

# VALDAI DISCUSSION CLUB REPORT



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## THE RUSSIAN-JAPANESE RAPPROCHEMENT: OPPORTUNITIES AND LIMITATIONS

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*The views and opinions expressed in this Report are those of the authors and do not represent the views of the Valdai Discussion Club, unless explicitly stated otherwise.*

# Contents

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1. Russian and Japanese Strategic Objectives in East Asia .....	3
2. Improving Russian-Japanese Relations.....	3
3. Factors Influencing Russian-Japanese Rapprochement .....	7
1) The Window of Opportunities Resulting from the Confluence of the Domestic, Bilateral, and International Agendas.....	7
2) Japan's Desire to Prevent Russian-Chinese Rapprochement Based on Anti-Japanese Grounds.....	8
3) Common Interest in Cooperating on Security Issues on the Korean Peninsula.....	8
4) Both Countries' Interest in Economic Cooperation, Primarily in the Russian Far East.....	9
5) Russia's Desire to Diversify Relations with Regional Partners in East Asia as Part of its Pivot to the East .....	11
4. Limitations of Russian-Japanese Rapprochement .....	12
1) Without a Strong institutional and Societal Foundation, the Desire of Leaders Alone is not Enough.....	12
2) External Inhibiting Factors: the U.S.-Japan Alliance and China's Strategic Partnership with Russia .....	14
3) Russia's Challenging Business Environment and Difficulties in Implementing Full-Scale Economic Cooperation.....	14
4) Japan's Linking of Economic Cooperation with the Territorial Dispute Resolution is Unacceptable for Russia.....	17
5) The Difficulty of Formulating a Legal Framework for Joint Economic Activities on the Southern Kuril Islands.....	19
6) Russian-Japanese Disagreements on Security Issues, over the U.S. Positioning Elements of its Missile Defense System in the Region, and North Korea's Missile and Nuclear Programme.....	19
5. Recommendations .....	20
1) Create a Solid Economic Foundation for Russian-Japanese Relations.....	20
2) Improve the Business Climate and Create Institutionalized Mechanisms to Support Japanese Projects.....	21
3) Develop a Strategic Dialogue on Issues of Politics and Security.....	22
4) Develop a Social Dialogue and Cultural Cooperation .....	23
6. Prospects for Russian-Japanese Rapprochement .....	23

## 1. Russian and Japanese Strategic Objectives in East Asia

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Russian-Japanese relations are not lacking for drama. The two countries gravitate to each other in the economic sphere, but are at odds over territorial issues. Neither country wants to take a back seat to the U.S. or China, yet neither wants to break off their alliance or partnership with them either. Both strive for independence in regional affairs, yet favor different approaches to security and other key issues – including the North Korean nuclear missile programme and the U.S. missile defense system. The leaders of both states have taken steps towards rapprochement, but the two societies generally distrust each other and neither side can accept the other's position concerning the Kuril Islands. At the same time, their mutually complementary economic interests naturally draw them together and both countries consider it abnormal that they have yet to sign a formal peace treaty. The edifice of Russian-Japanese relations can only be erected through sustained and painstaking effort. Is there sufficient time for the two countries to accomplish it?

Ideally, Moscow would like to see Russia's position in East Asia and the Asia-Pacific region as the exact opposite of what it experiences in Europe, where conflicts, geopolitical frontiers, sanctions, and echoes of the Cold War create a weighty burden. Russia is striving

to integrate into the dynamically developing region and to develop its Far Eastern territory in cooperation with its Asian neighbors. Moscow would like to establish a strong partnership with Tokyo aimed at developing the Russian Far East and at helping Japan become a more independent regional player with friendly relations towards Russia.

The ideal arrangement for Tokyo would be for Russia to abandon its support for China and exhibit greater independence in regional issues, while Japan would get the disputed southern Kuril Islands and access to Russian resources. Japan's long-term plan is to transform Russia into one of its closest friends, to the point of forming a U.S.-Japan-Russia triangle in which Japan would mediate disagreements between the other two.

In all likelihood, neither of these desired futures is fully attainable, especially if a conflict arises that touches on the interests of both countries. Russia would have difficulty remaining neutral if China were to come under pressure or North Korea were attacked. For its part, Japan would not be able to pursue rapprochement with Russia if Moscow abandoned its neutrality in response to heavy pressure on China, or if Russia took retaliatory action in the event of a military escalation on the Korean peninsula.

## 2. Improving Russian-Japanese Relations

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For the first time in many years, there is a chance that Russian-Japanese relations will see a qualitative improvement. Signs that relations might normalize first appeared in 2013. In March 2012, Russian President Vladimir Putin proposed resolving the territorial dispute based on a concept used in judo called

'hikiwake' (meaning, 'a draw'). This implies a compromise without clear winners or losers. During a visit to Russia by Japanese Prime Minister Shinzo Abe in April 2013, the two leaders agreed to renew talks on signing a peace treaty and begin a dialogue in the "2+2" format to include meetings of their foreign and defense

## THE KURIL ISLANDS DISPUTE: HISTORICAL OVERVIEW

*The first half of the 17th century: Japanese expeditions come into contact with the Ainu\**

Maarten de Vries, Dutch explorer, produced the first map of the Kuril Islands

The first Russian expedition to the Kuril Islands led by Ivan Kozyrevsky

Martin Spangberg, Russian explorer, mapped all the Islands and found a sea route to Japan

*The second half of the 18th century: the Ainu come under Russian rule; all the Islands marked as a Russian territory on maps*

*The late 18th century: Japan set up military outposts on the islands of Iturup and Kunashir*

1643

1711

1739

\*The indigenous people of the Kuril Islands

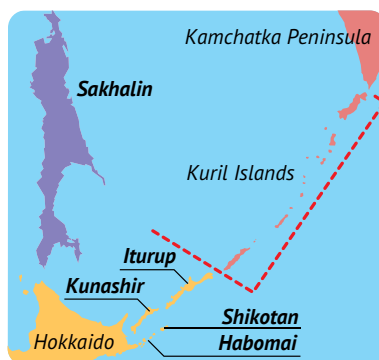
Nicolai Rezanov, Russian ambassador, failed to open Japan to trade with Russia. The growing rivalry between the countries. Nicolai Hvostov and Gavril Davydov attack Japanese trading posts without state authorization. Japan takes retaliatory actions

1804–1805

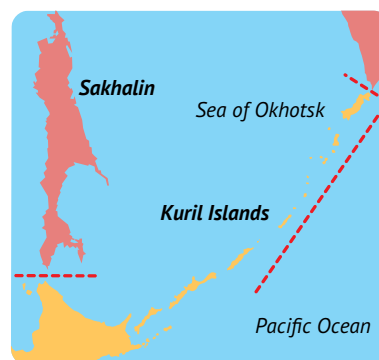
1855

Possession: ■ Russia ■ Japan ■ Condominium

1875



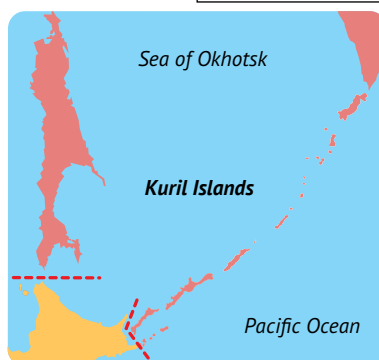
**The Treaty of Shimoda**  
The establishment of diplomatic relations between the countries. Several Japanese ports to be opened to trade. Vries Strait becomes the boundary thus Iturup, Kunashir, Shikotan, and Habomai Islands belong to Japan. The status of Sakhalin left undefined (de-facto condominium). The boundary coincides with Japanese territorial claims (so-called 'Northern Territories')



**The Treaty of Saint Petersburg**  
The period of Russian development of Sakhalin. Japan renounces claims on Sakhalin in exchange for the Kuril Islands owned by Russia

1945

1905



**World War II**  
In accordance with the Allies' decisions reached at Yalta conference, the USSR takes control over Sakhalin and all the Kuril Islands. Japan accepts the Potsdam Declaration that limits the Japanese sovereignty to the islands of Honshu, Hokkaido, Kyushu, Shikoku, and minor islands which to be determined

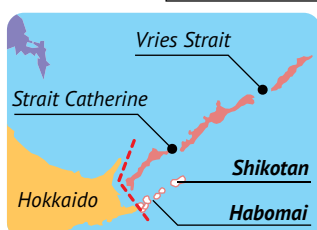


**The Treaty of Portsmouth**  
Russia cedes the southern part of Sakhalin to Japan after the Russo – Japanese War (1904 – 1905)

1951

1956

**The Treaty of San Francisco**  
Japan gives up all the claims on the Kuril Islands (territories not specified), but the Treaty (not signed by the USSR) does not recognise the Soviet Union's sovereignty over the Islands



**Soviet – Japanese Joint Declaration of 1956**

The end of the 'state of war' and the restoration of diplomatic relations between the countries. The parties agreed to continue negotiations for a peace treaty. The USSR 'taking into consideration the interest of the Japanese State' agrees to transfer to Japan the Habomai Islands and Shikotan after the conclusion of a peace treaty. However, the USA claimed that they refuse to return Okinawa to Japan in this case. Japan demanded all the southern islands. As the result, the peace treaty was not signed

