

Sanctions in Japan-Russia Economic Relations: *Impact and Adaption*



In 2016, Japanese Prime Minister Shinzo Abe launched an eight-point economic plan to reform Japan's relations with Russia. Abe's aim was to foster economic interdependence between the two countries rather than allow a stalemate to continue on the longstanding dispute over the Kuril Islands. Dr. Shagina provides an analysis of the hitherto outcomes of Abe's economic endeavors.

In May 2016, the Shinzo Abe government launched an eight-point economic cooperation plan with Russia, which encompassed energy, infrastructure, agriculture and other sectors. By fostering strong economic ties, Prime Minister Abe hoped to soften Russia's stance on the disputed Kuril Islands (the Northern Territories in Japanese), a group of islands seized by the Soviet Union in 1945, following Japanese defeat in the Second World War. Since then, persistent distrust and tensions have paralyzed bilateral relations, hindering prospects for a peace treaty.

Moving away from the stagnant territorial talks, the proposed eight-point cooperation plan offered a new approach. By using investments as political leverage, the Abe administration aimed to nurture mutual trust between the two countries in order to achieve a breakthrough in the territorial negotiations.

Looking beyond the territorial dispute, the main objective of this article is to analyze Japan-Russia

economic relations. It aims to explore factors that impede progress on the eight-point economic cooperation plan, and asks to what extent U.S. sanctions constrain the scope of Japan-Russia economic deals. In addition, it examines the ways in which Japanese businesses have adapted to the sanctions.

Maria Shagina is a JSPS Postdoctoral Research Fellow at Ritsumeikan University, Japan. Her main research interests are sanctions and energy relations in post-Soviet countries. She was a visiting fellow at the Centre for Russian, European and Eurasian Studies, University of Birmingham and is currently affiliated with the Geneva International Sanctions Network. She holds a PhD in Political Science from the University of Lucerne, Switzerland.

A New Approach to the Territorial Negotiations

Since 2012, bilateral relations with Russia have substantially advanced, arguably due to Abe's personal diplomacy – a series of a record-setting 25 meetings with President Vladimir Putin. Despite Russia's international isolation, the Abe administration has intensified its overtures to the Kremlin with an ultimate goal in sight; resolving the longstanding territorial dispute. Prime Minister Abe was confident he could change this dynamic, offering a new approach to their cooperation, by using economic instruments to create favorable conditions for achieving political goals.

In the past, due to the predominant notion of inseparability of politics and economics (*seikei fukabun*) the territorial dispute was seen as a stumbling block for economic cooperation between Moscow and Tokyo. From the late 1970s until mid-1980s, an all-or-nothing diplomatic approach was taken, consistently resisting the expansion of economic ties in the absence of a settlement of the territorial issue.¹ Economic cooperation with the Soviet Union was seen as contingent upon progress in the territorial negotiations. For example, Japan refused to provide financial aid to the Soviet Union as long as the territorial issue was unresolved.² In the late 1980s, with the arrival of the Gorbachev era and Perestroika, the *seikei fukabun* policy eroded, opening a way to a new thinking in diplomacy vis-à-vis the Soviet Union.³ This new thinking, labelled “expanded equilibrium” (*kakudai kinkô*), was put forward by Prime Minister Takeshita and envisaged the incremental development of economic relations alongside the progress on the territorial dispute.⁴ The policy logic was changed: previously Japanese investments to the Soviet Union were perceived as a reward for the resolution of the territorial issue, now Japanese aid was viewed as a way of creating the conditions for an eventual settlement in the future.⁵

The new policy was designed to manage bilateral diplomatic and economic relations by different actors. The Ministry of Foreign Affairs (MOFA), the Defense Agency and the hard-liners inside the Liberal Democratic Party consistently resisted the expansion of economic ties without the linkage to

The **Institute for Security and Development Policy** is an independent, non-partisan research and policy organization based in Stockholm dedicated to expanding understanding of international affairs. With its extensive contact network with partner institutes in Asia, each year ISDP invites a number of visiting researchers as well as guest authors from the region to participate in research, discussion, and exchange with European scholars and policy officials. ISDP's Focus Asia series serves as a forum for these researchers as well as guest authors to provide and clarify their viewpoints on the contemporary issues and challenges concerning their countries, adding a much-needed Asian perspective to the policy and research debate.

For enquiries, please contact: info@isdp.eu

No parts of this paper may be reproduced without ISDP's permission.

Disclaimer: The opinions expressed in this paper are those of the author only and do not necessarily reflect those of ISDP or its sponsors.

the territorial issue, while small- and medium-sized firms pursued their business interests in the Soviet Union based on a commercial approach. The formal disentanglement of economic and diplomatic relations was not, however, totally immune to the influence of Japanese government.⁶ For example, in objection to the MOFA, the Ministry of Finance and The Ministry of International Trade and Industry supported the participation of Japanese companies in the Siberian development projects as it was believed that it would create a fruitful atmosphere for the discussion of the settlement of the territorial issue.⁷ Moreover, the separation of politics and economics did not exclude the exposure of economic relations to the diplomatic and security-related developments of third countries. In particular, the U.S. factor was strongly present in Japan-Soviet relations and in strategic projects with Moscow the Japanese private sector was reluctant to proceed without the participation of U.S. companies in order to avoid security-related complications.⁸

Following this new logic, the Abe administration viewed economic cooperation as a tool for luring Japanese investments to Russia's Far East in order to nurture mutual trust and to hopefully achieve a breakthrough in the territorial negotiations. In May 2016, Abe proposed a new approach to the countries' bilateral relations – the eight-point economic cooperation plan, including joint activities in health care; urban infrastructure; energy; development of industries and export bases in the Far East; cooperation between medium-sized and small companies; cooperation on cutting-edge technologies; and people-to-people interaction.⁹ In addition, a separate set of priorities was defined for joint economic activities on the disputed islands in September 2017. Five areas, ranging from aquaculture, tourism, garbage disposal, greenhouse farming, to wind power generation, were planned to be conducted under a special legal status.¹⁰ The new approach followed the strategy of “small steps” whereby each successfully implemented project would create mutual trust and showcase diplomatic progress.¹¹ At present, there are reportedly 150 joint projects, 60 out of which are already at the implementation stage.¹² For example, a high-tech traffic signal system was installed in Voronezh and a rehabilitation medical center was built in Vladivostok (See Appendix I).

