

Food Aid to Russia: The Fallacies of US Policy

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My guess is [the Russians] are going to want additional [food] assistance.

Absolutely, we'd look at a package.
Obviously, there are the resources here.
-- Dan Glickman, US Agriculture Secretary (June 25,
Absolutelv. we'd look at a package.

If they wave [the food] in front of us, of course we'll take it.
But the policy is wrong. This aid will be damaging to Russia.
-- Nikolai Bandurin, poultry farmer in Rostov, Russia (July 11, 1999)

For the past nine years, the United States has provided large amounts of free and highly subsidized food to Russia. Some of this aid has come in the form of direct government-to-government assistance; other supplies have been given to private (or nominally private) distributors and processors in Russia. The program has been strongly backed by the US Department of Agriculture (USDA), whose chief mission abroad is to promote US farm exports. The program also has been vigorously championed by large American food producers and US shipping companies, which have been the dominant financial beneficiaries.

As currently projected, US food assistance to Russia will increase over the next few years. In late September 1999, the Russian government requested that the United States provide some five million tons of food aid in the year 2000, including 1 million tons of wheat for human consumption, 1.5 million tons of wheat for livestock, 1.5 million tons of corn, 1 million tons of soy meal and soya beans, and 15,000 tons of corn and vegetable seeds. This request, worth close to \$2 billion (including shipping costs), exceeds the already high levels of aid provided after the currency devaluation in 1998 (more than 3.2 million tons of food worth \$1 billion, plus shipping costs). Although the Russian harvest is expected to be much larger in 1999 than it was last year (with forecasts of 55-60 million tons of grain in 1999 versus the 47.8 million last year), it will still fall short of the hoped-for level of 70 million tons. Partly for this reason, USDA officials have indicated that they will approve Russia's latest request for food aid.

Despite the size and importance of the US food assistance program, this aspect of relations with Russia has been subject to remarkably little scrutiny over the past several years. Few in Congress have paid much attention to the program, much less raised critical questions about it. This is unfortunate because there is ample reason to believe that the food assistance has been highly detrimental to US interests in Russia and has placed an unfair burden on US taxpayers, who are being asked to subsidize large American grain and shipping companies. Far from promoting the emergence of a private agricultural sector in Russia, US food aid has inadvertently undercut private farmers and propped up the old state-controlled grain monopolies. It also has fueled corruption, rent-seeking, and waste. The best option now would be to terminate the program.

Genesis of the US Program

The US food aid program was launched during the Bush administration even before the Soviet Union had broken apart. When concerns arose in late 1990 and early 1991 that the growing chaos in the Soviet economy might lead to widespread hunger or even starvation, the administration set up an advisory panel to examine the merits of providing food aid to Soviet Russia. To the dismay of some administration officials (especially at USDA), the panel expressed serious doubts about the desirability of shipping food to the Soviet or Russian government, warning that "it could be wasteful and have the effect of providing too much support to the old system at a time when a more market-oriented system is emerging." Rather than heeding this advice, the Bush administration transferred large amounts of food aid to Russia over the next year-and-a-half. Although it soon became clear that the forecasts of hunger and starvation were wildly exaggerated (and in some cases had been deliberately fabricated to discredit efforts at market reform), US shipments of free and subsidized food to the Russian government continued.

Further shipments to the Russian government were approved during the first year of the Clinton administration, even though the policy was beginning to come under strong criticism both inside and outside the USDA. The department's Inspector General issued public warnings in 1993 that safeguards against the illegal diversion of food were proving ineffective. Among other abuses that came to light was a scheme devised by the Roskhneprodukt state grain monopoly, which colluded with a small group of banks and grain auction houses to buy up US supplies of grain at artificially low prices. These supplies undercut existing private farmers and kept domestic grain prices so low that they were a formidable barrier to entry for prospective growers.

In addition to spurring corruption and stifling the development of a private farm sector, the US food supplies were often simply wasted. A report by the US General Accounting Office in 1994 found that "food moved through state sectors in [Russia and other former Soviet republics] is owned by nobody and thus is treated very carelessly, contributing directly to massive food losses." According to a senior USDA official, no more than about five percent of the food supplied under the program ever made it to the intended recipients. By the time they received it, they no longer needed it.