## STRATEGIC AND ECONOMIC IMPORTANCE OF THE SOUTHERN KURIL ISLANDS

## Economic potential



The unique rhenium deposit (a metal used in high-performance rocket engines)



Fishery and fish processing (the major industry for the islands)



Gold and silver deposits



Polymetal ore



Geothermal power



Recreational resources



Airports

## Armed forces

18th Machinegun Artillery Division (military personnel – 3,500)



Divisional Headquarters



Air Defence Systems



Border Troops

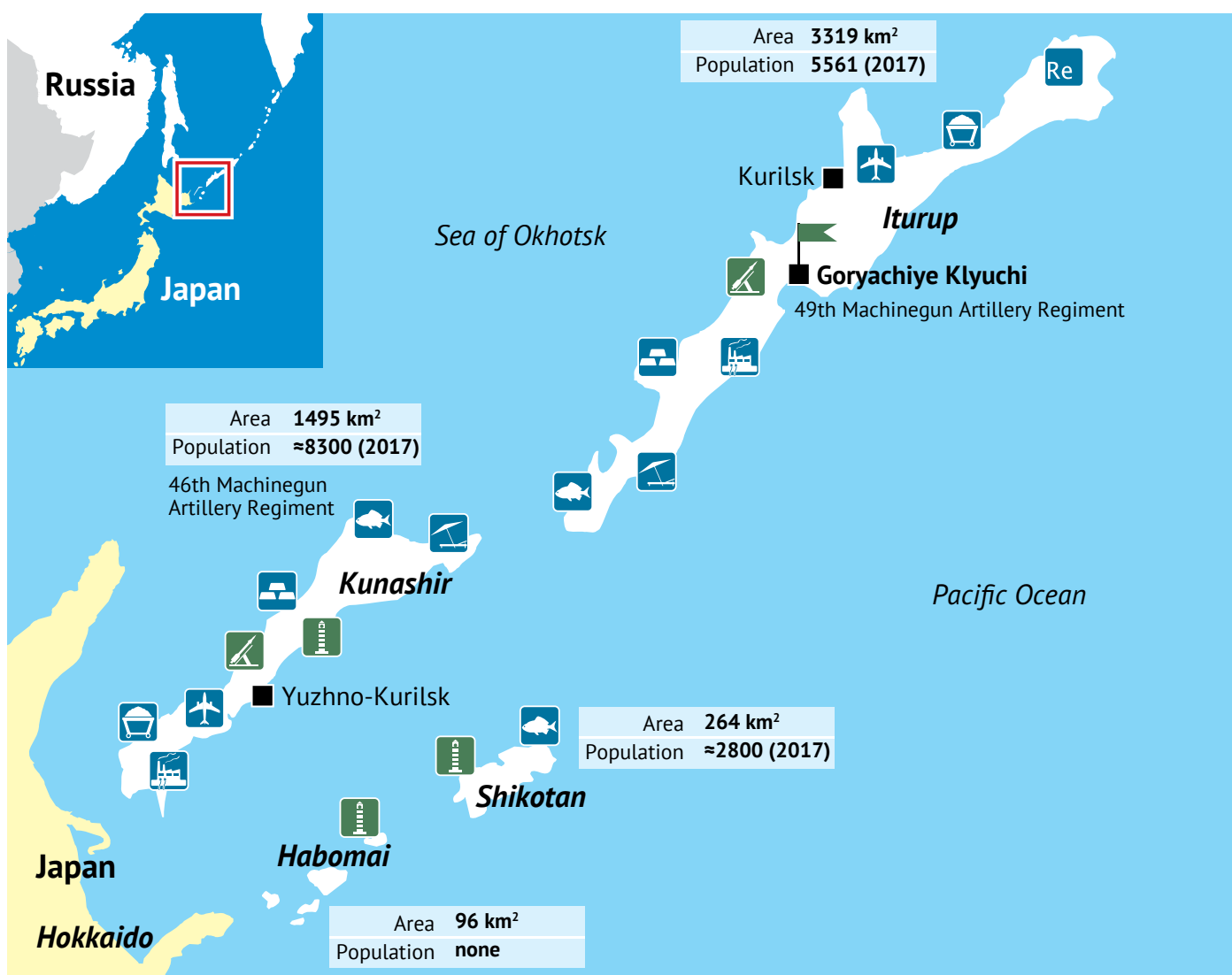
## Strategic Importance of the region



Control over passages to the Sea of Okhotsk



Access to marine resources



Source: RIA Novosti, Institute for Complex Strategic Studies, Sakhalinstat, open sources.



ministers, and to establish regular contacts between their Defense Departments. In response to a query from Japan, Russia signaled that it was open to discussing the territorial issue and was committed to the wording of the Soviet-Japanese Joint Declaration of 1956. According to that document, the Soviet Union, as a goodwill gesture, agreed to “transfer” the Habomai Islands group and Shikotan Island to Japan after the two countries concluded a peace treaty. The Ukrainian crisis and Japan’s support of Western sanctions caused a brief interruption to those nascent efforts to resolve the peace treaty issue.

During their meeting in Sochi in May 2016, Japanese Prime Minister Abe offered to President Putin a ‘new approach’ to the territorial issue that would be unhindered by past ideas. Abe moderated Japan’s position from demanding “all four islands in a batch” to a more flexible solution. This could imply that Japan is once more looking into a ‘two plus alpha’ formula that entailed, in addition to the return of Shikotan Island and the Habomai Island group – territories that Japan argues the Soviet Union had already promised to return – continued negotiations on the status of two other islands, Iturup and Kunashir. Abe also outlined an 8-point plan for Japanese-Russian economic cooperation that includes the development of urban infrastructure, the creation of “smart cities,” healthcare, development of small- and medium-sized business, energy, industry, advanced technology and innovation, joint development of the Far East, as well as an increase in humanitarian exchanges. During his September 2016 visit to the Eastern Economic Forum in Vladivostok, Abe invited President Putin to work together to develop the Far East, advance cooperation along the eight-point agenda, and to attend the Eastern Economic Forum every year. The Prime Minister even created a post unique for the Japanese government – Minister for Economic Cooperation with Russia – and appointed Minister

of Economy, Trade, and Industry Hiroshige Seko to the position, tasking him with stimulating Japanese businesses to develop specific projects with Russia. During his visit to Japan in December 2016, Vladimir Putin brought an agreement to begin consultation on joint economic activities on the disputed Kuril Islands without prejudice to either side’s position on the peace treaty, and granting Japanese former residents of the islands freedom to visit the graves of their ancestors on the Southern Kurils. Prime Minister Abe made a working visit to Moscow in April 2017 that focused on the systematic implementation of previously reached agreements. The Foreign Ministries of the two countries began consulting on the issue and, for the first time, a delegation of Japanese businessmen and officials visited the Southern Kurils in June 2017 to identify specific projects and prospects for joint economic activities. The parties approved a Joint Action Plan and a major list of 80 high priority bilateral economic projects.

Russia and Japan have different expectations regarding the signing of a peace treaty. Shinzo Abe insists that the issue be resolved during his term in office. And, since it seems his political prospects do not extend beyond 2021, that means Tokyo is allowing 4-5 years for the process of rapprochement. Russia recommends taking a longer-term approach. President Putin offered the experience of settling territorial disputes with China along the Amur River as a working example. That process lasted approximately 10 years. The Russian President emphasized the need to create an atmosphere of trust and cooperation between the countries, and to normalize their political dialogue as a prerequisite to resolving territorial issues. This goal should be underpinned by reaching agreement on joint economic activities on the southern Kuril Islands, developing economic cooperation between the countries, and normalizing the political dialogue.

### 3. Factors Influencing Russian-Japanese Rapprochement

#### *1) The Window of Opportunities Resulting from the Confluence of the Domestic, Bilateral, and International Agendas*

The current international situation opens up an important window of opportunity for Russian-Japanese relations. In the coming years, both countries will have leaders who are interested in developing that dialogue. Prime Minister Abe would like to finalize the outcome of World War II and go down in history as the politician who resolved a key territorial dispute. The fact that Prime Minister Shinzo Abe's father Shintaro Abe had served as Japanese Foreign Minister and advocated improving relations with the Soviet Union and the laying of a groundwork for their normalization also plays a role. President Putin would like to resolve all key border disputes with neighboring countries. The West's extension of economic sanctions against Russia gives Moscow even more reason to search for economic partners in Asia. The continuing revamping of the administration of U.S. President Donald Trump reduces Washington's attention towards its allies and provides them with a brief opportunity to exercise greater independence in international affairs. If this state of affairs remains unchanged, it means that, during the tenure of Donald Trump – unlike that of the previous administration – Japan will not face U.S. opposition for improving its relations with Russia. There is a reason to believe that such an approach corresponds with the strategy of the Japanese prime minister who, while continuing to rely on the U.S.-Japanese alliance, also seeks to preserve and strengthen Japan's role as one of the key leaders and power centers in the region. The desire to reinforce Japan's role as a leading power in East Asia can also be seen in Abe's effort to gradually remove post-war national security restrictions – in particular, by reinterpreting the Constitution

with regard to the right to collective self-defense and permitting Japan's Self-Defense Forces to act with greater force on a broader scale. Improving relations with Russia is apparently one of the logical expressions of this strategy because it would strengthen Japan's position in the balance of powers in East Asia and make Japanese foreign policy more autonomous. Thus, there is a favorable confluence of domestic political factors, the bilateral agenda, and conditions in the international arena.

