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Integration Processes within the Common Economic Space: Hazards for Russian Milk Producers¹

The principal differences between economic systems in Russia and Belarus condition price advantages of Belarusian products over those produced in Russia. Belarusian producers operate under government restrictions on prices paid by them for agricultural inputs and received by them from marketing of their produce on the domestic market. In this situation penetration into the Russian market enables them to get larger profits owing to higher market prices for food in Russia. As a result Russian buyers are actually rendering support to exporters of Belarusian commodities and - to some extent – to Belarusian farm producers.

The increase of production and exports of farm products is one of the priority objectives declared by the Republic of Belarus (RB). At present the per capita production of milk in RB is 2.8 fold higher than in the EU countries, that of meat – 1.1 fold higher, of grain – 1.6 fold higher². The orientation towards larger exports of farm products is established in the republican state programs. According to Guidelines of the program for social and economic development of the Republic of Belarus in 2011-2015, by 2015 the country plans to increase exports of agricultural and food products up to \$7-7.2 bn.

Dairy and meat products dominate in the structure of Belarusian farm production conditioning the prevalence of these items in the country's export structure. In 2011 the share of farm livestock, meat and meat products³ in the value of food exports to Russia amounted to 35.6%, the share of dairy products – to 47.9%, of sugar and sugar products – to 5.2%, of vegetables – to 2.1%. All other groups of food products accounted for less than 2% thereof⁴. Skipping the group of sugar and sugar products the supply of which to Russia is not attractive for Belarusian operators⁵, the export of meat and milk items is potentially most sensitive for the Russian market.

The expansion to the Russian market can be adjusted depending on the growth of domestic production in Russia: the Belarusian side is already building chains for the export of meat products to the non-CIS countries so as to re-channel supplies there in case of shorter demand in Russia.

Potatoes are also considered by Belarus as one of the priority items for export. So far their supply to Russia has been insignificant.

The country's strategic goal is the development of flax production and processing. Russia is not considered here as the main partner. The priority target for inviting foreign investments is the integration into production and marketing chains of transnational corporations which

¹ The paper was prepared in the framework of Foreign Trade Academy's project "Prospects and risks of deepening economic integration within the Common Economic Space".

² <http://law.sb.by/1002/>

³ According to the Commodity classifier for foreign economic activities the group also includes products made of fish, shellfish and crawfish but their share is small.

⁴ Federal Customs Service, <http://stat.customs.ru/apex/f?p=201:4:985447166262331:proverka:NO::>

⁵ In 2012 Belarus will cut the purchase of raw sugar almost 2 fold. <http://news.tut.by/economics/271049.html>

provides access to foreign technologies. Besides, the following priority directions for developing the country's agricultural production are named:

- ☐ highly efficient seed breeding;
- ☐ pedigree livestock breeding.

Elite seeds and pedigree animals are considered to be potential export items but so far they pose no threat to the Russian market.

The comparison of RB's potential exports of basic export items to all countries by 2015 with the current sales volumes of these products in Russia shows that the most vulnerable (i.e. the share of imported goods may reach 20% of the overall sales) segment of the market is that of milk and dairy products (*Table 1*).

Table 1

Estimated potential exports of basic food products from Belarus as compared with their total retail sales in Russia

Item	Projected exports by 2015 as compared with 2010 (to all countries)	Total retail sales of this item in RF (2010 ⁶)	Ratio of Belarusian exports (2015) to the total retail sales (less trade margin) in Russia (2010)
Milk and dairy products	2-fold growth (up to \$3 bn by 2015)	639.8 bn RF rubles or \$22.3 bn ⁷	Over 16% ⁸ (at present – 8.4%)
Meat and meat products	2.9-fold growth (up to \$1.8 bn)	1,326.1 bn RF rubles ⁹ or \$44.2 bn	5.7% (at present – 2.5%)
Potatoes	Small imports (500,000 tons or \$200 m)	80.5 bn RF rubles or \$2.7 bn	11% (at present – 3.8%)

Source: Rosstat, State Customs Service, RF Ministry of Agriculture, RB Ministry of Agriculture.

The main flow of Belarusian products is forwarded not to the border areas but to Moscow and thus the fears of Russian producers – first of all the ones forming the market of dairy products in Moscow – have grounds. The growing exports of Belarusian potatoes can also become sensitive for the national market as the structure of this crop production in Russia changes. At present the bulk of potato output is both produced and consumed by households. Only a small share of the overall volume produced is retailed. Therefore if one compares imports from Belarus with retail sales, the share of the former seems to be great. In case the production shifts from households to commodity farms supplying products to retail networks the competition with Belarusian potatoes is possible.

