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State Council Presidium Meeting On Fisheries Sector

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Report Highlights:

On October 19, 2015, President Putin chaired a meeting of the State Council Presidium (Council). The discussion focused on issues related to the development of the Russian fisheries sector. President Putin highlighted a number of problems in the sector and encouraged participants to coordinate among the business community, interested government agencies and fisheries associations for solutions for more sustainable growth of the sector. Industry sources cast serious doubts as to the possibility of real progress in addressing these problems, especially given the financial requirements. NOTE: A public version of this report is also being submitted without industry and post comments on the discussion.

General Information:

On October 19, 2015, President Putin chaired a meeting of the State Council Presidium (Council). Participants and main speakers at Council included:

Minister of Agriculture, Alexander Tkachyov
Deputy Minister of Agriculture, Head of the Federal Fisheries Agency, Ilya Shestakov;
Governor of Kamchatka Province, Vladimir Ilyukhin;
Governor of Arkhangelsk Province, Igor Orlov;
Governor of Sakhalin Province and the Head of the Working Group of the State Council Presidium, Oleg Kozhemyako;
Advisor to the President, Andrey Belousov;
Head of the Federal Antimonopoly Service, Igor Artemyev;
and others.

The meeting was publically reported on in the media.

In the opening remarks, Mr. Putin expressed concern that Russian “grocery stores are still filled with imported and rather expensive products and the quality is not always satisfactory.”

According to President Putin, the Russian fisheries industry has grown because of several government support measures. However, in spite of that growth, “achievements have not been sufficient to bolster Russian food security or develop coastal regions and related economic sectors.”

The President provided some statistical data to support his concerns:

- Frozen fish accounts for 87 percent of Russia’s exports in 2014, while fresh fish fillets and ready to eat products account for only 7 percent of Russian exports;
- The share of frozen fish in the domestic market is nearly 57 percent, and fresh fillets are slightly more than 2 percent.

In the course of his speech, President Putin also highlighted a number of serious problems in the sector, such as:

- Significant volumes of fish are shipped to other countries as frozen and low processed products;
- The fisheries industry “has spawned a whole host of rentiers that live off our marine resources;” and
- Production of coastal fisheries has dropped by 10 percent over the last 5 years.

According to President Putin, the following objectives should be established for the sector:

- Develop a modern coastal infrastructure, processing plants, effective logistics and a high-tech fishing fleet. According to Mr. Putin, Russia “lags considerably behind our competitors in all of these areas;”
- Modernization of the fishing fleet: “Russia’s fishing fleet is 90 percent worn out and not only not economically effective, but it is also dangerous for the crews.” President Putin stated that Russia

“must build our own, modern high-tech trawlers.”

- Encourage fish harvesting and fish processing companies to invest in modernization of fishing gear: The President believes that an increase in fishing quotas to companies that invest in fleet modernization will compensate for those costs of modernization, will help in the development of related sectors, and will improve supply to the domestic market.

Later, President Putin gave the floor to Oleg Kozhemyako, the Governor of Sakhalin province and the Head of the State Council Presidium Working Group on fisheries issues. First, Mr. Kozhemyako reported on recent achievements in the sector, including:

- Annual revenue for the government as a result of activities in the fisheries sector (in 2014) estimated at 15 billion rubles in taxes and \$2.5 million in currency returns;
- Recently, the total harvest of fish and seafood in Russia increased by 1 MMT, or 25 percent, and reached 4.3 MMT;
- The number of unprofitable companies in the sector is down by 50 percent;
- Annual investment in the sector doubled, reaching 10 billion rubles;
- Twenty new fish processing facilities were built in the Far East; and
- The fisheries sector employs 270,000. If you consider the total fisheries industry (including spin-off industries in related economic sectors) a total of nearly 1 million are employed.

