

# Regional Dimension of Economic Cooperation Between Japan and Russia

Andrey Belov

**ABSTRACT.** The past decade has brought remarkable changes to the economic cooperation of North-West Japan (Hokkaido and Japan Sea coastal prefectures) and the Russian Far East, such as fast growth of intra-regional trade, great structural changes, a huge increase in the number of cooperating companies and thousands of Russians coming to Japanese ports, which until recently were closed to them. Similar trends were observed in Asian, European and American regions involved in trade with Russia. In Japan, the initial “Siberian euphoria” has gradually been replaced by a much more realistic approach. The reason is that liberalization of trade, globalization and regional development created a number of problems: the prevalence of geopolitical over economic considerations in energy projects, the growth of the shadow sector in certain arrears of mutual trade, the very uneven distribution of benefits and losses from cross-border cooperation and the deep differences of public opinion in Japan and Russia. This paper argues that in terms of public finance theory, these problems can be considered as examples of a failure of market mechanisms, shadow economy, negative externalities and asymmetric information, which can only be solved by effective public policy and state intervention. *[Article copies available for a fee from The Haworth Document Delivery Service: 1-800-HAWORTH. E-mail address: <docdelivery@haworthpress.com> Website: <http://www.HaworthPress.com> © 2005 by The Haworth Press, Inc. All rights reserved.]*

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### *INTRODUCTION*

In the period of 2003-2004, regional policy appeared at the top of the Russian government's priority list. The reason is that in recent years, an uneven distribution of economic benefits and losses turned some Russian cities and oil-pumping provinces into Western-style high-income societies. At the same time, the impoverished North-Caucasus Region became a breeding ground of separatism and terrorism. The second "Region at Risk" is the Russian Far East. Rich in resources and connected by railway to Europe, it was dedicated to being an important international land bridge, energy provider and a Russian gateway to booming Asia and the Pacific basin. The sobering reality is that since the beginning of the 1990s, the region has lost at least one-seventh of its population, one-quarter of its gross regional product and half of its manufacturing industries. On the positive side of Russian Far East regional development, we may mention arms reduction, encouraging trends in foreign policy and an expansion of economic cooperation with Northeast Asia. Starting from the year 2000, the main ingredients of the social and economic dynamics of the Russian Far East are limited economic recovery, resumption of infrastructure development by the Federal Government and the inflow of FDI in energy related projects.

Since 1992, foreign trade achieved a new significance for the Russian Far East. The regional economy reoriented itself from the Russian domestic market to the countries of Northeast Asia; Japan, China, the Republic of Korea and the USA became its leading trade and investment partners. Inter-government trade agreements of the Soviet period were replaced by a network of connections between market-driven private companies. The structure and nature of exports and imports had changed dramatically; cross-border trade between neighboring regions increased by about 50%.

Japan plays a special role in economic cooperation with the Russian Far East, providing the greatest market for natural resources as well as machinery, technology and development capital. As a result, both positive and negative effects of the expanded regional economic exchanges can be found in the Japan-Russia case in a highly concentrated form. This article is focused on these problems, which have been brought about by the liberalization of trade between the Russian Far East and the

North-Western prefectures of Japan. The study starts with some methodological notes and background information on Japanese and Russian economic relationships, and then turns to the recent developments in energy, used cars and fishery trade. Finally, it argues that the current situation may require a corresponding public policy and proper government intervention.

### ***METHODOLOGICAL NOTES***

Several scholars contributed to the analysis of government intervention, in connection with foreign trade and regional development of the Russian Far East. Mikheeva and Minakir (1998) argued that only such “outside” factors as export revenues, foreign investments or federal budget support can become a driving force for a sustainable economic growth in the region. Gaddy and Hill (2003) illustrated a necessity of both domestic and foreign economic policy to overcome huge structural distortions in Siberia and the Far East caused by the Soviet system. Belov (2003) found that in the 1990s, the Far East had developed considerably weaker institutional mechanisms compared to other territories of Russia. Therefore, benefits from the expansion of international exchanges, the inflow of foreign workers and cross-border trade have concentrated for the most part in the shadow sector of the economy. The institutional weakness resulted in the distorted directions of domestic and international policy. Each of these authors points up the necessity of proper government policy based on an original set of arguments, such as an input-output model, structural approach and institutional analysis.

This study aims at the analysis of Japan-Russia trade and its influence on regional development from one more different angle, i.e., in terms of public finance theory. The goal is to show that in some areas of mutual economic exchange we have strong evidence of a market failure, shadow economy, negative externalities and asymmetric information. It may more convincingly justify state intervention, identify directions of an effective public policy and confirm a need for closer international cooperation.

The research is based on interviews and data mining conducted in Japan and Russia since 1994. The last seven interviews with businessmen, local officials and media representatives were carried out in Toyama and Hokkaido (Japan) in the period of July through August of 2004. Besides this, the author examined the central and local government sources of both countries as well as academic publications focusing on

Russian regional issues. For the most part, Japanese statistics and definitions for exports and imports are used in the paper, if not indicated otherwise (Japanese data provides a more sustainable and more accurate outlook of bilateral trade).

