Japan and the USSR: Prospects for Economic Cooperation in the 1990's

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Introduction

Japanese politicians, scholars and other observers have closely followed recent changes in the Soviet Union, changes in its relations with the West. The implications of such events as internal reforms in the USSR, including introduction of democracy and political pluralism, strengthening a parliamentarian system of policy making and major breakthroughs in Soviet international politics, including détente with the West, fruitful negotiations on regional conflicts, agreements on arms control and troop reduction with the United States, dramatically heightened expectations of major changes in bilateral relations with the Soviet Union. The logic of Soviet reforms, efforts by the Soviet leadership to change the image and the place of the country in world community are believed to imply a broadening dialogue with Japan, and bolder steps in finding ways of resolving existing problems in bilateral relations.

Despite such seemingly favorable developments, in what concerns the future of bilateral economic cooperation, government officials and business experts are much less enthusiastic and sometimes seem to be even more skeptical than at the beginning of 1980's.

Any attempt of predicting Japanese-Soviet economic cooperation in the coming decade seems to be unrealistic. The pace of Soviet reforms, their depth, as well as many other factors, are difficult to predict. As a result, the gap between most optimistic and unfavorable forecasts is now very significant.

Putting aside political uncertainties and assuming a positive scenario of gradual political détente that internal Soviet economic reforms continue to take place, the crucial question in bilateral economic relations seems to be the readiness of Japanese businessmen to cooperate with partners in Soviet Union and to become increasingly involved in the process of economic changes in USSR.

Significant amelioration in relations can be envisaged only if the corporate sector finds serious economic incentives for doing business in the Soviet Union and some kind of framework is created to coordinate official aid programs and initiatives of private entrepreneurs.

I Sources for pessimism: Existing Experience and Destabilizing Changes

In recent years Japanese corporations have shown decreasing interest in expanding business operations in Soviet Union or with Soviet partners. Analysis of statistical outlays shows that not only new-comers have become increasingly cautious about starting relationship with Soviet partners, but in some cases

companies that had long-run experience in this area began to curtail their activities and divert their energies to similar activities in other countries.[1]

Japanese experience in trading with the Soviet Union and participating in "compensation projects" makes it clear that besides unfavorable political atmosphere and cultural difficulties, the lack of current enthusiasm is well motivated by pure economic reasons. In general these causes could be summarized as follows:

1) The pace of industrial development and its priorities in the two countries during the past decades were rather different. Japan became relatively less dependent on imports of natural resources and more reliant on intra-industrial trade with other nations. On the other hand, the lack of competitiveness of most of Soviet manufacturing industries producing exports made it impossible to shift to a new pattern of trade, based on a horizontal division of labor.

2) The organizational structure of Soviet trade with all transactions carried out by state institutions, regulated and supervised by governmental bodies is imposing major managerial difficulties for Japanese business. Soviet decision-making processes are so complicated and so slow that they seriously underline efficient entrepreneurship. Managerial difficulties are aggravated by outdated communication systems and insufficient information networks.

3) Trade regulations in the Soviet Union, as well as laws on foreign direct investments have been thus far mostly restrictive and incomprehensible. Liberalization of foreign economic relations that started in 1986 has sometimes made these regulations even more contradictory and complex than before. Approval of cooperation projects, the issuing of trade licenses, the rights of Soviet entrepreneurs and foreign counterparts are often defined not by clear legal acts, but by bureaucracy in state organizations.

Whereas supervision by state ministries sometimes facilitates the realization of major projects in international cooperation, helping to overcome formal procedures, guaranteeing stable supplies of resources, providing financial incentives (as it was the case with the multi-billion dollar petrochemical joint venture in Siberia, where Japanese corporations are supposed to participate together with U. S. firms), tight restraints in licensing trade transactions and registering joint ventures impose serious constraints for developing small-and medium-scale nperations.

4) The legal framework sets limits for decent choice among various possible forms of cooperation. Emphasis is made on trade and joint ventures, which are stimulated, but no serious provisions are made for legalizing many other forms of cooperation projects, that in given circumstances may have prosperous future.

5) From the Japanese perspective the Soviet economy is often seen as a "black box"—with trade flows going in and out, and no comprehensive knowledge of what is happening within. Substantial lack of economic information and reliable statistics has been one of the most important restraints on bilateral cooperation. Obviously very scarce information is available on Soviet producers, as well as tradable merchandise, making it difficult to develop direct trade or to start joint ventures. Until now, all data concerning trade issues has been channeled through foreign trade organizations, which, in fact were departments of the Ministry for Foreign Trade. Under recent reforms, efforts were made to create an alternative information network for easing the exchange of commercial data and simplify access to respective information for Soviet enterprises and foreign

firms. However, there has been no actual improvement in this area.

6) Finally, another important factor is the difference in business approaches and skills between Japanese and Soviet partners. The long-lasting isolation of Soviet management from outside influence, institutionalization of specific relationship and subordination patterns within centrally-planned economy, have resulted in a generation of business managers that are often unfamiliar with practices and rutine procedures, adopted by their foreign counterparts. The majority of trained specialists are concentrated in state organizations and enterprises. Consequently, knowledgeable managers, who are capable of orientating in foreign markets and negotiating with possible partners are seldom available at small and medium, as well as most large enterprises.

