

Japanese Failure in Russian Business - Looking back and Thinking over its Business Potential

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Abstract

Compared to European and American counterparts, Japanese business record with Russia is mediocre. Post Ostpolitik quantity driven export deals have not helped her build up enough expertise in meeting Russian business requirement of which nature is totally different from what was in place in the USSR. The Japanese under performance has also derived from so-called Japanese style management and Japan Inc. type approach, which has not been compatible with changing global business paradigm. Considering geographical proximity and demand-supply balance of natural gas, possible frontier may lie in the Russian Far East. In cultivating such frontier rapidly changing nature of gas from local to more international commodity is to be taken into account.

1. Japanese Business Model with the USSR

1.1. Mediocre records with Russia

In the two and a half decades following the dissolution of the USSR, the bilateral economic relationship between Japan and Russia has come into a new stage, in which there have been introduced diverse transactions in sharp contrast to what had been during the Soviet times. However, compared to the achievements by European counterparts, Japanese records have been poor both in depth, quality and even in quantity. It is difficult to find out Japanese players, who have been standing out both in size of operations and market dominance among foreign investors. Western counterparts have been enlarging their influence by expanding their Russian networks. Except 'Sushi' no strong message was sent from Japan. The overall prospect for the bilateral economic relations is not pessimistic but not promising either.

So far the Japanese performance in Russian market has been mediocre, ranked in the second tier, with an enormous gap to catch up the first tier group of Europe and North America. Considering the geographical proximity and complementing industrial structures of both countries, something must have been wrong that has to be challenged and improved in a short time period. Otherwise this bilateral economic relation will become even more marginal under drastically changing global business paradigm.

1.2. Great records during the Soviet days

Contrary to this plight, when the USSR was broken up, there were mounting business expectations and potentialities discussed in Japan, all of which were based on the achievements during the Soviet times. Though starting rather belatedly, far behind Germany and France, Japan became one of the most successful exporters of heavy machineries, manufacturing plants and steel mill products to the USSR.

From mid-70s to mid-80s, over 20 million tons of large diameter steel pipes were shipped

from Japan and used primarily for construction of trunk lines carrying Soviet oil and gas to Europe. Negotiation trip to Tokyo by the USSR delegation was a sort of annual main event corresponding to project stages under the centrally planned system. Though the audience was limited, it was something like a roadshow for those involved in trades with the USSR. In addition to steel pipe deals Japanese construction equipment suppliers like Komatsu and Hitachi almost monopolized machines used for timber and lumber resources development and export in the Soviet Far East. Over 30 units of large scale fertilizer plants, ammonia and urea, were built throughout the Soviet Union, to such an extent that a small engineering company, Toyo Engineering Corporation-TOYO acquired a worldwide reputation, which helped TOYO be a global engineering house. Other than fertilizer plants, construction equipment and steel mill products, billions of dollars' worth of equipment for coal, oil and gas resources development were shipped from Japan. Japanese suppliers were always sitting at the center position among of all major western exporters.

For those transactions mega-export credits were extended by Japanese bank syndicate with the Export-Import Bank of Japan (JEXIM-predecessor institution of the Japan Bank for International Cooperation-JBIC) as agent as well as facilitator between two governments. There was a concerted division of labor among Japanese parties-- equipment manufacturers, steel producers, trading houses and Japanese bank syndicate-- a framework typical of Japan-Inc. business practices. This business structure found a parallel in Soviet business practices since government agencies of both countries played the coordinating role in structuring deals. For example, on the Soviet side, the State Import Corporation designated and controlled by the Ministry of Foreign Trade was the counterparty to the coordination team of manufacturers and governmental bodies on the Japanese side. In addition financing was negotiated and arranged through JEXIM and the Soviet Foreign Trade Bank. In short, the Soviet system beautifully matched with that of Japan Inc.

