THE CONSEQUENCES OF THE IMPOSITION OF RESTRICTIONS ON PORK IMPORTS IN 2014 AND THE IMPORT SUBSTITUTION PROSPECTS FOR RUSSIA'S DOMESTIC PIG FARMING SECTOR

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The short-term consequences of the bans imposed in 2014 on pork imports into Russia from the countries that used to be major suppliers of meat to this country are as follows: an altered geography of import supplies, rising prices on the pork market and related markets, and plummeting consumer demand for meat and meat products. At the same time, the medium-term perspective offers some favorable opportunities for turning the domestic pig farming sector into the main source of import substitution. The present course towards boosting import substitution is fraught with the risk of overinvestment into that sector with the resulting market oversaturation, while the rate of return on investment in the sector is too low to ensure loan repayment.

In 2014, the RF Government imposed a number of restrictions on pork imports from some foreign countries into the territory of the Russian Federation. The first shot in the current 'Pork War' was fired by Russia in late January when she introduced an embargo on live pig, pork and pork product imports from EU countries in response to findings of African swine fever virus (ASFV)[1] in Lithuania and Poland. This measure was followed by RF Government Decree No 778 of 7 August 2014, whereby a ban for a period of one year was imposed on imports into Russia of some agricultural food products originating from the USA, the EU, Canada, Australia and Norway. The ban was the government's response to the sanctions previously slammed on the Russian Federation by a number of countries. The list of banned agricultural products, raw materials and foodstuffs includes the most commonly consumed kinds of meat – pork, beef and poultry.

The upshot of the restrictions was a dramatic shrinkage of imports. According to data released by Russia's Federal Customs Service (FTS), over the first 8 months of 2014 the volume of meat and semi-processed meat products imported into the Russian Federation dropped on the same period of last year by 30.3% – to 925.2 thousand *t*[2]. Within the meat product spectrum, the deepest fall was demonstrated by pork imports – by 35.3%, while the decline in poultry and beef imports was less dramatic – by 16.3% and 9.2% respectively.

Although over the period from 2011 through 2013 the share of domestically produced pork in total domestic consumption of this type of meat increased from 66% to 74%[3], imports continued to play a very significant role on the Russian market. The main suppliers of pork in recent years have been those countries that are now subject to the bans introduced in 2014. Thus, in 2013, they supplied to Russia 71% of all imported pork: the EU – 57.2%, Canada – 12.8%, and the USA – 0.9%[4].

The imposition of bans on pork imports drastically altered the structure of imports and gave rise to temporary problems in the logistics of import supplies. After supplies from the EU had been discontinued in early 2014, 40% of pork imported into Russia in the first half year was shipped from Canada[5]. And after the issuance of RF Government Decree No 778 of 7 August 2014, Brazil became the main supplier of pork to the RF. From August onwards, the list of Brazilian companies certified by the RF Federal Service for Veterinary and Phytosanitary Surveillance (*Rosselkhoznadzor*) to be pork exporters to Russia has been extended. Besides, several Chinese companies have been allowed to supply pork into the Russian market. In October, for the first time in a decade, China began to supply pork to Russia – which previously had been banned for sanitary reasons.

Supplies from Brazil and China can only in part compensate for the existing meat deficit on the market, as they cannot fully replace the imports from the presently banned countries. Besides, in view of the changed geographical structure of imports, some time had elapsed before new contracts could be concluded with importers, and so in the first few months after the introduction of bans there was a gap in raw meat supplies. This was the major factor that influenced the price movement on the market.

1 The causative agent of African swine fever (ASF).

2 Less the data on trade with the Republic of Belarus and the Republic of Kazakhstan.

3 Based on data published by the National Union of Swine Breeders (NUPB).

4 Calculations based on data released by the RF Federal Customs Service (FTS).

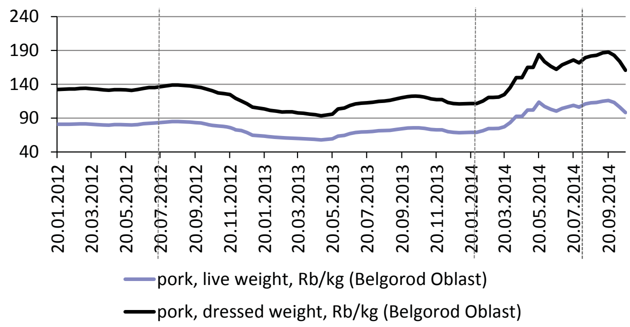
5 Based on data published by the National Union of Swine Breeders (NUPB).

