

**GAIDAR INSTITUTE FOR ECONOMIC POLICY**

**RUSSIAN ECONOMY IN 2015  
TRENDS AND OUTLOOKS  
(ISSUE 37)**

**Gaidar Institute  
Publishers  
Moscow / 2016**



UDC 33(470+571)(066)"2015"  
BBC 65.9(2Poc)

R95 **Russian Economy in 2015. Trends and Outlooks. (Issue 37) /**  
[V. Mau at al; ed S. Sinelnikov-Mourylev (editor-in-chief), A. Radygin];  
M.: Gaidar Institute Publishers, 2016. 440 pp. – ISBN 978-5-93255-459-3

The review provides a detailed analysis of main trends in Russia's economy in 2015. 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.

UDC 33(470+571)(066)"2015"  
BBC 65.9(2Poc)

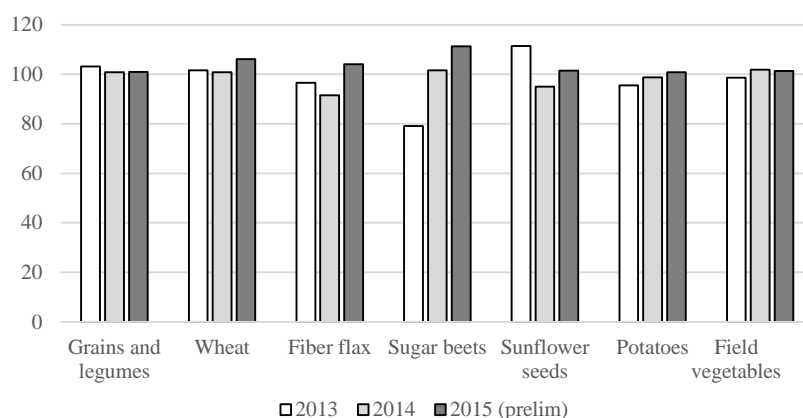
ISBN 978-5-93255-459-3

□ Gaidar Institute, 2016

## Import substitution in the wake of food embargo<sup>1</sup>

### 4.7.1. Production of agricultural and food products

In 2015, the war of sanctions and the shutting down of access to Russian food markets for countries included in the sanction list<sup>2</sup> created favorable conditions for domestic farm producers. The limiting factor was the drop of ruble exchange rate that dramatically lifted prices for many farm inputs, both imported (hybrid seeds, pesticides, breeder stock, etc.) and exported (fertilizers, fuels). Therefore, there were fears that farmers would fail to benefit from the shutting down of markets and to increase domestic agricultural output. However, farm producers did not reduce areas sown in all major crops as compared with the previous year (*Fig. 38*).



*Fig. 38.* Index of areas sown by farms of all types (as % of the previous year)

Source: Rosstat.

The growth of prices for inputs, first of all the imported ones, could have prompted a shrinkage of their application but so far annual indicators show no signs of it. For instance, the gross output of grain in 2015 was only slightly below that of 2014. The outputs of other major crops were above the 2014 indicators. The five-year averages prove that agriculture is on the upswing (*Table 31*).

*Table 31*

### Average annual output of major farm crops, million tons

	1990–1994	1995–1999	2000–2004	2005–2009	2010–2014	2014	2015*
Grains and legumes	99	65	76	89	85	105	104
Sugar beets	24	15	17	27	38	34	38
Sunflower seeds	3	3	4	7	9	9	10
Potatoes	35	34	29	29	29	32	34

<sup>1</sup> Authors of this section: Gataulina E. – RANEPА, Shagaida N. – RANEPА, Uzun V. – RANEPА, Yanbykh R. – RANEPА.

<sup>2</sup> Resolution of RF Government “On measures for the implementation of Decree of the President of the Russian Federation No. 560 of August 6, 2014 “On the application of selected special economic measures for ensuring the security of the Russian Federation.”

Field vegetables	9	10	11	12	13	14	16
------------------	---	----	----	----	----	----	----

\* Preliminary data as of February 1, 2016.

Source: Rosstat.

In 2015, positive trends were also observed in livestock production except for dairy cattle breeding where cow inventories fell at a higher rate as compared with the previous year and the average monthly output of milk ranged from 98% to 101% of the 2014 indicators. Poultry production showed monthly increases from 1% to 3% as compared with the respective figures of 2014, the production of meat – from 3% to 6%.

At the same time, the dynamics of farm production in 2015 was not stable. For instance, in the first and the second quarters of the year the increase of output was approximately the same as in 2014 while in the third quarter it fell to a notably lower level. The excellent performance in the fourth quarter leveled off the situation to some extent – the annual index shows the increase of output in the sector. However, its rates are somewhat below the growth rates of 2014 (Fig. 39).

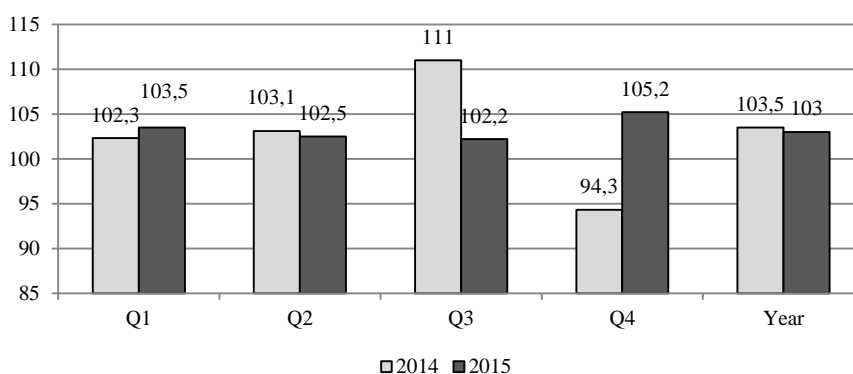


Fig. 39. Indices of farm production as % of the respective period of the previous year

Source: Rosstat, data as of February 1, 2016.

The performance of food industry in 2015 has also preserved positive dynamics. The situation therein was similar: in the second and the third quarters growth rates were far below the respective indicators of 2014 but over the year the output increased. However, the growth rates were also slightly lower than in the previous year (Fig. 40).

