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Economic Cooperation in the New World: The Soviet Far East

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New approaches to military behavior are an important part of a new image that Soviet authorities would like to reserve for themselves. These approaches include three main points that are most efficient for development of economic cooperation:

1. Transition to the strategy of defense sufficiency and retreat from the strategy of forestalling military action
2. Conversion of the defense industry
3. Revelation of most economic information that was closed because of the necessity to hide true potential and real problems

In the Soviet Far East these three points mean the following.

Usually for the Pacific countries the Soviet Far East was the outpost of USSR military power. At the same time, economically this region was almost unknown. Everybody knows that the region has enormous natural resources, but the economic potential, both military and civil, was a big secret. Furthermore, there have not been any significant changes with regard to points 1 and 2. In the all-union program on the conversion of the defense industry there is only one Far Eastern enterprise. The Soviet army and navy look after preservation of their positions in the territory, its economy, and official bodies very zealously. The most striking example of the army and navy's strong position and real power is their actual refusal to open Vladivostok officially. The remarkable thing is also that the highest military circles in the USSR achieved their ranks after service in the Far East (the minister of defense and his first deputy). That is why the Soviet Far East kept the image of the military outpost and why the Pacific countries were on the alert.

At the same time, new information (though partial) and the unofficial opening of most of the Far Eastern territories and cities have revealed that the region's true economic potential is very poor, its infrastructure bad, its natural resources exhausted. In such situations there are no political reasons to increase the scale of economic cooperation between the Soviet Far East and Pacific nations. Prospects for economic cooperation depend only on the economic situation and the progress of economic reforms in the USSR and the Soviet Far East. Moreover, the development of economic cooperation is not the only opportunity to make military circles move toward real changes and military reforms.

It is very difficult to estimate the final result of current reforms in the field of foreign economic relations. We can see both the positive and negative results of this reform. The reason is that reform—not only in the foreign economic cooperation sphere but in the Soviet economy as a whole—is being carried out without orientation toward a clear-cut final system. It is impossible to say what kind of management is desirable for the government: administrative or market. In reality we have a mixed system.

The effective market system is characterized usually by four separate markets that are correlated: commodities, money, capital, and labor markets. It is not only the presence of these markets that is of importance, but also the relationship between their domestic and international parts, which is perhaps more important. Historically the commodity market developed only in connection with the international market. Thus in the former Soviet Union the market has not developed on a big scale (only 3 percent of the total industrial output to date). The flows of capital, money, and labor were separated from international flows. That is why the first step of the Soviet government toward stimulating international economic cooperation was an attempt to attract foreign investment.

In principle, the mechanism of capital movement is rather clear and simple. Capital moves to the most profitable industries. As a result production increases and prices decrease. The latter means the decrease of profits and a search for new possibilities for investing. Therefore the state faces the problem of determining the national and territorial priorities in technology and industrial structure to define the main directions in attracting foreign investment in different forms.

Capital can be attracted in two main forms: selling stocks and establishing joint ventures. As stocks were lacking, joint ventures became the only form. However, the USSR practiced compensation and cooperation agreements on construction of enterprises abroad (primarily in the Third World countries). But compensation agreements did not have much influence on the internal situation in the investment area. More important, investment loans on compensation agreements were for the industries that foreign investors were interested in. Investment priorities were determined by the creditors, not by the Soviet government. There existed agreements on cooperation within the Eastern European economic arrangements. Yet all productive forces have been frozen and the former regional allocation of capital has turned into an agonizing trade problem. The future of these cooperation agreements depends on the availability of hard currency. Thousands of enterprises constructed in the developing countries cannot be used as investments by the USSR as in previous years. The reason is that construction was not associated with future participation of the Soviet side in management and receiving incomes.