After the rapid downfall of prices that resulted from Russia's accession to the WTO, and their subsequent partial recovery in response to the introduction of government measures designed to support the pig farming sector, by early 2014 the average purchasing price for pork (in terms of live weight) had been at the level of 68.9 Rb/kg, and in terms of dressed weight – 111.4 Rb/kg (Belgorod Oblast), both indices being below their average 2012 level (*Fig. 1*). The restrictions on pork imports imposed in January 2014 began to push the prices upwards, and so by April they had already climbed back to their level observed prior to Russia's accession to the WTO. The imposition of further restrictions in August 2014, when the prices were already sufficiently high, was another yet factor contributing to their upward movement, and so the average price of pork in terms of live weight in mid-October was recorded at the level of 116.1 Rb/kg, and in terms of dressed weight – 187.6 Rb/kg. Thus, the total growth of purchasing prices for pork since the year's beginning amounted to more than 65%.

The growth of prices in the pork market is caused not only by the recently emerged deficit of raw meat, but also by the shift in supplies from more highly competitive importers towards those with a lower competitive potential. Prices for Chinese pork are among the highest in the world market – about 3.3 USD/kg. The international prices of their products offered by Russia's former suppliers of pork are definitely lower: in Canada – 1.8 USD/kg, in the USA and the EU – approximately 2.2 USD/kg[1].

The deficit of raw meat products on the pork market triggered price growth on the related markets. The effects of restrictions on imports could also be felt by meat-processing combines, which use imported frozen meat products as their raw material. Pork fat – the main component in sausage production – became more expensive. So the meat processing companies had to switch over, in part, to a cheaper raw material (poultry), and to replace imported pork fat by beef fat. According to data released by *Rosstat*, since the year's beginning Russia's average poultry producer price index gained 32.6%, rising from 74.2 Rb/kg to 98.4 Rb/kg.

The rising prices for pork and pork products will also have a negative effect on consumer demand. In 2013, food accounted for 37.08% of the population's consumer expenditures[2]. The highest share in the structure of foodstuffs was taken up by meat products (9.25%). the growth in prices for these products will push up the consumer basket's value. Against the



Source: Institute for Agricultural Market Studies (IKAR).
Fig. 1. The Movement of Purchasing Prices for Pork (Rb/kg, VAT including, Belgorod Oblast)

backdrop of plummeting effective consumer demand, this process will result in a shrinkage of the demand for meat and meat product, or consumer switchover to cheaper products of lower quality.

In early October 2014, prices on the pork market began to decline (*Fig. 1*), their downward movement being caused by the effects of several factors. First, there is the shrinking demand for the products of the pig farming sector. In response to the weakening effective demand, the population is consuming less meat and meat products, while some of the meat processing companies have switched over to poultry. Secondly, pork supply on the market is currently on the rise. Q4 is traditionally marked by a seasonal increase in pig slaughter in farmer households followed by a surge of pork products onto the market. Besides, the market is replenished by additional meat supplies from Brazil and China. In view of the rising supply coupled with shrinking consumption, the moderately downward trend will be displayed by pork prices until December, when it is going to change direction in expectation of New Year's festivities.

Another factor capable of playing down the market prices of pork can be the necessary redistribution of the meat quotas. As reported by the National Union of Swine Breeders, as of mid-August 2014, only 47% of the pork quotas, 52% of the beef quotas, and 46% of the poultry quotas was actually realized. If towards the year's end the quotas are not bought out, and are redistributed, the result will be a surge of raw meat supplies on the market, and consequently a decline in the level of prices.

After the introduction of sanctions restricting the volume of food imports, the RF Government's main goal has become an accelerated rate of import substitution. Over the period from 2005 through 2013, the volume of industrial[3] pork production increased by more than 4.8 times, amounting in 2014 to 2041 thousand *t* (*Fig. 2*). The import substitution process in

1 As of early September 2014. Based on data released by the Federal State Budget-funded Institution 'Specialized Record-keeping Center in the Agroindustrial Complex'.

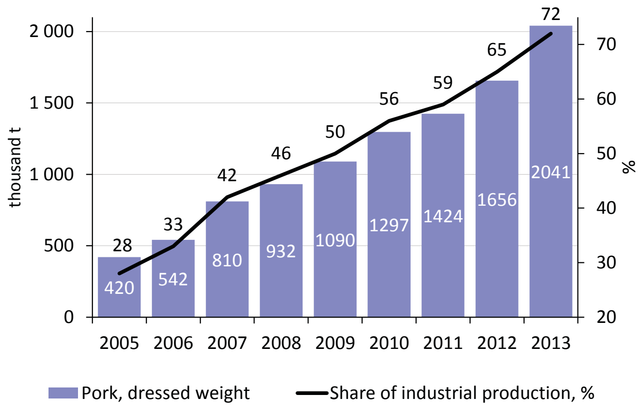
2 Data released by Rosstat.

