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SOVIET-JAPANESE ECONOMIC RELATIONS: STATUS AND PROPOSPECTS

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Jack F. Matlock

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THIRTEENTH SESSION

SENIOR SEMINAR IN FOREIGN POLICY

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THE SENIOR SEMINAR IN FOREIGN POLICY

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SOVIET-JAPANESE ECONOMIC RELATIONS: STATUS AND PROSPECTS

A Case Study

by

Jack F. Matlock

March, 1971

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SUMMARY

This study, based primarily on interviews with Japanese officials and businessmen, examines the status and future prospects of economic relations between Japan and the USSR. It notes the rapid growth of Soviet-Japanese trade and other economic ties during the past few years and describes the major joint development projects in the USSR which are under discussion. After examining economic and political factors which bear on the relationship, it concludes that despite many obstacles, Japan-USSR trade is likely to continue steady growth, but without any sudden or dramatic spurt. Large joint development projects in the USSR may well become more feasible within a few years if present trends continue.

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SOVIET-JAPANESE ECONOMIC RELATIONS: STATUS AND PROSPECTS

The Soviet Union and Japan are now the second and third largest industrial powers in the world. They are, furthermore, geographically adjacent and their economies are to a great extent complementary: the Soviets possess vast resources needed by Japan, some of which are more accessible to the Pacific coast than to European Russia, while Japan has developed efficient, technologically advanced industries in many fields which are lagging in the USSR. Economic factors, therefore, clearly favor a close economic relationship and a high volume of trade.

The rapid growth of trade between the two countries in recent years should, therefore, occasion no surprise. From 1965 to 1970, trade turnover increased from $409 million to $822 million, exhibiting growth at an average annual compound rate of 15 percent. In 1970 Japan became the most important trading partner of the USSR in the industrialized non-communist world.

Nevertheless, Soviet-Japanese trade still comprises a very small portion of the external trade of either country, normally fluctuating between two and three percent of the total turnover. Even the rapid growth of the past five years has not kept pace with the overall increase in Japan's foreign trade. It is clear, therefore, that Soviet-Japanese economic relations are considerably more circumscribed than basic economic factors would seem to permit and, indeed, encourage.

Economic factors, of course, do not dictate economic relations: given sufficient hostility, they can be irrelevant. For decades political restraints have minimized economic ties between Japan and the USSR. During the last few years, however, some of these restraints have begun to suffer erosion, while incentives for closer economic ties have grown.

After surveying the current scene, this study will examine the factors which bear on the Soviet-Japanese relationship and attempt to assess the direction that relationship is likely to take during the next few years. It is based primarily on interviews with Japanese officials, businessmen and scholars.

I. MACHINERY AND METHODS

State monopoly of foreign trade is a cardinal tenet of Communist ideology and has been a characteristic of the Soviet state since its inception. Economic negotiations with foreigners, therefore, are conducted under centralized state control, even though the details may be handled by one or more Soviet foreign trade monopolies, most of which are organized along industry or product lines. This form of organization contains elements of both strength and weakness vis à vis foreign trading partners. On the one hand it precludes competition among Soviet organizations for contracts, while Soviet trade officials are able to play off one foreign firm against another. On the other hand, it entails rigidity, red tape and slow decisions, which hamper the negotiating process and may often lead to missed opportunities. Handicaps stemming from the structural rigidity of the foreign trade system are exacerbated by centralized economic planning which controls and severely limits Soviet negotiators' freedom of action.

In dealing with the Soviet behemoth, the Japanese work through a complex system of government bodies and private organizations. The Japanese Government takes the lead in setting overall policy and maintains tight control over credit transactions. From 1957 to 1970, the Japanese Government entered into long-range and annual trade and payments agreements with the USSR. Most other economic negotiations have been conducted by private firms, but government officials often assist with research and technical advice. It is clear that no substantial transactions can occur without the approval, or at least acquiescence, of the Government.

On the government side, the Ministry of Foreign Affairs, Ministry of International Trade and Industry, Export-Import Bank, and Japan External Trade Research Organization all play roles in this process. Most private firms dealing in the Soviet trade are members of the Japan Association for Trade with the Soviet Union and Socialist Countries of Europe (SEETA), which acts as an informal coordinator of private efforts and as a liaison channel with the government. Negotiations on major Siberian development projects are conducted by the Japan Chamber of Commerce and the Federation of Economic Organizations (KEIDANREN), which select the Japanese participants in the USSR-Japan Joint Committee for Economic Development. The Joint Committee was formed in 1966 and has met roughly once a year since then. When both sides exhibit serious interest in a particular project, a joint sub-committee is often formed to work out the details.

Private Japanese trading firms handle most normal, non-credit trade. The larger Japanese trading firms as well as several smaller ones--14 in all--now maintain permanent offices in Moscow, and the Japanese make up by far the largest contingent of foreign businessmen stationed in the Soviet capital.

When large projects are considered, the pattern has been for one major Japanese firm with a primary interest in the project to take the lead in the negotiations, either within the Joint Committee framework or outside it. If a basic agreement is reached, the "lead" firm then organizes other companies interested in participation into a loose consortium and a new specialized firm is established to coordinate transactions related to the project.

The Japanese system is designed to create to the extent possible a united front in dealing with the Soviet trade monopolies. It does not, however, prevent all competition among the Japanese. Trade outside project agreements is conducted by highly competitive firms, some of which are willing to take losses on individual contracts in order to maintain or expand their share of the Soviet market. Even when trade is based on a project agreement, the Soviets normally retain the right to place orders with the lowest bidder among the participating firms. Nevertheless, results indicate that the system of guidance, coordination and consensus has served the Japanese well in dealing with the Soviets.

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II. STATUS OF ECONOMIC TIES

A. TRADE

Japanese-Soviet trade has grown remarkably since the Joint Declaration of 1956 which normalized political relations. Turnover has grown from the insignificant level of $3.6 million in 1956 to $821 million in 1970. The following table illustrates the trend over the past five years.

JAPANESE-SOVIET TRADE *
(Value in Millions of US Dollars)

Year	Japanese Exports to USSR		Japanese Imports From USSR		Turnover	
	Value	Percent Total Exports	Value	Percent Total Imports	Value	Percent Total Turnover
1966	214	2.19	300	3.15	514	2.67
1967	158	1.51	454	3.89	612	2.77
1968	179	1.38	464	3.57	643	2.48
1969	268	1.68	462	3.07	730	2.35
1970	343	1.80	479	3.19	822	2.42

Although the growth has been steady and rapid, one should note several characteristics. (1) The expansion of Japan's trade with the USSR has in recent years not kept pace with the increase in Japan's overall external trade. (2) Japanese-Soviet trade still occupies a minor segment of both countries' foreign commerce. (3) The trade has been heavily in favor of the USSR, although in the past three years it has been moving toward a balance.

The bulk of Japan's exports to the USSR are manufactured goods: chemical products, textiles and machinery. Soviet exports to Japan are largely raw materials and semi-processed goods: timber, coal, ores, pig iron, cotton and petroleum.

A recent development worthy of note is successful Japanese competition with Western firms for the sale of industrial plants to be located in European Russia. (Negotiations regarding Siberian development will be discussed later.) In December, 1970, Mitsui secured contracts to supply three ammonia plants and one ethylene plant for lcations in the Western USSR. The contract is valued at $110 million, and the same firm had previously sold other plants to the USSR.

