ANALYSIS

# Investment Trends in Russian Agriculture

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## Abstract
Investment is often considered to be the fuel for economic growth. Since the 1998 financial crisis in Russia, the volume of capital investment in the agricultural sector has increased. The two main sources for capital investment are the resources of an agricultural enterprise and bank credit. In addition, an increase in foreign investment in Russia's agricultural sector has occurred, although foreign investment in the food processing industry remains higher.


## Investment and Production
Plummeting agricultural production in Russia during the 1990s was accompanied by a decline in investment in the agricultural sector. Since reaching its nadir in 1998, the rebound in agricultural performance has gone hand in hand with rising investment. This article reviews contemporary investment trends in agriculture, thereby providing a context for understanding increased production.

Although often overlooked, investment is an important aspect of agricultural policy because, as argued by one Russian academic, "the investment sphere is the part of the economy which directly affects the country's rate of economic and social development, the technological level and effectiveness of production, competitiveness in the world market, and most of all, the standard and quality of life for the population." This article discusses: (1) improvement in agricultural performance and farms' financial condition; (2) an increase in capital investment in agriculture, fueled by an expansion of available credit from banks; and (3) investment in agriculture from foreign investors.

## The Rebound in Russian Agriculture
Following the demise of the Soviet Union, food production fell precipitously and investment into agriculture sank to a fraction of what it had been in the Soviet period. Whereas the 1990s was a decade of declining food production, since 2000 Russia has experienced a remarkable rebound in agricultural performance. The rebound may be measured first in the production sphere. The ruble value of agricultural production in Russia increased from RUR 304 billion in 1998 to RUR 2.5 trillion in 2009 (in current prices), before declining in 2010 as a result of the poor harvest. In 2009 the inflation-adjusted ruble value of food production for all food producers rose to 81 percent of the 1990 level, a notable improvement from the 61 percent in 2000 and 68 percent in 2005. The production value from private farms and households was actually higher in 2009 than in 1990, whereas the value of production for large agricultural enterprises in 2009 was about 60 percent of its 1990 level, which was low, but still an improvement over the 39.5 percent in 2000. The production index (1990 = 100) by producer is illustrated in Figure 1.

Prior to the disastrous heat and drought that ruined one-third of the harvest in 2010, crop output experienced the most improvement, reaching 110 percent of its 1990 ruble value in 2009. Increases in the physical volume of grain production and in yield per hectare allowed Russia to emerge as a global grain exporter, with exports of wheat, barley and corn averaging over 19 million tons a year during 2007–2009, which brought in several billion dollars of foreign revenue annually.

Conversely, animal husbandry continued to lag and was valued at just 52 percent its 1990 level in 2009. The main reason for the low valuation is a reduction in the number of beef cattle, milk cows, and pigs. Even though milk output per cow and weight per head of cattle and pigs has increased compared to 2000, these increases were not enough to offset the downward trend in numbers. In 1990 Russia's food producers had 57,000 cattle (including milk cows), a number that declined to 27,500 in 2000 and to 20,700 in 2009. The number of pigs fell from 38,300 in 1990 to a nadir of 13,800 in 2005, before rising to 17,200 in 2009. Even though animal husbandry was one of three priorities in the agricultural development program that was introduced in 2006, beef cattle and milk cow herds continued to decline. The situation was exacerbated by shortages of feed grain as a result of the 2010 drought. In July 2010 President Medvedev issued instructions for regional governments to develop programs to protect and assist the animal husbandry sector. Although domestic meat output increased in 2010, this is a short-term upward trend as farms killed off cattle that they could not feed; the problem of declining numbers remains.

There is also evidence of a rebound in the financial sphere, indicated by a decline in the number of unprofitable farms and enhanced farm revenue. In 2000, official statistics indicated that more than one-half of all large agricultural enterprises were unprofitable, and as recently as 1998 almost 9 out of 10 had been unprofitable. Following the introduction of the agricultural development program in 2006, the percentage of unprofitable farms fell to a low of 21 percent in 2008 before rising to 27 percent in 2009 as a result of the financial crisis, and declined again to 25 percent in 2010 as government emergency financial support was dispersed to help farms affected by the drought. Further, as food production increased, revenue streams rose. The decline in the number of unprofitable agricultural enterprises is shown in Figure 2.