1.3. Oil and Gas

As indicated in the previous section the Soviet oil and gas industry was a major importer of Japanese manufactured goods. It therefore should come as no surprise that Japan Inc. became heavily involved in oil and gas development in the geographically close Soviet island of Sakhalin. These projects, which were inherently more complex than mega-export transactions, began in the early 1970s when the establishment of project companies was mutually agreed upon. The Sakhalin Oil Development Company (SODECO) was founded with the sponsorship of a consortium of leading companies within the Japan Economic Federation (KEIDANREN). Financing requirements were met by public lenders-- Japan National Oil Corporation (JNOC) and JEXIM. It took more than two decades for the project to be completed, which, of course, resulted in its completion under the post-Soviet Russian government. Despite the complications created by this regime change, the Sakhalin LNG Project (so-called Sakhalin II) came on stream around 2000 and currently provides around 10% of Japan's total LNG demand.

The Sakhalin Oil Development Project (Sakhalin I) had been initiated even earlier than LNG phase but its completion came later than the LNG project. Once it started bringing oil to Japan, Russia became the fourth largest oil supplier to Japan, the largest among non-Middle East suppliers. Transportation cost benefits are enormous for both the oil and natural gas projects.

1.4. Other investment records

Since the fall of the Soviet Union several Japanese car factories have been built in Russia as well as plants of many other non-Japanese automotive companies. Still, the Japanese automotive presence in Russia is relatively small in comparison to other major global companies. For example, Toyota, which is not only Japan's largest car producer but also the world's largest, has a market share in Russia that is even smaller than that of Korea's largest producer and way behind German and American producers.

There are other Japanese manufacturers active in Russia such as Komatsu, here again, as far as the size of operations and diverse product mix are concerned, there is no comparison with European counterparts.

The Japanese presence in service industries such as finance, medical care, hospitality, construction and engineering, legal and accounting services, consulting, education and arts has been even smaller, which is the very sign of how poorly Japan Inc. has been functioning in business infrastructure building in Russia.

Though many Japanese companies are registered in Russia, many of them operate out of representative offices rather than as incorporated entities in Russia. This indicates that top management of many Japanese companies are uncertain about their ability to earn a sufficient return on capital in Russia and are therefore reluctant to establish the entities necessary to operate as full-fledged participants in the Russian economy. Thus it appears that Japanese business society has not been able to make use of experiences beginning in the 1970s and extending into the Perestroika era when the dysfunction of the Soviet system became obvious. In short, selling equipment manufactured in Japan was categorically different from doing business in Russia.

1.5. Follower Model

Japanese awareness of the potential of Russia as a market for Japanese exports in the early 70s through the mid-80s was stimulated by German success in the Russian market through its policy of Ostpolitik. Japanese manufacturers of heavy machinery and steel saw that the Germans were able to sell into Russia at very high prices compared with more competitive markets. Thus there appeared to be plenty room to accommodate a new entrant at satisfactory profit levels. Germans were charging Russia up to three times the prices that Japanese were receiving in other export markets. Under these circumstances Japanese entrants into the Soviet market brought about a sort of win-win relationship.

This was the case for initiation of the large diameter steel pipe deal. The economic competitiveness of Japanese manufacturing in the early 70s matched the highest international standards after almost two decades' historically high growth. Breaking into a new market with products of high quality and competitive prices was easy but to stay competitive under the changing business climate with new business models required another challenge.

2. Nature of Japanese Trade with the Former Soviet Union

2.1. Unique Transaction Nature to USSR and Japan

The Japanese success story in early days made little contribution to building up expertise for developing post USSR business. This is partly explained by USSR style business practices which had to be drastically modified after the dissolution of the Soviet Union. It was also due to Japan's unwillingness to modify or change inefficient practices of so-called Japanese style management. The USSR-Japan export-import business was based on a set of practices that were very specialized as a result of the business-government partnership in the two societies. Because these practices were rarely found in other international trade relationships the Japanese found it difficult to maintain a comparative advantage in the Russian market when the fall of the Soviet Union changed the business-government relationship on the Russian end. The important aspects of the relationship that changed are delineated in the following subsections.

