



# Russia's economic prospects in the Asia Pacific Region



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## ABSTRACT

Russia has declared a priority interest in developing a strong economic relationship with the Asia Pacific Region. There has been considerable internal debate over the best strategic approach to such a relationship. While a policy victory has been won by a strategy focusing on the export into the region of manufactured goods and services, a resource-export strategy is still dominant in practice and funding. Here the prospects of each strategy are assessed. Regarding resource exports, hydrocarbons, copper and iron ore prospects are reviewed, but most detail is provided on the coal sector. That involves an account of infrastructure issues, including a major debate over the expansion of the BAM and TransSiberian railways. The analysis suggests that Russia will struggle both to revitalise the Russian Far East through manufacturing exports to the APR and to replace revenues earned through resource exports to the West through an economic 'turn to the East'.

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## 1. Introduction

In recent years Russia has – not for the first time – declared a top-priority interest in developing its economic relationship with the Asia Pacific Region (APR). That can be explained by various events: Putin's questioning of Russia's partnership with the West in Munich in 2007, the severe effect on Russia's economy of the Western-originated global financial crisis in 2008, signs around the same time of political and social discontent in the Russian Far East (RFE) in the context of poor socio-economic indicators for the region, the impending depletion of natural resources oriented to Western markets and the opening of new areas of exploitation further east, and the general atmosphere that Asia is the rising powerhouse of the global economy (Lo, 2014). All these drivers have been given added force by recent events in Ukraine.

The new priority has produced a fierce policy debate (Fortescue, 2015), behind which is a tension between two reasons for economic engagement with the APR. First, there is a desire to increase national export earnings through expanding exports to Asian markets. Second, there is a desire to improve the prosperity of the RFE by providing new employment opportunities and improving local infrastructure, to reverse population decline. At the risk of some simplification, the first reason is likely to produce a policy oriented towards the export of natural resources, including many not sourced within the RFE; the second a manufacturing-oriented approach, based in the RFE and providing more employment than is likely from resource exploitation. The two goals are not mutually exclusive, but there has been clear tension between them.

This can be seen in a sudden change in strategy in 2013. Until then the policy process had produced an RFE development programme heavily oriented towards resource exports and the infrastructure needed to serve them (Gosudarstvennaia programma Rossiiskoi Federatsii 'Sotsial'no-ekonomicheskoe razvitie Dal'nego Vostoka i Baikal'skogo regiona', No.466-r, 29 March 2013, [archive.government.ru/gov/results/23721/](http://archive.government.ru/gov/results/23721/)). It met with

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strong opposition, and in August 2013 the founding Minister of Far Eastern Development (MFED), Viktor Ishaev, was dismissed from his ministerial position and his post as presidential representative in the Far Eastern region. He was replaced in the latter position by Yurii Trutnev, who was also appointed a deputy prime minister, and as minister by Aleksandr Galushka. Within a month Galushka presented a new strategy based on the export into the APR of manufactured goods and services (including agricultural products), produced in a new form of special economic zone known as a 'territory of accelerated development' (to be called here, after its Russian name, TOR) ([government.ru/news/7718/](http://government.ru/news/7718/)). That was not the end of the resource-export strategy. The struggle for state funding of resource projects, particularly for infrastructure, continued.

Here the commercial prospects of the two strategies are examined, with two success indicators being used. The first is commercial viability – will the projects earn a return on investment; the second – will each strategy meet the goals set by policy makers, in the case of the TOR strategy bringing increased prosperity to the RFE and in the case of the resource strategy maintaining national prosperity as supply and demand decline in the West. Given the complexity of the issues involved, data availability, and space constraints, the conclusions will be indicative rather than precise.

## 2. TOR strategy

The TOR strategy, as originally formulated, is to increase the prosperity of the RFE through the creation of new jobs and economic activity in special zones in which firms from the APR invest to produce non-resource goods for export to APR markets. This is in the context of manufacturing and equipment making up 3 per cent of total exports from the RFE and Baikal region in 2010, worth \$574.7 million (77 per cent were resource exports) (Popova, 2012, p. 8).<sup>1</sup>

Investors would be attracted to the zones through attractive investment and operating conditions: tax concessions, ease of gaining approvals, good electricity connections, convenient and competitively priced logistics and transport, and so on ([vedomosti.ru/politics/characters/2015/05/19/mi-ishodim-iz-prezumpstii-nevinovnosti](http://vedomosti.ru/politics/characters/2015/05/19/mi-ishodim-iz-prezumpstii-nevinovnosti)). There was much stress on a 'one stop shop' approach run by MFED agencies, requiring the transfer to the new ministry of major administrative functions previously carried out by other agencies.

