

Food Fight Between Russia And The West May Intensify

Law360, New York (September 16, 2014, 10:26 AM ET) --

Despite the imposition of sanctions by the U.S. and EU since March, Russia had not retaliated economically until Aug. 7, 2014, by imposing an import ban on meat, fish, vegetables and dairy products from the U.S., EU, Canada, Australia and Norway. That move, coupled with intensification in its military posture, has signaled a new aggressiveness by Russia. While it is unclear whether that shift occurred because Moscow was feeling the effects of Western sanctions, the ripple effects on Western markets have begun to show.

Some U.S. and EU food producers have been insulated from the Russian food ban, but that is mostly due to prior Russian import prohibitions. For example, Russia's February 2013 ban on U.S. beef imports has meant that U.S. cattle producers were already locked out of the Russian market. Similarly, Russia banned pork imports from the EU in February due to concerns about swine flu, so the new ban has had no effect on the status quo for EU pork producers. However, the ban has been a shock to a number of other industries that relied on Russia as a core export market. Exports of poultry and nuts from the U.S. to Russia each exceeded \$100 million in 2013, and exports of fish and prepared foods were each in the tens of millions of dollars. U.S. exports of fruit to Russia also exceeded \$230 million last year. With Russian markets off limits for at least the next 12 months, U.S. food and agriculture producers in these industries are expecting to see their revenues slide.

In the EU, the situation is even more extreme due to closer economic ties with Russia. Russian-bound exports of fruits and vegetables exceeded \$1 billion in 2013, as did exports of cheese. EU exports of milk products, butter, eggs and beef to Russia each exceeded \$100 million. EU member states such as Latvia, Lithuania, Poland, Spain and Finland have had strong trade relationships with Russia and are likely to be the hardest hit.

EU Takes Countermeasures

EU officials have sought to offset the Russian food ban's effects by setting aside €125 million to compensate EU producers of perishable fruit and vegetable products. With fruit and vegetable exports to Russia exceeding \$2.7 billion last year, EU producers began feeling the pinch almost immediately. In



Matthew R. Levy

some cases, prices for those products have already fallen by 50 percent or more in Europe, and many of those products will be destroyed or simply left to rot in order to stave off oversupply. The Russian sanctions hit Europe at a bad time — many crops were ready to harvest and economic growth had already been lagging.

Although the Russian government lifted a ban on imports of certain food products on Aug. 20, it has had a varied impact on U.S. and EU producers. For instance, even though lactose-free milk and dairy products were removed from the list of banned items, several EU countries have already experienced losses in the dairy market. EU Agriculture & Rural Development Commissioner Dacian Cioloș said, “In a number of member states export earnings are being lost and new outlets need to be found,” adding that the dairy sector needed “time and help to adapt” to the restrictions.

Given the sheer volume of EU dairy exports to Russia last year (€2.3 billion, including exports of cheese worth €1 billion), the European Commission agreed to help to pay the storage costs for butter, skim milk powder and certain cheeses in order to mitigate the effect of the Russian sanctions. On Aug. 28, the commission announced that it would cover daily costs of storing these specific products for three to seven months. The commission has not yet specified the amount it is prepared to provide to prop up the dairy industry, but any proposed aid would first have to be approved by EU member states.

The European Farmers Union Copa-Cogeca welcomed the initiative of the EU Commission, but claimed that “the move does not go far enough.” Copa-Cogeca has asked the EU for additional support in order to balance the market and help farmers in specific sectors and regions.

Russian Citizens Suffering with Food Prices

In Russia, food prices have increased by 10 percent in cities like St. Petersburg and even more significantly in remote areas. As many Western analysts predicted, Russian citizens are the other unintended sufferers of the import ban. Russia took steps to offset the domestic effects of the ban by signing a new agricultural trade deal with Egypt in July, and it is exploring new relationships with Brazil, Argentina, China and even New Zealand. However, the partial revocation of the food ban indicates that these measures, in tandem with Russia’s domestic production, might not be enough to completely supplant U.S. and European imports.

Intensification of Sanctions

The conflict escalated in late August when Russian troops crossed the Ukrainian border to fight alongside pro-Russian separatists. Following a meeting of the European Council on Aug. 30, the EU announced it would issue new sanctions on Russia, which were unveiled Sept. 12. Those new sanctions target Russian energy companies, financial institutions and the defense sector.

As part of a coordinated effort with Europe, the U.S. also issued new Russian sanctions on Sept. 12. Those new measures extend the existing sanctions regime by further tightening the issuance of credit to Russian banks, preventing exports of oil and gas exploration equipment to Russia, and freezing the assets of several Russian defense firms.

Neither the new U.S. nor EU sanctions significantly deviate from the prior, targeted approach, but the timing of these sanctions signals the West’s growing impatience with Russia’s cat-and-mouse tactics. Russian President Vladimir V. Putin called the new sanctions “strange” as they came shortly after Russia had withdrawn troops from eastern Ukraine and the pro-Russian separatists had entered into an uneasy

truce with the Ukrainian government. Russia may have presumed that the threat of new sanctions would not materialize if it took steps to deescalate the military situation. That calculation proved wrong, although both the U.S. and EU have suggested the new sanctions could be rolled back if Russia honors the truce in Ukraine.

Guidance

Russian sanctions are becoming the new normal for U.S. and EU companies, but with the political situation in flux, the compliance landscape may drastically change without warning. The food ban and troop movements showed a new aggressiveness by Russia and the imposition of new sanctions by the U.S. and EU appear likely to trigger additional retaliatory measures by the Kremlin. Russian officials have vowed a swift response, which may include a ban on the importation of foreign automobiles into Russia and a ban on Asia-bound flights from Europe crossing Russian airspace.

For U.S. and EU companies, this is discouraging news. The size of Russia's economy and its close ties with Europe in particular make the trade war almost as damaging to Western interests as to Russian. The U.S. and EU approach of targeting the sanctions to specific Russian actors and industries is a recognition of Russia's importance to the global economy. However, without a sustained effort by Russia to de-escalate tensions, Western companies should expect the current economic sanctions to remain in place, if not intensify. Today's food ban could become tomorrow's automobile ban, and Western companies in the food and agriculture, energy, financial services, defense, automotive and commercial aviation industries should consider themselves warned. The prohibitions on trade in those sectors could come from either the West or Russia at this point.

U.S. and EU companies with boots on the ground in Russia or with significant Russian trade relationships should also pay close attention to political and legal developments. Instability is the word of the day, and as any investor in a developing economy knows, instability is bad for business. Western companies may want to consider putting new projects in Russia on hold or even scaling back current operations until the situation settles. For the time being, Western food and agriculture businesses should carefully weigh the effects of the Russian import ban and consider whether alternative markets might offset the hit to their bottom lines. Even if diplomacy ultimately prevails in Ukraine, economic and political relations with Russia have significantly deteriorated and their trade relationship may not rebound quickly.

—By Matthew R. Levy, Linda Crow and Irina Mikhnova, Faegre Baker Daniels LLP

Matthew Levy is an associate in Faegre Baker Daniels' Indianapolis office.

Linda Crow is a partner and Irina Mikhnova is an associate in Faegre Baker Daniels' London office.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.