2.1.1. Simple and quantity driven transactions

Trade volumes of Japan with USSR at their height were oriented toward heavy machineries and steel pipes exports on an unprecedented scale. This outcome was driven by the nature of the transactions, which were uniquely suited to the business structures of the two markets. Transaction volumes were large but simply structured and covered by correspondingly simple export-financing contracts. Initial stage contract settlements took time, even if terms and conditions were similar to those with Germany, since the new transactions with Japan had to be embedded in the internal process of Gosplan (State Economic Plan) and Gosbank (a Soviet combination of a central bank and commercial bank which issued the guarantee letters to creditors). Nevertheless, once the agreement on a prototype contract was reached, the following deals and financings were more or less copies or repetitions, sometimes with a bit broader discount margin, making the whole set of transactions easy to negotiate and finance.

The USSR had a strong credit reputation so credit quality issues were a very minor concern. At the peak of those quantity driven deals over 10% of the total outstanding balance of JEXIM was committed to a single borrower, the Foreign Trade Bank of the USSR.

This confidence degenerated into over confidence as the Soviet Union approached its point of dissolution. However, at this time the Japanese economy was falling into its slow growth pattern, and loan opportunities for domestic banks were drying up. As a result, private banks took over much of the Russian loans held on the books of JEXIM. When the loan assets to the USSR turned sour, there was little outstanding loan balance at the JEXIM account but a large amount of Russian exposure on the books of Japanese commercial banks. This created a natural constituency for policies to ensure a soft landing in post-Soviet Russia, and the Japanese government responded with its own policies as well as through the policies of international organizations pressured by Japan to act. USSR credibility issues were soon cleared but a sort of trauma was left at the bottom of many lenders' mindsets.

2.1.2. Limited contractual obligations

The USSR tried to limit the foreigners' role and therefore influence in the workings of their domestic economy. Consequently the Soviets would only accept contracts based on FOB (free on board) or FOB plus erection supervising services, making contractors' obligations equivalent to those in commodity transactions. For export items such as an entire manufacturing factory, normally contract terms were on full-turn-key basis, in which the contractor (exporter) was obliged to commission an entire factory complex so that upon the transfer of the factory the operations would be in stream and thereby generating cash immediately.

Japanese exporters did not have to bear the cost and trouble of operating factories. However, this prevented Japanese firms from learning how to work with Russian society, experience that would likely have been useful after the dissolution of the Soviet Union.

2.1.3. Moscow based transactions

Almost every negotiation or meeting took place either in Moscow or Tokyo. Under the Soviet central system, except for certain engineering works and supervising services for plant erection, all the necessary activities took place in Moscow; Japanese consortium of exporters, trading houses and JEXIM could solve almost everything through negotiations with the Soviet team consisting of Ministry of Foreign Trade, designated import institution such as Promsyrimport (state steel pipe import agency) and Foreign Trade Bank, all domiciled in Moscow. The Japanese team was constructed under the typical Japan Inc. model, in which private and public partnership, or division of labor, worked marvelously. Though the Soviet Union and Japan had not finalized a bilateral peace treaty for settling territorial disputes, both governments tacitly recognized that each team could negotiate deals.

2.1.4. Japanese human resources

Communications normally went smoothly, since those in charge in Moscow and Tokyo stayed at the same positions in the same institutions or kept the same functions for a long time under the Soviet style assignment rules as well as the Japanese style management system of lifetime employment. The Japanese seniority system meant that normally top management was selected from working level people. Thus once those involved became familiar with their counterparts, suddenly deals became easy.

In addition, normal business practice under the centrally planned economy was more or less repeat-order oriented, where those who were the winners through an extremely tough initial competition were awarded with the following mega-contracts. Thus the ensuing transactions turned out to be easy deals with minimum transaction costs. Following up ongoing projects and keeping good contacts with counterparties became more important than professional skills.

The knowhow and talent required in Soviet business was quite remote from what was required under the normal international business where always competition have been taking place. The fall of the Soviet Union eliminated Soviet style sales-purchase practice, making Japanese style knowhow less meaningful. This implies that post-Soviet business dealings would have to rely on individuals who are familiar with the internal workings of Russian society.