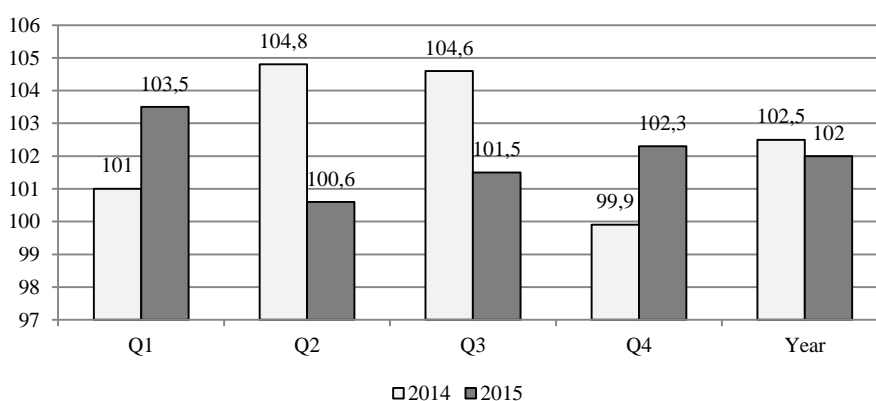


Fig. 40. Indices of food production as % of the respective period of the previous year

Source: Rosstat.

#### 4.7.2. Affordability of food products for population

Despite the increase of output in agriculture and food industry prices for basic foodstuffs have been rising since August 2014. The causes and dynamics differed by products, the periods of price growth and price drop alternated. For instance, such dynamics was displayed by prices for pork and chicken meat, the increase of which reached up to 1% per week in the first months after the introduction of embargo but later in the year these items got cheaper. The leader of price growth after August 2014 was vegetable oil (*Fig. 41*) largely due to the fact that this is an export product and the devaluation of ruble was to result in higher domestic prices for it.

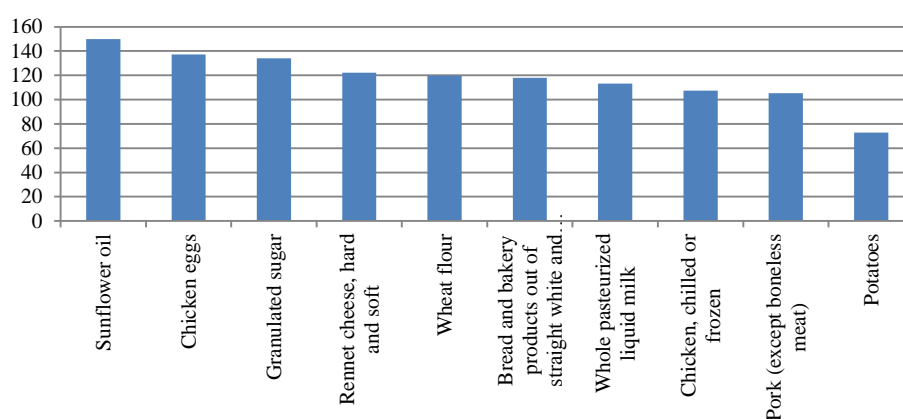


Fig. 41. Weekly chain price index for basic food products (August 4, 2014 – December 28, 2015), %

Source: Rosstat.

Prices for basic food products grew in the situation of falling real disposable money incomes of population. The rates of their decrease as stated by Rosstat were below the rates of price growth for basic foodstuffs. For instance, in 2015 the decrease of real incomes relative to 2014 was as low as 4%. Meantime, the purchase of food items by population notably fell. Over the year retail sales of food products in comparable prices (the all-Russia total) fell by 9.2% relative to the previous year, the decrease relative to December being even bigger – 11% (*Table 32*).

Table 32

#### Retail sales of food products in Russia (in comparable prices), as % of the previous year

	2009	2010	2011	2012	2013	2014	2015
January	103.6	103.3	100.1	105.6	101.6	101.8	95.3
February	99.1	103.7	102.7	105.6	100.6	103.1	92.7
March	98.8	104.1	101.4	105.7	102.8	101.6	92.9
April	101.6	104.8	101.1	104.6	102.0	101.9	91.3
May	98.1	105.7	100.6	105.7	102.5	100.5	91.3
June	97.8	106.6	101.0	105.3	102.7	98.9	90.9
July	96.5	108.5	101.1	102.8	103.6	99.5	91.0
August	94.5	108.0	103.4	102.1	103.9	99.8	89.9
September	94.3	105.6	105.8	101.6	102.8	99.5	90.2
October	96.2	104.4	106.3	101.6	102.7	99.4	89.3
November	97.8	104.2	106.8	102.2	103.2	98.3	88.5
December	100.4	102.4	107.6	102.2	101.8	99.5	88.6
<b>Annual total</b>	<b>98.1</b>	<b>105.1</b>	<b>103.4</b>	<b>103.6</b>	<b>102.6</b>	<b>100.0</b>	<b>90.8</b>

Source: Rosstat.

The situation differs by regions of Russia. In 2015 the biggest decrease of sales was registered in Omsk oblast and the Mary-El Republic (January-November) where the retail turnover in comparable prices fell by 22-25%. This indicator is an indirect sign of poorer economic access to food products and the worsening of situation with food security.

#### 4.7.3. Trends in imports and exports of agricultural and food products

The drop of food imports (groups 1-24 by Foreign Economic Activity Commodity Nomenclature (FEACN)) as seasonally adjusted was observed from August 2014 – the moment when Russia introduced a ban on import of food items from some countries. By December 2014 the shortfall in supplies as compared with 2013 reached 24% (Fig. 42). In January 2015 imports of food items were 42% below those of January 2014. Beginning from March 2015 the falling of imports was halted – their value varied from \$2.1bn to \$2.3bn.

