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TRENDS AND OUTLOOKS
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The review provides a detailed analysis of main trends in Russia's economy in 2014. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit spheres; financial sphere; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

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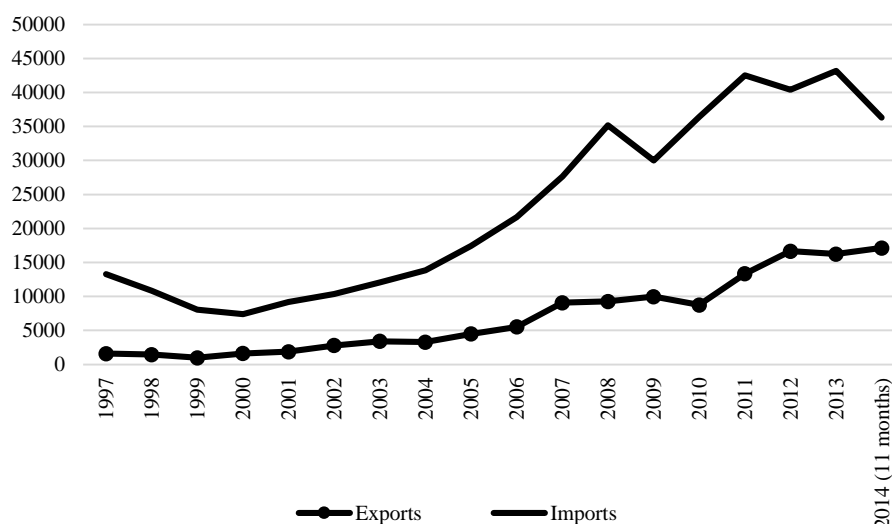
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4.6. Russian agriculture: the impact of sanctions

4.6.1. General Outline of Agricultural Performance

On 7 August 2014 Russia introduced restrictions on import of food products from countries of the European Union, the US, Canada, Norway and Australia¹ (hereinafter – retaliatory sanctions) in response to their sanctions against Russia driven by political developments in the Ukraine. This step astonished a lot of people in the country and even more so abroad as at the moment of enforcing retaliatory sanctions Russia remained a large-scale importer of foodstuffs. For many years one could observe an upward trend in imports of agricultural and food products that by 2013 amounted to \$43.2bn (*Fig. 40*).

High import volumes used to be a subject of public scrutiny and concern. But beginning from 1998 and even more so from 2006 the pattern of agricultural production in Russia started undergoing great changes: agriculture was adjusting to new conditions, new efficient production facilities were being put in operation, the location of production over the country’s territory was actively transforming, in some sectors the output was falling while in the others it was growing. In 2006 the Federal Law “On the development of agriculture” was adopted that established a middle-term planning for state support of agriculture – initially the term was set at 5 years but later it was extended up to 8 years (in the framework of State programs for agricultural development and regulation of agricultural, input and food markets). In 2006 started the implementation of Priority national project of agrifood sector development and beginning from 2008 state support was provided under the State Programs. This resulted in the growth of budget funding and higher predictability of state support to agriculture.

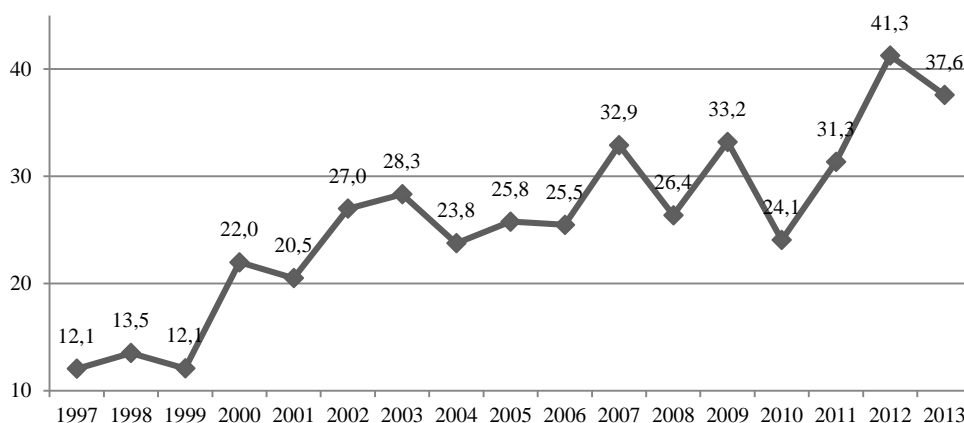


Source: Rosstat, Federal Customs Service.

¹ RF Government Resolution of August 7, 2014 No. 778 “On measures for the implementation of RF President Decree of August 6, 2014 No. 560 “On the enforcement of selected special economic measures aimed at ensuring food security of the Russian Federation””.

Fig. 40. Exports and imports of agricultural and food products, million dollars

These developments led to the change of some regions' contribution to the overall production. The growing import purchases of items the production of which in the country in that period was not profitable due to different reasons were accompanied by bigger export sales of other items that were competitive on the foreign markets. First of all this relates to grains including corn and vegetable oils. The structure of export and import transactions started to improve. For instance, while in 1997-1998 exports were as small as 12-14% of import volumes, in 2012-2013 the proportion grew up to 41-38% (Fig. 41). It implies that Russia has become not only a large importer but also a large exporter of agricultural products. In 2013 total exports amounted to \$16.2bn thus exceeding the 2006 level almost 3 fold.



Source: Rosstat, Federal Customs Service.

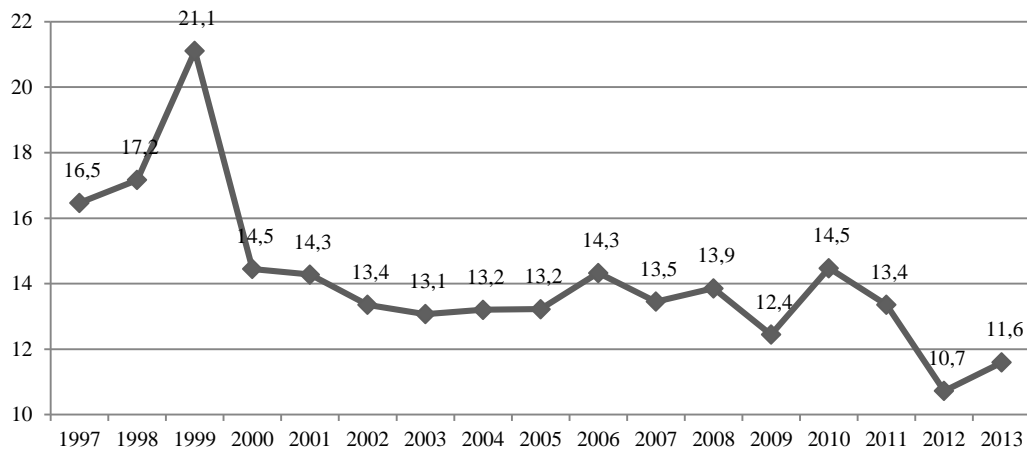
Fig. 41. Russia: ratio of food and agricultural exports to imports in 1997–2013, %