### ***BACKGROUND OF THE JAPAN-RUSSIA TRADE***

#### ***Three Stages of Trade Development***

At least three major stages could be distinguished in the development of Japanese-Russian relations during the past 50 years. The first stage started at the end of the 1960s, when Japan became an active player in the exploration and usage of natural resources as well as in the construction of the Russian Far East and Siberian infrastructure. Japanese and Soviet governments had signed a few so-called “compensation deals” or joint development projects, connected with forestry (the first agreement signed in 1968), the paper-pulp industry (1971), the development of coal and natural gas fields in Southern Yakutiya (1974), the exploration and development of oil and gas fields on the Sakhalin shelf (1975). As a result, in the period of 1960 to 1970, Japan was a leading foreign trade partner of the USSR but lost its position to West Germany in early 1970s.

The second stage of Japanese-Soviet relations began in 1986 to 1988, when M. Gorbachev put forward some new ideas about USSR cooperation with Asian-Pacific region countries. Since 1987, the Law on Joint Ventures (JV) went into effect, and the third JV registered in the USSR was created with the capital of the Japanese firm (JV “Igirma-Tairiku,” lumber production). 1988 was the starting year for fast development of cross-border or frontier trade, which soon became an important stimulus of Japanese-Soviet economic relations. By the end of the 1980s, the trade was driven by two mechanism systems: “plan-orientated” (inter-state agreements) and “market-orientated” (JVs and frontier trade). In 1989, mutual trade turnover exceeded US\$ 6 billion for the first time in the history of Japanese-Russian relations.

Since 1992, Japanese-Russian trade has reached a third stage. Export and import became extremely unstable but trade relations achieved a new significance for both countries. That is why the present state of Japanese-Russian trade needs special attention.

### *The “Post-Soviet Model” of Trade*

The break-down of the Soviet Union, the decay of former international trade connections, the fast liberalization of trade and hard currency operations, as well as long-term economic crises in both countries had a rather negative influence on the state of Japanese-Russian trade. Nevertheless, an absolutely new “post-soviet model” spread its roots in the area of bilateral trade (see Table 1). Let us describe its main features.

Firstly, inter-government trade agreements were replaced by a network of connections between market-driven private companies. Japanese and Russian domestic market situations, the dynamics of world prices and currency rates, along with Chinese, Korean and American competition, became an important factor for trade development. Japanese investments in the Russian economy are not especially big and up to now do not show a substantial stabilizing influence on trade relations. All this could explain why Japanese-Russian trade is so unstable and why during the last twelve years the turnover was back to the level of the 1970s twice (in 1992 and 1998) and also twice nearly reached its 1989 maximum (in 1995 and 2003).

TABLE 1. Trade of Japan and USSR/Russia, in Billions of US\$

Year	Export	Import	Total Sum	Balance
1989	3,081	3,004	6,085	77
1990	2,562	3,350	5,912	-788
1991	2,113	3,316	5,429	-1,203
1992	1,076	2,402	3,478	-1,326
1993	1,500	2,769	4,269	-1,269
1994	1,167	3,490	4,657	-2,323
1995	1,170	4,763	5,933	-3,593
1996	1,026	3,953	4,979	-2,927
1997	1,014	4,018	5,032	-3,004
1998	969	2,892	3,861	-1,923
1999	480	3,756	4,236	-3,276
2000	571	4,592	5,163	-4,021
2001	720	3,870	4,590	-3,150
2002	942	3,277	4,219	-2,335
2003	1,764	4,218	5,982	-2,454

Source: Adapted from Institute for Russian & East European Studies (Japan), 2004.

Secondly, the structure and nature of exports and imports had changed dramatically. Up to the early 1990s, Japan was supplying investment goods to the Soviet economy and had a positive balance of bilateral trade. At the beginning of the 1990s, investment demand in Russia rapidly decreased and Japanese exports became more consumer-orientated. Liberalization of the Japanese domestic market increased demand for Russian non-ferrous metals, fish and sea products, lumber and coal—all of which were difficult to sell in Russia. As a result, Japanese exports shrunk while imports expanded. The negative trade balance, most unusual for Japan, reached its peak level of US\$ 4,021 billion in the year 2000.

In 2003, imports from Russia to Japan were based on non-ferrous metals (33.7%), fish and sea products (24.8%), unprocessed wood and lumber (13.7%), oil (8.7%) and coal (7.2%). More than a half of the exports to Russia consisted of transport vehicles including second-hand ones (53.1% and 12.7% accordingly), followed by a big gap to industrial equipment (16.7%) and electronic goods (12.6%) (Institute for Russian & East European Studies, Japan, 2004).

Thirdly, due to trade structure and mechanism changes, a lot of activities are not reflected in the official customs statistics. For example, Japanese fish and marine products import data substantially exceeded Russian export figures because for a long period of time, fish caught outside the Russian 12 mile zone was not subject to customs control. Consumer electric goods are sold to Russia via customs warehouses in Singapore, the United Arab Emirates and other countries for the minimization of import tax payments. These products are not reflected in bilateral statistics. Used cars, which are brought to Russia by tourists and sailors as their private luggage, are also not included in official reports. Finally, Japanese companies produce a substantial group of commodities available in Russia (cars, domestic electronics, etc.) outside of the country. It indicates that the presence of Japanese companies and goods on the Russian market could be more profound than is shown by official statistical figures.

