

## 12 Timber in the Russian Far East and potential transborder conflict

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Economic globalization, the rise of Asian markets, and unstable center-periphery power relations stemming from post-Soviet reform inside Russia are fundamentally reshaping the economic structure of the Russian Far East (RFE), the vast eastern third of the Russian Federation (see Map 12.1). A great shift is taking place for the RFE – away from its traditional role as raw materials supplier to Russia's European core toward becoming a resource periphery for Northeast Asia. The RFE's links to the Chinese, Japanese, and South Korean markets already eclipse the region's economic ties to European Russia, and their importance will continue to grow.<sup>1</sup>

Moscow's declining economic influence in a region long known for its maverick governors and unruly organized crime poses significant development, foreign policy, and security dilemmas for the Russian state.<sup>2</sup> In addition to being a rich resource base, the Far East remains a vital military outpost securing Russia's borders and reaffirming the country's presence in Northeast Asia.<sup>3</sup> A stable RFE is therefore crucial to counteract rising Chinese influence. Russian fears of China primarily center on immigration.<sup>4</sup> But there is also growing concern, at least among regional leaders and local citizens, over China's economic dominance in the region.

The Putin administration's primary economic strategy to restitch the region to European Russia appears to involve an extensive series of oil and gas pipelines.<sup>5</sup> The decision to route the East Siberian oil pipeline to the Sea of Japan rather than to China is undoubtedly an effort to gain access to multiple markets (as discussed in Michael Bradshaw's chapter, Chapter 7), but it is also part of a broader geopolitical strategy to counteract Chinese influence. Despite optimistic official statements, this project will take decades to complete, assuming it is realized at all.

Unlike in other parts of Russia, the oil and gas sector at present plays a relatively minor role in the RFE economy. Fishing, mining, and forestry employ many more people and generate much more revenue.<sup>6</sup> These industries are particularly important in the administrative regions that form the Russian side of the 4,300-kilometer border with China (Primorskii and Khabarovskii *kraia*, Amur and Chita *oblasti*).



Map 12.1 Administrative regions of the Russian Far East (source: Adapted from J. Newell, *The Russian Far East: A Reference Guide for Conservation and Development* (McKinleyville, CA: Daniel & Daniel, 2004).

Dealing with fishing, mining, and forestry in the Far East presents a difficult challenge to Moscow because, in contrast to the energy sector, small and medium-sized companies are the primary economic actors in these industries. State control varies within these sectors, with mining the most centralized among the three and timber the least. Benefiting from weak federal control over

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1 forests, regional governments have long been vested with considerable adminis-  
2 trative powers, including the all-important ability to allocate, and take back,  
3 rights to exploit forestry resources.<sup>7</sup>

4 This chapter focuses on the Russian Far East timber sector and is divided into  
5 three sections. The first shows how, through privatization and radical decentral-  
6 ization, the timber sector has devolved into a complex network of state actors,  
7 businesses, and criminal interests. The second considers where business and  
8 state interests converge and diverge, teasing out the consequences for regional  
9 economic growth, internal stability, and foreign relations. The final section dis-  
10 cusses how development in the timber sector will shape regional stability and  
11 Russia's prospects for conflict and cooperation with China. Overall, the chapter  
12 argues that if the Russian state does not take measures against corrupt public  
13 officials and criminal businesses to increase Russia's ability to exploit its own  
14 natural resources, the possibility for conflict with China will grow.

### 16 **Key actors in the Russian Far East timber industry**

17  
18 Russia has the world's largest forestry resources. The forests of the Russian Fed-  
19 eration comprise 22 percent of the earth's total forest cover and more than 57  
20 percent of its coniferous forest cover.<sup>8</sup> In economic terms, this represents 21  
21 percent (82 billion cubic meters – bcm) of the world's standing timber volume,  
22 with a quarter of that total (20.4 bcm) in the Russian Far East alone.<sup>9</sup> During the  
23 Soviet era, Moscow held tight control over the country's forests. After the  
24 Soviet Union fell, radical privatization and decentralization of state functions  
25 fragmented Rosleskhoz, the once highly centralized Russian forestry agency  
26 responsible for both forest management and timber production. As regional gov-  
27 ernments grabbed more power, the federal agency fell into disarray, owing to a  
28 lack of financing and internal corruption.<sup>10</sup>

29 With regional bureaucrats and businessmen seeking to grab as much as they  
30 could, privatization in the early 1990s spawned thousands of small and medium-  
31 sized timber companies throughout the RFE. Many of the Soviet-era regional  
32 timber elite prospered during the transition by setting up their own companies,  
33 but new, smaller players were also able to establish their own businesses.

34 Of necessity, all these firms developed alliances with the state gatekeepers  
35 who control timber resources. Among the gatekeepers are powerful officials and  
36 entities within regional governments and the impoverished federal forest service.  
37 Other gatekeepers include individuals within the state security apparatus, such  
38 as policemen, border guards, customs officers, and immigration officials, who  
39 regulate the transport of timber along its many stages from harvest site to whole-  
40 sale yards and, eventually, over the border, and who help (or hinder) Chinese  
41 operators in the purchase and transfer of timber. Entwined within these relation-  
42 ships is the strong presence of organized crime, some participants in which also  
43 work in the state or business sectors. These complex relationships, combined  
44 with inadequate legislation and an often dependent judiciary, block any efforts  
45 to reform the timber industry.

Rather than attempting to untangle the multitude of state–business–criminal arrangements, this section summarizes the major actors and, where possible, notes their connections to each other. The last part of the discussion briefly addresses illegal logging and trade to give the reader some concrete examples of how these actors collaborate.

### ***Rise of the private sector: old elites and the explosion of new operators***

The Soviet-era Russian Forestry Ministry (Rosleskhoz) consisted of two main branches: one for forest management, Minleskhoz (the Federal Forest Service), and one for timber production, Minlesprom.<sup>11</sup> Minleskhoz had 81 regional forest services – roughly corresponding to Russia’s 89 administrative units. Each regional service managed the *leskhoz* (forest service units). These *leskhoz*, in turn, regulated the activities of the *lespromkhoz*, or state-owned timber harvest companies that formed the core of Minlesprom. Another division of Minlesprom, Exportles, tightly controlled timber exports by setting prices and regulating supply. Exportles had an extensive network of offices in major importing countries.

