

## **JAPANESE INVESTMENT AND TRADE PROGRAMS IN THE RUSSIAN FAR EAST<sup>1</sup>**

**Iwao Ohashi**

**Japan External Trade Organization, Tokyo**

First of all, I would like to stress that I am neither an academic researcher nor a government bureaucrat. I am a practitioner in business promotion with Russia. So, I will speak today from that perspective. What I will say does not represent the opinion of the Japanese government or the Japan External Trade Organization, where I work. I want to present a frank and honest view of mine.

I want to discuss three areas. First, I will discuss very briefly the current state of Japanese-Russian economic relations and the Russian Far East. Second, I will describe the Japanese government's program of economic assistance to Russia. Third, I will speak on the possibility of Japanese-U.S. cooperation in the economic development of the Russian Far East.

### **Current Japanese Trade and Investment in Russia**

First, on the current state of Japanese-Russian economic relations. There was a very quick increase in Japanese trade with Russia in the 1970s, especially in Japanese exports to Russia. This was because of the very large investment projects that started in the beginning of the 1970s in the Russian Far East, especially after Prime Minister Kakuei Tanaka's visit to Moscow in 1972. The increase came to an end in 1980, immediately after the Soviet Union under Brezhnev invaded Afghanistan. Then there was a long period of fluctuations in bilateral trade. Recent trends show that our imports are slowly increasing but exports are "back to square one," hovering at the low levels that we saw in the beginning of the 1970s. So, today, we have a very serious situation in bilateral trade.

Why has Japanese-Russian trade cooled down? First, Japanese exporters failed to adjust to the new business environment in Russia after the collapse of the USSR. This is very clear if you compare the Japanese case with that of American or German businesses in Russia. Second, Japanese export of traditional commodities shrank as Japanese companies failed to find new export opportunities. Germans and Americans found new business opportunities in Russia. OECD countries' exports to Russia expanded significantly, but Japanese businesses failed to find new business opportunities. Why was this the case? In my view, the Japanese business presence in Russia was traditionally dominated by a very limited number of large or specialized enterprises, and there are very few new Japanese businesses entering the Russian market, especially since the collapse of the Soviet Union. This contrasts sharply with the case of American and German companies. According to Goskomstat statistics on foreign direct investment (FDI) in Russia as of the end of 1999, the United States accounted for approximately 36 percent of the entire FDI in Russia, followed by Cypress, Germany, and others. Japan, with about \$152 million in cumulative FDI, accounted for only 1.2 percent of the entire FDI in Russia. This does not accurately reflect the reality, however, because Japanese investment is bigger than the Russian statistics indicate, and I will explain this later.

Where are the Japanese investment projects in Russia? The most famous projects are wood processing in Irkutsk, Sakhalin, and elsewhere. We also have international

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<sup>1</sup> Transcribed and edited by Tsuneo Akaha.

telecommunication services in Vladivostok, one or two office buildings in Moscow and Yuzhno-Sakhalinsk, banking services—one in Moscow and one in Yuzhno-Sakhalinsk. We also have production of digital exchanges in St. Petersburg, construction machinery Ivanovo, and some research and development projects in biotech in Moscow. A Japanese subsidiary in Belgium has also invested in an automobile production facility in Nizhny Novgorod. Russian statistics show this as a Belgian investment. A couple of years ago the Japan tobacco industry purchased Russian operations of RJ Nabisco, but Russian statistics show this investment as coming from Switzerland and Netherlands. Finally, oil and gas development in Sakhalin is a Japanese-American venture, but this is considered mainly an American investment project.

There are several problems in Japanese FDI in Russia. Many of them are common problems shared by other countries, including corruption, the weak banking sector, the investment tax regime, etc. So, these problems do not explain why Japan's investment level in Russia is low compared with the investment of other countries, such as the United States. In my personal view, there are various other factors. The most important one is the number of scandals Japanese investment has experienced, in Khabarovsk, Yuzhno-Sakhalinsk, and elsewhere in the Russian Far East. For example, one of the most typical cases is the construction of a hotel in Yuzhno-Sakhalinsk, which was taken over by a Russian partner, and resulted in a legal struggle. From the Russian point of view, they have a completely different picture. It is at least true that in Japan because of these kinds of scandals Japanese potential investors are simply afraid to invest in Russia. At least from that point of view, it is very important that these problems are solved as soon as possible.