Training and developing Russian specialists has been particularly difficult for Japan since historically the number of Russian immigrants and Russian-Japanese has been extremely small. Moreover, the availability of Russian studies programs at college level has been limited, leaving a very small number of those with Russian language background. There have been an even smaller number of those with double diplomas in the language and business related subjects. Because of the decline in Japanese-Russian business with the demise of the Soviet Union, in house experts on Russian business at Japanese firms were either reassigned or retire, thereby increasing the need for more training and development.

2.1.5. European Business

After the dissolution, potential hot spots were located west of the Urals and in the Far East. The European part was the centerpiece, where the rest of the world mobilized rich human

resources with Russian backgrounds. In contrast to Japanese business penetration of the US market, Japanese companies had not been successful in penetrating the European market. Because Europe became the point of entry into penetrating European Russia, Japan was at a distinct disadvantage in competing west of the Urals. Thus Japan's comparative advantage lay in the east where most of the business activity is energy related.

2.2. Difficulties for Japan

2.2.1. Division into 15 countries

The dissolution changed Russian business climate for Japan. The USSR was divided into 15 countries, which meant the days were gone when everything was solved in Moscow. In order to cover business opportunities new offices had to be set up in the major capital cities of newly independent countries. Operation costs increased but the dissolution created much chaos and little cash; it might take a decade for newly independent countries to pick up. Still you needed offices. And the demands for investment in the FSU had to compete with a booming emerging Asia in the early 90s. Thus interest in Russia declined.

2.2.2. Service industries and technical assistance

Economic transition created business opportunities for which the Japanese business structure was also at a disadvantage. Building a business in this environment requires first creating business systems, which means consultants, lawyers, accountants, etc. Capacity building required selling own service industries to the former Soviet Union (FSU) under the name of technical assistance.

The Japanese problem has been that in Japan professional services have been provided institutionally in different manners from the rest of the world. Most of professional services had been traditionally provided by in-house staff or by somewhat insider oriented professional service firms connecting through Japanese style relationship network. It was not the quality of services but the supply capacity limit of service systems that hindered Japan's entry into the technical assistance war. Japan had not constructed appropriate human capital system to work in FSU.

To facilitate massive scale technical assistance, society-wise a large human capital pool was needed. This in turn required a labor force that responded to economic incentives to change employers and careers, a labor structure that is quite foreign to the Japanese business model.

The hidden purpose of technical assistance is to implant donor's service system to the recipient thereby making market penetration into the recipient's system easier. The Japanese system cannot efficiently provide technical assistance and therefore cannot easily penetrate the new market. This handicap is not only a current problem but a future one as well.

2.3. Top Management with Animal Spirits

Even though Japan had advantages in dealing with the Soviet Union resulting from Japan Inc.'s ability to handle simple and large transactions efficiently and despite the cost advantage that Japan had over other manufacturers such as West Germany, it was not easy to start mega-trades with the USSR from scratch. In order to establish a so-called Japan Inc. syndicate in dealing with the USSR there were tremendous leadership efforts required within Japan. Those

business persons who took initiatives were the old generation who had survived World War II and participated in economic restoration in the aftermath. They had to deal with poverty stricken employees and obstacles such as negotiating with the General Head Quarter of Allied Forces-GHQ. Despite these problems this generation was able to finally lead industry to big jumps during high growth periods. They were dynamic business persons with great animal spirits.

For example, Shigeo Nagano, Chairman of Nippon Steel took leadership on not only steel pipe exports but overall coordination of other projects and relations with politicians and government. Hiroki Imazato, Chairman of NSK, an industrial bearing producer initiated the Sakhalin project. Under the leadership of Nagano, CEOs of other steel companies, paper producers, public gas companies, heavy machinery producers, engineering houses and trading houses were integrated into Japan-USSR Joint Economic Council, which functioned as overall economic counterpart of USSR institutions as well as a pressure group to Japanese Government for her economic policies to the USSR.