Mr. Kozhemyako, also reported on some serious challenges the sector faces, including:

- The current quota distribution structure discourages investment. Kozhemyako believes that extending terms for quota distribution among users up to 15 years will significantly improve the investment climate in the sector;
- Poor and inefficient performance of the Russian ship building facilities often means that the shipyards are not able to guarantee readiness of the fishing vessels by the beginning of the season. One of the principle reasons for the poor performance is a lack of qualified personnel. As a result, most owners have shifted their repairs to shipyards in Norway, China or Korea. In an effort to stimulate local ship construction, Mr. Kozhemyako proposed the allocation of 20 percent of total allowable catch for investment purposes, such as purchases of new vessels built at local shipyards, as well as construction of new fish processing facilities;
- With the current high share of raw material that is destined for export, the goal should be to increase the economic value of those exports. To accomplish this goal, it is necessary to apply a differential approach related to a fee for catch of fish and seafood. The fee for catch should be lower for the companies that ship high-value products and higher for the companies that export raw material.
- Kozhemyako believes that the most important issue is to make fish and products affordable for the Russian population, specifically for low income people. Mr. Kozhemyako thinks that a number of companies, middlemen, who buy products from fishermen and sell to retail, increase prices for the products and escape paying taxes. As a result, the retail price for fish is high, but the appropriate taxes have not been collected on the product. Kozhemyako contends that the

government needs to introduce VAT for large commercial companies (rather than medium and smaller businesses, or town-forming facilities) rather than a unified agricultural tax. Such a mechanism would eliminate middlemen and allow fisheries producers to conclude agreements directly with retail chains. Eventually, streamlining the process in this way will reduce the mark-up for fish and products and lower the price by 30-50 percent for consumers.

The other mechanism that may make fish and seafood products more affordable is the use of more transparent tools, such as fish stock exchange auctions. A fish stock exchange has already started in the Sakhalin region, supported by Sberbank and the local administration.

In closing, Mr. Kozhemyako also mentioned the need to annul excessive administrative barriers, such as the Veterinary and Phytosanitary Surveillance Service's surveillance of fish along the coast. He believes that these initiatives will provide a powerful motivation for sustainable development of the fisheries sector.

The next report was made by Ilya Shestakov, Deputy Minister of Agriculture and the Head of the Federal Fisheries Agency (FFA). Shestakov stated that in 2014, investments to capital assets were lower than average, at 12.7 billion rubles. He noted that this is a constraint to further development for this sector. Shestakov also, stressed the slow pace in building new fishing vessels. Since January 1, 2009, when fish quotas were distributed to users for the period of 10 years, only 16 fishing vessels have been built, including 10-low tonnage vessels.

Mr. Shestakov identified the following systematic problems that impact current further development of the sector:

- Depreciation of fishing gear: Currently 80 percent of fishing vessels have been in operation for 20 years or more. A number of companies are investing into vessel modernization, however, primarily into the renovation of the processing equipment and storage facilities on the vessel. Often the engineering infrastructure of the vessels can no longer support the growing processing capacities, resulting in an increase of in technical accidents on the vessel;
- Orientation of the sector toward raw material export: Ninety percent of fish products are exported with a very low degree of processing; and
- Lack of infrastructure: Specifically, there is a deficit in modern storage facilities, and depreciation of railway equipment.

The priority for the development of the fisheries sector is to improve its cost efficiency and development of coastal processing. Mr. Shestakov believes that this objective can be achieved with the introduction of amendments to the historical quota distribution system. He suggested that the government support a mechanism that will grant an additional 20 percent quota to companies that construct high-tech processing facilities on vessels in Russian shipyards or in Russian fish processing plants.

Another important step is to increase the social importance of coastal fishing, and to stimulate companies that supply fresh, chilled and frozen fish to coastal processing facilities. Competent regional authorities may be in charge of tracking shipments and the paperwork.

Mr. Shestakov supported the initiatives reported by other speakers of the Council, such as eradication of

the middlemen in the quota distribution system. Mr. Shestakov believes that currently between 10 to 15 percent of the quota for Pollack belongs to companies that do not have fishing vessels.

The shortage of affordable and quality fish products in the central part of Russia is due to the poor infrastructure and logistics. Recently approved regulations, such as on Free Port of Vladivostok and on the Territory of Priority Development, have created environments that will facilitate the implementation of these infrastructure projects. Plans include the creation of a network of wholesale distribution centers that will be integrated into the Far Eastern fisheries cluster, as well as facilities in Novosibirsk, Vladimir and Moscow provinces.

Mr. Shestakov also discussed the importance of modern railway refrigerator containers in order to reduce the cost of the product and to ensure the quality of the fish.

In his closing remarks, Mr. Shestakov raised the issue of aquaculture, noting that it is a priority.

Currently the share of aquaculture in total fish and seafood catch is estimated at 3.5 percent, while as worldwide the figure is close to 50 percent. Mr. Shestakov reported that 500 plots have been allocated for commercial aquaculture and will be offered at auction. The newly approved regulatory base, as well as government subsidies to support the sector, will provide a significant push for aquaculture development.