In 1993–1994, privatization of the state-owned timber harvest companies (*lespromkhoz*) began, and by 1996 their conversion into joint stock companies was essentially complete.<sup>12</sup> This process, like the privatization of many other sectors in Russia, was far from transparent, involving a bewildering, often shady, array of state–private sector arrangements. One common strategy was to divide a *lespromkhoz* up into separate units, strip the assets of the undesirable ones, let their debts mount, and then declare them bankrupt. New companies were built on the assets from the previous structures. The abolition of state export controls made it possible to ship forest products to China. Small new players could easily enter the business because some of the largest and most valuable timber grows in easily accessible areas near roads or, in winter, along the banks of frozen rivers.

The changes transforming the industry were quick and far-reaching. In 1991, just prior to the introduction of economic and administrative reform, 82 *lespromkhoz*, 14 sawmills, and ten pulp and paper plants were operating in the entire Russian Far East.<sup>13</sup> By 1995, 316 timber companies had registered officially in Khabarovskii *krai* alone, and by 2001 this figure had mushroomed to 550.<sup>14</sup> In 1998, approximately 700 entities were registered as exporters to China. By 2002, the number of exporters had increased to more than 2,300 (see Figure 12.1).<sup>15</sup>

To some degree, the presence of so many operators makes the forestry industry amorphous. However, a couple dozen sizeable timber companies emerged out of the ashes of the huge *lespromkhoz*. Together they produce the majority of reported timber output in the RFE.<sup>16</sup> Their connection to the smaller firms in the industry is not entirely clear. Sometimes larger companies create smaller ones to avoid taxation; others may simply buy timber from them, and still others

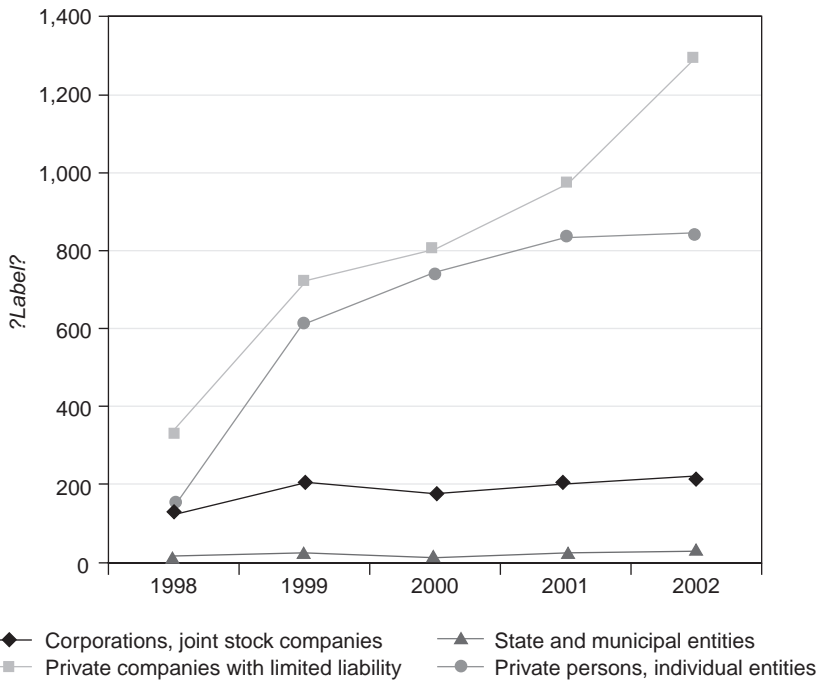


Figure 12.1 Russian timber exporters to China, 1998-2002, by category and number (source: Original source cited as "Database of electronic customs declarations of Russian Federation forest products exports in 1998-2003," distributed by M-INFO Consulting Company: Moscow, 2004. Adapted, with permission, from Alexei Lankin, *Forest Product Exports from the Russian Far East and Eastern Siberia to China: Status and Trends*, Washington, DC: Forest Trends, 2005, p. 26).

have no connection at all. In many instances, the same managers who ran the industry during Soviet times are still in control of the largest companies.

### **Regional administrations**

Other industries have certainly involved questionable privatization schemes, but the timber sector is distinctive because the federal government delegated to Russia's 89 regional governments control over the allocation of forest resources.<sup>17</sup> Accordingly, the way each *krai* and *oblast'* administers these resources varies considerably. Of prime importance is the power vested to regional administrations to allocate and cancel timber leases, the primary means by which timber companies gain access to the trees they harvest. In Khabarovskii *krai*, the largest timber-producing region in the RFE, Governor Viktor Ishaev firmly controls this power. His first vice-governor heads the all-important Commission on Forest Resource Use, which considers applications from local firms, makes decisions on competitions for leasing rights, has the

power to cancel leasing agreements, and collects industry taxes.<sup>18</sup> In Primorskii *krai*, the power structure is similar.

These arrangements can be highly fluid. Rights and responsibilities often shift between the various commissions, committees, agencies, and other governmental bodies, as each jockeys for control over the resources. Timber companies – to maximize income, avoid taxation, and increase access to untapped resources – also continually lobby for more favorable arrangements.

### ***The regional siloviki***

Broadly understood as officials within the Ministry of Internal Affairs, Federal Security Service (FSB), Border Guard, Customs, military, police, and other agencies involved in security and defense, the *siloviki* regulate the transport and export of logs to Northeast Asia. Corrupt officials within these institutions benefit financially from these cross-border activities. Loggers must bribe policemen who operate road checkpoints. Wholesalers and traders pay protection to police captains to ensure their business is safe from police raids and criminals.<sup>19</sup> Detailed data on the extent of this corruption are difficult to obtain, but one survey of 100 Chinese migrant traders in Primorskii *krai* revealed corruption at all levels. When asked, “Whom do you pay for your security?” 80 percent named the police, 62 percent identified government officials, 60 percent cited transportation providers, and 55 percent, border guards.<sup>20</sup>

### ***The Federal Forest Service: oversight agency or logging company?***

In contrast to Minlesprom, the basic structure of the Minleskhoz (Federal Forest Service) has remained essentially intact. The Forest Service is the primary government agency responsible for the sustainable use, protection, and management of the country’s publicly held forests. But the Forest Service has been rendered largely ineffective as a result of inadequate funding and internal corruption. The federal budget is supposed to provide 80–90 per cent of the funding for the *leskhoz*, with the rest coming from the *leskhoz* themselves. In most cases, they receive far less. In 2003, for example, the federal budget covered only 20 percent of the *leskhoz* budget in Khabarovskii *krai*.<sup>21</sup>

To augment these meager resources or, in some cases, where unscrupulous *leskhoz* officials seek to enrich themselves, many *leskhoz* regularly abuse the practice of salvage logging. Also frequently referred to as “sanitary” or “maintenance” logging, salvage logging is intended to remove old and unhealthy trees and trees posing fire threats. This kind of logging, allowed within protected territories, is usually exempt from lease payments and stumpage fees. *Leskhoz* themselves log or give salvage logging licenses to companies to do so. The focus is usually on species that command a premium price in Northeast Asian markets, such as Korean pine (*Pinus koraensis*) and Manchurian ash (*Fraxinus mandshurica*). Such extensive disregard for the law by the *leskhoz* has fostered widespread indifference toward logging regulations among timber companies.

