In Aug. 15, 2010, Russian Prime Minister Vladimir Putin issued a decree halting all Russian wheat exports effective immediately. Export contracts for millions of tonnes of grain were suddenly canceled and world wheat prices quickly jumped by $100 per tonne as millers, traders and government importers all desperately strived to cover their shortfalls. There were widespread fears of a repeat of the food price spikes of 2008 which provoked demonstrations and riots in 61 countries.

To justify its actions, the Russian government called the devastation of the country’s grain crop by the worst drought in 130 years, and attendant wildfires, a force majeure situation threatening national food security. As it became apparent that the damage would extend to the coming year’s plantings, the ban was extended to July 1, 2011. Ukraine imposed similar restrictions. Given the continued tense grain balance, a further extension to the fall of 2011 was not out of the question as of late January.

This unexpected reversal in Russia’s position in the global cereals trade has sparked a debate nearly as heated as the flames that scorched the Russian steppes this past summer. Was the decree really necessary? Whose interests did it actually protect? To what extent were domestic political considerations at play? Was the ban simply a case of pandering to Russia’s increasingly powerful meat and feed industry? When will Russian wheat return to world markets? Does Russia still
have the capacity to become the world’s number one wheat exporter within a decade, as had been widely predicted? How will the ban impact the structure of Russia’s domestic grain industry? Is the Russian government playing by WTO rules when it intervenes in grain markets with such a heavy hand? Given the ban and perception of heightened political risk, can Russia’s grain industry continue to attract the long-term private investment in wheat farms and storage, transportation and port infrastructure that is critical to realizing its wheat export potential?

THE WORLD NEEDS RUSSIAN WHEAT

Most informed observers agree that Russia’s wheat exports will return to previous levels for one simple reason: The world needs Russian wheat. Global wheat consumption has increased by 50 million tonnes in the last decade. In developing and rapidly urbanizing countries, especially in Africa, consumption should continue increasing for decades to come. Russia is one of the few countries with enough arable land to significantly increase wheat production. While the Russian harvest is notoriously subject to unpredictable weather extremes, its grain belt is so vast, stretching several thousand kilometers across five time zones from European Russia to the Altai region bordering China, that total crop failure is unlikely, notwithstanding the scale of last season’s drought.

Russia exports, which surged from just 2 million tonnes in 2002 to about 20 million tonnes in 2008, accounted for most of the rise in global wheat trade in that period. In the 2009-10 crop year, Russia’s share of global wheat exports peaked at 20%.

Russian grain production had climbed to over 100 million tonnes in 2008-09. Last summer’s inferno reduced the grain harvest by over 40% to just 62 million tonnes. Wheat production fell to 41.2 million tonnes, down from 61 million tonnes the previous year. Barley declined from 18.4 million to 8.4 million tonnes. The upcoming crop is forecast by USDA at just 60 million tonnes due to winter sowing reduced by 4 million hectares, another consequence of the drought, and despite a 7% increase in the harvested area to 35 million hectares.

On a much larger planted area, Russia was already producing 100 million tonnes of grain in 1992, shortly after the close of the Soviet era, but this was still based on an inefficient, centrally planned economy — yields were low and post-harvest losses high. Much wheat and barley already went for livestock feed, but with conversion rates about half of that in modern economies.

It is not just arable land available for planting that makes the medium and long-term-prognosis bright according to Gavin Snodgrass of ACG Trade SA, Geneva, which has an affiliated grain trading company and pig farm in southern Russia.

“Even the area they already plant could use a higher rate of inputs. They could easily increase yields with more inputs and better seed. We have already seen yield increases since 2002.”

Snodgrass added, “Exports could go up to 30 million tonnes. Some people are even predicting 40 million tonnes, but investment is needed in infrastructure.”

INFRASTRUCTURE GAPS

Increased grain storage and better port facilities are obvious needs. But Snodgrass also emphasizes bottlenecks in rail transport of grain as an obstacle to export growth.

“There is a terrific shortage of rail cars, and there are fewer every year,” he said. “In 2009, Russia had officially 28,000 grain cars, but only 22,000 were usable. By 2015, 70 percent of them will go out of service. Their average age is 24 years and they last only 30 to 35 years.”

The biggest holder of grain hopper cars is state-owned Rusagrotans. Private operator Baltrans ranks second.

Siberian grain traders have begun exploiting the surplus of shipping containers to move their grain by rail to ports.

When it comes to export terminals, Snodgrass said, “Novorossiysk port is at its max. Ships just get three-day slots. It can do 10 to 12 million tonnes per year. There is still a huge amount of truck traffic. During harvest there has been a 35-kilometer-long lineup of trucks to the port. There is a short window for shipments to take place. Tuapse is an alternative port, but there is only a single rail line. Right now cement and steel for Winter Olympics construction gets priority.”

Shipping Russian grain via Ukraine is
done, but Snodgrass said it is problematic. “Rusagrotrans doesn’t like to allow its railcars into Ukraine, because it is hard to get them back. It is difficult to use Ukrainian railcars to pick up grain in Russia. Now that there is a government friendlier to Russia in Ukraine, the situation might have changed.”

UNITED GRAIN COMPANY

One new player that is proposing to solve some of Russia’s infrastructure problems is United Grain Company (UGC), a state-owned national champion that was created by government decree in 2009. UGC took over the assets of 31 existing government-controlled operators in the grain sector. This included three export grain terminals including one at Novorossiysk.

