

## **Russian Agriculture: At the Crossroads or at the Barricades?**

**Speech by Allan Mustard, Minister-Counselor for Agricultural Affairs,  
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Last month I bought a book at Dom Knigi entitled “Rural Russia at the Crossroads” by Tatyana Nefedova. As I read it, I reflected on the history of Russian agricultural reform since freeing of the serfs, on the legacy of inefficient government policy toward agriculture, and on Russia’s preparations for accession to the World Trade Organization. It struck me that indeed, Russian agriculture is at a crossroad—and is busily constructing a barricade across that crossroad. As the rest of the world moves forward, Russian agricultural policy is looking at the past.

In the next few minutes I would like to discuss what I see as a series of paradoxes of Russian agriculture, and the impact they have on Russian agricultural trade policy. I will also set out what I see as two potential future courses for Russian agriculture: an optimistic scenario, and a pessimistic one, and relate them to the outlook for Russian agricultural trade.

In that regard, there is a pressing need for markets in land, labor and capital to emerge in Russia, and this need overrides nearly every other need in the agriculture sector. Much work has been done in the past decade, including via the BASIS project, but much more work remains. The BASIS project looked primarily at input markets, and as a true partnership between Russian and American agricultural economists represents a great step forward in bilateral research cooperation. There continues to be a need for such cooperation in studying policy options for Russia’s transformation to an agricultural market economy.

Now, this truly is a critical time for Russian agriculture. Production agriculture is split between the haves and have-nots. Roughly a quarter of former state and collective farms account for over 80 percent of profitability, meaning profitability is heavily

concentrated. Many of these profitable operations have been taken over by large holding companies that have replaced the management, arranged for debt relief, and invested in capital infrastructure. In the top 300 large farms, grain turns an 84% profit, sunflower 116% profit, and beef 22% profit.<sup>1</sup> With profit margins like this, it is clear that a well managed Russian farm can make money.

At the other extreme, half of former state and collective farms are bankrupt, and are so unprofitable, so uncompetitive, and so deeply in debt, they cannot reach financial health without a complete restructuring. Current Russian farm programs continue to pump money into these inefficient, unproductive farms simply to maintain rural employment, and thereby to reduce rural flight to the cities, but without regard for the real solution to rural poverty—making those farms profitable by making them efficient and competitive.

Then there is the question of private farmers and private plots. Over half of all agricultural production is grown or raised on private subsidiary plots of the rural population. These smallholders, and the very small number of private farmers in Russia, not only receive insignificant support from the Russian government, in some locales they are impeded by local bureaucrats. Marketing infrastructure, physical infrastructure, and credit for these producers are almost totally lacking. Nevertheless they are profitable and indeed by and large are thriving.

The paradox is clear. Russian agricultural policy puts the majority of its resources into the sector with the lowest return on investment, for social reasons, and seeks to protect that sector from foreign competition, at a time markets elsewhere in the world are liberalizing, capturing gains from trade, and thereby increasing the wealth of all their citizens.

## **Russia at the Crossroads**

In a very real sense Russia must choose soon between efficient, competitive agriculture that is a net contributor to the national economy, and inefficient, uncompetitive agriculture that continues to hinder economic growth. The choice would appear to be a simple one. First, official Russian government policy, as spelled out in Prime Minister Fradkov's July 28 decree on basic directions of the Russian government to 2008, puts competitiveness at the top of the list of goals for the agricultural sector.<sup>2</sup> Second, Russia seeks to join the World Trade Organization, and the disciplines agreed to in August make clear the future direction for WTO members: elimination of all export subsidies, expansion of tariff-rate quotas, more tariff cuts, and substantial reductions in trade-distorting agricultural supports. Third, the holding companies and private farmers have proven beyond doubt that Russian agriculture can be efficient and profitable without the need for large-scale government support aside from debt relief, and that rural dwellers do not have to live in poverty.

The first vision for Russia is thus of a mix of large former state and collective farms freed from debt, under new, competent management, with infusions of capital from holding companies, along with private farms created through the bankruptcy and reorganization of hopelessly insolvent former state and collective farms. This scenario further envisions redevelopment of the state agricultural bank into a cooperative credit institution for lending to both large operations and to smaller private farms, and use of funds currently wasted on farm subsidies for creating market infrastructure. This last point is important: if Russia is going to spend money on subsidies, it should spend that money on creating market institutions and market infrastructure.

Such an infusion of capital into competitive, profitable enterprises, which under new, market-oriented management would direct themselves toward production of commodities in

which Russia has a comparative advantage, would allow Russian agriculture to modernize. The commodities in which Russia can be competitive include, obviously, cereal grains like wheat and barley, sunflower, and potatoes. As the highly profitable food processing industry continued its current modernization, more added value would be captured by Russian agribusiness and more jobs created in both cities and the countryside. This scenario, based on principles of comparative advantage, would also strengthen the import and export business sectors, key engines of economic growth.

