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## UPDATE

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## Recent Development in the Russian Far East-Baikal Region and Its Implication

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### Background

Soon after the start of the third term of the Russian president Vladimir Putin in May 2012, the Ministry for the Development of Russian Far East was established as the first ever federal ministry dedicated to the development of a specific region. In addition, a national program called the ‘Socio-Economic Development of the Far East and Baikal Region’ was adopted in March 2013 which was revised in April 2014. All of this is an indication of Russia’s unprecedented interest in developing the Far East and the Baikal region.

Adjacent to the Korean peninsula, Russian Far East and the Baikal region stood up as a priority target for Korean cooperation activities in Eurasia. These regions constitute a geographical link in trilateral Northern cooperation (South Korea - North Korea - Russia) and Eurasian cooperation under the Korean government’s national agenda, ‘The Northeast Asia Peace and Cooperation Initiative.’ And experts in Korea have already pointed out that the Russian government’s development plan for the Far East and the Baikal region is a key factor that must be considered in securing future growth engines of the Korean economy.

In a similar context, on October 18, 2013, President Park Geun-hye proposed the 'Eurasia Initiative' with the vision of transforming the region into 'One Continent,' a 'Creative Continent,' and a 'Peaceful Continent' at the international conference on 'Global Cooperation in the Era of Eurasia' hosted by the Korea Institute for International Economic Policy (KIEP). This was followed by an announcement from the Korean government of the 'Eurasia Initiative Roadmap' on December 10, 2014.

This paper systematically analyzes the third-term Putin administration's development policy for the Far East and the Baikal region, and presents detailed policy responses while taking into account its geopolitical and geoeconomic significance for the region.

## Salient Features of the Far East and Baikal Region

The security situation in the Russian Far East and the Baikal region remains fragile due to their close proximity to Northeast Asia which exhibits some strategic instability. In addition,

these regions represent links that connect Russia to Northeast Asia geopolitically. From a geoeconomic perspective, the Far East and Baikal region are viewed as underdeveloped areas located close to the rapidly growing Northeast Asia and the Asia-Pacific area, while being resource-abundant regions.

Thus, the development of the Far East and the Baikal region has several geopolitical and geoeconomic significance. First, from the Russian perspective, it can strengthen the role of Russia as a Eurasian superpower and become a new growth engine for the sustainable economic future of Russia. Second, from Korea's standpoint, the region is important in that it can enhance opportunities for geopolitical cooperation with Russia and become a new foundation for growth outside Korea.

Given this, it can be said that bilateral cooperation linked to the development of the Far East and Baikal region will mutually benefit both Korea and Russia; while simultaneously presenting policymakers with the pressing task of preparing policy responses that reflect a precise understanding of the Putin administration's development policies targeting this region.

**Table 1. Typical features of the Far East and the Baikal region and the geopolitical and geoeconomic significance of regional development**

|   | Geopolitical   | Geoeconomic   |
|---|--|---|
| Features of the Far East and the Baikal region            | <ul style="list-style-type: none"> <li>- Fragile due to proximity to Northeast Asia, a strategically unstable region</li> <li>- Constitutes a link that brings Russia into the geopolitical context of Northeast Asia</li> </ul> | <ul style="list-style-type: none"> <li>- Underdeveloped area close to the dynamically developing Northeast Asia and Asia-Pacific region</li> <li>- Hub of the transportation and logistics network across the Eurasian continent, which is rich with natural resources</li> </ul> |
| Significance of regional development: Russian perspective | <ul style="list-style-type: none"> <li>- Strengthen status as Eurasian superpower</li> </ul>   | <ul style="list-style-type: none"> <li>- Secure new growth engine for Russia's sustainable growth</li> </ul>  |
| Significance of regional development: Korean perspective  | <ul style="list-style-type: none"> <li>- Increase opportunities for geopolitical cooperation with Russia</li> </ul>  | <ul style="list-style-type: none"> <li>- Offers possibilities for new growth base outside of the territory</li> </ul>   |

Source: Compiled by author.