At the International Grains Council meeting in June 2010, Sergei Levin, chief executive officer of UGC, estimated the need for grain infrastructure investment at $1.6 billion. He defined as critical the reduction of grain transport and port handling costs to levels closer to those in Europe and the United States. In an interview, Levin estimated, “It costs $75 to bring a tonne of Russian grain from farm to port for free-on-board delivery at an average, and may exceed $100 a tonne for grain from Siberia exported via Black Sea ports.”

For Russia to reach its potential as a global supplier, it is essential to reduce these costs, which are roughly three times the level in France.

UGC’s website contains a policy document dated June 2010 forecasting Russian grain production and exports to increase yearly by an average of 5 million and nearly 4 million tonnes, respectively, in a straight line projection that would have taken them in 2015-16 to 120 million and 37.8 million tonnes, respectively. The starting point was a forecast of 92 million tonnes and 19 million tonnes in 2010-11. A reset of these projections is in order.

DOMESTIC INDUSTRY

One of the original mandates of UGC...
was to give the Russian state a role in wheat exports which are dominated by global traders such as Glencore, Cargill and others.

Ironically, Russia’s export ban appears now to be strengthening the hand of the international companies in Russia’s grain market. Some major private Russian grain traders have been reported to have difficulties servicing their debts as a result of the sudden loss of export revenues. The result could be less availability of bank financing and even bank auctions of their physical assets like grain elevators. A sudden freeze up of credit had already harmed the sector’s development following the outbreak of the global economic crisis at the end of 2008.

As a matter of national policy, UGC reportedly is taking over some of these facilities, but the international grain companies with their deep pockets will exploit the opportunity as well to expand their increasing presence in Russia’s domestic grain trade. These developments have helped accelerate the long-term trend of concentration and integration of the entire Russian grain industry. Small and medium-sized players are increasingly falling by the wayside.

STATE INTERVENTIONS

With exports cut off, UGC has taken on a different role than the one originally envisaged. It has now become the main vehicle for government grain market intervention. Industry insiders estimate that UGC may have purchased 8 to 10 million tonnes of grain in the last two years in line with a more assertive national policy with regard to grain markets.

Up until the price spike this summer, state purchases have served to provide a floor price to farmers to ensure that grain production is profitable. Since the imposition of the export ban, these reserves are being released back onto the domestic market in an attempt to keep grain prices from spiraling upward in a time of shortage. For the time being, the policy has been successful with average Russian domestic grain prices $100 to $150 below international levels.

This latter policy is closely aligned with one of the key grain market policy goals of the Russian government during the last decade: the regeneration of the country’s feed and meat production and return to national self-sufficiency.

FEED AND MEAT INDUSTRY

If Russia’s grain traders have been the biggest losers from the export ban, the meat and feed industry have clearly been the winners. A sharp escalation of feed costs has been avoided, and producers of poultry, pork, beef and dairy products should be able to continue to take market share from imported products, thanks in part also to a system of ever shrinking quotas for meat imports.
The growth of the meat and feed industry since its almost total collapse following free market reforms in the early 1990s is truly remarkable. Meat production in the latest year rose 6% to 10.6 million tonnes. Poultry production in 2000 was only a few hundred thousand tonnes, and imports were about 80% of consumption. Since the ruble devaluation of 1997, there has been steady and growing investment in modern integrated poultry plants near all major population centers. Investment in swine production and more recently dairy have followed.

In 2010, the share of imports in poultry, pork and beef consumption are now only 16%, 18% and 24%, respectively, and they are expected to keep dropping in 2011, thanks in part to a system of import quotas that has protected domestic producers.

The government has stimulated growth by waiving all import duties on feed and meat production equipment and heavily subsidizing the interest rate on credits for purchase of domestically manufactured equipment.

Total Russian compound feed production is now estimated at around 27 million tonnes, with 14.6 million tonnes by independent producers, according to 2009 government statistics, and another 12 million tonnes by integrated swine and poultry operations, as estimated by industry sources. The U.S. Depart-
The Department of Agriculture estimates that 35 million tonnes of grain next year will go to feed use. Given the lack of significant maize production, wheat is the main ingredient in Russian poultry rations. Insiders estimate the ban immediately made an additional 5 million tonnes of high-quality wheat available to Russia’s feed industry. In early 2011, poultry feed producers were paying just $260 per tonne for wheat versus a maize price of $343 per tonne.

In the near term, it is apparent that not just global export demand, but domestic feed demand will continue to drive expansion of Russian grain production.

MARKET FRIENDLY ALTERNATIVE
At an industry forum in Novosibirsk in December, Arkady Zlochevskiy, president of the Russian Grain Union, an industry association representing grain traders, presented an alternative plan friendlier to free markets than an outright ban. His analysis showed that southern Russia would have a carryover of 5.9 million tonnes of wheat at the end of the 2010-11 marketing year. Zlochevskiy proposed that exports of 3 million tonnes of high-quality wheat that normally would be too valuable for feed use should be allowed from this zone near the Black Sea. At the same time, northern and central Russia should be allowed to cover their deficit of 3 million tonnes with imports of lower-cost feed grains.

So far this proposal appears to have fallen on deaf ears within Russia’s government. The only recent change to the embargo has been to allow the resumption of wheat flour exports. With wheat prices in Russia artificially low because of the ban, Russia’s millers should have no trouble competing in international markets.

CONCLUSION
In the near term, it is apparent that not just global export demand, but domestic feed demand will continue to drive expansion of Russian grain production. But with the country approaching self-sufficiency in meat, a new equilibrium seems likely, and the competition between the two sectors should subside, especially after grain production returns to the levels of 2008-09. Russia should then be able to resume its interrupted trajectory to global grain superpower status.