*Based on Japanese statistics; Soviet data vary to some degree. More detailed statistics from both Japanese and Soviet sources can be found in Appendix I.

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From 1957 through 1970, Soviet-Japanese trade was conducted within the framework of trade and payments agreements. Negotiations for another five-year agreement and for the 1971 protocol were broken off by the Japanese Government in February, 1971. The Japanese would prefer to conduct their trade without such agreements. Their principal objections to them are: (1) The Japanese Government is not able to commit private businessmen to a particular level of trade; (2) Import targets in past years have been met and exceeded by Japanese traders, but the Soviets have consistently purchased less from Japan than they had agreed; and (3) The USSR conducts trade with other industrialized capitalist countries without trade and payments agreements, and to insist that trade with Japan must be on this basis is a form of discriminatory treatment.

The Japanese seem confident that the absence of a trade and payments agreement will not have an adverse effect on the level of trade. If the Soviets insist on an agreement, however, the Japanese are probably prepared to reopen negotiations later in 1971, provided the Soviets meet at least some of the Japanese objections.

B. TRANSPORTATION AND TELECOMMUNICATIONS

As trade has grown, transportation links have naturally followed suit. The most spectacular development has been in the field of commercial aviation, with the establishment of a direct air route between Moscow and Tokyo, which not only facilitates travel between the two capitals, but shortens the airline distance between Western Europe and Japan.

Presumably on security grounds, the Soviet Government long refused to permit carriers from non-communist countries to operate over Siberia and the Soviet Far East. After lengthy negotiations, Japan and the USSR agreed in 1968 to establish direct air service between Moscow and Tokyo. The unusual agreement provided that Japan Air Lines would initially utilize Soviet aircraft and flight crews on the route, but would be permitted to operate its own equipment within two years. The latter phase was implemented in March, 1970, when JAL began using its own aircraft and crews. At present both JAL and Aeroflot operate four flights a week each way, half originating in Paris and half in London.

The route has proved to be a commercial success for JAL. Load factors are reported to be in excess of 80 percent, with most travellers merely transiting Moscow between Tokyo and Western Europe. Aeroflot has been less successful in attracting passengers and is believed to operate at about 30 percent capacity. A pooling arrangement with Aeroflot diminishes JAL's profit, but the Japanese seem nevertheless highly pleased with the route's profitability.

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In recent negotiations, the Soviets have pressed for rights to serve Osaka in return for JAL rights to Khabarovsk. The Japanese refused the proposal on the ground that service to Osaka is much more valuable than service to Khabarovsk. An agreement was reached in March, 1971, however, to establish service between Niigata, a small city on the Sea of Japan, and Khabarovsk. Each airline will operate weekly cargo service on the route from April, 1971, and weekly passenger service will begin in 1972.

Most Soviet-Japanese trade flows through the port of Nakhodka, the principal Soviet commercial port on the Pacific since the closure of Vladivostok to merchant shipping. A Japanese shipping firm, the Yamashita Shinnihon Shipping Line (YS Line), has been active in service to Nakhodka and has taken the lead in negotiating Japanese participation in the improvement of Soviet port facilities in the Soviet Far East, a subject which will be discussed below.

The YS Line is also pioneering a scheme to promote the shipment of containerized cargo between Western Europe and Japan via the Soviet railway system. The "Siberian Land Bridge," as the scheme is dubbed, involves the shipment of containers from Japanese ports to Nakhodka and thence by rail to Western Europe. The YS Line now accepts standard 20-foot containers for through-bill-of-lading service to a number of West European cities. Advertised rates and anticipated delivery times appear competitive with ocean shipping for some commodities and destinations,* but it appears that congestion and inappropriate handling facilities at Nakhodka will limit use of this service until more adequate facilities are available at the projected new port of Vrangel.

In the area of telecommunications, the most important recent development was the opening of a cable link from Japan to Nakhodka in 1969.

C. DEVELOPMENT PROJECTS

No aspect of the Soviet-Japanese economic relationship has attracted more attention than proposals for several large-scale joint development projects in the Soviet Far East and Siberia. Although these proposals have absorbed the attention of the Joint Committee for nearly five years and have received extensive publicity, results to date have been meager: agreement has been reached on two projects, one of which is still to be implemented, and a third proposal seems on the verge of agreement.

The common features of most projects are: (1) Provision of Japanese capital equipment and technology on credit terms; (2) Supply of project-related consumer goods on short-term deferred payment; and (3) Repayment of capital equipment loans out of a "production share" of the project's output.

Let us look at each of the significant proposals briefly. Further details are presented in Appendix II.

* Representative rates and estimated delivery times are $1,150 and 30 days, Japan to Helsinki; $1,250 and 40 days Japan to Hamburg or Frankfurt; and $1,400 and 45 days to London.

1. Timber (K-S Plan)

A project to develop timber resources in the Soviet Far East--in Japan known as the "K-S Plan," from the initials of the two chief negotiators, Kawai and Sedov--was the first Siberian development project agreed upon. The agreement was signed in July, 1968, and provided for the export of $163 million of Japanese goods to the USSR ($133 million of earth-moving and lumbering equipment and $30 million of consumer goods), in return for which the Soviets agreed to export to Japan $183 million of timber over a five year period.

The Japanese provided the machinery on five-year credit, but consumer goods sales were made on 12-month and 180-day deferred payment terms. A fixed price based on the 1968 level was set for the Soviet timber, with an automatic escalation of one percent a year applicable during the last three years of the contract.

The "K-S Plan" has now been in operation for over three years and the Japanese business interests involved seem to be satisfied with the outcome to date. The Soviets were slow in placing orders for Japanese equipment (all orders were to have been placed by the end of 1969; in fact, it was not until early 1971 that orders were substantially complete). In addition, Soviet timber is said to be of poorer quality and less carefully graded than that from other sources. Nevertheless, the rise in timber prices in the world market since the agreement was concluded rendered the fixed price advantageous.

The Soviets, as might be expected, are chafing under their delivery commitments at a fixed price, and are expected to be tougher in future price negotiations.

2. Vrangel Port

Japanese participation in the improvement of port facilities in the Soviet Far East has been discussed since the first meeting of the Joint Committee in 1966. Attention was directed initially at the expansion and improvement of Nakhodka, but when it was determined that the terrain around Nakhodka would make expansion difficult, it was decided to construct a new port at a nearby location on the eastern side of Vrangel Bay.

The Soviets expressed interest in acquiring Japanese engineering and equipment for the project, and after four years of negotiations a design agreement was signed in April, 1970. Japanese engineers visited the Vrangel site shortly thereafter and delivered engineering designs and specifications before the end of the year. In December, 1970, a general agreement was signed on the supply of Japanese equipment for the new port. As yet, the Soviets have placed no orders, but the Japanese expect them to begin negotiating on purchases in June or July, 1971.

The new port will provide a significant increase in Soviet commercial port capacity in the Far East. It will accommodate ships up to 100,000 tons and will contain specialized piers with an annual capacity of 10 million tons of coal, 800,000 tons of pulpwood and wood chips, and 120-140,000 20-foot containers.

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The total cost of constructing the new port at Vrangel is reported to be $300 million. The Japanese have agreed to supply $80 million in port and cargo handling equipment on seven-year credit terms, with the Soviets paying 12 percent down and six percent interest.

Vrangel port is scheduled for construction within three years, and Japanese business interests consider that it will permit a significant expansion of trade, since limited facilities at Nakhodka have become a severe bottleneck. Vrangel's container-handling pier also seems to be a key element in the "Siberian Land Bridge" scheme for shipping containerized cargo between Japan and Western Europe.