As a result, if measured by the ratio of import-export balance to the expenditures of population on foodstuffs, the general indicator of food dependency has fallen and beginning from 2000 is relatively stable ranging from 11 to 14% (Fig. 42). In the country at large food products became more affordable for consumers (despite some negative developments persisting in some regions and groups of population) owing to the general growth of real incomes: the share of foodstuffs in the total consumer expenditures has fallen, the structure of personal consumption improved and the level of per capita consumption of meat products became comparable to that of the pre-reform period.²

The Doctrine of Russia's food security³ sets thresholds of food independency for 8 products or product groups. By the moment of retaliatory sanctions' launching the level of demand satisfaction met these requirements for grains, potatoes, vegetable oils, sugar and poultry meat. There still remained problems with the supply of dairy products, beef, pork, vegetables and fruit. Fig. 42 and 43 show that before the introduction of sanctions and retaliatory sanctions not only the general indicator of dependency on imports but also similar indicators for selected groups of foodstuffs (except milk and dairy products) were improving. Still, domestic output failed to satisfy respective demand. Therefore the substitution of imports by Russian products could not occur at once but required some time and certain conditions. Consequently, an instantaneous ban on import should have resulted in the replacement of importers by other ones but it also could not happen at once.

² Uzun V.Ya., Shagayda N.I. *Prodovol'stvennaya bezopasnost' v Rossii: monitoring, tendentsii i ugrozy* [Food security in Russia: monitoring, trends and threats]. // Russian Presidential Academy of National Economy and Public Administration (RANEPА), 2014. <http://www.ranepa.ru/news/item/3674-prod-bez.html>

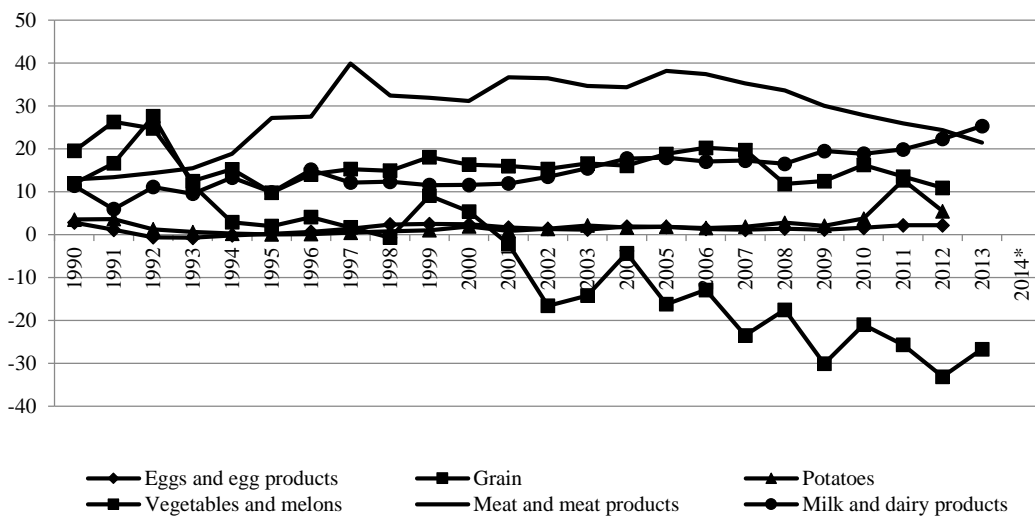
³ RF President Decree of January 30, 2010 No. 120 "On the adoption of Doctrine of food security of the Russian Federation".



Source: Rosstat, Federal Customs Service.

Fig. 42. General indicator of food dependency in 1997–2013, %

According to data of the RF Federal Customs Service, in August 2014 the decrease of imports relative to the respective period of 2013 was 3%, in September – about 11%, in October – already 18% and by the year end – 25%. To some extent this is due to the shrinking demand for food. For instance, in November 2014 the sales of meat and meat products fell by almost 7% as compared with October, those of milk – by 1.8%, of bread – by nearly 5%. At the same time the sales of fish and fish products grew by 4.8%, of vegetable oils – by 1.5%, of eggs – by 1.3%, of flour – by 8.2%.

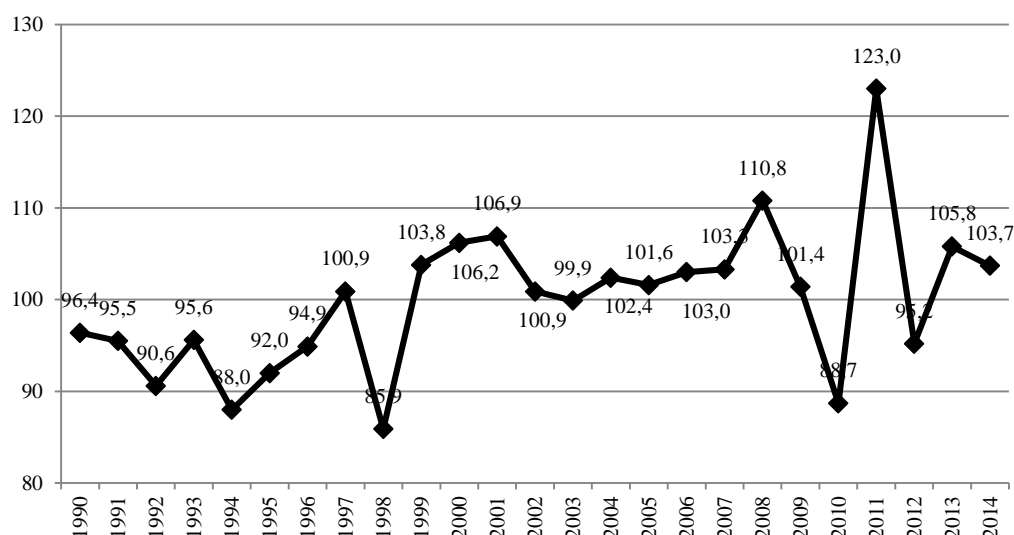


* 9 months.

Source: Rosstat.

Fig. 43. Dependency on imports (ratio of import-export balance to the domestic consumption), %

Many experts regarded the ban on import of agricultural and food items to Russia from selected countries as a new opportunity for the development of domestic farming. Indeed, 2014 was favourable for agriculture – the sector’s index of production exceeded the respective indicator for 2013 that was quite a good year for farming (Fig. 43).



