

RUSSIAN GOVERNMENT TURNS CENTRALIZATION EFFORTS ON ITS SEAFOOD INDUSTRY

Over the last two years the Russian federal government has adopted an increasingly nationalist tone when discussing fisheries. Russia, it seemed to say, would no longer sit idle as the state was deprived of the value of its seafood resource by such problems as illegal fishing, smuggling and the outsourcing of value added jobs to other countries, principally China.

Until recently the government has not backed its tough talk with enough action to change the status quo. Recent statistics include:

- In their biomass calculations for Atlantic cod, fisheries managers in the Barents Sea estimate at least 100,000 metric tons (MT) of illegal catch on top of the annual quota of approximately 450,000MT. Russia and Norway share territorial control of the fishery, but Russian vessels reportedly account for the majority of the poaching.
- The Barents Sea has hosted a king crab fishery for only the last five years. Observers estimate the illegal catch in the fishery at 44 million pounds, or double the legal catch quota. Again, Russian vessels are reportedly the main poachers.
- When compared to official Russian export records, import statistics in countries such as Japan, Korea and China suggest that as much as 70% of crab from the Far East fishery leaves Russia via unofficial channels.

But within the last six months the seafood industry appears to have become the latest target in President Vladimir Putin's administration's attempts to centralize control of Russia's strategic industries. In particular the federal government has targeted Russia's valuable natural resource industries for centralization and began in recent years with Russia's all-important petroleum industry. If the government's centralization effort in the seafood industry follows the experience in the petroleum industry, the Putin administration will have reclaimed for the state one more of the crown jewels that the preceding administration of Boris Yeltsin frittered away and curbed some of the lawless capitalism that lingers from the Yeltsin era.

Post-Soviet lawlessness

After the fall of the Soviet Union, President Boris Yeltsin abandoned communism in favor of capitalism and the market economy. As part of the process the administration began to privatize state assets and grant natural resource extraction rights to private enterprises. Some chaos is to be expected in such a monumental transformation, but what followed was the pillaging of Russia's crown jewels.

Valuable state enterprises, built with public money and providing healthy revenues to the state, were sold for a fraction of market value to well-connected tycoons. Generous resource concessions gave virtual monopolies to these same tycoons at rates that returned little, if anything, to the state. The deal structures were often questionable, for example trading loans for shares, and billions of dollars from the already discounted prices went missing. The deals made instant billionaires of the buyers, who earned the name "oligarchs" for the small number of them and the monopolistic control they acquired in Russia's key industries.

The chaos created by the transition to capitalism and the sell-off of state assets eroded the rule of law in Russia. Corruption became rampant, bleeding the economy of billions of dollars and contributing to the economic crisis in 1998. In the absence of the rule of law, businesses resorted to violence to protect their interests. Murders were commonplace in Russian business in the 1990s, with a variety of executives at prominent companies implicated in the violence.

Putin attempts to regain control

Vladimir Putin assumed the presidency in 1999 and since then has attempted to reassert the power of the central government both in the political and economic arenas. After Yeltsin's administration had unraveled Soviet-style central control into a Wild West-style market economy, Putin's administration pulled back on the reins, preferring a "state capitalism" model for Russia's strategic industries. This model retained the market economy but the state assumed major ownership stakes in the dominant enterprises.

Russia's petroleum industry remains the country's economic driver and is an example of the development of state capitalism in Putin's Russia. Under Yeltsin, state-owned petroleum enterprises were among the many assets sold fraudulently to the Russia's oligarchs. The Yukos oil company, for example, valued at \$30 billion in 2004 was sold for \$110 million in the early 1990s to a group of shareholders led by Mikhail Khodorkovsky.

Yukos received worldwide media coverage in 2003 when the Russian government imprisoned Khodorkovsky and banished him to Siberia. The government sued Yukos for tax evasion and seized the shares of the controlling stake in the company. Yukos eventually declared bankruptcy and was liquidated, with its prized assets acquired by Gazprom, a state-controlled petroleum company. Gazprom has since become the dominant player in Russia's petroleum industry.

