Will the Surge Continue in Russia's HVP Imports?

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One of the world's largest grain importers during the 1980's, Russia is now a top market for foreign high-value products (known as HVP's, or "value-added" products), notably from the European Union (EU) and the United States. The shift from bulk commodity imports to increased purchases of HVP's can be attributed to the region's transition from a state-run economy to a market-driven one, which has affected agricultural production, trade, and consumer demand. That, in addition to exporters targeting Russia with credit, food aid, marketing programs, and investment in wholesale and retail market infrastructure, is helping spur HVP imports.

As opposed to bulk products such as grains and oilseeds, HVP's include commodities that have been processed to some degree, or that are unprocessed but have a high per-unit value. Unprocessed HVP's include fresh fruits, nuts, and vegetables. Semiprocessed HVP's include products that require further processing for consumption, such as flour, vegetable oil, and frozen meat. Highly processed HVP's are ready for consumption with little additional processing, such as dairy products, prepared meats, dried fruits, and beverages.

Most of Russia's HVP imports go primarily to three major urban centers—Moscow, St. Petersburg, and Ekaterinburg—where the share of consumption made up by imports is reportedly as high as 80 percent for certain foods. These urban centers were the primary recipients of imports during the Soviet era as well.

While growth in Russia's HVP imports is expected to continue (albeit at a slower pace) over the next few years, it is likely that such growth will stabilize or decline as we turn into the next century. The pace of Russian economic recovery, future trade policies, productivity gains in the food sector, and changes in consumer preferences will affect the level of Russia's HVP imports over the next 5 to 10 years. Much of the outcome will depend on continued progress in implementing market reforms.

Market Reforms Help Spur Russia's HVP Imports

Rising HVP imports in most countries are usually attributed to increased economic growth and rising per capita incomes. Economic growth often generates improvements in transportation, which reduce shipping costs and make imports more competitive with domestically produced products, and improvements in information technology, which increase consumer awareness of the availability of different products and a preference for a more varied diet.

But in Russia's case, the economy has contracted each year since 1991. Real (adjusted for inflation) gross domestic product (GDP) in 1995 was only 65 percent of its 1991 level. Between January 1991 and November 1995, real personal incomes fell by one-third. Consequently, recent per capita consumption of HVP's, such as meat and dairy products, are 20 to 30 percent lower than 1990 levels.

According to Russian statistics, Russian imports of agricultural products (not including trade with other former Soviet Union countries) fell from $12.4 billion in 1991 to $8.6 billion in 1994, as imports of grains and oilseeds declined sharply due to contraction of the livestock sector and the need for less feed (table 1). Total agricultural imports seemed to have recovered somewhat in 1995, increasing to around $10 billion. Even though total agricultural imports fell during this period, Russia's HVP imports dramatically increased, and currently account for more than 90 percent of total agricultural imports (in value terms).

Ironically, the collapse of the Soviet centrally planned economic system and the introduction of market

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reforms are two of the main factors driving the shift from bulk to HVP imports. Under the Soviet system, agricultural production and consumption were highly subsidized, and output levels were based on government directives. The state also set all prices and controlled all foreign trade activity. Russia's market reforms, which include freeing prices, slashing subsidies, and reducing the state's role in production and trade, have spurred HVP imports as consumer preferences, not the government, determine demand. Moreover, agricultural trade is now more or less determined by relative prices, rather than by state plans.

In addition, exporters have recognized the potential for growth in HVP trade with Russia, a country of slightly less than 150 million people, with two large (more than 5 million inhabitants) urban areas, and the largest net food importer in the former Soviet Union (see box). Hence, exporting countries have targeted it with export credit programs and food aid, export subsidies, marketing schemes, and investment in retail/wholesale infrastructure to facilitate and expand HVP sales.

