Since 2000, the Black Sea region has emerged as a major player in the wheat global value chain (GVC). In particular, Russia and Ukraine have become dominant suppliers to the Middle East and North Africa (MENA) of inexpensive wheat. Private and public investment has drastically increased wheat production in the Black Sea region and has positioned Russia and Ukraine to play a vital role in improving food security in MENA. However, both Black Sea countries are encountering obstacles along the value chain that could hinder and even exacerbate food insecurity in heavily reliant countries, such as Egypt and Tunisia. This brief uses the GVC framework to dissect the differences between Russia’s and Ukraine’s wheat development strategies and possible consequences for MENA countries.

Abstract

Since 2000, the Black Sea region has emerged as a major player in the wheat global value chain (GVC). In particular, Russia and Ukraine have become dominant suppliers to the Middle East and North Africa (MENA) of inexpensive wheat. Private and public investment has drastically increased wheat production in the Black Sea region and has positioned Russia and Ukraine to play a vital role in improving food security in MENA. However, both Black Sea countries are encountering obstacles along the value chain that could hinder and even exacerbate food insecurity in heavily reliant countries, such as Egypt and Tunisia. This brief uses the GVC framework to dissect the differences between Russia’s and Ukraine’s wheat development strategies and possible consequences for MENA countries.

Keywords

Wheat, Black Sea Region, Russia, Ukraine, Global Value Chains
Introduction

In the last 15 years, the Black Sea region has emerged as a major contributor to the wheat global value chain (GVC). Russia and Ukraine currently account for a quarter of the world’s wheat exports (see figure 1) and have become strategic trading partners with import-dependent regions, including the Middle East and North Africa (MENA). As the Black Sea region continues to increase its share of the global wheat market, its domestic policies and geopolitical strategy will significantly affect not only the international price of wheat but also food security within import-dependent countries.

This report compares the structure of the wheat value chain for two Black Sea countries: Russia and Ukraine. Through a GVC lens, it is clear that although both countries have impressively increased wheat exports, they also face significant complications in terms of trade policies and infrastructure. Despite sharing similar challenges, Russia and Ukraine adopted differing policy strategies in an effort to capitalize on the growing demand for wheat in MENA.

Figure 1: The Black Sea’s Global Wheat Exports 2000-2013

Russia and Ukraine have taken control of a quarter of the world’s wheat exports and have become strategic trading partners with import-reliant countries in the Middle East and North Africa.

Source: FAOSTAT 2015
The Rise of the Black Sea Region in the Wheat GVC

After the fall of the Soviet Union, agriculture production declined in Black Sea countries. It wasn’t until the early 2000s when each government began to reinvest in farms and private firms started to vertically integrate that wheat production increased (see Research Brief 3 for further detail). The rise in world food prices in 2006 further invigorated the wheat industry in the region and private agroholding enterprises emerged as the main drivers of production and exports.

The rise of the Black Sea region in the wheat GVC is particularly significant for MENA countries that are highly reliant on wheat imports. Russia and Ukraine not only have lower production costs, thus providing a less expensive alternative to traditional exporters, such as the United States, but they are also geographically closer to the MENA region, offering lower transport costs. The Black Sea region is currently the largest exporter of wheat to several MENA countries including Egypt and Tunisia.

Figure 2: Comparison of Russia and the Ukraine

<table>
<thead>
<tr>
<th>Country</th>
<th>Russia</th>
<th>Ukraine</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population</td>
<td>143.5 million</td>
<td>45.5 million</td>
</tr>
<tr>
<td>GDP</td>
<td>$2.097 trillion</td>
<td>$177.4 billion</td>
</tr>
<tr>
<td>Top 3 Agriculture Exports</td>
<td>Wheat, Sunflower oil, Tobacco</td>
<td>Wheat, Corn, Sunflower oil</td>
</tr>
<tr>
<td>2013 Exported Wheat in Tonnes</td>
<td>18.5 million</td>
<td>9.5 million</td>
</tr>
<tr>
<td>Lead Wheat Firms</td>
<td>OOO Trading House RIF, United Grain Company, Louis Dreyfus, Glencore</td>
<td>Khlib Investbud, Nibulon, Kernel &amp; Louis Dreyfus</td>
</tr>
</tbody>
</table>

Challenges

Despite the Black Sea region’s successful integration into the wheat value chain, several issues are cause for concern for importing countries. As highlighted in the wheat GVC (figure 3), infrastructure continues to be a major constraint in the sector. Insufficient storage facilities, and antiquated railways and ports obstruct the Black Sea’s ability to efficiently transport wheat within the region or to export. Additionally, government regulations and trade policies have greatly fluctuated in the region in response to droughts, poor harvests and domestic inflation contributing to a volatile and insecure environment for private firms and creating unpredictable supplies for importing countries.