These difficulties create a rather unfavorable environment for Japanese corporations to expand business in the Soviet Union and directly affect their strategic decisions. In a world with numerous alternatives for expanding international business, existing trade opportunities and climate for direct investment in the Soviet Union in most cases are far less attractive than in many other parts of the world.

Obviously then pessimistic prognoses shared by a large part of Japanese analysts and corporate strategists can be supported by strong arguments. On the contrary, proponents of a prosperous future for Japan-Soviet economic relationship have more difficulty in defining what could be the economic motives for efforts to develop cooperation. References to the argument which was rather popular in 1970's that emphasized the potential complimentarily of the two economies, seems to lose its persuasiveness when considered in light of structural changes in Japan's economy. Complimentarily, at least in the sense it was usually perceived, is in fact decreasing.

II Long Term Interests in Soviet Economy: Opportunities in Creating New Markets

The Soviet government and enterprises in different industries are becoming increasingly interested in enlarging economic ties with Japanese banks and industrial corporations. Restructuring of the economy and modernization of industrial facilities require enormous capital investments, new equipment, technologies, and managerial skills. It is unlikely that current resources, available within the country would be sufficient. Therefore, foreign direct investment, trade and technology transfer are considered as extremely important for reshaping the internal economy.

The Soviet Far East with its tremendous problems can give a sense of what extensive role international cooperation projects could play in developing this vast region.

Under a long-term plan, adopted in 1987 and designed to speed development of the Soviet Far East, the central government is supposed to procure some 200 billion rubles in 13 years to modernize processing facilities in primary industries, develop communication infrastructure and promote high technology industries in the region.[2] At the present official exchange rate these investments would be the equivalent of a little more than 30 billion US dollars (less than 3 billion US dollars

a year). These financial commitments could obviously bring some changes, but they are hardly sufficient to transform the entire industrial structure. Some observers believe that these investments must be at least twice as big in order to yield any significant results. Therefore, it is becoming clear that in order to realize plans of developing the Far East, it would be necessary to find ways of attracting foreign capital. This example is very illustrative as far as the country is facing similar problems in financing development programs in the European part, in providing assistance for military enterprises, which are converting to civil industries, and other major projects.

This need for investments, technologies and trade does not automatically mean that the climate for business initiatives will become more attractive than elsewhere, but this situation should inevitably lead eventually to the introduction of reasonable incentives for capital inflows and the creation of a favorable business environment. The first steps in this direction were made in the last four years.

Until now, however, there has been a persistent reluctance on the part of Japanese businesses to take hold of new opportunities and get more involved in economic cooperation with the Soviet Union. Experience from previous decades fuels suspicions concerning not only the development of bilateral economic ties, but also the future of Soviet reforms in general. The current cautious approach to reforms in USSR gives ground to a "wait and see" attitude among Japanese businessmen.[3] This notion seems to be very important for the future of Japan-Soviet relations and deserves special comments.

There is hardly any doubt either in Japan or in other countries on the long-term need for reform of the Soviet economy. Both inside Soviet Union and abroad it is almost unanimously agreed that there is no other way for the country's economy to survive and develop other than becoming more market-oriented and more decentralized.

Within the USSR itself political support for a "centrally-planned" economy is becoming very weak. Judging by results of public opinion polls, only approximately 10 percent of the population believes in such an economy.[4] Public debate, as well as political discussions now mostly center on ways of reorganizing the managerial structure and developing markets.

From "outside" the Soviet Union it was always perceived that these changes are inevitable unless the economy completely decomposes, the only way out of stagnation was and is seen through activating market mechanism and becoming more open to international exchange. All differences in anticipating this transition are in estimates of how long it would last, whether it would be a smooth, continuous process, or whether there would be some recess along the way.

The difficult economic situation in USSR, which has become even more complex after events in East European countries and their reorientation towards partners in the West, is heightening probability that these processes of economic change will substantially accelerate in the next few years.

It is also widely acknowledged that the opening of Soviet markets would seriously influence the overall pattern of world trade and represents promising business opportunities.

The Soviet economy is an enormous market, starving for high quality goods

and modern equipment. Its absorbing capacity is likely to increase dramatically. In a report by Cambridge Econometrics *Europe in 1994*, an international group of experts forecasts that in 15 years the European Community's trade with Eastern Europe and the Soviet Union will exceed the turnover with the United States.[5]

Even at the initial stage of reforms, despite convertibility problems and balance of payments difficulties, one can predict rapid growth in purchases of items, needed for rebuilding or upgrading production facilities, basic consumer goods that could ease social tensions and, at least partly, relieve deficiencies in the domestic market.

These forecasts, predicting rapid development of markets are sometimes considered to be far-fetched and to underestimate the extreme complexities of the transition period. However, there is already some evidence— in case of Poland for example — that such changes may take place sooner than generally expected. Anyway, the already existing infrastructure, industrial potential, and standard of living, make it quite possible that a fullfledged market in East European countries and USSR could be created sooner than in most of the developing areas in the world.

The main problem of these countries is the way their economy is being managed. As a well-known American scholar Ed. Hewett (Brookings Institution) has stated, referring to the Soviet Union, "this country is not poor, it is poorly managed."[6] The extreme inefficiency of production processes, enormous losses in transportation and distribution, resulting from managerial failures are mostly resposible for the current economic crisis. This is the reason why reforms are primarily aimed at reorganizing government regulations and corporate-level managerial structures.