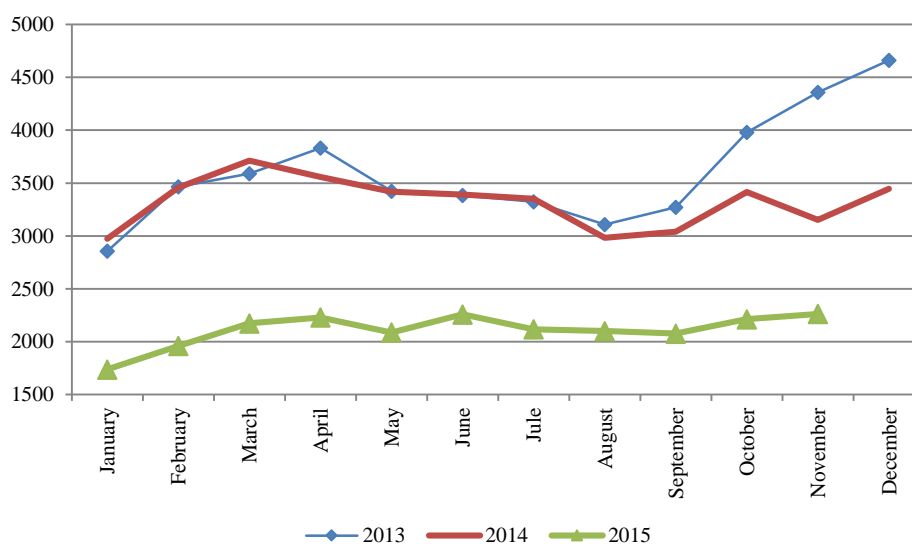


Fig. 42. Imports of food products, million dollars

Source: Rosstat.

In the recent years Russia has been intensely increasing exports of agricultural and food products. In 2014 foreign currency revenues from selling the output of agrifood sector were  $\frac{1}{4}$  above those from selling the produce of military industrial complex. In the situation of sharp drop of prices for energy products domestic agribusiness can to some extent offset the losses from exports of gas. Even more so, if the price of gas for farm producers is reduced, their production costs will fall making them more competitive. In 2013 foreign currency revenues from the export of foodstuffs corresponded to 22% of the revenues from the export of gas while in January-November 2015 – to 33%. In January-November 2015 currency receipts for the exported gas fell by \$9.7bn. A part of this shortfall (\$2.7bn) was offset by bigger receipts from the export of agricultural and food products.

The dramatic devaluation of ruble has inspired expectations that given relatively stable prices on the world food markets exports of agricultural and food products will grow remarkably. However, it hasn't happened. Beginning from February 2015 monthly exports have never once exceeded the 2014 figures. To only a small extent this can be attributed to the growth of home consumption of domestic foodstuffs owing to the shrinkage of import supplies. Exports largely decreased due to the internal policies of curbing them (introduction of export duties on grains, non-tariff restrictions of export, etc.) (Fig. 43).

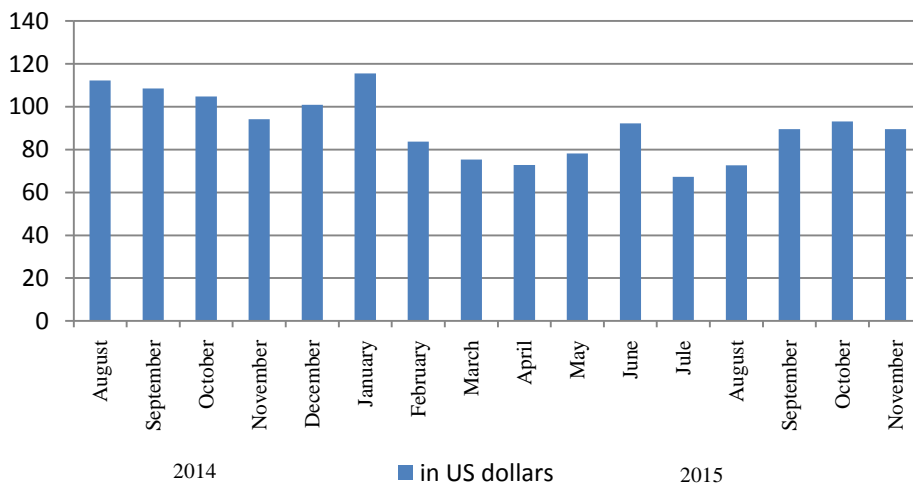


Fig. 43. Exports of agricultural and food products by months in 2014-2015 as compared with 2013-2014 (groups 1-24 by FEACN), %

Source: Federal Customs Service.

Owing to the devaluation of ruble export transactions have preserved their financial appeal. Over all the examined months ruble revenues from exports were well above those of the previous year (Fig. 44). Export revenues over 11 months 2015 exceeded the respective figures of 2014 by more than 36%.

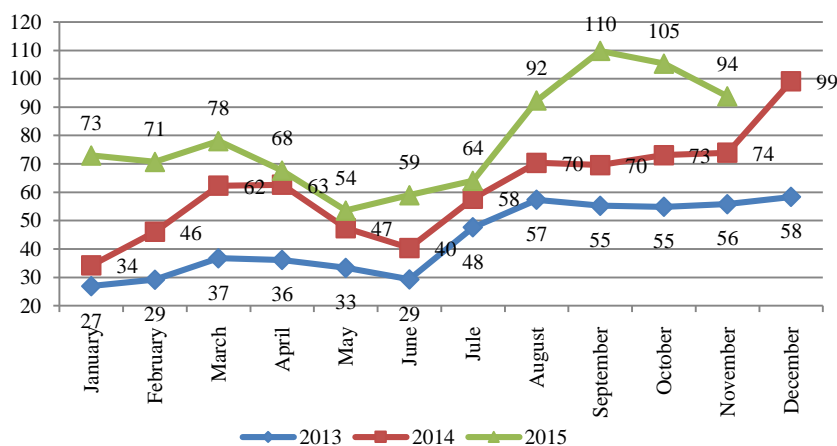




Fig. 44. Receipts from export of agricultural and food products from Russia by months (groups 1-24 by FEACN), billion rubles

Source: Federal Customs Service.

#### 4.7.4. Import substitution

Import substitution usually stands for the replacement of an imported commodity by the same or similar by quality domestic product<sup>1</sup>. This definition is quite acceptable for examining import substitution in respect of a specific commodity. Since there is a wide range of commodities (taking into account their brands, grades, etc.), the indicators of in kind import substitution are also numerous. The trends of their change can be opposite and therefore it's difficult to make general conclusions on their basis. In order to examine import substitution for a group of commodities one needs to shift from physical to value indicators.