### Foreign companies

Unclear property rights, a weak legal system, crime, corruption, and a general Russian mistrust of foreign involvement have dissuaded many foreign companies from investing in the RFE timber sector. At one point in the early 1990s, the US company Weyerhaeuser considered investing in the region but decided not to proceed when company managers realized, according to one analyst, that “basic parameters, such as the rights to a forest site and the right to export could evaporate at the whim of the authorities.”<sup>22</sup>

Nevertheless, the RFE’s extensive timber reserves remain highly attractive, and foreign companies continually try to penetrate the market. Hyundai Corporation made the first major investment by forming the Svetlaia Timber Venture with two Primorskii *krai*-based timber companies in 1991. Named after the coastal settlement of Svetlaia, the venture managed to secure a 30-year lease from the regional government to log on a plateau just above the settlement. The venture operated, in fits and starts, until 1997, when logging was abruptly scaled back and the operations were declared bankrupt. From the outset, the venture had trouble securing access to the resources, partially due to concerns about the environmental and social impacts of logging in the upper watershed of the Bikin River. Others speculate that the Russian partners sought to bleed the venture into bankruptcy so they could seize the timber harvesters and other equipment it owned and use the renovated port facilities.<sup>23</sup>

The handful of foreign investment projects that have been successful share a common feature: either strong and steady support by a powerful state entity or support by a large timber company that enjoys close ties with the state. The former is the case with the Malaysian transnational corporation, Rimbunan Hijau, which managed to secure two 48-year timber concessions in Khabarovskii *krai*. The first concession, with an annual allowable cut (AAC) of 550,000 cubic meters, encompasses most of the upper Sukpai River basin, about 150 kilometers from the city of Khabarovsk. The second concession, with an AAC of 495,000 cubic meters, is in the Bitchi River basin in Ulchskii *raion* in the central part of the *krai*.<sup>24</sup> Rimbunan is now the second-largest timber producer in the *krai* and exports logs to China and Japan. Governor Ishaev, who as mentioned before has strong control over the industry, personally courted Rimbunan during a visit to Kuala Lumpur.<sup>25</sup>

The other foreign venture – and the only major one in the entire RFE that produces processed timber – is Technowood. Sumitomo (Japan) and Terneiles, the largest and most economically sound Russian-owned timber company operating in Primorskii *krai*, joined forces to form this venture. Terneiles operates out the coastal town of Plastun and, like other large forestry companies in the southern RFE, supplies most local jobs and revenue for the town and *raion* budget. The firm even provides the wood chips used to fuel the boiler that generates the town’s electricity. By providing these social services, Terneiles enjoys enormous influence with the *raion* and *krai* administrations. The company holds more Primorskii *krai* forest land in long-term lease than any other, giving



Technowood a stable supply of raw material, as well as comparably smooth relations with state entities.

According to government statistics, Chinese timber enterprises operating on Russian territory produce a minute portion (less than 2 percent) of total timber exported by Russia to China.<sup>26</sup> Even this figure seems high given that, officially at least, Chinese investment in all sectors of the RFE totaled just \$13.2 million for 2003.<sup>27</sup> Russian nongovernmental organizations and industry representatives, however, paint a different picture. According to Anatoly Lebedev, director of a Vladivostok-based nongovernmental organization specializing in forestry issues, Chinese money is financing numerous small Russian timber enterprises. He also claims that Chinese operators control wholesale timber yards in the Primorskii *krai* cities of Luchegorsk, Dalnerechensk, Lesozavodsk, Ussurisk, Nakhodka, and Dalnegorsk.<sup>28</sup>

Illicit Chinese financing has been a hot-button issue in the local Russian media for some time. While there is clearly illegal investment, the strong reaction can be partially attributed to phobias about Chinese commercial activity on Russian soil. The presence of purchasing agents representing trading companies, usually operating in Russia with a tourist visa, can be misconstrued as investment when they are simply buying timber.

### ***Organized crime and the emergence of illegal logging and trade***

Criminal elements have infiltrated, or enjoy tight relations with, state entities and private enterprises, making it a challenge to identify where organized crime begins and where it ends. Few would dispute its influence in the industry, however. Local RFE papers regularly report on contract killings, intimidation, and other forms of violence in the industry.<sup>29</sup> One of the highest-profile assassinations in recent years was the murder of Bogdan Kovaliuk, then general director of Khabarovskglavles, a major timber enterprise in Khabarovskii *krai*.<sup>30</sup>

Weak regulation, corruption, and the explosion in the number of companies operating in the industry have led to a sharp rise in illegal logging. After years of trying to minimize public attention to the problem, the Russian government finally admitted in 2003 that it is an issue of concern.<sup>31</sup> Internationally, the Russian Federation is recognized as a major center for illegal logging, along with Indonesia, Cambodia, and a handful of other countries.

The *extent* of illegal logging depends on how it is defined. If defined purely in terms of adhering to all Russian forestry regulations, then virtually all logging operations, large and small, would technically be illegal.<sup>32</sup> However, illegal logging is usually more narrowly defined by excluding basic forestry violations such as failure to clean up a harvest site or logging on steep slopes. World Wildlife Fund-Russia (WWF) defines it by limiting it to five major violations: "harvesting more than permitted volumes, harvesting outside the permitted area, logging banned species or those not allowed for logging in a given area, commercial logging under the guise of salvage logging, and logging without a license or forged papers."<sup>33</sup>



Table 12.1 Disparities in trade statistics for logs, 2002–2003 (\$)

	2002	2003
Exports reported by Russia	735,941,000	718,868,188
Imports reported by China	975,270,140	969,024,232

Source: *World Trade Atlas*, Washington, DC: Global Trade Information Services, Inc., 2004 and Ivan Eastin, *Testimony before the U.S.–China Economic and Security Review Commission*, 13 January 2005, Center for International Trade in Timber Products (CINTRAFOR), [www.uscc.gov/hearings/2005hearings/written\\_testimonies/05\\_01\\_04wrts/eastin\\_ivan\\_wrts.htm](http://www.uscc.gov/hearings/2005hearings/written_testimonies/05_01_04wrts/eastin_ivan_wrts.htm) (accessed 1 June 2005).