Opportunities

International interest in the Black Sea’s wheat industry among both public and private investors is growing. The region has a considerable amount of land that has yet to be cultivated and could drastically increase the world supply of wheat and improve food security in several countries, including in the MENA region.

Case Study: Russia

Once a net wheat importer, Russia has become the Black Sea region’s biggest grain producer and one of the world’s largest wheat exporters. In the early 2000s, Russia experienced large increases in the country’s wheat supply primarily due to the increased use of inputs, like fertilizers, that led to improved productivity on existing farms. Private agroholding companies such as Razgulay, AgroTech Garant, and Cherkizovo Group, drove this revitalization by investing in the industrialization of every level of the value chain. Many of the agroholdings companies, created as subsidiaries of existing Russian firms with considerable financial assets, formed strategic partnerships lead firms in the global wheat industry. Agroholdings now control approximately 15-20% of the arable land in Russia, employ thousands of workers and produce over one third of the regions grain output.

Despite the significant integration of the private sector, the government of Russia continues to play a major role in the wheat sector. Russia’s Producer Support Estimate (PSE), which is comprised of market price support and input subsidies, is 21% as a share of gross farm receipts and 3% higher than the average OECD country. Russia provides the bulk of its support through market price supports with only 34% of the PSE allocated to input subsidies. The government also provides concessional loans and credit services to farmers in the livestock sector being the primary beneficiary of state support. Both wheat and oilseed exports are heavily taxed in order to pay for livestock support. Livestock producers receive subsidized wheat-based animal feed at a price below market value highlighting Russia prioritization of the livestock sector over wheat. Russia’s interference with wheat market prices, to bolster its livestock sector, create distortions that are contributing to an unstable wheat supply on the global market and price volatility for wheat importing nations.

Table 1: Russian Wheat Export Partners and Percentage of Total Wheat Exports

<table>
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<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Azerbaijan</td>
<td>54%</td>
<td>14%</td>
<td>Egypt</td>
<td>23%</td>
<td>Egypt</td>
<td>33%</td>
</tr>
<tr>
<td>Israel</td>
<td>29%</td>
<td>Egypt</td>
<td>10%</td>
<td>India</td>
<td>18%</td>
<td>Turkey</td>
</tr>
<tr>
<td>Georgia</td>
<td>7%</td>
<td>Israel</td>
<td>7%</td>
<td>Bangladesh</td>
<td>11%</td>
<td>Syria</td>
</tr>
<tr>
<td>Ukraine</td>
<td>5%</td>
<td>Italy</td>
<td>7%</td>
<td>Azerbaijan</td>
<td>7%</td>
<td>Libya</td>
</tr>
</tbody>
</table>

Russia has strategically become the primary supplier of wheat to several countries in the MENA region, as shown in the Table 1 above. Over one-third of Russia’s wheat is currently exported to Egypt, Iran and Yemen. Russia is also a large importer of fruits and vegetables from MENA. The interconnectedness of the Black Sea and MENA regions has helped to initiate Russia’s 2030 Strategy that aims to develop transport infrastructure to better link national and international transport passageways between the regions to improve trade logistics. Additionally, Russia hopes to develop a transit hub in the Mediterranean, which would include a modern elevator, cleaning and drying equipment as well as unloading and transshipment facilities. These government investments will help to solidify Russia as the primary wheat supplier in the Black Sea and help to ensure a more stable source of wheat exports. However, Russia will need to make significant investments to improve its railway infrastructure and lower the cost of production for farmers in order to remain competitive with its neighbors.

6) UN Comtrade Data. (2015). *Russian Wheat Export Partners*
Case Study: Ukraine

The grain industry in Ukraine has made significant strides since 2000 by increasing production and improving the quality of wheat. Similar to Russia, Ukraine recently began establishing itself as a grain powerhouse. Ukraine’s production capacity is estimated at only 100 million tonnes per year compared to Russia’s estimated at 130 million tonnes. However, Ukraine has only a third of Russia’s population and a much smaller livestock sector thus potentially enabling it to increase its exports and surpass Russia in the future. Ukraine’s grain industry is dominated by small enterprises and family farms but agroholdings have recently emerged bringing new technology and increasing production of higher quality wheat. Though Ukraine’s PSE has fluctuated greatly depending upon the government’s financial capacity and the macroeconomic environment, it has moved from price controls to input based subsidies, which accounted for 61% of the PSE in 2010.

