

# **International Trade and Economic Policy of Northeast Asia:**

## ***The Role and Interests of Russia***

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### **Introduction**

The goal of my presentation is twofold:

- to elaborate in what way Russia could constructively contribute to the ongoing regional integration processes in East Asia and Northeast Asia (NEA);
- to find out what models of regional integration would better suit Russian critical interest – to sustain underdeveloped and under populated territories of its Russian Far East (RFE).

During a long historic period (from 30s till 90s) great economic and financial resources and subsidies had been pouring by the Government into the Russian Far East that had been considered as a bastion a military power in the Pacific. However, at the beginning of the 90-s in last century most of the state orders for the local military industry had been cancelled, and all subsidies for the region in such spheres as transport, energy, wages, etc. had been stopped, and the socioeconomic situation in the RFE has changed radically to the negative. As a result of that the RFE has been transformed into a depressed territory, and for 15 years the region lost more than one million in population.

In 2000 newly elected President Vladimir Putin demonstrated his willingness to improve the situation. While addressing the Asia-Pacific and Russian Far East's audiences he always said that multilateral cooperation programs in energy, and transportation infrastructure development projects in Northeast Asia would have been most profitable for the countries of this region, and the best option for the RFE population to improve their standards of living.

Most part of those proposals looked like a rhetoric for a while, but gradually some changes became to happen that reflected a new situation in the Russian economics operating in a new environment of the Russian state budget's huge surplus beefed up by oil dollars<sup>1</sup>.

In 2005 then Minister of Economic Development and Trade German Gref said that the Russian Government **must and would** take part in construction of roads, airports, pipelines, energy power grids, area, and that the Government finally decided to increase the amount of money allocated to the RFE development programs: from 2,9 bln rubles<sup>2</sup> in 2004, to a sizable amount of 17,5 bln rubles in 2007.

The Asia Pacific region is a critical component of the Russian foreign policy, because Moscow is very interested to use its increasing economic potential to contribute to the economic development and comprehensive security of the Russian Far East and Eastern Siberia. There are several areas of Russia's regional involvement that could become substantial components of the EA and NEA multilateral cooperation: energy and natural resources supplies; transportation services, nature and ecology preservation, arms trade; and constructive participation in regional and subregional International Governmental Organizations (IGO).

## **Bilateral Russian trade with leading NEA countries and USA**

*(For detailed information -see – Power Point slides)*

### *China*

For a number of security and economic reasons, Russia's policy in Asia gives priority to its partnership with China. Russian–Chinese trade was rapidly increasing: in 2006 it has reached a record \$29 billion. One of the main trade boosters is an expansion of its border trade component.

As far as the Chinese illegal migration threat is concerned, Moscow and the regional political elite are sure that Russia needs a foreign labor force to develop vast territorial spaces in the RFE and East Siberia. The issue is how to construct adequate laws and then implement an effective immigration policy. In the RFE, more than 70% of legal working migrants are from China. Other sizable migrants groups are from North Korea and Vietnam.

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<sup>1</sup> Sevastyanov S., *Current State and Prospects for Russian – North – South Korean Triangular Economic Cooperation*, proceedings of the 15<sup>th</sup> IFANS – IMEMO Conference, IFANS, Seoul, 2005 pp. 124-125

<sup>2</sup> One US dollar is equivalent to 25,0 Russian rubles

## *Japan*

Recent improvement of economic ties and the numerous bilateral negotiations did not bring progress in resolving their so called Northern islands territorial dispute. At the moment both sides are not ready to soften their position on the issue.

