

Russia's Economy

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Author(s):

Rutland, Peter; Wegren, Stephen K.

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Abstract:

Russia is an ailing petrostate, but it is not clear if it is failing. It faces three sources of instability: shifts in international energy markets, the challenge of climate change, and the breakdown of the social contract at home. The country's changing economic fortunes may ultimately lead to a new political model as well.

"How did you go bankrupt?"

"Two ways. Gradually, then suddenly."

Ernest Hemingway, The Sun Also Rises

Foreign Strength, Domestic Weakness

There is a striking imbalance between Russia's resurgence as a power on the world stage since 2008 and its anemic economic performance and dim growth prospects. This divergence is largely explained by the decisive role that energy plays in structuring Russia's domestic political economy. Russia remains very much a "petrostate," in which the energy rent-seekers, in alliance with the security forces, have the upper hand over the profit-seekers. This is part of a broader pattern in emerging market economies, where *"The middle income trap is in the final analysis a political trap not an economic one."*¹

There is a broad consensus amongst outside observers about the trajectory of the Russian economy over the past decade. Moscow has seen the triumph of macro-economic stabilization over growth, and the consolidation of a political/economic elite that stifles competition and stymies the structural reforms needed to put the economy back on track.²

Russia was hit hard by the 2008 financial crash. While the country's foreign reserves meant that it was able to avoid a complete collapse of the banking system, investment never returned to its pre-2008 levels, GDP

growth has averaged less than 2% per year, and living standards have stagnated.³ Hopes for recovery were dashed by the late 2014 crash, caused by a slump in the world oil price and the post-Crimea sanctions imposed by Western nations, which further dampened Russian growth and drove oligarchs into closer dependency on the Kremlin, turning to state-owned banks for loans.⁴ Flat incomes have led to a boom in personal consumer lending, which hit \$130 billion in 2018, up 46% on 2017. That means an average debt of \$4,600, against a mean monthly salary of \$670, raising concerns about a possible bursting of the credit bubble.⁵

GDP grew by an anemic 0.7% in the first six months of 2019, after 2.3% growth in 2018. Profits rose 18% but investments are flat while imports of equipment have fallen by 5–10%.⁶ The arrest of Baring Vostok's Michael Calvey in February 2019 on spurious embezzlement charges set off alarm bells amongst foreign investors; while in June 2019 Sergei Petrov, the founder of the Rolf auto dealership network, was charged with illegal export of \$60 million.⁷ A survey of 400 Russian business people and experts commissioned by business ombudsman Boris Titov found heightened concern over the influence of "force structures" over the business community.⁸

Unfortunately, Russia's trajectory in the post-soviet space is far from unique. The Baltic republics aside, most

1 Elsenhaus, Hartmut and Salvatore Babones, 2017. *BRICS or Bust? Escaping the Middle Income Trap*. Stanford, CA: Stanford University Press, 107.

2 Aslund, Anders, "Russia's economy: macroeconomic stability but minimal growth," *Russian Analytical Digest* no 220, 28 May 2018. https://css.ethz.ch/content/specialinterest/gess/cis/center-for-securities-studies/en/publications/rad/rad-all-issues/details.html?id=n/o/2/2/no_220_political_economy; Becker, Torbjorn, and Susanne Oxenstierna (eds.) 2019. *The Russian Economy Under Putin*. London: Routledge.

3 IMF, 2019. *Russian Federation Staff Report Article IV Consultation*, 2 August. <https://www.imf.org/en/Publications/CR/Issues/2019/08/01/Russian-Federation-2019-Article-IV-Consultation-Press-Release-Staff-Report-48549>. Aris, Ben and Ivan Tkachev, 2019. "Putin's 20 years on the job in numbers." BNE, 18 August. <https://www.intellinews.com/long-read-putin-s-20-years-on-the-job-in-numbers-166248/?source=russia>

4 Grove, Thomas Grove and Alan Cullison, 2019. "Sanctions extend Kremlin's reach." *Wall Street Journal*, 12 September. <https://www.wsj.com/articles/u-s-sanctions-tighten-putins-circle-extend-kremlins-reach-11568194204>

5 Simmonds, Ann. 2019/ "Russians flock to easy loans," *Wall Street Journal*, 5 August. <https://www.wsj.com/articles/russians-flock-to-easy-loans-as-income-dips-11564911001>

6 Shapovalov, Aleksei. 2019. "Bank Rossii ne zhdet rost investitsii," *Kommersant*, 27 September. <https://www.kommersant.ru/doc/4104710>

7 Drankina, Ekaterina. 2019. "The entrepreneur who changed how the world sees Russia," *Meduza*, 28 June. <https://meduza.io/en/feature/2019/06/29/the-entrepreneur-who-changed-how-the-world-sees-russia>

8 Dergachev, Vladimir. 2019. "Zakrytyy opros FSO pokazal rekordnoe nedoverie biznesa k silovikam," RBK, 28 May. <https://www.rbc.ru/society/28/05/2019/5cebe7939a794754023bf449#ws>

of the other states are, like Russia, undemocratic regimes with sluggish economies (See Table 1 on p. 6 and Figure 1 on p. 5). The oil and gas exporters generate high GDP figures, though only a fraction of that wealth trickles down into higher living standards for their citizens. (Belarus shares in some of the economic rents as a transit country for Russian hydrocarbons.) It is true that Russia has tried to export authoritarian practices to neighboring countries, anxious to stem the tide of “color revolutions.” But there is also a reciprocal neighborhood effect: Russia finds itself dealing with partners whose political regimes are very similar to its own. Its deepening partnership with China will only add to this pattern.