Moscow considers the absence of a peace treaty with Japan an anachronism and the development of economic ties with Tokyo a natural priority. And, although Russia is sincere in its commitment to the phrasing contained in the Soviet-Japanese Joint Declaration of 1956 concerning the transfer of the two islands, it imposes a number of conditions on the realization of this scenario. Russia makes it clear that it will not compromise under pressure, but agrees to make certain concessions as part of a larger process of improving bilateral relations. Moscow's first condition is to create an atmosphere of trust that would prevent the politicization of the islands issue. However, a major expansion in economic cooperation would have to serve as the foundation of such a process. Russia thinks highly of the Japanese proposal designating eight areas of economic cooperation and focusing largely on investment by Japanese companies in the Russian Far East. Moscow has also noted that, by announcing a programme of economic cooperation with Russia, Tokyo is effectively withdrawing its support for sanctions and risks becoming the object of criticism by its G7 partners.

The possibility of carrying out joint economic activities on the southern Kuril Islands offers the greatest promise as it would shift that issue into the context of cooperation and create a qualitatively different atmosphere for bilateral contacts.



## *2) Japan's Desire to Prevent Russian-Chinese Rapprochement Based on Anti-Japanese Grounds*

For Japan, the issue of improving relations with Russia goes beyond the territorial dispute over the Kuril Islands. Tokyo is concerned about China's increasingly assertive attitude in regional affairs and the escalating territorial dispute over the Senkaku / Diaoyu Islands – a situation that Japan increasingly views as a key security threat. In parallel with its negotiations with Moscow, the Japanese leadership is attempting to form a network of regional cooperation as a counterbalance to Beijing. In particular, Japan is forming significantly stronger ties with India, Australia, the ASEAN countries, and other Asia-Pacific region countries. Japan is uneasy over the political and security-related cooperation between Russia and China that has deepened over the past three years. In particular, Tokyo is concerned about Russia being noticeably critical of U.S. actions in the region, its deployment of a regional missile defense system as part of a global system and naming the system of U.S. alliances as the one that seeks to achieve military superiority while ensuring its security at the expense of other states' security. Overall, Japan would like to see Russia act at least as a neutral observer in the Japanese-U.S. conflict with China and hopes to prevent the 'nightmare' scenario of a Russian-Chinese rapprochement based on anti-Japanese grounds. Japan does not see Russia as a major potential military threat, but it is concerned about Russia modernizing its military forces on the Kuril Islands and Russian-Chinese rapprochement on security matters leading to joint maneuvers in the region, such as in the Sea of Japan or in Japan's exclusive economic zone, particularly but not exceptionally emergence of Russian and Chinese warships in the vicinity of the Senkaku / Diaoyu Islands.

In this context and in view of Japan's geopolitical goals, its rapprochement with Russia is both logical and justified, and would enable Japan to improve security on its northern flank and free it to focus efforts in other areas, particularly the southwest.

## *3) Common Interest in Cooperating on Security Issues on the Korean Peninsula*

Japan is very interested in cooperating with Russia to stabilize the situation on the Korean peninsula and values the working contacts Russia holds with North Korea that enable Moscow to maintain a political dialogue with Pyongyang. Tokyo is deeply concerned about North Korea's independent nuclear missile programme and considers it a key threat to Japan's security. North Korea might manage to develop new delivery systems capable of overcoming elements of the U.S. missile defense system and quickly reaching Japanese territory. Here, Moscow and Beijing could act as intermediaries in establishing a dialogue with this dangerous neighbor. Shinzo Abe has repeatedly spoken of the importance of Russia's role in dealing with North Korea. Russia's position calls for the denuclearization of the Korean peninsula as an ultimate goal and a 'double freeze' in the near future of North Korea's nuclear missile programme in tandem with the suspension of large-scale military maneuvers by the U.S. and South Korea. Russia advocates a peaceful resolution to the issue of North Korea's nuclear missile programme through the resumption of six-party talks that have a place for all interested parties, including Russia and Japan. New opportunities in this regard have arisen with the coming to power of liberal South Korean President Moon Jae-in, who favors a restoration of dialogue with Pyongyang and expanded cooperation with Russia.

#### 4) Both Countries' Interest in Economic Cooperation, Primarily in the Russian Far East

Japan is also interested in Russia as an economic partner and as a source of resources. Russia is not currently one of Japan's key economic partners and Tokyo recognizes that Russian-Japanese economic cooperation holds

potential that remains untapped. Japanese businesspeople with long years of experience in this country remain interested in the Russian market, and a significant number of them plan to expand their businesses. The purposeful policy that Abe's cabinet pursues has resulted in a noticeable increase in new economic contacts with Russia. For its part, Russia is interested in Japanese investments, technologies, and

#### JAPANESE PUBLIC OPINION ABOUT FOREIGN COUNTRIES, 2016

Russia 

China 

United States 

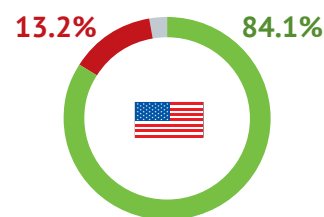
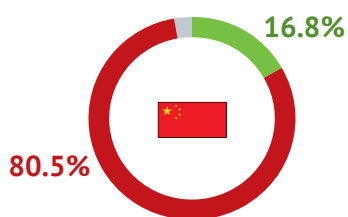
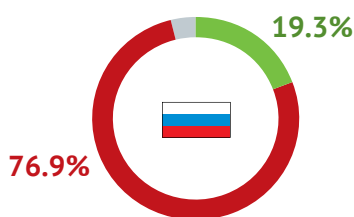
Japanese opinion about:



Feel affinity



Do not feel affinity



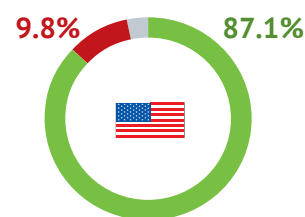
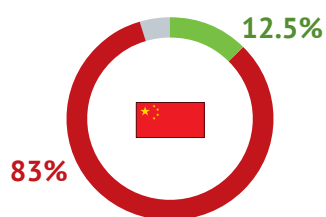
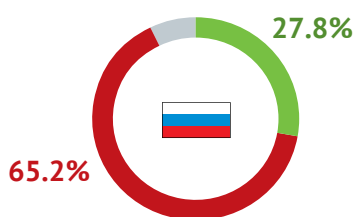
Current relations are:



Good



Not Good



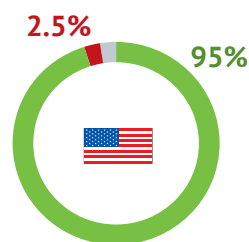
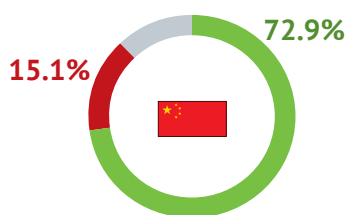
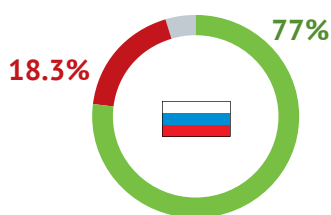
The future development of relations is:



Important



Not important



Source: Public Relations Office, Cabinet Office, the Government of Japan. November 2016.

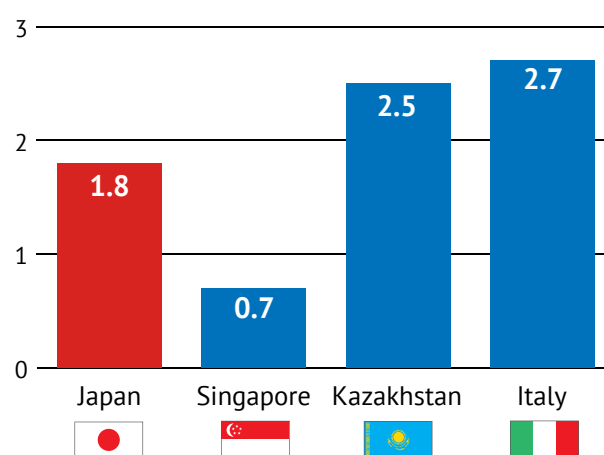
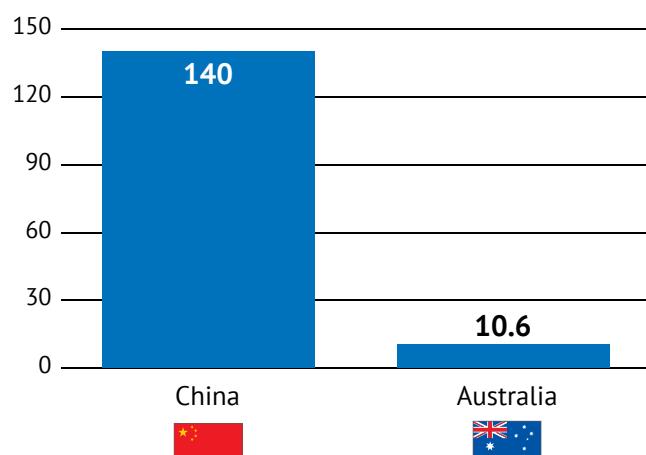
innovations, Japanese participation in energy projects, the creation of joint ventures with high added value, and especially in Japan's participation in the development of the Russian Far East.