Value substitution is the switch from paying foreign suppliers to paying domestic producers. The indicators of value import substitution depend not only on the volumes of imported and domestic items but also on the prices for them and the exchange rate of ruble. Value import substitution takes place in case domestic producers increase their share in the wallet of food consumers, i.e. in case the share of imported food products in the total consumer expenditures on buying foodstuffs reduces<sup>2</sup>.

In Russian statistics there are two indicators reflecting the cost of imported food products. Customs statistics shows their cost in border prices. The amount stated in this statistics goes to foreign suppliers of food items. The major part of these deliveries (about 70%) moves to retailers. The other part – imported inputs (seeds, feeds, live animals, meat for processing, etc.) – are not sold in retail stores but go to the production of food items that later enter retailing as domestic products.

Rosstat surveys the cost of imported foodstuffs in retailing but does it in retail prices. It's quite obvious that these statistical records disregard the part of imported products used for production purposes. Nevertheless, the cost of imported items in retailing is about 3 times higher than the cost of all imported foodstuffs in border prices (*Table 33*). It's hard to explain this difference by import duties (approximately 15% of border price). The major receivers of markups on imported food products are domestic companies – importers and commercial networks. They benefit from their monopoly position and imperfect legal regulation of the named markups.

As can be seen from data in *Table 33*, import substitution in consumer wallet was really the case. One of the above mentioned indicators – the share of imported products in retail sales to consumers – was gradually falling: in the third quarter of 2015 it amounted to only 27% while in the respective quarter of 2014 – to 32%, in 2013 – to 35%. The decrease of imported products' share in retail turnover was proceeding despite the fact that in the first three quarters of 2015 the total value of imports in border ruble prices was approximately the same as in the previous years. Reasoning from that, one can come to the conclusion that the share of imports in retail sales was falling primarily due to the reduction of markups on the way of imported products from the border to retail shelves.

---

<sup>1</sup> Animitsa E.G., Animitsa P.E., Glumov A.A. *Importozameshcheniye v promyshlennom proizvodstve regiona: kontseptual'no-teoreticheskiye i prikladniye aspekty* [Import substitution in industrial production of a region: conceptual, theoretical and applied aspects]. *Ekonomika regiona* [Economy of a region], 2015, No.3, pp. 160-172.

<sup>2</sup> Uzun V. *Prioritety agropodovol'stvennoy politiki: importozameshcheniye ili export?* [Priorities of agrifood policies: import substitution or export]. *Economist*. 2015, No.7, pp. 17-29.

Table 33

## Share of imported food products in retail turnover, 2013–2015

Year and quarter	Retail turnover of food products (including beverages) and tobacco			Imports of food products, beverages and tobacco (groups 1-24 by FEACN) (in border prices)	
	Billion rubles	Including imported products		Billion rubles (at current exchange rate of US dollar)	Share in retail turnover, %
		Billion rubles	%		
2013	11143	3956	35.5	1379	12.4
I	2482	894	36	301	12.1
II	2691	942	35	336	12.5
III	2818	986	35	318	11.3
IV	3152	1135	36	423	13.4
2014	12381	4243	34.3	1527	12.3
I	2730	983	36	355	13.0
II	2966	979	33	363	12.2
III	3140	1005	32	339	10.8
IV	3545	1276	36	470	13.3
2015*	9721	2877	29.6	1122	11.5
I	3098	991	32	372	12.0
II	3252	976	30	352	10.8
III	3371	910	27	397	11.8

\* 2015 – the total for 3 quarters.

Source: Rosstat, customs statistics.

In the previous sections it has already been shown that after the introduction of embargo in August 2014 imports of food reduced in both physical and value terms. This statement is true if the value of imports is estimated in US dollars (in border prices). But the exchange rate of dollar has markedly grown over this period. Population buys imported products for rubles and therefore it's reasonable to estimate the value of imports in ruble equivalent. *Fig. 45* shows that over the examined period there were only three months (March, April and May of 2015) when the ruble value of imports was lower than in the respective months of pre-crisis period. In all the remaining months the nominal ruble value of imports was noticeably higher than before the introduction of embargo. This is an indirect sign that despite the falling incomes population continues to spend the same or even bigger amounts on imported products. So, no import substitution has taken place in the consumer wallet – on the contrary, the share of payments to foreign suppliers has grown.

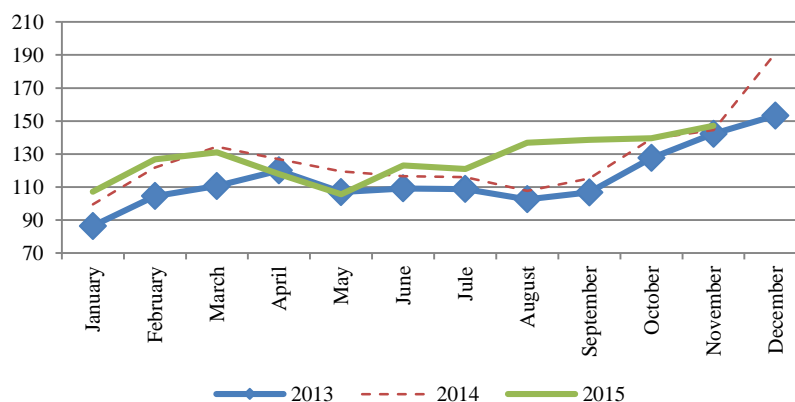


Fig. 45. Dynamics of food imports (groups 1-24 by FEACN), billion rubles

Source: Federal Customs Service.

The reasons of growing consumer expenditures on imported foodstuffs require a special examination. Consumers with high level of incomes are ready to increase expenditures and buy more expensive imported products in the same or approximately the same quantities. Additional expenditures of this population group offset the reduction of expenditures on these products by poor families.

This is the situation for agricultural and food products in general. For selected groups of commodities import substitution did take place. For instance, nominal ruble expenditures on imported meat and meat products in 9 months 2015 were somewhat below those of the respective period of 2014 (Fig. 46).