* preliminary data.

Source: Rosstat.

Fig. 44. Growth rates of agricultural production relative to the previous year in 1990–2014, %

Growth rates of agricultural production relative to 2013 amounted to 103.7% (in 2013 – 105.8%).

In 2014 the output of grain reached 103.8 million tons, the output of sunflower seeds – 8.8 million tons, that of sugar beets – 32.7 million tons, of livestock and poultry (slaughter weight) – 8.5 million tons (including 2.8 million tons of pork and 3.8 million tons of poultry meat), milk – 30.5 million tons, eggs – 41.3 billion pieces⁴.

A sharp devaluation of ruble has provided additional advantages for Russian farm producers on the markets occupied by importers. Products of the latter are becoming too expensive for Russian consumers and they will have to reorient to domestic produce. According to data of the Customs Service, in 2014 the cost amount of food imports fell by 7.7% as compared with 2013. The biggest decrease of physical import volumes was demonstrated by such items as cheese and curds (31.8%), fresh-frozen meat (24.3%), frozen fish (16.2%), poultry meat (13.6%) and butter (13.2%). Meantime, imports of corn grew (by 22.3%) as well as those of products containing cocoa (by 14.4%) and coffee (by 12.6%).

At the same time the continuation of sanctions war against Russia can have a negative effect on the performance of national agriculture since its success in recent years was largely determined by the adoption of new foreign technologies, the purchase of foreign seeds and other inputs. If introduced, retaliatory sanctions in respect of these inputs (a ban on supply of pedigree young stock, eggs, seeds and hybrids) will have serious consequences for the most advanced production units. In this regard less productive and poorly modernized corporate farms, individual private and even household farms turn out to be more sustainable to external shocks as compared with high-tech but reliant on imported inputs and technologies agroholdings.

The war of sanctions showed how much the country is dependent on the external world. Therefore, there is an urgent need to work out and implement the schemes for supporting agricultural research; for the creation of laboratories, seed stations and livestock breeding farms on the basis of public-private partnership in order to attract investments; for the development, maintaining and distribution of new varieties and breeds; for the education of students and provision of agricultural extension services. One should work out incentives that could motivate foreign companies to organize production and dissemination of elite seeds, modern technologies of herd improvement, to launch production of science-intensive products. With this in view it

⁴ According to Rosstat data.

would be rational to extend the notion of food security by setting the threshold levels of self-sufficiency in elite seeds, pedigree livestock, inputs, etc.

4.6.2. Impact of Sanctions and Retaliatory Sanctions on Relationships within the Eurasian Economic Union

Russia faces serious risks due to the fact that the country's leadership takes a lot of strategic decisions without due regard to the interests of its allies and commitments before them. The Eurasian Economic Union (EAEU) has a common customs territory. The procedure of changing its borders is not specified in the treaties on the establishment of the Customs Union and the EAEU. In 2014, Russia incorporated Crimea and thus unilaterally changed the customs area of the EAEU. No official agreement of other countries-members of the Union was obtained. In response to Russia's actions the US, the EU and some other countries imposed sanctions on it. These sanctions had a negative effect not only on the Russian economy but also on the economy of other members of the EAEU.

When elaborating sanctions against Russia, the EU countries went through a long coordination procedure in order to reach consensus. The European Union introduced respective sanctions only upon receiving the official consent of all its members. In the EAEU Russia imposed the ban on import of agricultural products without negotiating it with the allies. The Protocol on measures of non-tariff regulation in respect of the third countries (Addendum 7 to the EAEU Treaty) contains a provision permitting unilateral introduction of sanctions (Clause 50 of the Protocol). The procedures of coordinating such a decision with countries-members and the Eurasian economic commission are specified in Clauses 51-56 of the Protocol. A similar rule was already in effect in accordance with the Agreement on non-tariff regulation measures of January 25, 2008. When launching retaliatory sanctions Russia got no official consent of its partners in the EAEU and the latter did not introduce similar sanctions. A lot of problems appeared because of that. Belarus and Kazakhstan continue importing products from countries against which Russia introduced sanctions. It's quite natural that businessmen from these countries have got a strong incentive to re-export the imported items to Russia. The legal acts of the Customs Union, the Common Economic Space and the EAEU have no provisions restricting re-export but Russian authorities are against it. Business has surely found ways for evading Russia's ban: falsification of documents on commodity origin, drawing up of transit documents, change of packing cases, minor processing, etc.

The effective agreements enable Russia to forbid import from the countries subjected to retaliatory sanctions without the consent of other countries of the Union. But the maximum term established for such restrictions is 6 months. Therefore, in February 2015 Belarus and Kazakhstan will get the grounds to either require that Russia lifts retaliatory sanctions or to join them.

Russia needs to get the consent of its allies in simpler cases as well. For instance, if Russia imposes a temporary ban on the import of wine from Moldova, there can be all sorts of reasons for that. But in case no simultaneous bans are imposed by Belarus and Kazakhstan, the entrepreneurs from these countries will be able to import the items forbidden by Russia and to sell them on the territory of Russia as well.

The situation with Ukraine is similar. Russia threatens to exclude Ukraine from the CIS zone of free trade and to raise duties on its produce up to the level applied for the EU countries. Belarus and Kazakhstan do not support this idea and are going to preserve the effective terms of trade with Ukraine. The introduction of unilateral sanctions against Ukraine by Russia will generate new risks of the Ukrainian commodities' re-export.

In 2014 the lack of agreement in allies' actions has already provoked the appeal of Belarus to the Eurasian economic commission (EAEC) requesting not to extend import restrictions unilaterally imposed by Russia on the goods supplied to the customs territory of Belarus and forwarded in transit through the Russian territory to Kazakhstan. There were also applications to the EAEC concerning the introduced phytosanitary restrictions. Because of the discrepancies being

in place, customs check-points at the Russia-Belarus border resumed their operation thus impairing the common customs territory.

It should be also noted that the association of Kazakhstan, Belarus and Russia into the Eurasian Economic Union *per se* poses certain risks to domestic agriculture. Countries-members should unify their customs duties, quotas and tariffs; revise regulations and standards of food safety; reform the procedures of certification and testing of compliance with regulations. Moreover, special attention should be paid to the working out of coordinated position of EAEU countries at the current negotiations with WTO, in particular concerning the rules of building state reserves for the purposes of food security.