Fourthly, serious changes in bilateral trade did not yet sufficiently increase the share of Japan or Russia in the total trade turnover of each others' countries.

In the period of January to December of 2003, Russia occupied the 23rd position in the Japanese trade partner's list, while Japan was in 13th place for Russia. Such numbers, as well as the Table 2 data, do not sound very optimistic if considered separately to the general background of bilateral relationships. We have to take into account that in re-

TABLE 2. The Share of Russia (Japan) in Japan's (Russia's) Trade Turnover

Share of Russia in Japan's Trade	Total Sum	Export	Import
1992	0.61%	0.32%	1.03%
2003	0.70%	0.38%	1.11%
Share of Japan in Russia's Trade			
1992	3.51%	3.17%	3.93%
2003	2.25%	1.82%	3.24%

Source: Institute for Russian & East European Studies (Japan), 2004.

cent years, the major factor of international economic dynamics in Northeast Asia was a redirection of investment and trade flows towards China. Since 1992, Japan-China trade has increased by 4.5 times and Russia-China trade increased by 2.5 times. Apparently, Japanese-Russian relations will become more important only after the stabilization of both countries' trade with the rising Asian giant. Besides, the previous decade was the worst in post-World War II economic history both for Japan and Russia. The final breakthrough in the economic development of their neighboring regions occurred only in 2003. At the moment, the regional economies of both countries are rapidly improving, and a certain number of large-scale energy and infrastructure related projects are developing in the Russian Far East, creating new possibilities for export and import. And finally, for many Japanese prefectures and areas in the Russian Far East, mutual relations are far more important than bilateral relations between the countries.

The fifth and last peculiarity of the "post-soviet model" is connected to an increase in neighboring regions trade during the last 11 years, i.e., trade between the Russian Far East and northern prefectures of Japan. At the beginning of the 1990s, about 20% of trade flow was located at ports in Hokkaido and the Japan Sea coast (Hakodate, Niigata, Toyama, Tsuruga, Kita-Kyushu, etc.). By the end of the 1990s, the share of those ports increased to about 40% while the weight of the Pacific coast (Tokyo, Yokohama, Nagoya, Osaka, Kobe, etc.) came down to 60%. It was a result of deep changes both in the nature of trade and in regional politics of the two countries. Japan, for example, adopted the concept of revitalization of depressed regions (northern and Sea of Japan coastal prefectures) through international frontier exchanges. The central government and local administrations took a number of measures that yielded the above-mentioned results.

***“Macro Business” and “Micro Business” in Japan-Russia Trade***

The analysis of bilateral trade shows that there are two major layers of groups of Japanese companies dealing with Russia. The first group, which may be called a “macro-business” layer, includes gigantic worldwide famous firms such as Toyota, Japan Tobacco, Sumitomo, Hitachi, NEC, etc. For example, net revenues of Toyota in the 2003-2004 financial year reached 17.3 trillion Japanese yen (US\$ 149 billion), which exceeds the GDP of Greece, Finland and Portugal. Naturally, the attention of such a company could bring Russia serious economic benefits. Incidentally, in 2003 Toyota (including “Lexus”) was the most popular brand on Russia’s new foreign car market. 26,476 new Toyotas were sold in Russia (Sakaguchi, 2004), but this is only 0.5% of Toyota’s overseas sales. It is easy to understand, for Toyota and other members of the “macro-business” group, except a very few energy-related companies, the Russia-orientated business is not so important yet.

The major number of “macro-companies” are located either in Tokyo or in the megalopolises of Japan’s Pacific coastline. Such companies can lobby certain political decisions; they have acquired enormous economic potential and are highly competitive on the domestic and international markets. For those giants, Russia is a small partner, the attraction of which is not in the present but in the future, in its geographical location and influence on some neighboring countries.

The other group, which we call the “micro-business” layer, consists of thousands of small Japanese firms. It is virtually impossible to calculate their exact number. Those firms not only buy Russian lumber and marine products, offer maintenance and services for the Russian ships and crew members at Japanese ports, they also sell second-hand cars and consumer goods to the Russian sailors and tourists as well as looking for other opportunities in the Russian Far East. “Micro-business” in bilateral relations appeared at the beginning of the 1990s, during the period of economic liberalization in Japan and Russia. As a rule, “micro-companies” are located close to Russia in northern regions and the Sea of Japan coastal prefectures, i.e., the less developed areas of Japan. They have all the traditional pluses and minuses of the small enterprise in a market economy. As a positive feature, we can mention low entrance costs and fast reaction to the changing market situation. We can also point out scarce economic resources, the development of a shadow economy and lack of skills under the conditions of a “High Risk-High Return” situation as negative characteristics of small Japanese firms.