Using this definition as the basis for analysis, WWF estimates that roughly 50 percent of the logging in Primorskii *krai* is illegal.<sup>34</sup> For the country as a whole, WWF estimates losses at \$1 billion, with total turnover of the industry at \$6 billion. These losses include taxes that would have been paid to the state if illegal timber harvest were included, as well as timber that is sold underpriced. How much of this illegally logged timber is exported is difficult to gauge. One can get a rough idea by comparing Russian export statistics with Chinese import statistics, as in Table 12.1. The numbers indicate that Russia is significantly underreporting export volumes.

Both large and small companies are involved in illegal logging, as are the numerous regional and federal state entities (e.g. border guard, forest service, police) described earlier. Smaller companies, in particular, rely on individuals within these institutions to help ensure that illegally logged timber is “legalized” before it is exported, as they often do not have the necessary logging or export documents.<sup>35</sup> Such legalization can be secured at virtually every stage of the chain by bribing the officials responsible for that particular segment. It is most advantageous to start at the beginning by getting logging permits (usually for salvage logging) from the Forest Service. My field research, conducted in 1999–2000 in Roschino village in Primorskii *krai*, revealed that logging and transport certificates, complete with the embossed seal of the Forest Service, could be bought for \$300.<sup>36</sup> These licenses and certificates make it much easier to pass through police checkpoints. If such papers are not available, then police at checkpoints must somehow be coerced, bribed, or avoided. Logs are then sold to a wholesaler who acquires or forges customs export documents.

Although larger companies may indirectly control smaller logging companies or “launder” timber for them, larger companies can more easily acquire forestland through a lease or salvage license. Nevertheless, they also engage in illegal logging. Large numbers of high-quality Korean pine logs ready for export to Japan can be seen in the port of Plastun (where Terneiles operates), even though Russian regulations forbid commercial logging of the species. Korean pine may be logged only under certain circumstances, such as for building roads or during salvage logging. This timber may then be exported legally. The Forest Service participates by issuing bogus logging licenses, granting permission to build roads through Korean pine stands, and agreeing to expand the size of leased

plots to include Korean pine areas – all of which facilitate the commercial logging of the species. Many larger companies are also exporters and have been known to use fraudulent shipment declarations that list inaccurate prices, grades, species, and timber volume. One specific strategy is to mislabel high-quality timber as pulp logs to lower tax payments.

### **Business and corrupt officials versus larger state interests**

It should now be evident that there exist myriad ways in which elements within state structures have formed murky, but mutually beneficial, alliances with timber companies, traders, and organized crime. In some respects, for all the illegality and corruption involved, these alliances have enabled the RFE forestry sector to maintain some stability during a period of tremendous social, economic, and political upheaval. Revenues generated by salvage logging have enabled the Forest Service to fulfill at least some of its regulatory functions. Soviet industrial development patterns meant that entire towns and villages were built around one industry, and the example of Terneiles maintaining road infrastructure and providing heating and other social services is a business–state model seen throughout the RFE. Timber companies such as Terneiles provide services that the state can no longer, or is unwilling to, provide.<sup>37</sup> Individuals within the state security apparatus, such as border guards and customs officials, have created *de facto* stability along the Russian–Chinese border region, as the continued flow of economic benefits depends on the continued functioning of the timber trade and holding ethnic conflict to a minimum.<sup>38</sup>

Unfortunately, what should have been, at best, temporary state–business alliances have endured and solidified. Corruption and cronyism have evolved into what Judith Thornton has identified as “stable institutionalized norms.”<sup>39</sup> Ultimately, these alliances undermine the broader, long-term interests of the state. Loss of tax revenue, due to sheltering of profits and illegal logging, impoverishes state institutions administratively, financially, and morally. Unstable property rights and ownership regimes prove hostile to long-term private-sector stability and investment, both domestic and foreign. Links between Russian organized crime and its Japanese *yakuza* counterpart have been strengthening for some time, fueled by the timber trade as well as the lucrative trade in fish and used Japanese automobiles. This extensive black market has negatively affected Russia’s relations with its Northeast Asian neighbors, which regularly voice concerns about Russian corruption and crime. Corruption within customs, the border service, and other security agencies responsible for regulating cross-border flows of people and resources has led to a vigorous trade in illicit goods at trading points along Russia’s porous borders.

This section demonstrates that the collaboration of small and medium-sized logging businesses with corrupt state officials is working against the larger interests of the Russian state. Many of the Far Eastern timber companies and their crooked collaborators are making large profits by exporting raw logs to China. Such sales deprive Russia of much-needed jobs and tax revenue. Federal efforts

to improve the situation have failed because they have not been able to overcome the resistance of entrenched interests.

### *Prolonged collapse in Russian processing capacity*

The short-term collaboration between individual state officials and business interests is setting up steep obstacles to timber-sector reform. Nowhere is the situation more evident than in the prolonged collapse of the wood processing industry. The RFE has never been known as a manufacturing center, but in 1989 processed timber (lumber and panel products) accounted for 20 percent of the region's total timber production. The Sakhalin and Khabarovsk pulp and paper mills produced much of the paper and paperboard used in the region (see Figure 12.2). Almost half of all timber production was consumed regionally, 25 percent was sent to other parts of the former Soviet Union, and 30 percent was exported.<sup>40</sup> Today, virtually all of the pulp mills are closed; processed or "value added" timber comprises just 7 percent of total production, and the region exports more than 70 percent of its total harvest, primarily in the form of raw logs. If higher transport and energy costs, combined with outdated machinery, started a downward spiral in the processing sector, then crime and corruption