The new generations who took over founder generation were more technocrat-oriented business people familiar with stabilities brought about with dynamic animal spirits of old generation. When the USSR dissolved and business modality for Russia was reset, talents were needed to provide solutions for Russian society. For new services to go with transition from state system to market oriented institutions, the type of people required were those who would dare to challenge and go beyond bureaucratically spelled out job descriptions. Japan faced leadership crises for her Russian business.

3. Possible Gas Projects in the Far East

3.1. Shift of gas as a commodity

Based on experiences in the past it seems like that a possible frontier may lie in the energy related sphere in the Far East. During the last two and a half decades when Japan has been struggling over the protracted economic under performance, Sakhalin oil and gas projects had been completed which increased Japan's gas and oil consumption from Russia. There remains ample room to accommodate further increase.

At the same time there are several issues to be taken into account for energy business promotion. They are largely related to a so-called paradigm shift of gas business, which has been increasingly become a global business. The paradigm shift of gas business is basically due to increasing gas supply capacity globally. There are many new projects being initiated, while world gas demand appears to be weak for the foreseeable future. In addition, new mega gas field discoveries are being spotlighted. Many development projects are waiting for ready-to-go signals.

It is expected that the supply excess will be so large that gas will be treated in the same manner as oil in a very short time period. Spot market oriented transactions will be more commonly found, gas prices will be quoted in major exchange marketplaces like London or New York in the similar manners as oil, offtake patterns will be more diverse and flexible, more portfolio and financial investors will come into the market, more swing producer countries will show up, and gas re-export will be a normal phenomenon. Already there have been many LNG tank operators active in spot oriented transactions, and physical infrastructures for diverse gas

transactions are being prepared.

As the price movement of oil has been primarily subject to long term balance of excess production capacity relative to actual demand, so will be the case for natural gas. Both Japan and Russia have to take these paradigm shifts into consideration.

3.2. Japanese situation

3.2.1. Japanese natural gas demand projection

Japan's gas demand drastically increased due to the Fukushima nuclear accident. In 2010 total LNG imports were 70.6 million tons. This number soared up to 83.2 in 2011, 86.9 in 2012, 87.7 in 2013, and then 88.5 in 2014 (Japan Custom). Thanks to increasing shale gas production the US cancelled major LNG import contracts one after another which coincidentally occurred during this period and which in turn provided room for Japan to buy additional LNG.

At the same time since the Fukushima nuclear accident projecting Japanese gas demand has become hard work, especially in the long term. Depending upon assumptions, demands fluctuate with wide margins. Variables are;

- possible re-entry of suspended nuclear power
- new entrants' (non-traditional power companies) attitudes for LNG power and coal thermal investments
- level of renewables
- city gas utilities' gas demand
- impacts on power and gas business deregulation
- possible creation of gas wholesalers

Now Japanese gas demand has reached a historically high level but whether this demand level will be maintained or even increase is uncertain. It will be largely up to when and with which magnitude Japan will return to nuclear power. Re-entry of nuclear power has been highly political. Though the Japanese government has been anxious to restart, at the end of 2015, it seems highly improbable for the restart in eastern Japan to happen in foreseeable future.

Power and city gas deregulation is also a change agent for gas demand, which was partly hastened by Fukushima accident. The accident has weakened big power companies' (ESCOs) lobbying capacity in keeping power monopoly active and has provided room for new entrants into power generation and distribution.

There has been a policy debate with respect to regional power monopoly, pro or anti regional monopoly, or pro or anti competition through deregulation. Ten EPCOs (electric power companies) have been assigned one of ten regionally divided franchise bases from Hokkaido to Okinawa with monopoly from generation to distribution, which has been treated as an exception under the Japanese anti-trust law. Though power business liberalization has been a government commitment, its pace has been kept slow, making the Japanese case far behind predecessor cases of America and Europe. The accident gave a critical impact on this issue, partly because the strongest and largest opponent of deregulation, T (Tokyo) EPCO has become virtually government owned, which has facilitated the entry of new players in the market. The increase of players means increase of variables, which has made the projection more complicated.