Early accounts were vague on what types of activity and markets were being considered. In February 2014, when asked by a clearly sceptical reporter the intended export destinations of RFE-manufactured goods and services, Trutnev replied 'We are thinking about it' ([kommersant.ru/doc/2410187](http://kommersant.ru/doc/2410187)). He might have been playing his cards close to his chest, but the response was not reassuring. Much was made of Memorandums of Understanding signed with investors from Japan, China and New Zealand ([government.ru/](http://government.ru/)

[news/14040](http://news/14040)) and the interest of Mitsubishi, Mitsui, Daewoo, LG and Samsung ([kommersant.ru/doc/2498003](http://kommersant.ru/doc/2498003)).

We now have details on three TOR projects that have been established by government decree and another five approved by the relevant government commission. Another seven have gone through the initial approval process but are not yet publicly identified. Those approved look very different from what was initially suggested. The three established by decree are:

'Khabarovsk' ([government.ru/dep\\_news/18636/](http://government.ru/dep_news/18636/)). Residents include a manufacturer of roofing and insulation materials, a local food distributor and supermarket operator, and a Singaporean bitumen producer ([government.ru/news/16902/](http://government.ru/news/16902/); [kommersant.ru/doc/2723624](http://kommersant.ru/doc/2723624); [vedomosti.ru/politics/characters/2015/05/19/mi-ishodim-iz-prezumpstii-nevinovnosti](http://vedomosti.ru/politics/characters/2015/05/19/mi-ishodim-iz-prezumpstii-nevinovnosti)). The federal budget is to provide R1.26 billion for infrastructure.

'Nadezhdinskii' (Nadezhdinskii district, Vladivostok) ([government.ru/dep\\_news/18635/](http://government.ru/dep_news/18635/)). Residents include a bakery, a timber products firm, also identified as running logistics centres, and the food distributor and supermarket operator also involved in 'Khabarovsk' ([deita.ru/news/economy/03.04.2015/4870980-tor-nadezhdinskii-807-gektar-chistogo-polya-i-nikakikh-obyazatelstv/](http://deita.ru/news/economy/03.04.2015/4870980-tor-nadezhdinskii-807-gektar-chistogo-polya-i-nikakikh-obyazatelstv/)). The federal budget is to provide R1.99 billion.

'Komsomol'sk' (Komsomol'sk-na-Amur) ([government.ru/dep\\_news/18637/](http://government.ru/dep_news/18637/)). Based in the aircraft plant in the city, the focus is metal fabrication, composite materials, and precision instruments for aircraft construction, and in one source timber products ([kommersant.ru/doc/2723624](http://kommersant.ru/doc/2723624); [government.ru/news/17541/](http://government.ru/news/17541/)). Residents include an energy conglomerate with industry parks around Russia, a Moscow-based private investment company, and possibly the aircraft manufacturer Sukhoi. The federal budget is to provide R902 million.

Those approved at commission level are:

'Beringovskii' (Chukotka Autonomous Region). The core resident is the small Australian mining company, Tigers Realm Coal. The project is to export coking coal from the Bering coal basin. Planned output is 10 million tonnes per year (Mtpy), 5–6 Mtpy after enrichment. The deposits are situated close to an existing mine and 39 km from an operating deepwater port at Beringovskii. The port's current capacity is 0.25 Mtpy, and there are plans to expand it to 1 Mtpy. It is not clear how the remaining output is to be shipped ([kommersant.ru/doc/2718943](http://kommersant.ru/doc/2718943); [gazeta.ru/business/news/2014/06/10/n\\_6220925.shtml](http://gazeta.ru/business/news/2014/06/10/n_6220925.shtml)). The project receives no funding through the TOR programme, but has received \$16.3 million from the Russian Direct Investment Fund, for an 11 per cent equity share ([theaustralian.com.au/business/mining-energy/tigers-realm-coal-grabs-russian-project-by-the-tail-with-625m-raising/story-e6frg9df-1226861674038](http://theaustralian.com.au/business/mining-energy/tigers-realm-coal-grabs-russian-project-by-the-tail-with-625m-raising/story-e6frg9df-1226861674038)).

'Belogorsk' (Amur region). Soya processing and animal feed ([vostokmedia.com/n235691.html](http://vostokmedia.com/n235691.html); [amur.info/news/2015/05/13/93933](http://amur.info/news/2015/05/13/93933)).

'Mikhailovskaia' (Primore region). Pig farming ([primorsky.ru/news/common/86699/](http://primorsky.ru/news/common/86699/)).

<sup>1</sup> Financial figures are usually presented in the currency used in the original source. Particularly since the end of 2014 the exchange rate has been highly volatile. As a rough guide for the period covered by this article, \$US1 bought R32.00 on 1 January 2012, R30.54 2013, R32.86 2014 and R59.02 2015.

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