Hiroshige Seko, Japan's Minister of Economy, Trade and Industry (METI), was given the special portfolio of overseeing the execution of the eight-point cooperation plan. Seko's appointment as Minister for Economic Cooperation with Russia marked a unique phenomenon in Japanese politics, when the name of the country was directly linked to the official post for the first time.¹³ Moreover, Seko's posting reflected the fact that the ministerial position (METI) was now in charge of Japan's Russia policy, sidelining the MOFA. In contrast to the MOFA, which followed the U.S.' hawkish approach to Russia, METI pushed forward economic cooperation with no direct link to the progress on the territorial negotiations.¹⁴

Both Japan and Russia saw their own rationale in the eight-point cooperation plan. From Japan's point of view, the cooperation plan aimed to separate business development projects from the national political standpoint of no negotiation and thereby find a new approach to the stagnant territorial talks. The Abe

administration hoped to use Japanese investments as political leverage to soften Russia's stance on the territorial issue. Being a strategically important sector for Russia, energy cooperation was the main bargaining chip and a crucial lever in the territorial negotiations.¹⁵ For Russia, economic cooperation with Japan provided an opportunity to diversify its pivot to Asia and to diminish its over-reliance on China. Due to Western sanctions, Russia hoped to attract much-needed Japanese investment and technology, and to develop its outdated industries and untapped resources in the Far East. Finally, economic cooperation with Tokyo gave Moscow an opportunity to demonstrate that it is not fully abandoned and that it can find international partners despite international isolation, and the West in particular.

Mismatch in Expectations

Despite the countries' desire to advance their economic relations, both Tokyo and Moscow had different readings of the eight-point economic plan. In December 2016, a summit between Abe and Putin in Yamaguchi exposed their heightened expectations. The Abe government realized that the lure of Japanese investments would not bring an immediate change in their bilateral relations and that a grand bargain was out of reach.¹⁶ It became evident that Russia did not associate economic cooperation with progress in resolving the border issue. Having the upper hand in the territorial negotiations, Moscow was interested in delaying the progress as much as possible in order to get more investments into its underdeveloped eastern territories.¹⁷

Moscow perceived Tokyo's economic plan as an aid package and overestimated the Abe government's influence on the private sector.¹⁸ “We've held a lot of meetings with the Japanese side,” Alexander Krutikov, deputy minister for the development of the Russian Far East, said, expressing his disappointment. “However, these negotiations didn't result in decisions. In contrast to other countries, there are only a few Japanese investors in the Russian Far East.”¹⁹ Contrary to Chinese and to some extent South Korean investors, the Japanese looked for “win-win” projects, based on their profitability and feasibility.²⁰ However, despite the Japanese government's enthusiasm, the

eight-point cooperation plan sparked little interest. Originally planned to attract around 9 billion USD of investments, by December 2016 the economic plan brought in only 2.6 billion USD in Japanese public and private investments.²¹ The majority of agreements were in the form of non-binding memorandums of understanding (MoUs), underlying the uncertainty of Russia's investment climate for Japanese companies.

Acknowledging the economic plan's failure to achieve tangible results, the Abe administration changed its strategy. Until late 2016, the range of implemented projects was of a fairly low profile. The main focus was put on the health sector, infrastructure, and agriculture, whereby the projects sought to enhance living conditions and life expectancy of ordinary Russians.²² Realizing that small-scale projects were not going to conciliate Russia, more visible deals were tabled on the agenda. From late 2017 on, the focus of the economic plan shifted to larger projects, including with the Russian state-owned companies. For example, in August 2017, the Japan Bank for International Cooperation (JBIC) established a \$1-billion investment fund with Russian Direct Investment Fund (RDIF), for projects covering energy, cutting-edge technologies, and industries in the Far East. In September 2017, Japan Oil, Gas and Metals National Corporation (JOGMEC) and Irkutsk Oil Company (INK) signed the framework agreement for a joint exploration in Eastern Siberia.²³

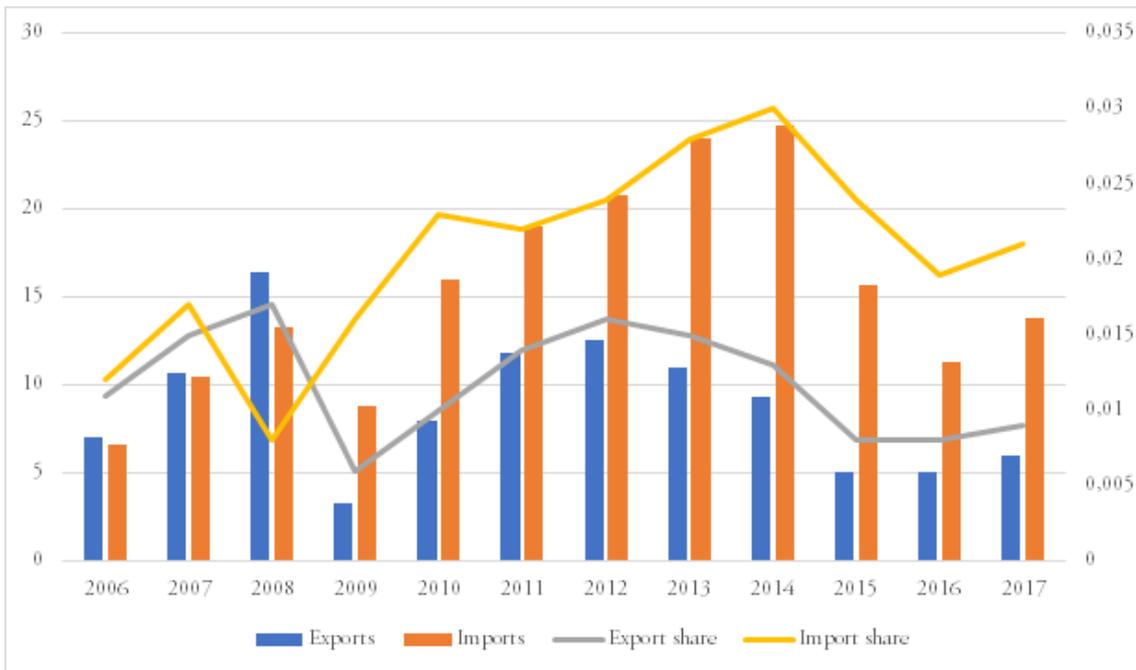
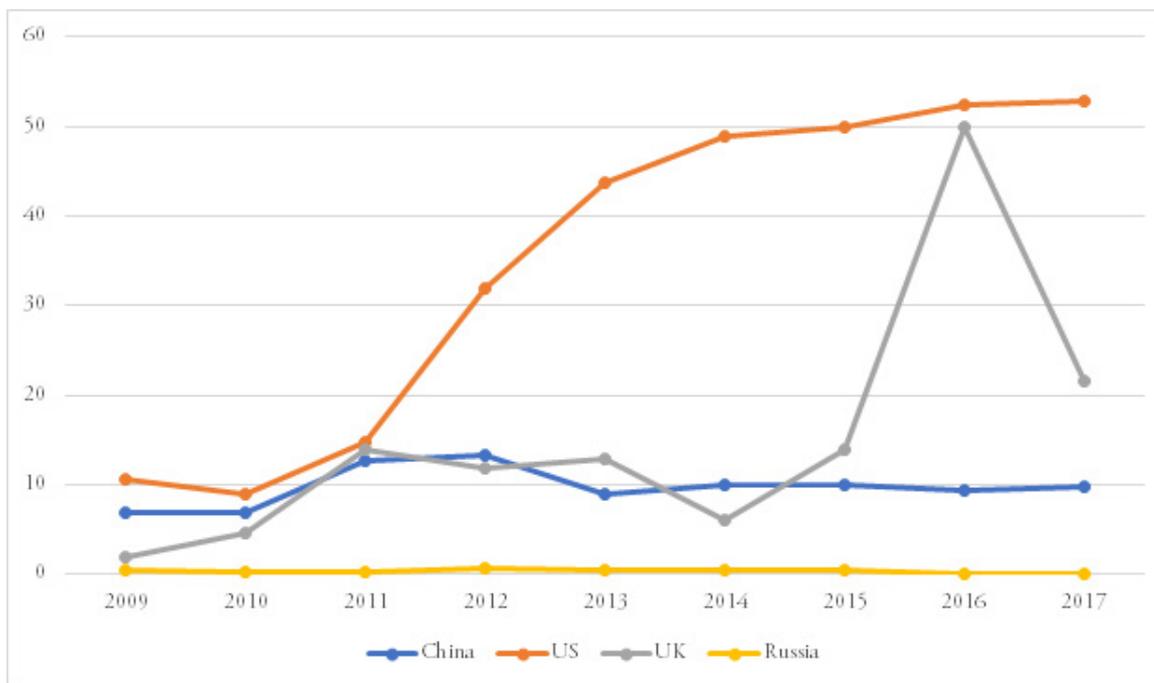
During the Eastern Economic Forum (EEF) held in Vladivostok in September 2018, the mismatch in expectations was visible again. Hiroshige Seko praised the progress in the Japan-Russia cooperation plan and underlined the importance of taking new measures in the field of energy.²⁴ In contrast, the Russian side publicly hinted at dissatisfaction with the insufficient level of Japanese investments.²⁵ After the EEF, Japanese companies notably raised their profiles in energy cooperation. For the first time, Japanese companies were involved in talks about equity participation in Russian majors, sanctioned by the U.S. and the EU in response to the Ukraine crisis.²⁶ Mitsui & Co, Itochu and Mitsubishi expressed interest in acquiring equity stakes in Novatek's Arctic LNG-2, Gazprom's Baltic LNG, and the expansion of Sakhalin-2.²⁷ Previously, Japanese companies steered away from the dealings with sanctioned Russian

