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Japanese Investment in Russia Floundering Despite Arctic Energy Deal

Without improvements to Russia's business climate, cases of Japanese investment into Russia will continue to be the exception, not the norm.

By James Brown

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Japan recently tied up a $2 billion deal to invest in Russia's Arctic LNG 2 project. But the deal was not without problems and hesitation from the Japanese side. **Kremlin.ru**

At the Eastern Economic Forum (EEF) in the Russian city of Vladivostok last month, Japan's Mitsui & Co and the state-backed Japan Oil, Gas, and Metals National Corporation (JOGMEC) signed a protocol with Russia's Novatek gas producer on investing in the Arctic LNG 2 project.

The original deal was agreed back in July at the G20 summit in Osaka, when the Japanese side bought a 10 percent stake in the project at a cost of $2 billion. News of such large investments

create the impression that the rapprochement between Russia and Japan in recent years has not been in vain. But in reality, despite this isolated deal, economic relations are far from flourishing.

Japanese Prime Minister Shinzo Abe's government has been pushing Japanese companies to invest in Russia for several years now, yet Moscow is in no hurry to improve the investment climate for them. Now the Russian authorities are running out of time: this rare window of opportunity for the Russian economy will most likely close as soon as the main proponent of improving relations between the two countries — Abe — leaves office.

Despite their shared border, economic relations between Russia and Japan have never been especially well developed, and the bilateral trade turnover has often lagged behind that between Russia and the leading European countries.

This is partly linked to the Russian economy's traditional focus on the West, but the main obstacle was a lack of political will in both countries. For a long time, Tokyo did not want to cement its ties to Moscow until the territorial dispute over the southernmost Kuril Islands had been resolved.

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In May 2016, however, Abe announced a new approach to Russia. Japan resolved to first create a firm base for economic and political ties, and then to use that base to try to resolve the territorial dispute.

As part of this new approach, Abe selected eight areas for economic cooperation: medicine, urban planning, small and medium-sized enterprises, energy, industry, the development of the Far East, technology, and humanitarian exchanges.

To underline his seriousness, Abe even created a new cabinet position — minister for economic cooperation with Russia — and appointed a close ally, Hiroshige Seko, to the post. Since 2016, Abe has not missed the annual EEF in Vladivostok.

For comparison, Xi Jinping, the leader of China — Russia's main partner in Asia — has attended the forum just once, in 2018. Finally, in September this year, Abe's government granted a long-held wish of the Russian business community, and further simplified the process of obtaining a Japanese visa, including five-year visas.

Statistics show, however, that despite Abe's efforts, Japanese businesspeople do not share their prime minister's enthusiasm for Russia.

The bilateral trade record of $34.8 billion was set back in 2013 — three years before Abe announced his plan for the eight areas of cooperation. In 2018, the trade turnover was just $23.1 billion, and in the first half of this year, it was down 0.8 percent compared to the same period last year. Japan has dropped from seventh place to tenth in the list of Russia's key trading partners.

The volume of Japanese investment in the Russian economy isn't particularly impressive either. In 2017, just 0.07 percent of all Japanese investment abroad was in Russian projects. As of June 2017, Japan had invested 1.8 billion rubles in Russia's Far Eastern Federal District, compared with 140 billion rubles from China.

The Japanese investment in Arctic LNG 2, therefore, is the exception to the rule, rather than an indicator of a positive trend in bilateral relations. And even this deal was plagued by difficulties.

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Mitsubishi, which had been expected to invest in the project together with Mitsui & Co, declined to take part, despite the Japanese government's readiness to provide active help. The company's management reportedly had doubts over the project's viability, and over the lack of guarantees that the project would not end up on the U.S. sanctions list at a later date. Nor had Mitsubishi forgotten that back in 2006, together with Shell and Mitsui, it had been forced to reduce its stake in the Sakhalin-2 project by 50 percent when Gazprom required a controlling stake.

Even Mitsui, which has a lot of experience of working in Russia and over 200 Russian-speaking employees, was for a long time reluctant to invest in Arctic LNG 2. It only agreed to the deal after JOGMEC offered to finance 75% of it, thereby violating its own rule of not providing more than half of the investment amount.

Western (primarily U.S.) sanctions are partly to blame for Japanese investors' lack of interest in Russia.

Japan only introduced symbolic sanctions against Russia in 2014. These were designed to keep the United States happy, while not hindering the development of economic relations with Russia either. The main fear of potential Japanese investors is that the project might subsequently end up under U.S. sanctions. This is particularly relevant for projects in the energy sector that take years to implement. In addition, most major Japanese companies invest in the United States, and do not want to lose access to the U.S. market.

Yet sanctions are not the main reason for the low volume of Japanese investment in Russia. According to a survey by the Japan Business Federation (Keidanren), Japanese companies

consider the three biggest obstacles to doing business in Russia to be: problems with the authorities (highly complicated authorization procedures and paperwork requirements), import and export procedures (opaque procedures in customs clearance and lengthy clearance times), and the legal system (contradictions between the civil and tax codes and the lack of an English translation of those laws).

The Russian government often states that improving the country's investment climate is a priority, but most of the Japanese companies surveyed say that the business environment in Russia became worse in the last year. For the Russian authorities, a convenient excuse is to blame excessive caution on the part of Japanese companies, or on sanctions. In reality, it's problems inside Russia that make the country unattractive to Japanese business.

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Soon Russia may lose the opportunity to raise major Japanese investment once and for all: Abe's current term ends in September 2021, and most of the other leaders of the ruling Liberal Democratic party don't support the prime minister's policy on Russia.

Even politicians close to Abe are disappointed with the lack of progress in this regard. It is said that Seko, who stepped down as minister for economic cooperation with Russia in September of this year, was so irritated by the slow implementation of the plan for economic cooperation that, during his final months in office, even the mere mention of Russia annoyed him.

There is also growing feeling in Japan that the Russian leadership is making a mockery of Abe. In June and July of this year, Russian air force planes entered Japan's airspace. And when Abe was in Vladivostok last month for the EEF, Russian President Vladimir Putin took part by video-link in the opening of a large new fish-processing plant on the island of Shikotan — one of the Kuril Islands to which Japan lays claim. In Japan this was considered a calculated insult.

The purchase of a stake in Arctic LNG 2 by the Japanese consortium is certainly a significant step in the development of economic ties between Russia and Japan, but if the Russian government doesn't quickly start work on improving the country's investment climate, this deal will not be the start of a torrent of Japanese investment, but rather a small island of success in a vast sea of missed opportunities.

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