At first sight, “macro” and “micro” businesses hardly seem to share similar characteristics. Nevertheless, the activities of both groups of companies may cause problems which would be difficult to solve on the market level and which may need state intervention. For research in this area, public finance theory provides a helpful theoretical framework. “Macro” businesses could easily become a monopolistic player in Russia’s emerging market. As a consequence, the related problems might be connected with a failure of market mechanisms. “Micro” businesses tend to have close ties with the shadow economy. Both types of businesses may be the course of positive and negative externalities and asymmetric information. The following study is focused on the reasons for government interference and is concentrated on three items, such as oil (the fastest growing and most promising segment of Japan’s imports from Russia), automobiles (the item with the largest share in Japan’s exports) and marine products (the area with the largest shadow sector). The closing section deals with the existing differences in each partner’s perception between Russians and Japanese.

***ENERGY-RELATED “MACRO-BUSINESS”:  
A MARKET FAILURE***

The major area of interests of Japanese “macro-business” is related to the imports of gas and oil from Russia. From the beginning of the 1970s, Japan was struggling in order to decrease its dependence on Middle East oil and secure oil shipment routes, as well as reduce an oil share in its energy balance. Russia could play an important role in solving those problems. At the moment, the Sakhalin shelf exploration and oil pipeline construction from Eastern Siberia to the port of Nakhodka (the Russian Far East Pacific coastline) are attracting a lot of attention. In 2003, Japanese companies signed an agreement to purchase 3.4 million tons of liquid natural gas from Sakhalin (the Sakhalin II project, shipments will start in 2007). The Nakhodka pipeline construction should be finished by 2008; its capacity will reach 60 million tons per year. When the two above mentioned projects kick off, the present Japan-Russia turnover will multiply by three to the year 2010 and investments from Japan will increase by 10 times (Mochizuki, 2004).

The import of energy resources from Russia has good prospects, although its influence on the development of Japanese-Russian relations could be multidimensional. First of all, we should take into account the importance of the political and strategic factors for the present energy

source cooperation. Japan and China's fierce competition for the access to the Eastern Siberia oilfields gives the best example. The collision of interests is so deep that "if Japan does win Russia's oil, relations between Tokyo and Beijing may sink to their lowest, potentially most dangerous levels since World War II" (Roberts, 2004). Both of the countries offered their own transportation routes and financing options. The Chinese one went through a feasibility study in 2002; in May 2003, it received an approval by the Presidents of China and Russia and reached a general agreement stage between the Russian Company Yukos and the China National Petroleum Company (CNPC). Nevertheless, it appears that Russia was afraid of China as a monopoly buyer, was not sure of the offered price formula and was pressurized by the big Far Eastern regions which were bypassed by the projected "Chinese" route (Amur, Khabarovsk and Primorski regions). Probably, we can say that in this case of natural resources development, the market failed to create a benefits-losses compensation mechanism.

In 2003, Prime Minister Koizumi put forward an offer, which Russia practically could not reject. He suggested to the Russian President an alternative pipeline variant on the basis of US\$ 5.2 billion of construction investments as well as offering a further US\$ 7.5 billion package of low interest loans and state guarantees for private company investments. According to Japanese mass media, Russia is drifting toward the Japanese proposal. As far as the feasibility research is not finished, the final calculation has yet to be made. The estimated costs of oil transportation to Japan from Siberia could be three times higher compared to that of the Persian Gulf. In such a case, the Japanese Government needs to come up with huge tax incentives to pursue companies to buy expensive Russian fuel on a liberalized national petroleum market.

The pipeline direction choice is an extremely difficult problem for Russia, which is looking for its own position in the Asian-Pacific region. The benefits of economic cooperation with China are too close to the fear of possible Chinese domination on the vast Siberian terrain. Japan and the USA are sharing the same reservations and are ready to use their potential to keep the present balance of power. The problems of the balance of political and economic factors for the project are not solved yet. Approximately the same situation exists in the Caspian basin and some other Russian oil provinces (Satpaev, 2003). It is obvious though that the market is not able to write a safe map for such a dangerous road; therefore, we may need an effective state intervention.

***CRABS AND USED CARS “MICRO-BUSINESS”:  
NEGATIVE EXTERNALITIES AND SHADOW ECONOMY***

Let us analyze certain characteristics of the imports of fish and marine products from Russia and the exports of used cars to Russia as an example of “micro-business.” Such trade plays an important role in bilateral economic relations and gives us a good example of problems generated on a regional level. In 2003, 24.8% of Japanese imports from Russia consisted of fish, crustaceans and other marine products, about 40% of which were imported via ports in Hokkaido, the most northern prefecture of Japan. Used cars and spare parts exports amounted to 12.7% and approximately 40% were shipped to Russia via Toyama prefecture (Sea of Japan coast). Namely, Hokkaido and Toyama will become objects of our further research. The role and status of those regions in the national economy are shown in Table 3.