entities to avoid U.S. fines for compliance breaches. To mitigate these sanctions risks, Japanese government-backed agencies provided public assurances for the private sector and pledged to cover the risks in case of the sanctions' threat. Such reinforced interest from Japanese investors was triggered by the Japanese government's desire to show its full commitment to economic cooperation in the wake of the January meeting in 2019 between the two leaders. As 2019 was seen as a turning point for the territorial negotiations, the Abe administration put additional pressure on Japanese businesses to achieve tangible results.

Despite Abe's expectations, neither his personal diplomacy nor increasingly ambitious deals seemed to change the position of the Russian government so far. On the contrary, the 25th meeting between Abe and Putin in January 2019 ended with talks about economic cooperation rather than about a peace treaty. Putin acknowledged certain success in Japan-Russia economic cooperation, but noted that the qualitative shift in their bilateral relations was still absent. He expressed hope to increase bilateral trade between both countries by at least 50 percent to 30 billion USD in the coming years and to strengthen ties in such areas as the LNG sector and technological cooperation.²⁸

Domestic Factors in Sluggish Economic Relations

Boosting economic cooperation with Russia has always proved to be difficult for Japan and the unresolved territorial dispute was not the main obstacle. Despite their complimentary economic structures, the trade balance between Japan and Russia has been moderate. For Japan, Russia remains an insignificant trade partner. Prior to the sanctions, in 2014 the share of Russian imports to Japan was at its peak of 3 percent, while only 1.3 percent of Japanese exports went to Russia. In 2017, the share of Russian imports to Japan fell to 2.1 percent, and the share of Japanese exports to Russia decreased to 0.9 percent (Figure 1).²⁹ The situation with Japan's foreign direct investments also failed to improve. In 2017, investments decreased considerably, resulting in a marginal 15 million USD.³⁰ As a result, Japanese companies accounted for just 0.03 percent of foreign direct investments in Russia. Comparing it to other countries, the

Figure 1: Japan's foreign trade with Russia, 2006-2017 (USD bn)**Figure 2: Japan's Outward Foreign Direct Investment, 2009-2017 (USD bn)**

Russian share is almost insignificant (Figure 2).

For years, domestic factors related to Russia's management of the economy put the brakes on Japan-Russian economic relations and the eight-point economic cooperation plan failed to change it. Complex administrative procedures and their non-transparent implementation, ineffective tariff

regulations, red tape and an opaque legal system have been the main impediments for doing business in Russia.³¹ Looking for profitable, "win-win" projects in Russia, Japanese businesses struggled to find them. Unsurprisingly, the eight-point economic cooperation plan sparked only moderate interest among Japanese investors, with roughly 40 percent of Japanese companies having no plans to participate in it.³²

Attracting Japanese investments to the Far East proved to be particularly difficult. Over the last years, Japanese businesses saw little potential in the region and the creation of the Advanced Specialized Economic Zones (ASEZs) failed to change that. Introduced in March 2015, the ASEZs offered a new type of investment platform with unprecedented benefits and a favorable tax regime. In comparison with other economic zones, the Russian ASEZs seemed to provide a better investment environment in the Asia-Pacific region.³³ Nevertheless, by 2017 only three Japanese food-processing firms had established their businesses there.³⁴ At present, the overwhelming majority, 82 percent, of Japanese firms are willing to invest in the European part of Russia, as opposed to 54 percent of companies which are open to investing in the Far East.³⁵

Impact of Sanctions

Although the lackluster economic cooperation was predominantly shaped by Russia's domestic factors, Western sanctions had a compounding effect on the business climate in Russia. Together with the sharp drop in oil prices and the depreciation of the Russian ruble, the situation turned into "a perfect storm of Fukushima magnitude" for Japanese investors.³⁶ After the Ukraine crisis, 55.9 percent of Japanese companies immediately felt the negative effect of Western sanctions.³⁷ In 2015, the number of Japanese firms entering the Russian market dropped sharply from 14 to two.³⁸ Fewer companies were optimistic about their future business prospects in Russia. According to the Japan External Trade Organization's survey, only 44 percent of Japanese companies were planning to expand their activities in Russia in 2015, as opposed to 77 percent in 2013.³⁹ By 2019, a large majority of Japanese firms (76.3 percent) were deterred from expanding their business operations in Russia, aggravated by the looming U.S. sanctions.⁴⁰

Western sanctions added more uncertainty to the Japan-Russia joint activities and increased investment risks despite the government's assurances. The volatility of the exchange rate, as well as an unstable political and social climate became the main concerns, superseding even the complexities of administrative and tax procedures.⁴¹ Exacerbated by these rising tensions, the Russian currency lost 50 percent of its value from

March 2014 and the depreciation became a primary risk for investments, making financial calculations particularly cumbersome.⁴² The currency fluctuations with the subsequent shrinking of the Russian economy and weakened consumers' purchasing power lead to a reduced interest among Japanese investors.⁴³ As a result, decreased sales, deteriorated creditworthiness of local clients and suspended new projects followed (Figure 3).