3. Wood Pulp and Chips (NS Plan)

Since 1967 the Oji Paper Company and associated concerns have been negotiating on a project similar to the "K-S Plan," with the Soviets paying for Japanese forestry and wood-processing equipment by delivery of pulpwood and chips. Although negotiations on the scheme were broken off by the Japanese in February, 1971, it appears that most details have been worked out and the present disagreement is limited to the price to be charged for the pulpwood and chips.

As it stands, the Japanese envision exporting $45 million in equipment and $5 million in consumer goods on financial terms similar to those agreed upon for the "K-S Plan," but with longer-term credit. The Soviets, however, are demanding an automatic escalation in the price of the wood during the first six years of the contract. Although the Japanese have informed the Soviets that further negotiations will be useless unless the Japanese price offer is accepted, a number of Japanese businessmen familiar with the project believe that a compromise settlement should be possible in the near future.

4. Natural Gas

Proposals for Japanese finance for a pipeline to supply Soviet natural gas to Japan have been under discussion for about five years. The Japanese are clearly interested in importing Sakhalin natural gas. During the negotiations, however, Japanese interest has waxed and waned and the Soviets have altered their position several times so that it is difficult to assess the prospects for eventual agreement.

As matters stand, the Japanese have proposed a $100 million loan (mainly to finance deliveries of Japanese pipe) to construct a natural gas pipeline from Okha in northern Sakhalin to Hokkaido. The Soviets would deliver 2.4 billion cubic meters of gas annually for 20 years.

When agreement in principle seemed near on this basis, the Soviets suddenly proposed that the Japanese in addition provide finance for a much longer pipeline from the gas fields near Yakutsk and agree in advance to take 10 billion cubic meters of gas a year. The Japanese were unwilling to commit themselves to the larger project, but the subject is scheduled for further discussion at the next meeting of the Joint Committee.

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According to Japanese sources, their negotiators hope to break the deadlock by offering $100 million in credit for a pipeline from Sakhalin to Hokkaido with an ultimate annual capacity of 10 billion cubic meters and to provide an extra $60 million for a pipeline linking the Sakhalin-Hokkaido line with Komsomolsk-on-Amur. The Japanese would make a firm commitment to take only 2.4 billion cubic meters a year, but would agree to consider purchases up to 10 billion a year if the Soviets should, on their own, extend the Sakhalin-Komsomolsk line to Yakutsk.

Although Japanese interest in acquiring Soviet natural gas is keen, negotiations are likely to be lengthy. Even with general agreement on a basic concept, which is not yet in sight, haggling over price and financial terms may go on for an extended period.

5. <u>Coking Coal</u>

Exploratory talks regarding the development of coal deposits in Southern Yakutia have been in progress since 1968. In August, 1970, Japanese specialists were allowed to visit the site of the deposits and 10,000 tons of coal from the area were shipped to Japan for testing.

The tests revealed that the coal is of usable quality for steel making, though somewhat inferior to US and Australian coal. On the basis of these tests, the Japanese submitted a questionnaire to the Soviets asking how much credit would be expected if the Japanese agreed to purchase, alternatively, five, seven and ten million tons annually from this source. (If pressed, the Japanese are willing to consider purchases up to 15 million tons a year.)

The Soviet reply has not been received, but the initial Japanese position is that while credit can be offered for mine development, the Soviets must finance the railroad construction necessary to link the mine to the Trans-Siberian. Since the coal deposits lie some 500 kilometers north of the Trans-Siberian, this position, if not altered, may be a barrier to agreement. On the other hand, the plan to construct a coal-loading pier with 10 million tons annual capacity at Vrangel indicates that the Soviets anticipate a sharp increase in coal exports, from either the Southern Yakutia deposits or elsewhere. In 1969 only two million tons of coal were shipped through Nakhodka.

6. <u>Petroleum</u>

The Soviets proposed at the first meeting of the Joint Committee in 1966 that Japan participate in the construction of a 40-inch oil pipeline from the Tyumen oilfields in Western Siberia to the Nakhodka area. The proposed pipeline, some 6,600 kilometers long, was estimated to cost $1.45 billion, and Japan was asked to provide a 20-year credit of $400 million for pipe and equipment, and to agree to purchase ten to twelve million tons of oil each year.

Although the Japanese were willing to consider petroleum purchases in this magnitude, they were not prepared to enter into a credit transaction of this size and duration, and negotiations lapsed after 1967. The present Japanese position is that agreement on Sakhalin natural gas takes precedence. The proposal may well be revived in the future, however, in view of rising petroleum prices on the world market, Japanese concern over its heavy dependence on Middle Eastern supplies and the increasing availability of Japanese capital. In the meantime, the Japanese have indicated that if exploitable oil deposits are found nearer the Pacific coast, they would consider sharing the development costs.

7. Copper

In 1966 the Japanese proposed the joint development of copper deposits in the Udokan Mountains of Chita Oblast. Guided by development costs in the non-communist world, the Japanese estimated that the project would cost about 400 million rubles, and offered to provide one quarter of the investment and to take the same proportion of production. The Soviets, however, estimated development costs at 1.4-1.7 billion rubles and asked for credits to cover half this amount. The Japanese were not prepared to participate to this extent, and furthermore found more profitable investments in copper elsewhere. Therefore, Japanese interest in the Udokan project became dormant, while the Soviets have attempted to interest some West European firms in the project. The Udokan deposit is considered the richest undeveloped deposit in the world, however, and the Japanese might consider the project again if market conditions change.

8. Nickel

Although not located in Siberia, nickel deposits at Buruktal in the South Urals have been the subject of negotiations similar in nature to those involving Siberian projects. The Japanese have offered to buy 5,000 tons of nickel matte per year from the Buruktal mine, while the Soviets have requested credits for $100 million to purchase equipment. Further negotiations are scheduled for April and May, 1971.

9. Other

- Iron Ore - There have been talks regarding development of resources in the Aldan area of Southern Yakutia. Progress on this idea is apparently dependent on successful conclusion of the coking coal project. The same Japanese firms are interested in both and they give priority to the acquisition of coking coal.

- Steel - During his visit to Japan in 1968, Gosplan Chairman Baibakov proposed the joint construction of a steel mill in the Taishet region. His proposal appears to have evoked little Japanese interest.

- Power Plant - Several Japanese firms including Atka and Co., Hitachi and Toshiba, sent representatives to Moscow in 1969 to discuss the possibility of joint construction of a power plant in Siberia which would export to Japan 5% of anticipated Japanese demand for electrical power from 1980. Interest in this project now seems dormant, possibly as the result of dis-

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approval by the Japanese Government and technical difficulties involved in transmitting the power to Japan.

III. CONTENTIOUS ISSUES

The development of economic ties between the USSR and Japan has been impeded by both economic and political factors. Until recently, the latter, which included a heritage of hostility and rivalry and Japanese fear of offending American sensitivities, were by far the most powerful. In Japanese eyes, at least, political factors have diminished in importance. This is reflected in the changed attitude toward Soviet trade on the part of major Japanese firms. Ten years ago, trade with the USSR was not considered fully respectable, and the economic giants for the most part stayed out. Now, most are actively engaged in finding or widening for their share of the Soviet market.