Price liberalization, one of the primary market reforms undertaken in Russia, has significantly altered domestic agricultural supply and demand. In 1992, most prices were freed from government control. Input prices rose significantly faster than the prices farmers received for their goods. Simultaneously, subsidies to producers and consumers were substantially reduced, leading to sharp declines in consumption and production.

Table 1
Russian Agricultural Imports Shift From Bulk to HVP's[1]

Commodity	1991	1992	1993	1994	1995
			1,000 tons		
HVP's:					
Meat (beef, pork)[2]	517	291	85	392	594
Poultry[2]	89	46	74	496	824
Butter	153	25	70	103	169
Dry milk	77	49	15	33	45
Citrus	266	43	172	609	455
Apples	156	79	81	261	381
Bananas	8	2	19	379	503
Wheat flour	556	944	54	13	234
Vegetable oil	201	463	93	127	352
Sugar	3,269	3,691	3,109	1,462	1,551
Coffee	45	35	13	26	26
Cocoa beans	17	24	22	58	56
Tea	143	47	55	85	142
Bulk commodities:					
Wheat	10,689	17,593	5,699	1,181	383
Barley	2,882	3,967	615	15	14
Corn	5,457	5,490	4,391	864	237
Rice	322	7	43	18	95
Soybeans	170	68	NA	NA	65
			Billion dollars		
Total agricultural imports[3]	12.4	9.6	6.0	8.6	9.7
			Percent		
Agriculture's share of total import value[3]	28	26	22	30	29

Notes: NA = Not available. [1]Imports from non-FSU sources. After 1992, these data do include imports from the Baltic countries. Data for 1994-95 are from the Russian Customs Committee. [2]Fresh/frozen meat. [3]In addition to traditional food and agricultural products, includes fish and seafood, alcoholic beverages, and tobacco products. Sources: Goskomstat Rossi, Statkom SNG, Russian Customs Committee.

The "former Soviet Union"

The Soviet Union was disbanded at the end of 1991, and 15 newly independent states were formed. The largest successor state to the Soviet Union is Russia, which is the focus of this article. However, due to data constraints and other considerations, it is sometimes necessary to use the term "former Soviet Union," which includes Russia and the other 14 independent republics (Ukraine, Belarus, Kazakhstan, Moldova, Uzbekistan, Tajikistan, Kyrgyzstan, Turkmenistan, Armenia, Georgia, Azerbaijan, and the Baltic nations of Estonia, Lithuania, and Latvia).

The term "Soviet Union" and the adjective "Soviet" are used when discussing events or trends that took place prior to the country's breakup.

The livestock sector, which was subsidized more than the crop sector during the Soviet era, was especially hurt by these changes. Herd size significantly declined as animals were slaughtered. Feed use declined, thereby reducing demand for grain and oilseed imports. Consumers were also affected, as prices rose due to the removal of subsidies, and real incomes sharply fell. As a result, consumer demand decreased, especially for livestock and dairy products.

The collapse of the Soviet centralized trade system resulted in the volume of food deliveries from the other former Soviet Union countries falling by more than one-half, further lowering supplies. These declines negatively affected the Russian food processing sector as processing costs grew sharply, making the sector less competitive with foreign producers. Although consumption of most HVP's fell after 1991, the decrease in the domestic supply was even greater and increased imports from sources outside the former Soviet Union filled the gap.

Privatization of state-owned property spawned the development of retail outlets, which are more responsive to consumer preferences. These developments have led to increased variety and availability of food and other products; improvements in quality, packaging, and other services; and growth in advertising and marketing activities. In addition, the distribution of income has become more uneven, creating new classes of consumers who are less price, but more quality, conscious. Many Russian consumers view imported HVP's as high quality and well-packaged, qualities which many domestic producers of HVP's have been slow or unable to duplicate. In addition, the domestic food processing sector is burdened with aging, inefficient equipment, leading to relatively high production costs. Coupled with the reductions in domestic supplies and increasing input prices described above, imported HVP's are also competitively priced.