Such kind of reforms as these countries are in need of could be rather defined as "reindustrialization". The emerging economy would be mostly based on the already existing industrial infrastructure, production facilities, and would likely incorporate many elements available now, especially skilled working force, highly trained engineers and research teams. Investments, under these circumstances, would be mostly aimed at renovation, equipment modernization, implementation of new technologies, and much less on building up new plants and infrastructural facilities. New industrial potential could be created without large-scale investments in construction of new plants and housing for personnel, with limited expenses for modernizing existing communication networks, and retraining the local labor force.

Considerable results could be therefore achieved in a much shorter period than if all components of industrial structure had to be developed from the initial stage.

On the side of consumer demand there are also reasons to assume that under favorable conditions it could expand relatively quickly and thus create a vast market not only for domestic products, but for imports as well. Public savings have attained an extremely high level and the market could absorb large amounts of consumer goods.[7] If limited convertibility, based on a realistic exchange rate, were introduced (as was the case in Poland recently), and even if prices for imported goods grew by 1000%, the overall demand for imports would still be very high and expand steadily.

Besides, the pace of Soviet reforms, the other divergence in Japanese and

other foreign approaches toward increasing economic links with USSR concerns the timing of possible rapprochement or the stage at which to enter Soviet markets.

The "wait and see" attitude— one possible approach which claims that caution is necessary, first favorable economic conditions should be created within the Soviet Union, and then Japanese business's activities there will gradually expand.[8]

Before moving into the Soviet market, the desire for a fair legal framework, a modern transportation and communication infrastructure and uncertainty about the future is quite understandable based on previous experience. At the same time, however, it reflects some misconceptions in anticipating future developments in the Soviet economy. Looking at economic reforms in USSR through the prism of the past leads to serious misunderstanding of how and to what extent international tie-ups affect the process of economic opening of the USSR, how international economic cooperation influences the course of reforms.

External influence in fact has an important impact in many different ways. In a broad sense, the very concept of restructuring, the strategy of reshaping the economic system is derived from close analysis of other countries experience. In terms of actual developments, many practical steps in alternating official regulations were stimulated by the necessity of enlarging international cooperation, creating a comprehensive environment for joint ventures, and promoting direct trade of Soviet enterprises with foreign partners.

Foreign business therefore is not simply adjusting passively to certain circumstances, but in some sense is participating in creating the overall climate for business activities.

The requirements of foreign companies, their suggestions, in particular, play an important role stimulating necessary amendments to existing regulations in legislation on trade and foreign investments. The way, in which changes in official regulations on shares of foreign companies in joint venture's assets actually took place, illustrates this impact.

Initially, when the legal framework for trade and foreign investments was first set up in 1986, it was stipulated that in case of jointly established enterprises, the stake of foreign companies could not exceed 49 percent, what meant that Soviet counterparts, providing 51 percent of investments, were entitled to exercise control over any of these projects. Less than two years later, in 1988, these limitations were softened as new provisions were enacted, permitting foreigners to gain financial control over the projects and leaving a minority share to their Soviet partners. Recently, in spring 1990, there were signs of further moves— the Soviet Minister of Finance V. Pavlov declared that the government was ready to allow foreign firms acquire Soviet enterprises and determine their own production capacities in USSR.[9]

These changes were obviously in line with the logic of reforms making Soviet economy more open. Still there is an interesting point about these changes in regulations. In 1988 formal removal of restrictions on foreign shares in joint ventures was preceded by case-by-case approvals of projects, giving foreigners majority stakes in joint ventures.

Interesting proposals by companies, promising benefits to the Soviet side,

gradually pushed the legislators towards easing existing impediments. It can be argued, therefore, that to some extent changes in the legal framework for business activities in the country occurred on basis of precedents. First, actual developments take place and formal amendments to regulations are introduced a posteriori.

Major industrial nations differ greatly in their approaches toward developing econonomic ties with the Soviet Union. Basicly their vision of present developments in the country and future prospects is very unlike.

These diverse approaches are based on different historical experiences of these countries in relations with Soviet Union, uneven involvement in economic interactions and political dialogue. But what seems most important is a dividing line between those who are ready to enter the market now and participate in market formation and those who prefer to wait for this market to be created.

Available data gives evidence that growth rates of trade and investment flows between USSR on the one hand and West European countries and the United States on the other were very high in the last few years. Whereas Western Europe was traditionally a major trade partner for Soviet Union, and accounts for almost 65 percent of its total trade with the West, rapid growth of trade with U. S. A. was especially signficant. In 1988, for example, it showed almost an 80 percent increase.[10]

In terms of growth rates in trade with Soviet Union, and number of direct investment projects, Japan is now lagging not only behind West Germany, Italy, France, but the United States as well. Comparative data on new joint ventures can give a certain understanding of Japanese involvement in new business activities in USSR. Out of a little less than 300 joint ventures, already operating in the country, only 16 are established with Japanese companies, whereas the majority, 206 are with counterperts from Western Europe.[11] Japan's share of invested capital is even smaller, not more than 3 percent.