The plans of two governments specified in the national agricultural policies allow to identify hazards for farm producers.

Adoption of state programs for supporting milk production. Such programs were enacted in both countries at about the same time – in 2009. The Russia's Ministry of Agriculture adopted

⁶ The latest available data.

⁷ The exchange rate being \$1 = 30 RF rubles.

⁸ Retail price was "cleared" of trade margin. The level of this margin was determined as the ratio between retail and factory (or another supplier) prices. According to the data of price monitoring carried out by the RF Ministry of Agriculture as of July 1, 2011 the trade margin for meat was 1.4, for milk – 1.2, for potatoes – 1.5. mcx.ru

⁹ http://www.gks.ru/bgd/regl/b11_58/IssWWW.exe/Stg/d1/2-15.htm

the departmental target program “Milk”. The State program for milk industry development was adopted in the Republic of Belarus.

Term of the programs. In the Russian Federation the program was adopted for 3 years. From 2013 to 2020 the State program for agricultural development and regulation of agricultural and food markets in 2013-2020 (henceforth – the State program) will be in force.

In Belarus the program is effective from 2010 to 2015.

Financing. The RF program “Milk” envisaged financing to the amount of 12 bn RF rubles, i.e. 4 bn RF rubles per annum on the average. It’s impossible to estimate precisely the amount of milk industry financing under the State program.

The program of the Republic of Belarus stipulates allocation of 37.1 trillion RB rubles (in 2009 prices) to the industry’s development. Given that the official exchange rate is 90 RB rubles per 1 RF ruble, within 6 years the country plans to allocate 412 bn RF rubles to its milk program, or 68.7 bn RF rubles per annum. This means that the scopes of support are incommensurable: the Republic of Belarus plans to spend on it almost 17 fold more funds than Russia¹⁰.

The projected growth of output as the result of program implementation. The RF State program for agricultural development in 2013-2020 sets the task to increase the production of milk by 2015 by only 0.3 m tons as compared with 2009. The Republic of Belarus projects to bring its milk output to 10 m tons by 2015, i.e. to enlarge it by 4.4 m tons as compared with 2009.

The plans of Belarus government concerning milk production constitute an additional factor of risk that the expansion of this product to the Russian market will enhance.

Russian producers of agricultural – and first of all dairy – products repeatedly draw attention of the RF government to the fact that it’s hard for them to compete with farm producers from Belarus¹¹. Three hazards are formulated below:

- ☒ volumes of Belarusian supplies to the Russian market;
- ☒ low prices;
- ☒ Belarusian subsidies per litre of milk exceed those in Russia 5 fold.

One of the hazards – volumes of supplied milk – was examined above. Further we’ll attempt to estimate two other hazards.

Level of prices for Belarusian milk. From all the available sources the author derived information on prices for farm products in Belarus and Russia on the way of these products from producers to final consumers (see *Table 2*).

¹⁰ At present the exchange rate of RB ruble fell almost 3 fold.

¹¹ <http://pomidorus.ru/news/444/>

Table 2

Prices for milk at different stages of product chain

Republic of Belarus	Russian Federation
Average farm producer price – 1545,000 ¹² RB rubles per ton or 9.81 RF rubles per litre	Farm producer price (as of July 1, 2011) – 16.31 RF rubles per litre
Minimal limit prices for farm products purchased for state needs ¹³ : Extra – 1210,000 RB rubles per ton or 7.7 RF rubles per litre Superior grade – 1045,000 RB rubles per ton or 6.6 RF rubles per litre First grade – 965,000 RB rubles per ton or 6.1 RF rubles per litre	Products for state needs are purchased on the free market
Data not available	Factory price: Dry milk with 20-25% fat content – 165 RF rubles per kg; 1 litre of packed milk with 3.2% fat content – 28.1 RF rubles per litre; Butter – 212.6 RF rubles per kg
Price indicated in declaration submitted to the State Customs Service	Retail price
Imports from the Republic of Belarus to Russia 040120 – milk and cream, non-condensed, without adding of sugar or other sweeteners, fat content over 1% but not more than 6% - 21 RF rubles per kg ¹⁴ 040210 – milk and cream, condensed or with adding of sugar or other sweeteners, powdered, granulated or in other solid forms, fat content not more than 1.5% - 84.4 RF rubles per kg 040221 – milk and cream condensed, fat content over 1.5%, powdered, granulated or in other solid forms, without adding of sugar or other sweeteners – 64.5 RF rubles per kg 040229 – other milk and cream with fat content over 1.5%, powdered, granulated or in other solid forms – 102.7 RF rubles per kg 040510 – butter – 141.2 RF rubles per kg	Packed milk with 2.5-3.5% fat content – 31.99 RF rubles per litre ^{15*} Butter – 239.55 RF rubles per kg*

*average price on consumer market in 2010; data for 2011 are not available.