Another factor contributing to the price competitiveness of imported food products is the movement in the real exchange rate of the ruble relative to other currencies. When measured without adjusting for relative inflation, the ruble has depreciated against major currencies such as the U.S. dollar and German deutschmark. But when the relative inflation between Russia and its trading partners is taken into account, the ruble has appreciated against the dollar and deutschmark since 1993, making imports relatively cheaper and enabling consumers to substitute imports for domestically produced commodities.

Export Assistance Also Contributed to Growth in Russian HVP Imports

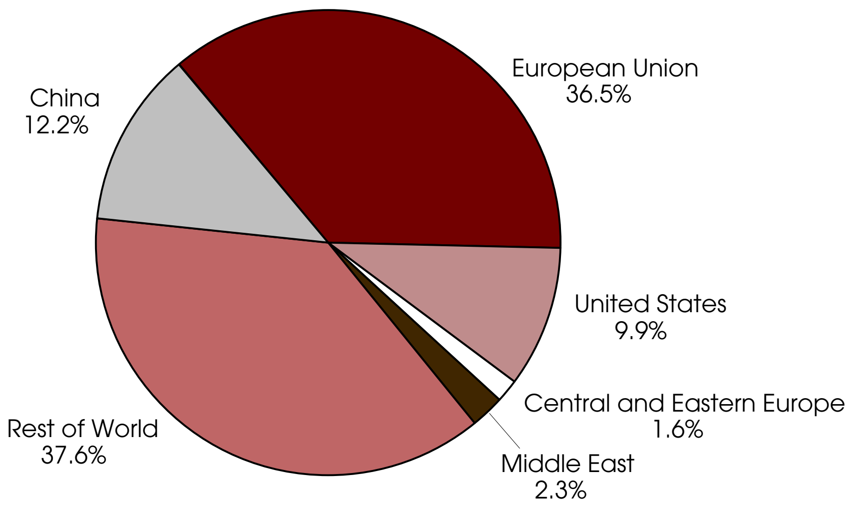
To some extent, the recent surge in Russian HVP imports can be attributed to food aid programs, such as concessional credit (longer term credit below market interest rates) and food donations, primarily during 1992-93. Commercial export credits and credit guarantees (which are provided by a government to reduce banks' risk in extending credit to an importer nation) also helped finance Russia's agricultural imports, especially during the first few years after the breakup of the Soviet Union.

During 1992-94, a large share of Russia's HVP imports (particularly oilseed meal, wheat flour, dairy products, vegetable oil, legumes, and other protein sources) were facilitated through commercial export, concessional credit, and food donation programs, provided mainly by the United States and the European Union (EU). More than 60 percent of total U.S. agricultural exports to Russia (of which HVP's made up around 40 percent) shipped in 1993 were provided through food aid or concessional credit programs. However, since 1995, the majority of Russia's HVP imports have been purchased commercially, although in some cases export subsidies and export credit and/or credit guarantees were provided.

The European Union Is the Largest Supplier of HVP's to Russia

Since 1992, EU countries have been the largest suppliers of agricultural commodities to Russia, providing almost half of Russia's HVP imports. Russia's imports of HVP's averaged $5.1 billion during 1992-93, and the EU supplied nearly 40 percent of that total (fig. 1). The EU's

Figure 1
Russia Imports Most of Its HVP's From the European Union



market share in 1994 was slightly higher, at 45 percent.

EU member countries (particularly Germany, France, Holland, Denmark, and Italy) have made significant inroads into the Russian HVP market due to their proximity, strong trade and investment ties, use of export subsidies and government credits, and reputation as a reliable supplier of quality products. Many European companies invested heavily in developing wholesale and retail outlets for their products, which has played a large role in establishing the EU as an important HVP supplier to Russia. In addition, during 1991-92, the EU extended for the first time two credit packages out of its general budget to Russia and the other countries of the former Soviet Union to help facilitate agricultural exports.