3.2.2. Japanese gas buyers

Since the end of World War II Japanese electric power and city gas markets have been under strong regulatory framework preserving regional monopoly and preventing rapid progress of liberalization. This regulatory framework has produced a unique status of Japanese gas buyers in the world. EPCOs and gas companies have not had strong incentives to expand their spheres of operations and therefore have not gone into the gas transaction market beyond what has been needed for their own operations in the franchise market.

Quantity wise, Japan has been the largest gas importer in the world, but from a global standpoint each importer has been a mere domestic electricity or city gas retailer playing in the designated monopoly market. Each company's growth has been limited and subject to the growth of its designated franchise area. For gas procurement, based on each demand projection companies enter into term contracts, in which being self-sufficient has been the basic policy.

The internal structure of the Japanese gas market became an issue after the Fukushima crisis. As a result of the withdrawal of nuclear, Japanese demand for gas soared. There was not any domestic shock absorber with ample inventory or emergency access system to meet the need because there were no major wholesale players in Japan who could absorb fluctuations in prices as well as volumes. Faced with emergency, individual companies negotiated with spot market suppliers and portfolio investors. They also began exchanging gas by sharing or switching LNG cargoes among themselves.

Though indirectly, Fukushima may have created a new international wholesale player. TEPCO and C (Chube) EPCO agreed to separate their gas thermal departments and merge them into a joint-venture company, JERA, with gas power capacity of annual consumption volume of 25 million tons LNG, Japan's by far the largest LNG user. JERA may be in a good position to go international, having warehousing functions in and out of Japan. If JERA succeeds, other players may also spin off their gas departments. For Japan to be a really full-fledged international gas buyer country, domestic shock absorber has been badly in need.

3.2.3. Increasing demand for coal and renewables

In addition to gas, an energy source with its rediscovered value for base power source is coal. Since Fukushima, for coal fired power generation plant replacement and new construction by non-traditional power companies, such as steel or cement producers and oil refineries, have been encouraged by, for example, simplifying the environmental impact assessment process. Depending on smooth implementation of this promotion mechanism, new entry pace will be accelerated. Increasing coal thermal may somewhat mitigate increasing gas demand, though to what extent is unknown.

Other elements are not as dominant as nuclear or coal in shaping future demand of gas but are not negligible either. A part of deregulation is renewables. As to renewables, among others, photovoltaic increase, may work negatively on LNG demand as experienced in Europe.

City gas demand has been stagnant in major cities since demand for cogeneration has been weak. Rather there will be more than expected demand in local cities as gas pipeline infrastructures are built up.

Under these circumstances Japanese natural gas buyers have been repeatedly remaking demand prospect scenarios.

3.3. Japanese import gas prices

The gas glut will make many gas prices, historically set forth independently by demand center location, more closely interrelated. Import gas prices which used to be decided independently by the market are about to be given an initial small room for arbitrage. Consumers are more sensitive to gas prices. JCC (Japan crude cocktail, a benchmark price for setting Japan's import gas price) has been independently fixed but when the US (Henry Hub) and European price mechanism can be arbitrated, why not arbitrage with Japanese import gas price? On a global basis various gas price formulae used by area or country have been more and more closely linked. The Russian gas price to Japan will not be an exception.

Because of regional monopoly, where EPCOs and gas companies have been operating under the mechanism of transferring the cost of gas to retail prices, Japanese LNG buyers have been said to be less tough in gas price negotiations relative to foreign counterparts. They have been acquiescently accepting the price based on blended costs of crude oil imported to Japan called JCC, which has been substantially higher in the long run when compared with gas prices charged in other markets. They have long been in a position of typical price taker. After Fukushima EPCOs and gas companies negotiation style has been being attacked, which has forced them to consider seriously defining grand strategy on gas price.

