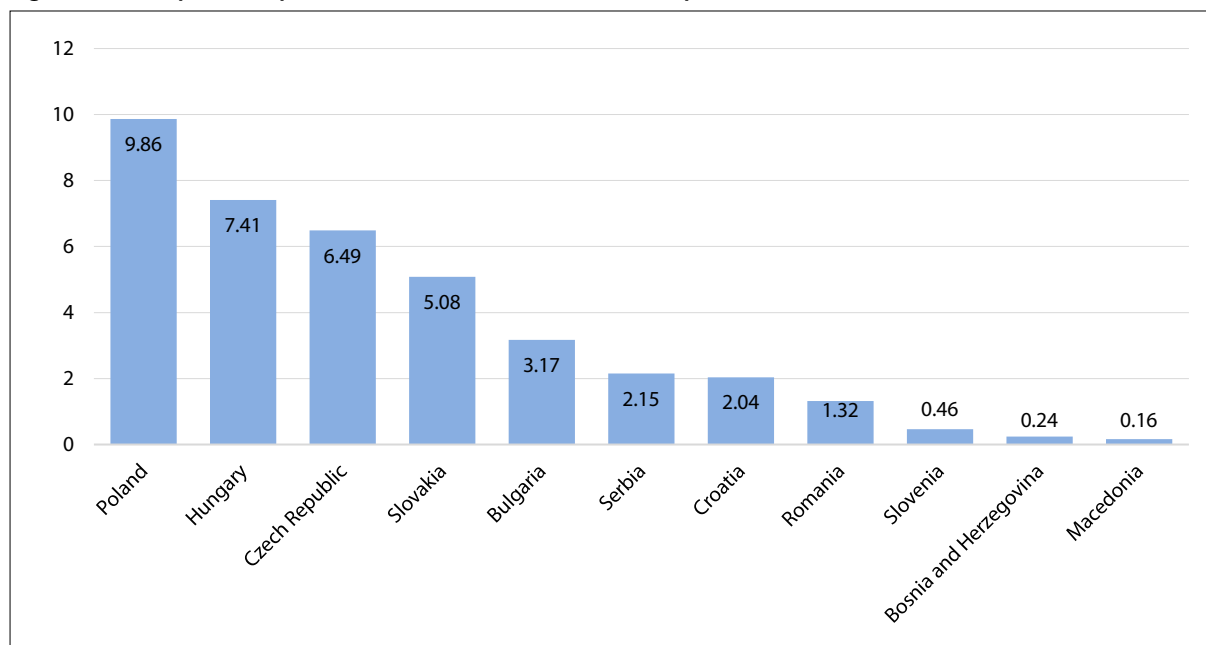


Figure 3: Gazprom's Exports to Central and Southeastern Europe in 2018 (in bcm)

Source: <http://www.gazpromexport.ru/en/statistics/>

ANALYSIS

Battle of the Crabs: Birth of a National Bourgeoisie?

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Abstract

To cut losses imposed by Western sanctions, an oligarch-connected company has used its access to the Russian state to gain control of the lucrative crabbing industry. This article lays out the details of the process for the take-over. Going forward, the question is whether Russian business as whole will seek to better defend its interests against this kind of encroachment.

An Oligarch's Family Seeks to Expand

From the beginning of November 2017 to May 1, 2019, first unnoticed, and then with increasing resonance, Russia witnessed a struggle to redistribute the market for crab production. Most of the media accounts link this initiative to Gleb Frank, the owner of the "Russian Fishery Company" (<http://www.catching.ru>) and the son-in-law of the oligarch Gennady Timchenko, who has long been seen as a member of President Putin's inner circle. According to some fishery industry insiders, the Timchenko family seemed to use its money, which it

had already moved from the West into Russia, to cut the losses incurred by sanctions. In the current Russian political landscape, such an initiative seemed to be guaranteed speedy success. However, the majority of the fishing industry was able to organize a remarkable public campaign and "hold the door open" for almost a year and a half.

Russia's Fishing Industry

The fishing industry in the new Russia has always been an exception. Established in the Soviet era, it was even

then a global player—regulation of ship navigation is international and part of the high-profit catch was exported. The industry is overwhelmingly masculine and has a traditional “sailor” culture inherited from the Navy. Fishing waters, as a rule, are associated with the Russian frontier—from Murmansk and Arkhangelsk regions to Primorsky Krai and Kamchatka. Residents of the dozen sparsely populated “coastal regions” are either descendants of people who never knew serfdom (in the North), or descendants of Cossacks, land-migrants and settlers (in the Far East).