Mostly due to high international price for oil Russian state budget is very healthy, Russian foreign exchange reserves and stabilization fund reached record levels of \$425 bln and \$130 bln respectively, and both (reserves and fund) are quickly growing. As a result of that financial dynamics Russia is not so much interested in Japanese FDI to the RFE natural resources development. But what Russia is really interested in is to attract Japanese investments into other (not natural resources development) industry sectors, and that was why Moscow was very encouraged by Nissan and Toyota decisions to build automobile producing plants in Russia.<sup>3</sup>

## *The Korean Peninsula*

Russia is trying to maintain balanced political ties with ROK and DPRK, and to fully participate in solving economic and security problems on the peninsula. In the economic area South Korea overwhelmingly dominates: in 2006 Russian trade with RK reached a record level \$10 bln, while Russia – North Korea annual trade in 2004 was only \$160 million. All three countries (RF, ROK, DPRK) consider implementation of joint projects in energy and transportation as major factors in decreasing tension on the Peninsula and eventually insuring unification of Korean states.

Trans-Siberian Railroad (TSR) extension to the Korean Peninsula and its connection to the Trans-Korean Railroads (TKR) is considered as most perspective and profitable international transportation project. Joint use of TSR and TKR would help ROK and Japanese business to decrease cargo transportation period to European countries three times (from 30-35 days by sea to 10-12 days by land), while Russia and DPRK would get much more profit for the transit of increased amount of containers.

Characterizing Russian energy export to NEA countries, one regional security problem should be taken into account. Most of Russian proposals to sell oil, gas and electricity to its neighbors could not fully materialize until Korean Peninsula security issue is solved. To make this happen Russia is actively participating in 6-Party Talks. Moscow believes that a solution to this problem would be facilitated by providing DPRK with adequate guarantees of security and by creating

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<sup>3</sup> RIA Novosti, September, 2006

conditions for its sound economic and social development in exchange for renunciation of its military nuclear program<sup>4</sup>.

### *The United States*

Though Moscow and Washington successfully cooperate in 6-Party Talks, the potential for closer ties between the RFE and USA is underexploited especially in economics sphere: bilateral trade and investments substantially declined in this century. The only positive examples in economics sphere are Sakhalin-1 project with an active Exxon participation, and latest investments into mineral extraction projects in Yakutiya.

### **The Russian Far East's New Economic Development Plans and Initiatives**

Several NEA energy and transportation infrastructure development projects had been discussed for many years, but the critical issue had always been unsolved: *who would pay to start and to implement them?*

An idea to form multilateral framework for cooperation in the energy sector in NEA had been gaining momentum in the region for more than 15 years. However in reality in December 2004 the Russian Prime Minister Mikhail Fradkov ordered to start construction of the Eastern Siberia - Pacific Ocean (ESPO) oil pipeline *using state budget money and not seeking any foreign investments to start this project.*

The ESPO first section from Taishet, Irkutskaya oblast to Skovorodino, Amurskaya oblast should be able to support a total delivery capacity of 80 mln tons of oil per year. Two other proposed pipeline portions starting in Skovorodino (the main one - going to Primorsky region, and an off-shoot - to Datcin, Northern China) should have an annual capacity of 50 mln tons, and 30 mln tons respectively.

In 2008, the ESPO pipeline will reach a key point of Scovorodino. At this time a decision should be made on pipeline construction priority: a main route to Primorsky region or an off-shoot to Datcin in Northern China. Moscow has absolutely no intention, as some foreign scholars speculate, to use this situation as a tool to play China and Japan off against one another.

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<sup>4</sup> Ignatov A. Russia in the Asia-Pacific in ed. by Azizian R. Russia, America, and Security in the Asia-Pacific, Honolulu, APSCC, 2006, p. 10.

Russian decision will be defined by economic considerations, and by probable lack of proved oil resources at this time to fill ESPO pipeline to its maximum capacity (80 mln tons of oil per year).

Another attractive option for energy cooperation in NEA is hydropower. In 2006 inexpensive energy produced at the Bureya hydropower station, Amurskaya oblast, has been brought via high voltage lines to Primorsky region that is bordering North Korean territory, thus offering Pyongyang a practical source of energy. It will also become a reliable source of affordable energy for China, and possibly ROK.