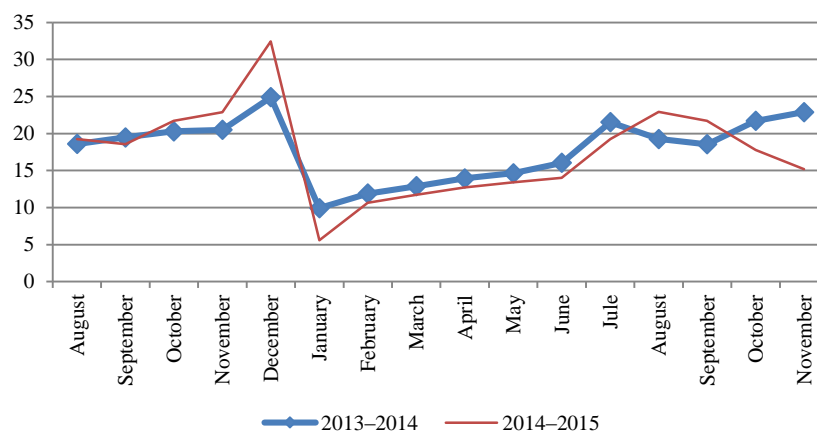


Fig. 46. Dynamics of imports of meat and meat products, billion rubles

Source: Federal Customs Service.

The physical volume of imported milk products and their value in dollar terms was reducing throughout almost all months of the examined period. The value of their imports in ruble terms was also smaller than in the previous year (Fig. 47).

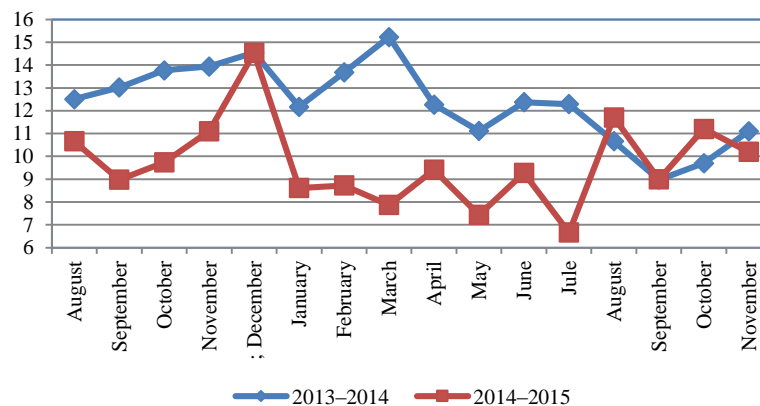


Fig. 47. Dynamics of imports of milk and dairy products, billion rubles

Source: Federal Customs Service.

Over 11 months 2015 imports of milk and dairy products totaled Rb 88.6bn while in the respective period of 2014 they amounted to Rb 129.7bn. So, one can state that relative to the previous year consumers started to spend a smaller share of their budget on purchasing imported dairy products.

In 2014-2015 the share of domestic output in commodity resources was expanding quite rapidly as compared with 2013 (*Table 34*). There were three reasons for that: growth of domestic production, shrinking of imports and smaller consumption of some products.

Table 34

**Self-sufficiency in food products, 2013–2015**

Item	Year	Domestic production, 1,000 tons	Imports, 1,000 tons	Commodity resources – total, 1,000 tons	Self-sufficiency in food products, %
Pork	2013	2816	980	3796	74
	2014	2974	426	3400	88
	2015	3115	250	3365	93
Poultry meat	2013	3831	527	4358	88
	2014	4164	453	4617	90
	2015	4492	250	4742	95
Cheese and curds	2013	1167	466	1633	71
	2014	1257	349	1606	78
	2015	1378	210	1588	87
Butter	2013	225	165	390	58
	2014	251	158	409	61
	2015	265	110	375	71
Vegetables and melons	2013	16109	2817	18926	85
	2014	16885	2929	19815	85
	2015	17474	2500	19974	88
Fruit	2013	3380	7201	10581	32
	2014	3525	6680	10204	35
	2015	3585	5560	9145	39

Source: RF Ministry of Agriculture.

The growth of domestic production has ensured import substitution and increase of consumption of only two of the examined products. The output of poultry meat grew by 661 thousand tons while imports reduced by 277 thousand tons, so consumption was up by 384 thousand tons. The situation was similar for vegetables and melons (*Table 35*).

Table 35

**Change of production, imports and consumption in 2015 as compared with 2013, 1,000 tons**

Item	Growth of production	Reduction of imports	Change of consumption
Pork	299	-730	-431
Poultry meat	661	-277	384
Cheese and curds	211	-256	-45
Butter	40	-55	-15
Vegetables and melons	1365	-317	1048
Fruit	205	-1641	-1436

Source: RF Ministry of Agriculture, authors' calculations.

For all other products the rates of imports' reduction were higher than the rates of production growth. Accordingly, import substitution was only partial and the consumption of these products eventually dropped. Given the falling incomes, population could not buy the same quantities of imported products that became more expensive while domestic producers failed to supply sufficient quantities of cheaper products.