Russia has declared the development of its Far Eastern territory as a key priority for the 21<sup>st</sup> century. The government has created a number of mechanisms to achieve this goal: the Ministry for the Development of the Russian Far East, 18 advanced special economic zones (ASEZs), and special free port regime for Vladivostok and four other Far Eastern ports. All ASEZs enjoy a special legal regime of doing business with large-scale tax and administrative preferences, while a free port regime entails special customs, tax and administrative regulation. Russia views Japan as one of the key foreign partners in the further realization of these projects. Japan put forward "Partnership for Quality Infrastructure" in Asia in 2015, and allocated \$110 billion in financing. Japan positions its initiative as cost-effective, not overly expensive, safe, meeting high ecological and

social standards, and contributing to economic development through the subsequent transfer of technology and the development of human potential. At the G7 summit in May 2016, Prime Minister Abe announced "Expanded Partnership for Quality Infrastructure" with the global expansion of this initiative and the allocation of funding totaling \$200 billion over five years. Russia is one of the countries to be included in the expanded form of this initiative – that also interprets infrastructure more broadly to include energy and resources. Furthermore, despite its growing level of activity, China cannot singlehandedly assist Russia in the near future to achieve the degree of technological modernization it is seeking for the Far East. Thus, Japan and Russia share a clear convergent interest in economic cooperation. The prospect of Japanese investment in the context of Russia's modernization and the development of the Far East, as well as plans to expand overall economic cooperation between the two countries strikes Moscow as attractive and as clearly answering Russia's interests.

## FOREIGN DIRECT INVESTMENTS (FDI) IN ASEZs

Investments (₽ bn)\*



\*according to the applications

Source: Far East Development Corporation.

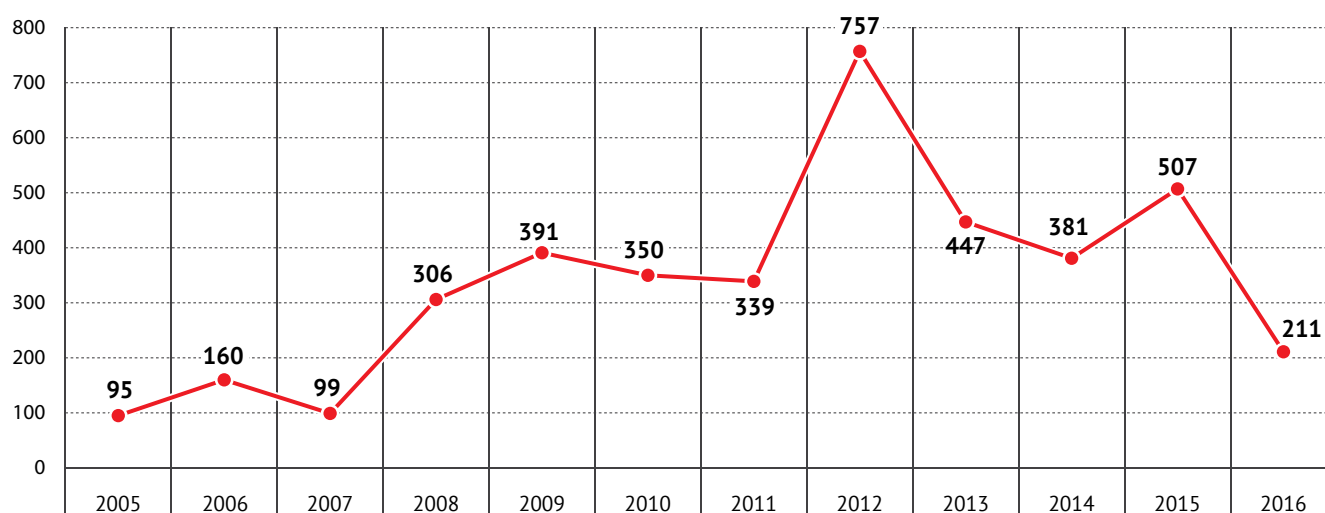
### 5) Russia's Desire to Diversify Relations with Regional Partners in East Asia as Part of its Pivot to the East

Russia, in turn, seeks to preserve the independence of its foreign policy and strengthen its presence in the Asia-Pacific region as an independent player, even while maintaining a close relationship with China based on mutual trust. Russia does not want to take sides in the territorial dispute in the South China Sea. It advocates a resolution to the conflict based on international law and the UN Convention on the Law of the Sea, but opposes U.S. efforts to pressure China and the internationalization of the dispute. Russia also takes a neutral position on the territorial dispute in the East China Sea. If its pivot to the East to succeed, it is important that Moscow improve relations with Japan, one of the leading powers in East Asia. Both Russia and Japan can strengthen their regional standing by cooperating on key security, political, and economic issues in the region, and by coordinating more actively in such regional

organizations as the East Asia Summit, APEC, and ASEAN Regional Forum. Russia also deems it important that Japan should pursue its own national interests and independent policy in East Asia and global affairs without regard to the position of its military and political ally, the United States.

In addition to economic cooperation, trust-based partnerships require improved relations on political issues and security. The example of a number of East Asian countries that cooperate closely economically and are highly interdependent, but that have nonetheless seen a serious deterioration in their political relations and worsening security conflicts shows that international political cooperation and the coordination of national interests is just as important. Russian-Japanese relations were already moving in a positive direction in 2013, and are now resuming this trend. Russia is seeking to raise those relations to a strategic level and to protect the results already achieved from the influence of purely political factors.

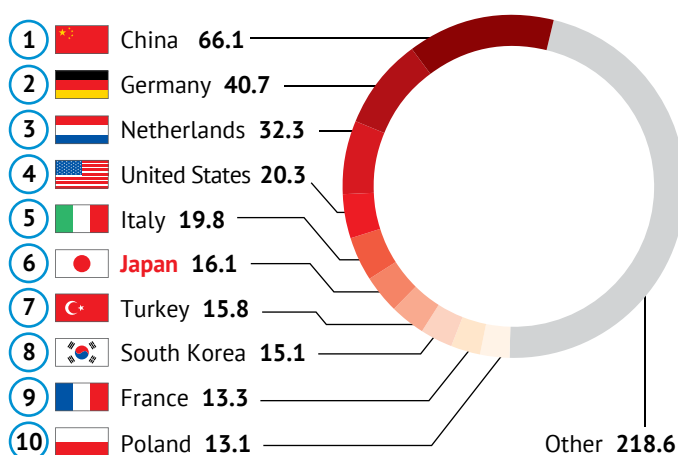
JAPANESE FDI IN RUSSIA, 2005 – 2016 (\$ MLN)



Source: JETRO.

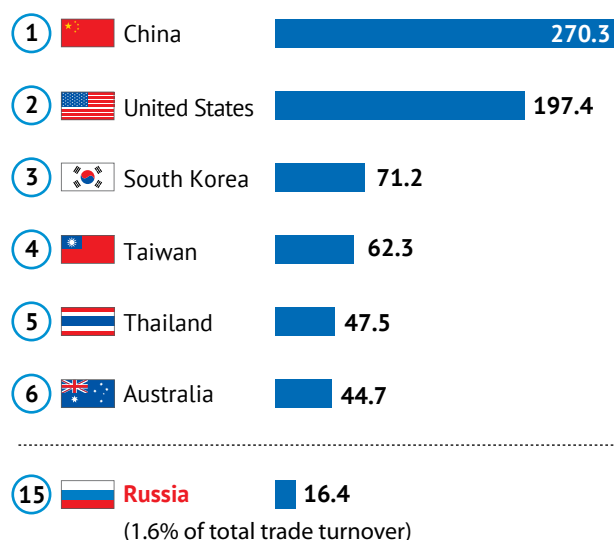
## FOREIGN TRADE PARTNERS, 2016 (\$ BN)

## Russia



Source: Federal Customs Service of the Russian Federation, Japan External Trade Organization.

## Japan



## 4. Limitations of Russian-Japanese Rapprochement

### 1) Without a Strong institutional and Societal Foundation, the Desire of Leaders Alone is not Enough

Several factors might complicate this emerging trend. Japan's programme for improved relations with Russia is the brainchild of Prime Minister Abe, who has developed a trust-based relationship with President Putin. Abe devotes a great deal of attention to foreign policy and has visited more than 90 countries in the last four years. If Prime Minister Abe's political position weakens or he leaves office, it could threaten the positive momentum he has created with Russia. The Japanese elite focus mainly on the U.S., and many of those elite in the Liberal Democratic Party and Foreign Ministry – that they head – do not share

the Prime Minister's views. A similar situation exists among Moscow's ruling elite, few of whom see Tokyo as a political heavyweight, even while President Putin is willing to undertake efforts to improve bilateral relations. The fact that responsibility for improving relations is so concentrated on the two leaders themselves brings with it serious risks and inconveniences. Without broad support from the political elite or public opinion, the Japanese Prime Minister pays a high political price for his political course with Russia, with the result that he might one day weaken his support for it.

