

World Agriculture & Trade



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Russia's Economic Crisis: Effects on Agriculture Are Mixed

The economic crisis in Russia that began in August 1998—triggered by devaluation of the ruble and the government's default on domestic debt—has strongly affected the country's agriculture and food economy. Food consumption has fallen, the result of a crisis-induced drop in consumer income and rising food prices from ruble depreciation. Nevertheless, agricultural production should be stimulated as major depreciation of the ruble against foreign currencies substantially improves the price competitiveness of domestic output compared with imports. Russian imports of agricultural and food products have dropped by about three-fourths, causing U.S. agricultural exports to Russia—2 percent (\$1.36 billion in 1997) of total U.S. agricultural exports before the crisis—to plunge by around 80 percent.

Russian gross domestic product (GDP) is projected to fall about 5 percent in 1999, much the same as in 1998, and could drop in 2000 as well, further decreasing consumer demand. More important for agricultural trade is that crisis-induced capital flight and lack of confidence in the ruble are likely to result in further depreciation of the ruble, keeping agricultural imports depressed.

Devaluation Makes Russia's Agriculture More Competitive

The public debt default and currency devaluation that triggered Russia's economic crisis resulted primarily from three events: 1) the drop in world prices for Russia's main exports (energy and metals), which put pressure on the ruble and reduced export tax revenue; 2) a large rise in the government's budget deficit (from about 4 percent of GDP in 1997 to 7 percent in 1998) as a result of increased expenditures; and 3) the Asian economic crisis, which created a spillover effect that eroded investor confidence in Russia.

The crisis has generated large-scale capital flight, continuing depreciation of the ruble against the U.S. dollar (about 75 percent since August 1998), dramatic inflation (100 percent since August), and a falling GDP. The effects on the agriculture and food economy, particularly the stimulus to output, have not yet fully played out; nor are they likely to be quickly reversed. With domestic capital flight expected to continue and foreign investment likely to remain depressed, Russia's 1999 GDP is projected to decrease to \$120 billion at the current exchange rate, and debt repayment obliga-

tions to the West will total \$17 billion, about 14 percent of GDP.

The crisis has reduced demand for food and lowered food consumption, because substantial depreciation of the ruble significantly raises domestic prices for foodstuffs. Russia is now mostly a free-trading country in agriculture and food—i.e., the government does not overly restrict movement of products into or out of the country—so world market prices largely determine domestic prices faced by both consumers and producers in Russia (at least for traded goods). Even with stable world prices, ruble-denominated prices rise as the ruble weakens.

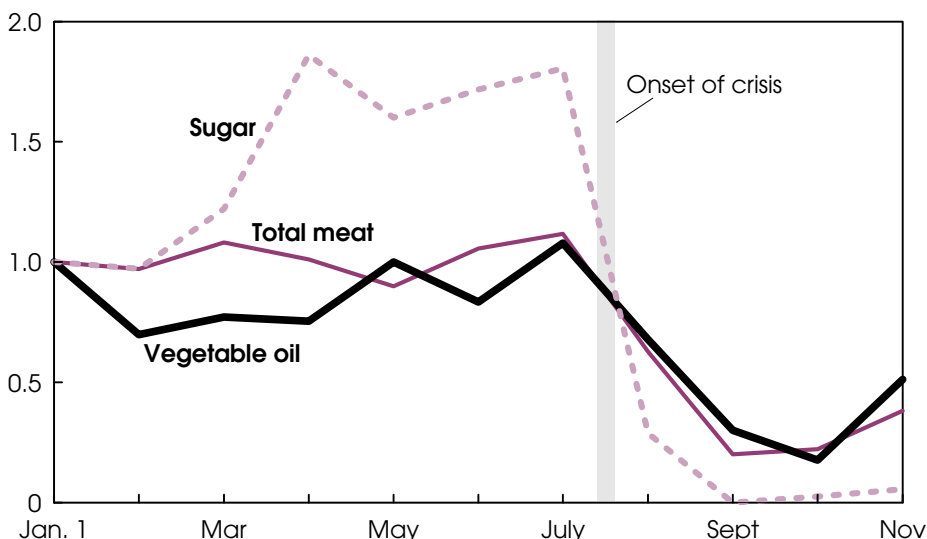
Reduced consumer wealth and income have also contributed to declining consumer demand for food. The government's debt default has led to a chain of events (including collapse of the banking system) that have wiped out most of the value of ruble-denominated financial assets in Russia—bank accounts, bonds, and corporate stock. In addition, the fall in GDP has hurt incomes by increasing unemployment, and high inflation has reduced consumer purchasing power by substantially lowering real income.