Experts agree, therefore, that Russia is an *ailing* petrostate. Where there is less certainty, however, is under what conditions Russia will turn into a *failing* petrostate. This article discusses three possible sources of instability: shifts in international energy markets, the challenge of climate change, and the breakdown of the social contract at home.

Oil and Gas Developments

Changes in global energy markets (the fracking revolution and the rise of China as a major customer) have shifted the equation of risks and rewards in Russian energy exports. Increasing global economic integration has left Moscow vulnerable to fluctuations in world markets, and post-Crimea sanctions revealed its exposure to Western interruption of access to cheaper capital and key technologies needed for off-shore Arctic development. Russia sees itself locked in an “energy war” with the US – and one that it is losing. At the St. Petersburg Economic Forum in June 2019 Rosneft head Igor Sechin said “the United States uses energy as a political weapon on a mass scale” and accused it of practicing “energy colonialism” with its sanctions on Iran and Venezuela.⁹

The basic patterns in the political economy of Russian energy remain unchanged. Gazprom uses its export revenue from sales to Europe to subsidize domestic consumers. Despite efforts to increase the domestic price, in 2017 the domestic price was still only \$3.80 /MMBtu against an export price of \$9.20.¹⁰ A 2006 decision to

increase the domestic gas price to European netback levels was ended in 2013 when the price was indexed to inflation, to avoid social unrest.¹¹ Due to the shale gas boom the US has taken over the spot as the world’s top gas producer, but Russia remains the #1 exporter, with 15% of the global gas market.¹² It supplies 25% of the gas used by the EU and 33% of the gas that the EU imports. The EU demand for gas is expected to fall from 600 bcm to 500 bcm by 2030, but with the Norwegian fields past peak, non-Russian European output will also decline from 300 to 200 bcm, so the continent’s dependence on gas imports will not shift. The future of gas hinges in large part on policies in response to climate change (see section below).

Meanwhile, the fall in US demand for gas imports and the construction of LNG export facilities in the US has led to strong downward pressure on European and Asian gas prices, which Gazprom has been forced to match in order to maintain market share. In 2012 Gazprom earned \$64 billion from exporting 217 bcm to Europe: in 2016, it earned only \$37 billion, even though its export volume grew to 262 bcm.¹³

Due to rising demand from China, the impact of the fracking revolution on the global oil price has been less severe than for gas. Nevertheless, the surge in US capacity thanks to fracking has put a cap on the global oil price of around \$70–80 a barrel. The hefty 60% depreciation of the ruble after 2008 enabled Russia to stay a competitive producer.¹⁴ Russia has continued to increase its volume of oil production. In 2016 Russia pumped 11 million barrels of crude oil a day, about 12% of the global supply, placing third after the US and Saudi Arabia.¹⁵ Russia is the world’s second largest oil exporter, and supplies about 20% of European oil consumption. In December 2018 Russia started cooperating with OPEC, pledging to take 228,000 barrels/day off the market. A coalition of 14 OPEC members plus 10 other countries agreed to cut output by a total of 1.2 million b/d. In July 2019 the agreement was rolled over for another nine months.

With the opening of a new oil export pipeline in 2009, China overtook Germany as Russia’s largest trading

9 Zhdanikov, Dmitri. 2019. “Russia’s Sechin Accuses U.S. of Using Energy as a Political Weapon.” Reuters, 6 June. <https://www.reuters.com/article/us-russia-forum-sechin-usa/rosneft-ceo-accuses-us-of-using-energy-as-a-political-weapon-idUSKCNIT70V0>

10 Astrasheuskaya, Natassia. 2019. “Gazprom takes on Chechnya.” *Financial Times*, 11 February. <https://www.ft.com/content/ea70de6c-2a30-11e9-a5ab-ff8ef2b976c7>

11 Mitrova, Tatiana. 2016. *Shifting Political Economy of Russian Oil and Gas*. London: Routledge, 17.

12 International Energy Agency (IEA), <http://energyatlas.iea.org/#!/tellmap/-1165808390/0>

13 Foy, Henry. 2018. “Russia’s \$55 bn gamble on China’s demand for gas.” *Financial Times*, 3 April. <https://ig.ft.com/gazprom-pipeline-power-of-siberia/>

14 Yermakov, Vitaly. 2019. “Russia’s hydrocarbon rent” Harvard University Davis Center, 9 May.

15 IEA. <http://energyatlas.iea.org/#!/tellmap/-1920537974/0>; US Energy Information Administration, <http://www.eia.gov/beta/international/rankings/#?cy=2015>.

partner in 2011.¹⁶ However, even under the most optimistic scenarios Russia will only be supplying 20–25% of China's total oil and gas imports, so is not in a strong bargaining position, added to which it has relied on Chinese loans to finance these projects.