The prices for Belarusian dairy products are well below those for Russian produce. It's clear that in this situation Russian market is attractive for Belarusian producers. But why are prices in Belarus so much lower than those in Russia?

Price regulation. In the Republic of Belarus prices for agricultural and food products as well prices for farm inputs are regulated. The legal basis for this regulation are Decrees of the President and Resolutions of the Government. Flour, bread, milk and dairy products, meat and (with some exceptions) vegetables are subject to regulation.

Besides, one sets prices for agricultural products purchased for state needs.

Until April 3, 2012 the RB Ministry of Agriculture took decisions on establishing minimal limit prices for agricultural products purchased for state needs. Among crop products concerned are grains, legumes (including those used for production of formula feeds), rapes, sugar beets, feed lupine, spring vetch. Among livestock products concerned are milk, pork, beef, live pigs and young cattle, cows, etc. Beginning from April 3, 2012 fixed prices are used instead

¹² Agriculture of the Republic of Belarus, 2012. Converted into RF rubles at the average annual rate of RB Central Bank as of July 1, 2011: 1 RF ruble = 157.43 RB rubles. <http://nrb.by/statistics/Rates/AvgRate/?yr=2011>

¹³ Beginning from March 30, 2011 – Resolution of RB Government No.23 of 30.03.2011.

¹⁴ The average annual exchange rate is 29.35 RF rubles per 1 USD. <http://www.fedstat.ru/indicator/data.do>

¹⁵ http://www.gks.ru/bgd/regl/b11_58/IssWWW.exe/Stg/d1/2-31.htm

of minimal limit prices. They are lower than the prices at which Russian producers sell their output. Although these prices are set for products purchased for state needs, they serve as a guide for other buyers.

Prices for farm inputs are regulated as well¹⁶. The most important of them are gas, electric and thermal power. The RB Ministry of agriculture periodically informs by its circulars about recommended prices for formula feeds, feed grains for their production, veterinary drugs. For instance, in 2012 the department informed formula feed factories, livestock and poultry farms about recommended prices for purchasing new crop grain from farm producers. *Table 3* demonstrates that if converted into RF rubles at the rate effective on July 1, 2012 (the date of issuing the directive), prices recommended by the RB Ministry of Agriculture were well below those observed in Russia in the period of the most intensive harvesting works (as of September 1, 2012) when they were the lowest.

Table 3

Recommended purchase prices for feed grains (the RB Ministry of Agriculture, 2012)

	Price in Belarus, per ton		For reference: per ton price in RF
	1,000 RB rubles	RF rubles	
wheat	1200	4320	6080
rye	750	2700	4870
barley	1100	3960	5950
oats	600	2160	5210

The RB Ministry of Agriculture also periodically sends advisory circulars to the attention of buyers of formula feeds and regional bodies administering agriculture in which it indicates recommended ex-factory prices for formula feeds. Thus not only prices for inputs needed for manufacturing of formula feeds but also prices for formula feeds being an input for livestock production are restricted. At present a circular dating back to June 9, 2010 is posted on the Ministry's website but unfortunately no later publications are available. Prices are presented in *Table 4*. It can be seen that formula feeds from Belarus could be bought much cheaper as ex-factory prices for them were lower.

Table 4

Limit ex-factory prices for formula feeds sold to farm producers

Type of formula feed	Recommended limit ex-factory price in Belarus, per ton		Price for formula feed in Russia as of 22.10.12, 1,000 RF rubles
	In 1,000 RB rubles	In 1,000 RF rubles	
For dairy cows KK-60 in bags	500	2.8	12.5 ¹⁷ – 13.5 ¹⁸ (delivery from Moscow oblast) 6.5 (wholesale, 21 tons and up, delivery from Belarus) ¹⁹
For broilers aged 31 days and more	1070	6.0	13 ²⁰ (Khabarovsk region) 5.5 ²¹ (Altay region) 25.7 ²² (Perm) 18.0 ²³ (Penza)

¹⁶ The same practice exists in the Russian Federation but in Belarus prices for inputs are lower than in Russia.