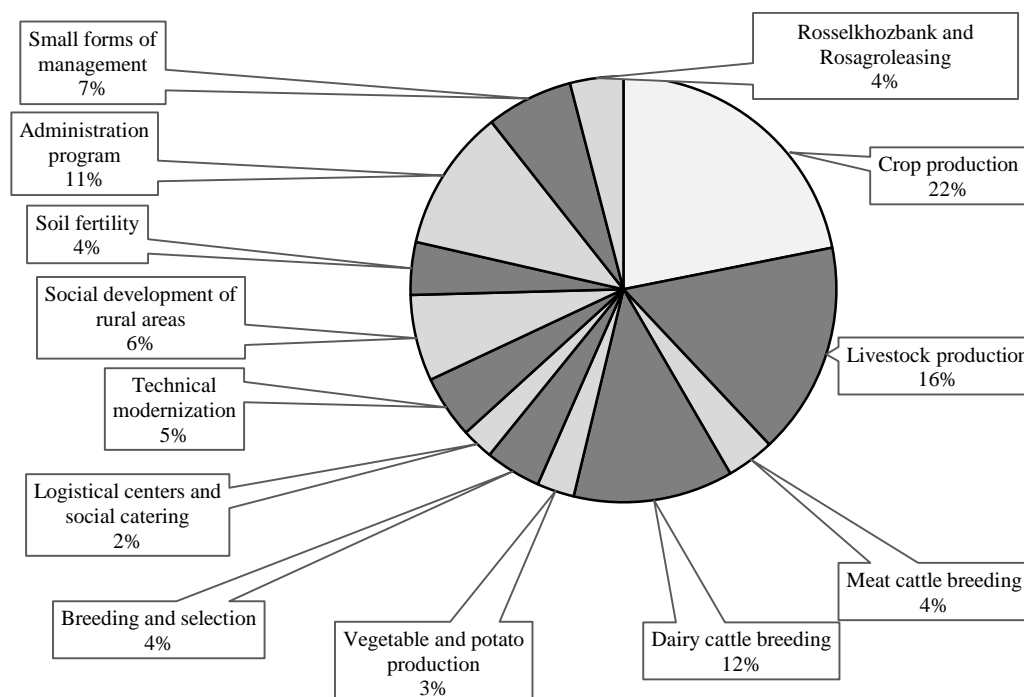
#### 4.7.5. Changes in budget support

Following the set course for import substitution some changes were introduced in the basic regulatory document pertaining to agriculture – “State program for agricultural development and regulation of agricultural, input and food markets for 2013-2020”. In particular, there appeared *five new sub-programs* targeted at the development of most vulnerable spheres in the domestic agribusiness:

- 1) Pedigree livestock breeding, selection and seed production;
- 2) Dairy cattle breeding;
- 3) Vegetable growing in the open and protected ground and production of seed potatoes;
- 4) Wholesale distribution centers and social catering infrastructure;
- 5) Financial and credit system of the agrifood sector.

The perfecting of agricultural policy mechanisms is in progress, some regulatory acts are at the stage of examination. New amendments to the “State program” are to be introduced in February 2016 (the term earlier specified in the “Roadmap for encouraging import substitution in agriculture for 2014-2015” was September 15, 2015).

In 2015 the new sub-programs will account for 23% of the total State program’s financing with dairy cattle breeding having the biggest share (*Fig. 48*). Allocations to the sector’s modernization are decreasing while administrative expenditures grow year after year (Rb 26.7bn): by the amount of allocated funds they rank fourth right after the development of dairy cattle breeding. The top two positions belong to the development of crop production (Rb 54.1bn) and livestock production (Rb 39.9bn).



*Fig. 48.* Financing of State program in 2015, billion rubles

Source: RF Ministry of agriculture.

According to data of the RF Ministry of Agriculture, the approved budget outlays as of October 1, 2015 envisage allocation of additional Rb 34.3bn from the federal budget to supplement

the initially planned expenditures on the State program (as specified in RF Government Resolution No. 1421 of December 1, 2014). Respectively, the total financing has amounted to Rb 222.15bn instead of Rb 187.8bn. The figure is not final. The increase of allocated funds *per se* is a positive fact but their distribution by items is not quite faultless.

Following the appearance of new sub-programs respective amendments were introduced in the rules of granting and distribution of subsidies for the reimbursement of interest rate on credits and loans (RF Government Resolution No.766 of July 28, 2015, new edition of the fundamental Resolution on agricultural subsidies No.1460 of December 28, 2012). The Resolution complements the list of potential receivers of subsidies by including therein farm producers and processors whose activities contribute to the progress of dairy cattle breeding, to the development of selection and seed production centers in crop growing and of selection and genetic centers in livestock breeding as well as to the purchase of raw livestock and crop output (vegetables, fruit, grapes, potatoes, melons and greenhouse products) from farmers for primary and/or further processing. The full list of subsidized activities is usually approved by the RF Ministry of Agriculture.

While for all investment credits reimbursement from the federal budget amounts to 2/3 of the refinancing (official discount) rate of the RF Central Bank, for credits (loans) received for the expansion of meat and dairy cattle breeding and for the development of selection and seed production centers in crop growing and of selection and genetic centers in livestock breeding the size of this reimbursement reaches 100% of this rate.

Besides, those borrowers who implement investment projects in meat or dairy cattle breeding have an opportunity to extend the term of credit agreements signed between January 1, 2008 and December 31, 2012 inclusive, from 10 to 15 years. The same Resolution increases up to 5% the minimal rate of partial subsidizing of expenditures on paying interest rate on credits to be reimbursed by regional budgets. All these amendments came into force on August 1, 2015.

Over 1/3 (35%) of the additional financing – Rb 12bn – instead of going to farm producers in import substituting sectors was spent on the increase of capital of Rosselkhozbank (Rb 10bn) and on the contribution to the authorized capital of OJSC Rosagroleasing (Rb 2bn). The State Program's passport did not envisage the financing of these measures in 2015. These allocations raise questions since farm producers can apply for a credit to any Russian credit organization, not exclusively to Rosselkhozbank that has got these injections for its ordinary activities without any commitments to grant additional privileges to farm producers as compared with other banks crediting agribusiness. For instance, Sberbank, the second largest creditor of the agrifood sector has got no such allocations in the framework of the State Program despite the fact that in 2015 it demonstrated better dynamics of providing credits for the seasonal field works: according to data of the RF Ministry of Agriculture as of December 3, 2015 the amount of such credits issued by Rosselkhozbank grew by 19% as compared with the respective period of the previous year while in Sberbank the increase was 85%<sup>1</sup>.

Rosagroleasing offers preferential federal leasing to agricultural producers and the contribution to its authorized capital makes it possible. At the same time it weakens competition as there are other leasing companies that could also provide this service in case of similar support by the state. But at the moment they have no opportunities to do it.

This direction is not new at all. The increase of capital of Rosselkhozbank and Rosagroleasing was regularly carried out in the framework of the first State program and now is being continued but already as a separate direction.

---

<sup>1</sup> <http://www.mcx.ru/news/news/show/46040.355.htm>

The Government has also attended to the criteria of selecting investment projects the implementation of which fosters import substitution. The rules of allowing grants to promising innovational projects in the agrifood sector have been specified in the RF Government Resolution No.678 of July 7, 2015. The measures are financed in the framework of sub-program “Technical and technological modernization, innovational development”.