So, latest events demonstrated that the Russian Government's obligation to support a sizable part of the RFE multibillion infrastructure development projects with its own budget money were becoming a reality. However starting from 2006, Moscow began more actively implement its **New Energy Policy (NEP)** regulating foreign investors' access to a lucrative Russian natural resources sector, while trying to redirect foreign investments flows to other sectors of the Russian economy.

*Two public companies (Gazprom and Rosneft) are clear Kremlin favorites now. In January 2007 Putin signed a decree allowing Gazprom and Rosneft to get equal share of all Russian continental shelf to extract oil and gas. That decision blocks foreign and other Russian companies from getting major share in these projects, and leaving them with a role of not owners but contractors/subcontractors.*

*Both above mentioned companies have chosen Northeast Asia and the Russian Far East as areas of their expanded investments' activities.*

*Gazprom priority in the region is to sell Sakhalin area extracted gas to local consumers in the RFE and later to foreign partners. Gazprom recently bought a control share of the Sakhalin-2 project, and is conducting negotiations with Russian companies to buy two components of the Sakhalin – Komsomolsk-at-Amur and Komsomolsk-at-Amur – Khabarovsk gas pipeline owned by Rosneft and Daltransgas respectively. In future Gazprom plans to prolong this pipeline from Khabarovsk to Vladivostok bringing it near the border with China and DPRK thus making plans to sell NEA countries gas transported by Sakhalin pipeline not a distant perspective.*

Sakhalin-3 project has been chosen by Gazprom as a main resource base to support its plans to deliver gas by a pipeline to internal and foreign consumers in Northeast Asia. Sakhalin-3 project is composed of four gas and oil fields with total resource base of more than 700 mln tons of oil

and 1,3 bln cubic meters of gas (just for comparison, joint total resource base of Sakhalin-1 and Sakhalin-2 is about 450 mln tons of oil and 1,0 bln cubic meters of gas).<sup>5</sup>

Gazprom and Korean Gas Company Kogas are considering a feasibility of constructing a gas pipeline from Kovikta to South Korea going through the Chinese territory.

*ROSNEFT also has an ambitious investments' program abroad and in Russia.*

ROSNEFT is developing strategic partnership with Chinese National Petroleum Company (CNPC) – one of the largest oil companies in the world delivering the lion's share of oil and gas to China. Rosneft and CNPC plan to form a joint venture to make geological survey in Eastern Siberia prospecting for oil reserves at the new areas. In partnership with the CNPC, Rosneft also plans to construct in China an oil processing plant and about 300 gasoline stations.<sup>6</sup> The Chinese public energy companies, until recently, focused on Siberian energy projects, but they decided to participate in the Sakhalin offshore ventures.

During a meeting with the international discussion club “Valdai” members in 2007 Putin made critical remarks on energy policy of Russia. Firstly, he confirmed that Russia would expand extraction of oil and gas but at the same time balance volumes of our foreign supplies with our state interests and production potential. Taking into account the urgent need in developing the RFE territories, we may suggest that *local consumers of oil and gas will get clear priority over their foreign counterparts.*

Secondly, he clarified that in tough production conditions of Siberia and Russian Far East (cold climate, mountainous terrain, lack of population and infrastructure, etc.) largest public companies like Gazprom, Transneft, Rosneft would be reliable leading operators of oil and gas extraction and transportation projects.<sup>7</sup>

The above mentioned statements have been fully materialized in the “Program of the gas industry development in the Eastern Siberia and the Russian Far East” that has been approved by the Russian Ministry of Industry and Energy in September 2007. The total amount of investments to realize this program will be 2,4 trillion rubles (about \$93 bln). In accordance with the program coordinated by Gazprom, by the year 2020 (in comparison with 2006) the volume of gas extraction will increase 18 times, and by the year 2030 - by 20 times. In material terms it

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<sup>5</sup> Kommersant, June 06, 2006

<sup>6</sup> RIA-Novosti, October 03, 2006

<sup>7</sup> Putin's fourth meeting with international discussion club “Valdai” members in Sochi, September 2007

means that delivery of gas to local consumers in eastern part of Russia will increase up to 27 bln cubic meters per year by 2020, and will reach 32 bln cubic meters per year by 2030. It will help to increase regional GDP from 2005 till 2030 by 3,8 times.

