Japan: Diminishing Interest in Soviet Trade Resources

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Key Judgments

Trade with the Soviet Union remains relatively unimportant to the Japanese economy in spite of a rapid expansion in economic relations during the past 10 years. The complementary nature of resource-rich Siberia and highly industrialized Japan provides a strong incentive for greater interdependence, and the potential for further trade is vast. In addition, the Japanese steel, shipbuilding, and machinery industries view the USSR as an important alternative market because of slower economic growth and rising protectionism in the West.

Until recently, Tokyo and Moscow apparently believed that they might be able to turn expanded economic relations to political advantage. The Japanese hoped that increased economic relations would enhance the Soviet stake in harmonious relations between the two nations. For its part, Moscow assumed that Japanese businessmen would find the lure of Soviet markets and natural resources irresistible and eventually pressure Tokyo to improve political relations.

In fact, the pace of Japanese involvement in Siberian development has slowed sharply since the late 1970s because of Soviet heavyhandedness and political-economic change in Japan. Moscow flaunted its military superiority in a way particularly irksome to the Japanese. Tokyo’s tilt toward China has caused Moscow to view Japan as the potential third partner, with China and the United States, in a hostile Pacific triad. The Japanese have delayed resource development projects because they are reluctant to become dependent on Soviet sources of supply, are concerned about the security implications of several projects, are distrustful of Soviet intentions in Asia, and have less need for Soviet raw materials than they once did.

The cooling of Soviet-Japanese relations may mean that the opportunity available in the early 1970s for rapid exploitation of Siberian resources by Japanese companies has been dissipated. Some projects continue to be implemented at a slower pace, but Tokyo’s linking of political and economic relations makes full-scale development less probable. The Soviet treatment of Japan is unlikely to soften Tokyo’s attitude. Even if the post-Afghanistan sanctions on the USSR were abolished, a number of political and economic factors would restrain the expansion of trade and economic cooperation in the 1980s.
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The Trade Perspective
Trade with the Soviets is relatively unimportant to the Japanese economy. In 1980 the Soviet Union accounted for only 1.7 percent of the value of Japan's total foreign trade, and the Soviet share in any given year has never exceeded 3 percent of the total. With the exception of platinum-group metals, Japan's dependence on the USSR for supplies of individual imported commodities remains low. On the export side there is little danger of major Japanese industries becoming overreliant on the Soviet market. The Japanese enjoy substantial annual trade surpluses, such as $1.2 billion in 1980.

Exports
Moscow has relied heavily on Japan for steel and industrial machinery. Producer goods make up the majority of Japanese shipments; iron and steel alone constitute one-third of all exports and two-fifths of sales of manufactured goods. Oil well drilling pipe, well casing and tubing, large-diameter welded pipe for pipelines, seamless pipes and tubes, and special steels lead the list. Steel plate, which the Soviets use to manufacture large-diameter pipe, is also important. If the West Europeans decide to move ahead with the Yamburg gas pipeline and Tokyo approves Export-Import Bank financing of Soviet purchases for the project, the volume of steel exports will be even higher in the future. During preliminary negotiations with Japanese steelmakers, Moscow proposed shipments of 500,000 tons of large-diameter pipe in fiscal year 1981 (which began last April) and 1 million tons in each of the subsequent three years. Since agreement on Yamburg is unlikely in the immediate future, the Soviets have instead reached preliminary agreement with the Japanese to purchase 750,000 tons of pipe in FY1981 for use in the construction of a pipeline from Urengoi to Pomali. This figure represents an increase of 50,000 tons over the level of 1978, the previous peak in pipe exports to the USSR.

Even in the steel sector, exports to the Soviet Union constitute only a small part of Japanese foreign sales. In 1980, shipments to the Soviet Union, the industry's third largest overseas customer, amounted to only 6 percent of total iron and steel exports. Moreover, drilling pipe and casing now booked for shipment to the Soviet Union could easily be diverted to other markets because of a worldwide oil drilling boom. The complete cessation of business with the Soviet Union would seriously affect Japanese steelmakers in only one product line—large-diameter welded pipe. The Soviet Union has been the principal buyer of this item for many years, thus the importance to the Japanese of such pipeline projects as Yamburg.

Japan's machinery exports to the Soviet Union are almost all capital goods destined for resource development projects or for upgrading Soviet manufacturing facilities. The value of shipments varies widely from year to year, as projects are started and finished. In 1978, machinery worth almost $1 billion accounted for about 40 percent of all exports to the Soviet Union. The next year the total fell to about $600 million. The industry generally attributes a further decline to $550 million in 1980 to Tokyo's ban on Export-Import Bank credits to the Soviet Union after the invasion of Afghanistan. Japan's machinery manufacturers customarily rely on official credits to finance large-scale plant exports.