Russian and Japanese public opinion could also prove inhibiting factors. Both societies would inevitably view a compromise concerning the Kuril Islands through the prism



of the memory of World War II and its outcome. As a successor to the Soviet Union that was a victorious state in the WWII, Russia considers the Kuril issue settled and objects to historical revisionism. If Moscow were to transfer two of the four islands in accordance with the Declaration of 1956, Russians could perceive it as a betrayal of national interests. According to opinion polls conducted in August 2016, a majority of Russians (78%) would not agree to any territorial concessions with Japan. The Japanese public also opposes all half-hearted compromises on the Kuril Islands issue and would view them as a sign of weakness in their leaders. Although more than half of Japanese favor some form of compromise, any Japanese Prime Minister who settles for just two islands would be committing political suicide. In fact, the idea of the ‘northern territories’ – as the islands are known in Japan – has become an important national symbol: stereotypes

regarding the ‘northern territories’ have long been politicized, played a role in the domestic political struggle, and fueled nationalists. As a result, a perception of Soviet aggression has taken hold in Japanese society, along with a demand for the return of ancestral territories. Japanese public opinion is generally negative toward Russia. Only adding to that impression, the Russian president has repeatedly said that the 1956 Declaration contained no provisions specifying on which terms the “transfer” of the islands would take place, the nature of this “transfer,” and under whose sovereignty the islands would be placed. The Japanese media constantly aggravates the problem by promoting a negative image of Russia and creating inflated expectations about resolving the territorial dispute on Japanese terms. This only leads to disappointment and makes it impossible to create a positive image of progress in relations between the two countries.

## RUSSIAN PUBLIC OPINION ON THE KURIL ISLANDS DISPUTE

### How should this problem be solved?

*As of May, 2016*

None of the islands should be given away **56%**

Two of four islands can be returned: Habomai and Shikotan (all the better that they won't give Japan access to the Sea of Okhotsk) **9%**

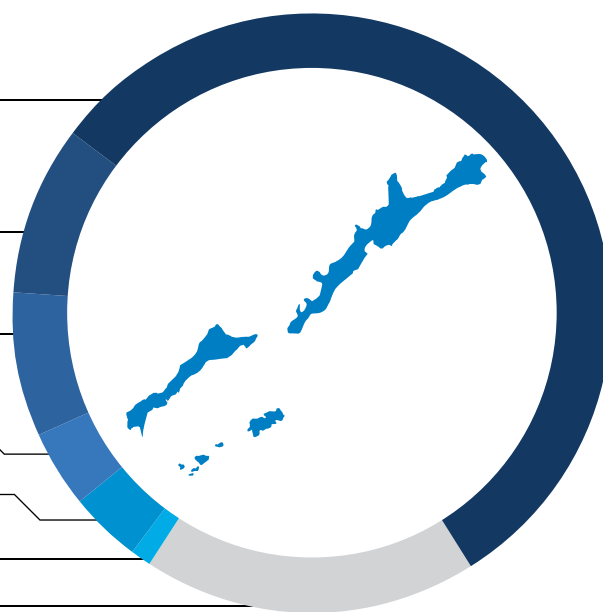
These four islands should be the joint property of Russia and Japan **8%**

All four islands should be returned **4%**

All four islands should be returned at some time in the future when it is appropriate **4%**

Other **1%**

It is difficult to say **18%**



Source: Levada-Centre.

## *2) External Inhibiting Factors: the U.S.–Japan Alliance and China’s Strategic Partnership with Russia*

A number of factors could serve as additional “spoilers” to improving relations between Russia and Japan. First, the emerging positive trend faces a significant number of very influential opponents in both countries. Second, Russian-Japanese rapprochement cannot but arouse the interest and apprehension of other regional players, especially China.

Finally, with Russian and the West locked in confrontation, Japan cannot ignore the position of other G7 countries, primarily that of its ally, the United States. Although Western countries realize that Japan has special interests in relation to Russia, they often require Tokyo to show solidarity, with Washington usually applying the most pressure on the issue. Hopes continue to wane that Washington and Moscow will enter a new period of improved relations. However, Washington has already applied less pressure on Japan than the previous U.S. administration. Trump’s current foreign policy stance suggests that U.S. allies should take greater responsibility for their own security and assume more autonomy, thus giving Japan a free hand in improving relations with Moscow. However, that trend could reverse if Russian-U.S. relations break down again or in case of staffing changes in the U.S. administration. If Chinese-Japanese relations deteriorate or the situation on the Korean peninsula heats up, Japan will want security guarantees from the U.S. – and that, in such circumstances, would be of greater importance to Tokyo than its relations with Moscow. Japan would not put its alliance with the U.S. at risk for the sake of establishing contacts with Moscow.

Similarly, Russia places a high priority on its strategic partnership with China. That

relationship is based on shared international and political interests, common approaches to resolving global problems, and similar positions on the formation of a polycentric world order. Japan cannot count on Russia taking an anti-Chinese position any more than Russia could seriously expect Japan to side against the U.S.

## *3) Russia’s Challenging Business Environment and Difficulties in Implementing Full-Scale Economic Cooperation*

Russia and Japan do not consider each other key economic partners. Japan has always viewed economic relations with Russia as holding only secondary importance, and has made full-scale expansion of economic cooperation dependent on a resolution of territorial disputes. Russia is much more interested in expanding economic relations with Japan. Tokyo is willing to significantly intensify economic contacts based on its eight-point plan, but will implement only those projects that Japanese businesspeople deem economically viable.

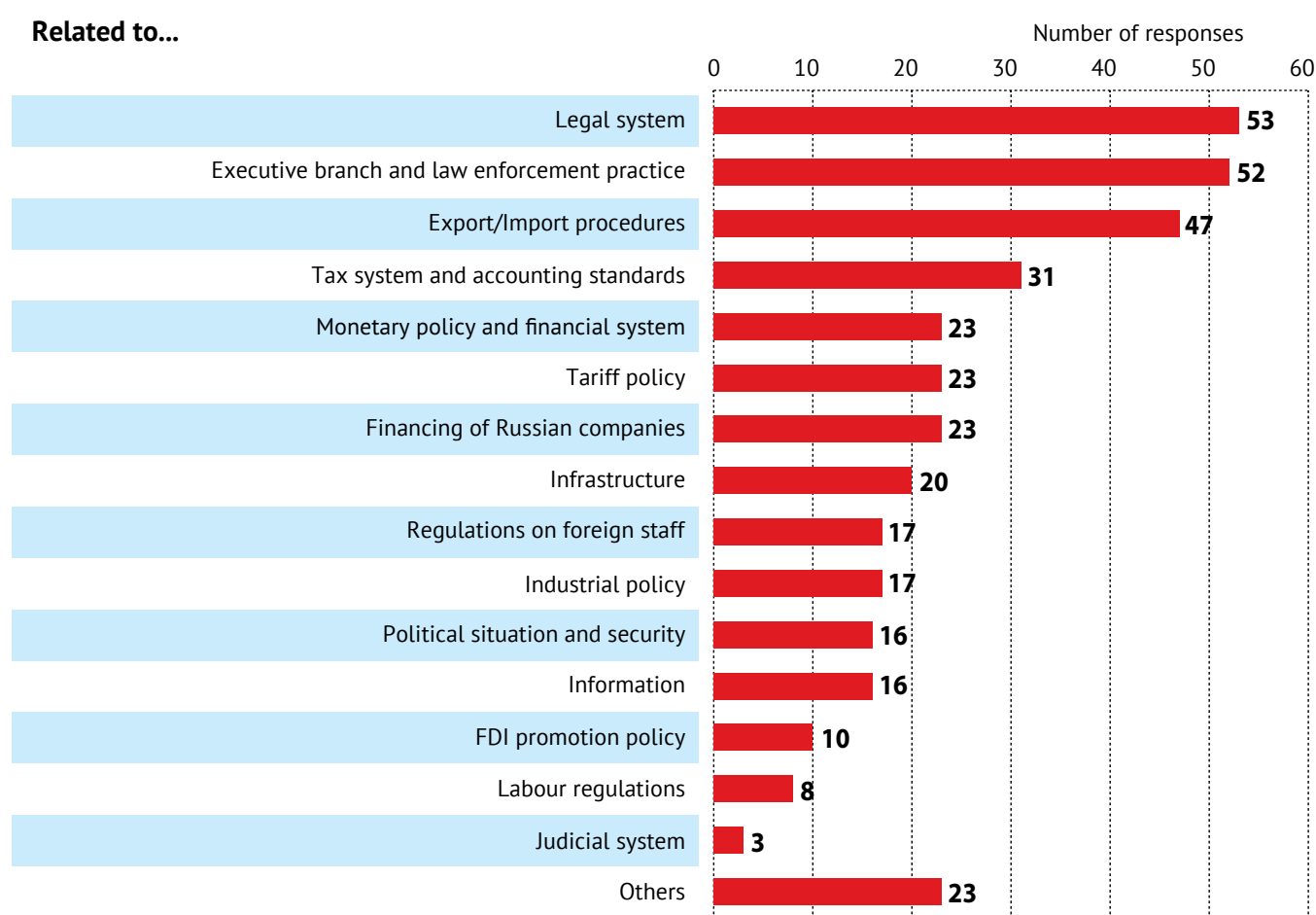
Structural problems in the Russian economy and system of governance – especially the high degree of bureaucratization, irregularities in the legal system, and law enforcement practices – could become obstacles to expanding Russian-Japanese cooperation. Japanese businesspeople point to the unattractive business climate in Russia and single out such problems as bureaucratic barriers, the opaque nature of decision-making, frequent changes in the rules of doing business, the tax and accounting systems, vague rules for doing business in many sectors, the lack of transparency, the amount of time required for the export and import

