

Coordination as a tool to decrease uncertainty for market agents: the case of Russia's Ministry of Agriculture in 2000s

Andrei Yakovlev,

National Research University – Higher School of Economics

**IAMO workshop “Political economy of agricultural policies and land relations”
March 5-6, 2020 | Halle (Saale), Germany**

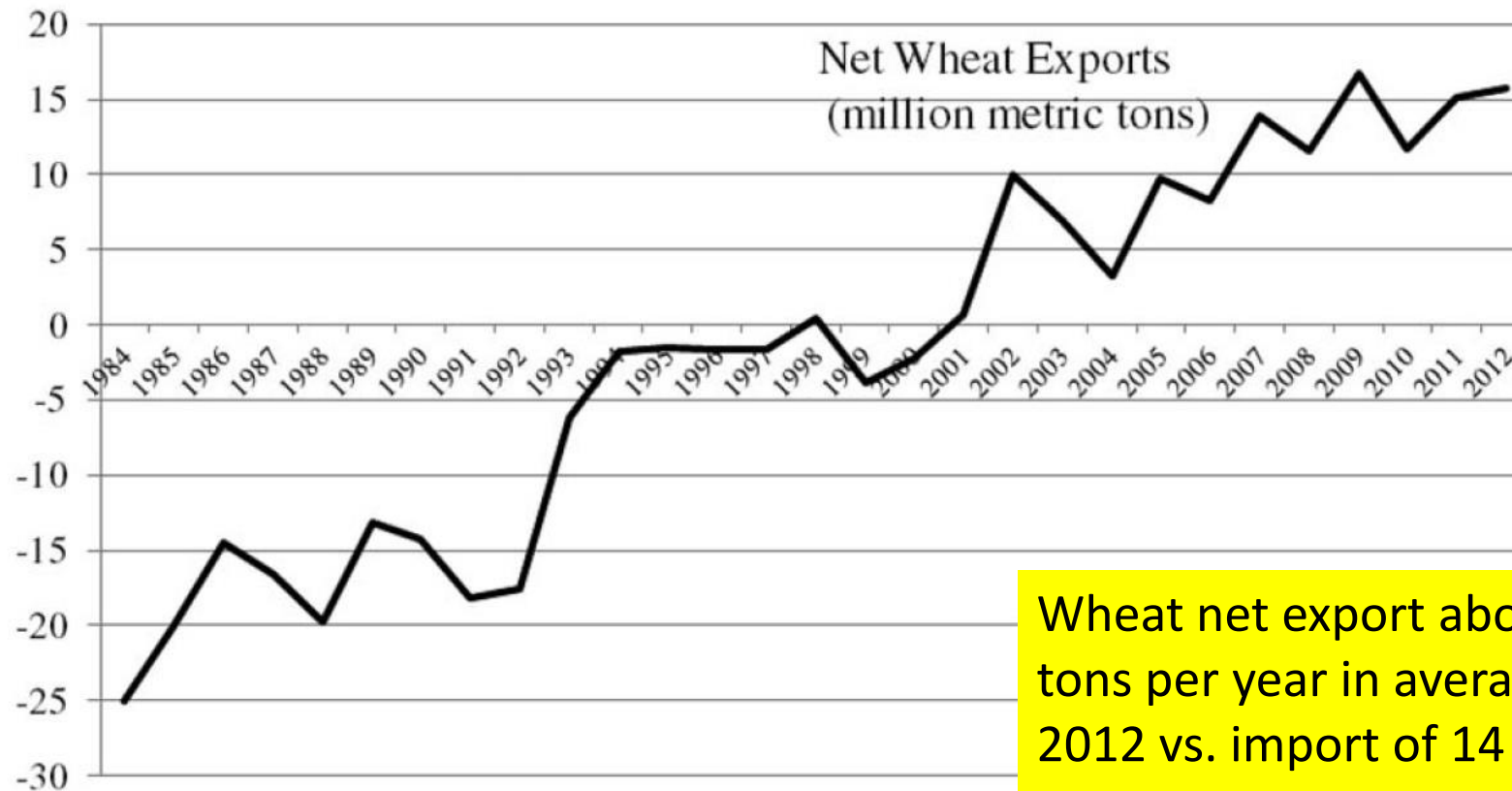
Content and the main ideas

- Introduction: main trends and contradictions in Russian economic development. Agriculture as success story. The reasons for it? The explanation of Susanne Wengle.
- New industrial policy approach of Dani Rodrik and its application to agriculture: Campania – Mozzarella case (Richard Locke paper)
- Alternative explanation for Russian case: two key problems for investment in agriculture – the lack of information on both sides (government and private sector) and uncertainty about sector development. Who and how could mitigate these problems?
- Conclusion with some implications for future research: ‘personality matters’ – especially in imperfect institutional environment. How to measure the impact of this factor?

