

Go east, young man. (Opportunities in the Soviet Far East)

By Vladimir Kvint

26 November 1990

Forbes Magazine

AMERICA WAS DISCOVERED because Columbus and his backers were looking for new business opportunities. With similar motives, American businessmen are now pouring into Moscow. But Moscow is not the only place where the Russian egg is. For the real opportunities, Americans must look east of Moscow—and east of the Lena River—to the Soviet Far East. There, they and other Westerners can make attractive investments with the fewest dangers, in terms of political risk.

Russia's Far East is developing as a new Klondike. Under the radical economic reforms of Boris Yeltsin (*FORBES*, Sept. 3), 11 free economic zones have been opened since the Russian parliament approved them on July 14. Five of them are in the Soviet Far East.

In a free economic zone, Westerners are granted tax holidays for five years. They can own a company, rent land, even use dollars and take on Soviet entrepreneurs as partners. Free zones are free not only for the foreigners but also for the Soviets, who can now own brokerage firms, factories, newspapers. Stalin was not able to liquidate the entrepreneurial drive. This fact can be readily confirmed by anyone with some knowledge of the miracles of entrepreneurship: Soviet women pull off every day simply to feed their families.

Speaking of potential partners, new Russian legislation is exploring the possibility of restoring, mainly to former Russian citizens, some of the property that was taken from their families during the October (1917) revolution. An example is the family of Yul Brynner, the late actor, whose father was one of the founders of non-ferrous metallurgy in the Far East and who owned big plants there in the pre-Lenin days. The Brynners may now claim the property back. The state is unlikely to give it back, but, as a compromise, the state may at least lease the enterprises to three families indefinitely. This possibility is specifically provided for in the Russian Republic's new Law on Property, enacted on Aug. 1, 1990.

When they think of investing in Russia, many American businessmen have a common concern: what to do with their rubles. The free economic zones solve the ruble problem. There you can use your rubles to buy

construction materials, pay wages, rent land and so on. You produce for rubles, and export for hard currency, which can now be paid into your account outside the country. If you want to be paid inside a free economic zone, the new law allows you to hold hard currency accounts, and to take your hard currency out of the country at any time.

It is unbelievable the bargains business people can get for their money in Russia. If a realistic ruble/dollar exchange rate of 3 rubles to 1 dollar is used, Russian labor costs are 5% or less what they are in America. And they may get cheaper. North Korea owes the U.S.S.R. about \$7 billion. To repay the debt, North Korea may send to the Far East free economic zones thousands of workers. They are even cheaper than the Soviet workers.

I think by the year 2000 foreign companies will invest in these regions not less than \$10 billion. Russia plans to invest 3.7 billion rubles (\$1.2 billion at realistic exchange rates) there over ten years, 1.5 billion rubles before 1995. These sums will be used to develop communications, roads and other infrastructure.

The Soviet Far East is most attractive to foreign business because of its unique combination of natural resources and an advantageous geographical position. The Far East provides the shortest route from Europe to Asia, via the Arctic Seaway. It costs less than half as much to deliver cargo from Antwerp to Japan using the Arctic Seaway than it does using the Suez Canal. Rail? One ton of cargo delivered from Munich to Japan costs about \$215 using the European and Trans-Siberian Railway, and just \$110 by ship along the Arctic Seaway.

In 1984 the Canadians used the Arctic Seaway to ship cargo from Vancouver to Lithuania. The trip took seven days less than it usually takes through the Panama Canal.

In 1985 the trip was repeated, this time in winter. Navigation in the Arctic Ocean throughout the year has become the key to the real exploitation of the Arctic. The U.S.S.R. has the world's largest fleet of icebreakers. There

Go east, young man. (Opportunities in the Soviet Far East)

By Vladimir Kvint

are about 25 of them, including 3 nuclear vessels. There is a need for more icebreakers of different classes, as well as for specialized transport ships.

While the opportunities in the Soviet Far East are almost unknown to Americans, the Japanese have been quietly pumping investments into the region for the last few years. They are aware of the area's treasures: The Soviet Union provides 40% of Japan's imports of precious and rare metals, and 70% of the Soviet Far East exports go to Japan.

One hundred and fifty Japanese companies have already established direct ties with Soviet Far East enterprises to conduct barter exchange without hard currency, and they are completely ready to enter the free economic zones.

The Americans are timidly testing the waters. Alaska is in almost direct physical contact with the northern region of the Soviet Far East, Chukotsky. Among the few concrete business results of the last colorless summit between Bush and Gorbachev was the opening of several new airports for flights between the U.S. and the Far East. As part of the negotiations, some Soviet airplanes can now bring 30 tons of cargo per flight to Alaska. There are no regularly scheduled flights from the West into the new airports, but there soon will be.

One of the new airports is in the major city called "Sunny" Magadan, on the shore of the Okhotskyoe Sea.

The city's name is ironic. In Russian, the word "zone" is indelibly associated with prison camps, especially those of Stalin's time. Magadan was the capital of the prison zone, better known as the terrible "Gulag." That is why the Soviets painfully call it "Sunny" Magadan. With a population of 570,000, Sunny Magadan may become the capital of a zone of a much more preferable kind, a free economic zone.