The peculiarity of the fishing business is that the state owns the aquatic biological resources (the fish and other seafood), and if a fishing company has not received (or lost) the right to catch, it is effectively excluded from the market—trawlers, sailors and warehouses become “redundant” if the industry regulator, Rosrybolovstvo, (<http://fish.gov.ru/>), denies them quotas and permits. There are hard currency quotas for crabs, Pollock, and other seafood which are mainly for export, and quotas for more “democratic” fish, usually destined for the domestic market. The physical volume of quotas is adjusted at the end of each year and depends on scientific forecasts, ensuring the sustainability of the resource and avoiding “overfishing” and poaching. The taxes for harvesting seafood were established long ago and their sizes are insignificant—a fact long acknowledged by both fishermen and regulators.

In the 1990s and early 2000s, the Russian fishery industry passed through a “perfect storm”: economic restructuring and the flourishing of violent entrepreneurship imposed a decline in official catches and the growth of poaching. The quotas for the annual auctions of 2001–2003 forced most companies to borrow from banks or informally negotiate with foreign “investors” (and they were only able to settle these debts by 2014–2015). The annual auctions were quickly recognized as being so unsuccessful, that the Russian Government has since 2004 switched to the so-called “historical catch” approach, essentially allowing each company to catch the same number of fish that it did in the previous year, first for 5 years, then from 2008, extended up to 10 years, and from 2019, for 15 years. The fishing industry achieved the last extension, adopted by the State Council in November 2015, in exchange for the so-called “quotas under keel”—the obligation to build new fishing vessels in Russian shipyards and domestic processing plants on the coast. Of course, the modernization of the old foreign ships and the construction of new foreign ones was more advantageous for the fishing industry from the point of view of “price and quality”, but the Russian government decided to support the Russian shipbuilding industry in this way.

A New Fishing Bourgeoisie

With hindsight, it is possible to assert, that in the years following the transition from auctions to the historical catch principle, a Russian fishing bourgeoisie developed with the following characteristics:

- Willingness to “whitewash” the business, which soon led to its consolidation. However, there is still a reasonable level of competition—small and medium-sized businesses make up 68% of the total number of enterprises and catch 35% of the quota volumes. The share of small and medium business in the fishing sector exceeds their share in the Russian Economy as a whole, which is approximately 22%;
- Absence of foreign minority shareholders (distinguishing it from other export-oriented industries such as metallurgy or oil);
- The need for building contacts at the top of the executive branch, among ministers and relevant deputy prime minister;
- Nomination of representatives from the fishing sector to legislatures at the national and regional levels, including representatives in the State Duma and several senators in the upper chamber Federation Council—not only from United Russia, but opposition parties as well;
- Highly trained government relations specialists, who actively participate in all in all aspects of rule-making (particularly measuring of regulatory impact);

The presence not only of regional and industry business associations, but also such “umbrella” associations as the All-Russian Association of Fish Industry Enterprises, Entrepreneurs, and Exporters (<http://varpe.org/>), which includes businesses covering 80% of the Russian catch. De facto representatives of these associations constitute a controlling majority in the Public Council by the regulator Rosrybolovstvo.

Putin Takes Action

In recent years, only the Federal Antimonopoly Service (which criticizes all types of grandfather clauses) opposed the historical catch principle, but a letter of unknown authorship sent to President Putin in November 2017 became a trigger for change. The quota owners immediately pointed to a “new major player, the Russian Fishery Company, with substantial financial resources who wants to enter the market and displace small companies...” (Kommersant, November 20, 2017, <https://www.kommersant.ru/doc/3473023>). According to the fishermen, the management of this company allegedly sent this letter to Putin, who instructed presidential assistant Andrey Belousov to deal with the matter.

Whoever initiated this letter knew exactly how to pull the right bureaucratic levers—he had analyzed the

financial balances of several crabbers for the three previous, profitable years, their investments in buying less successful competitors and modernizing old ships (but not investing in building new ones!), and their fragmented spending on corporate social responsibility. Most importantly, the letter informed the Russian leadership about the windfall profits the fishermen were making as a result of the devaluation of the ruble in 2015–2017, and from which the current crab kings, supposedly, could pay handsomely for participating in new auctions. Typically, governments transfer such excessive profits to the public treasury by temporarily increasing taxes or other fees, but auctions make it possible for a new player to enter the market who, in turn, is not interested in a sharp increase in fees for access to the ocean's resources.