The changed attitude is also apparent in government policy. As recently as 1965, the Japanese Minister for International Trade and Industry stated flatly, "I have no intention of giving Communist Bloc nations deferred payment," but since 1968 the government has been prepared to approve substantial credits for specific projects. As political restraints diminished,however, economic factors became more significant as barriers to expanded trade.

A. ECONOMIC FACTORS

1. Business methods

Japanese businessmen almost universally complain about the difficulty of doing business with Soviet officials. The rigidity and lack of imagination characteristic of the Soviet bureaucrat, combined with slow and inflexible implementation of agreements, place dealings with the Soviets in a higher category of risk and overhead expense than transactions with businessmen from capitalist countries.

2. Finance.

No single aspect of economic negotiation between the Japanese and Soviets has created more contention and delay than the question of credit terms. For some time, the Soviets pressed for a large, long-term bank credit on which they could draw with little restriction.* This was categorically denied by the Japanese Government, which requires all credits to be related to specific projects and controls length of credit, interest rates and down payments. Subsequently, the Soviets demanded long-term credit for project-related consumer goods imports. When this was refused by the Japanese, who argued that such terms were not granted to any other country, even underdeveloped ones, the Soviets held up negotiations on the "K-S Plan" timber project until it was resolved. (Japan finally permitted 12-month deferred payment for consumer goods.) The Soviets have consistently argued for longer terms,

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* For example, during his 1962 trip to Japan, Mikoyan requested a $350 million loan, repayable over ten years.

lower interest rates and smaller down payments than the Japanese are willing to grant. Furthermore, they typically seek Japanese loans for a much higher proportion of a project's total cost than the Japanese are willing to finance.

The agreements on the "K-S Plan" and Vrangel Port involve compromises by both sides and may have set precedents which will speed up future negotiations regarding financial terms. In any event, the Japanese Government seems prepared to approve longer term credits in the future provided the initial agreements are implemented satisfactorily and the Soviets are prepared to be reasonable regarding the interest rate and the price of their products.

3. Price

The Soviets have been extremely hard bargainers regarding price. At times they have failed to place orders agreed upon because they considered the price unacceptable. For example, the Soviet-Japanese Trade and Payments Agreement for 1966-70 provided for the Soviet purchase of 92 ships worth $260 million. Orders were actually placed for only a small fraction of this number because of disagreements over price. The Soviets naturally drive for the highest possible price for their own products, but often insist on a price level which makes the entire transaction unprofitable for the Japanese. It appears that the Soviets are poorly equipped to react flexibly to capitalist market conditions, sometimes granting unnecessary concessions, but more often persisting in unreasonable demands.

B. POLITICAL FACTORS

Though both Russians and Japanese seem inclined at the moment to minimize political factors, it is clear that a strong feeling of suspicion and mistrust lingers in their relationship. The Russians are traditional enemies of Japan, and most Japanese have a great respect for tradition. The Japanese industrialist, furthermore, views the USSR as a potential, and perhaps actual, supporter of forces which would wreck the political and economic system which made him prosperous. On the Soviet side, there is a tendency to view Japan as a near puppet of the United States, at least in matters relating to military security, yet at the same time to take alarm over any evidence of increased militarism or self-assertiveness on Japan's part. Specific political disagreements are few, but against this background they take on added importance.

1. "Northern Territories"

One of the few outstanding political issues between Japan and the USSR is Japan's claim to the "Northern Territories," the islands of Etorofu, Kunashiri, Shikotan and the Habomai group, which lie immediately northeast of Hokkaido. The Soviets consider them part of the Kurile chain, and occupied them at the close of World War II, expelling all Japanese residents. The Japanese argue that these islands are geographically and biologically distinct from the Kuriles and have been considered integral

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parts of Japan for centuries. At times the Soviets have indicated that they would return Shikotan and the Habomai Islands to Japan if the claim to Etorofu and Kunashiri is dropped, but this has not been accepted by the Japanese Government.

Following the US-Japanese agreement for the reversion of Okinawa, the Japanese Government intensified its campaign to focus attention on the Northern Territories issue. The Soviets,however, have given no sign of willingness to come to terms, and given their vulnerability to irrendentist claims in several other border regions, it is most unlikely that they will do so in the forseeable future.

Japanese businessmen and officials alike deny that the dispute over the Northern Territories has any effect on economic relations with the USSR. This may be true in the sense that a direct cause and effect relationship is difficult to establish. The issue is one, on the other hand, that the Japanese Government can cite if it wishes to justify a more cautious attitude toward economic agreements with the USSR than some Japanese business circles find advantageous. From the Soviet point of view, the persistence of Japanese claims to the islands is doubtless an irritant, and the Soviets have at times shown their displeasure by delaying negotiations on economic matters.

2. Imprisonment of Japanese Fishermen

The regulation of fishing in the Northwest Pacific is a subject of perennial dispute between Japan and the USSR. It is of course primarily economic in nature, but has little if any impact on the overall trade pattern since Japanese fishing interests are not involved to any large degree in the Soviet trade and have little influence with those business circles which are. The Soviet practice of seizing Japanese fishing vessels accused of violating Soviet territorial waters and sentencing the crews to harsh prison terms is a more serious issue and goes far beyond fishery economics. The fact that most of the alleged violations occur off the islands which Japan considers rightfully her own exacerbates the emotional reaction in Japan. Like the Northern Territories issue, ill treatment of Japanese fishermen is unlikely to have a direct effect on the level of trade, but it is a factor which reinforces an attitude of caution on the Japanese side.

3. Soviet Representation in Japan

During the past few years, the Soviets have pressed for permission to station more permanent trade representatives in Japan, both in Tokyo and in other Japanese cities. Since the number of Soviet officials now in Japan far exceeds the number of Japanese in the USSR, the Japanese Government has refused to permit additional commercial offices. The Soviets have attempted to bring pressure on the Japanese Government by indicating to Japanese businessmen outside Tokyo that trade could be increased if Soviet commercial offices were permitted in their localities. Although it is most unlikely that the level of trade is in fact suppressed by a shortage of Soviet representatives in Japan, it appears that the Japanese Government may gradually admit additional Soviet trade personnel, primarily in response to local pressures.

4. Strategic Considerations

Despite the enthusiasm some Japanese businessmen exhibit for increasing trade with the USSR and acquiring a larger proportion of Japan's fuel requirements from it, all seem to agree that it would be most unwise to drift into dependence on the Soviet Union for any vital commodity. Businessmen and government officials alike state that, even under the most favorable conditions, they would not contemplate obtaining more than ten percent of Japan's energy requirements from the Soviet Union. At the moment this reservation has no effect on negotiations since even the large natural gas and petroleum projects being discussed would not amount to ten percent of Japan's fuel imports, but it does indicate that the Japanese have consciously placed a limit on the extent to which an expansion of economic ties with the USSR will be permitted.

It is much more difficult to sort out Soviet strategic motives. On the one hand, the USSR has a strong incentive to improve ties with Japan so long as Communist China is hostile. On the other hand, there is considerable evidence that the Soviets genuinely fear the prospect of a more powerful and self-assertive Japan. In this context, Japanese participation in Siberian development projects is likely to be viewed with great caution whatever the economic advantages.

IV. FUTURE PROSPECTS

A. VARIABLES

The future is always murky and full of surprises, which renders most straight-line projections from recent experience highly suspect (*pace* Herman Kahn). The following are a few of the more important factors likely to bear on the Soviet-Japanese economic relationship. Some are amenable to reasonably confident prediction; others are not.