Khodorkovsky was targeted for his support of opposition parties in Russia, not because President Putin was attempting to strip the Russia's oligarch of their ill-gotten empires. Indeed most of the oligarchs remain in the administration's favor and have profited once again from the resale of their empires to the state. For example two oligarchs bought the oil company Sibneft from the state for \$100 million in 1996 and in 2005 resold their share in the company to state-controlled Gazprom for \$13.1 billion.

More than anything the Yukos example underlines the Russian government's determination to control the value of the country's important petroleum resources.

Next on the list: seafood

Russia's seafood resource does not match the importance of its petroleum resources, so the Wild West mentality has persisted in seafood industry even as the Putin administration began asserting its control over the petroleum industry.

But now the centralization and nationalization process in the seafood industry seems to be gathering momentum, especially in the Barents Sea fisheries:

- In late 2007 the Russian government signalled the renewed importance of fisheries with a new fisheries ministry, headed by an activist minister named Andrey Krainy.
- Crackdowns on illegal fishing in the Barents Sea have increased, or at least have received increased coverage in Russia's state-controlled media.
- To combat smuggling the state says it will implement in 2009 a "seafood exchange," through which all quotas and foreign trade deals must be channeled.
- To extend Russia's footprint on the value chain the new fisheries minister Krainy has reversed a planned privatization of Russia's derelict state fisheries enterprise – the Arkhangelsk Trawler Fleet (ATF) in the city of the same name on the Barents coast – now intending to reform the fleet as a state corporation named Rosrybflot, which will presumably be the government's tool in asserting control over the Barents Sea fishery.
- Until recently grounded, bankrupt and without quota, the ATF will now inherit quota and assets seized from fishing companies engaged in "illegal fishing" and "economic mismanagement" and will likely receive financial support from the government.
- Russia will bar foreign companies from buying or owning fishing quotas as of 2009. The terms of the new Russian-only quotas will be extended from five to ten years.
- Russia's high seas fleet is currently too outdated to exploit all of the fisheries in Russian waters and does not compete for fish in international waters, so the government has announced a \$2.5 billion budget meant in part to upgrade the country's high seas fleet.
- Although barred from future fishing opportunities, foreign companies will be encouraged to invest in Russia's shore processing sector. Loans and incentives to these foreign investors form part of the government's \$2.5 billion "fisheries upgrade" budget.

- Through these and other measures, Minister Krainy expects to increase Russia's output of fisheries products to 4.5 million MT by 2010. Seafood output in 2007 was 3.5 million MT, up by 10% from the previous year.

Sitting in Moscow, approximately 6,500 kilometers removed from the Pacific coast, the federal government has been less active in the Far East fisheries. To date its influence has not challenged the regional governments, businesses and in some case, crime syndicates that control fisheries production and trade.

Sources: Urner Barry, Barents Observer, Vladivostok Times, Vladivostok News, Norway Post, Alaska Report, Asia Times, Wikipedia, Norwegian Ministry of Fisheries, Kommersant

Implications for frozen seafood buyers:

- Since the federal government has so far devoted more effort to controlling the Barents Sea fisheries than to the Far East fisheries, these measures will have more effect on Barents species such as Atlantic cod, haddock and king crab and less effect on Pacific species such as pollock and Pacific cod.
- Seafood products processed from Russian raw material will likely still find their way to the more attractive markets in Europe and North America.
- But if the Russian government's efforts are successful, Russian companies will both harvest and process those products.
- This will cause some short term upheaval in the supply chain, especially for the supply chain based on Chinese processors, who depend heavily on Russian raw material.
- In addition to a shuffle in supply chain geography, an increased Russian share of the processing market may also bump up prices, as Russia can not compete on a level playing field with China's inexpensive labour pool.
- The Russian government seems to indicate that it may use subsidies to help Russian processors overcome some of China's labour cost advantage, but it is unlikely that the Russian government will commit long-term to the level of subsidies necessary to match Chinese price points.
- More likely the Russian government will seek to restrict the export of its seafood raw materials, forcing the market to adjust to whatever price Russian processors are able to offer.

Visit www.tradexfoods.com or contact your Tradex Foods account manager.

val@tradexfoods.com	jeffrey@tradexfoods.com
linling@tradex.com	felix@tradexfoods.com