Ukraine is also very attractive to foreign investors because of its low production cost, close proximity to Black Sea ports and superior grain infrastructure compared to its neighboring competitors. Lead firms, like Nibulon and Cargill, are Ukraine’s leading grain exporters and have made significant investments in the country’s physical infrastructure in order to facilitate and improve exports of wheat as well as corn. China has also pledged $1.5 billion in aid to support Ukraine’s agriculture sector and the two countries have signed agreement through the state run grain company, GPZKU, to export 2 million tons of wheat to China.

Ukraine exports wheat to a variety of countries, however in the last five years it has begun to concentrate on building strong partnerships within the MENA region, as shown in Table 2. Most notably, Ukraine has dramatically increased its exports to Egypt, a country attempting to diversify its wheat imports, and in 2013 traded the same quantity of wheat to Egypt as Russia. It has also become Morocco and Syria’s main wheat supplier thus solidifying its presence in the region. Like Russia, Ukraine imports a significant amount of fruits and vegetables from MENA and sees the trade relationships within the region as an important variable to the country’s economic strategy. Ukraine also suffers from a lack of contemporary grain infrastructure, but unlike Russia, the country is turning to the private sector to modernize ports and elevators. Private investment in Ukrainian ports has dramatically increased in the last five years and has boosted the country’s trade capacity to accommodate its own wheat trade as well as Russia and Kazakhstan’s grain exports.

In addition to wheat, Ukraine also is significantly increasing corn exports. In 2012, Ukraine tripled its corn exports, became the second largest supplier in the world and the leading supplier to Egypt. It primarily exports corn to the MENA region and the EU with the hopes to increase overall corn exports 91% by 2021.

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11) UN Comtrade Data. (2015)

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### Table 2: Ukraine Wheat Export Partners and Percentage of Total Wheat Exports

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Belarus</td>
<td>21%</td>
<td>Indonesia</td>
<td>17%</td>
<td>Egypt</td>
<td>10%</td>
<td>Bangladesh</td>
</tr>
<tr>
<td>Israel</td>
<td>19%</td>
<td>Israel</td>
<td>17%</td>
<td>Israel</td>
<td>10%</td>
<td>Spain</td>
</tr>
<tr>
<td>Netherlands</td>
<td>13%</td>
<td>Spain</td>
<td>11%</td>
<td>Bangladesh</td>
<td>9%</td>
<td>Rep. of Korea</td>
</tr>
<tr>
<td>Armenia</td>
<td>9%</td>
<td>Hungary</td>
<td>7%</td>
<td>Italy</td>
<td>8%</td>
<td>Philippines</td>
</tr>
</tbody>
</table>
Trade policies and Vulnerabilities

As leading wheat exporters, Russia and Ukraine play a large role in food security around the world, especially import-dependent regions like MENA. In the last decade, these countries have increased their reliance on Russian and Ukrainian wheat imports and are therefore vulnerable to price and supply fluctuations that occur in the Black Sea region.

Both Russia and Ukraine have a long history of using trade policies to protect domestic wheat supply. In response to rising food prices in 2008, Ukraine banned wheat exports and Russia restricted exports by imposing a tariff to stem domestic inflation. In 2010, after a severe drought that devastated the region’s wheat harvest, Russia banned all wheat exports for 6 months and Ukraine implemented a trade quota to protect domestic supply. More recently, as a result of the Crimea crisis and international sanctions that caused a surge in domestic food prices and the devaluation of the ruble, Russia has imposed a high tax on wheat exports essentially ending all shipments. These trade disruptions have significant implications for importing countries that are reliant on Black Sea wheat and often pushes these nations to purchase more expensive wheat from alternative partners.

In summary, as shown in the value chain comparison below, Russia and Ukraine have similar vulnerabilities in the processing link that each country is now attempting to rectify. In this aspect, Russia and Ukraine’s strategies diverge. While Russia is inclined to make public investments in infrastructure to improve the efficiency of the wheat value chain, Ukraine has turned to the private sector to modernize its grain infrastructure. The results are thus far unknown. However it can be argued the efficiency and profit-driven nature of the private sector could prove to increase the proficiency of the wheat market in the region and improve the overall food security of importing countries.

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