

Analysis

The Food Problem in Russian Agriculture

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Abstract

Since the collapse of the Soviet Union, enormous changes have occurred in Russia's agricultural system affecting who produces the food, how much is produced and food trade policies. Despite neo-liberal reforms, Russia finds itself in a roughly similar situation as during the early 1990s: increased food imports attendant with rising input costs for farms and higher food prices for consumers. As a result, one constant for Russia is its continued search for "food security."

Russia's Food Problems Under Yeltsin

When Boris Yeltsin was president, a confluence of factors created a hostile macroeconomic climate leading to a significant decline in food production during the 1990s (see Table 1 on page 7). Using an index of physical volume of output (1990=100), in Yeltsin's last year in office agricultural production by large enterprises (former state and collective farms) declined to 36 percent of their 1990 levels. Moreover, during the 1990s the structure of output changed so that by the end of the decade households and not-large farms were the predominant producer as measured in ruble value (see Table 2 on page 8). Most affected in the decline was the animal husbandry sector. Among all food producers during the Yeltsin presidency, the number of cattle (both beef and milk) and pigs declined by about 49 percent. To put those declines in perspective, during the first seven years of Stalin's collectivization when peasant households rebelled against nationalization, the number of beef cattle decreased by 40 percent and the number of pigs by 33 percent. However, on large farms in the Yeltsin period the number of beef cattle declined by 60 percent and the number of pigs contracted by 64 percent from January 1, 1992 to the end of December 1999. As a result of the decline in livestock holdings, national animal stocks in 1999 were smaller than herds in the late 1950s.

The national decline in domestic food production had two main effects. First, with the deregulation of foreign trade and liberalized food trade policies, declines in domestic production contributed to a significant increase in food imports during much of the 1990s, even as demand and food consumption were falling. In other words, the Russian consumer was substituting cheaper imported food for domestic food products, partly due to availability and partly due to preference. During the 1990s, Russia annually spent several times more on food imports than was allocated in the federal budget for support of agriculture (see Table 3 on page 8). In reality the

financial situation was even worse than what appeared on paper because only a small percentage of what was allocated to agriculture was actually spent. Moreover, inflation continued to erode the purchasing power of the ruble, and annual allocations to agriculture lagged considerably behind inflation.

Russia's relatively open foreign trade policy gave rise to the second effect: perceptions of danger over the nation's "food security." Declines in domestic production and the removal of trade protectionism led to increased calls for Russian food security after 1995. As food imports rose to 40 percent of Russia's food supply – and 85 percent of the meat supply in large cities – advocates of food security supported higher trade barriers in the form of tariffs or even import quotas in order to protect domestic producers. Advocates for food security were found among large farms and private farmers, food-producing regions, food processors, various agricultural interest groups and political parties, as well as in the Ministry of Agriculture.

Russia's national food crisis hit bottom when the ruble was devalued by nearly 75 percent in August 1998 and the harvest that year reached only 47.8 million tons of grain, the lowest since the 1950s. Even though the United States and the European Union offered food aid to Russia that extended into 2000, there were widespread reports of empty shelves, long lines, and hoarding as people stocked up in anticipation of continuing price escalation, even in relatively well-stocked cities like Moscow. Food imports, which had been rising during much of the 1990s, fell immediately after the 1998 financial crisis, but by mid-1999 had resumed their upward trend. When Boris Yeltsin left the political scene at the end of 1999, the problems facing Russian agriculture were multifaceted and the sector was in a catastrophic condition.

Russia's Food Situation After Yeltsin

Starting in late 1999, with Vladimir Putin as prime minister, and continuing when he became president,

Russia experienced a significant rebound in domestic food production. Part of the rebound was the “bounce” that occurred from the 1998 bottom. The changing price relationships between domestic and imported foodstuffs, with domestic products becoming more competitive on price, quality, and packaging, contributed as well. But a good deal of the improvement flowed from a different orientation toward agriculture by the Putin government, particularly since Putin indicated that he wanted to see import levels drop as the country became more self-reliant.

A broad-based strategy of state support for Russia’s agriculture was evident during Putin’s two terms. Policies and programs were introduced to assist large farms and the private sector (private farms and households operating a private plot). These initiatives strengthened each of three main food producers and increased the nation’s food output during 1999 through 2007. In late 2007, the national project in agriculture, which originally ran during 2006–2007, was extended to 2008–2012 (a program called “The Development of Agriculture”). This program envisioned state expenditures of several hundreds of billions of rubles during the next five years. Once Dmitri Medvedev became president, he repeated previous promises that state resources would continue to be used to stimulate development in the agricultural sector.