For the past two decades Russia has resolutely followed a strategy of diversifying its oil and gas export pipelines to reduce its vulnerability to transit countries such as Ukraine and Poland. The Nord Stream gas pipeline across the Baltic to Germany became operational in 2011, adding 55 billion cubic meters to Russia's existing 245 bcm export capacity. Construction began on Nord Stream 2 in 2018, which will double its capacity. However, the pipeline has run into several legal obstacles. It is still awaiting approval from Denmark since it must transit Danish territorial waters near the island of Bornholm.¹⁷ (Soviet troops occupied that island in 1945, but Stalin later gave it back.)

Russia signed the EU's Energy Charter Treaty in 1994, but never ratified it, and refuses to comply with its mandates. In 2018 the EU settled its long-standing lawsuit against Gazprom, aimed at forcing it to conform to the Energy Charter and allow third-party access to its pipelines. However, on 10 September 2019 the EU's General Court in Luxembourg overturned the European Commission's October 2016 decision to allow Gazprom to feed Nord Stream gas into the German system through the OPAL link. Gazprom will be limited to 12.8 bcm of OPAL's 36.5 bcm capacity.¹⁸ The court argued that the Gazprom deal was in breach of "energy solidarity," because it failed to take into account the impact on Poland. Critics such as Vladimir Milov argue that Russia did not need export pipelines such as Nord Stream on either national interest or commercial grounds – since Gazprom now has excess export capacity.¹⁹ Milov argues the pipelines were built to line the pockets of the construction companies owned by Putin cronies Gennady Timchenko and Arkady Rotenberg that get the contracts to build them.

Meanwhile in Ukraine even after the annexation of Crimea, some Russian gas continued to flow across the

country – the volume fell from 71 bcm in 2011 to 31 bcm in 2014 but was back up to 87 bcm in 2018. The contract is up for renewal from January 2020, and assuming Nord Stream comes fully into operation Gazprom was planning to cut the Ukrainian transit to below 15 bcm. In 2018 the Stockholm Arbitration Institute awarded Ukraine \$4.6 billion in compensation from Gazprom for gas transit fees, minus \$2 billion which Naftohas owed for 5 bcm of gas it had used and not paid for. (The decision is being appealed.)

Climate Change

On 23 September 2019 Putin surprised observers by ratifying the 2015 Paris Agreement. He did so by presidential decree rather than through a new law, by-passing opposition in the State Duma. For many years Putin had derided climate change, saying in 2017 "The issue is not stopping it because that's impossible, since it could be tied to some global cycles on Earth or of planetary significance."²⁰ It is unlikely that Putin's change of heart was driven by the mounting scientific evidence, nor by the forest fires and droughts that have been afflicting Russia.²¹ Rather, his action probably reflects a pragmatic calculation that the EU's mounting determination to tackle climate change will lead to regulations that could limit exports from Russian corporations. Now, the Kremlin's narrative is switching from climate change denial to Russia as its biggest victim.

Russia had reluctantly signed on to the 1992 Kyoto Protocol, aware that setting a target of 25% carbon emissions reduction from 1990 did not require any substantial policy shift, given the collapse of Russian manufacturing in the 1990s. As of 2019 Russian emissions are 26% below their 1990 level, so reaching the 30% reduction pledged under the Paris Agreement will not be too difficult.²² While economic activity inside Russia accounts for 11% of total global carbon emissions (behind China at 22% and the US at 13%), it is world leader when it comes to exporting carbon, at 2 billion tonnes a year, ahead of Saudi Arabia at 1.4 bn.²³ Rus-

16 National Bureau of Asian Research. 2018. *The Emerging Russia-Asia Energy Nexus, Special Report no.74*, December. <https://www.nbr.org/publication/the-emerging-russia-asia-energy-nexus/>

17 Kuznir, Julia. 2019. "The impact of EU regulations on Nord Stream 2," *Russian Analytical Bulletin*, 6 June, 9–13; Sididi, Marco. 2018. "German debates and policies on Russia 2014–17." In *EU Members States and Russia*, edited by Marco Sididi, 28–40. Finnish Institute of International Affairs, March.