One immediate opportunity for earning hard currency lies with the region's huge but under utilized ship repair facilities. The ship construction market is not very active, but repairs are always necessary. The facilities already exist in the modern port cities of Vladivostok, Vostochnyy, Slavyanka, Soviet Gavan and Nakhodka, which handle the bulk of trade between the U.S.S.R. and its Pacific partners.

This can bring immediate hard currency revenues. It is possible to lease port space for 50 years. Japan's Mitsubishi Corp. has already proposed to lease space and equipment, and pay hard currency.

Proximity to the Pacific Ocean also means fish and tremendous biological resources. The Far East accounts for 40% of the Soviet Union's fish harvest. By our estimates, \$1 invested in fish farming—there are more than 20 such fish factories in the Far East—brings about \$12 of profit.

Or consider logging. Thirty percent of Soviet forests are in the Far East; the territory accounts for 40% of Soviet lumber exports to such markets as Japan, Australia and South Korea. The lumber industry of the Far East cries for Western capital and know-how. The waste is sickening. Forty percent of Soviet timber remains in the forest, rotting on the forest floor. Workers fell timber and raft it down the rivers. Ten percent of the timber they put into the water is lost during this trip. A Norwegian company has been catching this lost timber and selling it for hard currency, illegally, for years.

In the Soviet lumber mills, 55% of the raw logs processed are scrap. This scrap is uselessly burned. As a whole, only 15% or so of the cut trees are really used in the timber industry of the Soviet Far East. The other 85% are wasted.

Confronted with evidence of such waste, many Westerners believe that Russians, like Brazilians, would rather decimate their forests today and worry about nature tomorrow. This is not true. A huge national preserve, Terney, has been set aside in the Far East; larger than some of the smaller European countries, it is recognized by the United Nations as a symbol of purity. Hunting, fishing, even drinking from the river is prohibited there. When I got permission to enter this territory, I had to bring my own water to drink. Precautions are such that to enter this heavily guarded land, I received special plastic shoes and a disinfected coat.

My point is that responsible environmentalism is a force inside the Soviet Union today, and Western companies that can reduce waste while still making money will find a warm welcome.

Go east, young man. (Opportunities in the Soviet Far East)

By Vladimir Kvint

Most Soviet gold and precious stones are mined in the Far East, in the basins of the Kolyma, Indigirka and upper Amur rivers. While I was studying the mines of the Far East, I held in my hands heavy pieces of greenish gold and pale unpolished diamonds. This wealth contrasted terribly with the poor living and working conditions there. Gold is mined using the most archaic methods.

More than 90% of Soviet diamonds the U.S.S.R. is the world's fifth-largest diamond producer—are mined in the Far East, in Yakutia. Diamond mining is a good area for joint ventures. By my calculations, if \$2 billion is invested in modern mining technologies, diamond production will increase by about 20% to 25%.

I have written before about prospects for Western investment in Soviet oil and natural gas exploration and production (FORBES, Sept. 17). I should add that in the Soviet Far East significant gas and oil fields are being discovered between the Lena and Vilyuy rivers. Offshore Kamchatka, on the Pacific, is also very rich in oil, as is the eastern coast of the Okhotskoye.

The coal mining industry, too, has a big future. The Far East, which equals more than 60% of the territory of the U.S., has 30% of Soviet coal. Its proven coal stocks are estimated at almost 13 billion tons. Soviet geologists believe probable recoverable reserves are at least 15 times the official proven figure. Half these immense stocks can be mined by the open pit method, the cheapest and most efficient way.

Another important task of the Far East is building its own iron and steel industry. Vast deposits of iron ore have been discovered there, quite enough to develop an integrated steel works with an annual capacity of up to 10 million tons for almost 90 years.

Shikotan Island, one of the closest islands to Japan, now belongs to the Soviet Union, but sooner or later it will become a free economic zone for joint investments with

Japan. I expect a big tourism industry to develop in the south of the Soviet Far East. The waters are wonderful—clear and pure. The shore of one of the south Kuril islands is called “The Emperor’s Beach,” because Japanese emperors used to come to the waters for bathing. Today, on the shores of this island facing Japan is a Soviet military unit; even the Soviets have to obtain special permission to go there. But as the area’s economy develops, economic interest will make Soviet leaders move the military out and open the island to tourists.

No one comes away with the impression that the Far East is a virgin land. It already has powerful, if not very efficient, industry. There is significant infrastructure, especially railroads. The industrial products of the Far East territory are exported to 50 countries, including 15 along the states of the Pacific Rim. The area’s main partner is Japan. Although, the Far East territory accounts for 50% of all Soviet trade with the Pacific Rim countries. As trade among Asia’s rapidly growing countries increases, the Soviet Far East’s economy will become more and more active.

In the Far East there is only one person per square kilometer. Will there be a lack of labor resources? No. The overmanned factories of western Russia will soon have to slash their payrolls if the economy is to be made competitive, or simply productive. Large-scale unemployment is on the threshold. For jobs and for freedom, the best Russians will move east.

In the U.S.S.R.’s territory there are 11 time zones: The Far East is 11 hours ahead of Moscow. Economically, too, the Far East, not only Moscow, is Russia’s future.

Vladimir Kvint, a Siberian economist who helped formulate the Soviet Union’s new free economic zone laws, traveled extensively throughout the Soviet Far East between 1973 and 1982, and in 1988. He is currently a business consultant and a distinguished lecturer of economics at New York’s Fordham University.