Production and financial trends are important because they impact on the incentives for agricultural investment. During the 1990s when farm unprofitability was high and revenues failed to meet production costs, investment in agriculture was unattractive. Two important events occurred early in Putin's first term to change the situation. First, investment flows into agriculture received a boost by the creation of a state owned and operated agricultural bank in 2000 (Rossel'khozbank) that was used to channel government subsidized credit to food producers, and the following year a new agricultural credit policy was introduced that replaced the previous commodity credit policy. The new credit system provided subsidized interest rates to purchase needed inputs or for farm operations instead of providing subsidized inputs. The intent of the new credit policy was to increase the utilization of capital, provide an incentive for banks to invest, and to provide the seasonal credit that farms needed. Second, a program of financial renewal was introduced in 2001 that restructured farm debt and wrote off penalties on overdue debt payments. The intent was to improve the financial condition of farms and free up capital that farms could use for investment. By April 2008, 12,820 large farms had participated in the program, with more than R84 billion of farm debt restructured and another R44 billion of penalties and fines written off. Together, debt restructuring and access to subsidized credit improved farms' financial situation and helped to expand production to meet growing consumer demand for food. Then, in Putin's second term, the national project was introduced which led to an expansion of credit that was channeled through Rossel'khozbank (and other banks), thereby allowing large farms and private farms to borrow at subsidized interest rates; some of the credit was used to finance seasonal needs and some was used for long-term investment.

## Trends in Agricultural Investment

Investment data are available for large agricultural enterprises and, to a lesser extent, for small forms of farming (private farms and household gardens). These data examine trends for capital investment, which is defined as investments that increase the production capacity of an enterprise. These expenditures include new building construction (other than residences), roads and infrastructure, the acquisition of machinery, equipment, and vehicles; for agriculture it also includes the acquisition of livestock, and the sowing and cultivation of perennial crops.

In the 1980s agriculture received about 32 percent of all capital investment in the economy. In the early 1990s, in the period before reform, the level of capital investment into agriculture declined but was still high, about 19–23 percent (different sources cite different percentages). There is agreement, however, that investment into agriculture fell precipitously after the introduction of reform to about 3.7 percent in 1995 and 3 percent in 1998. During 2000–10 the agricultural sector averaged 3.3 percent of all capital investments in the economy. Recently the trend is upward as the volume of capital investment into agriculture rose from R12 billion in 1998 to a high of R235 billion in 2008 prior to Russia's financial crisis, before declining to R182.9 billion in 2010 (in current rubles). Thus, capital investment in agriculture has not recaptured its prior significance and lags behind other sectors. Capital investment trends are illustrated in Figure 3.

As to the sources of capital investment, the agricultural sector is similar to the national economy in that there has been a decline in the percentage of capital investment from enterprises' own means and an increase from other sources. The agricultural sector differs from the national economy in that direct governmental funding for capital investment is no longer significant, whereas in the national economy budgetary funding for capital investment averaged about 20 percent during 1998–2009. The decline in state funding of capital investment marks a significant change from the Soviet period.

The early post-Soviet government transferred responsibility for capital investment from the federal government to large farms and regional budgets as early as 1993. By 1998, agricultural enterprises were funding more than 77 percent of their capital investment. This percentage declined to 44 percent in 2009, with the biggest drop occurring during 2005–2006 when enterprises' contribution fell from 60 to 44 percent, and then to a low of 38 percent in 2007. The decline of enterprises' investment levels reflects the expanded availability of credit for investment from banks that serve as conduits for subsidized credit from the federal government—the subsidized rate has been about one-half the market interest rate since 2007. In 2007, 62 percent of capital investment in agriculture came from sources other than the enterprise, of which federal and regional budgetary allocations accounted for less than 3 percent, the remaining 59 percent came from bank credit and loans from other sources. In 2010, farming enterprises provided 51 percent of capital investment as the credit market tightened.

The largest lenders to farms are Sberbank and Rossel'khozbank, accounting for about 80 percent of loans to agricultural enterprises (Rossel'khozbank provides about three-quarters of credit loans to private farmers and household gardeners). Farm enterprises obtain either short-term or long-term credit. Short-term credit is used mainly for seasonal operations and is repayable after one year, while long-term credit (eight or ten years) is used for investment and modernization. In 2009, 46 percent of the credit dispersed by Rossel'khozbank was considered investment credit.