The crabbers repulsed the first onslaught at the end of 2017, deploying a noisy media campaign, open letters to the authorities, and a meeting that brought together all fishing interests since the abolition of the “historical catch principle” would be a threat to the majority of fishermen. However, after the change of government in May 2018, the state authorities who had advocated the abolition of the historical catch principle for crabs began to operate in a much more organized manner and formally dropped the idea of defending competition and fighting against oligopolies. At the end of April 2018 the pre-final version of the annual Federal Anti-Monopoly Service report on the state of competition was released, and on August 16 the road map on competition development was signed by the new-old Prime Minister Dmitry Medvedev. These documents allowed, theoretically, revenues from future crab auctions in Russia's draft budget for 2019–2021.

The Battle is Joined

In late August and early September, the parties came into open conflict. Proponents of auctions made a bureaucratic error—they marked the draft crab bill amendments as “secret.” Perhaps the new Agriculture Minister Dmitry Patrushev lost sight of the two most important “institutional” barriers for such secrecy—(1) the clear norm in federal law no. 166-FZ “On fishing and conservation of aquatic biological resources”, which requires since 2004 the participation of citizens and business associations in matters relating to fisheries and (2) the obligation for a regulatory impact assessment of draft bills affecting businesses (in effect since 2010).

Opponents of the auctions have adopted a legalistic strategy for fighting to save the existing system: formally for the last 10 years the Russian administrative system has included a number of smart regulation mechanisms, whose business potential is rarely used (see “Regulatory Policy in Russia — Smart Suggestions, But Poor Imple-

mentation” in *Russian Analytical Digest* 227). For this purpose, they sought the support of major Russian think tanks, whose opinions carried weight with at least two state bodies, the Chamber of Accounts, headed by Alexei Kudrin, and the Ministry of Economic Development.

Ultimately, the anti-Moscow protest vote in the Primorsky Krai gubernatorial elections in September 2018 transformed the political context. The loss of Kremlin-appointed acting Governor Andrei Tarasenko had a dual influence. On the one hand, the crabbers had bet on him, and Tarasenko shortly before the first round of the election discussed their concerns about the auctions at a meeting with President Putin. On the other hand, while the Kremlin was not sure that a new governor would be elected in Primorye (eventually the new governor became Oleg Kozhemyako, also with a background in the fishing industry, but importantly no connection with the crabbers), it had to pause its introduction of the bill into the federal parliament, as well as the media campaign supporting this step.

Complicated Bureaucratic Infighting

The first setback Rosrybolovstvo and the Agriculture Ministry received came in October 2018 in the State Duma Budget and Finance Committee, which has authority over the draft budget for 2019–2021. The crux of the problem was that the Budget Code does not allow for planning income which does not have a basis in law, while the financial and economic calculation of such incomes must follow Ministry of Finance methodologies. Often these requirements are ignored, but this time the Accounts Chamber, having received a “heads up” from the fishing business associations, questioned the income from the crab auctions in its review of the draft budget. The budget was still accepted, but the justifications from Rosrybolovstvo, citing non-public correspondence with the Finance Ministry, looked weak.

Only after Oleg Kozhemyako's victory in the Primorsky Krai gubernatorial elections (December 16, 2018), could the supporters of the crab redistribution scheme use their second main resource—television. In the last days of December all national networks simultaneously broadcast reports about the “Crab Kings,” the majority of whom, ostensibly maintained foreign residences while receiving insane incomes provided by poaching marine resources and exporting them abroad. Only insiders and experts understood that these reports mixed the history of the 1990s (describing practices no longer in use) with outright nonsense about smuggling (the modern means of monitoring the catch by the Border Service (part of the Federal Security Service, FSB) and Rosrybolovstvo and a series of rigid regulatory restrictions practically prevent such opportunistic

behavior). Not only typical TV viewers, who could not afford expensive crabs, but also members of the State Duma and Federation Council from inland regions, were supposed to be horrified and convinced that it is time to impose order on this industry!

At the end of January, 2019, the Agriculture Ministry and Rosrybolovstvo finally submitted their “crab bill” to the government apparatus. It contained an additional requirement for future auction winners—building new crabbing vessels in Russian shipyards (a demand from the Ministry of Industry and Trade).

