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The growth and performance of the Belarusian agro-food industry in 2004-2012

Abstract. This paper provides an analysis of agro-food industry growth in Belarus, which is one of the key industries in the economy. Such an analysis allowed us to understand the main forces of relatively successful development. We pointed out that state owned companies in the Belarusian agro-food industry operate as *de facto* strongly integrated corporate groups which ensures reliable supply of raw materials. In addition, we looked at the government directed lending programs which, through allocation of credit, push funds toward priority subsectors.

Key words: Belarusian agro-food industry, food processing, competitiveness.

Introduction

The data analysis showed us that the development of the Belarusian national agro-industrial complex fully depends on exports. Almost all successful food-processing enterprises made a major profit in external markets due to the much higher consumer prices there compared to the lower costs of production in Belarus.

Belarus has a small domestic food market and a rather high agro-food output that is above consumption level in many sectors (milk, sugar, meat etc.). Therefore the growth prospects of the industry depend heavily on its export capabilities, but they are also limited by a greater vulnerability to external shocks, especially when they coincide with increased export concentration.

In 2012 food products accounted for over 10% of total Belarusian exports. Russia remains Belarus's largest trading partner, accounting for more than 80 percent of food exports, whilst another 11 percent is accounted for by members of the Commonwealth of Independent States (CIS)³ [National Statistical Committee of the Republic of Belarus 2013].

Milk, meat and sugar industries are export-oriented and the most profitable, but there is little trade diversification. Russia purchases up to 95 % of certain food products. Other important markets are Kazakhstan and Ukraine, in which the Belarusian food industry has strong advantages. It is obvious that the dependence on the Russian market will increase in future years: particularly after the formation of the Eurasian Economic Union in 2015.

The government has a strong influence on the food industry, maintaining social stability. It limits consumer food prices and forces companies to supply the domestic market. This is feasible because the government owns the main share of the total capital.

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³ The statistical data include: Armenia, Azerbaijan, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan.

Obviously export was the only possibility for generating enough profit, since internal prices during some periods remained much lower than production costs [Shpak, Pilipuk, Baranova 2012].

Recent years have shown that agro-food industrial performance in Belarus has remained strong since 2005. Industrial productivity growth was broad based and driven by improvements to the existing enterprises rather than by new entities.

The principal issue of this paper is to delve deeper into the competitive advantages of the Belarusian food industry. It attempts to analyze available data about the main growth and productivity drivers of the Belarusian agro-food industry and enterprise restructuring; as well as the state system of enterprise support, which is key to understanding the economical and social interplay between the state and the agro-food industry in Belarus. The other part of the article includes a general analysis of food trade performance, including changes in the trade patterns, issues of export diversification and factors regarding export growth. The period of analysis covers 2004-2012. The main section reviews the government's policies that have been largely responsible for a solid agro-food industrial performance. The analysis is based on data from national statistical sources.

Performance of the Belarusian food industry

The solid agro-food industrial performance reflects the peculiarities of its state-led economic policy, a favorable external environment and robust growth in neighboring Russia – a key trading partner.

After 2000, the Belarus food industry increased both investments and profitability. Industrial output more than doubled in the years between 2000 and 2012. This was accompanied by higher investment growth and improved profitability. The output grew on average at 8 percent p.a, and its structure was stable during the last decade. The largest sub-sectors (meat, dairy, animal feed and beverages) generated more than 74 percent of total output (Figure 1). Two of them (meat and dairy) represent 75% of total exports by the food industry (Figure 2).

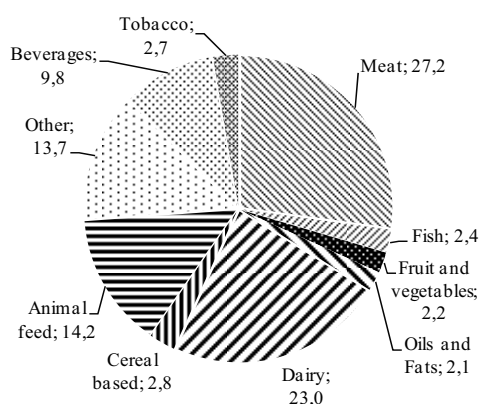


Fig. 1. Contribution to industrial output in 2012, by sub-sector

Source: own work based on National Statistical Committee data.