TABLE 3. Hokkaido and Toyama Prefectures in the Economy of Japan

	Japan	Hokkaido	Toyama
Surface area (thousand sq. km, 2002)	377,887 (100%)	83,454 (22.0%)	2,808 (0.7%)
Population (thousand, 2002)	125,570 (100%)	5,692 (4.5%)	1,123 (0.8%)
Gross Regional Product, GRP (bln JP Yen, 2000), including:	509,702 (100%)	20,713 (4.0%)	4,526 (0.8%)
Primary industries (%)	1.2%	3.2%	1.2%
Secondary industries (%)	29.0%	22.3%	36.9%
Tertiary industries (%)	74.1%	76.7%	64.2%
Net taxes (%)	-4.4%	-2.3%	-2.4%
GRP per capita (thousand JPYen, 2000)	3,101	2,856	2,931
Trade turnover (bln JP Yen, 2002)	94,337 (100%)	916.1 (0.9%)	233.5 (0.2%)
Export (bln JP Yen, 2002)	52,109 (100%)	231.8 (0.4%)	84.4 (0.1%)
Import (bln JPYen, 2002)	42,228 (100%)	684.3 (1.6)	149.0 (0.3%)

Source: Adapted from Statistics Bureau of Japan, 2004.

***Imports of Fish and Marine Products to Hokkaido***

Hokkaido is the biggest northern prefecture of Japan, with the lowest population density. In comparison with the all Japan average, the ratio of agriculture, forestry, fishery and tourism in Hokkaido's GRP is relatively high, although the processing industry is somewhat lagging behind the national level (Table 3). At the beginning of 1990s, Hokkaido's economy felt into a prolonged depression. Liberalization of foreign trade, which started in the middle of 1990s, was considered as a powerful anti-depression weapon. The short distance to Russia was one of the reasons for the rapid development of frontier trade in the 1990s (Table 4). The share of Hokkaido in the total Japan-Russia trade turnover increased from 5.8% in the year 1991 to 15.2% in 2002 (Hokkaido Government, 2003).

TABLE 4. Trade of Hokkaido and USSR/Russia

Year	Export to Russia (bln JP Yen)	Import from Russia (bln JP Yen)	Total Sum of Trade with Russia (bln JP Yen)	Share of Russia in Hokkaido's Trade (%)	Russian Ships to Hokkaido (Number)
1989	3.2	35.5	38.7	6.5%	488
1990	4.1	45.5	49.6	7.4%	778
1991	5.7	37.5	43.2	6.6%	1,298
1992	7.1	48.5	55.6	8.6%	2,760
1993	5.0	47.3	52.3	8.8%	3,302
1994	3.4	57.4	60.8	9.5%	4,605
1995	4.0	59.8	63.8	9.4%	6,068
1996	5.8	77.0	82.8	9.8%	7,723
1997	5.2	82.4	87.6	9.9%	9,576
1998	6.3	70.3	76.6	10.3%	9,459
1999	6.2	82.4	88.6	11.8%	9,192
2000	6.0	85.3	91.3	10.5%	9,503
2001	6.1	89.3	95.4	10.1%	8,719
2002	5.9	74.4	80.3	8.7%	5,438
2003	10.1	81.0	91.1	9.9%	5,450

Source: Hokkaido Government, 2003.

The largest oil and gas projects for Russia involving foreign capital are developing at a very near distance from Hokkaido on the northern shelf of Sakhalin. In 2003, the development speed rapidly increased, which gave small Hokkaido companies some new export opportunities. So it is possible to say that Hokkaido offers a positive example of “macro” and “micro-business” cooperation.

Nevertheless, the biggest percentage of Hokkaido’s imports from Russia is based on fish and crustaceans. Such imports amounted to 70-80% of the total, and about 50% of it was crab. A real “crab rush,” which spread around Hokkaido, seriously influenced economic relations with Russia. Japanese consumers enjoyed price dumping caused by increased crab shipments. More trading companies were organized; new options for the export of Hokkaido fishing equipment and packaging materials were created; more people took part in the maintenance and service of Russian ships. In the peak period of 1996 to 2000, 7-9,000 Russian crab-carrying ships visited 11 Hokkaido ports (Table 4) and 140-170,000 crew members went ashore each year (Hokkaido Government, 2003). As a negative result of the crab rush on the Japanese side, we may mention the increase of illegal imports, the instability in the Hokkaido fish market, as well as social problems at small ports caused by the overflow of Russian sailors.

Japanese crab importers were gaining considerable profits, while the inhabitants of small port towns suffered a serious social burden, which was transferred to them on a personal level. If we consider this case in the framework of public finance theory, it looks like an example of negative externality with a need for state intervention. The first administrative reaction was not effective enough, so local communities started independent actions. For example, “Japanese Only” signs appeared on the doors of 3 saunas in Otaru and on about 90 shops and restaurants in Mombetsu town. The two saunas cancelled their restrictions under the influence of local administration and public organizations later, but the situation in Mombetsu is improving very slowly (Doshin Information Institute, 2001). Small port towns have a lot of unsolved problems, particularly crime growth, although Hokkaido government and the regional mass media are paying serious attention to it.

And what was going on behind the border—in the Russian Far East? At the beginning of the 1990s, during an acute investment crisis, several billion dollars of Russian and foreign investments were poured into the fishing industry. As a result, enormous modern fleets of state-of-the-art trawlers; crab-catchers and processors newly built in Norway, Spain and Germany or re-equipped in China, Korea and the USA, have ap-

peared in the Okhotsk Sea waters. Russian Far East companies invaded a large segment of the European market of Alaska Pollack fillet and the crab markets of Japan and North America. However, fishing fleet harvesting capacity very soon exceeded natural stocks. Over fishing resulted in the depletion of resources and the decline of the overall catch. Investors started to flee. In less than 10 years, the Far Eastern fishing industry went through a full cycle from complete renovation, revival and boom to a new crisis.