The problems that arose with the government-to-government aid program finally induced the United States to halt shipments of free food to the Russian government at the start of fiscal year (FY) 1994. This action, however, did not signal an end to the food assistance program itself. The only thing that changed was the immediate recipient. Rather than transferring food to government-owned grain distributors, the United States sought to take the proceeds from sales of subsidized grain and use them to make loans to private farmers. Under this new arrangement, the US government continued to underwrite large amounts of food aid to Russia from FY 1994 to FY 1998, including millions of tons of wheat, corn and soybeans, tens of thousands of tons of rice, barley and rye, and thousands of tons of seed.

This approach seemed reasonable on paper, but it foundered when Russian banks and state-controlled (or nominally private) grain distributors found ways to undermine it. A few nominally private grain suppliers, such as Granitex, were able to persuade key banks not to extend loans to their smaller private competitors. As a result, much of the US loan program was stillborn. Control of the US food ultimately still rested with the largest, most inefficient grain distributors.

The shortcomings of the US food aid program became far more acute in late 1998 and 1999, when the United States returned to its earlier policy of shipping food to the Russian government. The onset of an economic crisis in Russia in August 1998, combined with reports that Russia's harvest in 1998 would be at a 40-year low, prompted yet another round of ominous predictions of famine and widespread hardship in Russia. Those predictions were played up by a few large US grain and meat companies, which sensed a lucrative opportunity to dispose of some of their recent surpluses at taxpayer expense. Many outside observers argued that the forecasts of starvation were completely unfounded, reminiscent of the exaggerated fears that skewed US policy earlier in the decade. Despite these cautionary voices, the Clinton administration ultimately sided with those who wanted a broad--and expensive--US response. On October 28, 1998, Agriculture Secretary Dan Glickman announced a large program of food aid to the Russian government, including a grant of more than 1.5 million tons of wheat (worth \$600 million) and a loan of \$400 million payable over 20 years at 2 percent interest (after a five-year grace period) to purchase additional shipments of corn, soybeans, poultry, meat, seeds and rice. The United States also paid all shipping costs, which came to more than \$300 million.

The US program was supplemented by pledges of emergency food aid from the European Union (EU) worth more than \$500 million, including a million tons of wheat, 500,000 tons of rye, 50,000 tons of rice, 100,000 tons of pork, and 150,000 tons of beef. All told, the promised food shipments were equivalent to some 10-12 percent of Russia's annual agricultural production.

When Secretary Glickman announced the US program, he declared that "it is in our interest to make sure that Russians are fed through the winter." The EU program was similarly couched in terms of the need for "urgent action" to deal with an "emergency." Despite this rhetoric, the United States and most other donor countries were unusually

slow in actually shipping their goods. If the US food had truly been needed during the winter, Russians would have ended up starving. None of the promised food arrived until March 1999, and most of it was not shipped until late summer 1999, just as Russian farmers were busy gathering their own harvest. Even when the food did arrive, very little of it went to the few small towns (in the far northeast near Magadan) that were genuinely short of it. Many of the regions that received food refused to distribute it, for fear of interfering with local production. A large share of the food stayed in Moscow and St. Petersburg, the wealthiest and best supplied areas in the country. (The EU, unlike the United States, refused to allocate food to Moscow and St. Petersburg, but even some of the EU-supplied food ended up there.)

The slowness of the response stemmed largely from bureaucratic obstacles on both sides. The Russian government initially was ambivalent about the promised food assistance. Several high-ranking officials, including the ministers of agriculture and finance, were opposed to the aid, but their concerns were overruled by Deputy Prime Minister Gennady Kulik, who served for more than twenty years during the Communist era as a collective farm manager and state agricultural official. Kulik knew that an influx of foreign food would bolster his power by allowing him to dispense favors to regional governments and state contractors. When a closed auction was held to award responsibility for food distribution throughout the country, a firm headed by a close friend of Kulik's was among the four that "won." This cronyism was blatantly illegal, but it stirred no public outcry.

