

AGRICULTURE: IMPORT SUBSTITUTION'S 'FRUITS'¹

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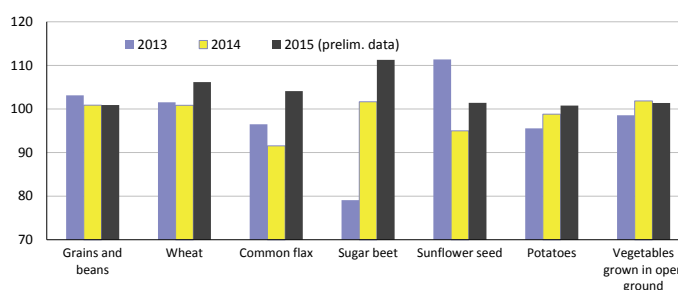
The food embargo has failed to create favorable conditions for Russia's agricultural production to thrive. Instead, such conditions arose as a result of the ruble's devaluation, when imported goods had lost their competitive capacity in Russia's domestic market. On the one hand, the ruble's declining exchange rate against the world's major currencies made life more difficult for Russian agricultural producers, because imported resources became more expensive; while on the other, in 2015 they could still increase their production of major categories of edible plants and modify their production structure in accordance with the structure of demand in the domestic and foreign markets¹.

The introduction, by Russia, of a food embargo in August 2014 did not create many advantages for domestic agricultural producers: the market remained open, and the ban on imports from some countries resulted in increased imports from other countries, often at a slightly higher price, which, in its turn, pushed up domestic prices and was beneficial for domestic producers. The most advantageous factor for domestic producers was the plunge of the ruble's exchange rate. As early as 2014, Russia's main agricultural products became actually competitive in the world market, or were approaching the competitive price level. This has been explicitly conformed by data released by the OECD.

Russian cereal grains, sunflower seed, poultry meat, eggs and milk in 2014 competed well with imported products: domestic purchasing prices became roughly equal to world prices. The domestic purchasing prices for beef and pork were somewhat higher than the prices for similar imported products. However, over recent years, even the prices for these two categories of products (especially prices for pork) have been approaching the world levels. Given the ruble's further devaluation in 2015, Russia's pork producers have, most probably, become serious rivals of foreign producers.

The import substitution opportunities for Russian products have increased since late 2014, when the ruble's exchange rate sharply plunged. Russia's agricultural producers did not reduce their field crops, and as far as agricultural plants are concerned, they have even increased their output (Fig. 1).

The downfall of the ruble's exchange rate against the world's major currencies also produced some negative effects: prices for



Source: Rosstat.

Fig. 1. Changes in Area under Crops in All Types of Farming Enterprises, Relative to Previous Year, %

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imported resources soared (hybrid seeds, pesticides, breeding eggs, etc.). In spite of all these drawbacks, in 2015, the crops of main agricultural plants were higher than their indices for the favorable year 2014 (*Table 1*).

Agricultural producers reacted quickly to the changing situation. So, while the production of rye, barley and oats declined, that of wheat (Russia's major agricultural export), corn (also an export product), millet, buckwheat, rice and beans increased, as the demand for these products in the domestic market was high. The production of flax as an alternative to the increasingly expensive cotton imports rose by more than 24%, and this was achieved not only in terms of increase in net area sown, but also (and almost always) in terms of crop yield.

Table 1

**AVERAGE ANNUAL CROPS OF MAJOR TYPES OF AGRICULTURAL PLANTS
(MILLION TONS)**

	1990– 1994	2000– 2004	2010– 2014	2014	2015*
Grains and beans (in weight after processing)	99	76	85	105	104
Sugar beet	24	17	38	34	38
Sunflower seeds (in weight after processing)	3	4	9	9	9
Potatoes	35	29	29	32	34
Vegetables grown in open ground	9	11	13	14	16

*Preliminary data as of 1 February 2016.

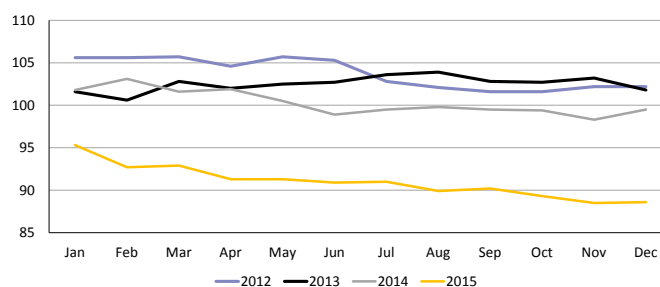
Source: Rosstat.