The reason is connected to the breakdown of the Soviet fishing rights system, a long-term inability of the Russian government to effectively manage marine resources, as well as a lack of international cooperation in the fishing industry (Allison, 2003). Domestic conditions for legal and easily controlled business were extremely unfavorable. As a result, on-shore fish processing rapidly dropped (canned fish production in the period of 1990 to 1999 decreased 12.5 times). The Far Eastern companies have moved for maintenance and service to foreign ports in Korea, China, Japan, USA and Canada with the biggest base established in the South Korean port of Busan. In addition, poaching and smuggling rapidly developed at sea, i.e., where law could not reach these infringements. Since the beginning of the 1990s, the large part of Far Eastern marine product trade was carried out illegally and was not reflected in Russian industrial and customs statistics (Belov, 1997). According to Russian data in the period of 1994 to 2002, the total export of crab and shrimps from Russia to Japan was about 44 thousand tons for a total sum of US\$ 387 million. At the same time, according to Japanese customs statistics, imports from Russia to Japan amounted to 643.7 thousand tons for a total sum of US\$ 52.5 billion (Arai, 2003). The reason for such a gap could be explained by the imperfect rules of Russian statistics, by the lack of enforcement and by the weak control on fishing companies' activities. The Russian Ministry of Economic Development once claimed that 75% of fish exports to Japan were illegal and estimated a yearly profit of such trade at 150 billion Japanese yen (US\$ 1.25 billion at 120 JY for 1 US\$). In addition to Japan, Russian Far East marine resources were exported to more than 40 countries all over the world.

The first real steps to improve the situation began only in the period of 2001 to 2002. The Russian government subjected all export fish shipments to customs control, regardless of the area of harvesting. The Japanese side tried to enforce the rule of law more aggressively and started to demand customs declarations from captains of entering Russian ships. Illegal fishing and exports declined for the first time in 10 years.

Accordingly, Hokkaido imports from Russia went down and less Russian ships made port calls. But the image of economic relations with Russia in fishery, as well as natural stocks of marine resources already was considerably, if not irreversibly, damaged.

Poaching, smuggling and the transfer of a fishing boat service bases from Russia to foreign ports are not unique characteristics of the Russian Far East. A very similar situation, but in a smaller scale, exists between Russia and Norway and the Republic of Korea. In the period of 2000 to 2003, Russian specialists mentioned several times the discrepancies in custom's statistics, illegal fishing and benefits for some local Norwegian and Korean ports from inflow of Russian ships in fishery industry newspaper "Rybatskie Vedomosti" and magazine "Rybnoe Khozyaistvo." Probably, the above mentioned problems are universal for each fish catching and trading regions under the conditions of weak institutions and slow government response.

#### *Exports of Used Cars from Toyama*

Toyama Prefecture is much smaller than Hokkaido in area and population. Nevertheless, the prefecture has relatively developed processing industries and a slightly higher GRP per capita. For several years, Fushiki (Toyama's largest and most modern port) has held first place in Japan on the number of visiting Russian ships. In 2003, the share of Toyama in Japan-Russia trade turnover came to 0.6% (0.5% exports and 0.6% imports). During the twelve-year period of post-Soviet trade, the main imported commodities were unprocessed wood and aluminum. As for exports, industrial equipment and plastic materials were replaced with second-hand cars and domestic electrical goods (Toyama Prefecture, 2003) (Table 5).

In 2003, transportation equipment became a major Japan to Russia export item (53.1%) with 106,831 cars, buses and trucks supplied (including 68,123 used vehicles) (Institute for Russian & East European Studies, 2004). As for used cars, the Japanese export total in that year amounted to 712,068 units, which means that Russia's share reached 9.5%. Russian tourists and crew members carried an additional 150,000 vehicles as private luggage (Otake, 2004). Therefore, the total number of used cars taken to Russia exceeded 218,000 vehicles. 87,000 of them (about 40%) were exported from the port of Fushiki in Toyama prefecture (Nomura, 2004b). The main reason is a convenient ferry connection between Toyama and several ports on the Russian Pacific side.

TABLE 5. Used Cars Carried to Russia from Toyama as Private Luggage

Year	1991	1995	1996	1997	1998	1999	2000	2001	2002	2003
Thousand cars	5.7	20.1	33.6	46.4	41.3	21.5	34.2	62.8	65.7	57.9

Source: Adapted from Nomura, 2004b.

The export of second-hand cars in Japan is a rather specific business. Perhaps its main peculiarity consists of low entrance costs. The main market player, The Japan Used Car Dealers Association (JU), was organized in 1992. The largest share of transactions is conducted through 140 auctions, which are in operation 6 days a week, except Sundays. 70% of the trade is available through designated computer terminals. Company registration in Japan, acquisition of JU membership and access to trading are not particularly difficult or expensive for foreign businessmen. Unsurprisingly, citizens of South-East Asia, China, Australia, New Zealand, Russia and other countries registered 300 firms out of the 1,000 regular dealers at the biggest Tokyo used car auction (Otake, 2004).

