The Domestic Effects of the Russian Food Embargo

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Abstract: This short article provides an analysis of the impact of Russia's food embargo on domestic producers. It is part of an occasional series of non-peer-reviewed texts that explain current events.

After the Russian annexation of the Crimean Peninsula in March 2014, the U.S., the EU and a number of other countries imposed economic sanctions on Russia. Western sanctions targeted Russian companies and individuals, banning visas, freezing assets and restricting trade of certain Russian financial products and technologies. On August 7, 2014, Russia retaliated with an embargo on agricultural products from the U.S., Canada, EU, Norway and Australia. The embargo banned a long list of food products including beef, pork, poultry, fish and other seafood, fluid milk, vegetables and potatoes, fruits, nuts and various processed foods like sausages and dairy products. Baby food, live animals, seeds and a number of specialized ingredients for food and animal feed (minerals and vitamins integral to livestock feed, for example) were excluded from the ban.[1]

The fact that agriculture was at the heart of counter-sanctions is itself quite interesting. The food embargo demonstrates that the country's dependence on imported food was a central concern of the Russian government. This anxiety has been evident in agricultural reform policies known collectively as the food security agenda that aimed at strengthening domestic producers and reducing Russia's dependence on foreign agricultural and food imports. The political salience of food security was on display on a few occasions in 2015, when *Rosselkhoznadzor*, the Russian

[1] Decree No. 778 of 7 August 2014. For full text in English, see USDA FAS GAIN Report "Russian Food Ban Extended Until August 2016." 6/25/2015. Report No. RS1540.

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agricultural monitoring agency, publicly destroyed hundreds of tons of illegally imported Western food. These events were highly symbolic policing moves, widely broadcast in Russian and international media. But Russia's food politics are grounded in the country's economic transformation. The food security agenda in general, and the food embargo more specifically have had significant domestic economic effects. The political science literature and public commentary on international economic sanctions have largely focused on the effects of sanctions on *target* countries.[2] This paper examines the *domestic* effects of the food embargo on the Russian economy and assesses whether the embargo has furthered domestic political and economic goals that the Putin government has pursued long before the annexation of Crimea.

When the embargo was first introduced, it was not clear how it would affect domestic consumption and production. Many argued that it would boost domestic agricultural capacity, as domestic production would replace imports. Russian politicians and industry representatives considered it shameful for Russia to have relied so heavily on imports and hoped that the ban would be beneficial for Russian producers. Others doubted the ability of Russian producers to compete with imports from non-affected countries, such as Belarus, Moldova, Brazil and New Zealand, and argued that the embargo will primarily result in a significant geographical shift of imports from Europe and the U.S. to these countries. Consumers, in each of these scenarios, would end up with different food on their table.

Prime Minister Dmitry Medvedev announced in May 2016 that Russia would uphold the embargo until at least the end of 2017. This decision is certainly a response to the continued sanctions by Western countries and may well be related to the effects of the embargo on European producers, who were most affected by the embargo.[3] Yet, it was clearly also made with domestic political and economic goals in mind. Indeed, Medvedev referred to Russian producers' calls to continue the embargo and made the case that committing to an extension of at least 18 months would give producers a longer time-horizon to recoup investments.[4] Arguably then, the

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[2] See for example, Jaleh Dashti-Gibons, Patricia Davis and Benjamin Radcliff. 1997. "On the determinants of the success of economic sanctions: an empirical analysis." *American Journal of Political Science,* 41(2); 608-618. And Marinov, Nikolay. 2005. "Do economic sanctions destabilize country leaders? *American Journal of Political Science.* 49(3): 564-576.

[3] For effects on the EU of the sanctions and counter sanctions, see Marcin Szczepański. 2015. "Economic impact on the EU of sanctions over Ukraine conflict." *European Parliament Research Service Briefing*, October 2015. Report No. PE 569.020.

[4] "Medvedev poruchil gotovit'sia k prodleniiu antisankstii do kontsa 2017 goda," RBC News, 27 May 2016,
http://www.rbc.ru/economics/27/05/2016/574824779a7947e9c81f2645?from=newsfeed.
See also USDA FAS GAIN Report "Russian Food Ban Extended Until August 2016." 25 June 2015. Report No. RS1540.

domestic effects of the embargo played a role in the foreign policy decision whether or not to extend the counter-sanctions, which warrants a closer look at them. And we are now, nearly two years after the inception of the embargo, in a position to make a preliminary assessment of the embargo's effects on the Russian economy and to disentangle how and why it affected various sub-sectors in different ways.