With time, the impact of U.S. sanctions gained salience and appeared to be the main concern for Japanese companies. Signed in 2017 by U.S. President Donald Trump, the Countering America's Adversaries Through Sanctions Act (CAATSA) strengthened the U.S. adversarial approach towards Russia. The CAATSA stiffened conditions for issuing new debt for designated Russian banks, and defense and energy companies. The technological sanctions were similarly reinforced: technology transfers to unconventional oil projects were prohibited if Russian energy companies held 33 percent or more in ownership shares. As a result, in 2018, 67 percent of Japanese companies reported to be affected by the negative effect of expanding U.S. sanctions.⁴⁴ The main problems were caused by the centrality of the U.S. financial system and the dominance of dollar-denominated currency in Japan-Russia business deals. Due to the U.S.' economic statecraft, Japanese firms experienced difficulties in financing sanctioned Russian firms and were hesitant to provide dollar-denominated loans. This, in turn, delayed their final investment decisions.⁴⁵ With new U.S. sanctions looming, future business expansions stalled – 43.6 percent of the respondents acknowledged the low priority of doing business in Russia.⁴⁶

Nonetheless, certain sanction risks were gradually alleviated as companies anticipated the negative ripple effects and factored them in at earlier stages. For example, the creditworthiness of local clients improved steadily, as Japanese companies closely followed the U.S. sanctions policy and abstained from dealing with entities on the Specially Designated Nationals (SDN) List.

Increasingly, Western sanctions became a thorn in the side of the Russian political and business elites as well. First, Western sanctions were discarded by the Russian side and barely mentioned within the framework of Japan-Russia economic cooperation. In fact, when

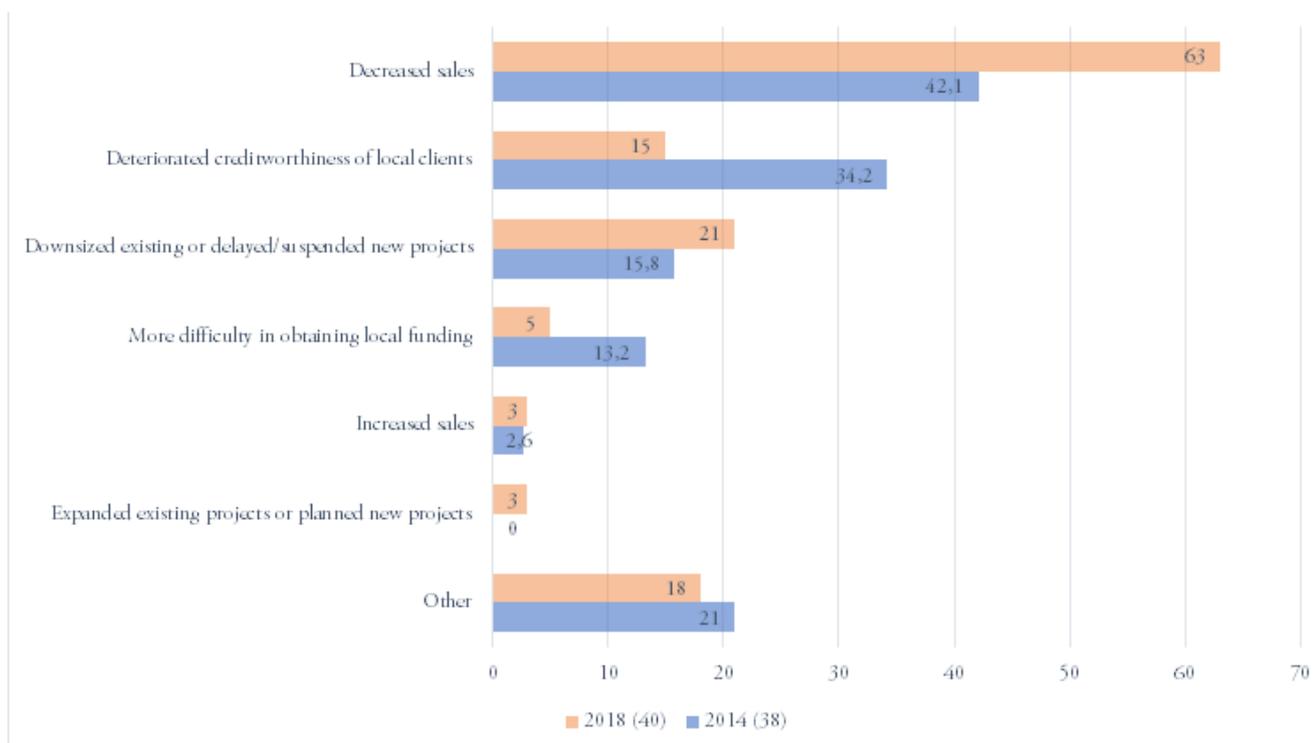
Japan joined Western sanctions, Moscow perceived them as “symbolic in nature, with more ‘peaceful’ measures” in comparison to the U.S.’ and the EU’s measures.⁴⁷ In the Russian media, Japanese sanctions were presented as being imposed reluctantly under strong pressure from the U.S. and there was no reason for them to infringe upon Abe-Putin relations.⁴⁸ As the joint projects became more ambitious and sanctions put brakes on Japanese cooperation with Russian state-owned companies, the Russian public narrative changed dramatically. Sanctions were consistently named as one of the main impediments for the progress in Japan-Russia bilateral relations.

