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Drought in the USA and Black Sea Region: Implications for Ukraine*

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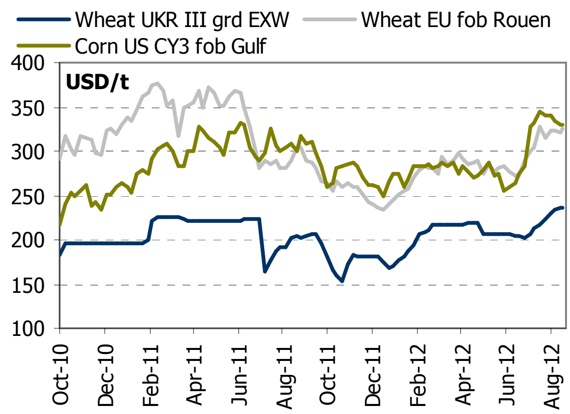
Persistent drought in the USA and Black Sea regions caused losses of the global grain harvest and spurred world grain prices. Ukraine, however, is expected to have enough grain to serve its domestic and export markets, which is beneficial to its crop farmers. Rising feed and food prices, however, increase the risk of export restrictions to lower the prices for final and intermediary consumers, as it was often observed in the past. The risk is especially high in the face of approaching Parliamentary elections in October. In this situation we hope that the government will not intervene in exports but rather follow a 'win-win-situation' approach, whereby farmers would benefit from high prices while poor consumers are being supported by the state.

Persistent drought in the US Corn Belt and some of the Black Sea regions resulted in considerably lower than expected new harvest estimates. The US' corn production has been revised from June's 375 m t down to August's 273.79 m t. Russia's grain harvest has been reduced from June's 85.9 m t to 72.65 m t in August, with wheat accounting for a 10 m t drop (from 53 to 43 m t). These factors substantially drove up the world grain prices.

Figure 1. Grain prices (EU, USA and Ukraine)



Source: APD; IGC; www.anyfoodanyfeed.com

Information agencies forecast enough grain in Ukraine to serve its domestic and export markets: 45 – 48 m t of harvest with 20-24 m t of expected exports. This will allow crop farmers to benefit from high world prices. Moreover, the drastic fall of the corn harvest in the US and the wheat harvest in Russia opens up new export opportunities for Ukraine. In 2010 Russia banned its grain exports at 41.5 m t of harvest, which is quite close to this season's estimates. This increases the risk of export restrictions in Russia that Ukraine could take advantage of.

Higher food prices, however, impose a burden on final consumers. This has been used by the government to justify a series of grain export restrictions in recent years. The risk of government intervention in the face of higher food prices is especially high in Ukraine, where on average about half of the households' budgets is spend on food. Moreover, the Parliament elections in October are approaching. Fighting higher food prices with export restrictions is flawed as it depresses the prices for all domestic consumers, including the wealthier consumers who can absorb a food price shock without major difficulty. It would be much more efficient to target assistance to those consumers who really need it rather than wasting a large part of this assistance on consumers who do not. For this purpose the government would be well advised to develop a special targeted social assistance program for poor households.

Also, higher feed prices primarily affect livestock producers. Two factors are important in this regard. The livestock sector and its sub-sectors have been undergoing a substantial consolidation process. Against the background of falling production, the supply of livestock products has been shrinking from households and increasing from farms. Moreover, households have been enlarging and transforming into family and peasant farms, likewise livestock farms become larger, more industrialized and eventually turn into, or join big agriholdings. As the livestock sector has been turning into bigger and more consolidated structures, its lobbing power has been growing accordingly. As a consequence, this increases the risk of export restrictions to lower grain prices. As a matter of fact, policy makers have implemented such restrictions four times in the last seven years.

The resulting low feed prices, however, are neither a sufficient nor even a necessary condition for a competitive livestock sector. Ukrainian livestock producers have been paying much less for feed than their competitors abroad, but this advantage has not resulted in dynamic growth. Livestock producers benefit at the expense of crop farmers, i.e. at the expense of reduced grain producer's revenues. Estimates of the forgone revenues during the export restriction episode in 2010/11 vary from USD 0.9 to 2.6 bn. This substantially undermines long-run competitiveness of the grain sector.

Nonetheless, a rational solution to the above described dilemma is possible and it includes the following components. First, the government should avoid export restrictions and let the crop farmers benefit from high world prices. This will ultimately lead to increased productivity and production. Livestock producers will indeed suffer from higher feed prices. But artificially depressing feed prices to the benefit of livestock sector is a short-sighted policy that ultimately undermines the competitiveness of the whole agriculture. If livestock producers compete just on a basis of artificially cheap feed, this actually subtracts, not adds value. A strong livestock sector should develop on the foundation of a strong crop sector, but not at its expense. Second, a targeted food assistance program should be developed that would help the people really in need. This program should be tightly linked to one of the existing social assisting program to minimize administrative costs.