A new mechanism of support – compensation of direct expenditures incurred on the creation and modernization of agribusiness facilities – was first announced in 2014. The rules of granting and distribution of subsidies for these purposes were approved by the RF Government in Resolution No.624 of June 24, 2015. The mechanism of reimbursing direct incurred expenditures suggests that:

- 1) The selection of investment projects is done on the federal level;
- 2) Compensation from the federal budget covers the following part of expenditures: up to 20% - for the creation and modernization of facilities in the agrifood sector; 30% - for the creation and modernization of selection and genetic centers for breeding and transplantation of dairy cattle embryos; for the Far East regions the rate is higher – 25% and 35%, respectively, but not above the size of normative expenditures.

Direct financing to the amount of Rb 11.4bn is envisaged for the creation and modernization of:

- fruit storages (Rb 1.2bn);
- potato and vegetable storages (Rb1.5bn);
- greenhouse complexes (Rb 3bn);
- dairy farms (Rb 4bn);
- selection and genetic centers and selection and seed production centers (Rb 0.7bn);
- creation of wholesale and distribution centers (Rb 1bn).

In 2015 400 projects to the amount of Rb 150bn were selected. Besides, Rb 2bn of subsidies were allocated to producers of farm machinery to let them sell their machines with a discount.

The shortage of logistical infrastructure largely curbs sales and the development of domestic market of farm products. Reasoning from that, a new sub-program “Development of wholesale and distribution centers (WDCs) and social catering infrastructure” was adopted. As follows from the name, its main target is the creation of WDCs; the principal mechanism of support – a partial compensation of direct incurred expenditures from the federal and regional budgets (20% of the estimated cost from the federal budget (for subjects in the Far East Federal District – 25%) in case of co-financing from the regional budgets)<sup>1</sup> for the selected investment projects. The State Program envisages that WDCs will service up to 20% of supplies in the framework of the state order including the system of social catering. In 2015 it was suggested to build about 15 pilot WDCs with the support of Rb 1.5bn from the federal budget<sup>2</sup>. On the whole, in 2015 the total financing of the sub-program from the federal budget increased from Rb 2.4bn specified in the passport of the State Program to Rb 7.4bn under budget breakdown as of October 1, 2015. However, only 4% of these funds or Rb 0.3bn were intended specifically for the creation of WDCs. It’s clear that in this case plans for the construction of 15 WDCs won’t come true. Moreover, according to data of the RF Ministry of Agriculture as of October 1, 2015 these amounts remained unused. The remaining 96% of the sub-program’s funds (Rb 7.1bn) were allocated to the subsidizing of interest rate on short-term credits to processors for the purchase of raw agricultural products (not exclusively of domestic origin) for primary

<sup>1</sup> RF Government Resolution No.624 of June 24, 2015.

<sup>2</sup> [http://www.mcx.ru/news/news/v7\\_show\\_print/37729.285.htm](http://www.mcx.ru/news/news/v7_show_print/37729.285.htm)

and industrial processing according to the list of the RF Ministry of Agriculture (RF Government Decree No.1586-r of August 18, 2015). According to the rules of WTO and the Eurasian Economic Union Russia cannot provide preferences for the subsidizing of purchases from domestic producers; therefore, the named subsidy fails to encourage import substitution.

The support of dairy cattle breeding shrank as compared with the previous year. The financing of badly needed subsidy per 1 liter of marketed milk from the federal budget fell down to Rb 6.2bn (-26% relative to 2014). The subsidizing of interest rate on investment credits for the building and reconstruction of dairy farms was one of the principal measures of support to dairy cattle breeding. Nevertheless, in 2015 the allocation of funds under this article (according to the budget breakdown as of October 1, 2015) shrank more than 2 fold as compared with the State Program's passport: from Rb 11.8bn to Rb 5.15bn. Even taking into account these subsidies, high interest rates set by banks make the conditions of crediting investment projects in the sector worse than in the previous years. For instance, in 2012 the average weighted interest rate of commercial banks was 11.1%. Given the 100% reimbursement of the Central Bank's refinancing rate that amounted to 8.1%, the borrower was to pay 3% (not including the regional part of the subsidy). According to data of the RF Central Bank, in January-September 2015 the average weighted interest rate set by commercial banks on credits to non-financial institutions for terms exceeding one year was 15.4%<sup>1</sup>. Under the terms of subsidizing, given the 100% reimbursement of the Central Bank's refinancing rate (8.25%) the borrower was to pay 7.15%. This means that credit terms deteriorated more than 2 fold. The same is true for meat cattle breeding to which similar terms of subsidizing are applied. Besides, without subsidies the 2015 interest rates were prohibitively high while in 2012 credits were much more available.

So, in 2015 the support of "prioritized" dairy cattle breeding was actually cut down. Even the restriction of imports under sanctions that enlarged the market niche for domestic farm producers has failed to offset the reduction of budget support. It's no wonder that the production of milk shows actually no growth.

The support of vegetable growing in the open and protected ground and of the production of seed potatoes – the sectors that were declared to be of priority importance – was as low as 14% (!) of the level initially envisaged in the State Program's passport for 2015: Rb 0.7bn instead of Rb 5bn. The principal part of support (Rb 4.5bn) was to be provided through a partial reimbursement of expenditures on the construction and modernization of potato and vegetable storages and greenhouses. However, after the amendments to the budget only Rb 0.2bn were left for these purposes.

The subsidy for purchasing elite seeds has grown remarkably – it amounts to Rb 2.8bn. However, if formerly it was provided for the purchase of Russian seeds, now it applies to all seeds included in the State register of selection achievements, i.e. to the supplied by foreign producers as well. Given that the major part of hybrid seeds of sugar beets and corn is imported, this subsidy supports foreign rather than domestic producers. This fact is due to the Russia's membership in WTO. According to Article 3 Part II of the WTO "Agreement on subsidies and countervailing measures", "subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods" shall be prohibited. This clause should be taken into account when choosing forms of state support in the future.

The support of production of fine wools and comeback is a new subsidy targeted at the substitution of imported raw inputs for enterprises in textile and consumer goods industries. The financing of this import substitution sector was also cut almost 3 fold: from Rb 153.5m under

---

<sup>1</sup> Simple average of the monthly weighted average rates of the RF Central Bank.



the State Program's passport to Rb 53.5m according to the budget breakdown. Given the amounts allocated and the great range of claimants this subsidy is unable to solve the problem. At the same time the funds may remain unused due to the requirement to prove the quality of wool in an accredited laboratory. There is no information about the number of such laboratories and whether it is sufficient. At the moment there are only plans to build two such laboratories with public co-ownership – one in Chita and one in Elista. The rules of distributing this subsidy were approved only on July 2, 2015 and the Decree on distributing it between the subjects of the Russian Federation – only on August 25, 2015. Such a delay does not contribute to the efficient utilization of the subsidy.