of goods, customs clearance, sudden changes in the classification of goods or import duties, the need to submit voluminous documentation to certify each individual product on an occasional basis, corruption, the difficulty and time involved in obtaining approval for projects, difficulties in financing Russian companies, the underdeveloped transport and logistics infrastructure, and the shortage of information on contractors and qualified experts with knowledge of the language and the ins and outs of doing business in Russia. Another matter of concern to the Japanese business community is Russia's policy of import substitution that Moscow launched

in response to Western sanctions. This practice has led to the production of lower quality goods, particularly in the oil and gas sector. The Western sanctions against Russia and the volatile ruble exchange rate are also cited as factors negatively affecting the business climate.

Local authorities on the Kuril Islands and in Sakhalin, Primorsky Krai, and Kamchatka often see no concrete benefits for their regions from these economic initiatives, and instead view them more as problems than as opportunities. To this day, Russia's reputation suffers from several unpleasant incidents concerning property owned by Japanese

## CHALLENGES FOR JAPANESE BUSINESS IN RUSSIA, 2016



Source: Japan Business Federation (Keidanren).

businesspeople that occurred in the Far East in the 1990s. Japanese businessmen argue that the signed memorandums will become full-fledged agreements and only be implemented on the condition that Russia create favorable conditions for Japanese businesses. The current phase of interaction largely consists of establishing contacts, creating mechanisms for deepening them, and the search for projects that are attractive for businesses in both countries. For the agreement to be implemented, the Russian side needs to improve the business climate and conditions for Japanese investors.

At the same time, the difference in the economic potentials of the two countries inevitably narrows the possibilities for forming a mutually beneficial partnership. In 2015 and 2016, the volume of Russian-Japanese trade dropped from 2014 levels by 30% and 25% respectively, but rebounded by 25% over the previous year in the first quarter of 2017. Lacking comprehensive economic interdependence, Russian-Japanese trade stands on a fragile foundation that could collapse quickly due to political or economic causes. Oil and gas make up approximately 70% of Russian exports to Japan, and Japanese automobiles account for 50% of imports. If mutual trade declines, both Moscow and Tokyo can compensate for the loss by relying on other trading partners and markets. Japan has a policy of diversifying its energy imports and does not want any one country to become the dominant energy supplier. For this reason, the political leadership in both countries may place a lower value on bilateral cooperation. In addition, Japan is interested among other things in selling its finished products in Russia, whereas Russia would most like to obtain Japanese investments and projects that would subsequently remain on Russian territory and contribute to national development and the creation of jobs. Moreover,

Russia is attempting to secure large-scale Japanese investment and carry out major projects, whereas Japan is cautious and, given the challenges of the business climate, prefers launching a number of smaller pilot projects whose success could pave the way for more ambitious investment later. The Japanese prime minister would have difficulty selling large-scale projects with Russia to his people given the prevailing negative perception of the country and the current low level of economic cooperation.

However, it takes a great deal of time to build trust between the two countries and achieve qualitatively better relations. Most of the Japanese companies that have no plans to do business in Russia see the Russian market as unpromising due to the condition of its economy in 2014-2016 and the resultant decline in economic attractiveness. Prime Minister Abe's Cabinet is currently pushing Japanese companies to establish economic contacts with Russia. Many Japanese companies and conglomerates are only beginning to enter the Russian market and show an interest in this direction. Although the success of those projects depends largely on the policy of the Japanese government, even more depends on the ability of the Russian authorities to provide a favorable business environment. This applies particularly to the Far East where significant effort is needed to implement existing agreements and secure the participation of Japanese business in the Advanced special economic zones (ASEZs) and the development of free ports.

In addition, the small size of the Far East's domestic market makes it impossible for Japanese businesses to carry out major investments with the final products consumed in the Far Eastern Federal District. Japan would have to transport those goods to either the European part of Russia where much

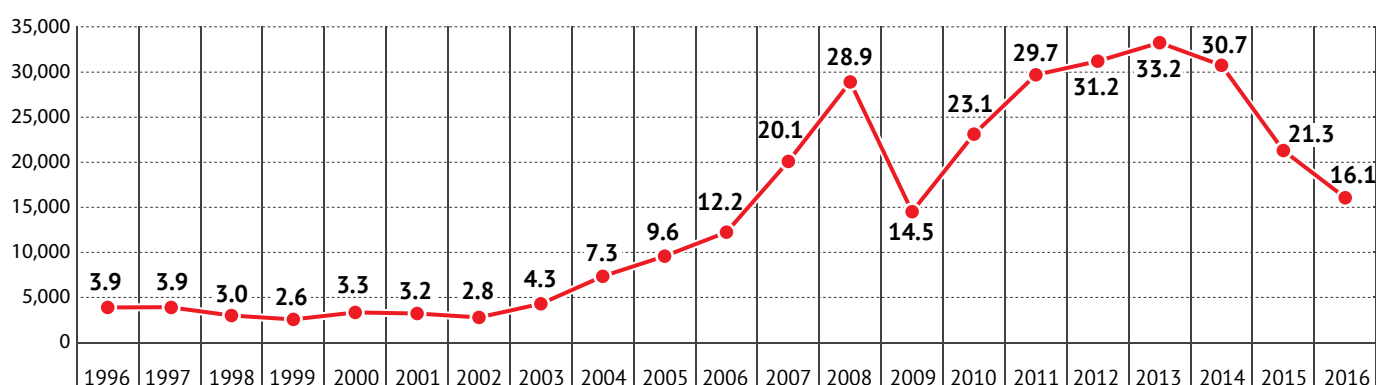
of the country's consumption is concentrated, or export them to the Asia-Pacific region. That makes for a difficult process of identifying the specific niches in which Russian products would be competitive in the region.

#### *4) Japan's Linking of Economic Cooperation with the Territorial Dispute Resolution is Unacceptable for Russia*

Russia has never been a foreign economic priority for Japanese business. The economic problems mentioned above have made doing business in Russia extremely risky in the eyes of Japanese businesspeople. What's more, economic cooperation between the two countries in areas other than energy and auto manufacturing remains on a very modest scale. Moreover, an unofficial linkage exists between the possible large-scale expansion of economic cooperation and Japanese investment with a resolution of the territorial issue in a form that the main political forces in Tokyo find acceptable – namely, the return of all four islands at once, or according to the formula

“two plus alpha.” Prime Minister Abe initiated a shift in Japanese policy: whereas resolution of the territorial dispute on Tokyo's terms was previously a prerequisite to the large-scale expansion of economic cooperation with Russia, now the targeted development of economic contacts with Russia serves as an incentive for Moscow to take a more conciliatory position regarding the disputed territories. However, either way, Abe maintains the same goal of resolving the territorial dispute – an approach that remains unacceptable for Russia. President Putin has repeatedly responded to such suggestions by stating that Russia does not bargain over territories. The Russian leadership considers Japan itself important and has an interest in developing economic, humanitarian, political, and even military relations with Tokyo. However, Russia is not willing to link these questions with any preconditions from the Japanese side. Russia looks favorably on the positive dynamic in relations between the two countries, efforts to take them to a new level and to conclude a peace treaty and implement Shinzo Abe's eight-point plan for improving economic cooperation, but that in no way implies that Moscow

RUSSIA – JAPAN TRADE TURNOVER, 1996 – 2016 (\$ BN)

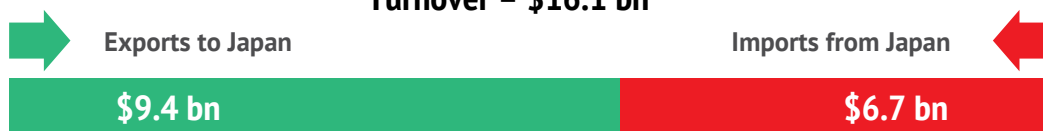


Source: Federal Customs Service of the Russian Federation.