So far, all the post-Soviet countries apply various tools for supporting agriculture - national measures of budget support differ greatly not only by their nature but also by amounts and mechanisms of implementation. For instance, in Russia the producer support estimate (PSE) calculated using the OECD methodology reaches 17% of output, in Kazakhstan – 12%, in Ukraine – 1%. In Belarus this indicator was not calculated but the study carried out by the RANEPa Center of agrarian policy showed that the ratio of budget support therein exceeds the respective Russia's and Kazakhstan's indicators several fold. Given that Russian farm producers *a priori* loose to their Belarus colleagues and it's still hard to talk about common agricultural policies. Many years are needed for forming mutually beneficial common policy in respect of the third countries.

4.6.3. Situation on Selected Food Markets

Import ban under retaliatory sanctions introduced by Russia in 2014 has had a short-term effect and will have long-term consequences for markets where the share of imports from countries subjected to restrictions is significant. Let's reiterate that these are meat and dairy markets and the market of fruit and vegetables.

On the market of pork the share of imports in consumption (including sub-products and fat) amounts to 26.2%, of them the share of countries against which sanctions are applied is as high as 24.1%. For poultry meat these indicators equal 12.5% and 7.6%, respectively, for beef – 33.6% and 7.3%.⁵

In 2014 the RF government introduced restrictions on import of pork twice. First – in January when the embargo was set on import from the EU of live pigs, pork and products out of pork due to the detection of African swine fever virus in Lithuania and Poland. Second – in August when it was done in the framework of retaliatory sanctions. The restrictions resulted in a notable drop of pork imports – by 35.3% within 8 months 2014 as compared with the same period of 2013. The decrease of poultry meat and beef imports was less dramatic – by 16.3% and 9.2%, respectively.

The ban on import of pork has resulted in its remarkable restructuring and led to temporary complications in the import supply logistics. Due to the suspension of deliveries from the EU at the beginning of 2014, 40% of pork in the first 6 month of the year was imported from Canada⁶. And after the introduction of retaliatory sanctions in August Brazil has become the major supplier of pork to the Russian Federation. In October for the first time in 10 recent years started the deliveries of pork from China that were earlier forbidden due to the sanitary reasons.

The supplies from Brazil and China partially compensate the deficit of raw meat inputs on the market but they are unable to fully absorb the share of countries subjected to sanctions. Besides, in the conditions of market geography change importers needed time for signing new contracts and as a result in the first months after the introduction of bans there emerged a gap in the supply of raw meat. This had an impact on the price situation on the market. From the beginning of 2014 the growth of purchase prices for pork exceeded 65%⁷.

⁵ Data of the Institute for Agricultural Market Studies (IKAR).

⁶ According to data of the National Union of Pig Breeders.

⁷ Data of the Institute for Agricultural Market Studies (IKAR).

The growth of prices on the pork market is due not only to the emerged deficit of raw meat inputs but also to the diversification of supplies shifting from most competitive to less efficient meat exporters.

After the introduction of retaliatory sanctions on import of food products the RF government sees its main task in ensuring accelerated import substitution. In the Russian pig breeding this process started in 2013 while earlier (in 2006-2012) the increase of domestic output just covered the positive dynamics of pork consumption.

Russian pig breeding has a potential for increasing production volumes thanks to large pig farms many of which have already announced construction of new complexes. Only the announced investments of seven biggest companies after their enterprises reach full capacity in 2017-2020 are able to provide for the increase of domestic pork output by 1.1 million tons live weight (or about 0.8 million tons slaughter weight). In recent years imports of pork and live pigs in slaughter weight didn't rise above 0.8 million tons and including sub-products and fat – above 1.2 million tons.⁸ In this regard there is a risk of over-investment in the sector and the consequent over-saturation of the market, drop of prices and decline of profitability.

The dairy market is also characterized by a high share of imports with many EU countries being suppliers of milk products to Russia before the introduction of sanctions. According to estimates of IKAR the share of imports in the consumption⁹ of cheese reaches 50.5% (2013), in the consumption of butter – 41.1%. Imports from the countries subjected to retaliatory sanctions account for 30.3% of cheese consumption and 10.3% of butter consumption.

The comparison of import volumes in 2014 and 2013 allows to conclude that the introduction of retaliatory sanctions did not produce a strong effect on the Russian dairy market. By the end of 2014 imports of all categories of dairy products (except cheese) were not noticeably smaller than those in the previous year (*Table 29*). But this is just the surface reflecting short-term dynamics.

Table 29

Imports of dairy products in 2013–2014, tons

Item	2013	2014	2014/2013, %
Milk and cream, non-condensed	266 103	273 329	102.7
Milk and cream, condensed	220 184	164 596	74.8
Butter milk, coagulated milk and cream, yoghurt, kefir	80 928	72 158	89.2
Milk whey, condensed and non-condensed	143 071	115 541	80.7
Butter	144 359	137 795	95.4
Cheese and curd	438 498	288 141	65.7

Source: Federal Customs Service.

First, in the first half of the year imports of dairy products demonstrated growth as compared with the respective period of 2013 and as a result their reduction following sanctions did not have a serious impact on the annual total for 2014. For instance, in the first 6 months of 2014 imports of whole milk products to Russia increased by 49.7%, those of butter and milk fats – by 50.4%, dry milk – by 10.5%, dry milk whey – by 29.3%¹⁰. Growth of import volumes at the beginning of the year was conditioned by low prices for milk on the world market owing to the increase of dairy production in key exporters of this product – the EU, the US and New Zealand. Bigger imports of whole milk products to Russia covered the deficit of raw milk on the domestic market due to the decrease of its production in the country. Besides, Russian producers have higher unit costs of producing butter and therefore cannot compete with foreign suppliers.

Second, an important role on the Russian market of milk belongs to the Belarusian produce that is not subjected to sanctions and is supplied (or at least should be supplied) to the territory of Russia under pre-agreed inter-state balances. In the first half of 2014 the share of Belarus in the total imports of whole milk products amounted to 71%, in those of condensed milk and cream – 82%, butter milk, yoghurt and kefir – 60%, dry milk whey – 76%. As a result of the introduced

⁸ Data of the National Union of Pig Breeders including trade with countries of the Customs Union.