### **Russia at the Barricades**

But there is another potential scenario. Russian trade policy is governed today by the concept known as “constructive isolationism,” advanced by Academician Nikolay Shmelev.<sup>3</sup> Under this concept, uncompetitive Russian producers must be protected from foreign producers by trade barriers until they can be made competitive. “Constructive isolationism” includes a geopolitical dimension I’ll not discuss here, but in a nutshell advances the argument that until Russian agriculture and industry can compete on equal footing with foreign competitors, the barricades must remain in place. Economists call this the “infant industry” argument, and it always has one unfortunate consequence. The infant never grows up. That is, the protected sector of the economy never becomes competitive.

Much of the impetus for this concept is fear: fear of foreigners, and in the case of agriculture, fear of dependence on foreigners for food. Never mind that embargoes have been proven not to work. Never mind that a global food system has been in place since the 1960s that ensures food is delivered to any customer able to pay for it (and is there any doubt that Russia can pay for anything it wants to buy?)

In agricultural trade, we see “constructive isolationism” in several places. We see it in domestic legislation, such as the draft Law on Agricultural Development, which calls for

“food independence” and proposes specific targets for the proportion of certain commodities consumed that can be imported. The draft law calls for policies leading to 90% self-sufficiency in grains, 70% self-sufficiency in vegetable oil, and 80% self-sufficiency in meat, dairy products and fish. Such a policy would have obvious ramifications for international trade.

We see it in veterinary and phytosanitary controls, where Russia has imposed the most complicated set of veterinary certificates in the world, and has advised that bringing its Soviet-era system of food safety, veterinary, and phytosanitary regulation into conformance with the World Trade Organization (WTO) will take seven years. The current head of the Ministry of Agriculture’s sanitary and phytosanitary service told the Russian press two years ago, “The only instrument of foreign economic policy the Ministry of Agriculture possesses today is our veterinarians,” and added that the veterinarians need only to find a small snag, and they can halt imports from any country.<sup>4</sup> Is this really an approach based on sound science? It certainly cannot be viewed as such within the context of international norms. On the eve of joining the WTO, does Russia really want to cheapen its rich scientific legacy and risk ruining its reputation for science-based decision-making?

We see it in statements by the Minister of Agriculture, who for example told *Rossiyskaya Gazeta* last June that the WTO has “exhausted itself” and is “not in a condition to protect developing countries from the whims of the developed countries.”<sup>5</sup> Just last month, the minister stated, “The state must apply quotas to more product categories as quantitative restrictions are more effective than customs duties.”<sup>6</sup> Quotas are of course prohibited under the WTO. We see it in documents of the Russian Agrarian Movement, which call for something called “reasonable protectionism” and for total self-sufficiency within a decade in poultry meat, food and feed grains, eggs, milk, and vegetables.<sup>7</sup> We see it in desire for a \$13

billion cap on domestic agricultural support as part of WTO accession negotiations, when today's actual domestic support is only about \$3 billion.

In a globalized economy, you cannot have efficient, competitive agriculture, and at the same time be self-sufficient and protectionist. Self-sufficiency presumes production at any cost, and that means gains from trade are lost. This in turn undermines attempts at economic efficiency. This loss of efficiency in turn means competitiveness is lost. When that happens, protectionism is the logical recourse.

Competitiveness is the root of profitability, and profitability is the only sure way to eliminate rural poverty and rural flight. Russia in this scenario will squander money on producing agricultural commodities in which it has no comparative advantage, putting those funds to inefficient use, and encouraging farms to produce commodities that are not competitive on a globalized market. Russian appears to want to continue to subsidize state monopolies like Rosagroleasing, inhibiting competition and development of market institutions. It will doom those uncompetitive farms to unprofitability, continued poverty, and continued dependence on protectionism and subsidies.

Again, fear seems to be the motivating factor here, and the question being asked is whether Russia can be made to feed itself. To my mind, that is the wrong question. Of course, Russia can feed itself—any competent agronomist can tell you that. The question should be, what standard of living does Russia want to enjoy? Gains from trade improve the standard of living for the populace of both trading partners—it is not a zero-sum game. Does Russia really want to adopt policies that lead to a lower standard of living?

The worldwide trend in agricultural trade policy is clear: reduction of trade barriers, reduction of domestic support, and elimination of export subsidies. The recent breakthrough in WTO talks, including the European Union's commitment to eliminate export subsidies,

shows movement in a positive direction. Russia is moving in the opposite direction, despite its stated intent to join the WTO: increasing trade barriers and increasing domestic support.