The second factor is that Japanese companies do not have sufficient know-how in risk management, especially in Russia, in balancing risks and benefits. More concretely, they do not know how to design effective financial schemes. From the Consul General's presentation, it is clear that American know-how is far more advanced than Japanese know-how in this area. Japanese business culture is not very effective in the current Russian realities. In Japanese business culture, a business failure or mistake is something that has a life-long impact. If a Japanese businessperson fails in a business venture, he/she will not be able to recover as a prominent businessperson. In Russia, of course, you have to make lots of mistakes. In fact, it is impossible not to make business mistakes in Russia. Another point about Japanese business culture relates to decision-making style. Japanese corporate decision-making is "bottom-up". It means that all relevant departments within a company must agree on an investment scheme. In other words, any Japanese investment in Russia must be appropriately designed from every point of view, which is in the current Russian reality simply impossible.

Finally, I want to mention the lack of Japanese recognition of Russia as a market of strategic importance. Many people say that the Russian Far East is important and that its vast, underdeveloped land offers a huge potential. But many Japanese companies cannot locate Russia in general or the Russian Far East in particular as a market in their global strategy. This is a very serious situation in Japanese companies.

### **Japanese Interests in the Russian Far East**

The Russian Far East is the most important region, or economic bloc, in the Russian Federation for the Japanese government and the Japanese business community. First and foremost, major commodities imports from Russia come from the Russian Far East. Including wood, timber, log, fish, sea products, diamonds, heavy oil, and other commodities, about 60 percent of Japanese imports from Russia are from the Russian Far East. Secondly, the Russian

Far East is host to the largest part of Japanese investment in Russia, such as in hotel business, wood processing, and so forth. Although Japanese pattern of investment in Russia is changing slightly, the Russian Far East is still the most important region of Russia for Japanese investors. Both government and private bilateral economic committees have a subcommittee focused on the Russian Far East, reflecting the importance of this region. The governmental committee on economic and trade cooperation is headed by the Japanese minister of foreign affairs and deputy prime minister of the Russian Federation. In 1994, it was proposed that the committee establish a subcommittee on the Russian Far East and the subcommittee met for the first time in 1996. As far as the private-level bilateral committee is concerned, the first meeting of its subcommittee on the Russian Far East was held in 1997. Since then the subcommittee has held a couple of meetings, and within this framework we have what we call the “Workshop on Cooperation in the Russian Far East.” Since 1997, we have held eight workshop sessions. These sessions are going quite successfully.

Japanese regions on the Sea of Japan coast look to the Russian Far East for economic opportunities. For example, Hokkaido, Niigata, and Toyama are three of the major prefectures that have great interest in the Russian Far East. Last year Akita Prefecture opened a new regular freight service between Akita and Zarubino. Tottori Prefecture is also hoping to promote the volume of trade between Sakai-Minato and Zarubino.

Turning to successful large-scale projects and current discussion of new projects in the Russian Far East, I mentioned earlier that there was a very rapid increase in Japanese trade with Russia in the 1970s. At that time we had very successful experiences in large-scale projects. People still have good memories about those projects. We are now trying to realize new projects in the Russian Far East. There are currently seven such investment projects under consideration.

The political importance of the Russian Far East in Russian-Japanese relations is evident in the clear priority the Japanese government places on this region. It is my view that the Japanese government has very clear priorities in the Russian Far East for various reasons. Many people believe that “Russian-Japanese economic relations” means Japanese economic relations with the Russian Far East. This position of the Japanese government is very important to the private businesses in Japan.