Turning next to foreign investment in agriculture, it too has increased significantly although it pales in comparison to foreign investment in Russia's food processing industry. Measured in US dollars, foreign investment into agriculture rose from $12 million in 1998 to a high of $862 million in 2008, declined to $437 million in 2009, and then rebounded a bit to $446 million in 2010. Much of the increase occurred after 2005—investment levels doubled from 2005 to 2006, and then doubled again from 2006 to 2008. Even at its height, however, foreign investment into agriculture was less than 1 percent of total foreign investment in Russia.

In contrast, foreign investment into Russia's food processing industry has been and continues to be much higher, an occurrence that is understandable given greater profitability and higher profit margins than for raw agricultural products. Foreign investment into food processing increased from $1.4 billion in 1998 to a high of $3.9 billion in 2008, declined to $2.3 billion in 2009, and then rose to $2.8 billion in 2010. Foreign investment in food processing accounted for 3.8 percent of total foreign investment in Russia in 2008, 2.9 percent in 2009, and 3.9 percent in 2010. In many cases, foreign investment in agriculture and food processing go hand in hand as foreign investors buy or lease farms in order to secure food supplies for their processing plants in Russia. This practice is especially popular in Moscow oblast where farms and processors are integrated in order to meet food demand in Moscow. Foreign investment trends into agriculture and the food processing industry are illustrated in Figure 4.

## Conclusion

The foregoing discussion highlighted an increase in the volume of capital investment and a rise in foreign investment in Russia's agricultural sector, and in that sense the situation is better than in the 1990s. Government contributions to capital investment into agriculture have fallen and are no longer a significant source of funding, replaced by enterprise funding and loans from the banking sector. A consequence of using bank credit for investment is growing farm debt. Bank credit used for investment relies upon the government's subsidized interest to make the loans attractive, and therefore the state has not disappeared from the equation entirely.

Going forward, the problems confronting agricultural enterprises and their capital investment are twofold. First, in the wake of the financial crisis banks have significantly reduced available credit for capital investment, and some, such as Rossel'khozbank and Sberbank, have placed limits on the amount that can be borrowed. In addition, farm assets such as land and capital stock do not significantly improve a farm's ability to borrow. Farmland in particular is not a useful source of collateral because of the difficulty of selling it should the borrower default. In other words, the mortgage collateral system remains weak, and the effect is a reduction in borrowing capacity and investment funds for farms. Second, farms' funds for investment capital are falling as a result of higher energy costs and input costs that exceed the rise in farm gate prices. Thus, the investment climate in Russia's agricultural sector remains susceptible to broader macro-economic trends.