Analysis of industry distribution of investments by Japanese companies shows that none of them were made in the manufacturing sector. In 1988 (unfortunately more recent data is not available), when the overall number of cases was six, three of the enterprises were in fishing, while two were in wood processing and one in services.[12] Although in 1989 the number of projects increased and many new agreements were signed, the distribution of enterprises by industry almost did not change — the only noticeable difference was that new projects tended to be even more service oriented.

In the case of West German investments, on the contrary, although a great share is also channeled in services, the ratio of the manufacturing sector is more than 55 percent. Industrial projects include 16 large-scale plants, producing industrial robots, high precision equipment, and cars. In the service sector there is also a great difference in allocation of European and Japanese investments. Japanese companies tend to concentrate in such areas as resort construction, hotel management, car rentals, tourism, while European investors tend to concentrate in computer software, engineering, consulting, information services.[13]

The difference in the number of joint ventures and present volumes of trade may be not so important by itself. A much more significant issue is the readiness and the willingness to face existing problems, to overcome constraints, arising

from low competitiveness of Soviet exports, inconvertibility of ruble and many other "sensitive issues." While European entrepreneurs are seeking unusual solutions to deal with problems of profit repatriation and balancing trade payments, Japanese business seems to be less active in searching for non-standard solutions.

In Soviet interactions with European and American counterparts, different models are approached in order to overcome limitations, imposed by inconvertibility of ruble. These include simple solutions, such as various incentives for expanding barter trade as well as complex multilateral arrangements, providing different options in reciprocal payments. Lately, for example, a special association of Soviet and French enterprises was founded (which includes corporations, banks, and governmental organizations of the two countries) with the goal of enlarging bilateral trade flows and introducing a system of multilateral payments in rubles.[14] West European countries are creating funds in hard currencies in order to promote a gradual shift from barter trade to regular trade transactions.[15] This includes the newly created Bank for Eastern Europe which was initiated by France and which is controlled by West European countries (with Japan and the U. S. A. joining this project as participants with minor shares).

These efforts by European companies and governments are clearly based on a long-term vision of the perspective. In the short run the gains of European countries may be not so important, but by starting these trade operations and organizing joint ventures, they are establishing themselves in the Soviet market and will be well placed if future business opportunities continue to improve. The mere presence of these companies strangthens the Italian or German-oriented psychology of Soviet businessmen and officials, who will likely follow some preferences in choosing future partners.

Starting operations in Soviet Union now is a matter of risky decision-making. There are pros and cons, but in this particular case long term perspectives should be considered with utmost attention. The scale of the market and the potential of the Soviet economy may be a serious incentive to gamble and strengthen efforts in order to back up reforms and get established in these markets.

Judging by recently published surveys, Japanese analysts and businessmen believe that the Soviet Union, as well as most East European countries, are posing stronger hazards to foreign investors than in preceding years. The first three months of 1990, the USSR's ranking by risk factor deteriorated by almost 10 percent.[16] In conventional terms a shift like that should mean that the environment in this country is becoming less stable and predictable than it was sometimes ago. Under present circumstances, however, there is another possible interpretation of the changes. Stability and reliability of the investment climate in the past were guaranteed by strict control over any trade transactions, state regulations of joint venture's finances and guaranteed resource supplies. Being a regrettable development by itself, heightening investment risks have a certain positive meaning — that fundamental changes in Soviet economy are under way, that centralized structures are weakening and still immature market forces are increasingly influencing the overall situation.

III Opportunities in Developing Japanese-Soviet Economic Relations in 1990's

As already mentioned, there is little hope of drastically expanding bilateral trade without fundamental changes in its structure. That mostly depends on the ability of the Soviet Union to build up its potential in export industries. With the existing pattern of commodity exchange — natural resources for Japanese machinery — it may be possible, at best, to increase slightly the volume of transactions. A more drastic change can be expected only after a shift towards a trade pattern based on a horizontal division of labor.

The crucial questions are therefore: 1) What could be done during the transitory period in order to enlarge bilateral cooperation?; 2) What steps can be made to speed up this transition?; 3) Are there any specific measures that could be taken now in order to promote close cooperation in the future?

Although the present state of bilateral trade is rather grim, there are grounds to suppose that even with the existing potential of export-oriented industries in Soviet Union, and the present commodity structure, there are quite a few ways of enlarging cooperation and increasing bilateral trade. These possibilities could be realized primarily through heightening the efficiency of Soviet exports. The more the Soviet Union exports, the more it would be able to import from Japan.

Analysis based on case studies and interviews indicates that within a rather short period, exports from the USSR to Japan could at least double if necessary steps by businessmen in the two countries were undertaken.[17] The two weak points in managing Soviet trade with Japan are 1) insufficient or improper processing of exported goods; and 2) poor information networks and lack of consulting services. Improvements in these areas could be achieved without large-scale capital investments, but would require considerable transfer of Japanese technological and managerial know-how.

Upgrading the quality of available exports, adjusting them to existing standards, and development of marketing system could substantially heighten Soviet returns on exports.

Another possibility for cooperation lies in joint efforts for eliminating losses, immanent to Soviet export industries. Not only losses which occur as a result of outdated production technologies (in the case of the lumber processing industries existing technologies are considered to be 30-40 percent less effective than those used in Japan or Finland), but also losses during storage and transportation. According to experts in the Soviet Far East, almost 60 percent of all logs cut in the region are wasted before being shipped for export.

