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Can You Spare Some Food? An Assessment of Russia's Search for Replacements of Embargoed States

Patryk Toporowski

By introducing a one-year embargo on the import of some food and agricultural products, Russia will have to substitute old channels for new ones on an unprecedented scale. With the exception of Belarus, there are few options to increase imports from suppliers close to Russia's biggest cities. Within the country's broader neighbourhood, China and Turkey offer some potential, whereas Latin America would be considered a more distant source for food. However, the change in trade patterns would have its price. Not only will Russia risk growing inflation but also it will increase its dependency on China, which can settle for good Moscow's role as a minor partner of Beijing.

In response to the escalation of the Ukraine–Russia conflict, the EU, U.S., Japan, Switzerland, Canada, Norway, and Australia have imposed several rounds of sanctions against Russia. These primarily hit officials and subsequently Russian corporations and industries (i.e., arms and energy) as well as the financial sector, and they have suspended cooperation on military issues, in space and investment. The Russian response to these sanctions was its introduction of an embargo on particular food and agricultural products from the U.S., EU, Canada, Norway and Australia (collectively noted hereinafter as countries under Russia's food ban),¹ which later was extended to new food and agricultural products.

By banning food from these countries, Russia has greatly limited possible supplies and needs to substitute traditional sources of imports with new ones, from domestic or foreign suppliers. Since it will not be possible to quickly replace imports with domestic production, new imports are necessary. This, however, will cost Russia in terms of higher inflation. Moreover, because most probably Russia will increase imports mainly from China (and to a lesser extent from Turkey, Belarus and Latin America), the scope of interdependency between the two states would increase.

Russia's Food Needs

Russia bought around \$32 billion worth of food from abroad in 2012. Its imports of food from the EU and other countries currently under the Russian food ban (plus Ukraine) reached \$16.1 billion, which amounts

¹ A list of products (in Polish), is presented at [www.mg.gov.pl/files/upload/21363/Zalacznik - rozporzadzenie rzadu Federacji Rosyjskiej - tlumaczenie.pdf](http://www.mg.gov.pl/files/upload/21363/Zalacznik_-_rozporzadzenie_rzadu_Federacji_Rosyjskiej_-_tlumaczenie.pdf).

to 50.3% of Russia's total food imports (Table 1). The other countries that could be hit by the food ban in the future (Japan and Switzerland, which have been sanctioned, but still are not fully banned by Russia) would cut an additional 0.6% from the Russia's usual food imports.

Table 1. Russian imports from the 5 biggest food and agricultural products exporters, in \$ billions, 2012

	Origin of import						
	World	Countries under food ban	Brazil	Belarus	Ukraine	China	Turkey
Import Value	32.14	14.44	2.26	1.74	1.74	1.47	1.39
Share	100%	44.9%	7.0%	5.4%	5.4%	4.6%	4.3%

Source: UN Comtrade.

Meat is a more important food category than fruits and vegetables in terms of value of imports. Russia imported significant amounts of beef (\$2.6 billion worth of frozen meat and \$0.6 billion in fresh meat, which cumulatively stood for around 10% of total imports of food and agricultural products) and most of these goods originated from Latin America in 2012. This means that imports of goods in this category would not be strongly influenced by the embargo on imports from Western countries. The other substantial import category is pork, which exceeded \$2.5 billion of total imports, with about \$2 billion coming from countries under the food ban, notably the EU. The third group is cheese, worth \$2.1 billion and originating mainly from the EU though also from Belarus (\$569 million) and Ukraine (\$308 million). Another important product sourced abroad is poultry, worth \$0.9 billion in 2012, out of which one-third (\$312 million) was from the U.S. and around \$176 million came from the EU and Ukraine.

As for fruits and vegetables, Russia imported citrus products worth \$1.3 billion in 2012, but not much of this product was sourced from countries under the ban (around \$200 million). Apples and pears are a significant import category, amounting to \$1.2 billion, and around 75% of these products came from the EU (27% from Poland). The other non-European important supplier is Argentina (\$104 million) and China (\$97 million). Quite important also are tomatoes, worth \$800 million in imports but with only one-third of all foreign supplies from the EU. The biggest suppliers of tomatoes are Turkey (\$293 million), China (\$78 million) and Morocco (\$57 million).

This all means that Russian demand for pork or poultry and for some dairy products such as cheese is likely to be satisfied by imports from other countries. Also, sources for fruits and vegetables, notably apples and pears, and to a lesser extent tomatoes, need to be substituted in order to satisfy typical domestic consumption. Russia would seek new sources primarily for these product groups.