Despite the various glitches that arose with US food aid in 1999, the Clinton administration has been eager to provide increased assistance to Russia in coming years. Kulik and his successor, Vladimir Shcherbak, have sought an expansion of the program. Although recent publicity about corruption in Russia may hinder efforts to provide increased assistance, Congress does not yet appear ready to end the food program.

Drawbacks of Food Aid

The benefits of US food aid to Russia are uncertain at best, at least for ordinary Russians. The food has not been needed, and even if it were needed, it has not gotten to Russia soon enough to make a difference.

The primary beneficiaries of the aid are the large US agricultural and shipping companies that are paid in full by the US government to transfer food to Russia. Also benefiting from the policy are the very small number of privileged Russians who can take advantage of rent-seeking opportunities afforded by the incoming supplies.

By serving de facto as yet another lucrative subsidy for US grain and shipping companies, the food aid program adds to the pernicious array of state benefits that these companies already enjoy. Such practices undermine the principles of free market capitalism that the United States claims to be promoting in Russia.

Within Russia itself, the food aid also has had adverse consequences. Most of the proceeds from sales of US food shipments in 1999 were supposed to help the Russian government pay off arrears on wages and pensions, but almost no money was actually collected for that purpose. As of mid-1999, only \$3.4 million had been transferred from food sales to state coffers, and the total rose only slightly thereafter, falling many times short of the projected sum of \$500 million. In 2000, the United States will no longer maintain even the pretense of shoring up the Russian pension fund. Revenues from the food aid requested for next year, according to deputy prime minister Shcherbak, will go solely toward improvements in agricultural production, thus increasing the state's control of Russian agriculture.

Part of the reason that state revenues from food sales in 1999 were so low is that rent-seeking and illegal diversions of the aid were widespread. Although the USDA has sought to downplay recent allegations of rampant theft and illegal diversions, all evidence was to the contrary. Among the documented cases to emerge was the sighting of a large, grain-laden ship departing from a Black Sea port in March 1999, shortly after the first US shipments were arriving. If, as widely suspected, this ship was re-exporting US-supplied grain, it was a clear violation of the bilateral agreement on food aid, which prohibits Russia "from re-exporting any of the commodities . . . and restrains the export of similar commodities" unless the export contracts were in place before the new aid agreement was signed. The ship's cargo was never checked by US inspectors, but officials in Russia expressed concern that it had been commissioned by organized crime groups, who have gained an increasing foothold in several ports where US food aid is delivered. Numerous other instances of illegal diversions also came to light during the latest shipments. In early July 1999, ten rail cars loaded with EU-supplied rye were seized while crossing the border with Estonia, another clear violation of the ban on re-exports. (The EU agreement with Russia contained provisions identical to those in the US-Russian agreement.)

The high incidence of theft and illegal diversions of food aid is partly attributable to the fact that the food is not truly needed. Officials in many of the regional governments have been tempted to resell the food elsewhere for hard currency. This arrangement has been made possible because many of the original Russian buyers of the food aid are paying far less than the going market rate. To avoid undercutting private Russian farmers, the donated food was supposed to be sold at prevailing market prices, but that has very rarely been the case. Officials in Kemerovo, Rostov, Krasnoyarsk, and many other regions have ensured that prices remain artificially low for the initial sales. The food can then be re-exported to earn a very healthy profit.

Another reason for the high rate of thefts and diversions has been the US government's failure to establish oversight of the food transfers and distribution. Although the EU sent hundreds of inspectors to Russia to monitor the transfer and distribution of food in 1999, the United States relied on only a handful of inspectors (ranging from two to fourteen at any one time), who were unable to cover more than a minuscule fraction of the country. The failure to impose adequate oversight of the food shipments ran contrary to warnings by some high-ranking Russian officials that tight supervision would be essential. In late October 1998, just after Secretary Glickman announced the latest US program, Russian

Deputy Prime Minister Natalia Matvienko warned Western governments that they must assert "firm and rigid control" over food distribution in Russia and must demand on-site checks of all suspected diversions. A failure to do so, she argued, would just repeat the "earlier cycle of abuses of humanitarian aid." Suffice it to say that her pleas went unheeded.