Amongst the 800 companies exporting second-hand cars from Japan, 350 firms are established by Pakistan citizens, 100 by Bangladeshis and 100 by citizens of Sri Lanka. These numbers reflect not only the geography of Japanese used car shipments but also show the high competitiveness of South-East Asia businessmen. In Toyama, at least 150 Pakistani dealers, exporting 80% of second hand cars to Russia, have their offices near the port. At the same time, The Shipment of Vehicles to Russia Control Association of Toyama Prefecture, organized by Japanese dealers in 1993, has only 37 members, more than half of whom are already out of business; this is rather understandable. The only unusual thing is that Japanese citizens living around big international ports probably lack a clear strategy towards the increasing number of other races, religions and cultures represented there. The general attitude of Japanese experts to the inflow of foreign buyers and sellers could be seen in the advice to Toyama Prefecture: "In the future, it would be possible to create a model of 'Internationalization from Inside' based on the port area. Such a model needs to be orientated on mutual coexistence with foreigners. Using the existing Toyama-Pakistan Connections Society, we have to avoid daily life disturbances between people who live in the area and Pakistanis, as well as overcome the difficulties in relations with Russians" (Nomura, 2004b).



Some more important points include: in the year 2003, about 60,000 stolen vehicles were brought out of the country by international criminal organizations; (Otake, 2004) the total number of registered vehicle thefts stood at 64,233. Therefore, according to Japanese experts, nearly all cars stolen in Japan are taken out of the country. In the period of June 2002 to September 2003, Lionel Dumont, a French citizen of Algerian descent, came to Japan using a false passport and was engaged in the used car business in Niigata (Sea of Japan port near to Toyama). According to mass media information, Dumont is one of the suspected leaders of the al-Qaeda terrorist organization and was trying to set up an al-Qaeda network in Japan. Naturally, these are isolated cases, however it shows that even law-abiding dealers may be afraid to lose the good reputation of their business.

Those examples show us how important connections are with Russia for Hokkaido fishermen and Toyama car dealers. But they also demonstrate the existence of a large shadow sector in fishery and used cars' trade and reflect a complicated psychological situation formed around trade relations with Russia in some regions of Japan. Perhaps it happens because certain parts of the social burden of the fish and car "micro-business" are transferred to the local community, and public efforts to eliminate the negative externalities are not efficient.

#### ***DIFFERENCES IN PARTNER'S MUTUAL PERCEPTIONS: ASYMMETRIC INFORMATION***

The last example, demonstrating a need for government intervention, is connected to deep differences in partner's mutual perceptions. It means that the image of Japan and Japanese in Russia is strikingly different from that of Russia and Russians viewed by the Japanese side. The existing image gap has several causes.

During the last hundred years, as both Japanese and Russian experts use to say, Japan and Russia were rivals more often than partners. Nevertheless, democratization of the USSR started in the middle of the 1980s. After the breakdown of the USSR, international politics changed direction; military expenses dropped dramatically, Russian troops left the disputed "Northern Territories" and so on. The Japan Defence Agency, in a 2003 White Book, for the first time pointed out the low possibility that Russia's military potential in the Far East in the foreseeable future will return to its Cold War capacity and structure level. So even the conservative by definition Japanese defence forces had admit-

ted that the “Threat from the North,” which was frightening Japan during hundreds of years, all but disappeared. The position of the Japanese government towards relations with Russia changed gradually, from the priority of territorial issue, to the necessity to create a reasonable climate for the solution of political problems. The Japanese finally have a reason to think about Russia as a “normal country” with a value system similar to Japan (Kimura, p. 19).

Despite all these changes, the last decade was one of the most difficult in modern Russian history. Economic and ethnic problems, criminal activities and mafia, as well as scandals involving some Russia-friendly Japanese politicians, seriously affected the image of Russia. Unsurprisingly, in 2002 American researchers mentioned a dominating negative public opinion about Russia and Russians in Sapporo and Niigata (the biggest cities in Hokkaido and the Sea of Japan coastline). Most likely such opinion will not change in the nearest future (Akaha & Vassilieva, 2002).

We can find also some different examples. In 2003, 25 of 490 surveyed processing firms wanted to start industrial activities in Russia in the coming three years. From this point of view, Russia moved to 10th place in their priority list (16th in 2002) and passed Singapore, Hong Kong, the Czech Republic and some other countries (Nomura, 2004a). The developing interest of Japanese businessmen already shows itself in the dynamics of Japanese investments. In the year 2003, Japan invested into the Russian economy US\$ 966 million in comparison with US\$ 441 million in the previous year of 2002 (Institute for Russian & East European Studies, 2004). This is also a rather impressive increase because of the fact that yearly direct investments to the sum of US\$ 817 million put Japan in 3rd place after Cyprus and Holland. At the same time, the share of Japan in the total accumulated investments is not so big (US\$ 1.9 billion or 3.3%). The Japanese invested mainly in the Russian Far East and Sakhalin oil and gas projects. And what is even more important, the improvement of business climate is not followed by comparable changes in politics or public opinion.