18 <https://www.spglobal.com/platts/en/market-insights/podcasts/focus/092719-european-pvc-interview-yves-heroes-kemone>

19 Milov, Vladimir. 2019. "Energy dependence." In *Russia 2030 Scenarios*, 9–20. Washington, DC: Free Russia Foundation.

20 Doff, Natasha, 2019. "The cold calculus behind Putin's lukewarm embrace of the Paris Pact," *Moscow Times*, 23 September. <https://www.themoscowtimes.com/2019/09/23/the-cold-calculus-behind-putins-lukewarm-embrace-of-paris-pact-a67383>

21 *The Economist*. 2019. "Why Russia is ambivalent about global warming," 15 September. <https://www.economist.com/europe/2019/09/19/why-russia-is-ambivalent-about-global-warming>

22 Aris, Ben. 2019. "The cost of carbon in Russia," BNE, 26 September. <https://www.intellinews.com/the-cost-of-carbon-in-russia-braced-to-implement-the-paris-accord-168633/?source=russia>

23 Swann, Tom. 2019. *High Carbon from a Land Down Under*. Australia Institute.

sia plans to continue making as much money as it can from exporting oil, gas, and coal until the last possible moment – and using more coal to generate electricity, to free up gas for export. The 2011 Fukushima accident led gas lobbyists in Europe to promote natural gas as the “cleaner” carbon fuel, encouraging Germany and other countries to switch their power plants from coal to gas for a transitional period, until renewables and storage technology develop to the point where they can provide the bulk of electricity generation.²⁴

China has established itself as a global leader in solar and wind turbine technology. But rather than invest in conservation or renewable energy, Russia’s approach to diversifying away from fossil fuels is to build more atomic power plants – with an ambitious program to export them overseas. Russia has persuaded Hungary and Finland to build plants, though Bulgaria cancelled its contract after a new government came to power in 2016. Subsidies for Rosatom’s export program are a way to keep the military-industry complex happy and share with them some of the spoils from Russia’s hydrocarbon economy. Veli-Pekka Tynkkynen points out that with its vast forest reserves Russia has the potential to be a “green superpower,” but the current political and economic system is blocking policies moving the country in that direction.²⁵ Instead, policy is held hostage by the hydrocarbon elite who are trying to maximize short run profits. Russia is a particularly pernicious example of the potent inter-connections between market forces, security concerns, and climate change.

About the Author

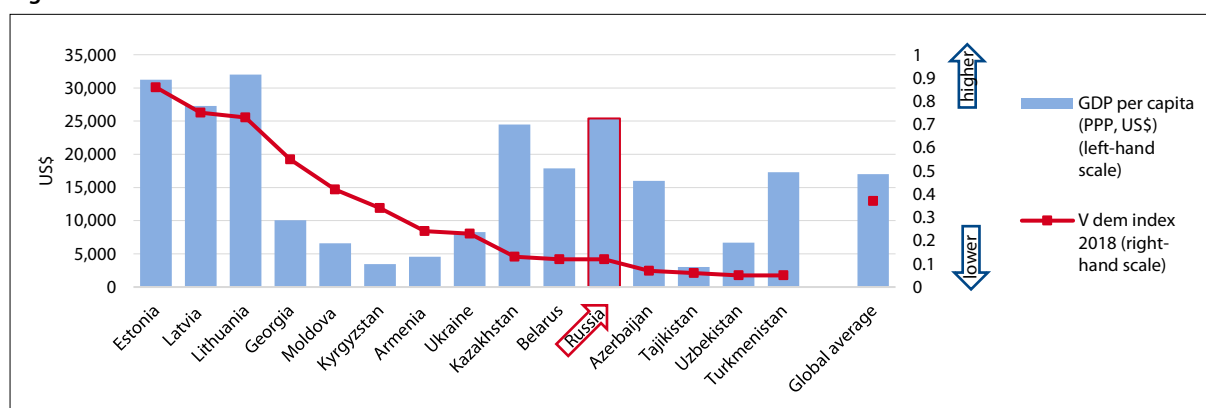
Peter Rutland is Professor of Government at Wesleyan University.

Growing Domestic Tensions

Putin has long been assumed to benefit from a social contract with the Russian population – he provides growing living standards in exchange for popular acquiescence to his continued rule. He has served as president for nearly 20 years, but living standards are stagnating for most Russians today and they no longer see the improvements in their lifestyles that defined the early years of Putin’s rule. These tensions are visible in the growing number of protests, such as those that affected Moscow during many of the summer weeks leading up to municipal elections in September. Signs of unhappiness are also visible in the Far East and other parts of the country, where regional voters are growing weary of the Kremlin’s heavy hand.

The uncertainty about Russia’s economic future eventually may undermine the stability that Putin has enjoyed for nearly two decades. If Russia’s current trading partners no longer want or need its energy exports due to changes in the energy markets and the growing pressure of climate change, the petrostate that supported Putin will no longer deliver the rents it currently produces. Russia has not yet begun to consider a life after petroleum. Nor has it made any serious progress in efforts to diversify its economy away from hydrocarbons. This lack of innovation may prove to undermine the status quo system and could provide an economic stimulus for political change in the not-too-distant future.

Figure 1: Political and Economic Performance in the Post-Soviet States



Sources: “V-Dem Annual Democracy Report 2018. Democracy for All?” V-Dem Working Paper, (May 2018). <http://dx.doi.org/10.2139/ssrn.3345071>; World Bank, GDP per capita (PPP). <https://data.worldbank.org/indicator/NY.GDP.PCAP.PP.CD>; see also Table 1 overleaf

24 Sharples, Jack. 2018. “Europe’s largest natural gas producer in an era of climate change: Gazprom.” In *Handbook of the International Political Economy of Energy and Natural Resources*, edited by Andreas Goldthau et al, 154–171. London: Palgrave.

