

## Torn Between Patriotism and Economic Necessities RUSSIA'S EU BORDERLANDS AFTER THE FOOD EMBARGO

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In response to Western sanctions, in August 2014 Russia introduced an embargo on meat, dairy, fruits, and vegetables from the EU, Norway, Australia, Canada, and the United States. The ban seriously affected not only the producer states but also Russian distributors and consumers. The embargo especially impacted Russia's northwestern border regions: Murmansk, Karelia, St. Petersburg, Pskov, and Kaliningrad, areas that are dependent for geographic reasons on EU products.

This memo assesses the embargo's impact on Russian distributors and consumers in these regions. First, it considers the impact of sanctions on regional consumer markets. Second, it examines the influence of the food embargo on cross-border entrepreneurial activity, focusing on shuttle traders and international cargo carriers. Finally, it considers the ways cross-border entrepreneurs have tried to adjust to the changing circumstances.

### **The Impact on Retail Markets**

The embargo's negative impact on Russian retail markets was actually mitigated or delayed, thanks to a few factors. First, the embargo was imposed in August, when a seasonal decline in prices could at least partially neutralize and conceal price increases. Second, Russian food distributors accumulated large supplies of banned products before the embargo came into force, so deficits were not immediately noticeable. Third, when supplies began running out, many distributors managed to import goods from countries that were not targeted by the embargo. Fourth, some European exporters managed to find ways to deliver products via intermediary states, such as Belarus, which quickly became a primary hub for these operations. Other routes emerged through the Faroe Islands and Greenland (for Norwegian salmon) and Serbia and Turkey. While adding new intermediaries to export chains led to a rise in costs, importers (and consumers) were able to avoid a total deficit of some products.

Despite this, nothing could prevent a sharp rise in food prices several months after the embargo was introduced, due to seasonal price changes, the depletion of pre-embargo inventories, a diminishing number of distributors, and the swift depreciation of the ruble. The most pertinent increase in retail prices was for fish: in the St. Petersburg and Murmansk regions, fish prices rose 20 to 50 percent. Fishing is a well-developed industry in the Murmansk region, but local fishermen tend to sell their catches to Norway in order not to pay burdensome customs fees when they return to port in Russia.

Consumers in Kaliningrad were the most negatively affected. The region is situated far from mainland Russia and dependent on Europe for 70 percent of its dairy products, 50 percent of its fruits and vegetables, and 40 percent of its poultry. Thanks to the embargo, prices of food and produce in the enclave as much as doubled.<sup>1</sup> Though Kaliningrad authorities and retailers had high hopes that they would be able to substitute products from Belarusian suppliers for EU-sourced food, the former's prices proved to be often unreasonably high. At the same time, Kaliningrad's problems have been partially mitigated by its well-known grey market supplies, discussed below.

### **The Impact on Cross-Border Entrepreneurs**

The Russian embargo was hastily introduced and implemented. Many entrepreneurs who made purchases prior to the embargo were not allowed to bring these goods into Russia (though some exceptions were made for those who managed to enter the country before midnight on August 9).<sup>2</sup> Many distributors had to return their goods to suppliers, incurring the costs of redelivery. This particularly damaged companies delivering large supplies of goods on cargo ships.<sup>3</sup>

The damage was not limited solely to the costs of being unable to deliver previously purchased food supplies. Some suppliers were left with unpaid loans, and international cargo carriers (especially from Russia's western regions) were suddenly deprived of a large share of their business. They had to scramble to secure orders for alternative international destinations or find a niche within Russia's internal cargo transportation market, which is occupied by shadow carriers able to offer lower prices.

While the embargo inflicted damage on international carriers, many local, small-scale shuttle traders initially benefitted.<sup>4</sup> The same regulations that prohibit companies from

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<sup>1</sup> Tine Poluyanova, "Uiazvimaya geografiya," *Novye Izvestiya*, September 3, 2014, <http://www.newizv.ru/economics/2014-09-03/207149-ujazvimaja-geografija.html>

<sup>2</sup> See, for example, Denis Puzyryov, Anna Levinskaya, and Yana Borodyuk, "Rossiya zakryvayet granitsu dlya produktov iz chornogo spiska," *RBK.ru*, August 8, 2014, <http://top.rbc.ru/economics/08/08/2014/941923.shtml>

<sup>3</sup> See, for example, Kseniya Sod'ko, "Rossiya razvorachivayet fury i suda s zapreschionnymi produktami na granitse," *PROVED*, August 8, 2014, <http://goo.gl/NnCGld>