The largest question marks lie on the Soviet side of the equation:

-- Priority granted economic development of Eastern Siberia and the Soviet Far East. Some Japanese economists maintain that Soviet interest in developing Eastern Siberia and the Pacific coast seems to have waned in recent years. Indeed there are sound economic reasons for emphasizing investment in the Western USSR and the Urals because the return on capital is almost always considerably higher there. At the same time, there are powerful political and strategic incentives for developing and populating the area along the Chinese border and providing a firmer base for the extension of Soviet power into the Pacific Ocean.

--Security consciousness. As has been noted, the Soviets are likely to be most reluctant to allow large-scale Japanese participation in the economic development of areas close to Japan. Recently, however, they have relaxed previous restrictions to a slight degree, by allowing JAL flights over Siberia and by permitting Japanese engineers to visit the Vrangel port site and the coal deposits in Southern Yakutia. Although none of the projects under consideration would involve more than brief, temporary visits by Japanese to the sites, the Soviet penchant for secrecy and concealment is likely to remain a major stumbling block in negotiations.

--Relations with China. It seems axiomatic that the poorer their relations with Communist China, the greater incentive the Soviets will have to cultivate the Japanese. To move too quickly and too far in establishing ties with Japan, however, would undermine whatever prospects may exist for a reconciliation with Communist China following the death of Mao, a hope that is doubtless still alive among some Soviet Party chieftans.

--Willingness to deal on economically realistic basis. Though the Japanese are considerably more patient and persistent than most other businessmen, they obviously cannot be expected to enter into transactions to their economic disadvantage. Unless Soviet negotiators (or more properly, those who give them instructions) acquire a more accurate sense for what is feasible and what is not, agreement on mutually beneficial projects is likely to continue to be long delayed and some significant opportunities lost.

When one turns to the Japanese side, the picture is somewhat clearer:

--Price and availability of raw materials. The Japanese are conditioned by the logic of their economy and by hard experience to place acquisition of raw materials above almost all other economic considerations. Certainly, access to raw materials takes precedence over investment profitability. Since the secular trend, particularly for fuels, is toward higher prices and possibly shortages on the world market, Japanese interest in securing a portion of Japan's requirements from the USSR is likely to grow.

--Availability of capital. In past negotiations, the Japanese have refused to consider projects in the USSR which involved medium or long-term credits exceeding about $150 million, in large part because of a shortage of capital. One can confidently predict that this limitation will rapidly ease. Both private and government sources in Japan estimate that funds for overseas investment and trade credits will grow markedly in the 1970s. One official who follows the Soviet trade closely expressed the opinion that in five or six years Japan would be in a position to grant credits in the $600-700 million range for single projects.

--Relations with China. Many Japanese believe that Japan will eventually have to choose between major economic commitments in Mainland China and the USSR, since they assume that dealing with one on a large scale would foreclose the possibility of substantial transactions with the other. This may or may not prove to be true; up to now, the Japanese seem to have been reasonably successful in dealing with both. In respect to some raw materials, the USSR and Communist China are at least potentially competetive suppliers. Thus, if Japan were to contract to buy large amounts of coal or iron ore from China, she would be unlikely to seek major quantities of the same commodity from the USSR.

B. LIKELY TRENDS

In spite of the many uncertainties and variables noted above, it seems highly probable that Soviet-Japanese trade will continue to expand over the next few years, even if agreement is not reached on any of the large development projects under negotiation. Given the basic economic factors, which are highly favorable, and the momentum of the past few years, it would seem that only a major and unforseen change of policy on one side or the other could arrest the upward trend.

Nevertheless, a sudden spurt in Soviet-Japanese trade appears unlikely. Indeed, without some of the large development projects, the increase in Japanese trade with the USSR will probably lag behind the overall growth in Japanese foreign trade.

As for the development projects under discussion, most seem some years away at best. Aside from the $45 million credit in return for pulpwood and chips, which may be agreed upon within a few months, the proposals involving Sakhalin natural gas, Southern Yakutia coking coal and Buruktal nickel seem to be the most promising. In general, most long-term trends appear to favor projects of this sort, and we may well see several such agreements during the second half of the decade.

APPENDIX I

TRADE STATISTICS

The following tables present Japanese and Soviet data on the volume of Japanese-Soviet trade (Tables 1 and 2), a breakdown of the composition of that trade (Table 3), and the projections made by a major Japanese firm of the trade pattern for the period 1971-75 (Table 4).

If Soviet and Japanese statistics for the volume of trade over the past decade (Tables 1 and 2) are compared, a curious discrepancy will be noted. The Soviet data indicate a considerably lower level of exports to Japan than is reflected in Japanese import figures. According to Soviet statistics, exports to Japan during 1960-69 amounted to $2,116 million; the Japanese figure for imports during the same period is $2,688 million. Of course, one would not expect the figures to coincide precisely, because of different systems of accounting, variations in the precise time of export from one country and of entry in the other and possible inclusion or omission of freight and insurance costs. Nevertheless, a discrepancy in the order of 25% seems too large to be explained by these factors, particularly since the Soviet and Japanese statistics vary only to a slight degree regarding trade moving in the other direction, from Japan to the USSR. (In the same 1960-69 period, Soviet figures indicate that imports from Japan totaled $1,649 million, while the Japanese export figure is $1,602 million.)

For consistency, Japanese trade statistics have been cited throughout the study .

TABLE ONE

JAPANESE-SOVIET TRADE BY VALUE

1956-1970
(Japanese Data)
Unit: Thousands of US Dollars

Year	Exports to USSR	Imports from USSR	Turnover
1956	760	2,870	3,630
1957	9,294	12,326	21,620
1958	18,103	22,168	40,271
1959	23,026	39,491	62,517
1960	59,976	87,025	147,001
1961	65,380	145,409	210,789
1962	149,390	147,309	296,699
1963	158,136	161,940	320,076
1964	181,811	226,729	408,540
1965	168,358	240,198	408,556
1966	214,022	300,361	514,383
1967	157,688	453,918	611,606
1968	179,018	463,512	642,530
1969	268,247	461,563	729,810
1970	342,703	479,142	821,845

SOURCE: Bank of Japan, Statistics Department. Economic Statistics Annual, 1969, Tokyo, March, 1970, supplemented by preliminary figures for 1970.

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TABLE TWO

SOVIET-JAPANESE TRADE BY VALUE

1960-1969
(Soviet Data)

Unit: Millions of US Dollars*

Year	Exports to Japan	Imports from Japan	Turnover
1960	76.1	61.6	137.7
1961	113.0	66.6	179.6
1962	113.0	145.8	258.8
1963	123.9	165.4	289.3
1964	164.7	193.2	357.9
1965	185.0	177.3	362.3
1966	238.7	224.2	462.9
1967	353.0	165.7	518.7
1968	391.2	185.0	517.6
1969	357.0	263.8	620.8

*Converted from rubles at the official rate of $1.00 equals 0.90 rubles.

SOURCE: Ministerstvo Vneshnei Torgovli SSR. Vneshnyaya Torgovlya SSR za 1969 god, Statisticheskii obzor, Moscow, 1970, and earlier editions of the same handbook.