Under present circumstances it seems unlikely that proper marketing of exports as well as improvements in organizing export industries could be quickly managed through the efforts of Soviet enterprises and trade organizations. These steps could be made in a smoother way and more efficiently if the expertise of Japanese trading and manufacturing companies could be utilized.

Various forms of mutually beneficial cooperation could be worked out in this regard. Having a much experience in promoting international projects and arranging different combinations of financial, technological, natural resources and labor,

Japanese general trading companies could play a major role as consultants and coordinators of new projects.

Renovation of existing production lines and organization of new processing facilities could be arranged on basis of different types of cooperative agreements, joint ventures being only one possibility. Although the efficiency of existing joint ventures in developing natural resources in the Soviet Far East is not very inspiring for Japanese companies, there is certainly much potential of making cooperation in this area more effective. One of the main reasons for the inefficiency of existing joint ventures is their scale and consequent difficulties in coping with the existing food chains and transportation infrastructure. They were created as small enclaves in an alien environment. A more complex approach in organizing ventures in resource development, providing upgrading of related infrastructure is necessary to make their operations smooth and profitable.

At the same time, efforts should not concentrate exclusively on joint ventures in USSR. Although such enterprises are essential for improving the production capabilities of Soviet export-oriented industries, a broader search of alternative solutions should be stimulated. There are, for instance, possibilities of organizing production facilities in Japan and managing them jointly; locating such enterprises in Soviet Union and attracting labor force from neighboring China or North Korea; or even jointly organizing these production facilities in third countries in Asia.

Under present market conditions, development projects not only in wood processing, but also in extracting and processing non-ferrous metals, oil, minerals, as well as enterprises involved in marketing of Soviet foodstuffs and processed goods, could become highly profitable, promoting at the same time restructuring of Soviet exporting industries.

It is worth mentioning that in this regard new opportunities may arise if special economic zones were created in the Soviet Far East. There are still no precise concepts of what form these zones would take, feasibility studies are under way, but potentially they could open ways of finding unusual solutions for combining capital, labor and technological resources in building up processing facilities.[18]

The second issue of extreme importance for expanding bilateral economic ties is the problem of unreliable information networks. The irony of the present situation is that many potential Soviet exporters do not know whether or not their goods are tradable in the world markets, and Japanese companies have very incomplete information about what commodities and services are available for import (especially in the European part of the USSR).

On the one hand, Soviet enterprises for several decades were cut off from regular data on commodity markets, technical and quality standards for manufactured items. On the other hand, information on Soviet enterprises for Japanese importers, being channeled through monopolistic state foreign trade organizations, has always been very limited. Building up a parallel, alternative "information bridge" between Soviet and Japanese business is quite realistic under present Soviet regulations and may become a real breakthrough in their economic relationship.

On the side of Soviet enterprises, and especially the new private sector (the so-called cooperatives) there is an extreme interest in creating a reliable informa-

tion exchange system. As a result of deficiency of information sources and lack of trade intermediaries, prices for respective services for the last two years grew by almost 400 percent in Moscow and other large cities.[19] Firms in information and consulting were among the most profitable enterprises. All that with rather limited experience in building up information networks, severe shortages of modern business equipment and communication facilities.

Under these circumstances, enlarging information flows and the processing and analyzing commercial data may be a promising business area for Japanese companies. Some of them, especially the "sogo shoshas" during the 1970's-1980's, accumulated great experience in organizing diversified information networks all round the world and they may be very efficient in expanding these activities in Soviet Union.

An effective system of information exchange and consulting could play a role of a locomotive in developing various forms of bilateral cooperation.

Soviet autarky, sustained for decades, isolated environment in which Soviet industries, as well as technical and scientific research developed, may now play a positive role and become a serious incentive for the Japanese side to develop bilateral economic cooperation with the Soviet Union. Recent surveys by Japanese experts (as well as European and American specialists) show that the Soviet Union is in possession of a large number of technologies that may be very promising if commercialized.

The best-known inventions and technologies are the ones that were practically implamented and realized in certain products: such an airplanes, military equipment, satellites, space shuttles and other. Usually technologies in such areas as airspace, composite materials, ceramics, biotechnology and some other are mentioned as the ones where the Soviet Union has a competitive edge.[20]

Obviously, this is only the tip of the iceberg. As a result of decades of isolation (when possibilities of adopting technologies from the West were limited), research efforts created original technical solutions and scientific inventions in almost all possible areas. The reason for such innovations not being known abroad is due to the wellknown inefficiency of Soviet managers to convert basic research into practical technologies. As a result of a poorly organized system of registering inventions and issuing patents, a high percentage of actual results have never been published or made public. The authors of these inventions, within this rigid centralized management structures, have had no ways of promoting their achievements.

There are serious grounds, therefore, to suppose that in many areas advanced technologies are still unknown by foreign companies and are not being promoted adequately by Soviet exporters.

Publicizing these inventions, developing production technologies on their basis and starting new businesses may open unexpectedly broad opportunities for cooperation with Japanese corporations. Inventions and technologies, developed in Soviet Union, could be a way of finding new niches in world markets and provide a sound basis for joint projects with Japanese companies.