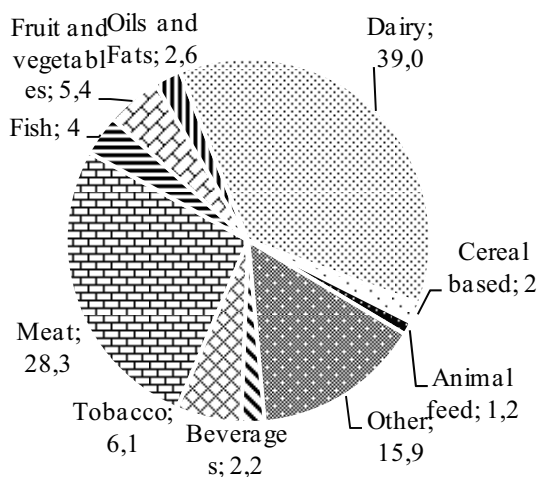
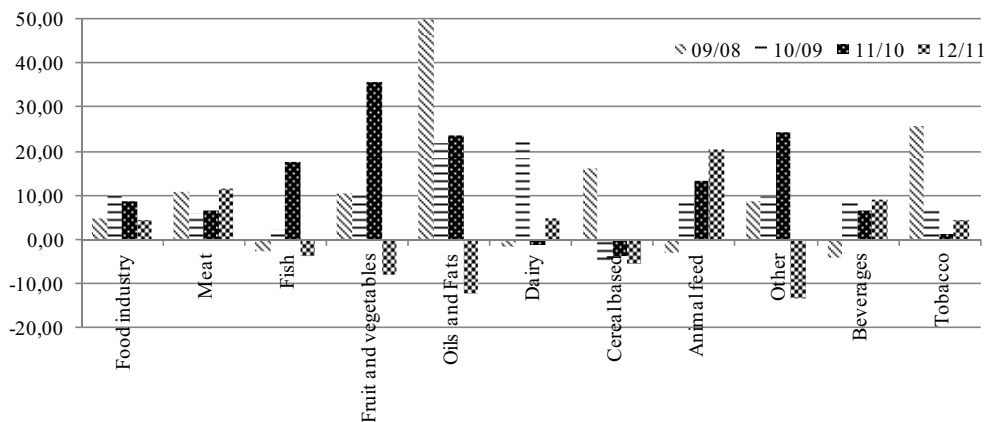


Fig. 2. Contribution to industrial export in 2012, by sub-sector
Source: own work based on National Statistical Committee data.

Detailed analysis of the growth dynamics detects extremely unstable trends in sub sectors (Figure 3). Significant variations in output occurred in almost all sectors. Two main factors impacted upon the industry: fluctuations in the external markets and the modernization of production facilities by means of various government schemes.

Fig. 3. Measures of industrial growth of total industry production.



Source: own work based on National Statistical Committee data.

The government built an efficient system of support and control, at the heart of which is an assurance of growth in quantitative output indicators (targets). But the real performance in the food industry showed that the main factor in meeting those targets was the growth of exports.

For example, the oilseed industry demonstrated a result of the support in 2008-2009. The production of rapeseed oil almost doubled in 2009 to 139.1 thousand tons. Exports increased sharply, three times, to 81.4 thousand tons to the value of \$53 million [Pilipuk 2009; Pilipuk, Karpovich 2010].

Recent growth in global demand was accompanied by a surge in output and profitability in externally oriented sectors. Major winners were the sectors that gained from strong world market prices for dairy, meat, oils, sugar and others.

Belarus's food export growth rates were high during the last decade (Figure 4).

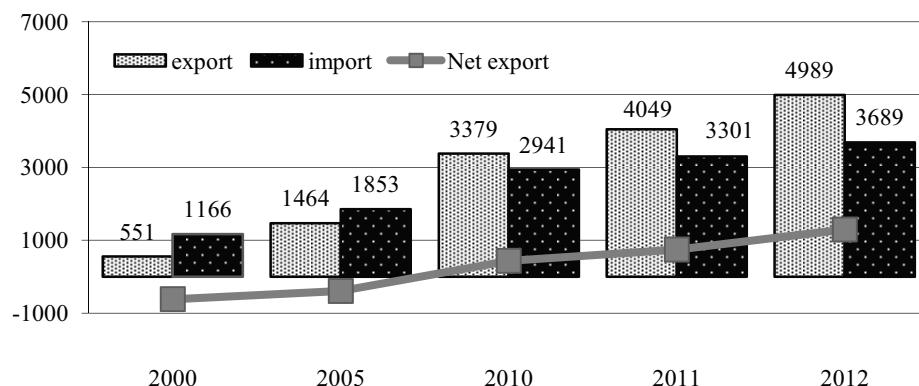


Fig. 4. The evolution of foreign trade of the Agro-food Industry of Belarus (million US dollar)

Source: own work based on National Statistical Committee data.