Machinery exports should expand in 1981. Tokyo has already approved in principle a $1 billion buyer's credit in connection with the third phase of a joint timber resources project. The contract signed by the Soviets last March specifies that plant and equipment purchases must be made within two years. Japanese firms are also bidding for contracts to build a number of chemical plants included in the Soviet Union's new five-year plan. The availability of government-backed credits is crucial, and machinery manufacturers and trading companies can be expected to lobby the government for removal of the economic sanctions now that Washington has lifted the grain embargo. Moscow may be trying to increase the pressure by offering a Hitachi-Marubeni group the prospect of a $1 billion order for Yamburg pipeline gas compressor stations.
Machine tools essential to the improvement of industrial productivity are the most important component of machinery exports to the USSR. Metalworking machine-tool exports increased by 45 percent in 1980. Many Soviet purchases are for state-of-the-art horizontal boring and drilling machines, numerically controlled machining centers, and lathes. The Soviets also rely on Japanese suppliers for numerical controls and industrial robotics technology. The Soviet market is no more important for machine tool makers than it is for steelmakers. Shipments bound for the Soviet Union were only 4 percent of Japanese exports of machine tools in 1980. Unlike pipe fabricators, Japanese machine-tool manufacturers are not highly dependent on the Soviet market for the sale of any one product line.

Imports
The inability of the Soviet Union and Japan to come to terms on many of the resource development projects discussed over the years has kept the volume of Soviet exports below its potential. Many of the resource projects involve substantial sums and exceedingly long leadtimes, and the Japanese have gone elsewhere to secure needed raw materials. Last year the share of Japanese imports coming from the USSR dropped from the 1.7 percent of 1979 to 1.3 percent. Although Japanese imports were inflated by an increase of about 75 percent in the price of crude oil, the value of imports from the Soviet Union declined in real terms. Prospects are not good for any resurgence soon.

Wood pulp, logs, and lumber composed two-fifths of all imports from the Soviet Union. Japanese trading houses have reacted to a two-year downturn in the domestic housing market by negotiating a 15- to 20-percent cut in log prices for the second quarter. Volume, which is decided on an annual basis, remains unchanged. The prospects for a rapid revival of the housing industry, and thus lumber import prices, are not good.

Of the $500 million Japan spent on Soviet manufactures and semimanufactures in 1980, 45 percent consisted of platinum-group metals—platinum, palladium, and rhodium—critical to Japan’s advanced technology sectors. Japanese dependence on the Soviet Union for strategic metal supplies is substantial. By value, the Soviet Union provides 39 percent of Japanese platinum imports, 62 percent of its palladium imports, and 38 percent of its rhodium imports. Dependence on the Soviet Union for other metals is low; Japan imported aluminum worth almost $100 million from the Soviet Union in 1980, but this was only 7 percent of total aluminum imports.

Japan is not dependent on the Soviet Union for mineral fuels. Imports from the USSR as a percentage of all mineral fuel imports have fallen steadily to 0.4 percent in 1980. Fuel oil worth approximately $130 million was the most valuable item. Coal imports have declined consistently over the last five years to a 1980 total of 2.2 million tons worth $124 million; in both FY1979 and FY1980, Soviet coal shipments have fallen short of the contracted quantities. The Japanese steel industry is concerned that imports of coking coal, which constitute most of the Soviet coal sold to Japan, will be slashed to 1 million tons in FY1981. Coal that otherwise would have been exported to Japan is now being consumed within the Soviet Union because of declining imports from Poland. Transportation bottlenecks in the Soviet Far East also may be contributing to the slowdown in shipments. Although the short-term outlook for energy imports from the Soviet Union is poor, ongoing joint development of the Yakutsk coal deposits and Sakhalin oil and gas should lead to some increase in the longer run.

Government-to-Government Trade Relations
Recently, the renewal and revision of government-to-government agreements between Japan and the USSR has given the Soviet leadership an opportunity to rekindle the interest of Japanese businessmen in bilateral commerce and thereby increase the pressure on Tokyo to ease the post-Afghanistan sanctions. Tokyo has already initiated a new bilateral trade and payments agreement covering 1981-85 so that the expiration of the old pact would not create obstacles for businessmen in their efforts to capitalize on opportunities presented by the Soviet Union’s 11th Five-Year Plan. Similar to the preceding accord, the new pact provides for:

- The import from the Soviet Union of approximately 90 items, such as wood, mineral fuels, cotton, and ores of several kinds.
- The export to the Soviet Union of roughly 70 items, including iron and steel products, industrial plants, machinery, and chemicals.
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- The use of convertible currencies in bilateral transactions.
- Regular consultations between officials of the two governments.
- Procedures for the settlement of commercial disputes.