## Putin Administration's Development Policies in the Far East and Baikal Region

Russia's development policy for the Far East and the Baikal region can be divided into two aspects: the 'plan (program)' and 'institutional mechanisms.' First, the plan (program) is essentially based on the 'Strategy for the Socio-Economic Development of the Far East and Baikal Region until 2025,' which was approved in 2009, and is developing along the lines of the program, "Socio-Economic Development of the Far East and Baikal Region," that was approved in March 2013 and revised in April 2014. In this regard, three sub-programs that include two existing federal target programs are underway.<sup>1</sup>

Second, 'institutional mechanisms' is identified with implementation of preferential laws and creation of institutions. The details are as follows: 1) the establishment of the Ministry for Development of the Russian Far East and the expansion of its authority, changes in federal governance including the Plenipotentiary Representative of the President of the Russian Federation in the Far Eastern Federal District assuming a dual role as the Deputy Chairman of the Government of the Russian Federation, 2) in addition to the already-existing 'OJSC Far East and Baikal Region Development Fund,' formation of 'Dalny Vostok,' 'Agency for Investment Attraction and Export Support in the Russian Far East,' and 'Agency for Human Resource Development,' to promote

expansion in the Far East related institutions, and 3) the enactment of tax incentives, the designation of fourteen zones of advanced socioeconomic development, the extension of the time period for Special Economic Zone in Magadan Oblast, and the formation of Vladivostok 'Industry-production' Special Economic Zone.

Such development policies for the Far East and the Baikal region can be viewed as a paradigm shift from conventional policy for the following reasons. To begin with, the program itself is based on the concept of "advanced development" rather than "catch-up development;" is centered on projects that are consistent with market rationales, and seeks to cultivate industries that are export-oriented towards the Asia-Pacific region, as well as forging economic relationships with nations in this region.

Second, from an institutional perspective, federal governance underwent innovation with the aim of reinforcing the performance of the development plans, and new laws and institutions were adopted to enhance investment attractiveness. Third, on the fiscal side, realistic and appropriate plans were put in place to secure a federal budget. Fourth, in a show of political will, President Putin publicly underlined in numerous announcements that the region's development would be backed by stronger cooperation with Asia-Pacific countries. Lastly, the most significant change was that institutional mechanisms for Far East and Baikal development will be guaranteed under federal law instead of being mere decrees from the federal government as in the past. The countless Far East and Baikal region development programs formerly approved by federal government decree were not accompanied by specific, detailed mechanisms and were unable to guarantee legal stability; this meant that most programs remained simply paper-

<sup>1</sup> 1. Sub-program: Implementation of national initiative "Socio-Economic Development of the Far East and Baikal Region until 2025" and other balanced national development measures, 2. Federal target program "Socio-Economic Development of the Far East and Baikal Region until 2018," 3. Federal target program for the Kuril Islands (Sakhalin Region), 2007-2015

work that did not lead to real action. The third-term Putin administration, however, has prepared the institutional mechanisms necessary to implement the plan (program), and most notably will guarantee policy measures on tax incentives, advanced development zones and PPP through federal law.

**Table 2. The third-term Putin administration's development policies for the Far East and the Baikal region: the Plan and institutional mechanisms**