Imports Fall and Domestic Production Rises in Some Sectors, But Not in Others

The first basic observation is that imports of a range of food sectors did indeed fall quite substantially in the 18 months since the inception of the embargo. While the embargo affected a range of foodstuffs, the story about where the meat and dairy on Russian tables comes from has been the most politically salient and economically relevant. Between 2014 and mid-2016, imports of milk and other dairy products to Russia have fallen considerably.[5] In 2014, Russia had imported 1.15 million metric tons of meat. In 2015, more than a year after the embargo had been in place, Russia imported 860,000 metric tons of meat and meat products, nearly 300,000 tons less.[6] Analysts predict that the supply of imported meat will fall by a further 20-30 percent in terms of weight by the end of 2016, with some variation depending on the type of meat.[7] Pork imports declined from 515,000 metric tons in January 2014 to 200,000 in January 2016.[8] Beef imports have not fallen as much as poultry and pork.[9] Beef now accounts for the largest share of Russian meat imports, in dollar terms making up roughly half of Russian meat imports.

The key questions that this decline in imports begs are whether or not the embargo did indeed create new opportunities for Russian producers, and whether declining imports were matched with rising domestic production. The answer has two critical components: first, the effects on producers varied across sub-sectors. Domestic production picked up in pork and poultry, but not as much in beef, and hardly at all in fluid milk and dairy products. In other words, there are distinct patterns and variation among what type of producers were able to take advantage of

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[5] Natalia Shagaida and Vasiliy Uzun. 2015. "Agriculture and Food: Does Import Substitution take place?" Gaidar Institute for Economic Policy. p. 2.

[6] Chris Harris, "Is Russia Nearing Self-Sufficiency in Meat?" https://farmgatetofork.com/2016/05/12/is-russia-nearing-self-sufficiency-in-meat (accessed, July 11, 2016).

[7] Ibid.

[8] USDA FAS GAIN, "Russian Federation Livestock and Products Semi-annual 2016 Report." Report RS1610, March 3, 2016. USDA FAS Moscow; p.12. Imports of live swine declined by 68%, from 8,000 heads in January 2014 to only 1,000 heads in January 2015 and January 2016.

[9] Harris; https://farmgatetofork.com/2016/05/12/is-russia-nearing-self-sufficiency-in-meat

the ban. A second important observation is that even though production increased overall, it did not make up for all of the import short-fall, because consumption declined during the same period of time.

Pork and poultry are often hailed as the success stories of Russian agriculture. Miratorg and Cherkizovo, for example, Russia's largest poultry and pork producers both reported significant sales increases of around 20 percent for 2015 and predict further sales increases in 2016.[10] According to the Russian Poultry Union, domestic poultry production in 2015 reached 4.5 million metric tons, which was 319,000 tons more than in 2014 and could rise to 4.7 metric million tons in 2016.[11] Pork production reached 2.6 million metric tons in 2015, a 4.2 percent year-on-year growth. And if we isolate production by large industrialized pork producers, their production expanded by 8.5 percent or 170,000 metric tons.[12] In other words, large domestic poultry and pork producers were able to fill the supermarket shelves that were emptied by the embargo. They were able to do this because they are relatively mature and competitive industries, as we will see in more detail below. In fact, pork and poultry producers are looking for opportunities to export pork.[13] Russian pork exports increasing from 500 tons in the first quarter of 2015, to 3,700 tons in the first quarter of 2016.[14] The main destination for Russian pork has been Ukraine and Belarus.[15]

Domestic dairy, beef and fish producers, by contrast were not able to increase output to make up for declining imports. Instead of boosting domestic production, the food embargo led to a geographical shift in imports. Lithuanian milk and dairy products were replaced with imports from Belarus. (Belarus is often identified as the main winner of the Russian food embargo: supplying no less than 96 percent of Russian fluid milk, and around 80 percent of Russian butter and cheese.[16]) Fish from Norway were

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[10] According to press releases of the respective companies, see http://www.miratorg.ru/ and http://cherkizovo.com/. Increased sales already started in 2014, see Sam Skove, "Despite Kremlin's Promises, Russian Food Ban Fails to Deliver," *Moscow Times,* June 30, 2015, http://www.themoscowtimes.com/business/article/despite-kremlins-promises-russian-food-ban-fails-to-deliver/524755.html.