Although the government preferred mainly to support big agricultural companies, in 2015 farmers demonstrated their better ability to adjust to the new situation: their share in the structure of production rose with regard to cereal grains (from 25.3 to 26.4%), sugar beets (from 10.3 to 11%), potatoes (from 7.5 to 8.6%), and vegetables (from 13.6 to 15.1%). The achievements of agricultural companies have been more modest: their share in the production of cereal grains and sugar beet slightly shrank (they lost 1.1 p.p. and 0.6 p.p. respectively), and their growth rates in the production of sunflower seed, potatoes and vegetables gained between 0.2 p.p. (sunflower seed) and 1.7 p.p. (potatoes).

Some improvements have been observed in pig and poultry farming. Pig and poultry population growth indices amounted to 9.6% and 3.8% respectively. In 2015, the decline of the overall cattle population amounted to 1.6%, that of dairy cows – to 1.8, that of sheep and goats – to 0.7%. Besides, in 2015, the growth rate in meat production remained at the same level as in 2014 (4.2%), that in egg production increased (by 1.6%), and that in milk production displayed a zero change.

On the whole, the agricultural sector displayed production growth rate of 3% in per annum terms (vs. 3.5% in 2014).

Production growth, however, was constrained by the factor of inadequate effective demand. The real



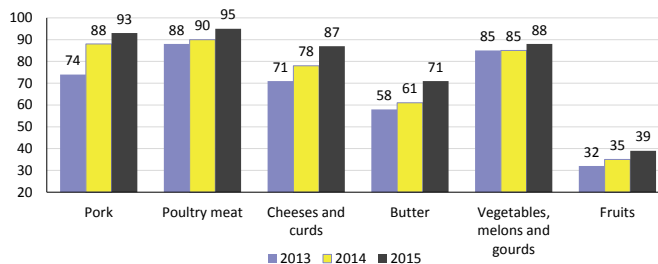
Source: Rosstat.

Fig. 2. The Turnover in Retail Trade of Food Products (In Comparable Prices, Relative to Previous Year), %

disposable money income shrank by 4%, and real wages – by 9.5%¹. This brought down the turnover in retail trade of food products, which by December 2015 had lost 11% on 2014 (Fig. 2).

Owing to the combination of all these circumstances (the ruble's devaluation, income decline), the demand for imports sharply plummeted, which has been confirmed by data released by the RF Ministry of Agriculture: the share of domestic food products across the main groups of food products increased in terms of volume² (Fig. 3).

However, such substitution can be regarded as a good result only when the consumption index is on the rise, or at least is not declining. In absence of reliable data on food consumption for 2015, we may derive some indirect estimates on the basis of the year-on-year data released by the RF Ministry of Agriculture on imports and domestic production. By applying this approach, we can see that domestic production growth in response to increased consumption resulted in import substitution only with regard to two product types – poultry meat and vegetables (Table 2).



Source: RF Ministry of Agriculture.

Fig. 3. The Share of Domestic Food Products Relative to the Sum of Imports and Domestic Output, %

Table 2

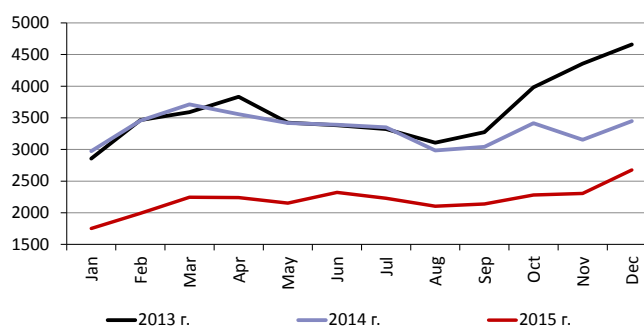
THE BEHAVIOR OF THE CONSUMPTION INDEX IN 2015 RELATIVE TO 2013 (THOUSAND TONS)

Product type	Production growth	Decline in imports	Behavior of consumption index
Pork	299	-730	-431
Poultry meat	661	-277	384
Cheeses and curds	211	-256	-45
Butter	40	-55	-15
Vegetables, melons and gourds	1,365	-317	1,048
Fruits	205	-1,641	-1,436

Source: RF Ministry of Agriculture; authors' calculations.