The failure of these forms of foreign investment (compensation agreements, productive cooperation, and construction of enterprises abroad) made the Soviet government resort to strict measures of regulation in the field of joint ventures. To date, the process of establishing and managing joint ventures in the USSR has been based on the rules of 1987:

1. The decree by the USSR Supreme Soviet on "questions concerning the establishment of joint ventures in the USSR, international organizations with participation of Soviet and foreign organizations, firms, and management bodies" (13 January 1987)
2. The decree by the USSR Council of Ministers on "the order of establishing and functioning in the USSR of joint ventures, international organizations of the USSR and socialist countries" (13 January 1987)
3. The decree by the USSR Council of Ministers on "the order of establishing and functioning in the USSR of joint ventures with participation of Soviet organizations and firms from capitalist and developing countries" (13 January 1987)
4. The decree by the CPSU Central Committee and the USSR Council of Ministers on "additional measures on improving the foreign economic relations in a new economic situation" (17 September 1987)
5. The decree by the USSR Council of Ministers on "further development of foreign economic activity of governmental, cooperative, and other enterprises and organizations" (2 December 1988)

From 1987 the regulation of the process of joint ventures establishment has become more liberal. First of all the share of the Soviet capital is not to be as much as 51 percent. The reality of Soviet and foreign partners is conditioned by commercial reasons. However, the share of a foreign partner is more than 50 percent only in exceptional cases. Then not only a Soviet citizen but a foreigner can also be the chairman or general director of the joint venture. But the most radical change, from the government's point of view, is the permission for Soviet enterprises and organizations to establish joint ventures by themselves after they are approved by the upper management body or territorial authorities (in case of new construction or large-scale reconstruction). Formerly it was only the USSR Ministries and Republican Councils of Ministries that had the right to establish joint ventures. Although real liberalization of the foreign investment process has taken place in the administrative sphere, the economic mechanism to rule this process based on a system of priorities has not been created.

The government and territorial authorities have only one criterion to stimulate the establishment of joint ventures: to cover deficits. But in the situation where everything is a deficit, this criterion is very uncertain. In fact the government's policy is more definite. As any joint venture has to find hard currency to make payments for raw materials, transport services, components, equipment, and profit repatriation, it must orient itself toward exporting its products. This means that the Soviet government stimulates mainly export-oriented investments. Meanwhile the biggest problem of the Soviet economic situation is the domestic market. This is one of the reasons why more than 4,000 joint ventures cannot improve the economic situation in the USSR. In other words, it is not because they are few in number, but because they have no incentive to solve domestic problems.

Priorities of enterprises in setting up joint ventures are also based on a desire to obtain hard currency, not to get profit. It is one of the most important reasons why foreign investors cannot wait for well-founded proposals from the Soviet side. For the latter it is more important to get hard currency than to establish profitable and perspective joint ventures. After the president's decree (November 1990) on hard currency taxes being put into force, this situation has been aggravated.

Soviet enterprises are oriented toward receiving (and keeping) "real money" even at the cost of losing profit, aggravation of the domestic market situation, and so on. The other reason for being indifferent to the results and motivations of joint ventures is that many Soviet managers are eager to prepare "emergency serodroms" for themselves (good salary, good labor conditions, stability). This is why foreign investors now have a much clearer system of priorities when they are going to invest money in the USSR. These priorities are as follows:

1. To receive permission to explore and to export natural resources and processed products (oil, gas, fish, timber, coal, minerals)

2. To obtain hard currency circulating in the USSR (hotel service, restaurants, communications, business service, commercial shops, and so on)

3. To "secure a place" or to invest money knowing that in the near future they will not bring profit, investors hope that after stabilization of the Soviet economy and transformation of the Soviet ruble into convertible currency their investments will give them a real advantage in using the Soviet internal market

This explains four main features of the joint-venture establishment process in the USSR: the rather high intensity of this process in 1988–89; the rather modest scale of this process; the distribution of joint ventures in favor of raw materials and the service sector; and the fact that only 30 percent of joint ventures (and even less) are functioning. For example, in the Soviet Far East till the middle of 1991 about 70 percent of the fifty joint ventures were established in fishery and timber industries; an additional 25 percent was set up in services.