|                          |   |   |
|--------------------------|---|---|
| Plan (Program)           | <ul style="list-style-type: none"> <li>- Strategy for the Socio-Economic Development of the Far East and Baikal Region until 2025 (approved in 2009)</li> <li>- National program, 'Socio-Economic Development of the Far East and Baikal Region' (approved in 2013 and completely revised in 2014) and sub-program, 'implementation of national program 'Socio-Economic Development of the Far East and Baikal Region until 2025' and other balanced national development measures' (approved in 2014)</li> <li>- Federal target program, 'Socio-Economic Development of the Far East and Baikal Region until 2018' (approved in 2013)</li> <li>- Federal target program, 'Socio-Economic Development of the Kuril Islands (Sakhalin Region) for 2007-2015' (approved in 2006)</li> </ul> |   |
| Institutional mechanisms | Changes in federal governance   | <ul style="list-style-type: none"> <li>- Ministry for Development of Russian Far East (established in 2012, authority extended in 2013)</li> <li>- Plenipotentiary Representative of the President of the Russian Federation in the Far Eastern Federal District assumes dual role as the Deputy Chairman of the Government of the Russian Federation (2013)</li> </ul>   |
|                          | Establishment of bodies related to development in the Far East  | <ul style="list-style-type: none"> <li>- OJSC Dalny Vostok (to be established): create and operate advanced development zones</li> <li>- Investment Attraction &amp; Export Support Agency (to be established): Promote investment and international economic cooperation</li> <li>- Human Resource Development Agency (to be established): Educate and attract emigrants</li> <li>- OJSC Far East and Baikal Region Development Fund (established in 2011): Participate in project investment</li> </ul> |
|                          | Adoption of preferential laws and institutions  | <ul style="list-style-type: none"> <li>- Enactment of tax incentives (in effect since 2014)</li> <li>- Designation of 14 advanced socioeconomic development zones</li> <li>- Magadan Special Economic Zone (extended from 2014 to 2025))</li> <li>- Vladivostok 'Industry-production' Special Economic Zone (plan confirmed in 2014)</li> </ul>   |

Source: Compiled by author.

## Key Areas of Cooperation and Support Measures

A review and assessment of the recent development in Russia's cooperation with Korea as well as with other countries regarding the Far

East and Baikal regions development resulted in the following areas of cooperation and corresponding measures of support. The first area of cooperation discussed was the production of semi-finished goods or parts within the advanced socioeconomic development zones.

Not only has Russia given tax benefits to the Far East and the Baikal region (including the Republic of Tyva) by lowering the corporate tax, but the government also intends to designate fourteen advanced socioeconomic development zones in the Far East that would enjoy a broad range of additional benefits. Division of labor across the wider region is therefore advisable, as the production of semi-finished goods and parts could make full use of such tax benefits, and these products could then be exported to Korea or another third country and turned into finished goods. This is also exactly in line with Russia's development policies for the Far East and Baikal region, as the Putin administration aims to attract manufacturing companies into the advanced socioeconomic development zones by creating investment-friendly conditions to achieve the twin goals of nurturing industries export-oriented toward the Asia-Pacific region and incorporating the economy of the Russian Far East in the Asia-Pacific value chain. The question here would be whether the Russian government's tax benefits would be enough to offset the relatively high labor wages in the Far East, and whether it will be possible to secure the logistics infrastructure necessary for exporting semi-finished goods or parts. Thus, it is advisable that companies seeking to venture into the Far East identify products suitable for such production methods and find a location for production facilities appropriate for this purpose.

Next, there is the issue of entry into the oil and gas processing sector and construction of plants. In the Far East and Baikal region, foreign investment is still the most active in the mining industry, while as a resource-rich area the most promising industry traditionally has been energy resources, especially oil and gas production and processing. To harness the region's full potential, the Russian government is building infrastructure that can efficiently export energy to the Asia-Pacific region, as

seen in the massive construction of oil and gas pipelines. On the other hand, the Russian government has also decided that exporting resources in crude form does not benefit regional development, which is why it is underlining the importance of fostering an industry for the 'deep processing' of energy resources in order to increase added value. Also, as clearly displayed in the Vladivostok LNG plant construction project, an ambitious initiative launched by Russia, oil and gas processing plants form the core foundation for expanding energy exports to the Asia-Pacific region. Since Korea is already globally competitive in oil and gas processing technology and plant construction, it can be said that the country is fully equipped with the capacity to get involved in the modernization of Soviet-period oil and gas plants in the Far East and Baikal region, and in new plant construction projects. Seeing that the lack of oil processing plants in the Far East and the ensuing high gasoline prices have pushed the Russian government to consider reimporting from Asian countries, it can be construed that cooperation in this sector has extremely high potential.

