

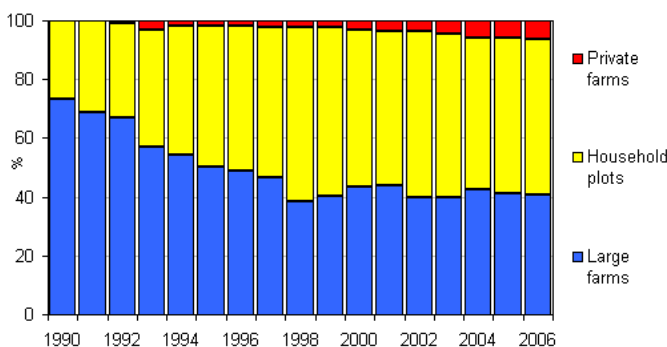
Merja Tekoniemi: Russia's agriculture facing challenges – state investment in market infrastructure needed

In light of statistics one can say that Russia's agricultural sector has both reformed and grown slowly. According to 2006 data agricultural output was nowhere near production levels reached in 1990. However, developments in the two main sectors have diverged. Crop cultivation reached the 1990 level a few years ago, whereas livestock production is still on a level hardly half that of 1990. In addition to these diverging developments between sectors there are some other significant differences within Russian agriculture.

Profitable mass production in a select group of farms...

In 2006 over half of agricultural output was produced on household plots, about 40% on large farms (established on the basis of former kolkhozes and sovkhozes) and the remaining over 6% on private farms. At the start of the 1990s, large farms still accounted for the majority of output, but their share fell until the crisis of 1998 and then levelled off at approximately 40%. The relative share of the population's own household plots rose in line with the shrinking share of large farms. The share of private farms is still small, but has clearly increased in the 2000s.

Chart 1. Russian agricultural output by producer sector



Source: Rosstat

At the beginning of the 2000s, vertically integrated holding companies emerged in Russian agriculture, often with main activities outside of agriculture. They

viewed agriculture as a developing sector offering quick profits and worth investing in. Some were enterprises operating in the food industry, keen to ensure the availability of raw material by creating their own production chains from field to shop. There is not much statistical data on these enterprises known as agroholdings, but the latest data collected by the VIAPI Institute and RosAgroFond (average figures for 2003–2005) indicates that concentration trend in the Russian agriculture has picked up in recent years. In 2005 there were almost 19,000 large and medium-sized agricultural enterprises in Russia. Of these, the 300 largest enterprises in terms of sales and profits produced 25% of total agricultural output and received 75% of total profits. They used less than 5% of the cultivated land used by all large and medium-sized enterprises. Differences between the best and worst performing enterprises in this group have increased continuously. Many regions seem to have one or a few very large holding companies that dominate the region's agricultural output.

The success of agroholding-type enterprises is based on deficiencies in Russian market structures and infrastructure, which these enterprises have overcome by their own efforts abetted by large injections of capital. There has thus been a market niche left to these enterprises, and a demand for their products. This relative advantage will disappear when Russian market economy structures develop. This is not likely to happen very quickly, however, and the existing holding companies have in any case a considerable competitive advantage. There is a risk that capital in the agricultural sector will become concentrated in the hands of a few large owners who can then act as monopoly producers in certain regions or federal districts.

... and farms on the brink of bankruptcy

The flip side of the coin for Russian agriculture is the old farms that have not attracted investment. Their buildings are dilapidated, and the machinery and equipment are outdated and run-down. Several of these farms have been kept alive artificially for years by state subsidies because they have been able to guarantee at least some level of livelihood for the

countryside. As part of so-called national priority programmes, Russia's agriculture has since 2006 received more support via both state and regional budgets. Farms are helped through subsidised loans and favourable leasing arrangements. Experiences of such measures have been very positive in some regions. On the other hand, some regions are not keen on using subsidies, and in some cases information on such possibilities is simply not available. Sceptics say that loans and subsidies will focus on regions that are already the best performers in agriculture and that the weakest regions will deteriorate further. In 2005 almost half of agricultural output was produced in 15 regions.

The challenges ahead

The dichotomy in agricultural output raises considerable challenges for the development of the sector. A country as big as Russia certainly needs both effective farms based on mass production and smaller farms for more small-scale local supply. Subsidising small farms and maintaining the vitality of the countryside – priorities specified in the national agricultural programme – are important objectives for large rural regions in particular. But it should be borne in mind that the objective cannot in practice mean continued subsidies to totally unprofitable operations merely on social grounds. Even though the share of profitable farms has increased clearly, a third of the farms are still unprofitable. Funds spent to support farms that have continued to record losses for years should be directed at rural areas as social benefits rather than production subsidies.

In order to increase domestic competition the state should invest in developing market infrastructure in particular. This applies to other industrial sectors as well, but in agriculture, in which products easily go off, fast delivery is essential. State infrastructure investments would establish the groundwork for enabling a still larger proportion of agricultural enter-

prises to compete with those companies that are currently doing well with the help of large own capital and by establishing their own production chains. At best this would help an ever larger group of companies that are currently struggling on the verge of profitability to become viable. In addition to measures referred to in the national priority programme, ie the improvement of machinery and equipment leasing and the development of credit systems, state investment in logistics is also needed. Moreover, problems relating to the functioning of agricultural land markets should also be addressed without delay.

In future, foreign competition will increase, although in the short term this will have no major impact on Russian agriculture. After the possible WTO accession, a transition period will be extended to help Russia to adapt to the new situation. Shortages in market structures and infrastructures and long distances in the country, among other things, are also discouraging foreign agents to get established in the Russian market.

Protectionist measures have played an increasing role in Russian trade policy in recent years, which can be seen expressly as a tactic for gaining time to adapt in terms of domestic output. That the development of livestock production has been selected as one of the agricultural priorities tells of the need to replace imports with own production. Indeed, imports are concentrated on livestock products in particular, whereas grain has been ample enough for export in recent years. Naturally, effort is needed to develop livestock production, which has been in poor condition ever since the beginning of the 1990s, but there is still a long way to go to an effective output model that entails large investments and produces large volumes at low unit costs. If this is what Russia aims for, it will have to pay a high price for greater self-sufficiency in meat production.

Merja Tekoniemi is an economist at BOFIT.