With governmental programs and financial support to the agricultural sector since 2000, agricultural production rebounded from its deep depression of the 1990s. In 2007 food production had increased for all of the major food products, except milk, in comparison to the 1998–1999 average (see Table 4 on page 9–10).

Moreover, each of the three major producers experienced an increase in food production, although not at equal rates. Private farms’ output since 2001 grew the most rapidly until 2007. As a result, by 2007 the value of private farms’ output accounted for more than 6 percent of national production, or more than three times the percentage obtained during the 1990s. Output on large farms increased steadily, though not as spectacularly as the value on production from private farms. By 2007 the value of output from large farms accounted for about 41 percent of national production. But because large farms had a larger base from which to begin, even lower growth rates translated into large production increases and contributed to higher export volumes for some products, particularly grain. By 2006–2007 Russia had not only established domestic grain reserves, but was exporting in excess of 10 million tons of grain annually during 2005–2007. More broadly, the value

of food exports more than doubled from \$1.6 billion in 2000 to \$9.1 billion in 2007, most of which was grain. Even with this increase, it should be noted that the export of agricultural products accounted for less than 3 percent of the total value of Russia’s exports, as oil and gas exports continued to dominate both in terms of value and volume. Household production, which grew rapidly in the first half of the 1990s and stagnated thereafter, continued to display uneven growth and increased the least among the three main producers (see Table 5 on page 11). In 2007 households continued to produce the highest total value of food production, a position they had held since 1997. In 2007 the value of production from households’ production accounted for almost 53 percent of national production.

The rebound in the domestic economy and an increase in real incomes among consumers facilitated an increase in food consumption. Although differences in consumption levels are evident across socioeconomic groups and regions, the general consumption trend is upward, particularly for meat, a high preference commodity (see Table 6 on page 12). While domestic producers responded to increased demand by producing more meat, the animal husbandry sector was slower to recover and herd sizes remained significantly below 1990 levels. The reason for a slower recovery is that the raising of beef cattle remained unprofitable due in large part to price disparities between feed costs and the wholesale price of beef. While the production and sale of grain was profitable in every year during 2000–2007, the raising and sale of beef cattle was unprofitable in every year during the same period. Because Russia’s meat production continued to lag 1990 levels, imported meat accounted for more than one-third of total supply after 2000 (see Table 7 on page 13). In mid-February 2008 President Putin stated that Russia’s largest cities import 80–85 percent of their meat supply. During 2003–2007 food imports grew at a faster rate than domestic production, thereby reflecting both increased demand and the inability of domestic producers to meet consumer demand (see Table 8 on page 13). In 2007, the value of food imports into Russia exceeded \$27 billion, and during the first half of 2008 alone the value of imports exceeded \$19.5 billion.

Flowing from concerns over food security, trade protectionism increased – including import quotas on various meat and meat products from nations outside the CIS during 2003–2005 and 2006–2009 – even as negotiations heated up for Russia’s entry into the World Trade Organization after 2001. In addition, the government opted for more regulation of internal food

markets in an attempt to protect consumers, including “voluntary” limits on wholesale and retail prices in late 2007 that extended through April 2008. In recent years Minister of Agriculture Aleksei Gordeev spoke many times on the undesirability of high import levels and about the need to regulate food markets to protect domestic producers, and in spring 2008 the government began to draft a federal law on food security.

Russia’s Food Problem Today

Russia’s food problem today consists of three separate, but related, components. The first aspect of the food problem concerns sectoral production, the second concerns rising retail prices, and the third problem concerns the banking and credit crisis that spread to Russia.

Sectoral Production

The first problem raises questions about why Russia has difficulty feeding itself. Despite an increase in food production from Russia’s domestic producers since 2000, advocates of “food security” assert that Russia is dangerously dependent upon imported foodstuffs. Indeed, in 2007 the value of Russia’s food imports was about three times the value of its food exports. Among G8 nations, only Japan and Russia are net food importers, and Russia imports almost one-half of the food and agricultural products it consumes each year. There is no single cause but rather a confluence of factors that has created the inability of domestic producers to meet demand.

While domestic food production has rebounded from its decline in the 1990s, growth rates in the agricultural sector have lagged growth rates in the economy as a whole and increases in real income. In other words, domestic production cannot satisfy increased demand that has resulted from higher real incomes. The value of total agricultural production in 2007 was just over 78 percent the level of 1990. But there are important sectoral differences. The value of production of plant products in 2007 was 107 percent that of 1990, but the value of animal husbandry production was less than 58 percent the 1990 level. In 2006, meat consumption had almost reached 1990 levels, but the size of beef and milk cattle herds was only 38 percent of the 1990 level, and domestic meat output was about one-half the 1990 level. During the first half of 2008 demand for meat increased by about 5 percent, forcing policy makers to reduce import duties to meet consumer demand. Meat imports increased which satisfied consumers, but domestic producers called for more protectionism.