Nevertheless, ruble depreciation has improved the price competitiveness of all trade-competing sectors of the Russian economy, one of the few benefits the country has experienced from its current economic problems. The crisis should therefore help, rather than hurt, Russian agriculture. Depreciation of the ruble has substantially improved the price competitiveness of Russian output relative to imports, and at the same time agriculture's terms of trade have improved, i.e., prices received for traded agricultural goods have increased more than prices paid for inputs. Although official statistical information is not yet available, evidence from Russian sources, including newspaper reports and discussions with agricultural specialists in Russia, indicates that Russian producers, particularly of livestock goods, are responding to ruble depreciation by expanding output. The effect of ruble depreciation alone should be an increase in production, but Russian agriculture continues to face many difficulties that could result in output of major commodities falling in 1999.

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As Crisis Hit, Major Russian Food Imports Plummeted

Index (Jan. 1998=1)



Source: 1997 Russian Statistical Yearbook.
Economic Research Service, USDA

Russian agricultural imports are taking a double hit from the income-induced drop in consumer demand and from the depreciation-induced rise in import prices. In fourth-quarter 1998, the total value of agricultural and food imports was only about one-fourth the value of a year earlier.

Russia's imports of foodstuffs consist mainly of meat and other high-value products (HVP's) such as fruit, processed foods, beverages, and confectionary products. Consumer demand for these goods is more sensitive to changes in income than demand for more staple foods. Since destruction of ruble-denominated financial assets during the crisis has hurt mainly the more affluent population—the driving force behind the growth of HVP imports—the crisis-generated drop in wealth and income is hitting these imports particularly hard. Total consumer demand for meat and other HVP's over the next couple years should continue to fall.

Crisis Has Slashed Russian Meat Imports

According to official Russian trade statistics, agricultural imports in 1996 and 1997 totaled \$9.2 and \$10.3 billion, and 1998 pre-crisis import flows were about the same as in 1997. Meat (beef, pork,

and poultry) is Russia's main agricultural import—accounting for almost 30 percent of imports—with the U.S. the dominant supplier of poultry and Europe the main provider of beef and pork. The Russian crisis has reduced Western meat exports to Russia by about three-quarters.

Poultry is the primary U.S. agricultural export to Russia, accounting in recent years for about two-thirds of the total value of U.S. agricultural and food exports to the country and about half of total U.S. poultry exports. Russians prefer poultry dark meat, complementing U.S. consumers' preference for white meat. In the past 2 years, imports from the U.S. accounted for about 55 percent of Russia's total poultry consumption. Since August, U.S. poultry exports to Russia have dropped to 20-25 percent of the previous volume, and no major rebound is expected in the near future. The drop in exports has affected U.S. poultry prices; the U.S. price for chicken leg quarters (which largely determines the world price) has fallen 50 percent since the crisis began.

Russia is also the EU's main export market for beef and pork, and EU sales of these products to Russia have declined about 75 percent since the crisis hit. The drop in beef and pork imports by Russia

has hurt the reforming countries of Central and Eastern Europe (CEE) as well. These countries now trade with Russia using currency rather than government-negotiated barter, so trade is strongly affected by movements in exchange rates. Russian purchases account for 30 percent of Poland's total agricultural exports and 10-15 percent of exports from Hungary and the Czech Republic. Pork is their dominant export, and Hungary reports that pork exports to Russia have virtually stopped. Because of the lower quality of their output, CEE countries probably face more difficulty than Western Europe in finding alternative markets.

Newly Independent States (NIS) neighbors have also been net agricultural exporters to Russia, and they too have experienced a crisis-induced disruption of trade. Particularly hard hit by ruble devaluation are Kazakstan's traditional exports of grain and meat to Russia. NIS trading partners have responded to the crisis by expanding barter trade with Russia, already strong before the crisis, taking agricultural goods in return for energy and metals.

Russia's crisis has hurt other NIS economies, not only through the trade effect, but also through capital flight contagion. In 1998, GDP in these countries fell a total of about 3 percent.

Food Security Concerns Spur Food Aid

The economic crisis has raised concerns about possible food shortages in Russia. Extremely bad weather in 1998 made it a poor year for Russian agriculture, especially the grain sector. The USDA estimate for Russia's 1998 total grain output is 48 million metric tons (mmt), compared with an unusually high 88 mmt in 1997 and a 5-year average of 80 mmt per year.

Despite last year's poor harvest, domestic agricultural supplies appear adequate to prevent widespread food shortages. Russia consumes about 20 mmt of food grain a year. Food grain production in 1998 fell below that level, but the quality was high, and drawing on sufficient carryover stocks from the 1997 bumper crop, Russia was able to meet overall domestic needs.