The third area for cooperation involves large-scale infrastructure construction projects. To date, the driver of Russia's economic growth has been the production and export of oil and gas, and large-scale infrastructure construction. This is why many local experts have found the cause of the recent slowdown in Russia's economic growth in the completion of the Vladivostok APEC Summit, the Kazan Universiade and the Sochi Olympic Winter Games. These experts argue that Russia can only achieve sustainable growth by actively pursuing yet another large-scale infrastructure construction project that would undoubtedly create jobs. The "Socio-Economic Development of the Far East and Baikal Region," the national program revised in April 2014 is, in essence, a transport and energy infrastructure construction project



for the region. However, there are voices of concern that these projects may be cast aside as the federal budget is being focused on infrastructure development in Crimea after its annexation by the Russian Federation in March 2014. So while the region is in need of some sizable foreign investment, sanctions against Russia render investment from western countries a distant hope. This is why Russian infrastructure construction businesses are seeking to cooperate with Korean companies. Korean companies are highly competitive in port infrastructure modernization both in terms of technology and experience, which means Korean-Russian cooperation is likely to lead to success. Although it will not be easy for Korean businesses to wedge into the market since Russian companies are very capable, technology-wise, of modernizing railways such as TSR and BAM and renovating and repairing roads, it is advisable to look into the potential of selling relevant technology and components, and exporting heavy construction equipment.

Fourth and finally, a key area of cooperation is trilateral economic cooperation projects between the two Koreas and Russia. ‘South-North-Russia trilateral economic cooperation’ projects involving the connection of the TSR and TKR, the construction of gas pipelines linking the three countries, and connecting the power system network represent the key link between the third-term Putin administration’s ‘Look East’ policy - which aims to develop the Far East and the Baikal region via cooperation with Asia-Pacific nations - and the Park Geun-hye administration’s “Eurasia Initiative,” which seeks to reinforce Korea’s link to Eurasian countries. The political and economic significance that this project holds is immense, since it overcomes the ‘physical obstacle’ represented by North Korea and dramatically transforms the transportation and logistics flow on the Korean Peninsula and across Eurasia. Recently, Russia has been in-

tensifying cooperation with North Korea by ratifying an agreement on settling North Korea’s debt to Russia, allowing ruble transactions for trade payments, and delivering on the Najin-Hasan project. This is encouraging news in that it lays the foundation for trilateral economic cooperation projects. The commercial success of the Najin-Hasan project in particular will heighten possibilities for the TSR-TKR connection project, and contribute greatly towards having it included in discussions on the international level. This calls for a swift conclusion of the share acquisition issue involving the Korean consortium, and a multi-modal transport project that combines marine transportation from Busan or another East Sea port to Najin, with land transportation through TSR. Up until now, the biggest obstacle in delivering a trilateral economic cooperation project was political risk, in other words, a lack of trust. Therefore, one example of success will help expedite other projects such as the South-North-Russia gas pipeline, power system network, and agricultural cooperation, among others.

The following are proposed as measures that can support cooperation in these various sectors: establishing a regular prime ministers’ meeting between the two countries and founding a counterpart agency for the Ministry for Development of the Russian Far East; formulating measures that support participation in PPPs and advanced socioeconomic development zones; increasing access to funding by utilizing investment and financing platforms, foreign finance and private financing; stimulating innovations in information delivery by taking into account the needs of information recipients; seeking multilateral cooperation; and pursuing a joint Korea-China-Russia research project that looks into the potential of linking Russia’s ‘Look East’ policy, China’s “New Silk Road Vision” and Korea’s ‘Eurasia Initiative.’ 