3 Production by agricultural companies and farmer households.

Russia's pig farming sector was launched in 2013, while previously, in 2006–2012, the rate of domestic production growth could only match the positive movement of the rate of pork consumption.

Russia's domestic pork production was boosted by the activity of agricultural companies and farmer households. Thus, the share of industrial production in total production oт increased from 28% to 72%. Over that period, the volume of pork production by private households dropped by 28.2% (to 790 thousand *t*) as a result of the recent outbreaks of African swine fever and the low competitive capacity of small private farms by comparison with modern industrial pig farming complexes.

Over the period 2015–2017, the RF Government envisages to allocate some additional funding to agricultural budget items in order to implement the import substitution program in the agro-industrial complex (AIC). As estimated by the National Union of Swine Breeders, Russia's pig farming sector indeed has a potential for boosting the domestic production volume at the expense of big pig farming companies, many of which have already made public their plans of constructing new pig farming complex (*Table 1*). The National Union of Swine Breeders predicts that the top 20 pork producers will be able to increase their production volume by 2.4 times over the period 2013–2020. As a result, the total pork production volume in this sector will increase from 2,528 thousand *t* to 4,243 thousand *t* (in terms of live weight). The share of the top 20 companies in Russia's total pork production volume will expand to 76% (vs. 52.7% in 2012). Thus, the sector will continue the process of its consolidation.



Source: National Union of Swine Breeders (NUPB) 'On the Necessity of and Prospects for Accelerated Import Substitution on the Pork Market in the Russian Federation'. Report at the conference held within the framework of *World Food Moscow*, 16 September 2014.

Fig. 2. The Movement of the Industrial Pork Production Index in Russia (in terms of dressed weight)

As estimated by the National Union of Swine Breeders, in 2014–2020 the pig farming sector, in order to successfully implement the accelerated import substitution program, will need additional investment and support in a total amount of approximately Rb 270bn, of which approximately Rb 200bn will be invested in order to ensure production growth (by creating genetic selection centers, slaughter and dressing stations, feed compounders), and approximately Rb 70bn will be used as subsidies to cover loans granted from the federal and regional budgets to boost production. For

Table 1

PLANNED INVESTMENT PROJECTS BY RUSSIA'S BIGGEST PORK PRODUCERS

Holding company	Regions where project is to be implemented	Available pork production capacities in 2014-2015 (thousand t, live weight)	Production growth in 2017-2020 (thousand t, live weight)	Investment, total (bn Rb)	Planned pork production capacities in 2020 (thousand t, live weight)
Agribusiness Holding Company MIRATORG	Kursk Oblast	360	444	75.0	804
RUSAGRO Group	Tambov Oblast, Primorsky Krai	200	259	40.5	459
CHERKIZOVO Group	Lipetsk Oblast	180	135	13.5	315
AgroPromKomplektatsiya Group	Kursk Oblast, Tver Oblast	87	75	15.0	162
SibAgroGroup	Krasnoyarsk Krai, Republic of Buryatia, Tyumen Oblast, Tomsk Oblast	79	73	14.9	152
Agroeko Group	Voronezh Oblast, Tula Oblast	70	110	27,0	180
OJSC Kambekon	Republic of Tatarstan	50	50	7.4	100
TOTAL		1,026	1,146	193.3	2,172

Source: National Union of Swine Breeders (NUPB) 'On the Necessity of and Prospects for Accelerated Import Substitution on the Pork Market in the Russian Federation'. Report at the conference held in the framework of *World Food Moscow*, 16 September 2014.

reference: over the period 2006–2011, in the framework of government programs (National Agroindustrial Complex Development Project and the 2008–2012 Government Program), more than Rb 250bn was invested in the pig farming sector (of which Rb 50bn was covered by investor funds, and Rb 200bn – by subsidized bank loans), and so the pork production volume shot up more than threefold in 5 years.

As demonstrated above, the declared amount of investment by 7 biggest companies (*Table 1*) will alone ensure pork production growth in the amount of 1.1m *t* in terms of live weight, or approximately 0.8 *t* in terms of dressed weight. In recent years, the volume of imports of pork and live pigs in terms of dressed weight has never exceeded 0.8m *t*, and including pork by-products and pig fat – 1.2m *t*[1]. In this connection there may arise the risk of overinvestment in this sector, with the possibility of market oversaturation due to the increased domestic production volume, which in its turn will push down prices and the rate of return on investment in the sector, making it too low to ensure proper loan repayment.

1 Based on data released by the National Union of Swine Breeders (NUPB); data on trade with the Custom Union's member states is included.