Estimating the Share of Imports in Russia's Food Consumption

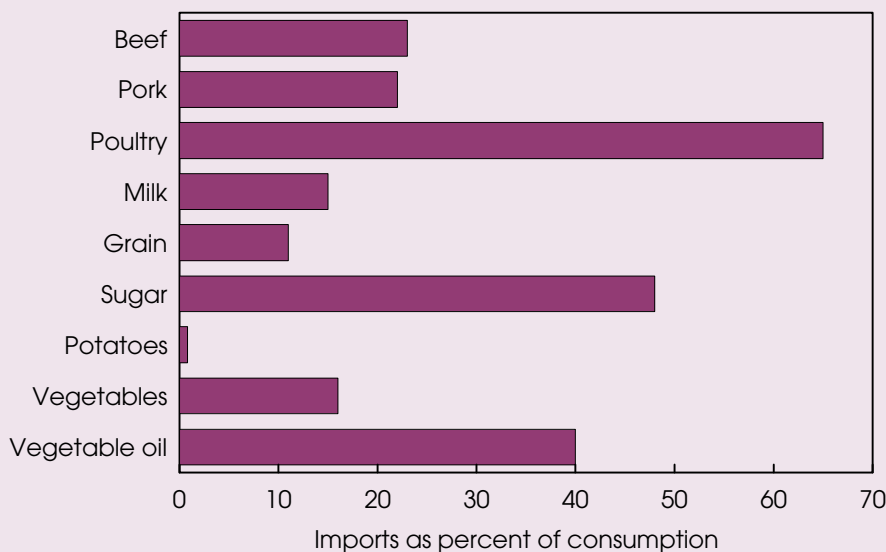
USDA's Economic Research Service (ERS) calculates the share of imports in Russia's food consumption by adjusting Russian data on both trade and consumer expenditures. The first step is to estimate the value of Russian food imports in a given year. Russian statistical sources concede that the country's official trade data (in *Customs Statistics of the Foreign Trade of the Russian Federation*) understate imports by 20 to 30 percent. The understatement occurs mainly because the data exclude barter trade between entities below the level of the national government, and they also exclude "shuttle trade" conducted by small-level traders among the Newly Independent States.

ERS values food imports at the retail level by multiplying quantities of goods imported by their Russian ruble retail price, thus adding the costs of processing, internal transportation, and retail sale. Then ERS corrects for the omitted trade by adding 30 percent to this value of food imports.

The next step is to estimate the value of total Russian food consumption. ERS derives the value of food consumption, measured in retail prices, from data on total consumer expenditures (in *Russian Statistical Yearbook, 1997*) and adjusts to include agricultural products consumed on the farm as well as foodstuffs distributed by the state to entities such as the military, hospitals, and orphanages.

The calculation indicates that imported foodstuffs accounted for about 20 percent of Russia's total food consumption in 1997.

In 1997, Imports Provided Under 25 Percent of Many Foods Consumed in Russia



Based on volume.
Sources: *Customs Statistics of the Foreign Trade of the Russian Federation* and *1997 Russian Statistical Yearbook*.
Economic Research Service, USDA

The drop in Russia's food imports is not a threat to the country's overall food security. Contrary to a commonly held misconception that Russia imports over

half its total food, USDA's Economic Research Service estimates that during the past couple of years imports accounted for only about a fifth of Russia's

total food consumption. The only major foodstuff for which imports provide over half of domestic consumption is poultry. However, imports do account for over half of food consumption in major cities such as Moscow and St. Petersburg.

Even with adequate food production, the economic crisis has negatively affected the distribution of food to segments of the population and regions of the country. As poverty increases because of rising unemployment and inflation, food is less affordable to a growing share of the population. In addition, many agricultural surplus-producing regions within Russia, in order to protect their own consumers, are restricting the outflow of foodstuffs. This can prevent food-deficit regions, particularly in the north and far east, from obtaining needed supplies even if they are willing to pay higher prices.