The exchange rate policy, which provided for a gradual real term depreciation of the Belarusian ruble against both the Euro and the Russian ruble, also supported export growth.

The commodity structure of exports has shifted further towards meat and dairy products. Total food exports have grown more than 10 times during the previous 15 years (Figure 5). Meat and dairy exports rose 17 times to \$3.5 billion. These two groups were responsible for more than 50 percent of total Belarusian food exports in the last five years. But there is little trade diversification. Belarusian exporters generally managed to keep a significant (albeit declining) share of the Russian market. The main reasons are strong historical relations, similar preferences of consumers and lack of trade obstacles because of customs union. So Russia still purchases up to 80 percent of all food products.

The reason is a strong import demand in Russia, where Belarus has preserved privileged access, which was secured in the mid-1990s, while Belarus continues to operate a complex system of non-tariff import restrictions.

Other important markets are Kazakhstan and Ukraine. Exports to European markets remain low, on a level of about 5 percent. In 2012 they amounted to 283.5 million US dollars. The main shares being occupied by rapeseed oil, casein, bilberries and chanterelles (22, 18, 8 and 6 percent respectively).

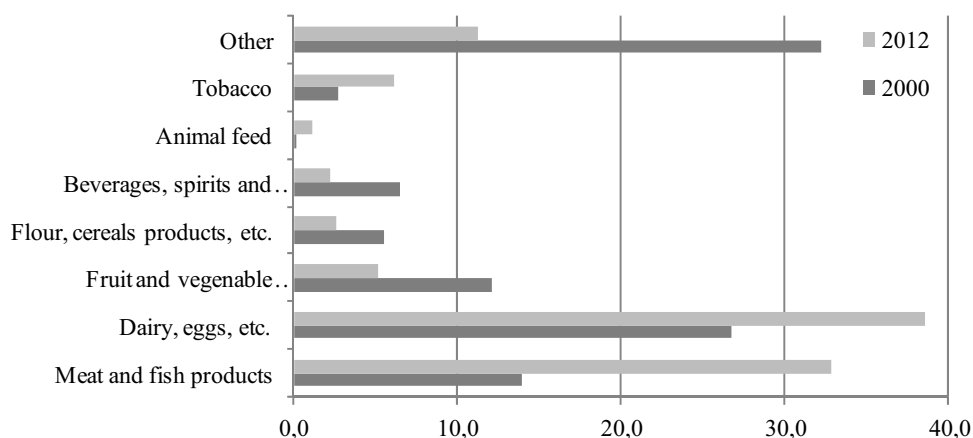


Fig. 5. Commodity structure of food export

Source: own work based on National Statistical Committee data.

However, the growth was increasingly driven by the expansion of the dairy-processing industry on the heels of domestically subsidized milk and high world milk prices. The dairy and meat processing sector's contribution to total industrial output accounts for 50 percent, reflecting an increase in the importance of the sector as regards tax revenues and export earnings (more than 70%). The problem is that the sector's expansion was based largely on purchasing meat and milk at subsidized prices for processing and exporting the processed goods at high world prices. This has been a highly profitable business in Belarus, but it has also made Belarus's food processing and industrial growth highly dependent and, therefore, vulnerable to (i) reductions in the levels of subsidy to agriculture (ii) drops in world milk prices (iii) increases in Russian agricultural production and, therefore, reduced demand for Belarusian food.

As we could see in almost all sub sectors the conditions of external markets were the main drivers to economic growth. The dairy industry is the most dependent on exports. Since 2008 more than a half of its production has been sold on external markets (68.4 % in 2012) [Pilipuk et al. 2011, Baranova 2010].

The analysis shows that the strong growth in the industry during the last decade was primarily driven by productivity. As we could see, almost all growth was generated by productivity gains, with employment levels practically unchanged (Figure 6).

The system of massive enterprise subsidies, some improvements in the business environment and significant improvements in the areas of consumer demand and tax policy are also responsible for the industry growth.