The floor was given also to Mr. Vladimir Ilyukhin, the Governor of Kamchatka Kray, and Mr. Igor Orlov, the Governor of the Arkhangelsk provinces. Both Governors reported on the current fisheries situation and recent development at the local level. The Governors agreed with the importance of stimulating and developing coastal processing facilities with additional measures of support, such as separating quotas for fish and seafood for coastal facilities.

Minister of Agriculture Alexander Tkachyov took the floor and stated that he agreed with the issues raised by the other speakers, but the main problem is how to deliver 2 million MT of fish from the Far Eastern regions of Russia to the European part of Russia. He highlighted the need for large and modern storage facilities with capacity of 200,000 MT.

Minister Tkachyov also noted the importance of increasing the production of refrigerated containers. Currently there are 4,000 containers for transportation of fish. The quality of railway cars is poor. Many are unable to maintain necessary temperature: during transportation the temperature inside the containers increases by 1-2 degrees a day and the quality of the product is severely impacted. According to the estimates of the Minister, 12,000 containers are needed in order to provide for transportation of fish and seafood from the Far East to the central part of Russia. Finally, there was discussion on how to reduce the transportation period from 20 to 7 days.

Stimulating consumer demand for fish and seafood is another issue that was on the agenda at the Ministry of Agriculture. Minister Tkachyov believes that this can be achieved by restriction of federal procurement of imported fish. Currently the Ministry of Agriculture is developing a draft document that will address the issue. Likewise the import substitution goal has been addressed and soon we will be able to “feed our children with our healthy fish, not with tilapia from China or aquaculture pangasius from Vietnam.”

The Minister reported that in 2014, Russia imported 900,000 MT of fish and seafood, and 30 percent of

the imports were fish produced through aquaculture. Russia produces 160,000 MT of fish through aquaculture. By comparison, China produces 60 million MT, or 375 times more. The Minister believes that with current government support, such as subsidies on credits and adopting regulatory structure, the aquaculture sector will be able to develop and increase the share of aquaculture production from 3 to 50 percent.

Comments

The systematic problems of the Russian fisheries sector discussed at the Council have been raised many times in the last 5 years in a variety of fora - conferences and meetings with participation of officials from different levels of government. Though there have been some improvements in the sector lately, however, an obsolete fleet combined with an underdeveloped fishing port infrastructure, administrative barriers, and lack of investment still remain constraints to sustainable development of the sector.

Trade sources and businesses are skeptical that the results of the Council, chaired by the President, will bring an immediate positive impact on the situation. Commenting on the discussion of the Council meeting, experts note that they are not surprised that most of fish and seafood products from the Far East are destined to foreign markets rather than European Russia. It is much more economically feasible to ship Russian catch to Korea and China. The price for fish is higher in foreign markets. In addition, the Russian fishermen would have to collect numerous documents to deliver their catch in the Russian ports. Moreover, officials reporting at the Council did not provide any financial estimates on how much investment would be needed to make the recommended coastal infrastructure and transportation improvements.

Some contacts believe that the recommendations presented by officials at the Council, such as increasing quota in favor of companies that are renovating their fishing vessels, were lobbied by the interests of large fishing companies, such as “Russkoye More”, and may lead to monopolization of the sector. The smaller companies are concerned that if quota is increased to one company, other smaller companies may lose theirs.

Post also would comment that the data provided by the officials, that characterize the economic improvements of the sector, were not qualified in terms of time period or scope. Moreover, in many cases the officials offered no real solution to the underlying problem. For example, Mr. Kozhemyako attributes the poor quality work at the shipyards to the lack of qualified personnel, but he proposes nothing to solve that particular issue. Mr. Shestakov notes the problem with processing facilities added on top of ships that can't structurally support those facilities, but then in his proposal he encourages the same types of action.

There is significant discussion among industry contacts, but no official statistics, that the numbers of bankruptcies in the seafood processing sector since Russia's implementation of the food import embargo have been significant. As Russia must choose the priorities within its import substitution drive, it is interesting that most of these proposals put the financial responsibility squarely on the shoulders of industry. This may be a difficult pill to swallow in a sector that is already struggling under serious financial constraints.

Post notes that aquaculture could potentially fill the supply gap, but the sector has received little attention from the government or from the private sector. Russia does have substantial water and land

resources in the Western part of the country which could be used to bring fish production closer to consumers. This also may present opportunities for increased soybean meal consumption in Russia.