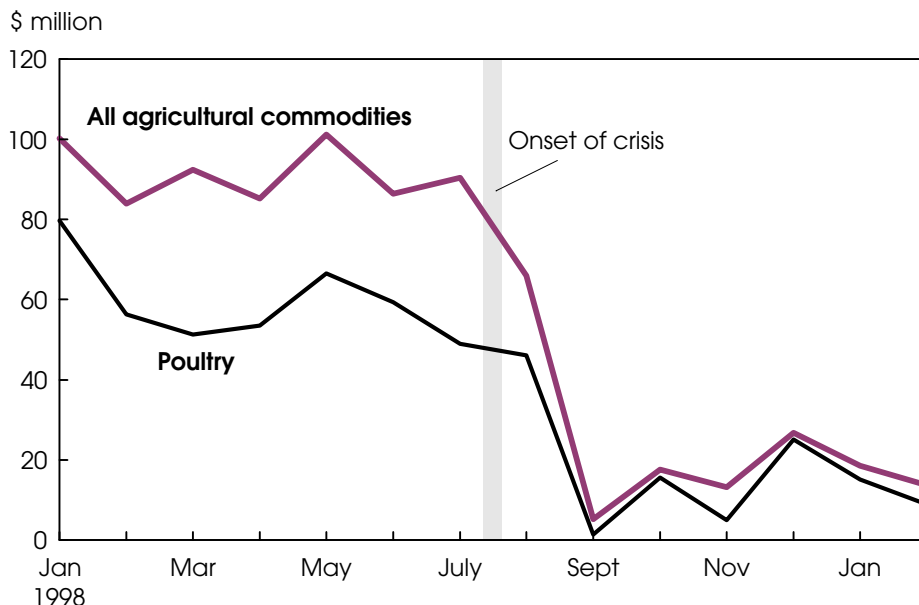
Both the U.S. and EU have responded to these food security concerns with food aid packages, including provisions for targeting some of the food to needy population groups and regions. The U.S. package includes donations worth about \$589 million (\$409 million for 1.9 mmt of commodities and \$180 million for transportation) plus a \$520 million trade credit for Russia to purchase 1.3 mmt of commodities such as corn, soybeans, and meat under P.L.-480 Title I. The donated U.S. commodities include 1.7 mmt of wheat from the Commodity Credit Corporation and 0.2 mmt of various commodities from the U.S. Food for Progress Program. The EU package provides 1.8 mmt of agricultural products (including 1 mmt of wheat) worth \$470 million. Most of the U.S. and EU food aid shipments are to be sold on the market at existing prices, with the revenue to go to the state pension fund. However, part of the Food for Progress donation is to be distributed by private voluntary organizations to the poor and elderly, while the remainder is to be sold, with the revenue supporting seed research institutes and credit facilities.

Russian Ag Policies Are Slow to Change

The main effect of the crisis on Russian agricultural policy has been a dramatic drop in federal subsidies to the sector—about 80 percent in real terms compared

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U.S. Poultry and Other Ag Exports to Russia Have Plunged



Source: Foreign Agricultural Service, USDA.
Economic Research Service, USDA

with 1997—though subsidies from regional budgets fell less. The declining subsidies reflect the crisis-induced need to reduce spending rather than major rethinking about the general desirability of government support for agriculture.

Agricultural reform in Russia has succeeded in making farms and other enterprises responsive to market price signals and competitive pressures (particularly from imports). However, there has been little reform in farms' internal operations. The former state and collective farms, although officially reorganized mainly as joint-stock companies, have done little to change their actual organization, system of management, and work incentives. Private farms, not to be confused with household private plots on large farms, account for only about 2 percent of total agricultural output.

The current dominant issue involving agriculture is the status of the land code proposed by the Russian legislature (Duma). Currently, most land is owned and controlled by large former state and

collective farms. The conservative Duma's draft code does not allow purchase and sale of land for agricultural use, but rather allows the buying and selling of small plots of land only for purposes that are economically insignificant, such as building a *dacha* (country cottage). The more reformist government of President Yeltsin has been resisting passage of such a restrictive code.

Elections for the Duma will be held in December 1999, and for President in June 2000. A new legislature and president could bring policy changes, particularly if economic fallout from the crisis continues to be high. Major policy changes are more likely to be made economy-wide than initiated at the sector level, but any significant changes involving spending, taxes, and prices likely would affect the agriculture and food economy. **AO**

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June Releases—USDA's Agricultural Statistics Board

The following reports are issued electronically at 3 pm (ET) unless otherwise indicated.

June

- 1 Crop Progress (4 p.m.)
- 2 Broiler Hatchery
- 3 Dairy Products
Egg Products
Poultry Slaughter
- 4 Dairy Products Prices
(8:30 a.m.)
Minn.-Wis. Base Month
Price - Final 1996-98
Basic Formula Milk Price
(Wisconsin State Report)
- 7 Crop Progress (4 p.m.)
- 9 Broiler Hatchery
- 11 Crop Production (8:30 a.m.)
Dairy Products Prices
(8:30 a.m.)
- 14 Crop Progress (4 p.m.)
- 15 Milk Production
Potato Stocks
- 16 Broiler Hatchery
Turkey Hatchery
- 18 Dairy Products Prices
(8:30 a.m.)
Cattle on Feed
Cold Storage
- 21 Crop Progress (4 p.m.)
- 22 Chickens & Eggs
- 23 Broiler Hatchery
NASS Facts Newsletter
(4 p.m.)
- 24 Catfish Processing
Cherry Production (Tent.)
- 25 Dairy Products Prices
(8:30 a.m.)
Hogs & Pigs
Livestock Slaughter
Peanut Stocks &
Processing
- 28 Crop Progress (4 p.m.)
- 29 Agricultural Prices
- 30 Acreage (8:30 a.m.)
Grain Stocks (8:30 a.m.)
Broiler Hatchery