

Fundamental Approach to Japan-Russia Economic Relations

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Japan-Russia Business Cooperation Committee
Keidanren

Amid major changes in the environment surrounding Japan, it is vital to build broader and deeper economic relations with Russia, both to foster peace and stability in the international community and to expand business in the Asia-Pacific region.

This year is the 50th anniversary of the establishment of the Japan-Soviet Business Cooperation Committee, which was the forerunner of the Japan-Russia Business Cooperation Committee. As we mark this milestone, and the governments of Russia and Japan make arrangements for President Putin to visit Japan, we have summarised below Keidanren's fundamental approach to Japan-Russia economic relations, which will set the direction for the future activities of this committee.

1. Keidanren Initiatives to Date

Since the establishment of the Japan-Soviet Business Cooperation Committee in 1965, Keidanren has been involved in setting up national projects and other initiatives, acting as a contact point for discussion of bilateral trade and investment. Following the transition to the Russian Federation, Keidanren has actively contributed to the development of Japan-Russia economic relations through initiatives including cooperation with the Russian business community to convene 13 joint meetings of the Business Cooperation Committee since 1993 and the dispatch of business missions to the Russian Far East and other regions.

Since 2005 Keidanren has also conducted an annual survey of Japanese companies to accurately identify problems they face in doing business in Russia and improvements they would like to see, and urged the Russian government and other relevant parties to improve the business environment. Although many aspects of these ongoing initiatives have yet to produce sufficient results, the business environment in Russia has gradually improved.¹

2. Current Assessment of Japan-Russia Economic Relations

Trade between Japan and Russia reached its highest-ever level in 2014, rising 6.3% from the previous year to a total value of around 3.6 trillion yen. However, although Japanese imports from Russia set a new record of 2.6 trillion yen amid rising energy and resource imports in the wake of the Great East Japan Earthquake, Japanese exports to Russia fell

¹ Since joining the World Trade Organization in August 2012, Russia has steadily risen in the World Bank's business environment rankings, moving from 112th place in 2013 to 51st place for 2016 (*Doing Business 2016: Measuring Regulatory Quality and Efficiency*).

below 1 trillion yen, declining for the first time since the Lehman crisis.

Japan currently ranks as Russia's sixth-largest trading partner for both exports and imports, whereas Russia only ranks as Japan's 14th-largest trading partner for exports and its 12th-largest trading partner for imports. Moreover, Japanese FDI in Russia fell below 300 million dollars last year, indicating that Japanese companies are still taking a cautious stance towards Russia.

Sluggish domestic consumption in Russia associated with last year's rouble depreciation and inflation has certainly had an impact on trade and investment. However, considering the economic might, market scale, and geographical proximity of Japan and Russia, it would be difficult to conclude that the full potential for bilateral trade and investment has yet been exploited.

3. Problems Faced in Doing Business in Russia: Issues the Russian Government Should Address

According to the latest results of the above-mentioned survey on the Russian business environment,² the proportion of respondents not currently doing business in Russia or planning to do so in the future who regard business prospects in Russia as "Very promising" or "Promising" plunged from 43.8% in 2014 to 15.6% in 2015. Behind this increase in the proportion of companies taking a pessimistic view of Russian business lie not only economic factors such as the slump in the economy associated with low crude oil prices and a resource-dependent industrial structure, but also political factors including sanctions against Russia. Reflecting this negative corporate mindset, the proportion of companies saying that they intend to "Expand or strengthen" business in Russia fell from about one-half last year to around one-third this year.

When asked which parts of Russia they regard as promising, most respondents continue to express interest in European Russia, with 90% regarding this region favourably. Interest in the next-highest region, the Russian Far East, had been on a steady upward trend since 2007, but last year dropped off for the first time and declined to below 50%. Despite Russian Government initiatives such as new special economic zones and the Eastern Economic Forum, it is important to bear in mind that Japanese companies do not necessarily have high expectations. To use the Russian Far East as a gateway to leverage expansion in business between Japan and Russia, the Russian government needs to address the following points:

- (1) Administrative issues (complicated approval and authorisation procedures, lengthy waiting times for approvals and authorisations, discrepancies among different administrative agencies, institutionalised bribery and corruption, etc.)
- (2) Legal issues (vague and unclear interpretation and application of laws, frequent legal

² Survey on the Russian Business Environment (FY2015), published on 17 September 2015, available at <http://www.keidanren.or.jp/policy/2015/081.pdf> (in Japanese) and <http://www.keidanren.or.jp/en/policy/2015/081ru.pdf> (in Russian)

- changes, new laws brought into force without operational regulations, confusion in administrative agencies during transition periods for revised laws, etc.)
- (3) Issues relating to export and import procedures (opaque and complicated procedures, arbitrary decisions and responses by officials, limited use of letter of credit settlement associated with banks targeted by sanctions, etc.)
 - (4) Issues relating to tax and accounting systems (complicated procedures for refund of VAT and import duties, deviation from International Accounting Standards, complicated procedures for payment of insurance benefits, frequent system changes, etc.)
 - (5) Issues relating to immigration and employment procedures for expatriate staff (lengthy waiting times for visas and work permits, frequent system changes, opaque procedures, etc.)
 - (6) Issues relating to financial policies and systems (continuing high interest rates, unstable exchange rates, complicated settlement procedures with foreign financial institutions due to financial sanctions, etc.)
 - (7) The Russian government's policy of giving preferential treatment to domestic industries (import substitution policy)

The Russian government should strengthen its efforts to improve the business environment, positioning such measures as the best prescription for promoting economic recovery and closer economic ties with Japan. In doing so, it should establish a forum for discussion between public- and private-sector representatives of both Russia and Japan with a view to drawing up a specific action plan giving consideration to timelines. Such an action plan would provide an effective basis for steady, continual efforts to resolve issues through implementation of a plan-do-check-act (PDCA) cycle.