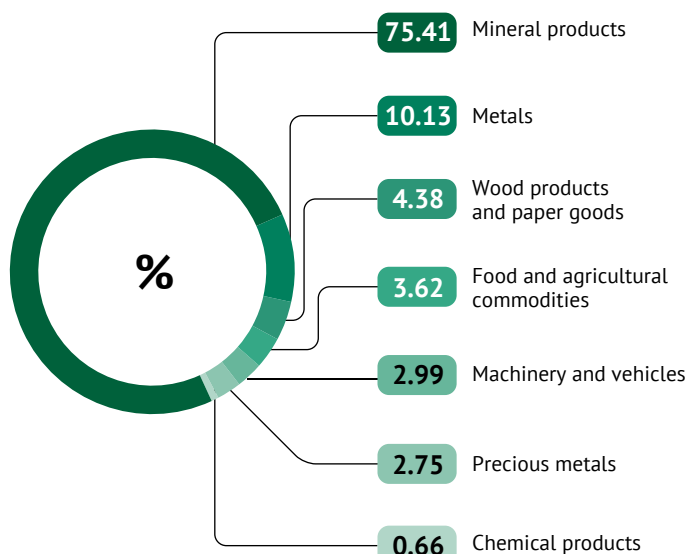


## RUSSIA – JAPAN TRADE IN 2016

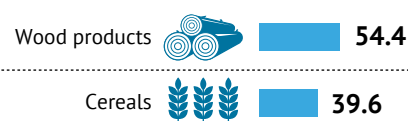
Turnover – \$16.1 bn



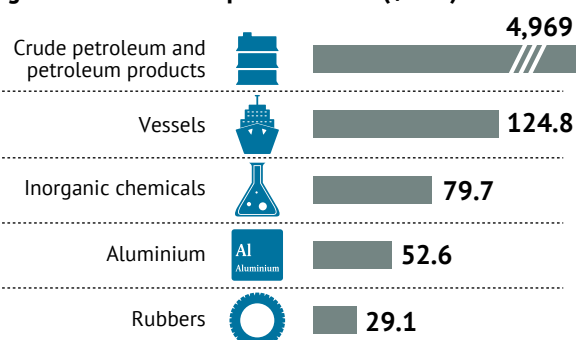
## Export Structure



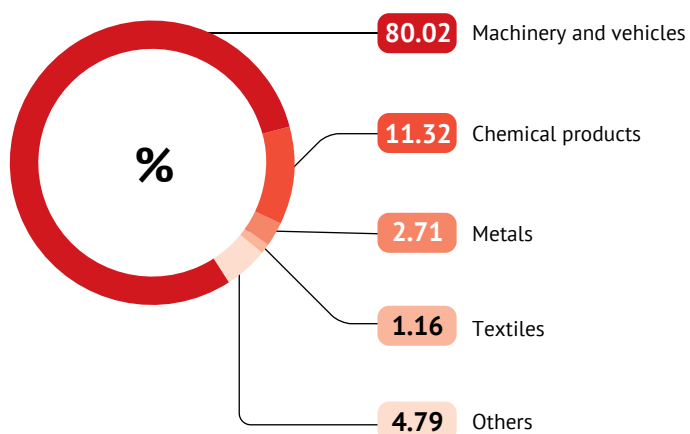
## The biggest increases compared to 2015 (\$ mln)



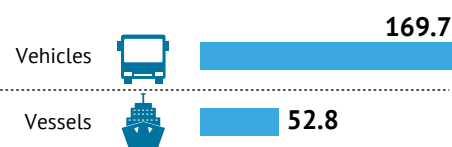
## The largest decrease as compared to 2015 (\$ mln)



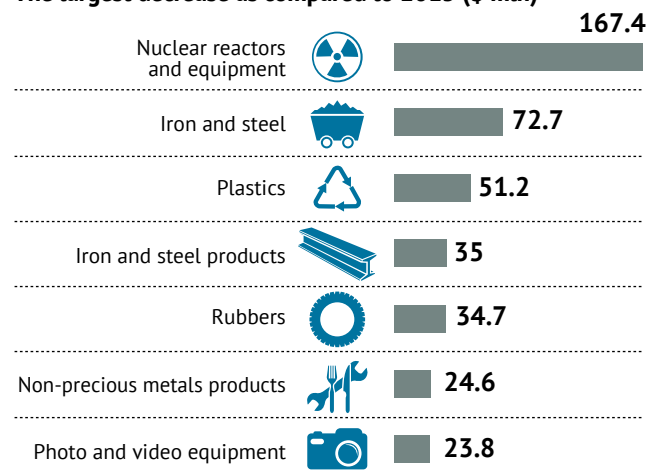
## Import Structure



## The biggest increase as compared to 2015 (\$ mln)



## The largest decrease as compared to 2015 (\$ mln)



Source: <http://russian-trade.com/reports-and-reviews/2017-02/torgovlya-mezhdu-rossiy-i-yaponiy-v-2016-g/>.

is abandoning its position on the territorial issue. The threat of making that issue the top priority could neutralize much of the progress already achieved in other areas.

### *5) The Difficulty of Formulating a Legal Framework for Joint Economic Activities on the Southern Kuril Islands*

The most difficult aspect of reaching an agreement on joint economic activities in the South Kurils is establishing the legal framework for its implementation. The Russian side believes that work should proceed based on Russian law and with the introduction of special rules such as those governing ASEZs. In August 2017 a South Kurils ASEZ was created to stimulate the development of the islands and projects for modernizing production, and attract Russian and foreign investment toward that goal. The Japanese side argues that it is necessary to create a special international legal regime for activities that would not be accountable to Russian law (up to and including the condominium principle) and thus would not fall under Russian jurisdiction and would not imply Russian sovereignty. Japan is anxious about the creation of the ASEZ because participation of Japanese businesses could mean acknowledgment of Russian jurisdiction. Moreover, Japan is anxious about the possibility that Russia would attract investment in the Kurils from China and South Korea, and this factor could adversely affect the possibilities for Russian-Japanese cooperation. Russia and Japan have yet to find a mutually acceptable approach for cooperating on the South Kurils. At the same time, if they fail to find a way to pursue joint economic activities there, that will clearly undermine the momentum for improving relations and adversely affect prospects for

reaching a solution on the territorial issue. In that case, Russia would continue developing the islands itself, but it would have lost an opportunity for cooperation with Japan.

### *6) Russian-Japanese Disagreements on Security Issues, over the U.S. Positioning Elements of its Missile Defense System in the Region, and North Korea's Missile and Nuclear Programme*

Finally, the last but not least important challenge is the ability of Moscow and Tokyo to build a constructive dialogue on global and regional political issues. Although Russia and Japan are restoring their relations on political and security issues, a number of irritants on the regional level remain. Japan is concerned over Russian steps to position missile systems and military divisions on the Kuril Islands, while Russia objects to the placement of the BMD in Japan, the U.S. THAAD system in South Korea, and the possible placement of a similar system in Japan. Moscow considers such moves a violation of the strategic balance in the Asia-Pacific region and a disproportionate response to the actions of North Korea.

Although both sides agree that North Korea must comply with UN resolutions, Russia is critical of the bloc approach to regional security and insists on the need for collective action. Russia also criticizes Pyongyang's provocative missile and nuclear activities, but Moscow and Tokyo take different positions on the overall approach to security on the Korean peninsula. Whereas President Putin emphasizes the need to refrain from militant rhetoric and to seek a constructive dialogue – particularly by renewing six-party talks – Prime Minister Abe underscores the need

for North Korea to uphold UN Security Council resolutions and halt provocative actions, and for increased pressure on North Korea. Japan believes that now is not the time to renew six-party talks and it participates in joint military maneuvers with the U.S. as a response to North Korea's "provocative" missile launches. Shinzo Abe stated in April 2017 that Japan would support the U.S. if it decides to take military action against North Korea. Russia, by contrast, supports the Chinese proposal brought up in the UN Security Council that North Korea halt its nuclear and missile testing and the U.S. and

South Korea freeze or downgrade their military maneuvers near North Korea as a starting point for negotiations. Russia considers it unacceptable to use force to resolve the North Korean problem and insists on reaching a peaceful settlement through negotiation. Russia has put forward a roadmap for peaceful resolution of the nuclear issue on the Korean Peninsula and jointly promotes the "dual freeze" plan with China.

Russia and Japan face a daunting task if they hope to coordinate their positions on the key agenda questions in the Asia-Pacific region.

## 5. Recommendations

### *1) Create a Solid Economic Foundation for Russian-Japanese Relations*

At this point, the policy of strengthening Russian-Japanese relations faces the main task of establishing a firm economic and political foundation that can withstand potential political turbulence between the two countries. Although the current window of opportunity is certainly not the last that will ever appear, there is no way to know how soon the next will come. It is therefore imperative that Moscow and Tokyo make the most of the current opportunity.

Large-scale, long-term infrastructure projects could provide an important step in this direction. A good example would be the **construction of a gas pipeline running from Sakhalin Island to Hokkaido Island**, with a branch line to the Tokyo prefecture and a total length of approximately 1,500 km. Experts estimate that the project would

require five years to complete. The pipeline would significantly increase the volume of Russian gas shipments to Japan and create the infrastructure for Russian-Japanese cooperation and the development of neighboring regions in the two countries. It would provide for not only the export of raw materials, but also create an economic and social superstructure. A second promising project is the construction of an energy bridge between Sakhalin and Hokkaido that would enable Russia to export electricity to Japan via seabed cables.