European and American companies were faster in trying to gain access to Soviet technologies and starting their commercial use. Although the data is incomplete, there is evidence that during the last two years (1988-1989) at least 11

joint ventures were created on the basis of Soviet technologies. Some of the enterprises were established outside the USSR and are operated in the United States and Western Europe.[21]

Japanese companies thus far have not shown signs of special interest in starting business of that sort, although they have accumulated great expertise in technology transfer—in evaluating new technologies, mediating between possible partners, preparing possible business arrangements, and finding places and countries with the most favorable conditions for allocating production facilities.

Mobilization of new Soviet export resources, some improvements in marketing products, and broader information exchange have already resulted in some increase of Soviet exports to Japan. There was a substantial growth in volume during the period 1987-1988, and the figures for 1989 are estimated to exceed 6 bln. dollars.[22] This data actually shows that even in traditional areas of trade slight changes in management and marketing can yield significant results.

Recently there have been signs that even in exports of iron scrap and fishery products, which were stagnant for many years, as a result of newly signed large contracts, deliveries will substantially exceed previous year records.[23]

Although the number of joint ventures and different projects with participating Japanese firms is increasing slowly, in 1989 feasibility studies of more than 70 projects occurred in different areas. Negotiations are under way for Japanese participation in several large scale projects—renovating an automobile plant, modernizing paper—production facilities in Sakhalin, building four petrochemical complexes (one of which in Siberia may become one of the world's largest in terms of production of plastics).

Development of Soviet markets by Japanese business would likely be a step-by-step process, when cooperation projects will emerge in those areas, considering promising and worth entrepreneurial efforts. Entering this market, isolated for a long period and still highly dependent on specific managerial practices, would be much more controversial than developing ties with traditional partners with free market economies.

A well-balanced strategy may, however, lessen many of the arising difficulties and assure continuity in expanding operations in the Soviet Union. This strategy could be aimed at : 1) coordinating efforts by private sector and governmental aid programs ; 2) creating special incentives for developing cooperation in areas that could have a multiplier effect on future business activities in Soviet Union ; and 3) choosing appropriate forms of forwarding aid and developing cooperation projects, so as to heighten the efficiency of loans and ensure profitability of direct investments.

As far as different alternatives exist in forwarding economic aid and organizing entrepreneurial projects, it may be rather essential to figure out which of them can be most efficient for Japanese businesses and are worth being stimulated. It is obvious that some forms of cooperation provide a multiplying effect on future business. Jointly operated plants, for example, help to train managers and personnel better than, say, pure financial assistance. The same applies to other areas of interaction. For example, cooperation in building up telecommunication networks will make possible new projects that can not be realized without means of rapid communication. Some hierarchy of preferences, therefore, could be thought of

that would help concentrate efforts on easing managerial and infrastructural constraints for future business activities in the Soviet Union.

For a certain period at least, loans, especially untied, will be rather ineffective. As long as the micro and macro managerial systems remain the same, the use of credits may be wasteful. They could, however, prove efficient in cases of financial assistance to newly organized private enterprises or reorganized stock companies, but not in supporting old business structures.

The Soviet Union is on the way to constructing a market economy from the initial stage and therefore only loans and grants, provided together with technical assistance and transfer of managerial skills, may guarantee their appropriate use. This logic helps understand why in present circumstances (FDI) are a highly preferable form of cooperation and that any loans, supposed to help modernize industries, should somehow be linked to the introduction of new technologies and managerial structures.

As far as financial assistance is concerned, there are different ways for Japanese banks and companies to participate in creating a financial and institutional framework for a competitive market system in the Soviet Union. Practical ways could be worked out to enable Japanese financial institutions and banks to become shareholders in newly emerging Soviet commercial banks or initiate the creation of new ones jointly with Soviet partners. It could help in getting better knowledge about the functioning of the local economy, help stimulate promising industries and entrepreneurial projects and, in a way, supervise and coordinate the use of financial flows from Japan (loans, grants, etc.).

Among many other options, there is one way of allocating financial assets that is worth special attention. As was already mentioned, there is a promising future for practical use of Soviet technical achievements through heightening managerial and organizational effectiveness of R & D. An unusual as it may seem, there consequently might be broad opportunities for venture business, based on original technologies. Rapid development of companies, specializing in financing venture firms is a matter of time. Providing assistance to newly created entrepreneurial projects, financing R & D teams is likely to become a business with bright future, and Japanese companies, specializing in related activities could initiate interesting projects.

Compared with loans and credits, FDI, as a form of financial commitment, is likely to have a relatively stronger impact on market formation in Soviet Union. Depending on conditions, different suitable forms of organizing projects could be found in each particular case, so as to meet expectations of the Soviet side and guarantee profits for Japanese companies. In general, however, joint ventures have proved to be more efficient than investments, say, in M & A (merger and acquisition) in terms of diffusing technical and business knowhow on the one hand, and on the other hand in accumulating experience of operating in an unusual environment.

A much more important issue is the industries, where FDI are allocated. In the long term, from the viewpoint of future climate for business activities of Japanese companies, effectiveness of current investments in different areas would be different. The cornerstone issue here is the ratio of investments in manufacturing industries.