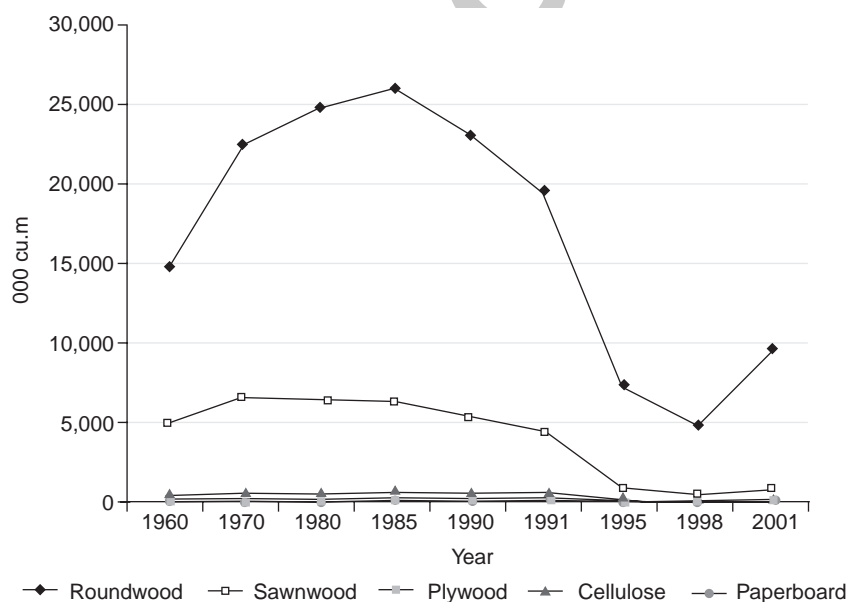


Figure 12.2 Timber production in the Russian Far East, 1960–2001. (source: Original source cited as database of the Economic Research Institute, Far Eastern Branch of the Russian Academy of Sciences, 2004. Adapted, with permission, from Alexander Sheingauz, *Overview of the Forest Sector in the Russian Far East: Production, Industry, and the Problem of Illegal Logging*, Washington, DC: Forest Trends, 2005, pp. 54–55.

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have certainly speeded its demise and repeatedly blocked efforts to rebuild the industry. Like foreign investors, most Russian timber companies have chosen not to reinvest in processing capacity, but instead reap immediate returns on log exports while sheltering profits abroad.

### ***Booming Chinese wood demand and increased manufacturing capacity***

Weak processing capacity has meant that Russia has remained almost entirely a raw log exporter, despite a decade-long boom in demand in Northeast Asia (see Map 12.2).<sup>41</sup> In just ten years, Russian timber exports to China, Japan, and South Korea have more than quadrupled, from 6.9 million cubic meters in 1993 to 26.6 million cubic meters in 2002 (see Figure 12.3).<sup>42</sup> China is the driver behind the dramatic rise, although Korea and Japan have both steadily increased imports. Following flooding in China in 1998, attributed to the deforestation of upper-



Map 12.2 Russian timber export to Northeast Asia, 2002 (source: Frontier forest data provided as a digital file courtesy of the Biodiversity Conservation Center, Moscow, [www.biodiversity.ru](http://www.biodiversity.ru), 2004. Timber production data from Alexander Sheingauz, *Overview of the Forest Sector in the Russian Far East: Production, Industry, and the Problem of Illegal Logging*, Washington, DC: Forest Trends, 2005, pp. 54–55. Original source data for timber exports are from the "Database of electronic customs declarations of Russian Federation forest products exports in 1998–2003," distributed by M-INFO Consulting Company, Moscow, 2004. For the more readily accessible statistics on timber exports by administrative region of the Russian Federation, as well as by specific customs export point, see Alexei Lankin, *Forest Product Exports from the Russian Far East and Eastern Siberia to China: Status and Trends*, Washington, DC: Forest Trends, 2005).

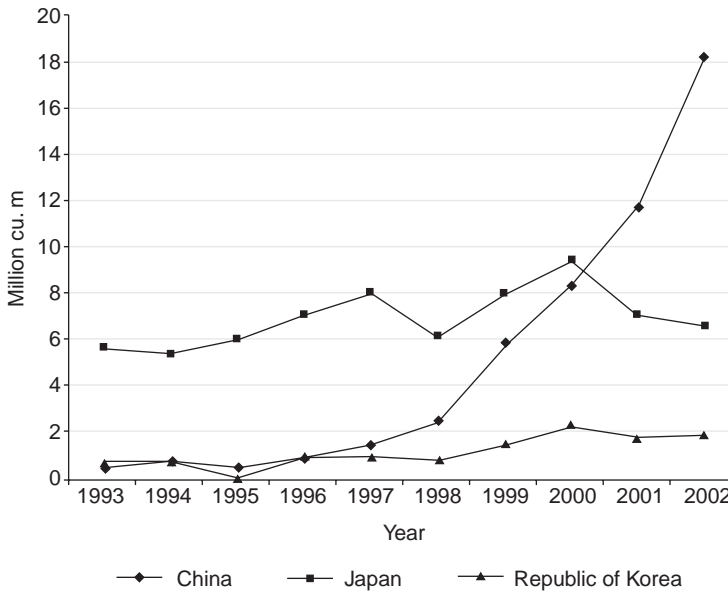


Figure 12.3 Russian timber exports to Northeast Asia, 1993-2002 (source: Online trade database, European Forestry Information and Data Analysis System, European Forestry Institute, [www.efi.fi/efidas/](http://www.efi.fi/efidas/) (accessed on 5 June 2005)).

river watersheds, the Chinese government passed the National Forest Protection Plan. To protect the few remaining natural forests, control water levels, and prevent soil erosion, this plan has strictly limited timber harvests in China. These restrictions, combined with rapid economic growth, have led to the skyrocketing imports. Overall, Chinese wood product imports have almost tripled since 1998, from 12 million cubic meters to 36 million cubic meters in 2003, catapulting China past Japan to become the world's second largest importer of forest products. Russia now provides about 45 percent of this total – including 61 percent of all Chinese log imports, up from 21 percent in 1997 – making it by far the most important source.<sup>43</sup>

Chinese wood deficits are projected to expand rapidly. By 2025, according to the Center for International Trade in Forest Products, China may face a deficit of 200 million cubic meters of wood per year. At 2003 rates (45 percent of China's total imports), Russia may therefore be expected to provide China with 90 million cubic meters of timber by 2025. This figure is more than three times the total reported yearly harvest in both the RFE and Eastern Siberia.

China has been expanding wood-manufacturing capacity throughout Northeast China (Heilongjiang, Jilin, and Inner Mongolia provinces), one of the country's major timber centers. Because of the region's proximity to the RFE and Eastern Siberia and the similarity between tree species in these parts of Russia and China, Russian logs have proven eminently suitable for the hundreds

of new sawmills and processing facilities in the region. Although the Chinese central government has not publicly formulated a development model whereby Russia supplies the logs and then China processes them into semifinished and finished goods for domestic use and export, this is how the development scenario is playing out. The provincial governments and Chinese forestry agencies have been instrumental in setting up modern timber processing mills along the Russian–Chinese border. And the Chinese government has adopted an ambitious new state program to modernize existing large pulp and paper factories throughout the region. These efforts are designed to take advantage of the inexpensive (and seemingly plentiful) Russian roundwood.