It should be noted that over the whole period of the programs' existence the major part of support has been provided in the form of subsidizing interest rate on credits and loans with the state debt under investment credits growing at the highest rate. Only in 2014 the amount of subsidies on the reimbursement of interest rate increased by 14% (from Rb 93bn to Rb 102.5bn). Under no other provision of the State program the government has carried forward obligations. So, for all its significance, the program of subsidizing interest rate has got hypertrophied importance in the structure of state support. At present it accounts for over 50% of the total financing under the State Program. The problem also resides in the multiplicity of subsidies (altogether there are more than 40 of them). The Accounts Chamber repeatedly stresses that such a big number of subsidies is hard to administrate.

In 2015 subsidies on the reimbursement of interest rate fell down to Rb 84bn including Rb 38bn on short-term credits and Rb 46bn on investment credits. For instance, Rb 29.3bn were allocated to the development of livestock breeding including production and processing of livestock products, development of infrastructure and logistical support of the markets, Rb 15.4bn – to the development of crop production. A separate budget item was the financing of dairy cattle breeding: subsidies on short-term credits – Rb 0.3bn, on investment credits – Rb 5.2bn. In meat cattle breeding investment subsidies amounted to Rb 5.1bn. Subsidies on short-term credits for processing crop and livestock products totaled Rb 7.6bn.

Besides, new executive orders provided for the allocation of additional Rb 150m to the construction of drip irrigation systems for perennial plantations including vineyards in Crimea.

In spite of repeated declarations of the importance of small-scale farming in the production of agricultural products and the welfare of rural community, the support to household farms and their cooperatives has not increased. The amount of subsidies for the support of beginner farmers and family livestock farms from the federal budget totaled Rb 6.3bn. In 2015 20 supply-marketing and processing agricultural cooperatives from 14 regions each got up to Rb 40m as pilot grants for the development of physical facilities but for Russia at large it's very little.

Rb 8bn from the federal budget are to be spent on the implementation of federal target program "Sustainable development of rural areas in 2014-2017 and for the period till 2020". In 2015 for the first time certain funds (Rb 152bn) were allocated to the complex improvement of social and engineering infrastructure in rural settlements.

So, among the existing sub-programs (including the newly launched) there is actually not a single one that really contributes to the breakthrough in import substitution. The financing is cut so dramatically that import substitution in the sectors declared to be the priority ones is in fact problematic. Subsidies on the purchase of elite seeds and on the reimbursement of interest rate on credits for the purchase of raw inputs by processors support not only domestic producers. This proves the need for a serious revision of Russia's agricultural policies.

The following *directions of policy improvement* are most important for the strengthening of food security:

1. Shifting of emphasis in the ideology of “Doctrine of food security”: instead of food independence, import substitution and self-sufficiency the main accent should be made on the economic availability of quality foodstuffs for all families including the poorest ones with import supplies being one of the tools.
2. Inclusion of the following target indicators in the “Doctrine”: a composite index of the country’s food independence (for all products); the rate of compliance of an actual food ration with the recommended one; the threshold level of satisfying the requirements of the poorest families making them eligible for food aid; the level of technological independence of the agrifood sector.
3. Changes in the import and export policies: the abolition of regulations restricting export and the working out of measures supporting it; switching from the prioritized support of import substitution for all types of foodstuffs to the prioritized support of export, i.e. the production of commodities the prices for which are competitive on the world market.
4. Working out of the program for targeted food aid to the poorest families whose incomes per family member are below the threshold level. It should be preceded by arrangements for the registration of such families, definition of the monthly amount of aid per capita, the list of foodstuffs’ groups, the categories of producers and sellers eligible for the participation in the program. If at the first stage of the food aid program’s implementation the threshold income is set at the average actual level in the first decile group, about one half of families in this group will claim for assistance, i.e. approximately 7 million people. Given that the size of assistance is Rb 1,000 per capita each month, the total amount of funds for food aid in the country will amount to Rb 84bn annually.
5. Abolition of food embargo. There are the following reasons for its abolition: the embargo results in higher prices for foodstuffs and bigger share of food expenditures in the budgets of families especially the poorest ones; the human rights for consuming certain types of food are violated; the control over embargo’s abidance is complicated especially inside the Eurasian Economic Union (none of the EEU countries has supported Russia’s embargo); the accelerated import substitution is not efficient; there are more efficient alternatives (for instance, the embargo on import of business and premium class vehicles).
6. The lifting of requirement for compulsory regional co-financing of the State Program’s measures in order to get the federal part of allocations. Given the dramatic budget deficit in the RF regions and their failure to comply with this requirement farm producers do not get any support at all.
7. Development of dairy cattle breeding in individual private farms encouraged by larger grants and greater number of supported farms. According to data of the RF Ministry of Agriculture, in 2015 4,500 individual private farms got the grants. But the actual number of applicants is much bigger. There are plans to increase the amount of grant to beginner farmers for the creation of dairy farms from Rb 1.5m to Rb 3m and to allocate to the overall support of individual private farms Rb 14bn in 2016, of which Rb 8bn are grants.
8. The changing of subsidy system: shifting from the transfer of funds for the reimbursement of interest rate on credits to farm producers to the transfer of funds directly to agent banks. This will enable farm producers (1) not to divert their funds to the payment of interest rate in full with reimbursement provided later; (2) to cut transaction costs of paperwork needed for getting the reimbursement of interest rate.
9. In order to supervise the situation and trends in ensuring food security it’s advisable (1) to complement the system of statistical survey with the system of studying opinion of both individuals and entrepreneurs engaged in the production, importing and further movement

of commodities to consumers; (2) to introduce the system of preparing annual national reports “On the situation and threats to Russia’s food security”. This will enable authorities to give a prompt response to new challenges in the sphere of food security and to timely adjust the state agricultural policies.