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TABLE THREE

COMPOSITION OF JAPANESE-SOVIET TRADE
By Main Categories and Selected Sub-Categories

Unit: Thousands of US Dollars

A. Japanese Exports to USSR

Commodity	1967	1968	1969
Foodstuffs	335	653	588
Raw Materials and Fuels	2,931	2,509	7,456
Synthetic Rubber	(2,348)	(889)	(2,808)
Light Industry Products	58,126	72,978	100,739
Textiles	(46,464)	(58,236)	(85,360)
Heavy and Chemical Ind. Prods.	95,823	101,807	155,811
Chemicals and Pharmaceut.	(21,255)	(20,730)	(36,706)
Metals and Metal Prods.	(21,513)	(30,755)	(45,136)
Machinery and Instruments	(53,055)	(50,301)	(73,969)
Reexports and Special Commods.	472	1,072	3,654
TOTAL	157,688	179,018	268,247

B. Japanese Imports from USSR

Commodity	1967	1968	1969
Foodstuffs	7,989	6,542	8,305
Raw Materials	204,743	260,410	264,1[illegible]
Cotton	(36,715	(49,804)	(45,8[illegible]2)
Iron Ore	(4,562)	(8,318)	(12,068)
Timber	(119,533)	(164,038)	(170,199)
Mineral Fuels	96,374	81,950	67,422
Coal	(34,120	(39,569)	(46,176
Crude Oil	(31,605)	(11,874)	(7,952)
Heavy Oil	(29,286)	(28,682)	(11,729)
Manufactured Goods	144,711	114,432	121,244
Pig Iron	(61,692)	(30,814)	(27,684)
Nonferrous Metals	(63,360)	(66,553)	(76,419)
Reimports and Special Commods.	102	179	403
TOTAL	453,918	463,512	461,563

SOURCE: Japan External Trade Research Organization, Foreign Trade of Japan, 1970.

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TABLE FOUR

JAPANESE FIRM'S PROJECTION OF FUTURE JAPANESE-SOVIET TRADE

NOTE: The figures below were prepared by the Marubeni-Iida Co., Ltd., one of the largest Japanese firms active in the Soviet trade. The estimates represent only the expectations of a single firm, but may be of interest since they are based on an intimate knowledge of factors affecting the Soviet-Japanese trade pattern. They assume that, of the Siberian development projects now under discussion, only the one involving pulpwood and chips (NS Plan) will be concluded in time to affect the trade pattern by 1975. If other projects should come to fruition during this period, the projections would be revised accordingly.

Year	Expected Japanese Exports	Expected Japanese Imports	Total
1971	430	500	930
1972	510	550	1,060
1973	590	590	1,180
1974	670	650	1,320
1975	740	710	1,450

Unit: Millions of US Dollars

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APPENDIX II

SIBERIAN DEVELOPMENT PROJECTS

This appendix provides additional information regarding the more important Siberian development projects under discussion between the Soviets and Japanese. It should be read in conjunction with the treatment of these projects in the case study proper.

1. Timber (KS Plan)

Under this contract, signed in July, 1968, Japan agreed to supply the USSR with $133 million worth of equipment such as bulldozers, dumptrucks, cranes and dredgers for the development of forestry resources in the Maritime Oblast. Payment terms included 20% down payment and five years credit for the balance at 5.8% interest.

Although the Soviets were quoted a flat interest rate, the Japanese made internal arrangements to provide a combination of Export-Import Bank and private bank credit. The Export-Import Bank furnished 80% of the credit at a rate slightly under 5.8%, while private banks provided loans for 20% of the amount at a rate higher than 5.8%. The arrangement was worked out, of course, to result in an overall 5.8% cost to the Soviets.

In addition, the Japanese agreed to supply $15 million of textiles and other consumer goods in 1969 and a similar amount in 1970. Payment for the 1969 sales was deferred for one year and the 1970 sales were payable in 180 days.

The Soviets in return committed themselves to deliver 7,600,000 cubic meters of logs and 420,000 cubic meters of sawn lumber over the five-year period 1969-1973. The timber was to be shipped at 1968 prices in 1969 and 1970, then at 1%, 2% and 3% above the base price in 1971, 1972 and 1973.

Imports of timber under the KS Plan were intended to be in addition to imports through normal commercial channels. In fact, however, Japanese imports of timber from the USSR have increased only slightly since 1968, and it appears that imports under the KS Plan have been largely at the expense of normal purchases. In 1971 it is expected that about one-fourth of Japan's timber imports from the USSR will be under the KS Plan.

In order to coordinate the implementation of the contract on the Japanese side, a special corporation, KS Industries, was established by Komatsu, Ltd., the heavy equipment manufacturer which pioneered the agreement, and eleven trading firms. KS Industries does not trade on its own account but checks export contracts signed by participating firms for compliance with the overall agreement, then obtains government approval and arranges for credit. In regard to imports, KS Industries establishes quotas for participating firms, a necessary exercise since the fixed price basis means that imports under the plan are likely to be either above or below the current market price. (During the period of this agreement, the fixed price has generally been below the world market.)

The "KS Plan" timber contract was the first agreement between the Japanese and Soviets involving credit for economic development in the USSR. It set a number of precedents which will probably serve as the basis for future negotiations on similar projects.

(1) The Japanese Government reversed long-standing policy, permitting--even facilitating--credit to a Communist country. Repayment terms, however, were kept relatively short (5 years), but with the understanding that longer repayment terms would be approved in the future if Soviet performance was satisfactory.

(2) Deferred payment was granted for project-related consumer goods. The Soviets had demanded longer-term credit for consumer goods while the Japanese Government held out for a long period for cash payment. The short-term deferred payment was, therefore, a compromise. The Soviet rationale for seeking credit for consumer goods was that they are needed to attract Soviet workers to the Siberian projects, where living conditions are spartan and the climate severe. The Japanese have observed, however, that many of the consumer goods provided for the project were actually sold in Moscow and other major cities in European Russia at prices five or more times the import cost. Although the Japanese consider the Soviet arguments regarding the necessity for consumer goods credit largely sham, they seem resigned to offering comparable terms in the future.

(3) Payment of loans is made by delivery of a share of the production of the facilities built using Japanese equipment. This is a common element in all other projects under negotiation except the one for construction of Vrangel Port, which is of course an infrastructure project rather than one for development of productive facilities.

(4) A fixed price was established in advance for Soviet deliveries. The Japanese are likely to continue to demand fixed price arrangements in the future, and as negotiations on the pulpwood and wood chip project indicates, the price level is likely to be a major source of contention.

2. Vrangel Port

The Vrangel Port agreement differs from the "KS Plan" in several respects. (1) It involves not only the supply of capital equipment by Japan, but also includes a contract for engineering design. (2) The credit terms, except for a slightly higher interest rate, are more liberal, providing for a smaller down payment (12% instead of 20%) and a longer period of repayment (7 years instead of 5). (3) Repayment will be made in dollars instead of commodities.

Japanese engineering was sought for the new port because it is to be built in an area where a loose sedimentary base predominates and the Japanese, accustomed to construction under similar conditions in the Tokyo Bay area, have developed an advanced technology to cope with these conditions.

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One of the principal causes for the delay in reaching an agreement on this project was Soviet reluctance to allow Japanese engineers to visit the site before doing the engineering. Though it seems incredible, it appears that the Soviets wanted the Japanese to design the port without actually visiting the site. Finally, in 1970, the Japanese were allowed to send engineers to the area and the design was completed shortly thereafter. This experience illustrates the extreme Soviet sensitivity to on-site inspection in the Siberian and Far East area, which may continue to be a barrier to agreement on joint projects.