### ***Russian efforts to develop domestic processing capacity***

Many Far East governors recognize that Russia's future stability and prosperity depend on the jobs and tax revenues derived from processing more of the region's rich natural resources. Local factories would reduce external dependence on processed products, such as furniture and paper. A strong value added sector is likely to have the environmental benefit of stemming the steady decline in the quality of the timber resource base, because processing would increase demand for woodchips, branches, and smaller-diameter trees. In addition to being tremendously wasteful, this unwanted timber, currently left at the harvest site, is fuel for forest fires. Expanding Russian processing capabilities is likely to reduce illegal logging. Closure of wood-processing enterprises has led to high unemployment in forest communities, leading some to log illegally simply to survive.

Khabarovsk governor Ishaev has long promoted wood processing but, despite the *krai* administration's relatively strong control over the timber sector, he has made little headway. In spring 2000, he issued a decree that by 2003 all Khabarovsk-based timber companies should export only processed and structural lumber. This decree proved too ambitious, given the dilapidated state of the processing industry, and was not enforced. Resistance from entrenched interests, who have profited from exporting logs, and the lack of federal support no doubt contributed to its demise. Ishaev subsequently issued a more modest directive requiring that at least 20 percent of the *krai*'s timber harvest be processed locally, a requirement that was even written into the lease agreement with Rim-bunan Hijau. But in the case of Rimbunan, as well as with other operators, this regulation has also proven virtually impossible to enforce.

Previous attempts to modernize the processing sector focused almost exclusively on Japanese investors. But, as discussed earlier, key Japanese investors are no longer working in the region. As a result, Ishaev and other regional leaders have started to target Chinese investors, and there have been some positive signs of interest. In 2003, three Chinese enterprises tentatively agreed to invest \$278 million in wood-processing projects in the Eastern Siberian region of Chita, which if completed would produce 300,000 cubic meters of wood and 400,000 tons of pulp annually.<sup>44</sup> In 2004, the city of Khabarovsk hosted the first ever

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1 China–Russia Conference for Investment Promotion.<sup>45</sup> Subsequently, presiden-  
2 tial envoy Konstantin Pulikovskiy led a delegation to the annual International  
3 Trade Fair in Harbin, China, in June 2004. Evidently, a number of agreements  
4 were signed, including a joint venture agreement between one of Khabarovsk’s  
5 largest timber companies, Flora, and Shenyang Heavy Machinery Corporation to  
6 build a \$300 million plant capable of producing 80,000 cubic meters of engi-  
7 neered wood products annually.<sup>46</sup> These agreements were quickly followed by  
8 an announcement of plans to build a quasi-free trade zone on both sides of the  
9 border at the Suifenhe–Pogranichny railroad junction. The zone will reportedly  
10 enjoy favorable tariffs and be free from visa requirements.<sup>47</sup>

11 But it remains to be seen whether foreign investment, Chinese or otherwise,  
12 and the proposed free trade zone will indeed improve the timber export mix in  
13 Russia’s favor. Japanese investment in wood processing quickly dried up and  
14 did little to enhance the region’s wood-processing capacity. Given China’s rapid  
15 expansion of capacity in Manchuria, the window of opportunity for the RFE to  
16 build its own plants is closing quickly.

#### 17 *Moscow seeks increased investment through recentralization*

18 The federal government is seeking to encourage the private-sector investment  
19 necessary for constructing a competitive wood-processing sector. Aside from  
20 coordinating support through presidential envoy Pulikovskiy’s office, the Putin  
21 administration’s forest sector development strategy has focused on legislative  
22 and administrative reform. In 2003, after years of piecemeal attempts, the  
23 administration proposed a complete overhaul of the 1997 Russian Forest Code  
24 in hopes of finally providing transparent and stable rules for the management  
25 and use of forest resources. Establishing a clear division of responsibilities  
26 between the center and regions – a relationship that has oscillated back and forth  
27 since early *perestroika* reforms – is a primary objective of this revision. With  
28 these responsibilities sorted out, federal officials hope a legal framework will  
29 finally be in place that provides secure and long-term access to forest resources.  
30 Such a stable environment should attract more investment.

31 Under the Putin plan, regional governments would retain some control, but  
32 the proposed changes are designed to recentralize power. Restructuring the  
33 timber leasing process is one of the primary means to achieve this goal. The  
34 1997 Code predominantly favors discretionary and short-term allocation of  
35 forest leases by regional administrations.<sup>48</sup> This crony-friendly system would be  
36 replaced with a federally controlled, open price-based auction system. Long-  
37 term leases would be extended to 99 years (from the current 50) and regional  
38 governments would no longer be able to allocate leases for short-term use (five  
39 years or less). They would retain the right to administer auctions, but only  
40 through special delegation agreements. In addition to increasing federal control,  
41 these changes clearly favor large companies by making it even more difficult for  
42 small companies to gain access to timber resources. To address the problem of  
43 weak law enforcement, a new Federal Service for Oversight in Natural  
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Resources, which would not be able to charge fees, would oversee forest users, the leasing process, and the Federal Forest service, which will remain the primary agency responsible for forest management and use.

Yet four years after efforts to revise the Forest Code began, revisions remain in draft form, stymied by continual, but fruitless, debates between stakeholders. To illustrate the problem, in one case the Putin administration wanted to give lessees in good standing the right to buy out (privatize) their leased forest parcel 15 years into their lease, but after vociferous debate this plan was temporarily shelved. Those who benefit from the current arrangements, including regional administration officials, are clearly resisting reform. In the case of the timber sector, Yeltsin-era reforms delegated so much power to the regions, and there are so many vested interests benefiting from the status quo, that even a very strong central government will have difficulty regaining control. As Thornton notes, policy makers will try to “block or distort changes in the rules of the game that threaten to reduce the value of their existing control rights.”<sup>49</sup>

Moscow’s neglect becomes apparent when one considers the perverse nature of Russian export tariffs for timber. Currently, tariffs are higher for processed wood products than for raw logs. The export tariff for particleboard is 10 percent of the production cost (but not less than \$4 for each cubic meter) versus 6.5 percent for logs (not less than \$2.50 per cubic meter). Fortunately, there are signs that the Russian government has finally started to address this situation. The government has adopted resolutions abolishing tariffs for laminated forest products and newspaper in sheets or rolls, and a recent proposal recommends a gradual increase in export duties on logs.<sup>50</sup>

The federal government may elect to follow in Indonesia’s footsteps and take the more drastic measure of banning all log exports. Such bans have been shown to increase domestic value added processing. But they are highly controversial, because some believe such protections prop up an industry that would otherwise be uncompetitive internationally. Others criticize them because the countries that institute them are generally inefficient at milling their own timber and would, therefore, be better off by specializing in log export. It is hard to imagine how a ban would exacerbate resource waste, given the already enormous levels of waste at Russian logging sites. The more pertinent issues with respect to Russia are whether such a ban would temporarily debilitate the entire industry, whether the sector would attract foreign and domestic investment, and whether the Russian government would be willing to risk retaliatory trade measures by the Chinese government. These concerns aside, it is curious that export bans have been noticeably absent in federal-level debate about how to reform the timber sector.