In October 2018, Putin questioned Tokyo’s attempt to build trustworthy relations, pointing to Japan’s alignment with Western sanctions. “We are trying to create conditions for trust. But Japan decided to impose sanctions on us. Is this a step towards trust? Why did you do it? To increase confidence? And, nevertheless, we aren’t ruling out a dialogue [with Japan],” commented Putin.⁴⁹ Later, Dmitrii Peskov, the Kremlin’s spokesman, and Mikhail Galuzin, Russia’s ambassador to Japan, reiterated the statement, by claiming that Japan’s support of Western sanctions hinders the signing of a peace treaty.⁵⁰ Acknowledging

the constraining effect of U.S. sanctions on their economic deals, Russia tried to increase its leverage over Japan, knowing Abe’s personal preoccupation with the resolution of the territorial issue. Japanese businesses, however, remained cautious of investing, as their strong U.S. nexus significantly limited their options. Despite the Abe government’s amicable Russia policy, the private sector was unwilling to risk its connections to the U.S. market and to anger the U.S. Office of Foreign Assets Control (OFAC).⁵¹

The expanding U.S. sanctions affected a number of deals within the framework of Japan-Russia economic cooperation, which were considered the projects with a great economic potential. First, in August 2015, cooperation between Gazprom and Japanese companies stalled after the Yuzhno-Kirinskoye field was targeted by U.S. sanctions.⁵² The undeveloped field was viewed as an indispensable source for Sakhalin-3 and the expansion of Sakhalin-2 – the flagship projects in the eight-point economic cooperation plan. Secondly, in July 2017, OFAC blocked a deal between Rosneft, JOGMEC, Inpex Corp and Marubeni Corp for the joint offshore oil exploration near Sakhalin. Referring to it as ‘backfilling,’ OFAC objected to the deal as it would allow Japanese energy companies to

Figure 3: How Did U.S. Sanctions Affect Japanese Business?



profit from the deal when U.S. oil and gas companies were prohibited to do so.⁵³ Thirdly, Japan-Russia cooperation in the aircraft industry was affected, as Japan's Toray Industries ceased the shipment of composite components for the building of Russian medium-haul aircraft MC-21. Under the CAATSA legislation, any non-U.S. companies and individuals could be under the risk of secondary sanctions for facilitating significant investment in Russia's defense sector.⁵⁴ The delivery was terminated as the end-user companies belonged to U.S.-sanctioned United Aircraft Corporation (UAC) and Rostec.⁵⁵

Indirectly, Western sanctions also affected Japan-Russia energy cooperation in the LNG sector. Although LNG was not directly targeted by the U.S. and the EU, the sharp decline in oil prices, combined with financial and technological sanctions, undermined the feasibility of LNG projects. Barred from international markets, Rosneft and Gazprom faced fierce competition for domestic funds for the development of their Far East LNG and Vladivostok LNG. At the same time, geopolitical tensions with the West shifted Russia's focus to China. Once considered flagship projects in Japan-Russia energy cooperation, Far East LNG and Vladivostok LNG were indefinitely postponed, as Moscow favored increasing its pipeline capacity to China instead.⁵⁶

Accommodating Mechanisms

To adapt to the unfavorable market conditions shaped by sanctions, Japanese companies adopted de-risking strategies. First, they participated in areas exempted from sanctions but vital for Russia's ambitious projects. Joint cooperation expanded in such areas as LNG and renewables, the nuclear power sector, and the shipping industry. For example, in 2014 Japan's JGC Corporation and Chiyoda Corporation engineered and constructed a modular plant for the Yamal LNG.⁵⁷ Last November, Japan's government-backed New Energy and Industrial Technology Development Organization (NEDO) in partnership with RusHydro (a Russian power company), launched a wind energy generation system in the Far East, employing Japan's cold-resistant technology.⁵⁸

In the shipping industry, Mitsui O.S.K. Lines (MOL) spent \$973 million on three ice-tankers out of Novatek's

15 brand-new vessels.⁵⁹ Later, MOL together with Marubeni Corp joined a feasibility study with Novatek for the building of a transshipment terminal on Kamchatka, while Saibu Gas Co. signed a preliminary deal with Novatek to allow the company to use its storage facilities in Kyushu, Japan's Southern island.⁶⁰ Such cooperation would help Novatek to solve the mismatch in LNG production and shipment capacities as well as reducing transportation costs to the Asia-Pacific.

In the nuclear power sector, Rosatom, Russian state atomic agency corporation, won two bids on the nuclear accident management plan at the Fukushima Daiichi plant. Rosatom will assist Japan's nuclear power plant, which experienced reactor meltdowns after the triple disaster in 2011, in cleaning up the nuclear waste.⁶¹ Recently, Japan also announced that it will invest 1.15 billion rubles in a center in Russia's Far East for the treatment and long-term storage of nuclear waste. With Japanese investment, the center plans to procure the necessary equipment for nuclear waste treatment.⁶²

Secondly, Japanese and Russian companies adapted to financial prohibitions developing accommodating mechanisms. Governmental backing of joint projects has become crucial for the mitigation of sanctions risks, as they are disconnected from Western financial institutions. Mutually established intergovernmental investment funds and export-import trade agencies have operated as a key platform for financial transactions. Government-linked JBIC and JOGMEC guaranteed the support of the Japanese administration in order to encourage private investments. For example, in 2016 JBIC signed an MoU for strategic cooperation with Novatek and two months later provided a €200-million loan for its Yamal LNG.⁶³ Later in 2018, JOGMEC signed an MoU with Novatek to pursue opportunities of cooperation in Arctic LNG-2.⁶⁴ With JBIC's support, Gazprom raised a ten-year bond worth ¥65 billion (574 million USD). The offering is reportedly the second-largest yen-denominated deal for an emerging market borrower.⁶⁵

Thirdly, the de-dollarization of business deals became another way to reduce exposure to the U.S. nexus. To avoid dollar-denominated payments, Japanese companies considered alternative currencies to secure wire-transfers. For example, JBIC proposed

direct ruble-yen currency swaps with Russian state-owned banks such as Gazprombank, VTB, and Vneshekonombank. Due to high interest rates and the ruble's volatility, the plan was unsuccessful.⁶⁶ Nonetheless, payments in euros and yen might have the potential, given their recent increase in the Russian reserves. Over the last year, the share of dollar assets decreased from 43.7 percent to 21.9 percent, while the share of euro-denominated contracts increased from 12.7 percent to 20 percent and assets in the Japanese currency rose by 20 billion USD.⁶⁷

Finally, the broader involvement of foreign participants helped Japan and Russia to keep dim lights over their intensifying cooperation. For example, to reduce Japan's visibility in financing Yamal LNG, JBIC provided the loan as part of an international financial package.⁶⁸ In a similar vein, Rosneft tried to minimize sanction-related risks for the construction of the LNG plant at Sakhalin-1. The Russian major invited Japanese and Indian companies to participate in the project, which was originally intended to be executed in partnership with Exxon Mobil only.⁶⁹

Conclusions

Despite Tokyo's economic initiative, the eight-point economic plan has showed only moderate results. Multiple meetings between the countries' political and business elites resulted in a few small-scale projects, while the majority of the ambitious ones remain on paper. The lackluster economic cooperation was predominantly shaped by Russia's domestic impediments such as administrative hurdles, red tape and opaque legal regulations, and the absence of a formal peace treaty was not the main obstacle. Taking a risk-based commercial approach, Japanese businesses struggled to find "win-win" projects and the encouragements and public assurances from the Abe government managed little change. The government's new approach of incremental advance of economic relations in parallel to progress on the territorial issue failed to encourage the participation of Japanese companies in the eight-point economic cooperation plan.

