	Change, %
Fresh, chilled beef	103	99	4
Refrigerated beef	332	531	-37
Pork	305	381	-20
Poultry	253	453	-44
Fresh, chilled fish	30	86	-66
Milk, skimmed milk	246	299	-18
Butter	94	150	-38
Cheese and curd	198	314	-38

Russian embargo impact on Russian Economy and agricultural sector

- Consumer prices for all key socially important goods rose by double digits.
- In May 2015 the average consumer price of beef increased by 23% compared to May 2014, for pork - by 22%, cheese - by 20%, for frozen fish - by 38%, carrot - by 39%, for apples - 37%, cereals and beans - by 49.2%.
- The prices of goods that do not fall under the embargo did grow too: the price of sugar rose by 52.2%, sunflower oil - by 23.7%, pasta - by 21.6%.
- The embargo only strengthened previously established price trends in the markets of meat and fish.
- The rise in prices for dairy products and apples became a direct result of decreased supply and reduced competition in the Russian market.

Russian embargo impact on Russian Economy and agricultural sector

- In 2015, there was a sharp drop in household income: real disposable income and the average wage in real terms decreased by 4% and 9.5%, respectively, which led not only to a significant reduction in consumption, but also to a change in its structure.
- In 2014, the share of food in the consumer basket resumed growth and reached 38%.
- This share is much higher than in developed countries (10-20%) and even higher than in some developing countries (e.g., in Brazil food accounts for 17.8% of the consumer basket).

Russian embargo impact on Russian Economy and agricultural sector

- Export of dairy products from Belarus significantly increased. In 2015, more than 80% of imported cheese in Russia was delivered by Belarus. Thus, in 2015 the dependence of Russia on imported cheeses, cottage cheese, butter and other fats from one country – Belarus is significantly increased.
- At the same time a positive impact of food embargo experience some Russian and foreign cheesemakers.
- During two years of embargo, foreign manufacturers of cheese, with production facilities in Russia, greatly expanded the production of famous brands. Finnish Valio made significant investments in production and expanded co-operation with Russian cheesemakers under their own brands.
- According to the Analytical Center of Government of RF, the market share of the most famous brands of cheese that are produced in Russia, increased in 2013-2015 from 23.5% to 25%. In particular, the company Hochland has fixed its leading position in the Russian market.

Russian embargo impact on Russian Economy and agricultural sector

- ▶ Russia's partners in the Customs Union of Eurasian Economic community, Belarus and Kazakhstan, will face serious temptation to benefit from the situation.
- ▶ Although President of Belarus Alexander Lukashenko ensured Vladimir Putin that his country will obey the Russian embargo, he specifically said that Belarus will not allow transit of banned foods to Russia, but will continue buying European products for its internal purposes.
- ▶ Such wording gives a wide range of opportunities for Belarusian businesses to engage in profitable relabeling and light processing of banned food products.

Russian import substitution policy. Expectations and Concerns

- ▶ The Russian government has taken action to downplay the negative impact of Embargo on internal market supplies and to convince the public that Russia is ready to replace selected missing goods with imports from countries on which sanctions have not been imposed (Latin America, Turkey, Egypt, Morocco, China, Uzbekistan, Turkmenistan and Azerbaijan).
- ▶ In addition to this political aspect, the Russian counter-sanctions were intended to stimulate Russia's agricultural production, which constitutes around four percent of Russia's GDP.

Russian import substitution policy. Expectations and Concerns

- In 2015 Russia's agricultural industry recorded annual growth of 3 percent, and grew by another 2.6 percent (annualized) in the first half of 2016.
- However, domestic production in the case of many product groups is uncompetitive in terms of price and quality when compared to imported goods.
- Many of the products on which the sanctions have been imposed are not produced or processed in Russia at all.

Russian import substitution policy. Expectations and Concerns

- ▶ According to the Russian Minister of Agriculture Mr. Tkachev, Russian agriculture and production sector has become much more competitive. He says that the average operating profitability of farming producers reaches 20% with governmental support and about 10% without donations.
- ▶ Depreciation of the ruble is another reason why home-made goods are in a more advantageous position if compared to the foreign products. The stronger is the US dollar the higher are the prices of foreign goods. And what is even more important Russians started to choose domestic products over foreign goods.

Russian import substitution policy. Expectations and Concerns

- That is why the market creep is very unlikely to happen even if the embargo will be abolished says Mr. Tkachev.
- For example the country has no more need for foreign pork or poultry – this niche is fully covered by the domestic producers. The same is relevant for sugar, buckwheat, potato and oil.
- The Minister highlighted that when it comes to beef market Russian farmers should be able to cover this niches for 80-85 % within five years from now.

Russian import substitution policy. Expectations and Concerns

- ▶ Tatyana Radchenko, deputy head of the Russian government's Analytical Center told RIA Novosti that during 2014 and 2015, Russia's production of meat and poultry rose by an average of ten percent, the production of cheese products rose by 10.6 percent and butter by 3.2 percent.
- ▶ Radchenko said that the proportion of imported meat and poultry products on the Russian market decreased from 27 percent in 2013 to 13 percent in 2015. The proportion of imported butter decreased from 36 percent to 26 percent, and imported cheese from 48 percent to 23 percent.