FAO country profile – Russia

Indicators	1997	2007	2017
Population, total (mill.)	147.7	143.3	145.7
GDP per capita (USD, PPP)	14 051	22 799	24 791
Rural population, total (mill.)	39.4	37.9	36.8
➤ Employment in agriculture (%)	12,2%	8,9%	5,9%
Area harvested, crops (mill. ha)	59.3	52.2	62.5
Govt. expenditure on agric. (% total outlays)	1,8%	0,7%	1,7%
➤ Fertilizers use, nitrogen, as N (1 000 t)	654.2	1 043.8	1 512.8
Food production value (2004–06 mill. Intern\$)	47 246	47 952	65 616
➤ Agric. value added per worker (constant USD)	5 722	8 571	15 880
Cereal import dependency ratio (%)	5,7	-17,3	-30,1
➤ Food (excl. fish) exports (mill. USD)	819	6 577	14 485
Food (excl. fish) imports (mill. USD)	9 141	18 290	19 635

Russian wheat export

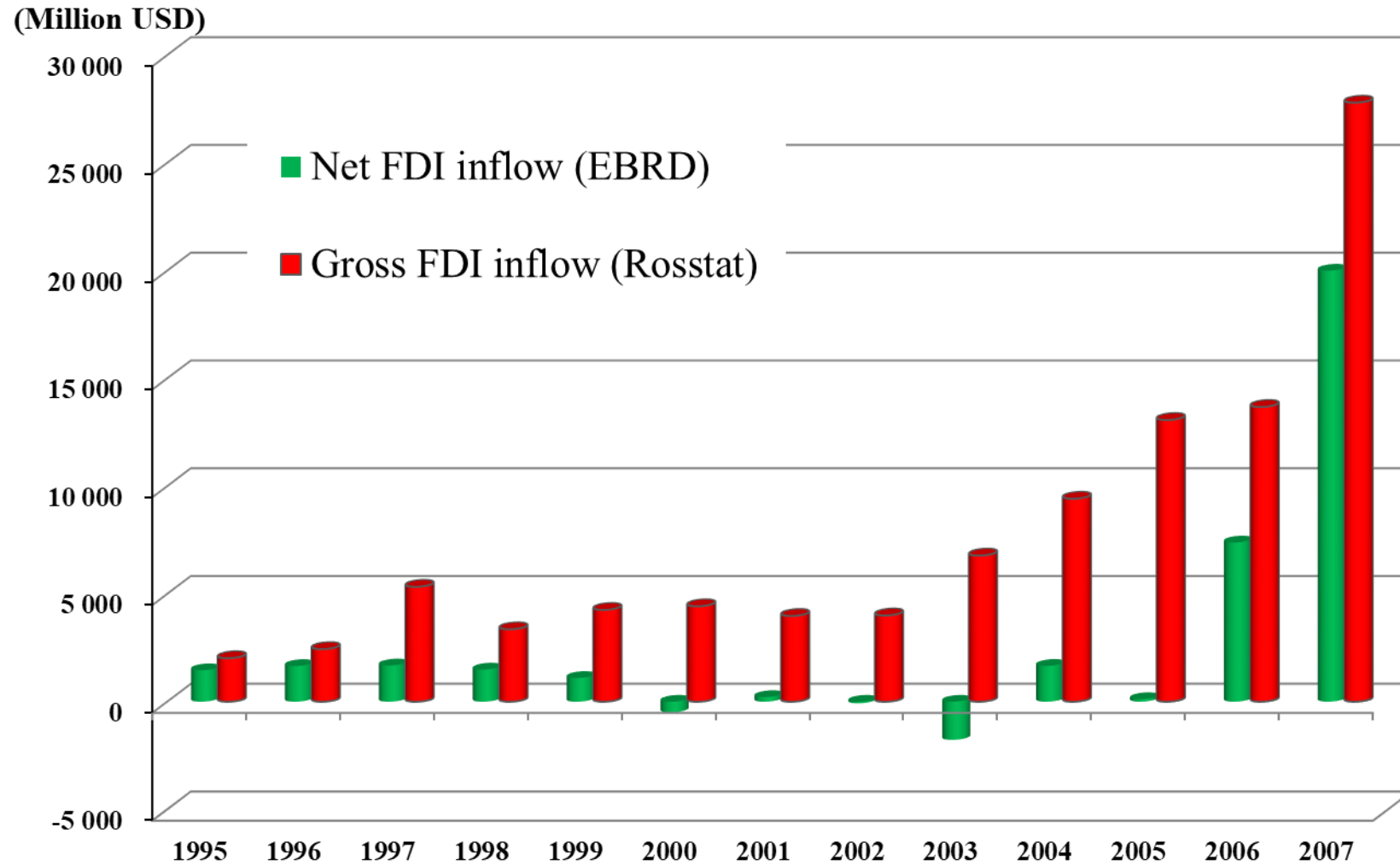


Wheat net export about 14 million tons per year in average in 2007-2012 vs. import of 14 to 20 million tons per year in 1987-1991

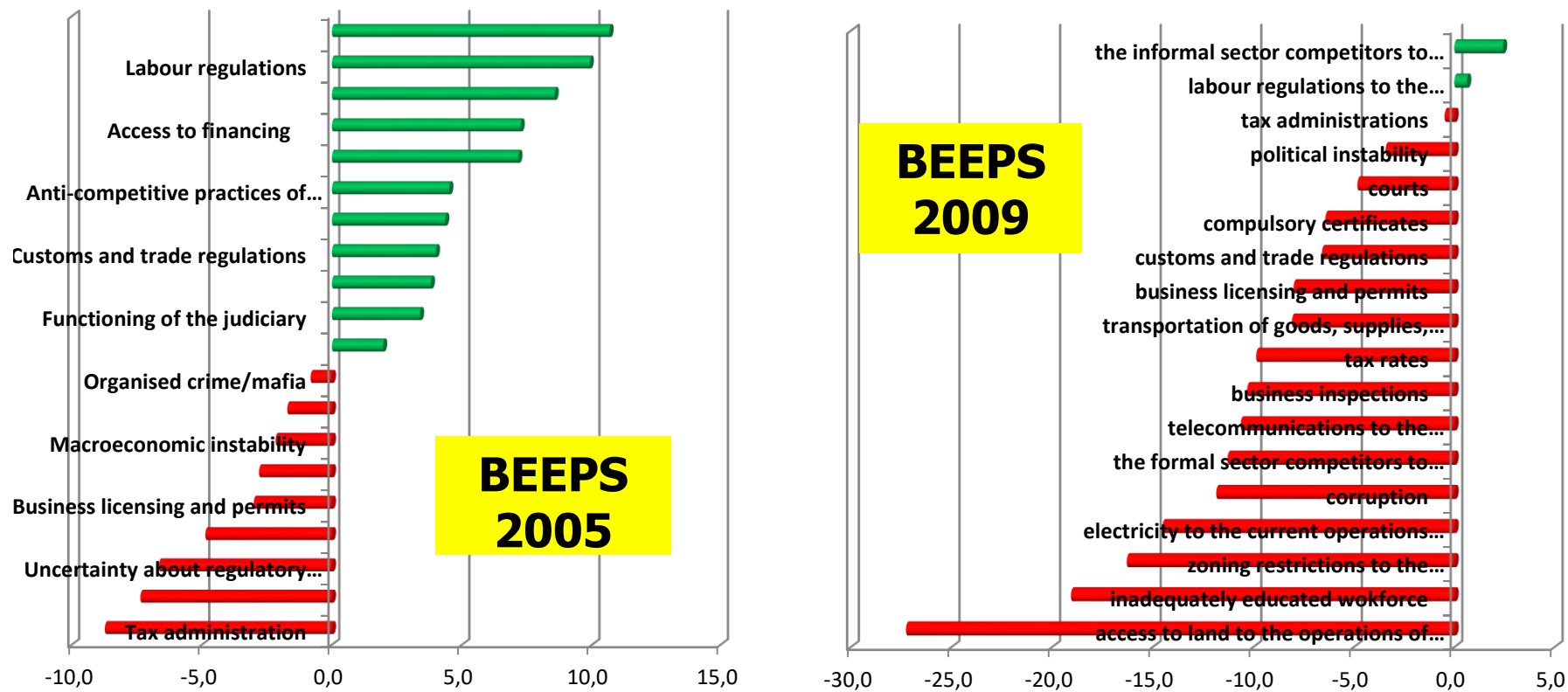
FIGURE 1 Russian net wheat exports (1984–2012)