Russia's Prospects for Replacing Food Sources Close to Home

Russia currently does not have the capability to substitute food imports with domestic production in the short term. That is why it will have to seek new sources of supplies. The most natural trading partners seem to be the ones that are closest because of lower transportation costs, which are a considerable food price factor. The closest non-EU trade partners are Commonwealth of Independent States (CIS) countries, due to their geographic locations near Russia's biggest urban centres. Moreover, some of them (Kazakhstan and Belarus) belong to the Eurasian Customs Union, which helps strengthen economic ties with Russia. In order to assess the food export potential of particular trade partners, an analysis of national data on the export as well as the import of these goods is necessary. Even if the trade balance in food is not a decisive factor on the possible increase of exports to Russia, a big imbalance would point at the low level of production potential compared to the country's needs, which would translate into little capacity to increase exports. When looking at the structure of trade with CIS countries, it appears that only Belarus possesses a surplus in trade in agricultural products. The others note a deficit in trade in agricultural products and thus they do not have the capacity to increase exports to Russia (Table 2). Belarus specialises in exporting dairy products, such as cheese (\$0.6 billion) or concentrated milk (\$0.55 billion). Kazakhstan also has some

potential for food exports but it produces mainly grains, i.e., wheat (\$1.7 billion) or processed products such as wheat flour (\$607 million), in which Russia is only mildly interested.

Certainly, some food and agricultural products that originate in countries under the food ban reach Russia through third countries, such as Belarus. Officially, Russia has called on neighbouring countries to cease such practices, and several shipments of food and agricultural products were cancelled because of suspicions that they came from banned countries. Since October, more detailed and restrictive inspections of imported food has taken place. However, if food availability in the domestic market becomes too aggravated, the Russian government likely would be eager to soften its stance on re-exports of products originating in embargoed countries, while maintaining the ban. On top of that, because of corruption at the local level, some banned food (e.g., under fake labels) would still enter the Russian market.

Nevertheless, importing food from banned countries through re-exports from neighbouring countries would undermine the Russian embargo and the government will ultimately seek stable suppliers from other countries. Indeed, the Russian authorities have imposed limits on all types of fruits and vegetables from Belarus and have created additional inspection points for transported fruits and vegetables because of the high level of re-export of these products from the EU and Moldova.²

Table 2. Exports and imports of food products of the CIS countries³ in 2012 (in \$ million)

	Armenia	Azerbaijan	Belarus	Kazakhstan	Kyrgyz Republic	Moldova
Exports	86.9	617.6	4,287.6	2,675.9	204.1	437.8
Imports	619.0	948.5	2,904.5	3,461.0	595.8	537.7
Net balance	-532.1	-330.9	1,383.1	-785.2	-391.6	-99.9

Source: UN Comtrade.

The CIS countries' marginal food exporting capacities means that Russia needs to seek supplies from other (relatively close) trade partners and neighbours.⁴ The closest one to Russian urban centres is Georgia. However, like the CIS countries, it does not have the capability to supply Russia as it is a relatively small economy and it exports food and agricultural products worth only \$273 million, while it imports around \$1 billion worth of these products. Additionally, it mainly exports food products that Russia already imports from countries not under the ban, namely beef, nuts and citrus. Hence, the Russia's closest neighbours (to its largest urban centres) do not have the potential to supply the country with the necessary amounts of food.

Import Prospects from the Russia's Broader Neighbourhood: China Growing in Significance

In proximity to Russia, though not as close to its largest urban centres as other immediate neighbours, are China, Turkey, Mongolia, South Korea and Japan. The biggest potential is found in China, which has considerable capacity to increase supplies to Russia. China exports \$52 billion worth of food, while it imports around \$35 billion, giving it a net surplus of around \$17 billion—an amount close to the Russian domestic market's additional needs under the embargo. The food export structure is relatively diversified; however, seafood and fish are the biggest export category (frozen fish amounted to \$5.5 billion, and processed fish exports were worth an additional \$2.2 billion) and the lion's share of food exports is processed food (around \$24 billion). Hence, if China finds it profitable, it potentially may partly satisfy

² R. Szoszyn, "Rosja wprowadza embargo na białoruskie warzywa i owoce," *Rzeczpospolita*, 14 October 2014, www.rp.pl/artykul/1148926.html.

³ No data for Tajikistan and Uzbekistan, as well as for the participating CIS state Turkmenistan. Ukraine is excluded as Russia will not consider it as a source for food.

⁴ No data on North Korea's trade.