[11] Harris, "Is Russia Nearing Self-sufficiency in Meat?" https://farmgatetofork.com/2016/05/12/is-russia-nearing-self-sufficiency-in-meat (accessed, July 11, 2016).

[12] USDA FAS GAIN, "Russian Federation Livestock and Products Semi-annual 2016 Report." Report RS1610, 3/3/2016. USDA FAS Moscow.

[13] Author's interview with Sergey Yushin, head of the National Meat Association, Moscow, May 2016.

[14] Data by Federal Customs Service, quoted in Natalia Shagaida and Vassily Uzun. 2015. "Agriculture and Food: Does Import Substitution take place?" Gaidar Institute for Economic Policy.

[15] Ibid.

[16] Maria Zheleznova, "Zhizn' na bezryb'e," *Vedemosti.* n. 4080, May 26, 2016. See http://www.vedomosti.ru/opinion/articles/2016/05/24/642146-zhizn-bezribe

replaced with fish from the Faroe Islands. Beef from the U.S. and Europe was substituted with beef from Brazil and Paraguay. In these sectors, domestic production remained largely stable, i.e. it did not increase as much as the decline in imports would have allowed. The catch of Russian fishermen has persisted at around 4.3 million tons of fish annually.[17] Russian domestic milk production has remained stable over the last few years around 30 million tons.[18] Domestic cheese production has benefitted from the embargo and increased production, though an interesting case of the geographical shift in food products concerns the type of fat used in cheese and other dairy products. Milk-fat has become a scarce and expensive commodity in Russia, in part because of production shortfalls, and in part because of the embargo and the devaluation of the ruble. In response to these trends, Russian cheese producers switched from importing milk fat from the U.S. and Europe, to importing the cheaper palm oil from East Asia. (According to *Rosselkhoznadzor*, over two thirds of Russian cheese contains palm oil).[19]

A second important observation is that food imports fell not only because of the embargo, but because the purchasing power of Russian consumers has declined over the same time period. Declining purchasing power was the result of both rising prices – inflation was particularly high for food products – and declining incomes.[20] Food became generally more expensive for Russians and imported food even more so. The devaluation of the ruble stems largely from an unrelated decline in oil prices and oil revenues since 2014, but it has made imported meat and dairy products relatively expensive. With less money to spend and with generally rising prices, Russian consumers switched from more expensive to less expensive meats and food. Beef prices rose more than pork and poultry, which meant that beef consumption declined, as consumers opted for cheaper pork and poultry.[21] Similarly, Russians have been buying less butter and less cheese. Overall, since 2014, consumers have purchased less meat and dairy in terms of weight, but they have paid more in ruble terms.

A further interesting aspect of the domestic effects of sanctions

[17] Marina Obrazovka, "Russian fishing industry witnesses stable growth." RBTH News, June 29, 2015, http://rbth.com/business/2015/06/29/russian_fishing_industry_witnesses_stable_growth_47297.html.

[18] USDA FAS GAIN, "Russian Federation Livestock and Products Semi-annual 2016 Report." Report RS1610, March 3, 2016; p. 20.

[19] Elizaveta Vereykina, "Sanctions Spark Russian Cheese Industry Boom," *The Moscow Times*, June 1, 2015, http://www.themoscowtimes.com/business/article/sanctions-spark-russian-cheese-industry-boom/522862.htm

[20] Shagaida and Uzun. 2105. Agriculture and Food.