25 Tynkkynen Veli-Pekka. Forthcoming, 2019. *The Energy of Russia. Hydrocarbon Culture and Climate Change*. London: Edward Elgar.

Table 1: Political and Economic Performance in the Post-Soviet States

	V dem index 2018	GDP per capita (PPP, US\$)
Estonia	0.86	31,250
Latvia	0.75	27,300
Lithuania	0.73	32,000
Georgia	0.55	10,045
Moldova	0.42	6,600
Kyrgyzstan	0.34	3,447
Armenia	0.24	4,572
Ukraine	0.23	8,300
Kazakhstan	0.13	24,483
Belarus	0.12	17,900
Russia	0.12	25,400
Azerbaijan	0.07	16,011
Tajikistan	0.06	3,015
Uzbekistan	0.05	6,662
Turkmenistan	0.05	17,286
Global average	0.37	17,000

Sources: "V-Dem Annual Democracy Report 2018. Democracy for All?" V-Dem Working Paper, (May 2018). <http://dx.doi.org/10.2139/ssrn.3345071>; World Bank, GDP per capita (PPP). <https://data.worldbank.org/indicator/NY.GDP.PCAP.PP.CD>

ANALYSIS

Effects of Russia's Food Embargo After 5 Years

By Stephen K. Wegren (Southern Methodist University, Dallas, Texas, USA)

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Abstract:

Russia introduced a food embargo against Western nations five years ago, essentially shutting off access to the Russian food market. This article assesses the effects and consequences of the embargo. In particular, the article examines the effects on domestic food producers, food exporters, and consumers. The conclusion considers whether the effects of the food embargo are easily reversible.

Macro Effects of the Food Embargo

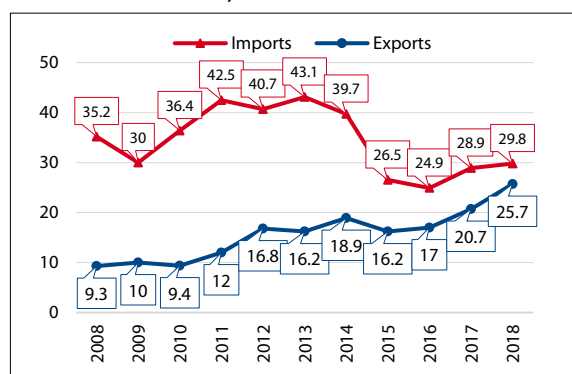
August 2019 marked the fifth anniversary of Russia's food embargo against the United States, members of the European Union, Canada, Australia, and Norway.¹ The embargo has been renewed annually ever since and most recently in June 2019 the Russian government announced an extension of the embargo to the end of 2020. The original decision for the food

embargo was a political message to the West that "we don't need you or your food." In terms of number of consumers, Russia represents the largest food market in Europe, so denial to its market is significant. Collectively, member states in the European Union have lost tens of billions of euros in food trade. The purpose of this article is to assess the economic effects of Russia's food embargo.

¹ In August 2015 the embargo was extended to Albania, Iceland, Liechtenstein, and Montenegro. There has also been a total ban on food imports from Ukraine since January 2016.

I start with three macro effects of the embargo, referred to as countersanctions in Russia. One macro effect of the countersanctions is that the value of Russia's food imports declined as would be expected from protectionist measures. The dollar value of food imports declined from a high of \$43 billion in 2013 to a low of \$24.9 billion in 2016 before rising in 2017 and 2018 as the economy recovered from recession and consumers opened their pocketbooks despite a drop in real income. Of note is the fact that since 2013 meat imports have fallen below one million tons annually and in 2018 totaled about 800,000 tons. In 2014, Russia imported over two million tons of meat and meat products.² Compared to 2013, the importation of frozen beef in 2019 is less than one-half its previous value; pork, poultry, and cheese are almost two-thirds lower; and seafood is down by one-third. For fruits and vegetables, the value of apple imports is about one-half the 2013 level and tomatoes are less than one-half, while citrus fruits, bananas, and soybean imports have increased. Figure 1 depicts the total value of Russia's food imports and food exports from 2008 through 2018 in US dollars.

Figure 1: Russia's Food Imports and Exports in Billion USD, 2008–2018



Despite the fact that the dollar value of imports has declined, Russia continues to import a lot of fresh and dried fruit, nuts, vegetables, beef, cheese, wine, spirits, processed foods, and snacks and juices.