Although the new agreement was widely heralded in the Japanese press as the beginning of a relaxation of the sanctions and an improvement in economic relations with the Soviets, the accord itself did not negate Tokyo's sanctions. Japan continued to:
- Restrict trade credit to the Soviet Union.
- Prohibit the export of high technology items included in the COCOM list.
- Restrict high-level intergovernmental personnel contacts.

For the present, Tokyo seems to be doing no more than is necessary to keep intact the pre-Afghanistan framework for bilateral trade. Nothing has been done to embellish the framework by, for example, negotiating a tax treaty.

On the other hand, Moscow, appears eager to reach agreement on some issues to establish the pretense of normal relations. The Soviets were especially accommodating during recent negotiations with the Japanese to settle airline routes and fishing quotas. Beyond undermining the existing set of economic sanctions, the Kremlin may also be trying to engender Japanese resistance to the sanctions that have been proposed if the Soviets invade Poland.

Export Credits
In complying with the sanctions, the Export-Import Bank has suspended almost all new credits, including suppliers' credits for regular merchandise trade. Japanese businessmen, who are agitated by news of West European competitors signing plant-export contracts with the Soviets and want to supply materials for the proposed Yamburg pipeline project, have been clamoring for a relaxation of the curbs.
In September 1980, the Japanese Government assuaged the complaints of the private sector without destroying the basic sanctions framework by granting additional credits for two ongoing resource development ventures. Approval was given for the extension of buyers' credits to the Soviet Union to support a $40 million supplement to the South Yakutsk coking coal project and the third phase of the Siberian timber project. Tokyo has also been contemplating approval in principle for suppliers' credits of less than $100 million. This limit was chosen because of a US proposal to review projects of $100 million or more in COCOM. At present, official supplier credits have been authorized for only two small projects—a $5.6 million high-pressure kiln for lacquer manufacturing and a $7.3 million sulfur-concentration project. Final agreement was delayed until December when the Soviets agreed to an interest rate consistent with OECD guidelines on export credits.

Officials contend the South Yakutsk and forestry projects are continuations of existing projects and therefore special cases. They contend that the additional credit for the South Yakutsk mining project is necessary to ensure commencement of coal deliveries to Japan in 1983. Without the infusion of new money, the USSR might be able to renge on its obligation to repay earlier loans with coal from the project. The Japanese argue that they, rather than the Soviets, would be the losers in that case. The Japanese have been eager to move forward with the forestry project because a substantial percentage of total lumber imports comes from the Soviet Union.

Tokyo justifies the approval of suppliers' credit of less than $100 million with the argument that it cannot sit idly by while the West European countries continue to trade with the Soviets on a business-as-usual basis. Japanese businessmen and diplomats have cited Creusot-Loire's takeover of the Novolipetsk steel plant project and the signing of a contract to build the Sayansk aluminum project by Klockner of West Germany as examples of opportunities lost because West European governments have been less stringent in their application of sanctions. The Japanese have a strong case; the Europeans have approved official credits or credit guarantees and adopted a liberal view of COCOM restrictions that otherwise might have blocked the projects.

One determinant of Tokyo's future decisions on export credits will be its perception of trends in West European trade with the Soviets. The Japanese tend to interpret every trip to a major West European country by high Soviet trade officials as the culmination of important trade negotiations. The outcome of talks on the Yamburg project could have a decisive influence on Japanese policy. If the West Germans reach an agreement, Japanese big business will intensify its lobbying for an easing of Tokyo's credit restraints.

A second influence on Japanese export credit policy is the stance of the United States. Abolition of the grain embargo opens the door to renewed private-sector lobbying for removal of Japanese sanctions against the Soviets. Moscow is encouraging Japanese businessmen by initiating or reviving commercial negotiations for a variety of plant export proposals. Some officials within the Ministry of International Trade and Industry (MITI) singled out the announcement of US approval for export license applications related to the Sakhalin oil and gas project soon after the lifting of the grain embargo as an indication that the United States is further relaxing its sanctions.

Tokyo's first move will probably be a relaxation of the curb on high-level personnel exchanges, followed by the granting of a few carefully selected export credits on a case-by-case basis. The Japanese Government is likely to take a firmer line on restrictions on the sale of COCOM items.

**Resource Development Projects**

Resource development projects in the USSR no longer appear as advantageous to the Japanese as they did from 1968 through 1977. Japan has been reluctant to move further ahead in Siberia for both economic and political reasons. Siberia's severe climate, great distances, and perennial labor shortages are serious obstacles to profitable development. Moreover, the Soviets have proved to be difficult business partners. They have sometimes overlapped their hand, apparently convinced that the Japanese were so hungry for Siberian resources that they would ultimately accept Soviet terms. Japanese entrepreneurs, however, are used to operating in a global economic arena and evaluate Siberian resource development projects as one of several alternatives. During the late 1970s, Japanese
businessmen began to conclude that it would be more prudent and profitable to pursue diversification elsewhere. Nevertheless, they have kept the door open by continuing to discuss new projects with the USSR.