[21] Beef consumption is expected to decline 14% in 2016, continuing a trend that started in 2015. USDA FAS GAIN, "Russian Federation Livestock and Products Semi-annual 2016 Report." Report RS1610, March 3, 2016. USDA FAS Moscow; p.11.

concerns the role of the so-called "household farms" (*lichnoye podsobnoye khozyaystvo,* or *LPK*), a characteristic form of Russian agricultural production since the late nineteenths century. During the Soviet and early post-Soviet eras, household farms traditionally made up for shortfalls in domestic production, especially in meat, but their relevance has declined over the last decade vis-à-vis the large industrial producers. On the one hand, this was the result of rural residents opting to buy the more affordable meat available in stores, as new vertically integrated meat producers have increased output both before and since the inception of the food embargo. Pork production on household farms also declined because Russian authorities destroyed tens of thousands of pigs held on household farms, as they were deemed a biohazard and the source of pathogens that negatively affect the industrial producers.[22] Whether the household farms will increase their share in food output if Russia's economic crisis and the embargo continues remains to be seen – many observers believe the decline in household production is an irreversible trend.

Domestic Political Context: Vladimir Putin's Food Security Agenda

These patterned effects of the food embargo on Russian producers can be explained if we place them in context of President Vladimir Putin's agricultural and trade policies over the last decade, commonly referred to as the food security agenda. While Boris Yeltsin's rural reforms centered on privatization and liberalization, under Putin, "food problems" (*prodovol'stvennyi problemi*) were elevated to be central concerns of the state. Since the mid-2000s, the Russian government has adopted various measures to support domestic producers under the umbrella of the food security agenda.[23] Food security generally refers to an individual's access to food, but Russian authorities interpreted it as a reduction in domestic reliance on imported food and on food aid. Putin's food security agenda is a facet of the overall deterioration of relations between Russia and the West. It is essentially an import substitution agenda that has both domestic and international goals: domestically, it allowed the government to keep food prices stable, internationally, it reduces dependency on foreign imports and aid. These goals were pursued through a series of rural reform programs, including the "National Priority Project: Development of the Agro-industrial Complex" (2005) and successive Agricultural Reform Programs. Their political salience was most clearly established through the

[22] Ibid.

[23] For detailed accounts of Putin's rural reform policies, see Stephen Wegren, 2002. "Russian Agrarian Policy Under Putin." *Post-Soviet Geography and Economics* 43(1): 26–40; and Wegren. 2009. *Land Reform in Russia; Institutional Design and Behavioral Responses.* New Haven: Yale University Press

"National Food Security Doctrine" (adopted in 2010).[24] A set of precise and ambitious self-sufficiency targets for staples of the Russian diet are the centerpiece of the Food Security Doctrine. In pork and poultry, the Russian government was aiming to achieve full self-sufficiency by 2020.[25]

Throughout the last decade, a myriad of support measures were designed to achieve the goals of the food security agenda — including trade restrictions, subsidized credits, tax breaks, local content rules, and newly created state-owned enterprises. While the government was initially hamstrung by a tight budget, as tax collection improved by the mid-2000s, state support for domestic agriculture strengthened. Grain, oilseed, sugar-beets, pork, poultry were all sectors that benefitted greatly from these supports, which resulted in growing outputs and increasing yields. Trade restrictions were one among the many policy tools the Russian government used to strengthen domestic producers. When Russia joined the WTO, trade restrictions and quotas for meat imports were reduced, although others were soon resurrected with reference to sanitary/food safety concerns. In fact, in 2014, only a few months prior to the adoption of the food ban, the Russian government had banned the import of live pigs, pork and pork products from the EU due to concerns about African swine fever virus.[26]

As a result of trade protection, state support and public and private capital investments, production capacity and efficiency of Russian grain and meat producers improved significantly over the last decade. Russia's grain exports have consistently increased during this period. According the Food and Agriculture Organization (FAO), the Russian meat sector increased total meat production from 7.7 million tons in 2005 to 10.6 million tons in 2010, with poultry output doubling from 1.4 million to 2.8 million tons and pork production increasing from 1.6 million to 2.3 million tons during that period.[27] Yet, it is critical to note that these production updates and efficiency gains were made by a small number of very

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[24] Ukaz "Ob utverzhdenii Doktriny prodovol'stvennoi bezopastnosti Rossiiskoi Federatsii." See, for example, announcement by the Kremlin press service, http://www.kremlin.ru/news/6752. Full text of the doctrine is available at http://graph.document.kremlin.ru/page.aspx?1049708 *"Osnovnye napravleniia agroprodovol'stvennoi politiki Pravitel'stva Rossiiskoi Federatsii na 2001-2010 gody"* available on the website of the Ministry of Agriculture, http://mcx.ru/documents/document/show/6455.191.htm. (Last accessed July 11, 2016.)