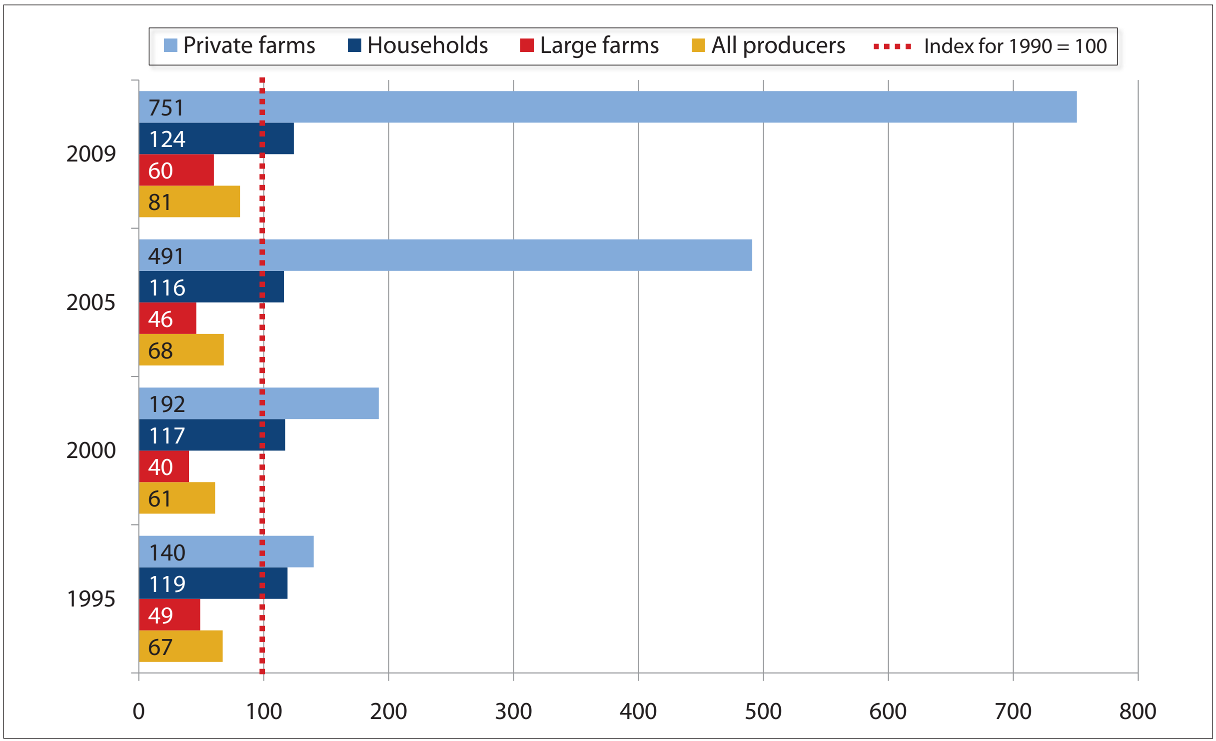
*About the Author*

Stephen K. Wegren is professor of political science at Southern Methodist University, Dallas, TX, USA. He has written extensively about land reform and agrarian issues in Russia.

*Further Reading*

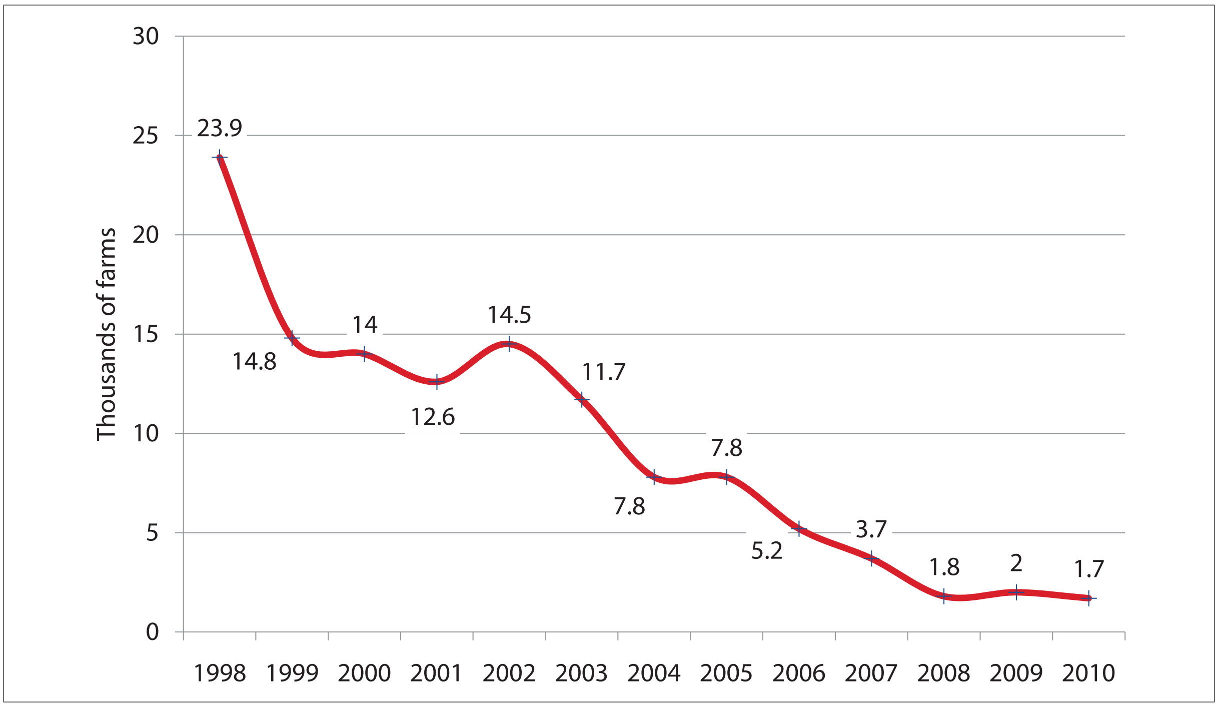
- "Agropromyshlennyi kompleks Rossii v 2010g (ekonomicheskii obzor)," *APK: Ekonomika, Upravlenie*, no. 3 (March 2011), pp. 68–77.
- Alfer'ev, V., "O merakh podderzhki resursoobespecheniia sel'skogo khoziaistva," *Ekonomist*, no. 3 (March 2011), pp. 41–47.
- Epshtein, David, Aleksandr Subbotin, and Olga Yastrebova, "Farms and the Financial Market: Russian Farm Performance, Access to Credit, and Government Support," *Basis Brief*, no. 38 (November 2005), pp. 1–4.
- Ivanova, V., and V. Goncharov, "Investitsionnaia deiatel'nost' v APK Rossii," *APK: Ekonomika, Upravlenie*, no. 4 (April 2011), pp. 10–14.
- "Sel'skoe khoziaistvo Rossii v 1990–2009 gg. (ekonomicheskii obzor)," *APK: Ekonomika, Upravlenie*, no. 8 (August 2010), pp. 47–57.
- Wegren, Stephen K., "Russian Agriculture in the Late Putin Period and Beyond," in Stephen K. Wegren and Dale R. Herspring, eds, *After Putin's Russia: Past Imperfect, Future Uncertain*. (Lanham, MD: Rowman and Littlefield, 2010), pp. 199–222.