The judgments of Japanese businessmen on a project’s economic viability are shaped in part by perceptions of the salability of its output at home. In the late 1960s and early 1970s high Japanese growth rates and steadily expanding demand for raw materials eliminated any doubts about the availability of markets five or 10 years in the future. Since the oil crisis of 1973/74, however, demand for the commodities imported from the Soviet Union has become much more erratic. A shift in the Japanese economy from raw-material-intensive heavy industries to technology-intensive industries is diminishing the need for new sources of many raw materials. Lower growth rates and sectoral shifts have narrowed the number of fields in which Japanese investors can feel certain of an adequate return on investment. Oil, gas, coal, and pulpwod projects still hold promise, but proposals for the development of nonferrous metals, iron ore, and asbestos lack appeal.

A number of other concerns contribute to pessimism even in the case of the most promising commodities:

- Shortfalls and delays in the deliveries of some commodities have raised questions about the reliability of the Soviet Union as a supplier; the USSR’s inability to fulfill coal export contracts is the most recent example.
The economic limitations of the Soviet Union stand in the way of several proposals. An acute shortage of labor in the Far East may contribute to Soviet reluctance to move ahead with pulp and paper plants, from which the Japanese hope to obtain long-term supplies. Lack of capital is another concern. As bilateral relations have worsened, Soviet inconsistency, secretiveness, and bargaining tactics have delayed, and in some cases even prevented, Japanese acceptance of project proposals.

Given the long-term nature of these economic constraints, the immediate prospects for joint resource development are mixed. In spite of difficulties in early 1981, timber projects should progress. Most of the USSR's timber exports are logs, which require relatively little labor to cut. Moscow's willingness to export logs makes it an attractive supplier to Japanese processors who are faced with increased opposition to log exports in Canada, the United States, and Indonesia. The prospects for pulpwood and coal exports are poorer because the Soviets are unlikely to give them sufficient priority. The Japanese should eventually receive gas from Sakhalin, but probably later than scheduled in the original plan. Other projects are likely to remain in limbo for some time.

The Political Perspective

The economic sanctions imposed by Tokyo after the Soviet invasion of Afghanistan made the connection between economics and politics more explicit than at any time since the restoration of diplomatic relations in 1956. The sanctions are only one manifestation of broader alterations in Japan's foreign policy. The recent buildup of Soviet strength in the Far East and the diversion of some US forces to the Indian Ocean have put more pressure on Japan to accept greater military and political responsibilities in northeast Asia. These increased responsibilities reduce Tokyo's freedom to circumvent the political and military ramifications of economic cooperation with the Soviet Union.

The Kremlin's reaction to the signing of the Sino-Japanese Peace and Friendship Treaty and the movement of a Soviet garrison into the Northern Territories have put additional strain on Tokyo. The Japanese suspect the Soviet troop buildup in the Northern Territories was an attempt to deter them from improving relations with Beijing. If so, the attempt has backfired.

The potential Soviet threat to Japan's security has assumed an immediacy it never had before. The presence of troops on the disputed territory has also underlined the USSR's contention that the islands are an integral part of the Soviet Union. No longer willing to ignore Moscow's refusal to even acknowledge the existence of a territorial dispute, Tokyo has linked basic improvements in relations to a Soviet admission that a territorial problem exists, as well as to Soviet withdrawal from Afghanistan.

Although many Japanese now accept a greater degree of linkage between their economic and political relations with the Soviet Union, they are still unprepared to subjugate Soviet-Japanese trade and economic interests to political issues arising elsewhere in the world. In the case of overt Soviet military intervention in countries outside the Soviet Bloc, Tokyo will respond as it did after Afghanistan.

Poland is a special case. Because it is a satellite country, Soviet intervention there might not arouse Japanese politicians were it not for the likely reactions of Japan's allies. Afghanistan and the relative decline in US power during recent years have heightened Tokyo's awareness of the need for Western unity in the face of aggression.

Moscow could soften Tokyo's policies by withdrawing troops from Afghanistan, offering political concessions on the Northern Territories, or presenting attractive new trade opportunities. The Kremlin, however, has shown no indication that it feels compelled to break the present stalemate in relations with Japan. Recent Soviet diplomatic initiatives fail to address the crucial
territorial issue and therefore have no chance of success. A Japanese foreign policy more independent of Washington and the reversal of Tokyo's rapprochement with Beijing are major policy goals of the Kremlin, but no coherent strategy exists to achieve them.