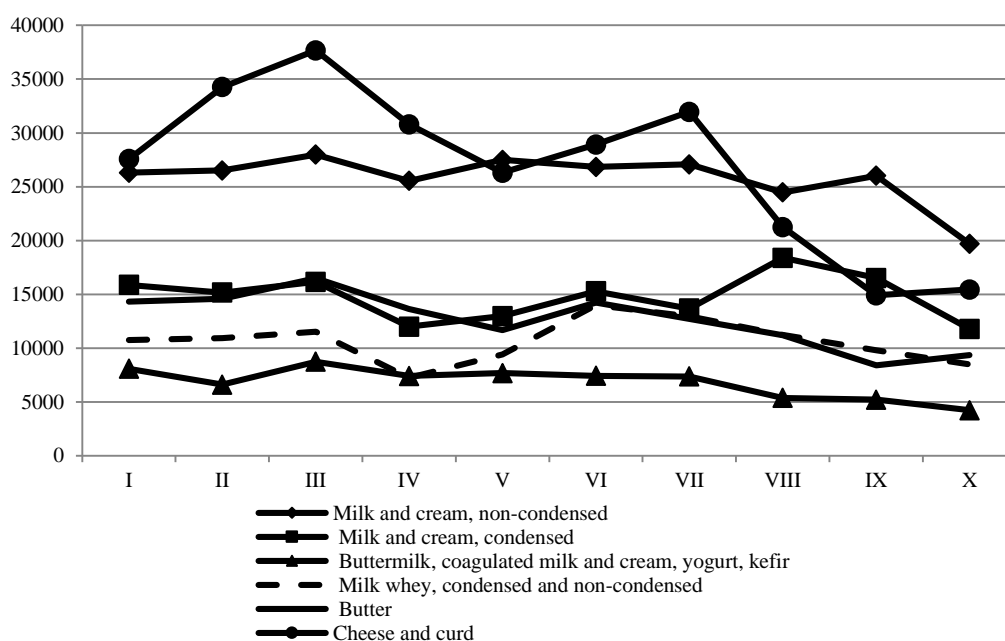
⁹ Including supplies from countries of the Customs Union.

¹⁰ According to data of the Federal Customs Service.

retaliatory sanctions the geographic structure of milk imports became less diversified and the share of Belarus surged up to 90% and more for some types of commodities.

The share of Belarusian products in the Russian imports of butter and cheese is not big (about 27%) while the dependence on European suppliers of these items was rather strong. The EU countries accounted for nearly 60% of import supplies of cheese. Therefore the introduction of sanctions primarily affected these groups of dairy products the processing of which requires the biggest milk inputs per unit (Fig. 45). The withdrawal from butter and cheese markets of countries under sanctions was partially compensated by larger supplies from Belarus whose share in the structure of butter imports grew from 27 to 52% and in the structure of cheese imports – from 27 to 64%.¹¹

Such a strong dependence on Belarusian supplies of dairy products is fraught with certain risks. First, in the conditions of deficit of domestic raw milk on the Russian market, Belarus is raising prices for this item supplied to Russia while prices for it on the world market have been falling all through 2014. Second, the own capabilities of Belarus to produce dairy products are not limitless. Following greater demand from Russia, the country itself felt short of raw milk. As a result various “grey” schemes are being applied when Belarusian milk processors buy inputs in the EU, e.g. in Lithuania.



Source: Federal Customs Service.

Fig. 45. Dynamics of dairy imports in 2014, tons

So, after the introduction of retaliatory sanctions Russian dairy companies have got a stimulus for development. One of the basic problems in the development of dairy production and import substitution is the deficit of raw milk. In the situation of year by year shrinking of dairy herd, decrease of raw milk output and non-efficient distribution of funds under the existing state support of the sector prices for raw milk in Russia rose by more than 40% over the two recent years. Still, there are some factors that hold back private investments in the dairy industry and impede its development. Low attractiveness of the sector is due to the long period of investments’ pay back, high volatility of prices for raw milk and inputs on the Russian market, non-competitiveness (in terms of both price and quality) of milk-intensive products (cheese, butter, dry whey, dry skimmed milk, dry whole milk), the lack of extensive and consistent state support. In case the “window of opportunities” that opened owing to import substitution is not filled by domestic dairy producers,

¹¹ According to data of the Federal Customs Service.

the decrease of imports from one group of countries will be compensated by more expensive imports from the other.

On the vegetable market the share of imports in consumption (2013 data) amounts to 18.8%, including 5.8% from the countries subjected to sanctions. Consumption of fruit depends on import supplies to an even greater extent – their share is as high as 58.5% including 14.7% from countries under embargo¹². Given that the production of fruit and vegetables in Russia is a seasonal activity and the existing storage capacities are not sufficient, the dependence on imports of vegetables and fruit is even greater in winter and spring periods (from November to April) when the market is affected by the deficit of domestic produce.

In 2013, the EU countries accounted for 20% of potato imports (Egypt – for 29%, China – for 13%). 24% of tomatoes were also supplied from the EU (39% - from Turkey, 10% - from China). At the same time the share of these countries in imports of frozen vegetables to Russia was as high as 79% (that of China – 7%).

Market supply of apples and pears on the Russian market is basically provided by imported items the share of which is about 80%. In 2013, the EU countries accounted for about 59% of the apple and pear imports.

In 2014, 3155 thousand tons of vegetables were imported as compared with 2980 thousand tons in 2013 (annual total). Imports of fruit amounted to 5014 thousand tons versus 6352 thousand tons in the previous year¹³. So, the overall imports of vegetables in 2014 grew by 5.8% as compared with 2013 primarily due to the intensive imports (e.g. of potatoes) in the first half of the year. Imports of fruit dropped by 21% due to the introduced retaliatory sanctions.