The program clarifies that **gas extraxtion surplus** will be delivered to China, ROK, and other APR countries. By 2020 China and ROK annual import of gas from Russia will reach 25 - 30 bln cubic meters, and other APR countries will annually buy 20-21 bln cubic meters.<sup>8</sup>

### **Recent Changes in the RFE Security Assessments**

The priority of security threats for the RFE in the 21<sup>st</sup> century have changed. The most urgent of them are now either internal (declining socioeconomic and ecological situation, negative demography, etc.) or para-military in character (terrorism, illegal migration and fisheries, etc).

For Example, industrial waste dumping and deadly water pollution had been a serious problem in China for a long time, and lately it became an acute problem for the nature and ecology of the RFE. The largest chemical plant blast happened in Jilin province in 2005, and it dumped 100 tonnes of toxic compounds into the Songhua in China's northeast, leading to sparking concern in the RFE territories when in December 2005 toxic waste reached Amur River and later Khabarovsk – the largest industrial city in the region. China's growing appetite for timber and other natural resources, such as fish, nuts, etc. are fuelling illegal exports from the RFE. In this situation Russia has no other options but to press China to follow more strict ecological standards and to seek bilateral cooperation in this field.

In other words, one more potential sphere where the Russian Far East could make substantial input into East Asian regionalism is a strict compliance with ecology standards and preservation of natural resources that could be accessible to other regional countries. To characterize this subject we will look at several cases.

In Spring 2006 Russian state company Transneft started construction of the East Siberia – Pacific Ocean (ESPO) oil pipeline. President Putin insisted that a new route should be be charted at least 25 miles further away from the northern shore of the Lake Baikal. Environmentalists have been campaigning for a long time to protect Baikal - the world's deepest freshwater lake holding more than 20 percent of the world's unfrozen fresh water — from the pipeline.

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<sup>8</sup> Lenta.ru, September 10, 2007

Another positive example – international cooperation project aimed at utilization of the Russian old nuclear submarines. The Russian Pacific Fleet decommissioned submarines were waiting for dismantlement and deactivation of nuclear reactors for years while posing a serious ecological threat to the surrounding areas. Considering situation at the RFE, the United States and Japan allocated lion's share of foreign money to solve this acute problem. By the end of 2006 75% from about 200 Russian decommissioned nuclear submarines had been utilized, and that all decommissioned submarines should be utilized by 2010.

### **Russian Approach to Multilateralism in the Asia-Pacific region**

*At the Asia Pacific level* Moscow is using APEC as a key international organization to promote its economic interests in the region. During last several years Moscow managed to make more visible input to the implementation of the APEC annual agenda selecting Vladivostok as a venue of such events as: 7<sup>th</sup> Investments Symposium in 2003; Meeting of the APEC Transportation Working Group 2005; Meeting of the APEC Industrial Science and Technology Working Group 2007. As a next critical step in this direction Moscow has chosen Vladivostok as a venue of the APEC Summit in 2012. This Summit should be of help for the RFE, and Vladivostok to attract attention of Russian and foreign investors.

### **Northeast Asia**

For the last 10 years the RFE was actively participating in a number of multilateral economic cooperation projects in NEA, including TRADP (Tumen River Area Development program). However Moscow blocked most of the TRADP plans being concerned about potential loss of control over and ecological threats to strategically important part of the Primorsky territory, and about producing critical competition to local Russian ports.

The TRADP and its successor the Greater Tumen Initiative (GTI) so far is the only one example of the intergovernmental mechanism in NEA for economic cooperation. During its history of operation TRADP demonstrated several shortcomings as follows:

1. Participating states interests and visions' controversies.
2. The project has never become participating states' priority. As a result leading international financial institutions (WB, EBRR, ADB) were not interested to support it.
3. TRADP incomplete regional membership: absence of Japan as a possible leading financial donor.