Gradually, U.S. sanctions have added more uncertainty to Russia's adverse business climate and they have increasingly become a constraining factor in Japan-Russia economic cooperation. The centrality of the

U.S. financial system and the dominance of dollar-denominated trade limits Japanese companies' business opportunities and stifles the scope of economic cooperation. Regardless of Tokyo's full commitment to revitalize the bilateral economic relations, the government could not exert a lot of influence on the Japanese private sector and failed to incentivize the inflow of investments. Similarly, to the situation in the 1970s, the Japanese private sector remains cautious of engaging in strategic projects with Russia because of the business-related complications with the U.S. and prefers self-policing and over-compliance to the Japanese government's public assurances of risk mitigation.

With U.S. sanctions intensifying and with Russia pushing for more ambitious deals, Japanese business is caught between a rock and a hard place. On the one hand, the Abe administration is under enormous time pressure to solve the territorial issue within his term and 2019 is considered to be a crucial year. The administration is increasing pressure on Japanese companies to invest more to show tangible results. On the other hand, the expanding U.S. sanctions leave less leeway for Japanese businesses to forge deals with Russia. There are less legal loopholes and exempted areas for the Japanese private sector to navigate through without being exposed to U.S. sanctions.

Appendix

Eight-point Economic Cooperation Plan	Examples of Implemented Projects
1. Extending healthy life expectancies	<ul style="list-style-type: none"> • Cooperation agreement with R-Pharm JSC for the treatment of tuberculosis (Otsuka Pharmaceutical); • Agreement with Mitsui & Co on the acquisition of a 10 percent-share in R-Pharm; • Rehabilitation medical center in Vladivostok (Hokuto Social Medical Corp).
2. Developing comfortable and clean cities	<ul style="list-style-type: none"> • High-tech traffic signal system (Kyosan Electric Manufacturing) and construction of smart housing in Voronezh (Nice Corp); • Creating new development strategies in Vladivostok (Nikken Sekkei); • Waste combustion for heating swimming pools.
3. Medium-sized and small companies' exchange and cooperation	<ul style="list-style-type: none"> • Launch of the online resource “Japan x Russia Business Matching Support Project”; • Participation of Japanese companies in Russia's INNOPROM.
4. Energy	<ul style="list-style-type: none"> • Financing Yamal LNG (JBIC); construction of LNG modular plant (JGC Corp and Chiyoda Corp); • Rosatom won two bids for the nuclear accident management plan at the Fukushima Daiichi plant; • Installation of a wind power generation system in the Far East (NEDO, Mitsui & Co and Komaihaltec); • Construction of a polyethylene plant in the Irkutsk region (Toyo Engineering Corp); • Agreement to conduct a feasibility study for the construction of a liquefied hydrogen plant in the Magadan region (Kawasaki Heavy Industries); • Wind turbine localization project (WINDPRO Global and Far East University).
5. Promoting industrial diversification and enhancing productivity	<ul style="list-style-type: none"> • A production line for pressure and differential pressure transmitters (Yokogawa Electric Corp); • Agreements to conduct technical audits at Uralhim-mash as a potential supplier of chemical equipment for Japanese EPC-contractors at Sakhalin-2 and Arctic LNG-2 (Irkutsk Oil Company, Sojitz and Chiyoda Corp); • Localization of an assembly factory for medium- and light-duty trucks scheduled for 2019 (Hino Motors)

6. Developing industries and export bases in the Far East	<ul style="list-style-type: none"> • Greenhouse farming installation “Sayuri” in Yakutsk (Hokkaido Corp); • Agreement on acquiring a 10 percent stake in Khabarovsk Airport JSV (Sojitz Corp, Japan Airport Terminal Co, Japan Overseas Infrastructure Investment Corp); • Engine production for export in the Primorsky region (Mazda-Sollers); • Agreement for the development of the Elga Coal Mining Complex in the Sakha Republic.
7. Cooperation on cutting-edge technologies	<ul style="list-style-type: none"> • Implementation of postal automation system by Russian Post (Toshiba); • High-temperature cable (Rosseti and Tokyo Rope); • Localization production plant for cutting machine tools in Ulyanovsk (DMG MORI); • Establishment of an international innovation center for automation in oil refining (Gazpromneft and Yokogawa Electric); • High-temperature superconductivity projects (Rosseti and University of Chubu).
8. People-to-people interaction	<ul style="list-style-type: none"> • Student exchange between Japanese and Russian universities; • International judo exchange tournament in Vladivostok; • “Russia Year in Japan” and “Japan Year in Russia”.

Endnotes

1 Lonney E. Carlile, “The Changing Political Economy of Japan’s Economic Relations with Russia: The Rise and Fall of Seikei Fukabun,” *Pacific Affairs*, Vol. 67, No. 3 (1994): 413.

2 Gerald L. Curtis, “The Tyumen Oil Development Project and Japanese Foreign Policy Decision-Making,” in Robert A. Scalapino ed., *The Foreign Policy of Modern Japan* (Berkeley: University of California Press, 1977): 163.

3 Motohide Saito, “Japan’s “Northward” Foreign Policy,” in Gerald L. Curtis *Japan’s Foreign Policy after the Cold War: coping with change* (New York: An East Gate Book, 1993): 285.

4 Hiroshi Kimura, *The Kurilian Knot, A History of Japanese-Russian Border Negotiations* (Stanford: Stanford University Press, 2008): 105.

5 Carlile, “The Changing Political Economy of Japan’s Economic Relations with Russia,” 427.

6 *Ibid.*, 412.

7 Curtis, “The Tyumen Oil Development Project and Japanese Foreign Policy Decision-Making,” 164.

8 *Ibid.*, 167.

9 Ministry of Foreign Affairs of Japan, “Japan-Russia Summit Meeting,” 7 May 2016, https://www.mofa.go.jp/erp/rss/northern/page4e_000427.html.

10 Yukio Tajima, “Japan and Russia to iron out cooperation on disputed islands,” *Nikkei Asia Review*, 26 October 2018, <https://asia.nikkei.com/Politics/International-relations/Japan-and-Russia-to-iron-out-cooperation-on-disputed-islands>.

11 Céline Pajon, “Japan – Russia: The Limits of a Strategic Rapprochement,” *Russie.Nei. Visions*, No 104, Ifri, October 2017, 15.

12 “Nash prem’er zhdet Vladimira Putina s otkrytoi dushoi” [Our prime minister awaits Vladimir Putin with an ‘open soul’], *Kommersant*, 8 November 2016, <https://www.kommersant.ru/doc/3136227>; “Japan’s Economy minister praised cooperation with Russia,” *TASS*, 21 January 2019, <http://tass.com/economy/1040948>.

13 “Nash prem’er zhdet Vladimira Putina s otkrytoi dushoi.”