But even in the framework of these limitations, the joint-venture establishment process is further constrained by restrictions—first of all, administrative restrictions. According to the practice of foreign investment attraction from different countries, governmental bodies that have to regulate the establishment of joint ventures try to simplify it. In many cases the procedure to receive permission for establishing a joint venture is very formal; usually permission is given without any obstacles. Moreover, in some countries (for example, in the United States) it is possible to establish enterprises with 100 percent of foreign capital, with the exception of certain industries (production of weapons, for example). In the USSR, granting permission to establish a joint venture depends so far on ministries in Moscow even if this enterprise is to be set up in the Soviet Far East. Each foreign company that wants to invest in the Soviet Far East has to do the following: find a Soviet partner; obtain approval of the territorial authorities for the planned project; study its feasibility; receive the approval of the related ministry in Moscow. It makes the whole procedure too complicated even for those investors who have the biggest commercial interests in the Soviet Far East (exploitation of natural resources or the hard currency market).

The second constraint is the nonavailability of real market regulations. This implies that it is impossible to solve problems that are simple for a market-regulated economy—to buy raw materials, to find builders, to build the required industrial facilities or houses, to get proper supplies, and so on. The whole economic situation in the USSR is very unstable and unusual for foreign investors who are beginners in the Soviet market. During the 1990–91 period, numerous laws on the establishment of market regulation were adopted. Many of them run counter to each other or to those adopted in the 1988–89 period. The decline in industrial output and national income (9 percent in 1991 according to official estimates) has provoked the Soviet government to change its intentions and undertake practical steps that are too abrupt and unexpected for business (new currency regulation, tax policy, customs regulation, wage control, prices policy, and so on). Big deficits in the national budget and high inflation are turning the economic situation into threatening uncertainty. According to the UN forecast, the inflation rate in the USSR will be at least 500 percent by the end of 1991. Along with the general instability, this cannot be attractive to investors. The appearance of certain market institutions in the USSR (commodity exchanges, currency sanctions, stocks) has not changed the uncertainty of the situation. The scale of their operations is too small and the government's support too uncertain and ineffective.

The third constraint is financial problems. The biggest problem is the nonconvertibility of the ruble. This means that even in the case of good results from investments it is impossible to remit the foreign part of profit abroad. Theoretically it is possible to buy hard currency at the currency auction. But there arises a problem: lots of exchange rates. Now there are four different exchange rates: official (about 0.6 ruble per US$1), commercial (1.8 rubles per US$1), market (about 30 rubles per US$1), auction (about 70 rubles per US$1). A foreign investor can buy hard currency at the auction rate. This means that he has to tie prices to the auction rate or to prefer export of his products.

The fourth constraint is the lack of investment guarantees. Here the situation began to change after the adoption in June 1991 of a new law on foreign investments. But the fruits of this law may be seen only after a certain period of time. The important obstacle for foreign investors is the lack of a modern banking system and credit system. This throws light on why capital flows in the direction of the USSR are so slow in spite of great efforts.

In the Soviet Far East, comparatively large-scale forms of investment cooperation are compensation agreements with Japan and joint fish-catching companies with the United States, Australia, New Zealand, and Singapore. The best-known compensation agreements are: three general agreements in the forest industry, an agreement on the exploitation of the South Yakutian coalfield, and an agreement on prospecting the Sakhalin offshore oil and gas fields. For many years there has been cooperation in the forest industry with North Korea. The main feature of these compensation and cooperation agreements is that they were based on intergovernmental decisions; therefore, all of them had safe state backing. The same situation obtains with joint fish-extracting companies, which are dealing with one of the largest government corporations: dealing with "Dal'ryda" is the same as dealing with the government itself. At least "Dal'ryda" has no government support; the financial situation in these companies is stable enough thanks to long-standing commercial traditions and a remunerative field of operations. The cessation of governmental economic activity has had a more negative influence on the fate of compensation and cooperation agreements. Practically all these agreements are in the past. Hence, neither direct nor indirect foreign investments have a sufficiently favorable climate in the Soviet Far East.

In accordance with the decree by the USSR Council of Ministers in May 1989, "On development of foreign economic activity by Soviet organizations," Soviet enterprises received rights to invest abroad. This was an attempt to organize a counterflow of investments. The official intention was that the Soviet enterprises would develop their foreign economic activity through establishing joint ventures with the Soviet participation in capital and management and buying stocks. To date, the main forms of activity with Soviet capital are trade and services. The industrial activity is represented by catching and processing fish and other sea products and by bringing export machines and equipment up to world standards. The modest scale of such operations can be attributed not only to the lack of experience, business infrastructure, and money, but also to the administrative restrictions. The decree of May 1989 foresees that Soviet enterprises can establish joint ventures and conduct operations with stocks in foreign countries only after such activity is approved by the related ministries.