To increase effectiveness, in 1995 TRADP finally evolved into the GTI with an increased operational geographical area. In 2008 Japan is still not a part of the project, but in current positive financial situation in most GTI participating countries (China, ROK, RF) it does not look as a critical problem.

A principal issue for GTI now is to enhance multilateral cooperation by putting its plans and activities into the context of the NEA larger political initiatives, especially 6-Party Talks. At the same time GTI proposed plans should be effectively coordinated with participating states own priorities in developing this region. In Russian case one of such priorities it is an envisioned role for Vladivostok as a center of international cooperation in the Asia-Pacific.

### **Special role for Vladivostok in NEA and GTI cooperation models**

In 2012 the APEC Summit will take place in Vladivostok, and to improve the host city's infrastructure the "Big Vladivostok" project is developed. The project capital will amount to 147,5 bln rubles (about \$6 bln). It should be implemented during five years (2007-2011) on the basis of the public/private partnerships. The complex of "Big Vladivostok" project includes: reconstruction of the international airport, development of road network, including construction of a bridge(s) to the Russian Island, development of port infrastructure, communications, engineering objects, and construction of the multipurpose administrative business center, including 5 large 4-5 "stars" hotels and international conference center for 7 thousand people.

Realization of this complex project would support the role of Vladivostok as a "world city" or a "key city" that by the quality of its infrastructure and services could be compared to such NEA cities as Dalian, Tianjin, Niigata, Sapporo, Busan, etc. Vladivostok is envisioned to become one of the NEA centers in providing such critical services as:

- transportation and logistics (modernized airport, sea port, roads, bridges, communications, etc.);
- tourism (tourist recreational zone at the Russian Island, gambling zone, new large and small hotels);
- international education (after APEC Summit several hotels would be transformed into dormitories for Russian and foreign students of the new Federal university to be created at the Russian Island. At this moment foreigners already complement a sizable amount of students' body in several Vladivostok universities);
- scientific consulting in energy, environment and other spheres. It is of critical importance taking into account recent cases of water pollution in China when toxic waste reached

Amur river and Russian city of Khabarovsk, and potential ecology threat for northern part of Japan Sea as a result of ongoing construction of industrial objects at the bank of Tumen river in Jilin province, and new construction plans in southern Primorsky region in Russia (oil refining factory with capacity of 20 mln tons per year, etc.).

## **Conclusions**

Negative demography and underdevelopment of vast territories are critical threats for the RFE and Eastern Siberia. To preserve the territorial integrity, Moscow is increasing state budget allocations to improve regional energy and transportation infrastructure thus indirectly improving local population standards of living due to positive collateral socioeconomic effects. Local RFE experts argue that to make proposed changes a reality the Russian Government should develop and undertake a more comprehensive long term program aimed at increasing attractiveness of the RFE to foreign capitals and Russian private investors, and to complement the above mentioned measures with one more critical component – to give the FRE territories more economic freedoms to start several free economic zones, tourist/recreational zones, etc.

There are several promising areas of Russian cooperation with its foreign partners that could contribute to its integration into Northeast Asia and East Asia.

First, the most perspective among them is to position itself as a major energy supplier to the East Asian countries. The fact that public companies Gazprom and Rosneft got a preferential access to the Russian natural resources may lead to slowdown in extraction ratio. At the same time in unfavorable climate and infrastructure conditions of the REF territories, oil and gas extraction and transportation could be effectively realized by public companies, such as Gazprom, Rosneft, Transneft, etc. They would be able to support stable supply of energy to Asian markets according to approved schedule and in quantities coordinated with foreign partners. Overall, Russia as a consolidated player at the Asian energy market could be a reliable partner to its neighbors.