Japanese firms interested in the project (the Yamashita Shinnihon Steamship Line and 14 trading firms) have formed a special corporation to coordinate implementation of the agreement from the Japanese side. It is called the YV Company, Ltd. (YV being derived from the initials of Mr. Yamagata, President of the YS Steamship Line, and Vrangel), and will perform functions similar to those of the KS Company in regard to the KS Plan timber project.

3. <u>Pulpwood and Chips (NS Project)</u>

This project, in many ways comparable to the "KS Plan," but involving the import of pulpwood and wood chips instead of timber, has been discussed since 1967 and has been under intensive negotiation since the fourth Joint Committee meeting in February, 1970.

At the latter meeting, the Japanese proposed supplying forestry and wood processing equipment on credit and taking 20 million cubic meters of pulpwood and chips over a ten-year period beginning in 1970. The Soviets offered 12.65 million cubic meters of pulpwood and chips, plus an unspecified quantity of semi-processed wood products between 1971 and 1980.

Negotiations on the project were continued in Tokyo in October, 1970, and in Moscow during February, 1971. Agreement was reached on practically all points except the price to be paid for Soviet pulpwood and chips. When the Soviets persisted in demands for an automatic price escalation during the first six years, the Japanese broke off negotiations and announced publicly that further negotiations would be useless unless the Sovets met their price offer.

The project involves the supply of $45 million in capital equipment by Japan, presumably on ten-year credit terms, as well as $5 million in consumer goods on short-term deferred payment. If agreement is reached on the price of the wood products, which Japanese businessmen consider likely, the agreement will continue the patterm of progressively more liberal credit terms offered to the Soviets for development projects.

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4. Natural Gas

In 1966 the Marubeni Iida Co., a major trading firm, and Teikoku Oil Co., began talks with the Soviets regarding the export of natural gas from North Sakhalin to Hokkaido. The Soviets expressed interest in constructing a pipeline from the Okha oilfields to Cape Kril'on on the southern tip of Sakhalin, from which natural gas could be delivered to Japan either in liquified form by tanker or by a pipeline across the La Perouse Straits. For this project, the Soviets requested $200 million in pipe and other capital equipment on 15-year credit, as well as $50 million in consumer goods, also on 15-year credit. Although the Japanese had serious reservations about some of the Soviet terms (the size and length of the credit and the principle of long-term credit for consumer goods) negotiations continued at the second meeting of the Joint Committee in June, 1967.

The interest of the companies which initiated discussions on the project waned in late 1967 when Marubeni Iida concluded a 20-year contract for the supply of natural gas from Brunei. The Soviets kept the subject alive, however, and Gosplan Chairman Baibakov discussed it with the Japanese during his visit to Tokyo in January, 1968. During the third Joint Committee meeting in December, 1968, the Soviets came forward with a greatly expanded proposal. They stated that although North Sakhalin natural gas reserves were believed to be about 62 billion cubic meters, vastly larger reserves (875 billion m^3) had been located in Northern Yakutia, and that both sources should be used to establish a long-term supply of natural gas to Japan. Accordingly, a two-stage project was outlined.

In the first stage, a 1,000 km pipeline would be built by 1971 from Okha in North Sakhalin to Cape Kril'on. It would have a capacity of 10 billion cubic meters, of which 2-2.4 billion could be supplied to Japan annually.

The second stage would involve the construction of a pipeline from Yakutsk to Sakhalin, to connect with the Okha-Kril'on system. Two alternate routes were considered: a direct Yakutsk-Okha Line of 2,000 km and a route to the south running 3,600 km from Yakutsk to Khabarovsk, then via Komsomolsk-on-Amur to Sakhalin. This pipeline would have an annual capacity of 20-25 billion cubic meters, of which 10 billion could be supplied to Japan.

After examining the Soviet proposal, the Japanese decided to make a concrete offer in regard to phase one, but to avoid any commitment regarding phase two. Accordingly, the Japanese notified the Soviets in late 1968 that they were prepared to participate in phase one of the Soviet plan under the following conditions:

(1) The Soviets would construct a 1,000 km natural gas pipeline from Okha to Cape Kril'on, while the Japanese would construct a 60 km line under the La Perouse Straits from Cape Kril'on to Northern Hokkaido, then a 440 km line on Hokkaido to bring the gas to Sapporo and Muroran.

(2) The Japanese would provide a credit of $100 million for pipe and other capital equipment for the Sakhalin portion of the pipeline and would spend 28 billion yen (ca. $78 million) for the Japanese portion of the line.

(3) Japan would purchase 2-2.4 billion cubic meters of Soviet natural gas for a 20-year period beginning two years from the contract date.

The pipeline project was discussed again at a meeting of Japanese and Soviet experts in January, 1969. At that time, the Soviets insisted that the Yakutsk-Sakhalin line was an integral part of their plans and demanded an advance commitment for Japanese participation in phase two, as well as for the eventual purchase of 10 billion cubic meters of natural gas a year. The Japanese refused to commit themselves to the larger project and the larger purchases and the negotiations came to a standstill. It was agreed, however, that each side would develop its own proposal and talks would be renewed later.

Meanwhile, Soviet Premier Kosygin compounded what was already a confused situation by proposing to Shigeo Nagano, the head of the Japanese delegation to the Joint Committee, that previous proposals be scrapped and replaced by a scheme for piping Yakutia natural gas to Magadan, where it would be liquified and shipped by tanker to Japan. Kosygin also informed Nagano that export of Sakhalin natural gas would not be feasible because reserves there amounted to only 16 billion cubic meters.

Both Japanese and Soviet specialists working on the natural gas project considered Kosygin's proposal impractical because of the difficulties in constructing a pipeline over territory so rugged and so far north as the Yakutsk-Magadan route, and also because freezing of the port of Magadan would prevent shipment of liquified natural gas on a year-round basis. As for the Sakhalin reserves, Kosygin's figure included only reserves in the A and B categories, while preliminary planning is normally based on A + B+ C_1 categories.* The Kosygin proposal for a Yakutsk-Magadan pipeline was therefore quietly forgotten by mutual agreement of the Soviet and Japanese specialists.

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* Soviet classifications of oil and gas reserves do not coincide precisely with American Petroleum Institute or other foreign systems. Category A covers deposits in the area fully outlined by wells with proved production. Category B covers reserves in areas with favorable logging indications, cores and a commercial flow from at least two wells. Category C_1 includes deposits determined by geologic and geophysical data and in which at least one well has produced a commercial flow. (Robert W. Campbell, The Economics of Soviet Oil and Gas, pp. 60-61.) According to Soviet data of January 1, 1966, Sakhalin natural gas reserves in the A+ B+ C_1 categories came to 49 billion cubic meters; reserves in the more specualative C_2 + D categories were estimated at 676 billion cubic meters (ibid., p. 200).

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Both the Soviets and Japanese continue to elaborate their individual proposals for a natural gas pipeline project. Another discussion of the topic is scheduled for the fifth meeting of the Joint Committee, originally schedules for April, 1971, but now postponed on Soviet initiative. The Japanese plan to renew their offer to supply $100 million credit for a pipeline from Okha to Cape Kril'on, and to offer an additional $60 million for a line from Sakhalin to Komsomolsk-on-Amur. The latter could eventually form part of a Yakutsk-Sakhalin line if the Soviets wish to build the rest with their own resources.

Although interest on both sides in development of a natural gas pipeline appears genuine, a number of serious problems remain.

(1) The Japanese continue to be reluctant to involve themselves in the total Yakutsk-Sakhalin-Hokkaido system which the Soviets have proposed. We may assume, however, that they will be prepared to go further than the $160 million credit offer they intend to make at the next negotiating session provided other conditions are favorable.