[25] For example, grain and potato targets are at 95 percent; milk and dairy products at 90 percent; salt, meat, and meat products at 85 percent; sugar, vegetable oil, fish products at 80 percent. Yelena Vassilieva. 2010. "Russian Federation: Food Security Doctrine Adopted 2010." Global Agricultural Information Network GAIN Report RS1008. Moscow: USDA Foreign Agricultural Service.

[26] Maria Zheleznova, "Zhizn' na bezryb'e," *Vedemosti* May 26, 2016. http://www.vedomosti.ru/opinion/articles/2016/05/24/642146-zhizn-bezribe. (Last accessed July 11, 2016.)

[27] Dmitry Prikhodko and Albert Davleyev. 2014. "Russian Federation: Meat Sector Review." Rome: FAO/OECD.

large, vertically integrated and technologically sophisticated conglomerates. Russia's pork and poultry producers were most able to make these productivity gains. Beef production, by contrast, did not (at least, not yet) experience a similar growth, because investment in beef has been far smaller and the investment that has been made takes a longer time to mature. Moreover, Brazilian beef exporters (whose currency, the real, has devalued along with the Russian ruble in recent years) have been consistent competitors for Russian beef producers.

The Russian dairy sector was similarly troubled by lack of investment, volatility of milk prices and competition from Belarusian and Lithuanian fluid milk and by cheap imported dairy products from these countries and the U.S. (including cheese, butter, dry whey, and milk powder). Ownership and production in the Russian dairy sector is far more fragmented and less concentrated than in the meat sector, with many small producers barely breaking even, but continuing production. There has been much less private investment in the dairy industry, because of the long time horizon that investments in dairy require and the high volatility of prices for raw milk.[28] Unlike the poultry and pork sector, where large vertically integrated actors, like Cherkizovo and Miratorg, were able to take advantage of highly subsidized credits, the many smaller milk producers were less able to benefit from state support programs. The milk and dairy sector, then has been the most negatively affected by the food ban: with the lack of domestic capacity and declining imports, raw milk prices have increased more than 40 percent since 2014.[29] And, as mentioned above, the Russian dairy products industry has replaced milk with cheaper inputs, such as palm oil or hydrogenated vegetable oils, which is generally considered a decline in the quality of these products. What the future holds for dairy and beef is not yet clear; with the protection of the embargo and the continued state support, significant investments in production updates are coming online in 2016 and, in the next five years, the sector might well follow the path that pork and poultry charted.

Conclusion: the Food Embargo is Part of an Unfinished Agenda

The effects of the Russian food embargo are thus varied: some domestic producers benefitted, while others did not. Russian consumers' options changed, both as a result of the embargo, but also because of the general economic climate marked by declining oil prices and economic crisis. The embargo itself is best thought of as a continuation of the long-standing, but unfinished food security agenda. The rationale for focusing

[28] There are a few exceptions to this trend, Ekoniva is one of them.

[29] Shagaida, Natalia, N. Karlova, et. al. 2014. "Russian Agriculture: the impact of sanctions," Gaidar institute for Economic Policy, Russian Presidential Academy of National Economy and Public Administration,. p 3. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2658006

counter-sanctions on agriculture and the effects of the embargo were linked to the goals and the progress of the food security agenda. The myriad state support measures under the umbrella of the food security agenda had strengthened Russian pork, poultry, grain and oilseed producers, though it had been less successful in the dairy and beef sectors. Pork and poultry production, then, had already soared in the years before the adoption of the embargo, as large vertically integrated conglomerates had invested in state-of-the art facilities. Beef, milk and dairy remained stagnant, with outdated production facilities and fragmented ownership. These differences in the recent recovery of domestic production accelerated with the food embargo: pork and poultry producers were able to boost production to replace imports, while dairy and beef were not. The embargo ensures that dairy and beef remain protected for another few years, giving them a chance to catch up with pork and poultry, which have reached the goals set out for them by the food security agenda.

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