A century ago the visionary Russian Prime Minister Pyotr Stolypin introduced far-reaching agricultural and land reforms that promised to bring backward Russian agriculture of that era into the modern age. His efforts to bring prosperity to rural Russia were derailed by the Bol'shevik Revolution and collectivization. At the dawn of the 21<sup>st</sup> century, the Russian government has a chance to live up to Stolypin's dreams of prosperity and profitability for Russian agriculture. Russia has within its grasp an opportunity to revitalize its countryside, to make Russian agriculture a money-making proposition, and to improve the standards of living of millions of Russian citizens, including today's impoverished rural dwellers. Will Russia look to the future, or continue to cling to the past?

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<sup>1</sup> Евгения Серова, Институт Экономики Переходного Времени (Yevgeniya Serova, Institute of the Economy of Transition)

<sup>2</sup> «Основные направления деятельности Правительства Российской Федерации на период до 2008 года, утверждены Председателем Правительства Российской Федерации М.Е. Фрадковым», Москва, 28 июля 2004 г. ("Main Directions of the Activity of the Government of the Russian Federation in the Period to 2008, affirmed by Chairman of the Government of the Russian Federation M.E. Fradkov," Moscow, July 28, 2004)

<sup>3</sup> Николай Шмелев, «Экономическая составляющая российской внешней политики», *Современная Европа*, Выпуск 2, апрель-июнь 2001 г. (Nikolay Shmelev, "The economic component of Russian foreign policy," *Contemporary Europe*, Issue 2, April-June 2001, <http://www.ieras.ru/journal/journal2.2001/1.htm>)

<sup>4</sup> «Лобби нового созыва вербует среди отраслевиков Минсельхоз», *Ведомости*, 04.09.2002 ("Lobby of the new conclave recruits from among sectoral specialists of the Ministry of Agriculture," *Vedomosti*, September 4, 2002)

<sup>5</sup> Полная цитата: "Все эти вопросы приводят меня к заключению, что ВТО исчерпала себя. Она не в состоянии защитить развивающиеся страны от произвола развитых. Она не может проводить ту линию, ради которой она, собственно, и существует - линию либерализации мировой торговли и рационального размещения производительных сил в мировой экономике". *Российская газета*, 24 июня 2004 г., стр. 4 (full quote: "All these issues bring me to the conclusion that the WTO has exhausted itself. It is not in a condition to protect developing countries from the whims of the developed countries. It cannot promote the line for which it, itself, exists – the line of liberalization of world trade and rational distribution of productive assets in the world economy." *Rossiyskaya gazeta*, June 24, 2004, page 4)

<sup>6</sup> Дарья Быхун, ИТАР-ТАСС. 19 августа 2004 г., «Глава Минсельхоза РФ: Необходимо максимальное квотирование импорта сельхозпродукции в Россию» Полная цитата: "На сегодня противостоять экспансии западной, как правило, некачественной сельхозпродукции для нашего государства гораздо

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важнее, чем выделять прямые дотации аграриям", - подчеркнул Гордеев. Он отметил, что "с этой целью государство должно квотировать больше видов продукции, поскольку количественные ограничения эффективнее, чем таможенные пошлины". (Dar'ya Bykhun, ITAR-TASS, August 19, 2004, "Minister of Agriculture: Maximum Quotas Required on Agricultural Imports to Russia," Full quote: "'Today it is much more important for the state to resist the expansion of Western usually low-quality agricultural products that subsidize producers directly," Gordeyev said. He said that "to this aim the state must apply quotas to more product categories as quantitative restrictions are more effective than customs duties.")

<sup>7</sup> Полная цитата: «В ближайшее десятилетие за счет собственного производства можно полностью обеспечить внутренние потребности в продовольственном и фуражном зерне, мясе птицы, яйце, молоке и молокопродуктах, овощах и картофеле. Необходимо принять меры по формированию специализированных зон производства этой продукции и осуществлять разумный торговый протекционизм, не допускающий демпинга на внутреннем рынке со стороны зарубежных импортеров и недобросовестную конкуренцию.» <http://vesti-rad.ru/?mode=art&section=7&doc=7-1075746291>, на сайте Российского Аграрного Движения под рубрикой «Российское Аграрное Движение, Нормативные акты, Регулирование продовольственного рынка, Основные условия и принципы роста продовольственного рынка.» (Full quote: "In the coming decade it will be possible based on domestic production to cover completely domestic requirements for food and feed grain, poultry meat, eggs, milk and dairy products, vegetables and potatoes. It is necessary to take measures to for specialized production zones for these products and to carry out reasonable trade protectionism which does not permit dumping on the internal market by foreign importers as well as unfair competition." From the website of the Russian Agrarian Movement, found under the rubric "Russian Agrarian Movement, Normative Acts, Food Market Regulation, Fundamental Conditions and Principles of Growth of the Food Market.")