### **Conclusion: prospects for conflict and cooperation**

An array of corrupt state–business alliances emerged out of the chaotic post-Soviet era to provide a certain stability in the Russian Far East timber sector. Today, there is little chance of a complete breakdown of law and order, such as

1 in the Congo, where rebel-occupied territories are financed by illegal logging  
2 and trade.<sup>51</sup> Individual officials inside the Russian government who profit from  
3 the status quo ensure order within the industry and keep the peace along the  
4 Russian–Chinese border so that the trade can continue. But these alliances  
5 provide benefits only for a select few and undermine the broader, long-term  
6 interests of the state, such as increased domestic and foreign investment, higher  
7 tax revenue, improved forest management and use, and an internationally  
8 competitive wood-processing sector.

9 If Russia does not take action soon, the rife corruption in the Far Eastern  
10 forestry sector could provoke conflict with China, which has benefited from the  
11 situation. Public resentment about the export of jobs and lost profits across the  
12 border could undermine the current stability.

13 Regional leaders realize the need to reform the timber sector and increase  
14 Russia's ability to profit more from its natural resources. But reform efforts have  
15 been sporadic. Regional administrations are crippled by internal corruption and  
16 generally lack the necessary financial and administrative resources necessary to  
17 impose change. Only a federal government committed to fundamental and com-  
18 prehensive reform will be able to wrest control of the timber sector from current  
19 power brokers, though such efforts ultimately may only move corruption from  
20 the regional to the federal level. For the Putin administration, the timber sector  
21 remains a low priority, efforts to rewrite the Forest Code and public announce-  
22 ments about the need for foreign investment in the processing sector notwith-  
23 standing.

24 Whatever measures the Putin administration decides upon, it would be well  
25 advised to find a solution to the RFE's weak manufacturing capacity soon.  
26 Public resentment in the RFE over perceived Chinese economic dominance  
27 appears to be steadily increasing, if regional newspapers like *Tikhookeanskaia*  
28 *Zvezda*, *Vladivostok*, *Dal'nevostochnyi Federal'nyi Okrug*, and *Priamurskie*  
29 *Vedomosti* are any indication.<sup>52</sup> Of course, the Far East's governors have long  
30 manipulated public sentiment toward China for their personal political purposes,  
31 and the region's newspapers reflect the interests of their corporate and state  
32 owners, but their discussion of the forestry sector touches on issues of real  
33 concern and cannot be dismissed as mere propaganda.

34 "China has the clear intention of turning the RFE into a raw materials  
35 appendage of its northern provinces," writes *Tikhookeanskaya Zvezda* journalist  
36 Raisa Eldashova.<sup>53</sup> Russian leaders frequently express similar views. After an  
37 October 2003 meeting between regional Russian and Chinese leaders, presiden-  
38 tial envoy Pulikovskiy commented that when presented with investment projects,  
39 "the Chinese party always returned to the idea of simple trade as the most bene-  
40 ficial to China."<sup>54</sup> This is emblematic of the contrast between Russian develop-  
41 ment visions for the RFE with those of the Chinese decision makers: Russians  
42 want investment, Chinese want timber without any strings attached.

43 Local papers are also littered with reports of illegal resource harvesting by  
44 Chinese on Russian territory. Russian resources are being "shamelessly plun-  
45 dered by the Chinese," writes *Priamurskie Vedomosti* journalist Pavel

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Bondarevskii.<sup>55</sup> The numerous reports of logging and timber smuggling, and collection of pine nuts, endangered ginseng, fur pelts, and the like undoubtedly have merit, but so do the countless incidents of illegal harvesting by Russian nationals. “What Far Easterners should fear . . . is the plundering of the RFE’s natural resources by inventive Russians who market them to China, Japan, the US, South Korea, and other countries,” writes Viktor Larin, hoping to inject some reason into the debate.<sup>56</sup>

Reform should also proceed with haste, because the window of opportunity for Russia to develop a processing industry that can compete with Chinese plants is closing rapidly. China is already the world’s largest furniture exporter and will soon become the largest plywood exporter. Chinese manufacturers are now major producers of flooring products and a variety of engineered wood products. Giant Western firms, such as Wal-Mart, Home Depot, and IKEA, are fueling the Chinese expansion by providing investment and technology to their Chinese suppliers.

The danger is that Russian fears (real or perceived) of China’s emerging economic dominance will stoke long-held Russian concerns about Chinese migration into the Russian Far East. Russian apprehensions could result in conflict that could be manifested in a variety of ways ranging from a general chilling of relations, to clamping down of borders by regional and federal authorities, to incidents of ethnic violence.

In a more optimistic scenario, the federal government could embrace the challenge and use timber-sector reform as a means to achieve larger geopolitical objectives. Economic prosperity, driven in part by an expanding processing sector, would discourage the two-decade-long out-migration that has drained the social and intellectual capital of the RFE. Reversing this trend would provide increased security and stability along Russia’s eastern borders as China continues to grow.

It may be that the federal government lacks the capacity to push through reforms. Or that the Far East’s forestry sector is so corrupt and decentralized that the Putin administration is not sure what can be done to reform it. But if it is a matter of political will, as I believe, then what is required is a fundamental shift in how Moscow approaches the development of the Russian Far East.