A second macro effect of the food embargo is that Russia's trade partners for agricultural and seafood products have changed.³ Russia has increased its food trade

with Belarus, Turkey, Brazil, Ecuador, South Africa, Chile and Argentina, countries that are not subject to the food embargo. Prior to 2014 the European Union was Russia's primary trade partner in general and in food trade. Since the food embargo, China has become Russia's largest food trading partner. In 2018, Russo–Sino bilateral trade for all goods reached \$100 billion and the two countries expect trade to reach \$200 billion by 2024. Agricultural trade should track the rise in total trade. In 2018, food trade with China (both imports and exports) reached a record \$5 billion. In that same year Russia began to export pork to China for the first time in ten years. Russia's agricultural exports to China are likely to increase as a result of Trump's trade war because China has stopped buying soybeans from the U.S. which had been its largest supplier. In July 2019, China announced that it had reached agreement with Russia on phytosanitary standards that would allow importation of barley and soy from all Russian regions. Russia is also expanding agricultural trade with other Asian nations, targeting in particular Japan and Vietnam. Thus, five years after Russia's embargo began it is difficult to see how displaced Western nations can recapture a significant presence in the Russian food market.

A third macro effect is a reduction in imports of agricultural machinery. While a lot of attention is given to import substitution for food products, much less attention is devoted to the replacement of machinery imports, but this drive for self-reliance is as important as the substitution of food. The end goal is the same: increase self-sufficiency and thereby reduce vulnerability to Western actions. In 2017 Russia imported about one-half of its agricultural machinery used for food production and in the food-processing branch the percentage exceeded three-quarters.⁴ Starting in 2013 the federal government began to provide subsidies to domestic producers in order to revitalize agricultural machine building. Buyers of agricultural machinery also received subsidies. In August 2018 subsidies for domestic buyers were raised to 25–30 percent of the price of machinery, a policy that is costing the federal government R8 billion in 2019.⁵ The quest for higher self-reliance appears to be paying off. Since 2014, the annual value of production of domestic agricultural machinery rose from R32.5 billion in 2014 to over R100 billion in 2019. As

2 TASS, "Piatiletie prodembargo. Itogi i vektory razvitiia agropromyshlennogo kompleksa Rossii." August 6, 2019, <https://agrovosti.net/news/indst/pyatiletie-prodembargo-itogi-i-vektory-razvitiya-agropromyshlennogo-kompleksa-rossii.html>, accessed August 9, 2019.

3 Stephen K. Wegren and Christel Elvestad, "Russia's Food Self-Sufficiency and Food Security: An Assessment," *Post-Communist Economies*, 30, 5 (2018): 565–87.

4 Kvedomosti.ru, "Agrariyev ostavili bez traktorov." June 5, 2018, <http://kvedomosti.ru/news/agrariyev-ostavili-bez-traktorov.html>, accessed June 5, 2018.

5 "Piat let embargo. Polet normal'nyi." September 2, 2019, <https://agrovosti.net/news/indst/pyat-let-embargo-polet-normalnyi.html>, accessed September 2, 2019.

a result, domestic producers of agricultural machinery have increased their market share from 24 percent in 2014 to 60 percent in 2019.⁶

Overall, the food embargo reflected not only a preference to protect domestic producers but also a mindset that agriculture is a strategic sector worthy of governmental support. As a result, the state program for development of agriculture (2013–2020) allocates more money on an annual basis than any previous state program. In 2013, the agricultural sector was allocated R197.7 billion, which rose to R307.9 billion in 2019 (including money to promote food exports).⁷ The food embargo and associated policies of food self-sufficiency and food security reflect a shift in thinking that Russia cannot depend on the West and is better off distancing itself from it.

Effects on Food Producers

Protectionism from Western competition combined with a sharp increase in state financial support to agriculture contributed to a rise in domestic food production. The nominal ruble value of agricultural output grew by nearly 42 percent from R3.68 trillion in 2013 to R5.11 trillion in 2018. The ruble value of meat production (mostly poultry and pork) rose by 45 percent. The total volume of meat production from all producers increased from 12.1 million tons in 2013 to a record 14.8 million tons in 2018. Beef production, however, is stagnant and leading producers struggle with profitability as imported cheaper beef undercuts domestic production.

Turning to grain production, during 2014–2018 annual grain harvests averaged just under 115 million tons, a post-Soviet high. Wheat harvests averaged nearly 71 million tons annually from 2014 through 2018. In addition, the effort to reduce reliance on imported vegetables led to an increase in greenhouse production.⁸ Greenhouse production in 2019 is on track to produce 1.4 million tons, thereby representing a tripling in output compared to 2013 when production was 424,000 tons of vegetables. The main greenhouse products are tomatoes, peppers, and cucumbers. In 2014, Russia imported 60 percent of its tomatoes and cucumbers, today, only

38 percent.⁹ Overall, the area used for greenhouse production has increased by 1,000 hectares since 2014, and the area used for greenhouse production now exceeds 2,500 hectares. The increase in domestic vegetable output has an additional benefit in that it dampens the seasonal increase in vegetable prices that occurs each winter.