Finally, the Russian Far East has some strategic importance, as a supplier of energy to Asia and Japan in the twenty-first century. Of course, this point is already very clear to you.

### **Japanese Trade and Investment Programs in Russia**

What are the Japanese government and private companies doing to develop new trade and investment opportunities in Russia? There are various new approaches the Japanese side is taking. First, more attention is being paid to opportunities in the Russian high tech area. Second, Japan is trying to establish new contacts in other important regions of Russia besides the Russian Far East. Unlike Americans and Germans, in the past Japanese businesses neglected other regions of Russia, such as Nizhny-Novgorod, Sverdlovsk, etc., where regional administrations have more liberal policies, infrastructure is more developed, and consumer markets are larger than in the Russian Far East. Third, Japanese are trying to invite new players, not only from Japan but also from Russia as well. As I noted earlier, our business with Russia has been dominated by large or specialized enterprises, but it is very important to invite new and more companies into this business. Fourth, there is an effort to combine the role of government and private sector. Typically, this means joint (government-private) committees and subcommittees on the Russian Far East. For example, in 1998 and 1999, subcommittees of the

government and private bilateral committees held joint sessions. Lastly, we are attempting to develop new schemes, such as investment protection agreements. The leaders of the two governments signed such an agreement a couple of weeks ago. We are also trying to establish investment companies jointly, both between Russia and Japan and between the public and private sectors. We have many problems in this area, but we are making some efforts, especially in the Russian Far East. For example, some Japanese private companies are looking into the possibility of extending loans to a Russian bank in the Russian Far East. If successful, Japanese companies will be able to use the Russian bank to distribute funds to potential Russian importers of Japanese equipment. We still have a long way to go in these efforts.

### **Government Assistance Programs in Russia and the Russian Far East**

Now, I wish to turn to government assistance programs in Russia. First, let me talk about the Hashimoto-Yeltsin Plan. Consul General Tanaka described this program yesterday, so I need not give you much detail. The “Initiative for Investment Cooperation” encompasses investment protection agreements, investment companies, and feasibility studies. Last year JETRO funded eight feasibility studies for infrastructure construction projects. Six of them were in the Russian Far East. “Integration of the Russian Economy into the International System” refers to APEC and WTO. “Expanded Assistance for Russian Economic Reform” means Japan Centers in Vladivostok, Yuzhno-Sakhalinsk, and Khabarovsk, \$1.5 billion in the Japan Export-Import Bank’s loans, development of small businesses in Russia, development of the Siberian land-bridge, etc. Under the “Training Program for Russian Entrepreneurs and Business Managers,” we invite quite a few Russian business managers, especially from the Russian Far East, to Japan, and every week we receive delegations in Tokyo. Under the “Dialogue on Energy Cooperation” the two sides discussed twenty feasibility studies on possible joint activities discussed. Finally, the Hashimoto-Yeltsin Plan includes “Cooperation for the Peaceful Use of Nuclear Power” and “Cooperation in Outer Space.”

Next, I turn to Japanese public financing. There are two Japanese agencies that finance projects in the Russian Far East, the Export-Import Bank of Japan and the Japan Bank for International Cooperation. So far Japan has announced nine investment projects financed by the Export-Import Bank. Several years ago the bank established a credit line of \$1.2 billion and so far \$850 million has been spent for nine projects. The last loan agreement was concluded in November 1997. There has been no new investment project since then. Among the nine investment projects, only one has been successfully implemented. The other projects have many problems. The Export-Import Insurance Department of the Ministry of International Trade and Industry (MITI) is another government agency that provides public financing. This is the government-guaranteed insurance system for exports, imports, and foreign investment. This agency established a credit line worth \$2.9 billion in 1993, of which \$1.8 billion has been used. MITI has softened credit conditions for the Russian Federation twice, in 1996 and 1997, but after the 1998 crisis the situation has completely changed and the trade insurance system is in a difficult situation today.