Japanese investments, made in recent years, which emphasize the processing of natural resources and fishery products, will certainly stimulate bilateral trade, but together with FID in tourism, hotels and other services they are unlikely to strengthen the overall role of Japanese companies in Soviet markets, and have multiplicative effect on the future business relationship between the two sides.

To a certain degree the present structure of Japanese investments is a major reason for their low effectiveness. Obviously Japanese companies chose to invest in industries which traditionally had outdated technologies and equipment, employed unskilled workforce industries, where the overall effectiveness highly depends on infrastructural conditions (especially transportation facilities). In a sense Japanese investors were, therefore, predisposed to face multiple problems from the very beginning and hardly could rely on rapid business expansion.

Investments in processing foodstuffs and natural resources, besides being supportive to export oriented industries, cannot play a significant role in terms of gaining access to internal markets. Getting establishing in most important markets, therefore, would require some reorientation in investment policies, a significant increase of FDI in the manufacturing sector.

Among various options of FDI in manufacturing there is one that deserve close attention. Under a program, inaugurated recently by the Soviet government, a large number of enterprises, that turn out military goods and equipment, will be converted to produce consumer items and high technology machinery. However, investments, provided by the government, which are supposed to amount to 9 billion rubles[24] (approximately 1.4 billion U. S. dollars), are unlikely to be sufficient to renovate almost 2000 large and medium size enterprises. Under present Soviet regulations of FDI, Japanese companies could negotiate ways of creating joint ventures with these enterprises and thus establish themselves in crucial industries.

Such an undertaking has many strong points. Military industries were traditionally in an exclusive position in terms of using advanced technologies, organizing R & D and attracting knowledgeable managers and a skilled work force. These plants are usually well located and their supplies of raw materials and semi-finished products have always been better than those of other industries. With much experience in high-tech production, these enterprises, after being modernized will become leading manufacturers in electronics, the production of transportation and high precision industrial equipment. Investments in reorganizing these enterprises, therefore, would involve less risk, while at the same time would open the way for cooperation in high technology industries.

Consideration of the possible multiplying effect of direct investments in different areas, communication networks should be emphasized in the list of priorities. Poor communication networks are currently one of the main constraints for expanding business activities in the Soviet Union. Due to the low capacity of communication circuits as a result of outdated equipment, it is improbable that information flows can expand substantially without fundamental modernization of hardware.

Japanese companies, with reliable technologies, extensive experience in developing infrastructural projects abroad, could effectively use their skills and contribute to the renovation of Soviet communication networks. This kind of involve-

ment could, as a matter of fact, result in a considerable spinoffs: procuring equipment and technologies, providing know-how in modernizing telecommunications gives to the firms involved preferential access into related areas, such as computerization, information networks, creation of data banks, production of electronic appliances and other high technology industries.

This promising area of cooperation may turn out to be very beneficial for Japanese companies. There is evidence that Japanese firms suppose that by use of new or revitalized land, sea and air routes in the USSR, they will soon be able to offer cheaper, quicker and more reliable communications between Japan, East Asia and Europe. Under a joint agreement, for example, a fiber optic cable is being installed, connecting Japan and Europe through the territory of USSR.[25] It is believed that the project will be completed by the mid-decade and will dramatically improve international telecommunications.

This fiber optic line, crossing the whole territory of the Soviet Union, may become an important starting point for Japanese-Soviet cooperation in telecommunications. Involvement of Japanese companies in this project places them in a favorable position to expand their activities, and the line may become a sort of a framework to which other local telecommunication projects could be attached.

1990's: a need for joint efforts.

Since the reforms began in the Soviet Union, the approach of Japanese businesses has already passed through at least two stages in anticipating future development of economic relations with this country. First, there was a kind of euphoria, especially among companies that were not previously involved in bilateral cooperation. There was sentiment that moves toward decentralized the economy and introducing market principles would quickly loosen the restraints on entering Soviet markets and expand operations there dramatically. In 1986-1987 attention centered on potential opportunities. Business talks and negotiations were mostly about great prospects for joint ventures and trade options.

As a result of their problematic experience in operating joint ventures in Soviet Union since 1986 and difficulties in developing trade, Japanese attitudes toward economic cooperation with thh Soviet Union have changed considerably. In addition, "glasnost" resulted in broader access to Soviet economic information and statistical data, giving Japanese analysts a much more realistic view of the Soviet economy, disclosing numerous difficulties on the macro and macroeconomic level. For the first time it became possible for Japanese companies to realize the real scale of difficulties, needed to be overcome structural disproportions in their bilateral trade, to adjust legal regulations of trade and investments, and to cope with differences in managerial systems.

Recent developments, however, demonstrate that there is a growing understanding on the Japanese side that entering Soviet markets and expanding various forms of cooperation is far more complex than was apparent originally. They now recognize that in order to intensify economic exchange in the future, substantial efforts are currently needed to create an appropriate business infrastructure. Instead of large-scale cooperation projects, recent proposals made by Mr. Shintarō Abe in Moscow early 1990, were emphasizing exchange of business missions,

training Soviet students and specialists, enlarging transfer of Japanese technical and managerial knowhow.[26]

This shift in approaches can be considered as a positive sign. It reflects the fact that Japanese attitudes are becoming more balanced and realistic. Correct understanding of the strong and feeble points constitute a solid basis for practical steps in further development of economic ties with the Soviet Union.