14 Interview with expert, Sapporo, February 2018.

15 Gilbert Rozman, “The Japan-US-Russia Triangle in 2016,” *The Asan Forum*, 29 April 2016, <http://www.theasanforum.org/the-japan-us-russia-triangle-in-2016/>.

16 Jeremy Maxie, “Russia-Japan Summit: No Grand Bargain Within Reach,” *The EastWest Institute*, 20 December 2016, <https://www.eastwest.ngo/idea/russia-japan-summit-no-grand-bargain-within-reach>.

17 Alexander Gabuev, “The Russia-Japan Economic Relationship: It Is Political, but Not about the Territories,” in *Japan – Russia relations. Implications for the US – Japan Alliance*, ed. Gilbert Rozman (Washington: Sasakawa Peace Foundation USA, 2016), 121.

18 Alexander Gabuev, “Vernut nelzia sotrudnicat: chem vazhny novyie dogovorennosti Rossii i Yaponii” [Return no cooperation: why new agreements between Russia and Japan are important], *Carnegie Moscow Center*, 19 December 2016, <https://carnegie.ru/commentary/66491>.

19 “What Prevents Japanese Investors From Boosting Ties With Russian Far East,” *Sputnik International*, 18 December 2017, <https://sputniknews.com/analysis/201712181060111346-japan-russia-far-east/>.

20 Interview with a Keidanren representative, Tokyo, January 2018.

21 Pajon, “Japan – Russia: The Limits of a Strategic Rapprochement,” 18.

22 *Ibid.*, 18.

23 “Framework Agreement signed between JOGMEC and INK on new joint exploration project,” *JOGMEC New Releases*, 7 September 2017, http://www.jogmec.go.jp/english/news/release/news_06_000050.html.

24 “Minister ekonomiki Yaponii: VEF stal vazhnoi plozhadkoi dlia nepreryvnogo dialoga s Rossiei” [Japan’s Minister of Economy: EEF became an important platform for a dialogue with Russia], *TASS*, 8 September 2018, <https://tass.ru/vef-2018/articles/5539112>.

25 “Poka u nas zdes deklaratsii” [So far there are only declarations], *Kommersant*, 31 October 2018, <https://www.kommersant.ru/doc/3786397>.

26 For example, in late 2018 Mitsui & Co. confirmed talks for acquiring stakes in Arctic LNG-2, the expansion of Sakhalin-2 and Baltic LNG. Itochu signed an MoU with Gazprom that could potentially lead to a 10% share in the latter project.

27 “Gazprom and Itochu signed Memorandum of Understanding on Baltic LNG project,” Gazprom’s Press Release, 13 December 2018, <http://www.gazprom.com/press/news/2018/december/article470681/>; “Gazprom and Mitsui discuss Sakhalin II and Baltic LNG project,” Gazprom’s Press Release, 22 January 2019, <http://www.gazprom.com/press/news/2019/january/article473520/>.

28 “Putin tones down rhetoric with Abe but treaty progress is unclear,” *Nikkei Asian Review*, January 2019, <https://asia.nikkei.com/Politics/International-Relations/Putin-tones-down-rhetoric-with-Abe-but-treaty-progress-unclear>.

29 Japan External Trade Organization (JETRO), Japan’s International Trade in Goods (Yearly), <https://www.jetro.go.jp/en/reports/statistics.html>.

30 Japan External Trade Organization (JETRO), Japan’s Outward and Inward Foreign Direct Investment, Historical Data, https://www.jetro.go.jp/ext_images/en/reports/statistics/data/country1_e_17cy.xls.

31 Japan Business Federation Keidanren, “Rezultaty anketnogo oprosa otnositelno usloviy vedeniia biznesa s Rossiei (2017 fin.god). Obzor” [Survey results regarding the conditions of doing business with Russia (2017 FY), Overview], 6 September 2017, <http://www.keidanren.or.jp/en/policy/2017/064ru.pdf>.

32 Japan External Trade Organization (JETRO), “2016 Survey on Business Conditions of Japanese-Affiliated Firms in Russia,” December 2016, https://www.jetro.go.jp/ext_images/en/reports/survey/pdf/rp_firms_russia201612.pdf.

33 Jiyoung Min and Boogyun Kang, “Promoting New Growth: ‘Advanced Special Economic Zones’ in the Russian Far East,” in *Russia’s Turn to the East. Domestic Policymaking and Regional Cooperation*, by Helge Blakkisrud and Elana Wilson Rowe (Cham: Palgrave Pivot, 2017): 64-65.

34 Pajon, “Japan – Russia. The Limits of a Strategic Rapprochement,” 19.

35 Japan Business Federation Keidanren, “Rezultaty anketnogo oprosa otnositelno usloviy vedeniia biznesa s Rossiei (2018 fin.god). Obzor” [Survey results regarding the conditions of doing business with Russia (2018 FY), Overview], 11 September 2018, <http://www.keidanren.or.jp/en/policy/2018/070ru.pdf>.

36 Gabuev, “The Russia-Japan Economic Relationship,” 119.

37 Japan External Trade Organization (JETRO), “2014 Survey on Business Conditions of Japanese-Affiliated Firms in Russia,” March 2015, https://www.jetro.go.jp/ext_images/en/reports/survey/pdf/2015_03_biz.pdf#page32

38 Masahiro Tokugawa, Keiko Suganuma, Nami Odagiri, “From Russia to Eurasia: Specific Features of the ‘Russosphere’ from the Perspective of Business Activities of Japanese Firms, *RRC Working Paper Series* No. 77, June 2018, 44.

39 Japan External Trade Organization (JETRO), “2014 Survey on Business Conditions of Japanese-Affiliated Firms in Russia,” March 2015, https://www.jetro.go.jp/ext_images/en/reports/survey/pdf/2015_03_biz.pdf#page32.

40 Japan External Trade Organization (JETRO), “Issledovanie ‘Deiatelnost’ yaponskih kompanii na rossiiskom rynke v 2018,” [2018 Survey on business conditions of Japanese-affiliated firms in Russia] February 2019, https://www.jetro.go.jp/ext_images/russia/Anketa_on_act_JP_companies_in_Rus_in_2018_ru.pdf.

41 Japan External Trade Organization (JETRO), “2014 Survey on Business Conditions of Japanese-Affiliated Firms in Russia,” March 2015.

42 Gabuev, “The Russia-Japan Economic Relationship,” 120.

43 JETRO Russia, “Dopolnitelnye sanktsii SSHA v otnoshenii Rossii zatronuli 67% yaponskih kompanii v Rossii” [Additional US sanctions vis-à-vis Russia affected 67% of the Japanese companies doing business in Russia], 5 October 2018, https://www.jetro.go.jp/russia/topics/_431066.html.