Producers of raw agricultural products have not been the only beneficiaries of the food embargo. Since the introduction of countersanctions, Russia's federal government has also emphasized the development of the domestic food processing sector, which grew by an average of 5 percent annually during 2015–2017. In 2018 output increased 7 percent with the value of output exceeding \$100 billion.¹⁰

One branch that has not benefited much from the embargo's protectionism is milk and dairy. The number of dairy cows continues to decline, milk production is essentially flat, and Russia has increased importation of milk and dairy products from non-embargoed countries such as Belarus. In 2013, milk and dairy imports totaled 5.5 million tons. During the first half of 2019, Russia was on pace to import 6.6 million tons of milk and dairy.

Effects on Exporters

Starting in 2014 Russia has had six consecutive years with grain harvest in excess of 100 million tons, a result of favorable weather and myriad state subsidies. Russia became the world's leading wheat exporter for the first time in agricultural year 2015/16 and then repeated in 2017/18 and 2018/19.¹¹ It is too early to say definitely for the 2019/20 agricultural year but Russia's wheat exports are estimated at 34 million tons which will rank first if forecasts for the United States are accurate.¹² In addition to an increase in food trade with China and in Asia, grain exports are also growing to the Middle East, specifically Egypt, Saudi Arabia, Iran, Morocco, and Syria.

Russia's large harvests revealed deficiencies in grain storage, transportation, and shipping.¹³ In response, the transition from a food importing nation to a food exporting country is underway. In 2019, R38.5 billion was included in the agricultural budget to support food exports. Some of the money will be used to improve

6 Ibid.

7 Minsel'khoz, "Za poslednie 5 let Rossiia sokratila import prodovol'stviia na tret'." August 5, 2019, <http://mcx.ru/press-service/news/za-poslednie-5-let-rossiya-sokratila-import-prodovol'stviya-na-tret/>, accessed August 8, 2019.

8 Importation of vegetables fell from 2 million tons in 2014 to 1.1 million tons in 2018. TASS, "Piatiletie prodembargo."

9 "N-TV (Germaniia): piat' let 'nutinskikh' sanktsii—tseny na produkty pitaniia v Rossii vzleteli." September 4, 2019, <https://agrovesti.net/news/indst/n-tv-germaniya-pyat-let-putinskikh-sanktsij-tseny-na-produkty-pitaniya-v-rossii-vzleteli.html>, accessed September 4, 2019.

10 USDA Foreign Agricultural Service, "Russian Federation Exporter Guide. Annual 2018." GAIN Report no. RS1911, July 12, 2019, gain.fas.usda.gov, accessed September 14, 2019.

11 An agricultural year is July 1 of one year to June 30 of the next year.

12 "Minsel'khoz SShA snizil prognoz po urozhaiu pshenitsy v RF v 2019–2020 sel'khozgodu." September 13, 2019, <https://agrovesti.net/news/indst/minselkhoz-ssha-snizil-prognoz-po-urozhayu-pshenitsy-v-rf-v-2019-2020-selkhozgodu.html>, accessed September 13, 2019.

13 Stephen K. Wegren, "Grain Production in Russia: Too Much of a Good Thing?" *Post-Communist Economies*, 30, 6 (2018): 835–46.

infrastructure and logistics for the transportation of grain to seaports. By 2024 more than R400 billion will be allocated to support an increase in food exports. Seaports are being modernized and expanded to handle higher levels of grain exports. Grain export capacity during the 2017/18 agricultural year was theoretically about 53 million tons, but actual capacity was approximately 40 million tons (estimates vary). By 2024, total seaport capacity is expected to increase to almost 78 million tons.¹⁴

Effects on Consumers

Countersanctions have brought two main consequences to consumers. First, countersanctions contributed to high food inflation during 2014–2015. Devaluation of the ruble and the import ban led to speculation and price gouging. Prices for meat and products have risen 30 percent since 2014 and experts point to a lack of competition that would restrain price increases.¹⁵ Since 2016, however, food inflation has been moderate, falling to just 1 percent in 2017 and 4.7 percent in 2018.

A second consequence of countersanctions has been a growth in black market food trade. Anecdotal evidence suggests that products from embargoed countries are available and the main consequence is not availability but price as consumers pay more for imported food. Belarus and Kazakhstan are most frequently identified by the Russian government as responsible for allowing the transit of “contraband” food through their countries into Russia and being complicit in mislabeling the country of origin for food products. The governments in Belarus and Kazakhstan vehemently deny responsibility and accuse Russian middlemen who seek high profits from black market sales. The Russian government continues to work bilaterally and through the Eurasian Economic Commission on regulations and policies that allow the tracking of country of origin and certification of product content. An associated problem to black market food trade is the increase in counterfeit food and inaccurate labeling of contents. Anecdotal evidence suggests that so-called “falsification” has increased since 2014,

particularly in milk and dairy products. The rise in falsification is attributed to less competition from Western products.¹⁶

Meanwhile, Russian consumers are affected because their government is attempting to stop food smuggling. Regular consumers in Russia are caught up in the inter-governmental struggle. In early 2019, rumors spread that small quantities of foreign food carried home by Russian travelers would be seized in airports and at border crossings. To calm fears, the government explicitly denied any intent to seize food for personal consumption.