Long-term benefits of developing economic relations between the two countries are undoubtedly worth the effort in overcoming existing economic difficulties. The effectiveness of these efforts would, however, highly depend not only on the pace of Soviet reforms, but on the readiness and willingness of Japanese business to work out and implement a comprehensive strategy of doing business in Soviet Union.

NOTES

1 Although there is no precise statistical data on the rate of Japanese companies which withdraw from operations with Soviet partners, investigations made on the basis of case studies show that almost 10 percent of firms curtail their business there after a two years period. *Unpublished manuscript*. Policy recommendation paper for The State Committee for Foreign Economic Relations. IMEMO, 1988.

2 More specific data about the "Long-Term State Program for the Comprehensive Development of the Productive Forces of the Far Eastern Economic region up to Year 2000" can be found in V. Ivanov, A. Kollontai, *A Pacific-Oriented Economy* (Moscow, Novosti Press Agency Publishing House, 1989), pp. 18-20.

3 Arguments, supporting the "wait and see" approach are in great part summarized in two articles: "Experts differ on the future of Soviet-Japanese trade," *Japan Times Weekly* (December 31, 1988) and "Economic, territory problems mar improvement of Japan-Soviet ties," *The Japan Economic Journal* (November 5, 1988).

4 Data from a report made by the Moscow Institute for Public Opinion. Revealed by the director of this Institute in a presentation made at the Center for International Affairs of Harvard University on May 16, 1990.

5 "East Europe market could exceed North America", *The Financial Times* (April 4, 1990).

6 "Ghephardt urges direct Soviet aid," *Boston Globe* (March 7, 1990).

7 Estimates made by Soviet economists say that by the end of 1989 there were more than 165 bln. rubles worth individual savings in the country, that were accumulated mostly because of deficiencies of consumer goods, *The New York Times* (May 14, 1990).

8 Complaining about difficulties in developing trade with Soviet partners and operating joint ventures, discussing ruble inconvertibility or bureaucratic constraints, Japanese business experts are usually giving estimates of how long the climate for business will remain unfavorable and when Japanese companies may become interested in expanding relationship with Soviet Union. See *Nihon Keizai Shimbun* (January 9, 1990), p. 9.

9 *The Financial Times* (April 5, 1990).
10 *Vneshnaya Torgovlya SSSR* (Foreign Trade of the USSR), (1989) pp. 47-48.
11 It is difficult to evaluate the real number of joint ventures in the Soviet Union because of two reasons: official statistics still do not give this data, and there are no comprehensive regulations concerning when it is appropriate consider a joint venture get created—when feasibility studies begin, when they are registered, or when they start operating. At present, therefore, quite different figures could be found in the press and research papers. The figures, given in the text were given by the newspaper, *Isvestia* (December 14, 1989).
12 *Economicheskaya gazeta* (August 9, 1989).
13 *Ibid.*
14 *Nihon Keizai Shimbun* (March 3, 1990).
15 The idea is to create a revolving fond of dollars or other hard currencies from which Eastern European nations could borrow to settle their trade debts with each other and West partners. These loans would be repaid when the borrower earned a trade surplus. "Europeans Weigh Fund To Aid East", *The New York Times* (May 9, 1990).
16 *The Japan Economic Journal* (March 10, 1990).
17 These estimates were made by a group of economists in IMEMO after case studies in the Soviet Far East, at enterprises that are involved in trade with Japan, in Soviet trade missions in Tokyo and Sapporo. Unpublished manuscript. A policy recommendation paper for the Soviet Ministry for Foreign Economic Relations. IMEMO, 1988.
18 Possible models for special economic zones in the Soviet Far East are analyzed in *A Pacific-Oriented Economy*, op. cit., pp. 29-37.
19 Data from a presentation by a representative of the Soviet association of cooperatives at the conference "USSR-markets of the future", Honolulu, Univeriity of Hawaii, Manoa, May 3, 1990.
20 A special survey on the state of Soviet high technology industries, and possible ways of East-West cooperation was published recently by *Nihon Keizai Shimbun* (April 2, 1990).
21 Many of the joint enterprises, established in high technology industries, are not only aiming at production of certain high-tech items. Joint research and development activities are also often provided by the agreements. In a recently established cooperation project between Pratt & Whitney (U. S. A.) and one of the leading Soviet aircraft manufacturers, for example, emphasis is made on joint research in order to develop new aircraft engines. *The Wall Street Journal* (May 18, 1990).
22 According to Japanese statistics, Japanese-Soviet trade in 1988 increased 20 percent over 1987. *Tsushō Hakusho* op. cit., 1989, pp. 693-694. Estimates for year 1989 are given in *The Japan Economic Journal* (May 12, 1990), p. 1.
23 Data on new large contracts on exports of Soviet metallic scrap can be found in *Nihon Keizai Shimbun* (September 1, 1989); on fishery product in *Asahi Shimbun* (December 3, 1988).
24 Report by Soviet Prime Minister N. Ryzhkov to the session of the Supreme Soviet. *Vestnyk Verkhovnogo Soyeta SSSR* (Decomber 18, 1989).
25 *The Japan Economic Journal* (March 24, 1990), p. 7.

26 See *Nihon Keizai Shimbun* (January 16, 1990).