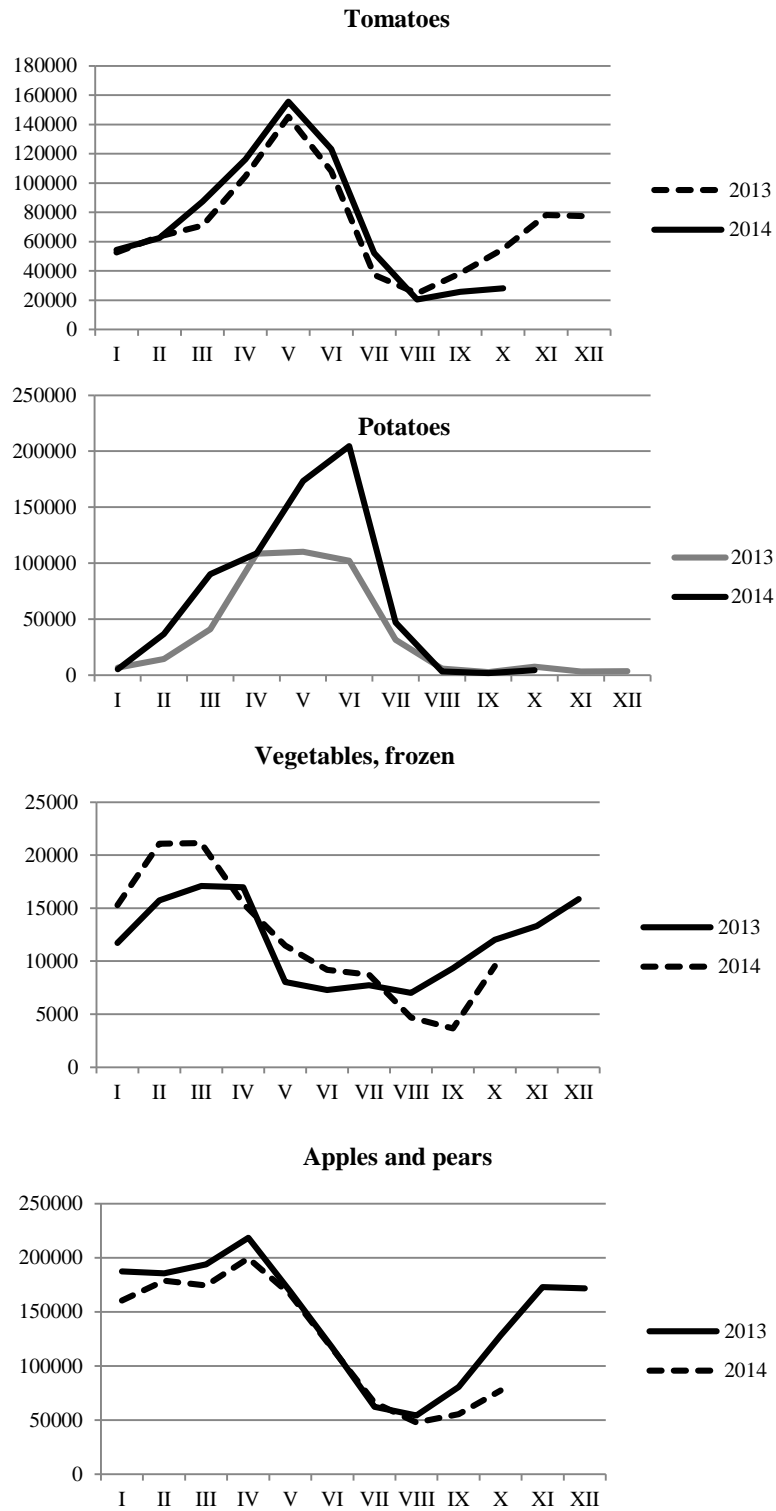
The examination of import supplies' dynamics by selected groups of commodities reveals that right after the enforcement of sanctions imports of vegetables and fruit fell (*Fig. 7*). Imports from countries subjected to retaliatory sanctions were partially replaced by bigger supplies from other countries that had already been Russia's permanent trade partners. First of all, this refers to Belarus that increased exports of vegetables and fruit to the Russian market despite the fact that the country has never been their large producer. Therefore, the Belarusian origin of this produce raises doubts. Trade with other CIS countries – Kazakhstan and Moldova – became more active. There appeared few new countries among suppliers since time was needed for signing new contracts.

Following the enforcement of sanctions the geographic structure of import supplies changed. Belarus, Kazakhstan, China, Moldova and Israel were among major exporters of potatoes to Russia. There started purchases of frozen vegetables in China, Belarus, Ukraine, Serbia and Moldova. The major suppliers of apples and pears were China, Serbia, Azerbaijan, Belarus, Ukraine, Armenia and South Africa. Tomatoes were primarily imported from Ukraine, Belarus, Turkey, China, Morocco and Azerbaijan.

Do domestic producers have any chance for substituting imports of some groups of fruit and vegetables in the current situation or one can expect only a replacement of one import supplier by another? Traditionally big volumes of vegetables and fruit in Russia are grown by households. There are few large producers able to ensure sufficient volumes and stability of supplies to trade networks that feel short of quality domestic produce out of season. Besides, most of them have no storage capacities. Meantime, smaller producers – individual private farms – cannot offer traders big lots, year-round supply and suitable commodity assortment. Therefore, the development of competitive environment for medium-size farm producers urges the creation of a system of wholesale food markets.

¹² Data of the Institute for Agricultural Market Studies (IKAR).

¹³ According to data of the Federal Customs Service.



Source: Federal Customs Service.

Fig. 7. Dynamics of vegetable and fruit imports in 2013 and January-October 2014, tons

So, the introduction of retaliatory sanctions against supply of food items from a whole range of countries opens opportunities for import substitution on some food markets. One more factor fostering this process is the devaluation of national currency conditioning the shrinkage of cheap imports to the country. At the same time, there are certain risks and dangers for the implementation of import substitution strategy as Russian producers use imported inputs the prices for which have

surged. In the current economic situation the cost of investment resources is growing. Non-controlled growth of new investment credits supported by the government may result in over-production (first of all in pig breeding). In the medium run real disposable incomes of population are expected to further fall pulling the demand for food products down. In this case there may develop a situation when the ensuring of food security becomes impossible due to the aggravating problem of economic availability. And the most important factor is that lower rates of economic growth bring about the risk of curtailing budget support.

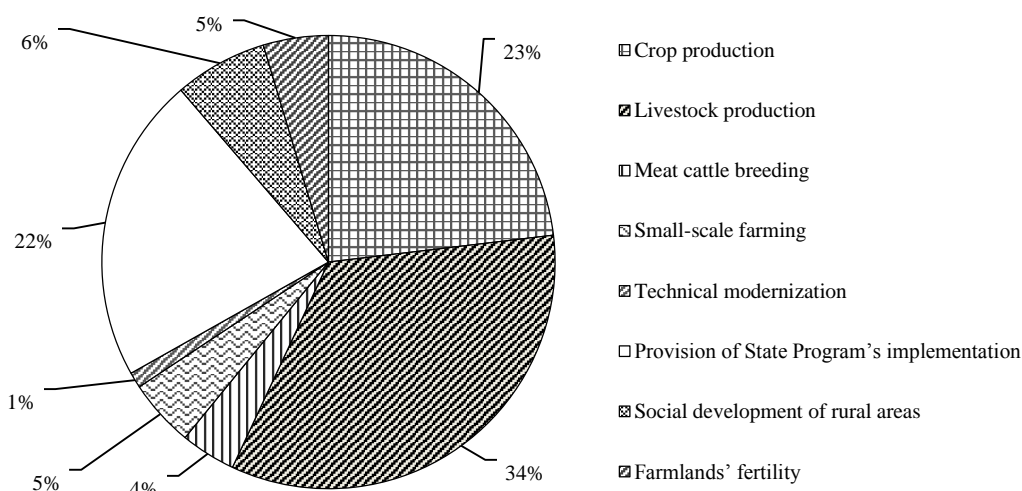
4.6.4. Shift of Budget Support Priorities

The State program for agricultural development and regulation of agricultural, input and food markets for 2013-2020 (hereinafter – the State Program) which is the second such program beginning from 2008 is one of the “longest” instruments of long-term planning in a selected sector of national economy. It consists of 8 basic blocks–sub-programs (*Fig. 8*), two of which are covered by separate federal target programs (FTP): FTP “Sustainable development of rural areas in 2014-2017 and for the period till 2020” and FTP “Development of Russian farmlands’ reclamation for the period till 2020”.