Further, the debate over what to do with seized contraband food continues. In June 2019, the federal agency *Rospotrebnadzor*, which has oversight for food safety, suggested a moratorium on the destruction of seized contraband food which had been the standard practice.¹⁷ Since 2015 more than 32,000 tons of contraband food have been destroyed according to government sources.¹⁸ Consumer groups and some Duma deputies called on the government to distribute confiscated food to the poor. A few days after this suggestion was published, the federal agency *Rossel'khoz nadzor*, which is in charge of destroying contraband food, called the idea “stupid.”¹⁹ The Ministry of Agriculture does not support a ban on the destruction of contraband, arguing that if it is not destroyed it will appear on the black market. In August 2019, *Rossel'khoz nadzor* announced that the destruction of contraband food would continue through 2020.

Conclusion

Russia's food embargo began with a policy decision to punish the West for its sanctions. The embargo will end with a policy decision, although that does not appear to be in the cards anytime soon as neither Russia's political nor economic elites currently favor termination. In September 2019 Prime Minister Dmitry Medvedev claimed that agricultural producers requested that countersanctions be continued.²⁰ The question is whether the effects of the food embargo can be easily reversed. At first glance the answer appears to be yes. Food production can fluctuate according to weather and consumer demand.

14 Ekaterina Diatlovskaia, “Minsel'khoz predstavil proekt ‘Eksport produktsii APK’.” October 11, 2018. <http://www.agroinvestor.ru/analytics/news/30587-minselkhoz-predstavil-proekt-eksport-produktsii-apk/>, accessed October 11, 2018.

15 “N-TV (Germaniia): piat' let ‘nutinskikh’ sanktsii—tseny na produkty pitaniia v Rossii vzleteli.”

16 Elena Maksimova, “Opros: piat' let prodembargo—kakoi effekt?” August 7, 2019, <https://www.agroinvestor.ru/interview/news/32232-opros-pyat-let-prodembargo-kakoy-effekt/>, accessed August 8, 2019.

17 Ekaterina Diatlovskaia, “Rospotrebnadzor predlozhit zapretit' unichtozhat' produkty.” June 11, 2019, <https://www.agroinvestor.ru/markets/news/31891-rospotrebnadzor-predlozhit-zapretit-unichtozhat-produkty/>, accessed June 11, 2019.

18 “Rossiia eshche na god prodlila rezhim unichtozheniia sanktsionnykh tovarov.” August 26, 2019, <https://kvedomosti.ru/news/rossiya-eshche-na-god-prodlila-rezhim-unichtozheniya-sanktsionnykh-tovarov.html>, accessed August 26, 2019.

19 “Rossel'khoz nadzor nazval ‘glupoi’ ideiu Rospotrebnadzora zapretit' unichtozhenie produktov.” June 17, 2019, <https://kvedomosti.ru/news/rosselkhoz nadzor-nazval-glupoj-ideyu-rospotrebnadzora-zapretit-unichtozhenie-produktov.html>, accessed June 17, 2019.

20 “Medvedev zaiavil, chto sel'khozproizvoditeli schastlivi i prosiat ne otmeniat' prodembargo.” September 11, 2019, <https://agrovesti.net/news/indst/medvedev-zayavil-chto-selkhozproizvoditeli-schastlivi-i-prosyat-ne-otmenyat-prodembargo.html>, accessed September 11, 2019.

Food exports can rise or fall depending on supply and domestic demand. I would argue, however, that deeper systemic effects extend beyond policies and are becoming embedded into Russia's food system to the exclusion of the West. For example, supply chains between food producers and food processors, and between processors and food retail chains have formed that exclude Western companies. Domestic food producers are buying Russian-made agricultural machinery and equipment. As with all machinery and equipment, after-purchase ser-

vice, repair, and maintenance by domestic companies is at least as lucrative as the initial purchase. Domestic crop producers have access to high-yield seed that is developed and produced in Russia. Thus, when Putin predicted that Western companies would have a difficult time reentering the Russian food market, he had in mind not merely food but broader production linkages. These production linkages constitute the real legacy of countersanctions and they are not easily reversible.

About the Author:

Stephen Wegren is professor of political science at Southern Methodist University, Dallas, TX, USA.

ABOUT THE RUSSIAN ANALYTICAL DIGEST

Editors: Stephen Aris, Matthias Neumann, Robert Orttung, Jeronim Perović, Heiko Pleines, Hans-Henning Schröder, Aglaya Snetkov

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Editors: Stephen Aris, Matthias Neumann, Robert Orttung, Jeronim Perović, Heiko Pleines, Hans-Henning Schröder, Aglaya Snetkov

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Research Centre for East European Studies at the University of Bremen • Country Analytical Digests • Klagenfurter Str. 8 • 28359 Bremen • Germany

Phone: +49 421-218-69600 • Telefax: +49 421-218-69607 • e-mail: laender-analysen@uni-bremen.de • Internet: www.css.ethz.ch/en/publications/rad.html