(2) The size of Sakhalin natural gas reserves is still questionable and the Japanese will probably seek permission to inspect the deposits themselves before making a commitment to a large loan. It will probably be most difficult to obtain permission for an on-site visit.

(3) Japanese resistance to an advance commitment to take 10 billion cubic meters annually when the pipeline from Yakutsk is complete has been a stumbling block in the past, but this resistance may be weakening. Recent Japanese press articles indicate that potential demand in Hokkaido has grown faster than projected. Furthermore, Japanese businessmen and economists who follow the fuel import situation seem to believe that by 1980 or thereabouts Japan will have no difficulty in utilizing Soviet natural gas at the rate of 10 billion cubic meters a year.

(4) Price may well be the most serious barrier to eventual agreement on the project. Recent speculation in the Sapporo press indicates that the Japanese hope to contract for Soviet natural gas at a price substantially lower than that prevailing on other markets. It is difficult to imagine the Soviets selling natural gas as cheaply as the Japanese hope, and even if agreement is reached on other aspects of the project, negotiations on the price level are certain to be arduous.

5. Coal and Iron Ore

In December, 1968, the Soviets proposed to the Joint Committee that the possibility of exploiting coal and iron ore deposits in Eastern Siberia be investigated. They stated that iron ore deposits in Southern Yakutia amounted to at least a billion tons, and that confirmed coal deposits of coking quality at Galinskoye (Amur Oblast) and Kimkanskoye (Khabarovsk Oblast) also amounted to a billion tons. Their preliminary estimate was that an investment of 220-300 million rubles would be required to exploit the Galinskoye deposit, 180-200 million rubles for the Kimkanskoye site, plus 100-120 million rubles for railway construction.

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A joint subcommittee was established to look into the matter and talks continued through 1969. By 1970 it was apparent that the cost of mining of iron ore in the area would be excessive (one Soviet estimate placed investment cost at 3 billion rubles for a mine in South Yakutia with a 16 million ton annual production), and the Japanese lost interest. They did, however, invite the Soviets to continue to supply data on the economics of developing the deposits in South Yakutia and elsewhere in Siberia.

Coal mine development seemed more promising. The Soviets proposed development of mines in South Yakutia and the construction of two concentrating plants with an annual capacity of 25 million tons to produce coking coal. The Japanese were allowed to visit the area in August, 1970, and to ship 10,000 tons of coal from these deposits for testing. Tests revealed that the coal is of usuable quality for steel making and the Japanese are prepared to consider credits for equipment to develop the mines and concentrating plants in return for a long-term contract for the supply of up to 15 million tons of coking coal a year.

The Soviets have not yet replied to a recent Japanese request for details regarding the amount of Japanese credit desired, therefore it is impossible to judge how far apart the Japanese and Soviet concepts are at this point. It would appear that the Japanese would agree to provide credit for the same proportion of capital investment in mining facilities as the Japanese share of total production would be. They will, however, resist participating in the finance of railway construction. The Soviets are likely to insist on Japanese credit not only for the mines, but also for all ancillary facilities necessary, including the rail connection to the Trans-Siberian line. In addition, it may not be easy to reach agreement on a price for the coal. Nevertheless, both sides appear seriously interested in moving toward agreement, and the Soviets may be spurred to bargain realistically by an awareness that Communist China is a potential competitor as a supplier of coal to Japan.

6. Petroleum

The Soviets laid a proposal before the first Joint Committee meeting in 1966 for Japanese participation in a project to construct a wide-diameter petroleum pipeline from the Tyumen oilfields in Western Siberia to the Pacific coast. The initial Soviet proposal contained the following elements:

(1) A pipeline would be constructed along the following 6,600 kilometer route: Ust' Baruik-Megion-Anzhero-Sudzhensk-Bogotol-Irkutsk-Chita-Bikin-Nakhodka. Most of the line would be a single line of 1.02 meter pipe, except that the 1,160 km segment between Megion and Anzhero-Sudzhensk would comprise a double line of 1.02 meter pipe and the terminal 820 km segment would be of 720mm pipe. A total of 7,760 kilometers of pipe would therefore be required. (Subsequently, the Soviets revised the plan by substituting a single line of 1.2 meter pipe for the double line of 1.02 meter pipe on the Megion-Anzhero-Sudzhensk segment.)

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(2) The total cost of the project was estimated at $1.45 billion. The Japanese were asked to grant a 20-year credit for $400 million in return for a 20-year contract for the annual supply of 10-12 million tons of oil.

The Japanese replied to the Soviet proposal at the second Joint Committee meeting in 1967 along the following lines:

(1) Japan would agree to some form of participation in the pipeline project if it could be assured of a low-cost, stable supply of petroleum.

(2) Japanese purchase of 10-12 million tons of oil from 1975 would be possible.

(3) Japanese credit could not be made available for the development of oil fields, but only for the pipeline.

(4) A 20-year credit would not be feasible. The Soviets should arrange for more rapid repayment, using means of repayment other than oil if necessary.

(5) Japan must be assured of a continued supply of petroleum for a period longer than 20 years.

The Soviets replied that Japanese credits must cover more than equipment for the pipeline itself, since many other facilities must be built to make the project viable. In making this point they suggested that Japan had a greater interest in the pipeline than the USSR. This negotiating ploy--used also in regard to other projects--offended the Japanese negotiators, who say that it still rankles. The Soviets also suggested that by 1975 the USSR might be in a position to supply more than 10-12 million tons of oil to Japan, thus implying that if Japan insisted on more rapid repayment than 20 years, she should be prepared to take a larger quantity of oil.

A joint subcommittee was formed in 1967 to continue studying the project, but it has in fact not functioned. Japanese interest has shifted to the Sakhalin natural gas project and the Tyumen pipeline is still considered too large for the Japanese to finance.

Although Japanese interest in the Tyumen-Pacific pipeline is dormant, it is not dead. Given the rising price of oil, Japanese concern over excessive dependence on Middle East supplies and the increasing availability of capital, it is probable that consideration of the project will be renewed in the near future.

7. Copper

Most of the Siberian development projects under discussion were proposed originally by the Soviets. The idea of joint development of the copper deposits in the Udokan range north of Chita is an exception: the Japanese initiated discussion of the subject at the first Joint Committee meeting in 1966.

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The Japanese proposed construction of mining and refining facilities in the Udokan area which would produce each year 20 million tons of ore with a 2% copper content and 400,000 tons of metal. Using a world average for required investment of $1,000-$1,200 per ton of annual metal production capacity, the Japanese calculated that the project should cost about 400 million rubles ($444 million). They offered credit for 100 million rubles($111 million) in return for a quarter of the copper production.

The Soviets replied that severe natural conditions and the lack of infrastructure required a much larger investment than is normal elsewhere. They estimated the costs at 1.2 to 1.5 billion rubles for mine and refinery development, plus 200 million rubles for construction of a 500 km railway between the site and the Trans-Siberian line. The Japanese were told that if they could supply credit for half the cost of the project (i.e., $800 million or more) it might be feasible.

Discussion of the project ended at this point because of the wide discrepancy between the Soviet and Japanese views. Although the Japanese do not exclude the possibility of reviving discussions on the project in the future, it would seem that the Soviets must reduce sharply the amount of credit requested, or else the world copper market must tighten appreciably before the Udokan project would be attractive to the Japanese.

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