The situation for Russia is quite different. A direct presence of a Russian company in the Japanese market can be considered as something rather exotic. Political decisions are also retarded in a way, while one can see a “real Japanese boom” developing amongst ordinary Russians. The amount of Japanese restaurants and shops, books and films translated into Russian reached such a level that they have become an everyday life phenomenon for a wide group of the Russian population. It is said that the Japanese boom has happened in Russia for the second time,

with the first occurring during the Japan-Russia war at the beginning of the 20th century. According to one Russian journalist, at that period Saint Petersburg beauties strutted in Japanese clothes in their boudoirs, while geishas of Kyoto were selling their luxurious kimonos trying to help the Japanese Army (Kulanov, 2003).

We can also add that in Soviet times, Japanese language was taught in 20 universities and now in 70, plus another 30 various language courses. In 1998, only one special magazine about Japan was issued in Russian, but in 2004 the number was 4. Five years ago, a quick Internet search for “Japan” in the Russian Yandex portal returned about 400 pages, but now it is more than 7 million. Only Germany surpasses Japan by the number of Yandex linked Russian language internet pages. Several opinion polls, especially in the Far Eastern part of Russia, show the admiration for Japan’s economic successes and cultural heritage by ordinary Russians (Larin, 2004).

The stunning growth of the popularity of Japanese culture has several reasons. First of all, it is an international phenomenon noticeable in all continents. The 1990s was a period of deep structural reforms in Japan. A new generation of political leaders, businessmen and artists took the opportunities for creative work. Their joint efforts substantially raised the so-called Japan’s Gross National Cool (McGray). On the economic side, we had a new orientation of Japanese exports from selling goods to content and services. For example, cultural exports are now worth three and a half times the value of all the televisions Japan exported in 2002. The U.S. market for made-in-Japan animation was estimated at \$4.36 billion in 2002, 3.2 times the value of Japanese exports of steel products to the U.S. (Nakata, 2004). By the looks of it, while Japan was in prolonged economic depression, the country managed to find a new “post-industrial” export potential niche on world markets. At the moment, Russia is not on the front line in the absorption of Japanese cultural influence. Sushi-bars rather go to Moscow through New York and Kitano’s films come from Cannes more often than from Tokyo. Secondly, in recent years some traditional Japanese local markets became global (tuna, Alaska Pollack roe, live crab, etc.). As a result, certain elements of Japanese business culture and cooking and eating habits spread worldwide. Following electronic devices and Quality Control Circles, the ancient Japanese dish of sushi “went global” (Bestor, 2002). Thirdly, we can mention how Russians perceive the place of their country in the modern world. In fact, Russia is not an active participant in European or Asian integration, and the country feels somewhat overwhelmed by the political power of the USA and the economic potential

of China but growingly respectful of the economic and social achievements of Japan. The Japanese boom is obviously rather complex and not such a well “researched” phenomenon. All we can say is that, a solid base for positive perception of not only Japanese goods but Japanese ideas is being created in Russia.

The above-mentioned examples demonstrate the deep differences of public opinions in Japan and Russia. According to several opinion polls, the image gap between the two countries is really big and probably widening. From the economic point of view, the country and its citizens’ image abroad can be considered as a kind of externality or as a case of asymmetric information. Due to the existing differences in each partner’s perception, Japanese business in Russia gains certain benefits and Russian business in Japan has to burden some extra costs. Sooner or later, the incongruous image problem should be solved. In such a case, the economic approach could be useful for the development of a corresponding public policy.

### **CONCLUSION**

The conducted empirical study has confirmed that the most important areas of Japan-Russia economic relationships can be characterized by a prevalence of political over economic factors, the development of illegal economic activities, transferring of the social burden on local communities and the existence of considerable differences in each country’s mutual perceptions. In terms of economics and public finance theory, these problems may be described as cases of market failure, shadow economy, negative externalities and asymmetric information. Such an approach convincingly demonstrates a significance of government intervention and provides the following policy implications.

Firstly, the need for a deeper state involvement and closer government cooperation of the two countries is confirmed by means of economic analysis. At the same time, Japan’s policy toward Russia is famous for a complex mix of political and economical considerations. If the government of Japan decides to put economics at the top of its priority list, the suggested approach can provide a credible and face-saving explanation for such a policy shift. Secondly, the liberalization of trade under conditions of an institutional vacuum in Russia and insufficient international cooperation created a number of problems, which cannot be solved by the market alone. At present, the partner with more profound government institutions should take the initiative in dealing with

these issues. Arguably, the most urgent task for Japan is a more assertive introduction of the rule of law in the areas of joint interests and concerns. Thirdly, the existing plans of inter-government cooperation should be revised to incorporate effective countermeasures against market failure and other mentioned problems.

At first glance, the review of Japan-Russia regional trade (“Narrower Asia”) seems to be almost irrelevant compared to the issues of cooperation with European (“Wider Europe”), American or other Asian regions. Nevertheless, the post-Soviet model of international economic exchange probably has brought similar problems to frontier business and local communities all over the world. These problems must be solved by effective government intervention. The studies in this area should provide the necessary information for general public and policy makers. It means that a future research agenda must be aimed at cross-regional comparisons and extensive mining for appropriate empirical data.

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