However, in light of the latest efforts to restrict the participation of several of the largest foreign investors such as Shell and British Petroleum, it is clear that Russian and foreign companies alike must go through the Kremlin to define the terms of their investments in Russia's energy sector. Chinese and Indian companies recently have been following this rule to get access to the Sakhalin projects. This leads to an interesting conclusion: Moscow is treating Russian energy resources not just in a pure market terms. This change in perspective may reduce the number of

foreign investors, especially private firms from developed countries, while increasing the presence of resource extracting companies from developing states such as China and India.<sup>9</sup>

Another point is that, unlike some experts' suggestions, the consolidation of Moscow control over decisions on energy extraction and transit routes is unlikely to lead to a confrontation between Beijing and Tokyo over energy resources. This is largely because for various reasons Japanese business is apprehensive about making substantial investments in this sector, other than in the Sakhalin offshore projects.

China is the only country in Northeast Asia that could become a preferential "state-business" partner for Moscow. Such a partnership has already developed a firm intergovernmental basis (the Russo-Chinese strategic partnership),<sup>10</sup> as well as a business foundation (through a series of bilateral cooperation agreements between Gazprom and Rosneft from the Russian side, and CNPC, Sinopec, and other companies from the Chinese side). In recent years, Beijing has initiated a series of proactive investment activities in eastern Siberia and the RFE. However, the critical problem for Moscow is that China is seeking a substantial discount on the price of Russian resources. To avoid placing Beijing in the position of enjoying a buyer's monopoly in price negotiations, Moscow should find ways to deliver a substantial part of its energy resources to Japan, the ROK and other countries. That is why, considering a proposal to form an International Governmental Organization for cooperation in energy sector in Northeast Asia, Moscow is still interested in its realization.

Second, Russia became a critical supporter of natural resources (timber, fish, seafoods, metals, etc.) to NEA countries. In future, Moscow should develop regional cooperation in natural resources' processing and preservation sphere, because all East Asian countries, especially China and Japan, are dependant on Russian energy, metals, timber, fish, and will depend more in future.

Another area of possible Russian input - providing railway transportation services between East Asia and Europe by connecting TSR and TKR - could not be realized due to a nuclear problem at the Korean Peninsula. Moscow believes that everything possible should be done to solve it, and its role at the 6-Party Talks negotiation table may increase in future.

Finally, Russia's role as a consistent supporter of multilateral cooperation in the Asia-Pacific, primarily in security and economic matters, is gradually emerges. Multilateralism will be an important addition to the bilateral approach at all levels of the regionalism in the Asia-Pacific

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<sup>9</sup> Sevastyanov S. The More Assertive and Pragmatic New Energy Policy in Putin's Russia: Security Implications for Northeast Asia // East Asia #25, 2008. PP. 35-55.

<sup>10</sup> Russia and China signed the Treaty on Good Neighborly Friendship and Cooperation on July 16, 2001

taking into account that both Moscow and Beijing has changed its attitude to multilateral cooperation to a more positive one. For example, a multilateral solution to the Korean Peninsula security problem in a 6-Party Talks format may become a key to forming a new international governmental organization dealing with the NEA comprehensive security issues.

To increase NEA states' priority in implementing GTI Strategic Action Plan 2006-2015, its activities should be considered in the strategic context of the NEA political situation, and to be effectively coordinated with participating states own priorities in developing this region. Thus Proposed GTI projects should be put in the largest framework of the efforts undertaken in the 6-Party Talks format to solve Korean Peninsula security problem. In this case Russia would be more willing to increase its share in realization of those projects.<sup>11</sup>

At the same time "Big Vladivostok" project has all the reasons to be included into the activities of the GTI Strategic Action Plan, taking into account its very positive role in the GTI Plan's priority sectors: transport, energy, tourism, investment, education, and scientific consulting with environment as a cross-cutting scheme.

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<sup>11</sup> Sevastyanov S. Business and Investments Opportunities in Northeast Asia and Greater Tumen Region: Russian Perspective. Investment Forum 2007 "Greater Tumen Initiative – Gateway to Northeast Asia. Tumen Secretariat: Vladivostok, Russia, 16 November 2007.