The failure to attract foreign investment and to organize effective capital flows in the framework of the acting economic mechanism has caused an avalanche of suggestions regarding the establishment of free economic zones in different areas. In the Soviet Far East, three free economic zones have now been officially approved by the Russian Supreme Council: Nakhodka city, Sakhalin territory, and the Jewish autonomous oblast. The main goal in the establishment of the free economic zones in the Soviet Far East is to encourage capital flows from both sides (from Pacific countries and internal regions of the USSR) toward these territories. Decrees on these zones provide certain privileges in taxes, mainly for foreign investors. But the idea of stimulating domestic investment has not acquired the form of practical measures. Due to this failure, as well as the lack of clear and feasible rules, nothing has taken place in the free economic zones in regard to investments. It is necessary to emphasize that the encouragement of domestic investment is a key point, as it is impossible to develop infrastructure without it.

At present the investment process is running into the same problems as elsewhere in the Soviet Far East. Free economic zones were planned as an effective instrument to attract investment, market experience, and technology; in reality, in terms of the aforementioned reasons of the failure in Soviet investment policy, the activity in these zones is connected mainly with the export-oriented joint ventures dealing with natural resources. All other kinds of activity proceed from the necessity of technology transfers for competitive production. But technology transfer is one of the most complex problems. In the past the USSR pinned all its hopes in the field of technology transfer on industrial cooperation and specialization programs with socialist countries such as China, North Korea, and Vietnam. But these countries have no technology, resources, or experience. That is why there is no emphasis on new technologies from developed countries.

The Soviet investment policy, both in the past and at present, is based on the assumption that foreign investors are eager to fight for opportunities to invest in the USSR. In reality, countries that want to attract foreign investment compete in creating a more favorable climate for investors. From this standpoint, what is important for the USSR is not the creation of free economic zones but the creation of a favorable investment climate both for foreign and domestic investors.

The solution to this problem in the Soviet Far East is based on the new concept of regional economic development adopted by the Association of the Far Eastern Councils of People's Deputies at the end of May 1991. The main idea of this conception is to create a favorable investment climate throughout the Soviet Far East. Its features are:

1. Formation in the Soviet Far East of the Regional Economic Administration to draw up financial plans, to stimulate policy and infrastructure programs, to control the economic and financial results, and to take suggestions on new regulation measures. In terms of the whole economic policy the territorial authorities (executive committees) have to make decisions on: registration of foreign firms and Soviet investors, training a labor force, and providing additional advantages to investors.

2. It is necessary to enable foreign investors to operate with rubles and to give them guarantees for conversion of rubles into hard currency by market exchange rate. This will solve the problem of profit repatriation. For this a special regional bank is to open.

3. The advantages in taxes: reduction of taxes on profit to a level lower than in competitor countries; differentiation of tax rates in various industries, with preferences to processing branches of fishery, forestry, and nonferrous metals, high-tech industries, banking, domestic trade, and so on; release of for-

eign investors (completely or partially) from the tax on profit repatriation; release of foreign and domestic investors from the tax on reinvesting part of their product; a more favorable system of tax concessions in comparison with neighboring countries; implementation of the policy of accelerated amortization, above all in industries in which the state and territory are interested; and free import of machines and equipment for projects financed by foreign investors.

4. Formation of investment funds for realization of different regional programs using both internal financial sources (governmental and commercial funds, loans) and loans of international financial organizations or commercial banks.

5. Formation of a commercial credit system in the Soviet Far East through utilization of domestic as well as foreign credit resources plus quotas of foreign bank operations by the central regional bank.

6. Permission for foreign banks and their branches to carry out financial operations in the region.

Besides the investment climate, guarantees, and general economic and political stability, the most important thing for effective international economic cooperation is the labor market and international labor flows. The general situation of the labor force in the USSR is complex. On the one hand, large-scale unemployment is expected. According to some estimations the number of unemployed in the near future will be about 40 to 50 million people. On the other hand, there exists a large-scale structural deficit in the labor force. There are a lot of job vacancies in construction, services, machinery (tools-workers), forestry, fishery (seasonal workers), and other industries. In reality it is very difficult to estimate the situation because of disorder in two main fields: one is wages; the other is organization and technology. It is necessary to set correlations between wages and results of labor. It is necessary to improve the organization levels and technology in accordance with the average world levels.