But at this point, an unexpected surprise worked in favor of the fishing industry: two weeks earlier, at the Gaidar Forum, Prime Minister Medvedev announced the launch of a “regulatory guillotine” aimed at removing redundant norms and bad regulations (the idea had been introduced in 2004 by the consulting firm Jacobs, Cordova & Associates). The curator of deregulation was appointed Deputy Prime Minister Konstantin Chuychenko, who as government chief of staff also headed the Commission on law-making activity, which considers all bills before they are submitted to the State Duma. In this situation, he obviously did not want to lose face, so the commission removed the secret classification, and Deputy Prime Minister Alexei Gordeev (who is responsible for agriculture and fisheries) sent the bill for regulatory impact assessment.

More Insider Intrigue

Going forward the political struggle around interpreting the rather complicated regulations of the government and the State Duma and certain gray areas in the Russian rule-making process formed the main canvas of confrontation.

While the public consultations were given less public time than required (15 working days), the regulatory impact assessment was implemented in full. The fishers marshalled good expert support and their experience in public discussions showed as they hit the regulator with a series of criticisms:

- 1) The bill did not provide a financial and economic analysis of its impacts. The two paragraphs submitted by the bill authors did not meet the requirements of the government regulations or the Finance Ministry requirements for financial and economic analysis;
- 2) Independent anti-corruption experts identified a number of inappropriate blanket rules in the bill (typical for Russian laws and a situation which usually is ignored);
- 3) On the site regulation.gov.ru, users posted nearly 1500 negative comments along with more than 650 dislikes. The few comments in support came from

a small industry association and companies associated with the Russian Fishery Company, confirming the previous conviction that it was behind the initiative.

Agriculture Ministry officials ignored the critical opinions and in the mandatory summary of the discussion they simply repeated anodyne answers. Moreover, in about a third of the cases, there was no reaction to the business comments at all (a direct violation of the regulatory impact assessment procedure).

The fishery associations appealed all of the violations to the Prosecutor General’s Office, and wrote letters to the Finance Ministry, Justice Ministry and the main legal department of the Presidential administration, but received only formal answers: officials refused to comment on the substance, a sign that the political decision had already been taken at the top.

The public consultations in the Ministry of Economic Development—the main department responsible for assessing the regulatory impact in the executive branch—were the only ones to turn out differently. The ministry issued a negative opinion, and this was the most significant victory for the fishing industry during the entire campaign.

The crabbers marshalled the following important arguments against the bill in the public hearing:

- 1) The drafters plan to receive 82 billion rubles in income in the next two years, but no one considered the associated losses: the unreceived tax income in the regions or the inability of the new players, who have financial resources, but lack competence, quickly to establish a production process.
- 2) The threat to domestic shipbuilding, which has been receiving bank credits since 2017 against the collateral of the existing quotas (in fact, property rights) which were now subject to redistribution. Will a new construction program be launched? According to the draft law, the model “first catch-then build” will allow the new players to use state resources, to receive profits, and then simply abandon the construction of new boats or lobby to receive state subsidies for their completion.
- 3) The risk of establishing foreign control over the fishing resources. It will be impossible to prevent this in the process of electronic bidding.
- 4) Social costs are not calculated, including a reduction in employment and a decrease in labor productivity; Devastation of existing seaside settlements, including due to the use of rotational employment methods (fly in/fly out), inevitable when new players enter the market; the phasing out of corporate social responsibility programs;
- 5) According to the data of the Higher School of Economics’ Institute of Agrarian Research, if the crab

auctions were implemented for not more than 28% of the total amount of allocated quotas (the optimum according to their econometric model), it would be necessary to introduce an export duty for 3 years (this is a classic fiscal move to address wind-fall profits);

- 6) Last but not least—the quotas are considered property rights, which was confirmed by the Russian Federation Constitutional Court in 2001; the European Court for Human Rights supported similar positions in cases brought by Icelandic and Finnish fishermen between 2002 and 2008.

For the sake of fairness, it is necessary to mention the arguments in favor of the new regulation, in addition to support for competition and the one-time receipt of funds from auctions to the budget:

- 1) Outdated vessels have rather uncomfortable conditions for sailors (who make do because their salaries are twice the average pay received in the respective coastal regions);
- 2) The fishing industry had 10 years since 2008 to build ships, but they did not build any and it is not clear where the money went;
- 3) Coastal regions will not lose jobs, as new players need both sailors and ships to fulfill their quotas.