<sup>4</sup> See Serghei Golunov, "The Grey Trade of the EU-Russia Borderlands: Economic Obstacle or Opportunity?" PONARS Eurasia Policy Memo No. 315, March 2014, <http://www.ponarseurasia.org/memo/grey-trade-eu-russia-borderlands-economic-obstacle-or-opportunity>

importing food from targeted countries do not prohibit individuals from transporting food from those same countries if the total weight does not exceed five kilograms. For this reason, many small traders (and inhabitants) of Russian borderland municipalities did not feel the negative impact of sanctions as they could make daily trips to neighboring countries. Moreover, the new regulations created new business opportunities, as several people can bring a significant amount of produce back with them in one vehicle. Many entered the so-called “ant trade,” in which goods are brought into Russia by numerous individuals and collected and distributed by larger domestic enterprises. In St. Petersburg, “free” trips to Finland were offered in exchange for being an “ant,” something that was already popular before the embargo. However, after the exchange rate of the ruble declined dramatically from October 2014, the shuttle trade in goods from the EU ceased to be profitable. Instead, the devaluation led to a massive influx of Finnish, Polish, and Baltic visitors who came to Russia to buy up amazingly cheap Russian consumer goods, a phenomenon observed virtually for the first time since the 1990s.<sup>5</sup>

Shuttling, ant trading, and smuggling helped ameliorate the effect of the embargo in the Kaliningrad region in particular. Products delivered by these means are typically sold in local markets under the guise of arriving from non-embargo countries or as having been brought to Russia pre-embargo or, more stealthily, directly from vehicles in residential areas.

### **Reaction of Cross-Border Entrepreneurs**

Many Russian cross-border entrepreneurs took a patriotic stance and did not oppose the government’s embargo policy. Many of them shared the official view that Russia is on the “right side” in its confrontation with the West. Some cargo carrier representatives publicly claimed not to be significantly affected by the embargo and said they were ready to deliver goods from non-embargo countries.<sup>6</sup> Some entrepreneurs were simply silenced by the dominant viewpoint and feared confronting customs officers and encountering legal “problems.” Only a handful of entrepreneurs ventured to complain about the bans to official ombudsmen.<sup>7</sup> Only the Murmansk Fish Processing Plant, which had to shut down because of the embargo, sued the Russian government. Not surprisingly, it lost its suit in the Supreme Court in November 2014 and announced its closure.<sup>8</sup>

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<sup>5</sup> See, for example, “Poliaki i Lityovtsy yedut v Kaliningradskuyu oblast’ za yedoy i posudoy,” *NTV.ru*, December 18, 2014, <http://www.ntv.ru/novosti/1275841#ixzz3Ty35V4DI>; and “SMI: finny yedut v Rossiyu za deshiovoy elektronikoy, yedoy i benzinom,” *NTV.ru*, December 17, 2014, <http://www.ntv.ru/novosti/1275363/#ixzz3Ty49U2R2>

<sup>6</sup> Irina Yefimova, “Mezhdunarodnye perevozki Rossii v nadiozhyh shofiorskih rukah,” *PROVED*, September 22, 2014, <http://goo.gl/ZB8GK5>

<sup>7</sup> Natalya Matveeva, “Aleksandr Abrosimov: sozdaiutsya usloviya, kogda importiory vynuzhdeny iskat’ nepravomernye sposoby vvoza tovara,” *PROVED*, September 3, 2014, , <http://goo.gl/vVQrYc>

<sup>8</sup> Yevgeniya Golovina, “Murmanskii rybokombinat zakroietsya iz-za otkaza Verhovnogo suda,” *Slon.ru*, November 11, 2014, <http://slon.ru/fast/russia/murmanskiy-rybokombinat-zakroietsya-iz-za-otkaza-verhovnogo-suda-1182933.xhtml>

Instead of confronting the federal government, many businesses and local governments chose to work “behind the scenes” (though at one point, Kaliningrad regional governor Nikolai Tsukanov tried to openly persuade the Kremlin to lift or soften the embargo). The Kremlin and the Russian parliament remained firm, insisting that the embargo will not be lifted even if it means losses for companies or even entire regions.<sup>9</sup> Some businesses tried to obtain at least indirect reimbursement from the government, such as tax cuts, support for finding new partners from non-targeted states, or a levying of restrictions on certain foreign competitors (such as cargo carriers). Though the government promised to support cargo carriers that incurred losses, these promises have not yet materialized into visible measures.

One of the most popular “paths of least resistance” for Russian distributors has thus been to engage in shadow import schemes through smuggling or the ant trade. There have been many cases of products originating in the EU but sold with forged documents indicating a false country-of-origin. A wide range of potential opportunities exists for clandestine cooperation between entrepreneurs and corrupt customs officers, but it is difficult to track the prevalence of such schemes.

## Conclusion

Russia’s imposed food embargo has had a range of effects on the country’s northwestern borderland regions. In most cases, it did not initially cause a significant increase in prices, but a delayed effect did emerge, coupled by the rapid devaluation of the ruble, that was felt more from the end of 2014 and into the new year. The embargo has affected Kaliningrad the most. Though the food embargo damaged the interests of Russian distributors, suppliers, and international cargo carriers, the vast majority of these have not ventured to confront the Russian government. Rather, they have tried to solve problems on their own, not always through legal methods. Meanwhile, local shuttle traders, who were previously treated unfavorably by the authorities, have found a new lease on life and are taking advantage of the loopholes provided to small-scale importers.

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<sup>9</sup> Anna Yegorova, “Regiony nesut ubytki ot embargo. Fors-mazhor neizbezhen,” *PROVED*, September 20, 2014, <http://goo.gl/QUERY6K>