Of the cases of theft and illegal diversions that have been detected, most have involved EU-supplied food. The reason for this is that the EU has far more inspectors on the ground, who therefore stand a better chance of detecting some of the undesirable activities. Because so few US inspectors are present, it is not surprising that they have been unable to detect as large a number of cases of theft and diversion. If the problem of corruption and theft has been so widespread with the EU-supplied aid, which is being monitored quite closely, one can assume that these activities have been far more common with the US-supplied aid, which is subject to very little oversight. The fact that no inspectors are present does not make the problem go away; it just allows it to be glossed over.

Even when well-documented cases of corruption and theft have come to light, Western governments have done remarkably little. No US official publicly objected when Kulik awarded a lucrative food distribution contract to one of his cronies on a non-competitive basis. Nor did any US official express concern about the continued presence of a large number of groups and individuals who were known to be involved in the abuses of the early 1990s. Even as the US food program has been compounding the entrenched corruption in Russia, the United States has been doing very little to combat it. Secretary Glickman's enthusiastic endorsement of increased food assistance gives Russian officials and criminal groups every reason to believe that they can continue siphoning off the aid with impunity.

Worst of all, the US food aid has inhibited the development of a private farm sector in Russia. Despite attempts at safeguards, the foreign supplies have undercut small indigenous producers and have given new life to the state-controlled grain monopolies that want to keep private competitors at bay. US officials have argued that the food aid is too small to make a net difference in market prices, but that is a highly dubious claim. In many key regions, US food aid is sold at artificially low prices to favored buyers, who can then move against their competitors. Because the latest supplies from the United States and other Western countries are equivalent to some 10-12 percent of Russia's annual food production, the infusions of aid are bound to distort market signals and undercut the prices at which aspiring private farmers in Russia must sell to make a profit. Furthermore, the very knowledge that Western countries will step in to provide food assistance--whether needed or not--gives the Russian government and legislature an incentive not to press ahead with desperately needed agricultural reforms. Nearly eight years after the Soviet Union collapsed, Russia still has no law on land ownership, and it also has failed to provide many other standard protections for private farmers. Western food aid reduces the pressure on the Russian government and parliament to adopt crucial, long overdue measures.

Quite apart from the deleterious effects that US food aid has had in Russia, it has also been detrimental to other parts of the former Soviet Union. For many countries in the region, Russia is a very important agricultural market. In 1997, food and other agricultural products accounted for 53 percent of Latvia's total exports to Russia, 46 percent of Estonia's exports, and 37 percent of Lithuania's. Similar proportions exist for exports to Russia from Ukraine and several East European countries, notably Poland. US food aid has enabled the Russian government to reduce its food imports from the Baltic states, Poland, and other former Communist countries, thus complicating their efforts to contain the damaging spillover from last year's Russian crisis. Rather than using US tax dollars to fund shipments of US-grown food to Russia, the United States would be better advised to finance Russian imports of food from neighboring countries. Such an arrangement, however, would contravene one of the basic purposes of the US food aid program, namely, to provide generous subsidies to US food and shipping companies.

Conclusion

Food aid, whether supplied to a foreign government or to non-governmental entities, should never be more than a last resort. In an extreme emergency, subsidized food shipments might be justified to prevent near-term starvation and disease, but in almost all other cases, food aid tends to be counterproductive. The risk of waste and of illegal diversion of food supplies--a risk that looms especially large in the former Soviet Union--is only part of the problem. Even if all the food goes to the intended recipients, the aid is bound to foster long-term dependence, inhibit private farmers, introduce distortions throughout the recipient country's agricultural sector, and give US grain and shipping companies an incentive to rely on and promote government-funded assistance overseas, adding to the generous state subsidies they already receive through domestic programs.

All of these drawbacks have plagued US food assistance to Russia throughout the 1990s. The distortions and perverse incentives that inhibit a sound distribution of Russia's agricultural goods, rather than the overall supply of food, are the real problem in Russia. Only far-reaching reforms and the emergence of a full-fledged private farming sector can alleviate this basic problem. The US aid program is unnecessary, wasteful, and detrimental to the very principles that the United States wants to encourage.