A Decision Already Made

The negative policy impact assessment issued on March 7, 2019, failed to hinder passage of the bill. Moreover, further developments demonstrated that the authorities had decided to no longer comply with their own regulations, silently acknowledging that the principles of transparency and evidence-based policy making favor the current owners of the quotas. First, despite the need for two rounds of conciliation meetings after the negative impact assessment opinion, the bill was immediately submitted to the Commission on Legislative Activity. Three days later, the government submitted it to the State Duma. Interestingly, at this point the media was invited to leave the government meeting, demonstrating that there were expected votes against the bill (!), and already on March 19 the bill was in the parliament.

The strategists of the fishery associations hoped for a lengthy discussion in the State Duma and some compromises, for example, the introduction of a transition period. First, natural resources are subject to joint management by the federal and regional governments, according to the Constitution, and the Duma rules stipulate that such bills should be sent to the executive and legislative bodies of the regions, as a rule, for 30 days, to allow sufficient time for them to prepare their positions. Moreover, since 2005 the Council of the Duma has considered 72 amendments to the law “On fishing

and conservation of aquatic biological resources”, and in 71 of the 72 decisions the Council consulted with the regions. Secondly, at the Russian Union of Industrialists and Entrepreneurs’ Congress held at this time, Vice Prime Minister Dmitry Kozak said that any regulatory innovations that entail additional costs for business should be introduced only after a sufficient transition period typically lasting two to three years. Thirdly, there was hope for amendments from opposition party deputies seeking to score points on popular themes and from single-mandate deputies from the coastal regions (though all of them are representatives of United Russia, they should be re-elected in 2.5 years and protest votes on the frontier may well give victory to opposition candidates). Finally, the online broadcast of not only the plenary meetings, but also the meetings of the Committee on Natural Resources and parliamentary hearings on the “historical catch principle”, seemed to guarantee the possibility of making the strongest arguments in public, thereby attracting the attention of the mass media.

But neither the regulations of the State Duma nor the articles of the Constitution could stop the development of events. The Council of the State Duma pretended that the bill was not regulated by article 72 of the Constitution (co-management of resources by the federal and regional governments), but by article 71 (exclusive management by the federal government), and gave only 10 days to receive comments, excluding the regions from the mailing of the requests for comments. Most of the opposition’s amendments were rejected, and, conversely, amendments that improved conditions for the new players were accepted. The only gesture in favor of the regions was that the company winning the auction must be registered in one of the coastal regions so that tax income would flow to the region rather than Moscow (but nothing prevented the winners from creating subsidiaries there; and someone created them back in 2018, in anticipation of future auctions). The law was adopted quickly. The first reading was held on April 4, and the third one on April 10, 2019. On April 22, the Federation Council approved the bill and President Putin signed it on May 1. This game is over and the oligarchs are coming.

Conclusion

There are several conclusions that we can draw from this episode.

- 1) The fishermen, despite a number of miscalculations, including delays in recourse to external expert support and a chaotic media strategy, demonstrated that they could resist the powerful and devious oligarchic groups for quite a long time despite the existing legal system and their limited access to the media;

- 2) Despite its loss in this “Battle for the Crabs”, the industry was able to induce both the State Duma and the Federation Council to create groups to monitor the implementation of the law. Now it is unlikely that someone will manage, for example by manipulating electronic platforms, to “exclude” undesirable bidders on certain lots or buy up the crab lots for one or two affiliated companies.
- 3) The State Duma, Agriculture Ministry and Rosrybolovstvo immediately after the adoption of the law publicly and firmly defended the “historical catch principle” for other types of marine resources (i.e. except crab);
- 4) For the sake of suppressing the various “oppositions,” the authorities sacrificed a number of their own procedures, ignored the previous positions of the Constitutional Court, and also accepted serious media damage to the economically successful industry.

What conclusions will Russia’s domestic business community (not just the fish sector) draw from these events? Will it support opposition candidates in the next elections? We will learn the answer on September 8, 2019, the next election day across Russia’s regions. In two coastal regions, Murmansk and Sakhalin oblasts, will the Kremlin-appointed governors “answer for the quotas”? Will the business community be ready for future regulatory innovations against the backdrop of a “shrinking pie”—future investments in the industry data platforms and the possible transition from reactive to proactive government relations will provide an answer to this question. Will it invest money in social support activities in the regions where their profit margins are no longer as big as they used to be?

In other words, will a national bourgeoisie in Russia finally be born?

About the Author

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