## Notes

- 1 This theme pervades J. Thornton and T. Ziegler, eds., *Russia’s Far East: A Region at Risk*, Seattle and London: National Bureau of Asian Research and University of Washington Press, 2002.
- 2 The most insightful history of the region remains J. Stephan, *The Russian Far East: A History*, Stanford, CA: Stanford University Press, 1994.
- 3 Some question the extent of the commercially viable resource base; see M. J. Bradshaw and N. J. Lynn, “Resource-based development in the Russian Far East: Problems and prospects,” *Geoforum* 29, no. 4, 1998, pp. 375–392.
- 4 On this theme, see work by Mikhail Alekseev: M. N. Alekseev, *Globalization at the Edges of Insecurity: Migration, Interethnic Relations and International Economic Interactions in Russia’s Border Regions*, Zurich: Center for Security Studies and

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- Conflict Research, 2002; and M. N. Alekseev, "Economic Valuations and Interethnic Fears: Perceptions of Chinese Migration in the Russian Far East," *Journal of Peace Research* 40, no. 1, 2003, pp. 85–102.
- 5 Large-scale infrastructure projects have long been used as a means to extend influence over the peripheries and to secure borders. The Trans-Siberian Railroad and the Baikal Amur Mainline (BAM) are two notable examples.
- 6 By most accounts, the fishing industry is the RFE's largest. Like the timber industry, it too has experienced tremendous fragmentation. International conflicts over access to marine resources in the Sea of Okhotsk have been marked by violence.
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- 9 Data are from 1995 and come from the Far Eastern Forestry Inventory Enterprise, based in Khabarovsk.
- 10 On 17 May 2000, Putin issued Decree 867, "On the Structure of the Federal Bodies of the Executive Authority," which handed over the functions of the Committee on Environmental Protection (*Goskomekologia*) to the Ministry of Natural Resources. The Forest Service was also folded into the ministry, but remains a distinct entity.
- 11 A. S. Sheingauz, V. P. Karakin, and V. A. Tyukalov, *Forest Sector of the Russian Far East: A Status Report*, Khabarovsk: Economic Research Institute, Far Eastern Branch of the Russian Academy of Science (FEBRAS), 1996, p. 48.
- 12 While reforms in the timber sector began as early as 1988, large-scale change really started with the first phase of privatization (1993–1996).
- 13 A. S. Sheingauz, *Developing a Forest Conservation Strategy in the Russian Far East*, Khabarovsk: Economic Research Institute, FEBRAS, 2003, p. 44.
- 14 Sheingauz, *Developing a Forest Conservation Strategy*, p. 44.
- 15 A. Lankin, *Status and Trends in Forest Product Exports from the Russian Far East and Siberia to China*, Vladivostok: Pacific Institute of Geography, 2004, p. 40.
- 16 Based on a rough tally of RFE production statistics, these firms account for between 70 and 85 per cent of total annual production.
- 17 A key early law was "The Fundamental Forestry Law of the Russian Federation" adopted in March 1993. The Russian government tried to codify the many laws and regulations (which often conflicted) by adopting the Russian Forest Code in 1997.
- 18 Sheingauz, *Developing a Forest Conservation Strategy*, p. 44.
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- 20 M. A. Alexseev, "Socioeconomic and Security Implications of Chinese Migration in the Russian Far East," *Post-Soviet Geography and Economics* 42, no. 2, 2001, pp. 122–141.
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- 22 J. Thornton, *The Exercise of Rights to Resources in the Russian Far East*, Discussion Paper from the University of Washington, Seattle, Department of Economics, 1999, pp. 1–53, here p. 30, econpapers.repec.org/paper/fthwasher/0058.htm.
- 23 J. Newell, *The Russian Far East: A Reference Guide for Conservation and Development*, McKinleyville, CA: Daniel & Daniel, 2004, p. 133.
- 24 Newell, *The Russian Far East*, p. 175.
- 25 The agreement with Rimbunan was made at the same time as the Malaysian government purchased jet fighters that were built at a defense factory in Komsolmolsk-on-Amur. This timing raises questions about whether the logging concession was awarded to Rimbunan on entirely fair terms.



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- 27 A. Vasyenov, *Chinese Factor in RFE Economic and Business Development*, Khabarovsk: BISNIS, 2004, p. 6. 2
- 28 J. Newell, *The Russian Far East*, p. 71. 3
- 29 Useful compilations are the 1999 and 2000 editions of *Organized Crime and Corruption Watch*, published by the Transnational Crime and Corruption Center, American University, Washington, DC. See [www.american.edu/tracc/Publications/OCWatch/v2n2\\_2000.pdf](http://www.american.edu/tracc/Publications/OCWatch/v2n2_2000.pdf). 4
- 30 Sheingauz, *Developing a Forest Conservation Strategy*, p. 44. 5
- 31 S. Kuzmichenko, *Commercial News Update from the RFE*, Washington, DC: BISNIS, 2003, p. 4. 6
- 32 Alexander Sheingauz, interview by the author at the conference "Commercial Forestry in the Russian Far East," Yuzhno-Sakhalinsk, Russia, 18 September 2001. 7
- 33 World Wildlife Fund-RFE (WWF-RFE), *Implementation of the WWF Forest Strategy*, Vladivostok: WWF-RFE: Vladivostok, 2001, p. 11. 8
- 34 WWF-RFE, *Implementation*, p. 11. 9
- 35 The amount of timber that is simply smuggled out of the country without any form of documentation is actually quite small. While there are a number of land and river crossings along the Russian-Chinese border, most are small and have limited infrastructure on either side to handle significant amounts of timber. About 90 percent of all timber exported goes by train through three routes (Zabakalsk-Manzhouli, Gorodekova-Suifenh, and Naushki-Erlianhot). In the case of Japan and South Korea, timber moves by ship, which requires customs documents. 10
- 36 See Newell, *The Russian Far East*, pp. 72–73. 11
- 37 Such provisions are often a prerequisite for access to resources; a major factor when allocating large timber leases is the ability of the company to provide these services. However, this requirement has made the leasing process complex and subject to graft. It has meant other concessions by the state, such as a compromised ability to collect taxes and the loss of control over critical infrastructure. In the case of Terneiles, the concession is evident in the company's almost complete control over Plastun port. 12
- 38 M. A. Alexseev, "Socioeconomic and Security Implications." 13
- 39 Thornton, *The Exercise of Rights*, pp. 1–53. 14
- 40 A. S. Sheingauz, *Forest Industry of the Russian Far East: A Status Report*, Khabarovsk: Economic Research Institute, FEBRAS, 1999, p. 48. 15
- 41 Despite recent proclamations that the industry is rebounding, comparing the percentage of roundwood as a portion of total exports to the major markets for two periods, 1997 and 2002, reveals it has remained essentially the same for Japan and South Korea and deteriorated for China: Japan (88 percent and 86 percent), South Korea (95 percent and 94 percent), and China (74 percent and 90 percent). 16
- 42 This timber comes almost entirely from the southern RFE and southeastern Siberia. 17
- 43 S. Ziufang, *Meeting Chinese Demand for Forest Products*, Washington, DC: Forest Trends, 2004, p. 50. 18
- 44 No author, "China to Launch Largest Lumbering Project in Russia's Far East," *People's Daily* (Beijing), 7 July 2003, [english.people.com.cn/200307/07/eng20030707\\_119621.shtml](http://english.people.com.cn/200307/07/eng20030707_119621.shtml), (accessed 5 June 2005). 19
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