Russian consumers by redirecting exports from other destinations, provided there is satisfactory infrastructure to increase the intensity of Chinese sales to Russia. In 2012, China exported to Russia food products worth \$1.5 billion, mostly processed food (i.e., fruit juice) and fruits such as citrus, apples and pears, while among animal products the majority of products were seafood or fish. China, though, is about to begin generating additional food supplies, including meat.⁵ China, thus, would clearly have the opportunity to gain a noticeable significance in Russia's overall imports.

Among the other countries in Russia's "broader neighbourhood" are Mongolia, South Korea, and Japan to the east and Turkey to the west. Even if Japan would be willing and able to trade with Russia, still it and South Korea import more food (\$64.2 billion and \$21.4 billion, respectively) than they export (\$3.7 billion and \$5 billion). In fact, neither specialises in food production, with the exception of some fish and seafood products, which Russia is interested in (i.e., frozen fish, which amounted to around \$0.6 billion and \$0.8 billion of Japanese and South Korean exports, respectively). Still, even if they have some potential to produce more food, it would be difficult or economically unfeasible to send it to Russia. It is interesting to note that even far-eastern Russian seafood producers export their products rather than transport them towards Moscow due to the costs of transport and insufficient infrastructure.⁶

Mongolia also does not have the potential to increase food exports to Russia: its food imports (amounting to \$423 million) significantly exceeds its exports (\$20 million), and changes in production would take years. Among its exports, the biggest categories are horse meat (\$4.5 million), already sold mainly to Russia, and nuts (\$4.1 million), which it sells mainly to China.

Turkey, contrary to the countries on the eastern side of Russia, has the potential for food exports. It is a net exporter of food and agricultural products, sending \$12.7 billion worth of goods abroad while importing \$6.3 billion. The problem with Turkey as a source is found in its food export structure in which the most important goods are citrus (around \$1 billion) and nuts (\$1.2 billion), which Russia already receives from countries not covered by the food ban. Still, Turkey wishes to increase poultry exports to Russia, which would mean that it is increasing its production potential. Still, Turkey's net exports would be less than China. However, Turkey's share of Russia's total imports of food and agricultural products is relatively high and stood at 4.3% in 2012, amounting to \$1.3 billion. Turkey's advantage to the other potentially important food suppliers is its relatively close proximity and good access to Russia's urban centres, including transportation by sea. Hence, it might be the second biggest beneficiary of the Russian food embargo in economic terms.

Limited Opportunities for Distant Suppliers

Russia may seek to reach even farther afield for food. For instance, when it banned meat from the U.S. in a previous dispute, it increased supplies from Argentina, Brazil and Uruguay.⁷ With that path somewhat paved, these countries might increase exports of food to Russia. Moreover, and interestingly, in 2012 Brazil was the biggest food supplier to Russia at \$2.3 billion, which stood for 7% of Russia's total food imports. When analysing Brazil's structure of food trade with Russia, it appears its exports \$1 billion in frozen beef—again, a product already available from countries not covered by the food ban. Pork and poultry meat amounted to \$0.5 billion of Brazil's exports to Russia. Poultry meat, however, could be sold to Russia in larger quantities, as Brazil exported \$7 billion worth globally, so there is margin for some re-orientation of these products.

This points to the fact that since Brazil has already traded intensively with Russia in the past, its trade relations might be improved further as it may be in the interests of both countries. There are also other

⁵ Russia already has accepted new Chinese pork exporters, which will send their goods in the near future (see, e.g.: E. Reed, "Russia to Import Pork from China," *Global Meat News*, 30 September 2014, www.globalmeatnews.com/Industry-Markets/Russia-about-to-import-pork-from-China; earlier, China increased sales of fruit and vegetables to the Russian market.

⁶ E. Piper, "'Parmigiano-Belarussiano' and Other Secrets of Russian Chefs under Food Ban," *Reuters*, 10 September 2014, www.reuters.com/article/2014/09/10/us-ukraine-crisis-russia-food-idUSKBN0H51K020140910.

⁷ *Ibidem*.

South or Latin American countries that hold considerable amounts of food trade potential with Russia. For instance, Ecuador sold \$900 million worth of food to Russia, which stood for 2.8% of its food imports. Also, Argentina supplied Russia with \$794 million worth of food (reflecting a 2.5% share), Chile sent \$400 million (1.2%) and Uruguay sold \$383 million worth of food (1.2%). Each of these countries are net exporters of food and possess a competitive advantage towards the rest of world in this respect, hence they have the capacity to increase supplies to Russia. Their export potential in terms of type, though, is rather low. They currently sell Russia food and agricultural products from countries not covered by the food ban (i.e., exotic fruits), while products such as apples and pears (e.g., in Argentina, these amount to \$100 million) or pork (in Chile, \$50 million) are not their most important sectors. For Argentina, most important are grains (corn, wheat, barley, etc.), while for Chile it is grapes, for Ecuador, bananas, for Uruguay, soybeans and beef.