In the Soviet Far East there is both unemployment and a labor shortage. The unemployment is due to the shortage of high-paying jobs (for example, in nonferrous metallurgy in Magadan); the deficit is because of the surplus of low-paying jobs. Labor flows are one of the important conditions for effective capital flows. New investments in the Soviet Far East will be effective only if the labor problems are solved. There are two basic obstacles. The first is wage and labor conditions: in this region it is impossible to improve the latter without big investments; modernization of industrial relations seems necessary to increase the first. The second obstacle is the shortage of houses: it is impossible for workers to change their jobs if the jobs are connected with the territory where they live.

From 1988 some organizations in the Soviet Far East began to import foreign workers, mainly from Vietnam and China. In fact the import of foreign workers to the Far East began in the 1970s, when North Koreans were invited for timber cutting. Guest workers are employed now in three industries (besides forestry): construction, agriculture, and light industry. It is these industries that have problems of wages and labor conditions. The total number of guest workers in the region is approximately 30,000 people distributed between forestry, construction, agriculture, and light industry. But 30,000 guest workers do not imply that it is possible to take foreign investors' bearings on the utilization of international labor flows. To date, guest workers in the Soviet Far East are not free people with contracts with their employers. Soviet organizations that are in need of guest workers strike a proper bargain with the Chinese and Vietnamese organizations and pay the main part of wages to these organizations with different commodities (cement, steel, cars, oil products, fertilizers, fish, timber, coal). These are not international labor flows; this is the renting of guest workers. To use a foreign labor force as a stable and effective source of economic growth in the region, it is necessary to change the rules of arrival and departure for Soviet and foreign people. But the most important thing is to recognize the need for a normal labor market with respect for the private property of each worker and with the wages arranged between employers and workers with a minimum level guaranteed by the government.

Capital and labor flows are very important for the development of international economic cooperation. But without the proper development of infrastructure in the Far East, stable and effective cooperation will be impossible. The key element of the infrastructure system is transport—in the case of the Soviet Far East and Northeast Asia as a whole, sea transport. From this point of view it is necessary to review the Tumen River Area Project.

The railway transport, together with seaports in the Soviet Far East, is one of the main bases of Soviet "service export" because of container flows between Japan and Europe. These flows are based on the ports of Nakhodka and Vostochny, which are now under reconstruction. Besides, these ports are the main elements of the Nakhodka free economic zone and the proposed Vladivostok zone. In the near future one more project will be under consideration in the Soviet Far East: the development of Vanino port (Okhotsk Sea) in Khabarovsk territory for using the BAM railroad as the second container route and for adding the economic potential of a "BAM Zone" to the common export potential of the Far East.

If the Tumen River Project is realized, all of these projects in the Soviet Far East may fail to be realized. The route through the Tumen River Area is shorter than through Transsiberian or BAM, and a big part of potential cargo flows will be reoriented to the southern variant. This will mean that in the Soviet Far East such areas as Nakhodka-Vladivostok, Vanino-Komsomolsk, and the BAM Zone will lose their economic developmental potential. In any event it will affect the value of capital invested in seaports and railroads in the Far East, where part of this capital has been invested by Japanese firms. As a result, instead of the development of economic cooperation in Northeast Asia, strong contradictions and disappointments may appear between the USSR, from one side, and China and Korea from the other. In general, however, the Tumen River Project is very useful not only for China or North Korea but for the former Soviet Union. For example, the realization of this project can help the active development of the Khasan Area in the Soviet Far East. But it is necessary to coordinate carefully the goals and main elements of investment policy in order to obtain good results for both sides. In this case realization of this project will help the development of Northeast Asian economic cooperation. It is necessary to prepare a feasibility study for estimating all possible variants and influences of this project. In preparing for this feasibility study, a joint working group must be formed and it must include specialists from China, the USSR, and both Koreas, as well as UN experts.