The imports of the other product types were declining at a faster rate than the domestic production index was rising, which can hardly be regarded as a positive trend in the import substitution process.

Usually the shrinkage of imports in terms of value is interpreted as a positive outcome of import substitution. Indeed, in 2015, food imports in dollar terms shrank on 2013 by 39%, and on 2014 – by 34% (Fig. 4).



Source: Federal Customs Service.

Fig. 4. The Behavior of Imports (Groups 1–24, OKVED Codes), Million USD

1 Data released by Rosstat.

2 Calculated as the ratio of imports to imports plus output. Data released by the RF Ministry of Agriculture.

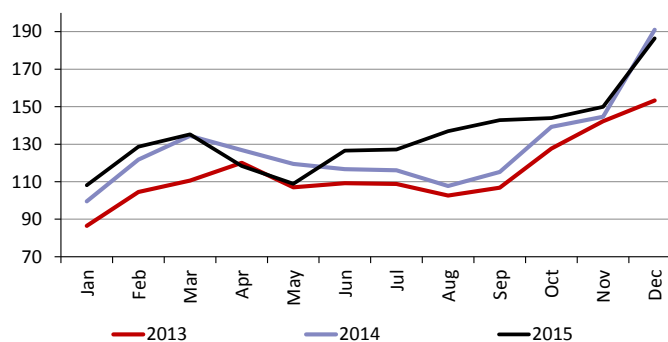
At the same time, when taken in ruble terms, imports increased: their growth on 2013 amounted to +17%, and to +5 % on 2014 (Fig. 5). This is an indirect sign that people did not reduce their expenditures on imported products; instead, their expenditures slightly increased. In other words, the consumption of imported foodstuffs shrank in terms of physical volume, but not in ruble terms.

In 2015, the dependence on meat and milk imports in terms of physical volume, calculated as the ratio of the balance of imports and exports to the production index and the individual consumption index, sharply declined (Fig. 6).

In 2015, food exports (Groups 1–24, OKVED Codes) declined on 2014 by 15% in dollar terms (Table 3).

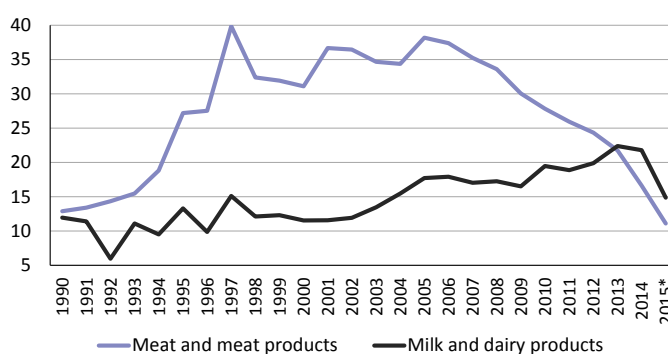
The ruble's declining exchange rate has made Russia's exports of agricultural products and foodstuffs very profitable. In 2015, in spite of export decline in terms of physical volume, Russia's exports in ruble terms increased by 35% on 2014, and by 92% on 2013.

The choice of development priorities for each sector has remained a relevant issue for the government. Is it necessary to support those industries that have so far failed to satisfy in full the existing domestic demand for their products (as estimated on the bases of the recommended consumption targets)? Or would it be better instead to grant support to those products whose prices are competitive both in the domestic and foreign markets, so that Russia could get closer integrated into the system of international division of labor? The correct choice is not determined by the framework of agriculture alone, or the agricultural sector's budget. It will depend on the government's general strategy.



Source: Federal Customs Service.

Fig. 5. The Behavior of Imports (Groups 1–24, OKVED Codes), bn Rb



Source: Rosstat; calculated on the basis of the balance sheets for 2015 (data for September).

Fig. 6. Russia's Dependence on Meat and Processed Meat Products, Milk and Dairy Products, %

Table 3

THE BEHAVIOR OF EXPORTS OF AGRICULTURAL PRODUCTS AND FOODSTUFFS (GROUPS 1–24, OKVED CODES)

	2013	2014	2015	2015/2014,%	2015/2013,%
Million USD	16,262	18,981	16,181	85.2	99.5
Bn Rb	521	737	998	135.4	191.6

Source: Federal Customs Service.