EU countries supply a wide variety of food products to Russia, especially highly processed products, and they have a strong presence in most of Russia's import markets—unlike other countries, including the United States. For example, in 1994, the EU held a market share of 40 percent or more in 6 of the top 10 HVP markets (table 2). While the United States was the single largest supplier of poultry meat (giving it a sizable share of the meat and meat products market), its market share was less than 15 percent in the other top 10 Russian HVP markets.

Although the EU's share of the Russian HVP market was relatively steady during 1993-94, its share in 1995 decreased due to increased competition from Asia (China and India), the Middle East (Turkey), and Central and Eastern Europe (Poland, Hungary, and Bulgaria). Ties between Russia and countries in Central and Eastern Europe are being re-established, thereby expanding trade among them. In 1995, for example, Russia was the second-largest agricultural export market for Poland and Hungary.

U.S. Market Share Small, But Growth Potential Large

The United States has traditionally been an important supplier of agricultural products to the Soviet Union and its successor states. U.S. agricultural exports to the Soviet Union increased from $1.5 billion in 1970 to $2.8 billion in 1989, and the region was one of the top destinations for U.S. grains and oilseeds. Until 1990, bulk commodities (primarily grains) made up 80 to 90 percent of U.S. agricultural exports to the Soviet Union. At the same time, agriculture's share in total exports (food and nonfood) to the Soviet Union was equally large.

The level and composition of U.S. agricultural exports to the region started to shift after the collapse of the Soviet Union at the end of 1991. Between 1991 and 1994, U.S. agricultural exports to the former Soviet Union decreased 60 percent to around $1 billion (although 1995 exports increased 35 percent). At the same time, the share of HVP's in U.S. agricultural exports to the former Soviet Union sharply increased, from 15 percent in 1988 to over 80 percent in 1995. Agriculture's share in total U.S. exports (both food and nonfood) to the former Soviet Union fell to around 30 percent. This shift reflects the fall in the region's bulk imports, as well as increasing consumer demand for U.S. nonfood products, such as electronics, clothing, and cars. Reduction of trade restrictions, which were adopted during the Cold War to limit technology transfers to the Soviet Union, may also explain the increase in some nonagricultural exports.

The value of U.S. HVP exports to Russia grew from $377 million in 1992 to $945 million in 1995, with the share of HVP's in total U.S. agricultural exports to Russia increasing from 35 percent in 1992, to over 90 percent in 1995 (fig. 2). In 1995, Russia became the 5th largest country market for U.S. HVP's (up from the 11th largest market in 1994). The leading U.S. HVP exports to Russia include livestock and dairy products, snack foods, fruits, vegetables, juices, and other beverages. In 1994, Russia became the top export market for U.S. poultry meat, and in 1995, U.S. poultry exports to Russia doubled in value to over $600 million.

The provision of export assistance and food aid was a significant factor in facilitating U.S. HVP exports and in developing consumer preference for many U.S. HVP items. Since 1992, the United States has provided Russia with a mix of credit guarantees, concessional credits, and food donations. Russia received 70 percent of total fiscal 1993 planned U.S. concessional credit and food donations to the former Soviet Union region, in part due to its suspension from the credit guarantee program during most of 1993 because of payment defaults.