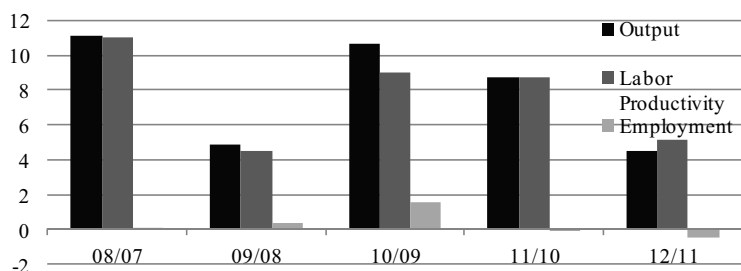


Fig. 6. Indices of output, labor productivity and employment increases in Food industry, increases over the period, percent

Source: own work based on National Statistical Committee data.

Increased capacity utilization complemented strong growth in labor productivity, but utilization is now closer to capacity and the existing capital stock needs renewal and replacement. In 2005-2012 capacity utilization in the industry increased by more than 25 percentage points to reach an average level of 70-75 percent (Figure 7). Thus, better capacity utilization could also directly explain a significant share of the observed overall industrial growth in that period.

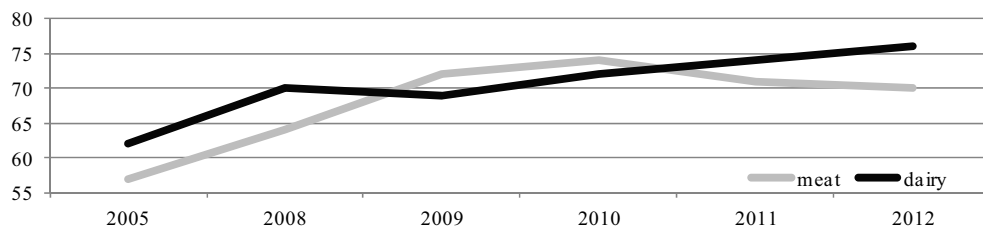


Fig. 7. Capacity utilization (percent) in main sub-sectors (dairy and meat industry)

Source: own work based on National Statistical Committee data.

Restructuring in food Industry

According to the practice of other transition countries, the first stage of enterprise restructuring (often called “defensive restructuring”) is typically divestiture of non-core assets and activities, shedding excess labor, and closing down at least some of the chronically unprofitable firms [World Bank, 2008]. The Belarus government’s preferred alternative policy of “enterprise consolidation” forces better performing enterprises to take over some loss-makers and does not allow downsizing of the acquired loss-making units. The losses are absorbed by larger enterprises and in many cases the management of combined assets is improved.

In the last few decades the government has been implementing a top-down approach towards food industry restructuring and consolidation. As a result, more than 100

unprofitable companies in sub sectors were assimilated by 2013 and now work as branches of effective enterprises. The last trend of restructuring is a merging of all state owned food enterprise companies which are located in each administrative region (Brest, Vitebsk, Gomel, Grodno, Minsk, Mogilev). In 2013, nine holdings were organized which include 69 organizations, generally in two main industries (dairy and meat), and there are some arrangements in hand towards merging them all into one Belarusian Meat-Dairy Company in 2015.

The other side of restructuring reflects improvements in the enterprise product mix. For example, the share of innovative products in the output of the Food Industry has tended to increase in the last decade (to 7.3 % in 2012). There are two factors which have influenced product innovation in the Industry: state enterprise support in the form of directed credits and the increase in the external demand for food in Russia. But research shows real risks associated with the practice of administratively set targets for food enterprises (targets for output, average wage growth etc.). One is the heavy reliance on the obligation of Government Owned Enterprises to purchase all raw materials from agriculture at fixed prices, even if the quality is low. A significant problem is also the loss-making enterprises which are a source of various forms of non-payments – undermining the ability of more efficient food processing companies to invest and grow.

Consequently, government policy of output targets leads to expanded outputs beyond the level justifiable by the existing demand. It results in over-production and excessive, expensive build-up of inventories which become an additional tax on the availability of an enterprise's working capital.

A strong system of food security was built by the government in the last two decades and the Food Industry is one of the most important parts of it. The goals are similar to the system in other developed countries, but the methods are different, because of the dominance of state property in agriculture and the food industry. As we could see the government has made significant institutional changes in the administration of state enterprise support in order to join WTO. However, if a state company uses any kind of government support, in most cases they have to increase the share of government ownership. The main channels for state enterprise support in Belarus are budget subsidies and tax incentives, budget interest rate subsidies and budget spending on repayment of guaranteed credits (called guarantees)⁴.