Source: FAO (<http://faostat3.fao.org/home/E>)

Foreign direct investment inflow into Russia, 1995-2007



Changes in business climate



Conditions for doing business in Russia: “green = better” and “red = worse” comparing to CEE average indicators in BEEPS 2005-2009

Possible explanations of this ‘success story’?

Susanne Wengle (2018). “Local effects of the new land rush: How capital inflows transformed rural Russia”. *Governance*. Vol. 31, Issue 2 (April 2018), pp. 259-277:

- Clear improvement of state capacity in Russia after 2000 – but not in terms of ‘good governance’ concept actively promoted in 1990-2000s by international financial organizations and assuming transparency, accountability, rule of law and equal access to resources and opportunities for all actors.
- Political projects as the tool to realize political priorities → additional resources and preferential access to relevant markets not for all but for certain actors
- Food security agenda of Vladimir Putin (announced already in 2000, adopted as National Food Security Doctrine in 2010) as such political priority and new agricultural operators (NAOs) as main beneficiaries of this political project

Interesting but incomplete view. Putin as ‘political sponsor’ - yes, NAOs as main actors on the side of private sector – yes. But who and how did implement this political project on the side of government?

New industrial policy approach

Rodrik D. (2004). [Industrial policy for the twenty-first century](#). *KSG Working Paper*:

- Policy experiments to support catch-up development:
 - Import substitution, planning, and state ownership of 1960-70s
 - Economic liberalization and opening up of 1980-90s
- **But:** both set of policies could not provide sustainable growth in developing economies
- Developing societies need to embed private initiative in a framework of public action that encourages restructuring, diversification, and technological dynamism beyond what market forces on their own would generate.

New industrial policy

The example: Taiwan has traditionally grown and exported sugar, an industry that in 2003 has fallen into hard times due to low international prices and other reasons. What should now be grown in the fields to replace the sugarcane that is the source of income for many farmers? In many countries, the result would have been a depressed rural sector, increasingly indebted farm households, and a drag on the economy. In Taiwan, the response has been a \$65 million government investment program to develop a world-class orchid industry. The government pays for a genetics laboratory, quarantine site, shipping and packing areas, new roads, water and electrical hookups for privately-owned greenhouses, and an exposition hall — in fact everything except for the cost of the greenhouses. It also provides low-interest credit to farmers to help them build the greenhouses.

(New York Times, August 24, 2004)

New industrial policy

- Two key problems – information externalities & coordination externalities
- *Information externalities*: cost discovery in new activities. Entrepreneurs must experiment with new product lines.
- **But:** this is an activity that has great social value and yet is very poorly remunerated. If the entrepreneur *fails* in his venture, he *bears the full cost of his failure*. If he is *successful*, he has to *share the value* of his discovery *with other producers* who can follow his example and flock into the new activity.

New industrial policy

- *Coordination externalities*: In orchid case in Taiwan an individual producer contemplating whether to invest in a greenhouse needs to know that there is an electrical grid he can access nearby, irrigation is available, the logistics and transport networks are in place, quarantine and other public health measures have been taken to protect his plants from his neighbors' pests, and his country has been marketed abroad as a dependable supplier of high quality orchids.
- But all of these services have *high fixed costs*. → Profitable new industries *can fail to develop* unless upstream and downstream investments are coaxed **simultaneously**.

New industrial policy

Elements of institutional architecture:

- Political leadership at the top – high-level political support
- Coordination and deliberation council(s) supporting private-public interactions, searching and gathering information on investment ideas, achieving coordination among different state agencies when needed, pushing for changes in legislation and regulation to reduce transaction costs, etc.
- Mechanisms of transparency and accountability – industrial policies need to be viewed by society at large as part of a growth strategy.