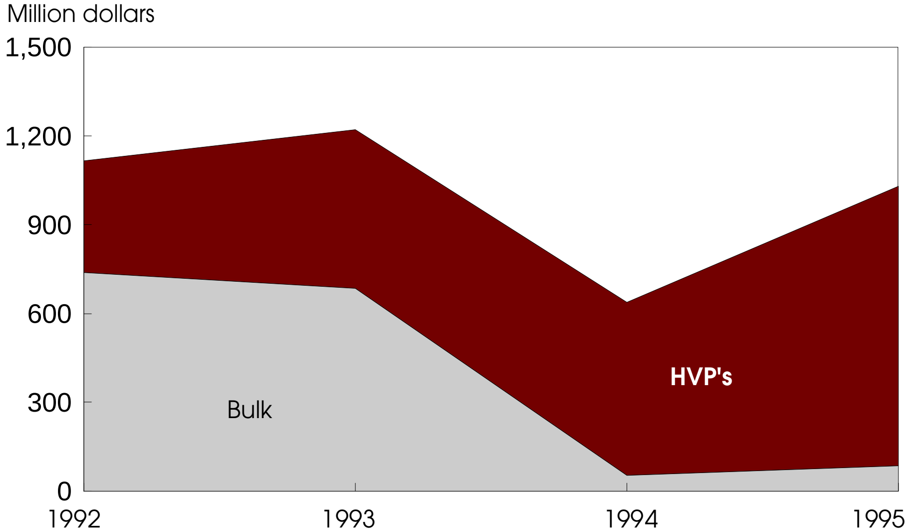
Table 2

EU Supplies a Large Share of Top Russian HVP Imports[1]

Product/exporter	1992	1993	1994	1994 share[2]
		Million dollars		Percent
Vegetables, fruits, nuts:				
US	21	31	65	4
EU	19	149	395	24
Meat and meat products:				
US	11	117	353	38
EU	178	322	402	43
Beef				
US	0	1	3	2
EU	162	169	162	**
Pork				
US	0	24	7	3
EU	0	52	116	47
Poultry--				
US	11	83	306	69
EU	16	90	86	19
Cocoa and products:				
US	3	77	35	4
EU	91	335	456	54
Sugar and confectionary:				
US	4	4	12	1
EU	162	362	123	16
Miscellaneous food products:				
US	1	2	1	0
EU	42	136	187	29
Processed meat:				
US	0	8	64	12
EU	139	276	275	52
Beverages:[3]				
US	4	14	9	2
EU	95	260	421	**
Processed grain products:				
US	0	8	6	2
EU	108	161	192	53
Coffee, tea, spices:				
US	5	11	13	4
EU	10	22	31	9
Oils and fats:				
US	46	24	5	2
EU	68	100	89	40

Notes: ** = Market share over 100 percent due to underreporting in Russian data. [1]From outside the Commonwealth of Independent States (CIS). [2]Share of exports in reported Russian imports. [3]Alcoholic and nonalcoholic beverages, excluding distilled. Sources: USDA/ERS, Eurostat, Russian Customs Committee.

Figure 2
U.S. HVP Exports to Russia Soar



Source: USDA.

In some cases, the provision of export assistance, especially when combined with competitive prices, helped to develop consumer preferences for U.S. HVP's, notably poultry meat. Poultry meat was included in the first credit guarantee package offered to the Soviet Union in fiscal 1991, as well as subsequent credit guarantee packages offered to Russia in fiscal 1992-93. With the first large U.S. poultry exports to Russia made during the Bush administration, these dark-meat parts became known in Russia as "Bush Legs," solidifying the association of affordable, easy-to-prepare poultry meat with the United States. Since 1994, Russian imports of U.S. poultry meat have been purchased commercially, without credit guarantees.

While the U.S. market share of the Russian HVP market is still relatively low (less than 15 percent of total imports from sources outside the former Soviet Union in 1994 and 1995), there is strong potential for growth. One reason for the relatively low U.S. market share is that many U.S. trade competitors (primarily the EU and Central and Eastern European countries) benefit from their closer proximity to the urban areas of Russia. As a result, U.S. exporters are focusing on the Russian Far East, a net food importing region that can purchase agricultural products from Pacific coast ports more cheaply than they can purchase Russian goods due to high internal transportation costs. This economic region contains nearly 8 million people, and in 1993, average monthly wages were nearly 80 percent higher than the Russian average, making it an attractive export market. As these activities expand and the U.S. presence at the wholesale and retail level grows, U.S. market share of the Russian HVP market could increase. Additional growth potential exists as U.S. exports of traditional bulk commodities to Russia are replaced by increased HVP sales.