In many cases the support was efficient, and brought high development trends in agro-food sub sectors, because of a strong designated system of monitoring and evaluation under the Ministry of Agriculture, which verifies recipients' performance with the agreed targets and produces regular monitoring reports. We still agree with the view of the World Bank [World Bank, 2010] about the potential risk of gaining unattractive features in the country's investment climate and it is bound to become a stumbling block for Belaruss' external trade negotiations, both globally (WTO) and regionally (Single Economic Space).

⁴ Real high credit interests stimulate companies to use government support in return for share in capital. Particularly if the Government has 100% of the share, the support will cost nothing.

Competition

Favorable global demand and export prices increase competition in the Food Industry. In foreign markets it leads to a loss of food market share by the Belarusian Food Industry. One of the important reasons was the requirements of the supply chain, which Food Processing Companies couldn't follow – especially in relation to constant quality, regularity and predictability of supply.

The fundamental problem is that the system of management in agro-food companies does not focus on maximizing the value of enterprises as the main market-based incentive. This creates a system of incentives strongly biased towards production and some technical modernization.

According to the survey undertaken by the Institute for Privatization and Management (IPM) in 2007, the top three objectives were growth (55 percent), securing good wages for employees and technical modernization (45 percent each) [World Bank, 2010]. Therefore within industries competition remains limited. Liquidation and bankruptcy in agro-food industries isn't allowed by the Government in most cases, and loss-makers continue to rely on various sorts of government support⁵. Most enterprises are still fully controlled by the Government. All sorts of formal and informal controls limit their flexibility regarding adjustments in staffing, wage levels, and the redirection of sales to new regional markets within the country.

The other problem for the industry is price controls in the retail segment, including controls of retail margins which appeared stricter than controls over producer prices. In order to overcome the administrative monthly ceilings for price increases, companies make small changes in products, even just in their names, and increase the price of the “new” products.

For example, we could look at the performance of the dairy industry. Administrative controls are used by the Government with regard to pricing and milk procurement. Price regulation is biased towards households (by keeping low retail prices) and farmers (fixed procurement prices for milk), which puts milk processors at a disadvantage. This became particularly obvious after the devaluation of the Belarusian ruble in 2011 [Shpak, Pilipuk, Baranova 2012].

Summary and conclusions

The Belarusian Food Industry is an important sector which spans a wide range of economic activities. The important feature of the industry is the high state share in the total capital of the sectors' enterprises (70%). The country focuses on the development of major (large-scale) processing. Small and medium-sized enterprises' share in total output is less than 7%. Overall, agro-food industrial performance in Belarus during 2000-2012 remained strong. High rates of output expansion were driven primarily by strong external (mostly Russian) demand for Belarusian food and strong growth in labor productivity.

⁵ For example, the flax processing industry (43 enterprises) wades through deep debts above U.S. \$30 million of overdue liabilities. Total financial debt in October 2013 amounted to more than U.S. \$150 million. Despite the fact that the state provides price support from \$200 to \$1800 per ton of fiber, they agreed with a large-scale restructuring program for 2014-2015 with funding of about U.S. \$200 million [Kukresh, Kazakevich 2014].

There are some flourishing domains of which we can be proud. For instance, the dairy, meat and sugar Sub-sectors. Moreover, consumer preferences are evolving very quickly and are becoming more demanding and sophisticated. The industry needs to adjust and adapt to these circumstances.

The Government has made a significant effort to improve the competitiveness of sub-sectors of the agro-food industry through the system of direct state planning, financial support and control of performance targets of output, profit and productivity.

The production structure in nearly all sub sectors was consolidated in order to move the resources of the weakest enterprises to better management and by exploiting additional economies of scale. Such targets were strictly controlled and this system was efficient due to favorable conditions in the markets (domestic and foreign).

However, our research indicates that competitive pressures on Belarusian exporters will become stronger in the long term. The future prospects for the growth of Belarusian exports to Russia and Kazakhstan may be lowered because of their strategies of increasing food production up to a level of national food independence.

Consequently, competitiveness of the industry links to the ability to penetrate export markets. The other side is that state controls limit flexibility and the attractiveness of major Belarusian Food Companies to external business partners, and it also undermines incentives for restructuring and global integration.

Going forward, the main strategic question would be about the role of the government in boosting the competitiveness of the Agro-Food Industry and supporting the food security of Belarus. The important thing is to direct government support towards existing, and new, sub sectors of the food industry so as to strengthen their comparative advantages. The strategic goal is to generate enough profit to allow for adequate reinvestment to maintain, or even expand, the current market share in domestic and/or foreign markets.

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