Russian import substitution policy. Expectations and Concerns

- Beef and dairy herd numbers have fallen while almost all the rest of the sector has seen increased levels of activity.
- Natalya Zubarevich argues persuasively that the difference is due to uncertainty about the duration of the counter-sanctions, since crops, pigs and poultry have relatively short payback periods whereas investing in cattle requires a five-to seven-year horizon, and nobody can be confident that the counter-sanctions will last that long.
- The increase in the agricultural yields and reallocation of resources would require additional time.

Russian import substitution policy. Expectations and Concerns

- ▶ The development of land cultivation, animal husbandry and gardening have been neglected for years in Russia and so this along with the reconstruction of food and agricultural production processing plants (slaughterhouses, warehouses, cold stores, sorting plants, etc.) will require a few years, vast financial outlays and the preparation of qualified staff at the very least.
- ▶ The development of agricultural production must also be accompanied by the development of agricultural machinery production and services, the reconstruction of research and development centres dedicated to agriculture, the development of veterinary and epidemiological services and many other measures.

Russian import substitution policy. Expectations and Concerns

- Electricity and farming tycoon Dmitry Arzhanov told that he plans to invest heavily in apples and potatoes to fill gaps caused by the food embargo.
- But Arzhanov said cheap Polish apples would probably flood back to Russia if the embargo were lifted soon.
- In general Russia needed to keep import restrictions in place long enough for domestic producers to invest and turn a profit, which often required several years, he said.
- "I'm not for counter-sanctions or against them. I'm for consistency. If they have been introduced then they will need to remain for a certain time."
- Arzhanov's concerns illustrate the likelihood that import restrictions may ultimately prove hard to remove because of the domestic lobbies that benefit from them.

Russian import substitution policy. Expectations and Concerns

According to the report of analytical Center of RF Government:

- ▶ “The introduction of the embargo has created an opportunity for import substitution by domestic manufacturers, but the potential of import substitution in the short term proved to be far from fully realized.”
- ▶ The reasons lie in a number of objective economic factors:
- ▶ The production of some products, such as beef and fish, is associated with long payback periods of investment projects;

Russian import substitution policy. Expectations and Concerns (cont.)

- ▶ The production cycle can significantly exceed the annual period of the embargo, which has a negative impact on incentives to invest in production capacity. The announcement of the extension of the embargo for a year increases the incentives to invest, however, the planning horizon is again limited to an annual period;
- ▶ An increase in interest rates to a large extent limited the ability of producers to obtain loans not only for investment but also for working capital;
- ▶ Increased expenses for imported raw materials;
- ▶ Food production has grown only in several food categories, and could only partially substitute imported products under ban.

Russian import substitution policy. Expectations and Concerns

- ▶ Russia remains one of the world's largest manufacturers.
- ▶ The problem is that much of this manufacturing is not competitive on global markets, is consumed domestically and is correlated with performance in the hydrocarbons industry.
- ▶ Research suggests that successful economic diversification occurs when there is a substantial and sustained investment in activities that are close to a country's existing areas of comparative advantage.
- ▶ This might see resources allocated to the development of oil refining, petrochemicals, and even the oil and gas extraction equipment industry.
- ▶ In Russia's case, this might mean that attempts to stimulate industries such as nanotechnology or beef herds are likely to fail.

Russian import substitution policy. Expectations and Concerns

- ▶ An October 2015 article under the name of Prime Minister Dmitry Medvedev, who also chairs the Government Commission on Import Substitution, suggests that part of the political elite still wishes to see Russia pursuing integration with the global economy.
- ▶ It starts with the proposition that the main aim of economic policies to enable the country “to enter the group of countries with the highest level of well-being”.
- ▶ But, it continues, Russia lags behind these countries in labor productivity and needs to become more competitive.
- ▶ Most countries that make a breakthrough into the leading group use the advantages of free trade: “It is hard to name countries that have made continuing, steady progress by prolonged self-limitation in trade.”
- ▶ The article concludes that sanctions will sooner or later come to an end, that a return to cooperation with the West is inevitable, and that import substitution must not become the “slogan of the day”.

Russian import substitution policy. Expectations and Concerns

- ▶ The import-substitution plans may reduce competition in the economy is made even more worrying by the fact that the intensity of competition across the Russian economy is already low by global standards
- ▶ This is important because of the role that competition plays in stimulating productivity and innovation
- ▶ Real diversification will occur only if new industries are export-oriented.

Russian import substitution policy. Expectations and Concerns

Pascal Lamy, a former head of the World Trade Organization:

- import-substitution policies rarely bring long-term economic benefits, because they contradict the principles of free trade.
- It's a tiny and shrinking part of the market of ideas. But blaming the foreigner has always been a fundamental trick of domestic politics: it has worked for centuries.
- Import-substitution policies may well work in terms of boosting domestic production. But they do so at the expense of consumers, who end up paying more, and erode overall economic performance by distorting the allocation of resources.
- In most of the cases import substitution policies have failed. They degrade the efficiency of their economy.



Thank you very much for your attention!