High Costs for Russia

Russia's embargo on food and agricultural products was a clear sign that the country is ready to make tough decisions and execute them. By imposing the embargo, Russia showed it would not change its stance towards Ukraine and that no country (namely “Western” ones) would affect its decision. This psychological message was even more important than the embargo itself.

But this policy will cost the Russian government much. In terms of its economy, the prices of food, which is an important spending category for Russians, will rise.⁸ This is because Russia is not likely to replace imports with nationally produced goods in the short term. Russia needs several years to expand its own crops (including capital for investment and labour to cultivate and harvest them). Additionally, there is likely to be lower competition on the Russian food market, which might increase prices even further. In effect, the rising food prices will increase poverty across the country. This also could increase wealth inequality among society, enlarging the differences in quality of life between the poorest and wealthiest. On top of that, many consumers may be unsatisfied with the replacements, as new products may not be of the same quality or may be different than what they previously consumed. In order to keep its people satisfied, the government would need to compensate them for more expensive food with decreasing prices for such essentials as natural gas or gasoline, or subsidise food for the poorest. These actions would cost the national budget, but Russia's deteriorating budgetary situation—along with a depreciating rouble and lack of structural reforms—could in the mid-term mean no growth in the coming years.⁹ In addition to that, the World Bank has stated that there are substantial risks to medium-term growth (i.e., inertia in structural reforms, falling oil prices, etc.).¹⁰ If access to foreign capital (mainly European or U.S.) would be even further tightened, Russia could approach insolvency. A government in need of capital would dry up the nation's financial market, leading to solvency problems for corporations operating in Russia.

In the broader context, the Russian embargo will have implications for global patterns of trade in food and agricultural products. On one hand, Russia needs to establish or develop trade with suppliers other than the countries under its food ban. On the other hand, the West, notably the EU, needs to find a market for its food and agricultural products. Certainly, the EU's agricultural industry is not the biggest in the West and most of its products are consumed internally. Still, the amount of food affected by the embargo or ban, amounting to about \$14.4 billion, needs to be saved or sold to other consumers, even at some loss to farmers because of possibly lower prices. Weakening economic links between the West (the EU and the U.S.) and Russia would mean even less influence on Russia in economic and political terms. Thus, the West should prepare its own plans to mitigate the possibly negative economic consequences of problems in trade relations with Russia.

⁸ Around 30% of the consumer price index basket is food and beverages, and in August 2014, inflation amounted to 7.6%, though food inflation amounted to 10.1% (see: www.tradingeconomics.com/russia/inflation-cpi). At the same time, food prices in Poland had fallen.

⁹ IMF, “Transcript of a Press Briefing on the World Economic Outlook (WEO),” 9 October 2014, www.imf.org/external/np/tr/2014/tr100714.htm.

¹⁰ World Bank, “Russia Economic Report 32: Policy Uncertainty Clouds Medium-Term Prospects,” 24 September 2014, www.worldbank.org/en/country/russia/publication/russian-economic-report-32.

There are two different options for countries under Russia's food ban, and these also could be combined. One option is to strive as much as possible to re-establish and maintain good economic relations with Russia, which would be helpful in maintaining the political dialogue. The other option is to focus on some other business interests or, in a broader way, economic opportunities elsewhere in order to minimise the long-term risk linked with economic dependence on Russia, notably in the energy sector.

For Russia, the current conflict is unworkable as well because of its rising dependency on China. More intense cooperation with China would obviously translate into greater interdependence of these two countries, but the growing mutual dependency would not be equally divided. For China, this would not be a substantial change, as it already sells commodities worldwide, diversifying its positions and not focusing on a particular market or product. Hence, the increase in trade with Russia does not create much risk. The greater dependence of Russia on China could be used by the latter to further change the terms of bilateral economic relations in the future. For instance, Russia might be forced to allow China's participation in more joint projects in strategic sectors such as energy and mineral exploration (which Russia has not wanted to do in the past).

For Poland, the Russian market may become even more difficult. Russia might maintain economic cooperation with both the EU and China, but in fact it means that it could have more opportunities to substitute imports of many products from the EU (and thus from Poland) with Chinese suppliers. The increasing competition from Chinese businesses in the Russian market would discourage Polish exporters from entering or remaining in the increasingly difficult market. This would mostly affect the food and agricultural sector once the ban is lifted, as new Chinese food exporters (i.e., apple producers) would now compete for Russian consumers with Polish sellers.