### Figure 1: Index of Agricultural Production (1990 = 100)



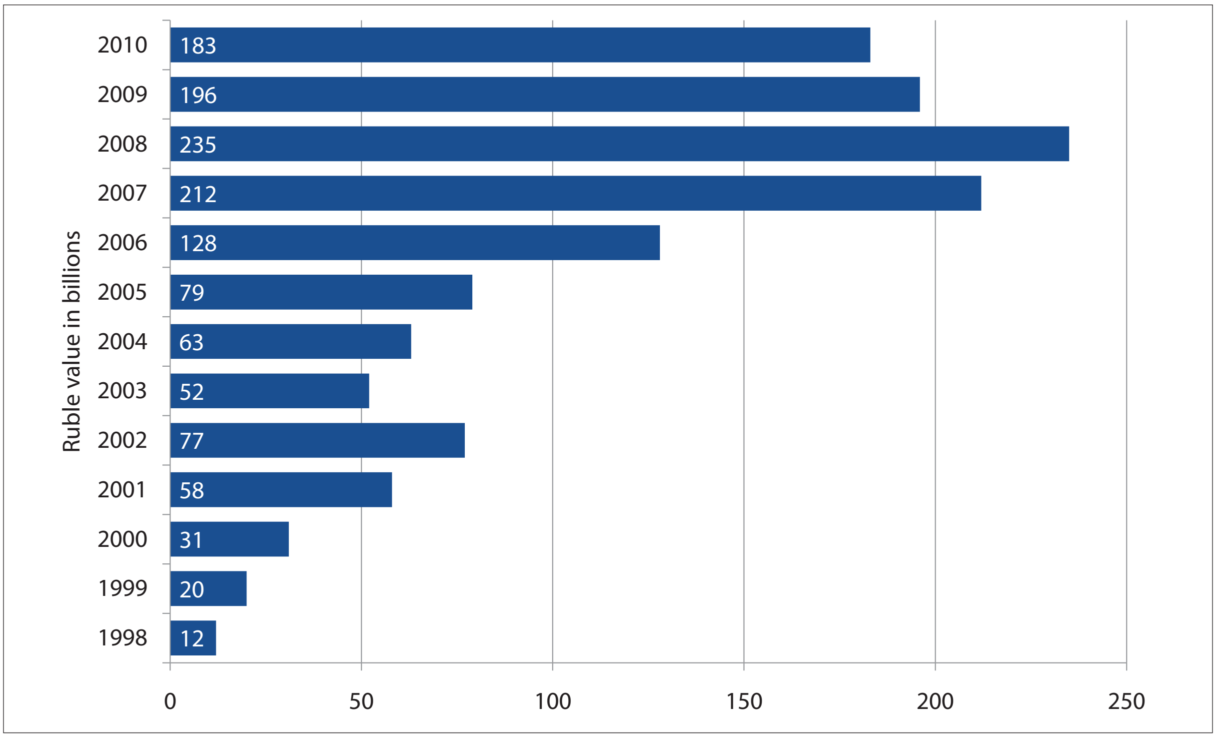

*Source: Sel'skoe khoziaistvo Rossii v 1990-2009 gg. (ekonomicheskii obzor), APK: Ekonomika, Upravlenie, no. 8 (August 2010), pp. 48.*

### Figure 2: Number of Unprofitable Agricultural Enterprises



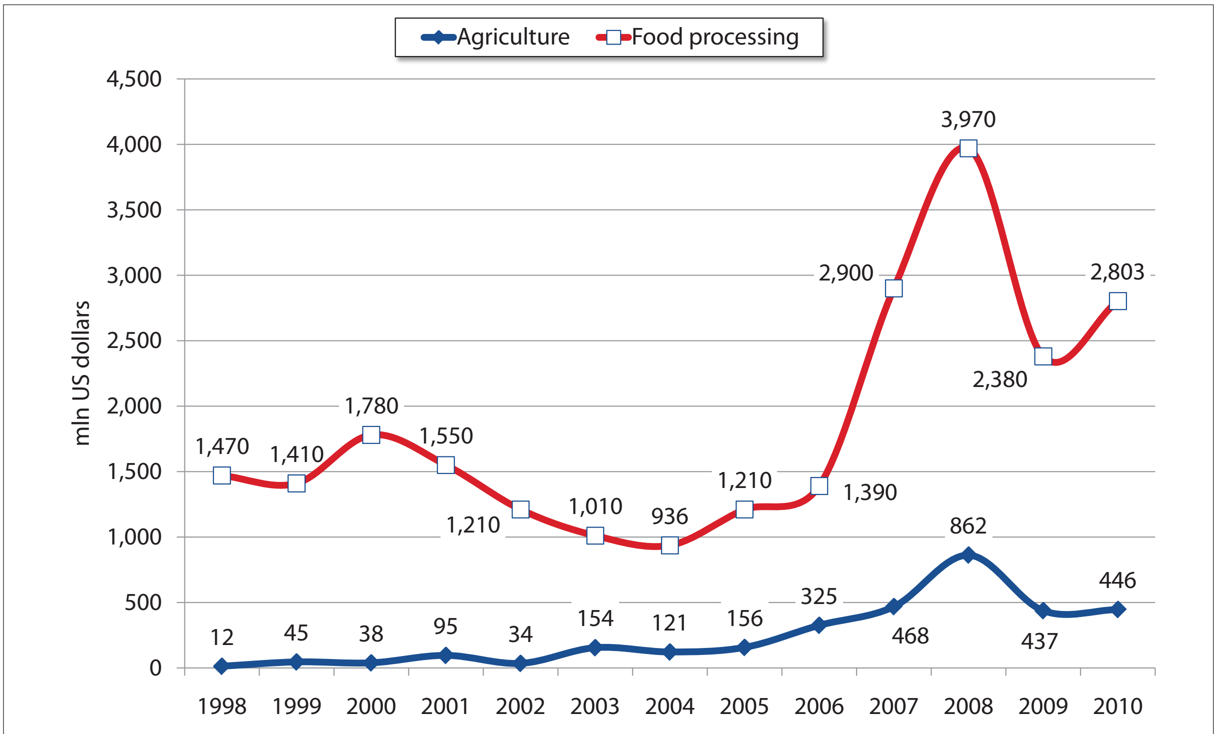

*Sources: Osnovnyye pokazateli sel'skogo khozyaystva v Rossii (various years).*

## Figure 3: Capital Investment in Agriculture




*Sources: Osnovnyye pokazateli sel'skogo khozyaystva v Rossii (various years).*

## Figure 4: Foreign Investment




*Sources: Finansy Rossii (various years), and Rossiyskiy statisticheskiy ezhegodnik (various years).*