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Research Report

The rouble crisis and the Russian grain export controls

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The rouble crisis and the Russian grain export controls

Since 1 February 2015, an additional tax has been levied on Russian wheat exports to reduce the recently strongly rising wheat exports. The aim is to dampen further increases in the already high domestic wheat prices and to stabilise bread prices. However, recent experiences in various countries as Ukraine, Kazakhstan, Serbia, and Russia show that grain export restrictions do little if anything to moderate bread prices. Poor people will also fail to profit from this governmental market intervention. Instead, grain export barriers will disconnect the Russian grain producers from the international markets while necessary investments in the grain sector decline which decreases food security. This form of protectionism by the government is ample cause for serious concern. Considering the current downswing in the Russian economy, the destabilisation of the strategically important grain sector will most certainly not improve the investment climate in Russia.

The rouble crisis has unexpected consequences in Russia. Last year, Russian wheat farmers harvested a bumper crop. The 2014 wheat harvest was about 22 per cent larger than the average wheat harvest in the three preceding years (Rosstat, 2015). Yet, an export duty on wheat was levied. The levied tax is 15 per cent per ton but at least 35 euros per ton plus 7.5 euros per ton. The tax is not levied on exports into countries of the Eurasian Economic Union. At the time the resolution was adopted, the domestic wheat price had increased higher than the global market price (in roubles). The initial term of the regulation will end in June 2015. Since December 2014, the authorities have also used administrative barriers to hinder grain exports. Booking freight trains and obtaining export certificates has become cumbersome. Russian authorities explain the measures with the need to reduce the recent high wheat exports and to ensure adequate grain supplies for the domestic population; the idea is to put a stop to the domestic price increases for grain-based consumer products. Until January 2015 in the economic 2014/2015 period, the grain export increased by more than 30 per cent above the wheat export in the preceding year (Interfax, 2015). According to prevailing arguments¹, wheat producers find it more lucrative to export wheat in exchange for dollars than selling it domestically in exchange for roubles. This diminishes the domestic wheat

supply and in turn, leads to higher bread prices. The government measures are meant to ensure the adequate food supply for Russian people.

Given these circumstances, we seek answers to three pertinent questions, which we will discuss in this IAMO Policy Brief:

- Will the government measures have the desired outcome?
- How will the measures impact the overall economy of the Russian Federation?
- What are the impacts on the world markets and the German grain producers?

Efficacy of the adopted measures

For export restrictions to improve food security they have to bring down the domestic wheat prices thereby halting increases in domestic bread prices. Will export restrictions accomplish this? This is rather doubtful.

Firstly, Russian experiences with ad hoc export restrictions for the purpose of reducing prices in 2007/2008 and 2010/2011 show the following: While the restrictions temporarily halted the grain prices, this price consolidation was mainly seen at

¹ Deputy Prime Minister Arkady Dvorkovich. vestnikkavkaza.net/news/politics/65592.html

the producer price level. Even on this level, wide regional discrepancies existed in regional markets. The following examples demonstrate this: During the 2010/2011 export stop, wheat prices deflated by 70 per cent in the Northern Caucasus, the largest wheat producing region and the only region with direct access to the world market. On the other hand, only a 30 per cent deflation was seen in the far away Ural (Götz et al., 2014). When exports were taxed in 2007/2008, the deflation of domestic wheat prices was only temporary and price increases above world market prices occurred despite taxation. With the above experiences in mind, we expect a notable price damping effect as a result of the current export restrictions in regions such as the Northern Caucasus while the price deflation will be far less pronounced in remote areas, which primarily supply their grain to the consumer regions of Russia.

Secondly, in all likelihood, the value of the rouble will further decline. This supports the assumption that any price deflation will be of short duration. In the short time between 25 December 2014 and 10 February 2015, the Russian rouble lost another 30 per cent in value. Part of this rouble devaluation is caused by the sharp drop in crude oil prices. In the first six days of 2015, crude oil prices dropped just short of another 11 per cent. The rouble devaluation reduces the grain export prices in US dollars and gives Russian wheat producers a competitive edge in the global wheat markets. This counteracts the effect of the export taxation. Therefore, as a result of the rouble devaluation the wheat export will increase and the domestic wheat prices will keep rising.

Thirdly, increased storage counteracts any price damping effects. This can be explained with the fact that the export controls are initially put in place for five months. Foreseeably, wheat traders will store large amounts of wheat in expectation of higher domestic prices after the expiration of the export duty. Additional storage further decreases the available domestic supply and leads to higher prices. According to current expectations, the amount of stored grain will be more than 18 million tons at the end of the economic year. This will exceed even the stored grain volume during the 2010/2011 export ban (Agra-Europe, 2015)².

Fourthly, consumers will quite likely not experience any price reductions. For wheat export restrictions to have an effect on bread prices any decrease in wheat prices must be passed on to the consumer along all stages in the wheat-to-bread value chain. The 2007/2008 as well as the 2010/2011 export restrictions did not result in any notable price damping effects for consumers. In the spring of 2008, Russia imposed an export tax. Yet, the reduced wheat prices did not lead to the corresponding decrease in flour prices. Instead, the decrease in wheat price increased the difference between wheat and flour prices. While the mills increased their profits, consumers were still confronted with rising bread prices.³ It must be pointed out that food prices in Russia are currently subject to strict government control (Interfax, 2015; Agra-

Europe, 2015).⁴ To what extent the grain processing industry can actually be pushed into passing price decreases on to the consumer is everybody's guess.