Why don’t Russian farms just produce more if demand is growing? One reason is that increases in costs

from fuels, feed, and fertilizers have created price disparities between inputs and farmgate prices whereby input prices have risen faster than wholesale prices received by producers. Moreover, many large farms are just emerging or recently emerged from acute financial strain (about 20,000 large farms have gone through bankruptcy procedures during the past four years), and for these farms increased input costs and price disparities restrict economic expansion. Because Russia today is more integrated into the world economy than at any time in the past 60 years, the worldwide increase in the price of oil and feed grains has affected the livestock sector. In Russia, farms have not been sheltered from these commodity price increases, and rapidly rising feed and transportation costs offset the infusion of state financial assistance to the animal husbandry sector.

Another factor restricting production expansion is the shortage of skilled workers and antiquated agricultural machinery and technology. Because incomes for agricultural workers are at or near the bottom of the national income scale, large farms often lose skilled labor to other professions or other branches of the economy. Factor in lower levels of rural amenities, educational and cultural opportunities, and substandard rural housing and it is easy to understand the difficulty of retaining high quality rural labor. As a result, less-skilled labor is used that decreases efficiency and adds to production costs. In addition, it is estimated that much of Russia’s technological base in agriculture is two to three generations behind the developed world, a reflection of years of neglect and lack of investment. These shortcomings affect both production levels and yields.

Retail Prices

The second aspect of Russia’s contemporary food problem concerns rising retail prices. Since the beginning of 2008, retail food prices have risen significantly – over 11 percent in Russia compared to 3.1 percent in the European Union. In Russia, the hardest hit have been the poorest segments of society that even before escalating food prices spent more than one-half of their income on food. In April 2008 Minister Gordeev spoke in favor of a food security law that would regulate retail prices for some foodstuffs and that would increase subsidies to agriculture. In June 2008 legislators wrote a draft law that would provide food stamps for the poor in Russia. The idea for regulated food prices was not embraced because it conjured up memories of a planned economy, but it did highlight the vulnerability that Russia feels as a result of its food insecurity. A large part of rising food retail prices in Russia reflects

worldwide trends in the price of oil and feed grains such as corn and other food grains, the latter a result of higher biofuel production in the developed world. But Russia has experienced higher price increases than in many other European states. Why? One reason is that food inflation is part of the broader inflationary problem that Russia is experiencing. By June 2008 inflation was running at a 15 percent annual rate (compared to 8 percent in 2007), reflecting an overheated economy and a splurge of government spending as a result of high oil revenues.

Related specifically to agriculture is the gap between demand for and domestic production of high-preference and high cost meat products. Because Russia imports so much of its meat supply, the retail price of meat reflects higher production costs incurred by foreign producers for fuel and transportation, as well as higher feed costs. In addition to rising fuel and feed costs, another factor is that Russia remains plagued by inadequate infrastructure that affects the transportation of food once it is produced. It is both difficult and costly to move food from areas of surplus to areas of demand. Rising tariff rates by transport monopolies increase the cost of the transportation across Russia's vast spaces, thereby creating pockets of deficit for certain commodities. High demand areas therefore turn to imports. Inadequate infrastructure also affects export capacity for the volume of surplus grain that is being produced. This situation in turn limits exporters' earnings and creates disincentives to increase production that may put downward pressure on retail prices of bread and bread products, as well as feed grains. Further, a lack of competitive wholesale markets in many regions adds as much as 30–35 percent to the cost of bread products, as estimated by the president of the Russian guild of bread and pastry makers.

The Financial Crisis

The third aspect of Russia's food problem concerns the recent crisis in banking and credit markets that started in the US and subsequently spread to other regions of the world, including Russia. Attendant with the dramatic decline in the price of oil, the financial crisis poses several critical questions for Russia's agriculture going forward. By November 2008 the price of a barrel of oil was down more than 50 percent from its July 2008 high, so with a decline of oil revenues into state coffers the first question is whether the Russian government will be able to stay the course and fully fund the five year development program in agriculture that was extended in late 2007. It is too early to draw any firm con-

clusions and there have been no published indications of backtracking. Before the financial and credit crisis hit in October 2008 Russia had monetary reserves of \$515 billion. By the end of October the Russian government had announced \$200 billion of bailout funds for banks and other financial institutions, and with an appreciation of the dollar against the ruble suddenly the reserves did not look so large. The allocation of relief funds might affect the willingness and ability to spend the amount of money originally intended, which for agriculture was planned to total over R500 billion by 2012. Russian agriculture already receives much less state financial support than EU nations and other developed countries. For this reason, supporters of the state program to develop agriculture argue that any reduction will have direct consequences on domestic production and will exacerbate food insecurity even more.