44 *Ibid.*

45 Japan Business Federation Keidanren, “Rezultaty anketnogo oprosa otnositelno usloviy vedeniia biznesa s Rossiei (2017 fin.god). Obzor” [Survey results regarding the conditions of doing business with Russia (2017 FY), Overview], 6 September 2017.

46 Japan External Trade Organization (JETRO), “Issledovanie ‘Deiatelnost’ yaponskih kompanii na rossiiskom rynke v 2018.”

47 Sergei Chugrov, “The Image of Russia in Japan and the Image of Japan in Russia,” *Working Paper 33*, Russian Council of International Affairs, 2017, 8.

48 Rozman, “The Japan-US-Russia Triangle in 2016.”

49 “Putin vozmutilsiya santksiiami, kotorye Yaponiia vvela protiv Rossii” [Putin resented sanctions which Japan imposed on Russia], *Gazeta.ru*, 18 October 2018, https://www.gazeta.ru/business/news/2018/10/18/n_12184231.shtml.

50 “Peskov rasskazal, chto meshaiet podpisaniyu mirnogo dogovora s Rossiei” [Peskov told about what impedes signing a peace treaty with Russia], *Vedomosti*, 27 January 2019, <https://www.vedomosti.ru/politics/news/2019/01/27/792520-peskov-nazval-glavnuyu-zadachu>; “Russian envoy claims Japan’s sanctions violate 1956 declaration,” *The Japan Times*, 21 March 2019, <https://www.japantimes.co.jp/news/2019/03/21/national/politics-diplomacy/russian-envoy-claims-japans-sanctions-violate-1956-declaration/>.

51 Ivan Timofeev, “Russia-Japan Dialogue. The Sanctions Factor,” *Valdai Club*, 21 January 2019, <http://valdaiclub.com/a/highlights/russia-japan-dialogue-the-sanctions-factor/>.

52 Federal Register, “Russian Sanctions: Addition to the Entity List To Prevent Violations of Russian Industry Sector Sanctions,” Bureau of Industry and Security, Commerce, 80 FR 47402, 7 August 2015.

53 Jack Farchy, “U.S. Stymies Japan’s Plan to Explore for Russian Oil,” *Bloomberg*, 14 July 2017, <https://www.bloomberg.com/news/articles/2017-07-13/u-s-is-said-to-stymie-japan-s-plan-to-explore-for-russian-oil>.

54 U.S. Department of the Treasury, “Countering America’s Adversaries Through Sanctions Act,” (Public Law 115-44) (CAATSA), 2 August 2017.

55 “MC-21 ostalsia bez materialov dlia kompozitnogo kryla iz-za sanktsii SSHA” [MS-21 was left without components for a composite wing because of U.S. sanctions], *Kommersant*, 10 January 2019, <https://www.kommersant.ru/doc/3850312>.

56 Maria Shagina, “Under Pressure: Russian Energy Cooperation with Japan and South Korea since Western sanctions,” *Foreign Policy Research Institute*, February 2019, 11.

57 “Chiyoda joins Russian LNG plant project,” *Nikkei Asian Review*, 13 May 2014, <https://asia.nikkei.com/Business/Chiyoda-joins-Russian-LNG-plant-project>.

58 Saki Hayashi, “Arctic emerges as collaboration hot spot for Japan and Russia,” *Nikkei Asian Review*, 2018, <https://asia.nikkei.com/Politics/International-relations/Arctic-emerges-as-collaboration-hot-spot-for-Japan-and-Russia>.

59 “Mitsui O.S.K. to join pioneering Arctic shipping effort,” *Nikkei Asian Review*, 9 July 2014, <https://asia.nikkei.com/Business/Mitsui-O.S.K.-to-join-pioneering-Arctic-shipping-effort>.

60 Tsuyoshi Inajima, “Russia Eyes Island Storage for Arctic LNG Amid China Demand Boom,” *Bloomberg*, 12 January 2019, <https://www.bloomberg.com/news/articles/2019-01-12/russia-eyes-island-storage-for-arctic-lng-amid-china-demand-boom>.

61 “Russia’s Rosatom wins two bids for accident management at Fukushima NPP,” *TASS*, 12 January 2019, <http://tass.com/world/1039631>.

62 “Yaponiia vlozhit bolshe milliarda rubley v khranilishche radioaktivnykh otkhodov v Primorie” [Japan will invest more than billion rubles in the storage of radioactive waste in Primorie], *East Russia*, 22 January 2019, <https://www.eastrussia.ru/news/yaponiya-vlozhit-bolshe-mlrd-rubley-v-khranilishche-radioaktivnykh-otkhodov-v-primore/>.

63 “MoU with JSC Novatek for Strategic Partnership,” *JBIC Press Release*, 5 September 2016, <https://www.jbic.go.jp/en/information/press/press-2016/0905-50312.html>; and “Yamal LNG secures \$200 mln JBIC loan,” *LNG World News*, 16 December 2016, <https://www.lngworldnews.com/yamal-lng-secures-e200-mln-jbic-loan/>.

64 JOGMEC and NOVATEK Signed a Memorandum of Understanding,” *JOGMEC News Releases*, 10 September 2018, http://www.jogmec.go.jp/english/news/release/news_03_000002.html.

65 “Capital Markets Weekly: SoftBank Achieves IPO Success But Year-End Is Approaching Fast,” *Seeking Alpha*, 16 December 2018, <https://seekingalpha.com/article/4228557-capital-markets-weekly-softbank-achieves-ipo-success-year-end-approaching-fast>.

66 “Japan Bank: US Sanctions Could Lead to Direct Ruble-Yen Currency Swaps,” *Sputnik International*, 3 September 2015, <https://sputniknews.com/business/201509031026525213/>.

67 “Po zakonam sanktsionnogo vremeni” [According to the laws of sanctions time], *Kommersant*, 10 January 2019, <https://www.kommersant.ru/doc/3850165>; “Luchshe yuania, krepche rublia” [Better than the renminbi, stronger than the ruble], *Kommersant*, 26 April 2019, <https://www.kommersant.ru/amp/3955481>.

68 Shoichi Itoh, “Japan’s Opaque Energy Policy toward Russia: Is Abe Being Trumped by Putin?” in Erica Downs (et al.) *The Emerging Russia-Asia Energy Nexus*, NBR Special Report No. 74, December 2018, 41.

69 “Exclusive: Exxon, Rosneft to build LNG plant with Japanese, Indian partners – sources,” *Reuters*, 23 October 2018, <https://www.reuters.com/article/us-russia-exxon-lng-exclusive/exclusive-exxon-rosneft-to-build-lng-plant-with-japanese-indian-partners-sources-idUSKCN1MX1UN>.

Image Credit

Cover Image: Aleks_Shutter - Shutterstock

Figure 1-3: Japan External Trade Organization (JETRO), Japan’s Outward and Inward Foreign Direct Investment, Historical Data, https://www.jetro.go.jp/ext_images/en/reports/statistics/data/country1_e_17cy.xls.