It is important to raise Russian-Japanese relations to a qualitatively new level of economic cooperation that would include numerous projects. Increasing the number of successful projects – in addition to the activities of Japanese companies that have already been working in Russia for decades – will contribute to an even greater influx of Japanese investments. To achieve

this, it is first necessary to **implement plans for the 80 priority projects in various fields** (such as industry, agriculture, health care, infrastructure, innovation, small business, and humanitarian exchanges) that would be located in different regions. In addition to cooperation on energy, it is important to carry out projects in such other sectors as manufacturing, agriculture, petrochemicals, finance, medicine and pharmacology, information and communication technologies, innovations, urban infrastructure, services, education, transport infrastructure, and tourism. Only systematic efforts in all areas of potential cooperation and the building of close contacts between small and medium-sized businesses will create enduring ties that could produce a new level of interaction and mutual understanding in general.

It is important that Russia and Japan intensify **efforts by relevant agencies and business associations in identifying common interests and business opportunities**. It is important to provide more information regarding potential contacts between analogous agencies and structures in both countries. Much welcomed is cooperation between Economy Ministry of Russia and Japan's Ministry of Economy, Trade, and Industry, as well as between the Ministry for the Development of the Russian Far East, the Russian Direct Investment Fund, the Japan Bank for International Cooperation, the Russian-Japanese Business Council, the Japan-Russia Business Cooperation Committee of the Keidanren (Japan Business Federation), and other relevant agencies, as well as the holding of the Russia-Japan Business Dialogue. The relevant Russian agencies will have to help the Russian business community, and especially small and medium enterprises (SMEs), identify priorities for cooperation with Japanese companies in key

areas, create a database and docket of Japanese companies currently looking for business partners in Russia as well as a list of promising Russian partners, and their size and areas of activity – especially in the priority regions of Siberia and the Far East. They should hold a regular exchange of contacts, increase the promotion of these opportunities through the media and business websites, create and support English and Japanese versions of the websites of key business structures and relevant agencies responsible for cooperation with Japan, and update the pertinent content on a regular basis.

## *2) Improve the Business Climate and Create Institutionalized Mechanisms to Support Japanese Projects*

Another important area is the **creation of a favorable climate for business development, including SMEs, especially in the Far East**. Japanese businesspeople should have assurance that their businesses will be protected from changes in the rules of doing business, differences in interpretation of the law, bureaucratic pressure, and crime. That requires clear and transparent conditions for conducting economic activity (uniform single-window system for doing business, importing and exporting goods, clearing customs, taxation, financial statements, etc.) and shortening the wait time for the review of proposals and import-export clearance procedures, primarily in the Far East. Easing the issuance of visas for Japanese citizens should also produce a positive effect, and there are high hopes for the effect of the introduction of a simplified visa procedure in the free port of Vladivostok. An effective feedback mechanism is needed to resolve any difficulties

that might arise. In other words, real and ongoing political support is necessary to ensure effective economic cooperation. **Joint Russian-Japanese projects need institutionalized support** to succeed. The Russian-Japanese Investment Fund together with a Platform founded in April 2017 to support Japanese investment in the Far East, ASEZs, and the free port of Vladivostok – and that will begin operations in the third quarter of this year – must solve the problem of co-financing, assist investors in the preparation of investment proposals, and provide support for projects during their implementation. It is important that this work is performed in a systematic manner and that similar mechanisms operate at both the federal and regional levels. It might be possible to offer a preferential MFN policy for Japanese business partners that could include infrastructure and priority support for business deals. It is necessary to train and provide a professional staff with knowledge of the Japanese and English languages, as well as the Japanese style of doing business, that could accompany Japanese businesspeople.

**The strengthening of Russian-Japanese economic cooperation must go beyond the initiatives of the two leaders** and take on new institutional forms. Creating a special agency responsible for joint Russian-Japanese initiatives would probably be an effective solution. It would also be advisable to appoint officials with influence among the political elite who would be responsible for overseeing efforts with Japan. Such a move would engender greater trust from the Japanese by demonstrating Moscow's commitment to undertake significant efforts to improve bilateral relations. The Russian-U.S. Bilateral Presidential Commission that operated in 2009-2014 offers a positive example. A similar body could oversee the entire block of interactions

with Japan – at both the federal and regional levels – in politics, economics, high technology and innovation, humanitarian activities, and cultural cooperation.

### *3) Develop a Strategic Dialogue on Issues of Politics and Security*

Russia and Japan should deepen their cooperation on a wide range of global and regional issues. As part of their strategic dialogue on issues of politics and security, **they should coordinate their positions on key regional problems** and integration projects. Russia and Japan can cooperate on key issues concerning security and the fight against non-traditional threats and security challenges (bilaterally and multilaterally with the ASEAN countries), strengthen cooperation at the regional level, and formulate joint initiatives. In addition to the non-proliferation of nuclear weapons and weapons of mass destruction, it would be worthwhile to discuss such issues as maintaining regional security, maritime security and freedom of navigation, the fight against terrorism, drug trafficking, organized crime, money laundering, transport security, natural and man-made disasters (including the accident at the Fukushima-1), cooperation on information and communication technologies, food security, e-commerce, education and science, and joint research. Dialogue in the 'two plus two' format should continue, as should **confidence-building measures between the two countries**. The latter should include dialogue between the heads of the General Staffs, visits by ships to each other's ports, and the holding of bilateral and multilateral exercises. The two countries could also consider restoring their inter-parliamentary dialogue and establishing exchanges between their respective parliaments.



#### *4) Develop a Social Dialogue and Cultural Cooperation*

The two countries can take significant steps in **the field of social dialogue and cultural cooperation**. Russia and Japan declared 2018 the year of cultural exchange. Japanese culture enjoys a well-deserved popularity among Russians, including among youth. In turn, many images of contemporary and classical Russian culture are well known in Japan. Humanitarian cooperation between the two countries could create a positive atmosphere for cooperation in the fields of tourism, small business, education, and science. One area that offers promise is developing tourism routes in Russia, especially in the Far East, and presenting them to the widest possible audience in Japan. The two countries could provide more support to Russian experts on Japan and Japanese experts

on Russia, enabling them to create greater awareness in both countries of the potential for Russian-Japanese relations in various spheres. Increasing the volume of publications in Russia about Japan and vice versa could also serve this objective, as could stepping up contacts between professionals in education and science, and holding conferences and seminars with a wide range of participants from different regions of Russia and Japan. It would also be worthwhile to establish a “second track” format by creating a public council composed of major political and public figures, as well as authoritative representatives of the business community and expert circles. This could play a constructive role in developing areas of future cooperation with Japan. It is important to develop student, youth, cultural, and sport exchanges, and to train specialized personnel as part of the humanitarian foundation for Russian-Japanese cooperation.

## 6. Prospects for Russian–Japanese Rapprochement

A review of the factors helping and hindering Russian-Japanese rapprochement indicates that the process is very fragile. Despite the fact that rapprochement is in both countries’ interest, it proceeds largely due to the efforts of their respective leaders and could be derailed at any time. The current congruence of their domestic and bilateral agendas, as well as the situation in the world makes it imperative that they undertake concerted and systematic efforts to utilize the opportunities that now exist. Without such efforts, rapprochement might slow and give way once again to disappointment – especially because

the current window of opportunity will not last for more than the next few years.

Although it is, of course, overly optimistic to hope that the programme proposed by Prime Minister Abe would be implemented fully, both countries would derive significant economic and political benefits from even its partial realization. Russian and Japanese public opinion, as well as the imperfect Russian economic model – particularly in the Far East – are the main obstacles to concluding a peace treaty and enhancing cooperation respectively. The best way to overcome them is to create a strong foundation for economic cooperation

that could withstand the political vicissitudes in Tokyo and Moscow. Creating a new context for relations by shifting from the prevailing focus on the problems that divide them to a more stable political framework, deepening economic interdependence, improving their publics' perceptions of each other, and pursuing a strategic dialogue on security would enable Russia and Japan to put the question of a peace treaty and the territorial dispute in a completely different perspective.

The decision to conduct consultations on joint economic activities on the South Kurils represents progress on this issue, especially because the Japanese side had rejected such proposals on repeated occasions. Against the backdrop of worsening security issues in East Asia and territorial disputes in the East China and South China Seas, the possibility that Russia and Japan could carry out joint activities on the Kuril Islands could actually make a meaningful contribution to the strengthening of cooperation and trust between the sides and turn the Kuril Islands into a source of development that would bring the countries closer together, rather than pushing them apart. Creating such an atmosphere of trust is the only possible way the two countries could conclude a peace treaty.

Russia and Japan are two of the leading powers in East Asia, and improving relations and building trust between the two countries is an important factor for strengthening the positions of both players in the region. Discussion of key international political and regional problems, a better understanding of each other's positions, and a desire to coordinate those positions are no less important than economic cooperation as prerequisites for creating relations based on trust. Improving Russian-Japanese relations will, on one hand, help strengthen Russia's position as an independent player in the region, lend greater weight to its pivot to Asia and make it more balanced, and give Japanese foreign policy greater autonomy. On the other hand, it could make a significant contribution to the creation of a polycentric regional order in which Russia and Japan would play a key role – as opposed to the U.S.- and China-centric bipolar order in which Moscow and Tokyo would hold far weaker positions. Even accounting for limiting political and economic factors in the international arena, Russia and Japan still have great potential to build trust-based relations that would contribute to the development of both countries and become an independent factor in international relations to play a stabilizing role in East Asia.

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