3.4. Russia and Japan

3.4.1. Lowest cost gas producer

Russia has also been a price taker, who has been charging prices based on those in other major market. At the same time it has been said that Russian export gas prices have been set based on importers proximities to Russia. There have been arguments that because Russian production cost has been lowest among major gas producers, a politically flexible gas price mechanism has been possible. Though cost analysis has not been clear, many involved in initial stages of gas supply to Europe such as gas from Urengoy or Yamburg have had impressions that Russian cost is lowest among major producers. Now the gas sources are in Yamal or in east Siberia where merits of sizable gas fields may be offset by physically difficult geologies and transportation cost. Also like China, new buyer countries with good access to other gas sources are bargain hunters requesting lower price deals. Russia is in need of insightful worldview and broad perspective.

3.4.2. Implication of Japan to Russia

Russian position as by far the largest gas supplier to Europe has been being challenged. Major Middle East gas producers including Iran have been aiming at providing gas through new pipelines. Qatar, the world's largest LNG exporting country, has been trying to increase pipeline gas export which is more competitive than LNG. If Qatar will try to export pipeline gas to Europe, then why not Iran? Iran has a huge gas field adjacent to the Qatar gas field. Pipeline gas from Qatar and Iran will compete against Russian gas in the European market. Mediterranean new discoveries have similar potential.

The Ukrainian Crisis and ensuing economic sanctions have forced Russia to cultivate non-EU and non-NATO markets, the representative of which is China with whom Gazprom is said to have concluded a gas supply contract at a breakeven price level. Pivot to Asia so far has not been

profitable for Russia. China has enough gas contract backlogs including one with Turkmenistan.

Compared to deals with China, Sakhalin LNG must have been profitable to Russia. There may be some more room to deal with Japan.

However, as Japan has been short of expertise to move business with Russia smoothly, as has Russia with Japan. Plants and equipment trades and oil and gas export have been rather stereotyped transactions. In oil and gas, both Russia and Japan have followed business practice established for many years worldwide, although Sakhalin projects brought about stable gas flow and stable cash flow to each, which is in contrast to lumpy cash flows of single shot deals of plant and equipment.

With mutual inexperience in dealing each other what are the incentives to enhance further economic relations while overcoming each one's inexperience and lack of knowledge? In addition since the outbreak of the Ukraine crisis, straightening out economic relations has become a politically more complicated exercise. Is it rewarding? Do both Russia and Japan reconcile political difficulties with economic benefits?

The possible merits for Russia will be;

- Russian bargaining position to China may be reinforced
- Russian bargaining position in the Far Eastern market will be strengthened relative to LNG from the US and other Pacific and Indian Ocean basin gas
- if pipeline gas project with Japan were realized, Russia may become pipeline gas price marker in Pacific basin
- New investment opportunities will be created surrounding project sites such as infrastructures build-ups like hotels, telecommunication systems, logistics systems, all of which will incorporate a small prototype of smart city, which will be perfect suggestions for what both have to do by making use of advantage of each.

Those merits vary as to time frame, the longer the time span the bigger the merits. The point is whether both Russia and Japan have enough endurance or perseverance. Good thing is that the merits to Russia are not necessarily demerits of Japan.

3.4.3. Possible options

Possible project candidates having been discussed for over ten years among those involved in the energy business are:

- Sakhalin expansion (one more liquefaction train in Sakhalin)
- Vladivostok LNG
- pipeline gas from Russia to Japan
- Electric power supply to Japan

Those projects have been discussed from conventional angles, not with the intention to construct new win-win structures but with the intention of making use of advantages of each. Project candidates selected from conventional angles are sure to be exposed to competition in the global gas project pool, where traditional relationship will play a decisive role. While in Japanese power sector joint-ventures or M&A over IPP have never been discussed seriously, in the event that pipeline gas supply becomes a reality many small and medium sized projects surrounding pipeline will develop. As a result, joint ventures or some other types of Russian direct investment

will be natural. For this to happen both have to work through difficulties by accumulating mutual understanding with repeating trials and errors of rethink, remake, rewrite, redesign, endure and persevere together. Only by so doing so can both develop competent teams. It will not be easy but often times a small success will lead to big and diverse development. It will not be any exaggeration to say such development will be possible in the Far East.