Development of coordination: Campania – Mozzarella case

Locke R.M. (2001). 'Building Trust'. Paper presented at the APSA Annual Meeting. San Francisco, California. September 2001.

Campania (South Italy):

- Population of 5.8 million people
- unemployment rate = 25.8% (national average 9%, North – 5-6%)
- per capita GDP = 51% of Center-North Italy
- organized crime syndicates, as well as high corruption and clientelism

However: In this poor region around Caserta city could developed a vibrant cluster of buffalo mozzarella cheese production: about 200 producers of different size, employing approximately 20,000 people and producing about 500 million USD in annual retail sales

Campania – Mozzarella case

Some history:

- Mozzarella – traditional local cheese produced around Caserta from buffalo milk;
- Improvement of agriculture in 1960-70s → increase of production, sales in Rome, Milano etc.
- Distinct taste → high demand; limited supply → significant premium (profit margins – about 25%)
- But: incentives for some local producers to increase their production by adulterating their product → threat of undermining of quality and distinctiveness of the entire local industry

Campania – Mozzarella case

- **First step**: Four leading local firm came together and formed in 1981 *Consorzio Mozzarella di Bufala Campana*.
- Key idea – to lobby the support for the industry
- Main activities:
 - 1986 - the law mandated that all producers of buffalo mozzarella cheese individually wrap each piece of cheese in a paper indicating the name of the producer.
 - 1989 - the Consorzio applied for a Denominazione di Origine Controllata (DOC) from the Italian government.

Campania – Mozzarella case

Second step: government provides the support.

- In 1993, the DOC was granted and the Consorzio was given the right to enforce the correct use of the DOC, perform necessary controls, and to sue those who used this label illegally. In 1996, a similar recognition was granted to the Consorzio by the European Commission.
- Buffalo mozzarella is the only southern cheese in Italy to obtain a DOC (all other – in North).
- But: in the return for its grant of the DOC the Italian government insisted that ***any producer of buffalo mozzarella in the Campania region must be allowed to join the Consorzio***. Membership is voluntary and dues vary depending upon the level of involvement in the Consorzio and size of the producers. Consorzio members must follow very specific production procedures aimed at guaranteeing the quality of their products.

Campania – Mozzarella case

Evolution of the Buffalo Mozzarella Sector (rough estimates)

Year	Number of Buffalos	Production of Buffalo Milk (millions of kg)	Production of Mozzarella (millions of kg)
1960	27	-	
1970	55	-	
1980	103	65,5	
1990	143	102	8,2
1993	151		24,2
1996	170	150	35.40

Source: Consorzio Mozzarella di Bufala Campana DOC (Locke, 2001)

Campania – Mozzarella case

Third step: development of self-enforcement.

- Between 1987 and 1993, consumer groups conducted three independent investigations of buffalo mozzarella cheese produced by various local companies. The tests found that between 33% and 60% of the samples analyzed were in fact adulterated. → threat that customers began to discount the price of the product.
- To reverse this situation, the Consorzio established its own monitoring and inspection team for surprise visits of individual members to test their product.
- Fines for adulterating: \$6000 for the first time, \$12000 the second time, expulsion from the Consorzio a third time.

Campania – Mozzarella case

Monitoring and its Consequences for Consorzio Members

Year	Number of Samples Analyzed	% of Positive (adulterated) Results	Expulsions from Consorzio
1993		23%	
1994	165	15%	
1995	194	10%	2
1996	214	11%	6
1997	199	7%	2

Source: Consorzio Mozzarella di Bufala Campana DOC (Locke, 2001)

Campania – Mozzarella case

Next steps:

- the Consorzio has worked with the agricultural extension service of the University of Naples to develop ways of increasing the supply of available buffalo milk
- The Consorzio has encouraged local producers to experiment with pasteurization techniques, aimed at extending the life of the product and hence, making its export to distant markets more feasible.
- Finally, the Consorzio continues to promote collective marketing and sales efforts in Italy and abroad.

Today, Consorzio-affiliated buffalo mozzarella can be found in shops in the United States, Japan and Latin America.