Turning to the Japanese government programs in the Russian Far East, “Technical Assistance and Training Facilities” refers to Japan Centers in the three major cities mentioned above, as well as the Small and Medium Enterprise Center in Vladivostok. It also includes various short-term study programs in Japan that I mentioned earlier, as well as the Russian Far East Regional Venture Fund, which is financing seven investment projects in Vladivostok, Yuzhno-Sakhalinsk, and elsewhere. As far as public financing is concerned, MITI has planned

about twenty cases of investment insurance and the Ex-Im Bank has financed the construction of a dairy food factory in Khabarovsk. The “Feasibility Studies and Potential Investment Projects in the Russian Far East,” involves two agencies. The New Energy Industrial Technology Development Organization (NEIDO) is trying to find potential investment projects, especially in the Russian Far East, for controlling CO<sub>2</sub> emissions. The Japan External Trade Organization (JETRO) is trying to finance a project to conduct a feasibility study on the construction of a hydro energy power station in the Russian Far East.

### **Solutions for Some Problems**

What is Japan’s economic commitment in the Russian Far East? Is Japan’s interest in the region economic? Or, is it political? There seems to be great confusion in the Japanese government. If Japan is interested in promoting business with Russia, is Japan’s current approach proper? I have very deep reservation. If we want to promote ties with Russia for purely business reasons, then sometimes a focus on the Russian Far East may not be appropriate or relevant. But the fact remains that the Japanese government is focused on the Russian Far East, I believe, for a mixture of political and economic reasons. It is also mixing aid and business, when they are two completely different things. Promotion of economic development in the Russian Far East is very important, but what is the proper approach, through aid or through business promotion? Economic aid may not necessarily be beneficial to the business community. In order to organize real business efficiently, we need to sort out these issues.

Nor have we established any effective financial schemes for investment projects, especially with respect to the investment environment in Russia generally and in the Russian Far East particularly. Everybody looks to the government and its financing through the Export-Import Bank and trade insurance. It may be important to establish financial schemes without such agencies. Business information and intelligence on the grassroots level is very important. As I mentioned before, Japanese contacts with players of the game in Russia are very limited. Information among Japanese businesses is monopolized by very few, specialized firms or agents. Small and medium Japanese companies lack basic information about the Russian Far East, such as the business climate, business enterprises, and quality of life. This situation must change.

### **Possible U.S.-Japan Cooperation in the Russian Far East**

We have some experience in U.S.-Japan cooperation in the Russian Far East. The most obvious example is the U.S.-Japan cooperation in the Sakhalin oil and gas development. There are a number of smaller examples. Some Japanese companies, for example, buy logs and timber from American-Russian joint ventures because in some cases that supply is more stable and more reliable than supply directly from local Russian companies.

What are the benefits to the Japanese side in U.S.-Japanese cooperation? First, Japanese experience and connections in the Russian Far East were very rich in the 1970s. If this rich experience can be combined with American money, it will be very beneficial to both sides. Second, a combination of U.S. intelligence and know-how and Japanese finances and Japanese markets will also be beneficial to both sides. Many products in the Russian Far East could be marketed in Japan. Third, Japanese companies can serve as subcontractors for U.S. projects. This is typically seen in Sakhalin. Considering the Japanese business culture mentioned earlier, this is an important area in which Japan can reduce its risks in business ventures in the Russian Far East. Finally, the U.S. side has a lot of business support services, e.g., consultants, and if Japanese businesses can use these services, it will be beneficial to them.

What are the possible disadvantages to U.S.-Japanese cooperation from the Japanese perspective? The ceremony that was held at the start of commercial production at Sakhalin 2 in July last year was in a completely American atmosphere. The Sakhalin governor and people in Moscow talked as though this were purely an American project. The so-called “American Village” that was mentioned yesterday is in fact financed by the Japanese side as well. Japan invests more than Russian statistics show. These disadvantages have political implications as well. Moreover, subcontracting, development of consumer markets, and export of equipment and food exports to Japan are mostly small-scale, so they may intensify competition among small Japanese businesses.