Fifthly, even if the consumer price increases were to be slightly less, this would only marginally improve the security of the food supply. Food security is mostly a problem of poor households rather than an issue of general availability of food items. Assuming that these households spend a major part of their income on grain and grain products, the small reduction in grain prices will scarcely improve their nutritional situation. As is generally known, grain prices constitute only a small percentage of baked goods prices. Research indicates that a 17 per cent reduction in wheat prices in central Russia only leads to a 3 per cent bread price reduction in Moscow (Götz et al., 2014).

In summary, we doubt that in the face of the ever declining value of the rouble the export taxation will have a beneficial effect on the Russian domestic wheat prices, the bread prices or the food security of the Russian population. We expect the wheat export taxation to be largely ineffective.

Economic costs of the government measures

Aside from examining whether levelling the export tax will prevent bread price increases their economic costs need to be taken into account. It is also worthwhile to contemplate whether the measure is economically sensible.

We expect that the measure will only moderately halt the further increase in wheat prices. However, in the face of continuing rouble devaluation, this damping of wheat and bread prices would be short-lived. In the short term, producers and grain traders would experience loss in profit and income while consumers would hardly notice any price relief. Low grain prices are also beneficial for keeping farm animals.⁵

Secondly, unforeseeable government intervention in the grain market will make it impossible for Russian grain producers and traders to hedge against price fluctuations in international futures markets. With increasing risk for grain producers

² The government has already threatened enterprises with exclusion from government subsidies in retaliation for not offering enough grain for domestic consumption (Agra-Europe, 2015). However, it is unclear to what extent the government is able to control the sales volume of wheat for domestic consumption.

³ Bread prices increased as a result of higher energy and labour costs. The price lowering effects of the export restrictions were so small that they could not prevent increases in bread prices.

⁴ Due to the drastic devaluation of the rouble and the Russian sanctions against the import of agricultural goods, the prices of largely imported food items will increase. This will affect especially the fruit and vegetable supply (Agra-Europe, 2015).

⁵ A close relationship exists between wheat and feed wheat because the products are interchangeable. High wheat prices are usually accompanied by high feed wheat prices.

and storage facilities the costs of producing and storing grain will increase. As a consequence, growers will receive lower prices for their wheat from traders and the profitability of the wheat production decreases.

Thirdly, even if the government interferes with the wheat markets for a limited time only, the integration of the Russian grain market into the global market will be diminished for quite a while. Russia will become a less reliable and therefore less important grain supplying country. Grain import contracts for delivery after 30 June 2015 will be deemed uncertain. Since the current government restrictions may continue or even be tightened, Russian grain traders are unsure about their ability to export grain at predictable prices. Foreign importers will only be ready to assume the default risk of Russian grain contracts if the price of Russian grain is lower than the price of grain from other countries. This will lead to lower domestic prices, and Russian grain export prices will sink below the price of comparable grain from other countries. As a result, the Russian grain industry will be negatively impacted for the long term.

Fourthly, in the medium and long term, Russian grain producers will produce less grain due to lower prices and higher price risks. This will decrease Russian grain exports and disconnect the Russian grain sector from the international grain markets. Furthermore, investments in the development of the grain sector will likely diminish. Russia has a considerable growth potential in the grain sector with additional business opportunities. To realise this potential, comprehensive investments, especially private sector investments in modern technologies, are required (Glauben et al., 2014). Export restriction decrease private investments in the grain sector. Especially in times of recession, these investments could result in significant and welcome income opportunities.

Overall, the government measures lead to the separation of the Russian grain sector from the international markets. Grain producers and traders will suffer income losses while consumers profit little or not at all. In the long-term, necessary investments in the strategically important grain sector will diminish. This works against a more secure Russian food supply and consumer price moderation.

Impact on the global markets and the German grain producers

The short-term impact on the global grain market will be limited. Currently, the wheat and feed grain silos are well stocked. Therefore, we do not expect a significant impact on the global grain market. However, in the medium and long-term, we anticipate noticeable price increases due to the less reliable integration of the Russian grain sector.

The short and medium-term impact of the Russian export taxation on the German grain markets is awaited to be positive. The temporary Russian retreat from the traditional grain import countries

Egypt, Turkey, India, and Armenia opens additional export opportunities for German grain.

In the medium and long term, the Russian retreat from the global grain markets will have a negative impact on securing adequate food supplies to satisfy global needs. In 2012, the FAO and OECD estimated that the global grain production must increase by 30 per cent until 2050. As a large grain supplier Russia would be able to play a significant role in securing the global food supply.

Concluding remarks

According to the above findings, Russian politicians would be well-advised to forego government interventions in the Russian grain industry even though the rouble crisis will de facto lead to consumer price inflation. As past experiences show, additional taxes on Russian grain exports will not notably help the Russian consumer. This also applies to the poor population. On the contrary, in the medium term, export taxes will impede the strategically important Russian grain sector and slow production and trade with grain and grain products. This will decrease the integration of Russia's grain sector in international markets and will negatively impact the ability to secure sufficient food supplies for the Russian population. In the long run, export restriction will come at a high price for the Russian economy. Direct financial support for needy populations to assist in adapting to high consumer prices is a more efficient and in the long run, the more cost-effective response. The Russian Grain Union suggests providing food vouchers (Reuters, 2015).

The repeated restrictions on wheat exports are also not without consequences for the global food situation. According to projections by the USDA in December 2014 (USDA, 2014), in 2014/2015, Russia could be the second-largest global wheat exporter and fifth-largest global supplier of feed grains. The repeated encumbrances on Russian grain exporters contribute to a disintegration of the global grain markets. Russia could be an important grain export country and play a significant role in ensuring the future global grain supply (Glauben et al., 2014). However, permanent access to global markets is essential to actualise this potential. With this in mind, the current efforts to establish a free trade area between the EU and the Eurasian Economic Union are a positive sign.

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