A second question concerns the effect the financial crisis will have on investment into agriculture. In recent years the volume of private investment has increased substantially. As the agricultural sector has become profitable, Russian banks, food processors, and other companies have become very active in purchasing agricultural land and even whole farms. But that may change with the global financial crisis and impending world recession. As this article was being completed, the effects of the financial crisis were being felt primarily by oligarchs and less so by ordinary people, but it was precisely Russian oligarchs, their companies, and their banks that in recent years were the primary domestic investors in the agricultural sector.

As the financial crisis spreads throughout other European nations, a corollary question is the effect of the crisis on foreign investment into Russian agriculture. In recent years, foreign investment in agriculture also increased significantly rising from \$154 million in 2003 to \$325 million in 2006. Whether or not this trend will be maintained remains to be seen, but at first glance it appears doubtful as the first stages of the financial crisis brought capital flight and a significant reduction in foreign investment in the Russian economy. It is difficult to see why the agricultural sector would be an exception.

A final question concerns the extent to which the credit crisis will affect the distribution of credit from state-owned Rossel'khozbank to food producers. While the private credit market is still developing and presently unable to provide the volume of credit needed by producers, Rossel'khozbank has been the primary source for state credits and financial assistance to agricultural borrowers (large farms, private farms, and ru-

ral households). If the credit crisis is short-lived then the effects are not likely to be too detrimental over the longer term. But if the credit crisis persists as many analysts believe, the impact on Russian agriculture will be severe as producers may not have access to the credit they need to finance production for current demand or to invest in an expansion of production capacity to meet future demand.

For the short-term future at least, the trajectory of Russia's food problem is unlikely to change significant-

ly. Domestic production will continue to lag demand, consumers will continue to experience upward pressure on retail prices, and Russia is likely to remain a heavy importer of the food it consumes. The irony is that almost 20 years after market reform was begun in agriculture, the Russian countryside and agrarian policies have changed in fundamental ways, but some of the core problems remain.

About the author

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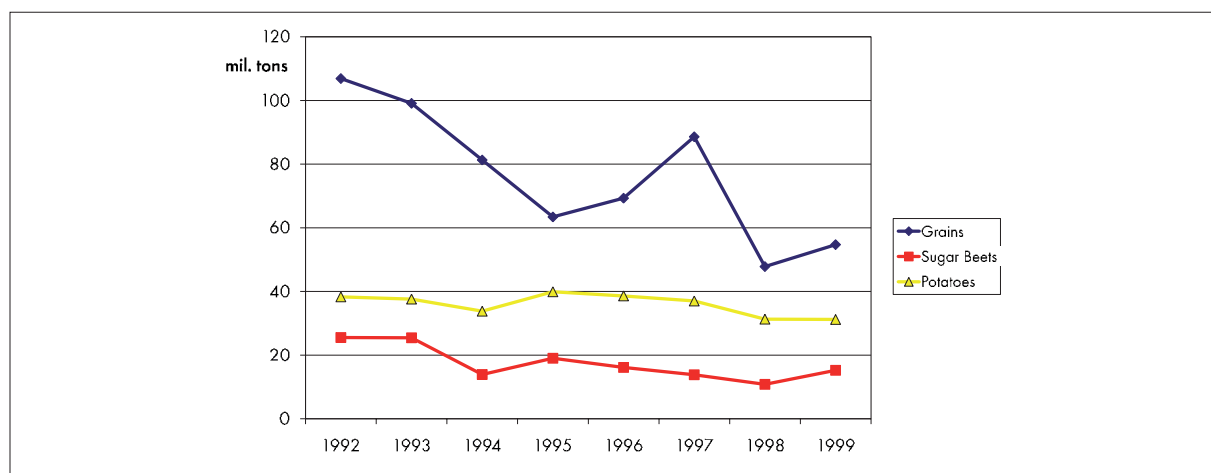
Further reading

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Tables and Graphs

Russian Agricultural Statistics

Production of Grains, Sugar Beets and Potatoes in Russia, 1992–1999 (mil. tons)



Sources: see overleaf