In 2014 the financing of State Program notably reduced as compared with the previous year – from Rb 213bn to Rb 170.1bn. However, while the funds allocated to the sub-program for crop production development were cut 1.7 fold, those for livestock production development – 1.2 fold, for technical and technological modernization – 4.3 fold, the outlays for administrative support of the State Program’s implementation¹⁴ were *vice versa* nearly doubled. Now measures for bureaucratic support of the Program cost almost as much as the development of crop production (23%). Appropriations to the development of meat cattle breeding, improvement of farmlands’ fertility and sustainable development of rural areas slightly grew but the aggregate share of these measures does not exceed 15% of the allocated funds.

Essential amendments were made in the State Program due to the introduction of retaliatory sanctions against food supplies from the EU. A new point ranking second was added to the five traditional guidelines of agricultural and food policies that were: 1) ensuring of Russia’s food independence in accordance with criteria set by the Doctrine of food security of the Russian Federation adopted by the RF President Decree No. 120 of January 30, 2010; 2) improvement of Russian food products’ competitiveness on the domestic and foreign markets in the framework of Russia’s accession to WTO; 3) improvement of financial stability of agricultural and food enterprises; 4) sustainable development of rural areas; 5) reproduction and more efficient use of land and other inputs in agriculture as well as “greening” of production. The newly added point is the accelerated import substitution for meat, milk, field and greenhouse vegetables, seed potatoes, fruit and vegetable products.

¹⁴ The sub-program “Provision of State Program’s implementation” incorporates measures for improving the management of State Program and the system of taxation in agriculture, provision of public services and works, forming of public informational resources in the field of ensuring food security, carrying out of phytosanitary and veterinary control, etc. Except for the latter, all other measures have only an indirect bearing on the support of farm producers and are primarily intended for the strengthening of bureaucratic apparatus of agrifood sector management.



Source: State Program as amended by Federal Law No. 349-FZ of 02.12.2013 "On the federal budget for 2014 and for the planning periods of 2015 and 2016".

Fig. 47. Structure of financing by basic directions of State program for agricultural development and regulation of agricultural, input and food markets in 2014

For the implementation of this task 5 new sub-programs will be added to the 8 already existing beginning from 2015: "Development of field and greenhouse vegetable growing and seed potato production", "Development of dairy cattle breeding", "Support of pedigree livestock breeding, selection and seed production", "Development of wholesale distribution centers and social catering infrastructure", "Development of financial credit system of the agrifood sector" (Table 30).

Table 30

Financing of State Program from the federal budget, million rubles

Sub-program	Financing from the federal budget, million rubles				
	2013	2014	2015	2016	Total till 2020
1	2	3	4	5	6
Sub-program 1. Development of crop production, processing and marketing of crop products	67468	39288	51838	61678	555391
Sub-program 2. Development of livestock production, processing and marketing of livestock products	73313	57449	30709	40034	346447
Sub-program 3. Development of meat cattle breeding	4903	6738	6949	9348	76548
Sub-program 4. Support of small-scale farming	8620	8189	9760	15 796	114280
Sub-program 5. Technical and technological modernization, innovational development	5300	1900	3145	4106	31 610
Sub-program 6. Provision of State Program's implementation	21429	37394	24045	25493	229031
Sub-program 7. Development of field and greenhouse vegetable growing and seed potato production	0	0	7000	7041	43039.6
Sub-program 8. Development of dairy cattle breeding	0	0	24224	34317	247401
Sub-program 9. Support of pedigree livestock breeding, selection and seed production	0	0	7190	12 707	77335
Sub-program 10. Development of wholesale distribution centers and social catering infrastructure	0	0	2433	10 310	79 279
Sub-program 11. Development of financial credit system of the agrifood sector	2000	0	10000	11200	86700

Cont'd

1	2	3	4	5	6
FTP Social development of rural areas till 2013	9012	0	0	0	9012
FTP Preservation and restoration of farmlands' fertility and of agricultural landscapes as the national endowment of Russia in 2006-2010 and for the period till 2013	6625	0	0	0	6625
FTP Sustainable development of rural areas in 2014-2017 and for the period till 2020	0	11293	13993	16129	139610
FTP Development of Russian farmlands' reclamation in 2014-2020	0	7899	8578	9981	81909.6
TOTAL	197671	170150	187864	258139	2126220

Source: Resolution of RF Government No. 1421 of December 19, 2014 “On introducing amendments to the State program for agricultural development and regulation of agricultural, input and food markets for 2013-2020”.

So, the Ministry of Agriculture suggests supporting the “window of opportunities” that opened for Russian food suppliers following the introduction of retaliatory sanctions by the increase of State Program’s financing within its 8-year term from the current Rb 1.5 trillion up to Rb 2.1 trillion.¹⁵ Although earlier the government intended to optimize the State Program’s budget by cutting it by at least 20%¹⁶, it didn’t happen – on the contrary, additional Rb 20bn of respective allocations were included in the enacted budget for 2015. However, this is rather a compensation of funds cut in 2014 than above-projected appropriations. There are plans to allocate Rb 50bn more in the framework of anti-crisis plan for supporting import substitution.

In order to improve availability of food in the aggravating economic situation and to foster demand for domestic produce the government adopted measures for forming the system of internal food aid. Thus, Government Executive Order No. 1215-r of July 3, 2014 enacted the Concept for developing internal food aid in the Russian Federation that specifies the latter as “a system of state assistance to population in the form of direct supplies of foodstuffs to relevant individuals or by providing them with monetary aid for the purchase of food in order to improve nutrition and ensure a balanced diet based on rational rates of food consumption”. A similar system of assisting the neediest people short of funds for healthy nutrition such as pregnant and breastfeeding women, school children, handicapped, families with incomes below the subsistence minimum has long existed in developed countries, e.g. in the US and the EU. In case this measure embraces 15 million of most vulnerable Russian citizens, the demand for domestic produce will surely rise. According to estimates of the RF Ministry of Agriculture, in 2014 the total deficit of food for poor people was as big as 5.7 million tons to the amount over Rb 317bn.