4. Towards Broader and Deeper Economic Relations between Japan and Russia: Issues to be Addressed Under the Leadership of Both Governments

To build broader and deeper economic relations between Japan and Russia, both governments should address the priorities listed below in an effort to move forward with existing projects and identify new initiatives.

(1) Development of Core Infrastructure and Urban Environment Infrastructure in Russia

Russia, especially the Far East region, has a high need for electric power infrastructure including oil and gas development and LNG export facilities, distribution infrastructure such as railways, and urban environment infrastructure.

Given these circumstances, to move ahead with the mutually beneficial projects listed below for development of core and urban environment infrastructure, it is important for Japan to attract private-sector funding by expanding finance and guarantees available through the Japan Bank for International Cooperation (JBIC) and insurance available from Nippon Export and Investment Insurance (NEXI) as well as relaxing conditions

imposed by these organisations. Flexible use also needs to be made of support systems in the energy sector such as those available through the Japan Oil, Gas and Metals National Corporation (JOGMEC).

Core Infrastructure

- (a) Resource and energy development (oil, gas, rare metals, etc.)
- (b) Development of LNG export facilities and gas pipelines
- (c) Electric power infrastructure (upgrading of obsolete power generation facilities, upgrading and modernisation of power transmission networks, energy conservation, renewable energy, nuclear energy, etc.)
- (d) Distribution infrastructure (modernisation of the Trans-Siberian Railway and the Baikal-Amur Mainline, development of railways from coalmines to export ports, expansion of national highway network, development of ports accessible by large ships, expansion and modernisation of existing port facilities especially in the Far East region, development of ice-free ports, upgrading of international and domestic airports, etc.)
- (e) Development and expansion of ICT networks

Urban Environment Infrastructure

- (f) Upgrading of water supply and sewerage systems
- (g) Development of waste disposal facilities

(2) Bilateral Public- and Private-Sector Cooperation Aimed at Modernising the Russian Economy

To promote modernisation of the Russian economy, the Russian government is encouraging foreign investment in Skolkovo and advanced social and economic development territories through bodies such as the Japan-Russia Advisory Council on Modernization of the Russian Economy and the Eastern Economic Forum. To provide backing for this series of Russian initiatives aimed at transforming and diversifying the industrial structure, the Japanese business community requires detailed information that will help Japanese companies to make investment decisions.

At the same time, to effectively utilise Skolkovo and new special economic zones in the Far East, the public and private sectors of both Russia and Japan should set up user-friendly cooperative frameworks and systems for implementing a PDCA cycle incorporating feedback from users and investors, and take steps to ensure the visibility of progress.

(3) Intergovernmental Discussion Aimed at Encouraging the Movement of Natural Persons

As mentioned above, immigration and employment procedures for expatriate staff entering and leaving Russia present major obstacles to business. A bilateral agreement simplifying visa procedures by shortening the timeframe for visa screening and

extending the validity of multiple-entry visas took effect in October 2013, resulting in simplification of certain procedures.

However, since January 2015 it has been mandatory for staff other than highly qualified specialists (HQS) to pass a Russian-language test on Russian society, history, law, etc. in order to obtain a work permit, and this has placed greater burdens on companies that are considering rotating or increasing their expatriate staff.

With a view to enhancing economic relations through free movement of natural persons, the governments of Japan and Russia should aim for reciprocal visa waiver arrangements and relax immigration and employment procedures for expatriate staff.

(4) Japan-Russia Cooperation in the Arctic Ocean

The Arctic Circle has long attracted international attention due to the potential of untapped undersea resources and consideration for the establishment of Arctic shipping routes. Given this interest, the Government of Japan has determined a fundamental plan entitled Japan's Arctic Policy, which includes Japan's intention to take an active part in international rule-making on matters such as resource development in the Arctic Circle. The Policy sets out Japan's commitment to reinforcing its efforts to play a leading role in Arctic Circle development.³

It is vital for Japan to maintain ongoing dialogue with Russia and other Arctic Circle nations as it proactively participates in international rule-making related to Arctic development. In the aim of resolving global issues, the public and private sectors of both Japan and Russia need to explore and expand cooperative relationships to pursue the potential for developing Arctic shipping routes and conducting resource exploration while making optimum use of Japan's strengths in science and technology.

5. Conclusion

Difficult political and historical issues still remain to be resolved in both Russia and Japan, but we hope that efforts to build broader and deeper bilateral economic relations will have spillover effects on other fields and lead to a positive future for both our countries, including the early conclusion of a peace treaty.

To enhance the overall capabilities of Japanese public- and private-sector players contributing to Japan-Russia relations, the various councils and forums devised and operated by the Prime Minister's Office and other relevant ministries and agencies need to be organically linked and appropriately integrated as required.

³ Japan's Arctic Policy (October 16, 2015, Headquarters for Ocean Policy)

Full text in Japanese is available at:

http://www.kantei.go.jp/jp/singi/kaiyou/dai14/shiryou1_2.pdf

A provisional English translation can be downloaded from:

<http://library.arcticportal.org/1883/>

Keidanren will continue business dialogue with our Russian neighbours in the aim of building truly reciprocal and multifaceted economic relations and fostering mutual understanding and trust. We will also strive to make even greater contributions to closer economic relations with Russia based on Japan's distinctive corporate culture and management philosophies, including our approach to cutting-edge technologies and excellence in manufacturing.