Continued Strong Import Growth Could Slow Over Long Run

The increase in Russia's HVP imports will likely continue during the next few years and then level off or decline over the next 5 to 10 years. Russia's adherence to market reform and the rate of economic recovery will play a large role in determining the future for HVP imports. Positive economic growth in Russia could occur as soon as 1997. Economic growth and rising incomes would likely increase demand for imported HVP's.

A related factor is the movement of the real exchange rate. Although the Russian ruble has significantly appreciated against the dollar in real terms since 1993, it is likely that the rate of real appreciation will slow over the next few years. At some point the ruble will begin to depreciate, depending on how economic reform proceeds. If significant depreciation takes place, imported HVP's would become more expensive, and possibly less competitive.

The outlook for Russia's agricultural support and trade policies will also affect long-term prospects for its HVP imports. Currently, Russian agricultural support (including subsidies and debt write-off) is lower than during the Soviet era, and moderate, albeit increasing import tariffs exist for most agricultural products. However, calls for higher support and protection levels for Russian domestic producers through the implementation of higher tariffs, quotas, and other measures are rising.

For example, in an attempt to protect domestic poultry producers, Russia temporarily discontinued issuing import permits for U.S. poultry meat in early 1996, claiming that U.S. poultry did not meet its sanitary standards. At the same time, the import tariff on poultry was increased and a minimum import price was introduced. These steps were immediately challenged by the United States as unfairly restricting trade of agricultural products. Import permits resumed following negotiations between U.S. and Russian officials that resolved the sanitary issues and lowered the effective tariff rate. Other conflicts between domestic producers and foreign interests may develop, and the volume of HVP imports will depend upon how these conflicts are resolved in the future.

A major constraint to increasing domestic support is the lack of budgetary resources to finance such a policy. Moreover, if Russia wishes to join the World Trade Organization (WTO) it must conform with WTO disciplines on domestic support to agriculture and market access, which would reduce Russia's ability to introduce distortionary support and trade policies. However, if Russian support to agriculture grows and trade policies become more protectionist, HVP imports could decline much sooner than projected.

Some of the growth in Russian HVP imports has been the direct result of an expanded private sector. Despite lower purchasing power, consumers have clearly responded to the increased variety of products, both food and nonfood, as well as to advertising and other forms of market promotion, and purchased imported HVP's. As a result, some domestic firms are manufacturing similar items on their own or through ventures with foreign investors (see "Russian Food Processing Modernizes as It Opens to the World Market," elsewhere in this issue). Through transfer of technology and management skills, it is conceivable that Russia will be able to produce many of these products as efficiently as foreign producers, which would lower the demand for imported HVP's. However, this kind of recovery of Russia's food industry may not occur for another few years. And, the speed at which market reforms motivate producers to increase productivity and reduce costs will largely determine when they become competitive.

Several other factors will also affect HVP exports to Russia. Under the recent General Agreement on Tariffs and Trade (GATT) Uruguay Round agreement, member nations agreed to decrease and cap the level of export subsidies on agricultural products. The reduction of subsidies will result in higher prices that could make these exports less competitive with Russian HVP's. The effect of higher import prices may be amplified if the inflation-adjusted ruble exchange rate depreciates against the currencies of its trading partners and makes imports even more expensive. Also, U.S. export credit and food aid programs may face some reduction as expenditures are cut to reduce the Federal budget deficit. Similarly, the EU may face budgetary constraints as it expands to include Central and Eastern European countries. EU expansion is expected to substantially increase costs associated with the Common Agricultural Policy (known as CAP, the unified farm policy applied by EU members), unless expansion is accompanied by lower domestic prices and lower subsidies. Such changes may lead to higher world prices, lowering Russian demand for imported HVP's.

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