Russian case: starting stage in late 1990s

- Soviet heritage of the sector: distorted prices and lack of incentives → inefficient production for many decades with permanent shortage of main products and deep dependence on the food import in 1980s.
- Production development: collapse of 1990s with deep decline of domestic production – due to breaking of old production and supply chains (based on plan directives and governmental procurement).
- Political constraints: Agrarian Party as junior partner of Communist Party. Regular bargaining between Kremlin and opposition – with subsidies for agriculture as one of tools. Not market performance, but electoral results in the regions with high share of rural population – as the main ‘indicator of efficiency’.
- Informational constraints: only statistical reports (with time lags and limited coverage) and reports of sectoral departments (with potential bias) are available for policy makers.
- As result: strong need for restructuring and investment but the sector was considered as a ‘**black hole**’ for the federal budget – without hopes to improve the situation.

Appointment of Alexei Gordeev to the position of Minister of agriculture in August 1999

Who is Alexei Gordeev?

- 1955: born in former DDR in the family of Soviet officer
- 1973-78 – study at Moscow Institute of Railway Engineers
- 1978-80 – service at Soviet Army
- 1981-86 – at different positions in Agroprom Committee of RSFSR
- 1986-91 – deputy CEO of Agriculture-Industrial Complex ‘Moskva’
- 1992-96 – deputy head of district administration in Moscow oblast
- 1996-99 – head of department, deputy minister at the Ministry of agriculture
- 1999-2009 – minister of agriculture and vice prime-minister (in 2000-2004)
- 2009-17 – governor of Voronezh oblast
- 2017-18 – presidential envoy in Central federal district
- 2018-20 – vice prime-minister (responsible for agriculture and ecology)
- Since February 2020 – deputy chairman of State Duma

Solutions for coordination problems

- One of first steps: Invitation for heads of sectoral business associations to participate at the meetings of ministry collegium. “Second opinion”: Reports of departments’ heads followed by reports of relevant sectoral associations. Broader picture of reality from contesting views presented by different associations.
- Minister became more prepared to lobby the interests of all sector in the government. But he needed more arguments → informal meetings with heads of the most active sectoral associations. Small offices provided for them in the main building ministry.
- Special article #16 in the Federal Law “On development of agriculture” – granting to agrarian unions the right to participate in elaboration and implementation of state policy in their sub-sectors if these unions represent agricultural producers which together provide more than 2/3 of total volume of relevant goods and services.
- ‘Selective incentives’ in terms of Doner & Schneider (2000) – associations get access to decision-making, therefore they can attract new members, receive more resources and provide more information and services for members but also for the ministry → in fact they start to produce public goods.

Price fluctuations as the source of uncertainty

Price volatility as specific feature of agriculture (especially in the grain market):

- good weather → large harvest → low prices → loses for many farms
- bad weather → decline in production → high prices → loses at next stages of value chain (food industry and other consumers)

High uncertainty for investors – as constraint for investment.

Governmental intervention in the market (buying excessive supply under too low prices and selling reserves in the case of shortage) – as possible solution

Federal Law #100 in July 1997 with special article about grain interventions – but without implementation mechanism and allocation of money.

2001: Decision to allocate financial resources – 6 billion RUB (about 230 USD millions).

August 2001 – resolution of government defining the rules of interventions.

November 2001 - first interventions.

Government interventions in Russian grain market

	Time period	Participants	Volume (RUB million)	Volume (million tons)
2001	14-23.11	15 trading firms	675	0,25
2002-2003	13.11-22.1	343 producers	4941	2,83
2005-2006	29.8-11.1	350 producers	5021	1,66
2008-2009	26.8-21.5	2153 producers	38060	8,06
2009-2010	2.11-4.2	1127 producers	6958	1,78

- A lot of critics – non-equal access for different market actors, limited impact (only 1,5-2% to 7-8% of domestic production). Only intervention of 2008-2009 (the biggest one) was evaluated positively by the most experts.
- More general view: Fund for grain interventions as important signal for market participants and investors (especially for large producers) → increase in investment

Conclusion and implications for future research

- A lot of studies on ‘bad equilibria’. But how it is possible to exit such institutional trap?
- Susanne Wengle: importance of political priorities at the top political level. ‘Political projects’ as the tool to change the bad equilibrium. National food security – as such priority for Vladimir Putin.
- But who and how can implement it? → ‘right people in the right places’ in the time of changes.
- How it is possible to describe such people? ‘Public entrepreneurs’ with technocratic background and experience both in private and public sector
- Long-term planning horizon (strategic documents as a proxy), active communications with business community (as an indicator of openness), personal characteristics (local origin, for instance), institutional building.