¹⁷ <http://www.agroserver.ru/b/kombikorm-dlya-molochnykh-korov-i-koz-157660.htm>

¹⁸ <http://www.agroserver.ru/b/kombikorm-dlya-molochnykh-korov-164113.htm>

¹⁹ <http://www.agroserver.ru/b/kombikorma-dlya-krs-kk-60-kk-61-kdk-60-161777.htm>

There are also recommendations concerning limit factory prices on oilseed meal (cake) and on products produced and marketed through OJSC “Belzoovetsnabprom”.

Despite the fact that the circulars are recommendatory, their effect should not be underestimated: in the Republic of Belarus there are a lot of enterprises that remain state-owned. For instance, by January 1, 2012 23.6% of corporate farms were fully owned by state and 24% had a state share in their capital²⁴. In this situation government recommendations look like insistent demands of the owner to follow his directives.

In addition to these prices and tariffs, the discount rate and bank interest rates on credits are regulated. The *discount* rate being the basis for shaping bank interest rates on credits was established directly till November 2012²⁵.

The terms of crediting were examined taking the case of Belagroprombank through which the most part of credits to the agrifood sector is channeled²⁶. In addition to the fact that interest rates on credits are set pursuant to the President’s Decrees, it was revealed that:

- ☐ credits on purposes that the state identifies as priority ones (including the development of agriculture) are granted at much lower interest rates as compared with those in Russia;
- ☐ by means of credit terms benefitting entities engaged in export supplies to the Russian Federation, Belarus applies support measures that are prohibited on the territory of the Common Economic Space. In case a commodity is exported outside the Republic of Belarus, the producer can take a credit in RF rubles at the interest rate equal to the discount rate established by the RF Central Bank. This is far below market interest rates in Belarus.

Additional interest rate benefits in credit terms can be provided through support programs established under Decrees of the President. For instance, under the program for developing dairy industry the state partially compensates interest rates on credits – to the amount of discount rate. A Belarusian farm producer has to pay to the bank only 1.5% interest irrespective of the market interest rate. In Russia a farm producer pays the difference between the market interest rate and the discount rate that is compensated by the state.

The restriction of retail prices for farm products in Belarus leads to the restriction of prices for inputs. Lower costs result in competitive advantages of Belarusian commodities over the Russian ones. The restraining of prices on the domestic market coupled with the possibility

²⁰ <http://uspikorm.ru/p8110151-kombikorm-dlya-brojlerov.html>

²¹ http://borona.net/trade/poultry/Forage-fodder-feed-concentrates/Forage-fodder-feed-concentrates_314.html

²² <http://perm.tiu.ru/p5211937-kombikorm-dlya-brollerov.html>

²³ <http://www.agroserver.ru/b/polnoratsionnyy-kombikorm-dlya-tsyplyat-broylerov-pk-6-rost-fini-187501.htm>

²⁴ Agriculture of the Republic of Belarus. Minsk, Belstat. http://belstat.gov.by/homep/ru/publications/2012_16.php

²⁵ http://www.ng.by/ru/issues?art_id=70038

²⁶ According to Decree of RB President No. 480 of September 14, 2010 “On some issues of dairy industry development” two banks are charged with crediting the industry under the state program – Belagroprombank and the Savings bank “Belarusbank”.

to sell produce on the territory of Russia causes the reduction of output of products subject to price regulation in Belarus or to their outflow to the foreign market.

It's hard to estimate the surplus export revenues of Belarusian market operators from administratively lowered production expenditures since there are mechanisms of regulating exporters' incomes. Among them is the forced sale of 30% of foreign currency revenue. Given that administrative methods of establishing exchange rates are applied, such sales can infringe economic interests of exporters. In recent time due the deficit of currency, the foreign currency revenues of exporters-state entities are redistributed between enterprises of the industry at undervalued exchange rates (there are so called "intra-departmental exchanges")²⁷. Taking into account that not the part of the currency revenue that constitutes the exporter's profit is to be sold but a part of the overall currency revenue, the exporter's profit gets smaller. So, the current state of affairs with price advantages of Belarusian commodities is not stable but in the short and medium run it is hazardous for the Russian farm producers.

Given the principal difference between economic systems in Russia and Belarus it's impossible to secure similar approaches to the support of farm production and to compare the extent of such support. The fact that dairy products in Belarus are produced under the administrative restriction of prices but are sold in Russia by market rules implies that the support to Belarusian producers is partially rendered at the expense of Russian consumers.

²⁷ <http://news.rufox.ru/texts/2011/08/25/209490.htm>