There is a very serious lagging behind in the implementation of sub-program “Technical and technological modernization, innovational development of the sector”. Modernization of agriculture first of all suggests technical re-equipment and transfer to more advanced farm technologies in order to reduce costs and raise productivity. Low rates of technical and technological renovation of agricultural production on the whole and stagnation of farm machinery building in particular were identified as the most serious challenges for the Russian agricultural sector.¹⁷ To overcome this negative trend, next year the support of investment projects will be provided not through subsidizing of credits and loans taken for these purposes but by direct reimbursement of a part of their cost upon putting of investment objects in operation. For that end the Ministry of Agriculture is working out an investment map of Russian agriculture taking into account proposals of regions.¹⁸ The following directions are named as priority ones: development of dairy cattle breeding, creation of seed selection centers, strengthening of storage infrastructure, improvement of soil fertility, provision of farm producers with machinery and credits. 9 thousand credit agreements all over the country have been included in the list of priority investment projects eligible for subsidizing.

In order to expand marketing of farm products, the creation of wholesale distributional logistical centers (including those on cooperative principles) will be financed as a separate budget item. The Ministry of Agriculture has worked out a departmental target program “Development of agricultural consumer cooperation till 2025” the basic projected instrument of which will be the support of input supply, marketing and processing cooperatives through providing grants for the

¹⁵ Presentation of amendments to the State Program: speech of the RF Minister of Agriculture N. Fyodorov, October 2014.

¹⁶ Report of the RF Minister of Finance A.Siluanov at the meeting of the Government “*Gosprogrammy urezhut radi optimizatsii byudgeta*” [State programs will be cut in order to optimize the budget]. *Nezavisimaya gazeta*, No. 215 (6262), 06.10.2014.

¹⁷ National report «On the progress and implementation in 2013 of the State program for agricultural development and regulation of agricultural, input and food markets for 2013-2020”.

¹⁸ Report of the RF Deputy Minister of Agriculture A.V.Petrikov at the XIX Nikonov’s readings in the Free Economic Society of Russia.

development of material and technical facilities. But it's not clear whether it will be financed in the conditions of budget deficit.

4.6.5. Ways for Improving Agricultural Policies in the Current Situation

1. Sanctions, retaliatory sanctions, drop of prices for oil and the consequent devaluation of ruble have changed the economic situation in the country, resulted in the surge of prices for imported food items and triggered the rise of prices for domestic foodstuffs. In these conditions the government should refrain from mistakes made during the previous crises (1917-1921, 1929-1930, 1990-1991), namely trying to hold down the purchase prices for farm products bought from domestic producers. Given the new exchange rate of ruble, the world prices for agricultural products have become much higher than those of the domestic market. Any attempts to retain this situation, to make national producers sell their output at the prices far below the world ones have always ended with a total deficit of food and empty shop shelves. In the new conditions only in case domestic producers receive the world or close to them prices, they will have real incentives for increasing production and import substitution.

2. The crisis has already led to and in the following months will further aggravate the drop of personal incomes, with lower decile groups being most affected. The growing prices for food products will inevitably result in shorter consumption, especially of higher quality products. The shrinking of demand may lead to the withdrawal from farm business of those producers who entered it for receiving high profits. The corporate pattern of agricultural production is less sustainable than farmer one – it's not a mere coincidence that family farms are prevailing all over the world. The change of market situation may cause the worsening of financial performance and bankruptcy of agroholdings that in the previous years have already accumulated serious creditor indebtedness. It's necessary to elaborate the policy for restructuring debts of such entities with the ultimate goal of preserving production facilities and their transfer to small businesses working under contracts with large processing and marketing companies.

3. In the crisis situation the government should by no means promise to feed everybody or strengthen the centralization of food supply. During previous crises prices for and deficit of food products led to the active involvement of all population in farm production. About 36 million families in the country have summer cottages (“dachas”) and household plots. In the crisis situations their role in family food supply and incomes immensely grows. At the beginning of 1990s the average share of returns from household farming in incomes of rural families increased from 21.5% (1990) to 41.6% (1992). In recent years the role of these farms notably dropped as it was cheaper to buy everything in a food store or at the market – incomes in kind brought only 7% of family incomes in rural areas. In the changed situation the government should render assistance to such farms for the expansion of their production, help them with provision of seeds (for instance, even less severe crisis of 2008 led to a sharp increase of seed potato purchases by population) and other inputs. Agriculture is a domain of small business. One should support farmers and individual rural entrepreneurs, remove fantastic bureaucratic procedures hindering their access to land and other inputs. Small entrepreneurs are efficient when they are united in cooperatives, are acting in concert with large businesses. The development of cooperation and contract farming policies will help to ensure sustainability of agricultural production.

4. The lion's share of budget funds still goes to large-scale agribusiness. Small- and medium-size farms have far scarcer access to markets of basic inputs, to subsidizing and other forms of state support. At the same time they produce over 50% of agricultural output. In this regard it seems necessary to re-guide agricultural policies so that to enable small farm producers and their cooperatives to participate in the implementation of State Program together with large agroholdings. In order to cut transaction costs we can recommend providing services to rural borrowers primarily through credit cooperatives. Cooperatives may assume all the commitments

related to recording, application for and payment of all subsidies that a specific farm producer is eligible for under all measures and programs.

6. The program of sustainable development of rural areas should not be limited to the per capita financing of social and communal infrastructure and providing of young specialists with dwelling. No doubt very important, these two directions of government support fail to encompass the whole range of rural population's needs that differ by regions of the Russian Federation. It's worth using here the experience of the European Union's project "Leader plus" that envisages involvement of rural population in revealing the most urgent problems and distribution of grants on a competitive basis by open voting.

7. The decision of the RF Ministry of Agriculture on the direct reimbursement of a part of investment projects' cost upon their putting in operation instead of subsidizing interest rates of credits and loans taken for these purposes is absolutely correct from the theoretical point of view. First, it's difficult to plan the budget for reimbursing interest rates at the moment of their unpredictable growth. Second, according to Supplement 2 of the WTO Agreement on Agriculture unbound subsidies for the modernization of farms are classified as "green box" support measures while subsidies for the reimbursement of interest rates distort input markets and are included in the "amber box". Still, there is one fact raising concern: farm producers can enter the program of priority investment financing only if they are included in the lists recommended by the regional departments of agriculture. The terms of participating in the program of technical modernization in most cases are not specified thus increasing the risk of corruption.

8. With the creation of Customs Union and the EAEU Russia has ceded a part of its sovereignty. In the new conditions the government has to coordinate its decisions with the alliance partners. The most important issues to be coordinated with members of the EAEU are:

- changing of the Union's customs borders;
- introduction of bans on import or export of basic food products from the selected countries and unions;
- introduction of temporary sanitary and epidemiological restrictions on import of selected agricultural and food items from the selected countries;
- introduction of export duties on selected products and inputs.

When taking foreign policy and economic decisions Russia should bear in mind the risks associated with their impact on the alliance partners.