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## RUSSIA-CHINA RELATIONS



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Analysis

# Russian-Chinese Relations: Current Trends and Future Prospects

By Vladimir Portyakov, Moscow

## Abstract

The Russian-Chinese relationship has been strengthening since the signing of the "Treaty of Good-neighborliness, Friendship and Co-operation" in 2001. Against this background, 2008–2009 saw both progress and negative patterns in Russia-China relations. The main features of Russian-Chinese relations in 2008–2009 were associated with the presidential transition in Russia and the impact of the world economic crisis. Cooperation took on an increasingly intense dynamic and some significant agreements were reached, demonstrating that the relationship can survive leadership changes. However, the global economic crisis impacted on trade and also highlighted the growing imbalance between the two countries, with China's seemingly continual economic growth signaling a change in the power relationship between Moscow and Beijing.

## A Decade of Expanding Cooperation

On July 16, 2001 Chinese President Jiang Zemin and Russian President Vladimir Putin signed "The Treaty of Good-neighborliness, Friendship and Co-operation between Russia and China". This treaty aimed to lay the foundations for the long-term comprehensive development of relations and strategic interaction between the two countries within an equal and trust-based partnership. Indeed, the growing scale of their strategic partnership and incremental diversification of its forms and methods have ensured an overall positive background to Russian-Chinese relations in the first decade of the XXI century. It is symptomatic that the experts from the Institute of International Affairs at Tsinghua University in Beijing, in rating the strength of China's foreign relationships according to a quantitative assessment of whether they are seen as "hostile" (-9 to-3), "not hostile, not friendly" (-3 to 3) or "amicable" (3 to 9), awarded China-Russia relations the highest rating of 8 points at the beginning of 2008 (compared to 5.5 points in 2000), while Sino-French relations received 6.3 points, India 5.4 points, and the United States 1.1 points.

## Developments in 2008–9 and Their Impact

In 2008–2009 some important developments in Russian-Chinese relations took place, and as a result the relationship has taken on some new features and nuances connected with the internal political processes in both countries, as well as advances in world affairs.

### *A New Russian President*

Significantly, the full range of China-Russia relations remained unaffected and adapted painlessly to the presidential transition in Russia. This resiliency can be attributed to the objective interests of both Russia and China in continuing their mutually beneficial cooperation, the common ideological and political platform the new president shares with his predecessor, and Medvedev's familiarity with China. As deputy prime minister in 2006–2007, he headed Russia's effort during the "Year of Russia" in China and the "Year of China" in Russia.

In addition, China welcomed the fact that the newly elected Russian president chose China for his first foreign visit outside the CIS. The significance of Medvedev's visit to China, held on 23–24 May 2008, was highlighted by the signing of a Joint Declaration outlining their agreement on major international issues. This document reaffirmed the commitment of both countries to civilizational and cultural diversity within the world community and to the formation of a multipolar world. Dmitry Medvedev and Hu Jintao continued the tradition of regular meetings (several times a year) to exchange views on pressing international and bilateral issues, which was established during the presidency of Vladimir Putin. Moreover, in 2008–2009 contacts in this format became more intense: apart from the official visits (Hu Jintao visited Russia in June 2009) and meetings on the sidelines of the G8 summit, APEC and the SCO, there were bilateral meetings at the summit of BRIC (Ekaterinburg, Russia, June 2009) and the G20 (three times).

### *New Agreements and Cooperation*

These multi-level mechanisms replenished bilateral cooperation with new elements at new levels, which have made practical interaction more effective. An "Action Plan for 2009–2012" aimed at the implementation of the "Treaty of Good-neighborliness, Friendship and Cooperation" was adopted by the two countries. A Russian-Chinese energy dialogue took place at the lev-

el of vice-premiers, which helped to conclude new agreements on cooperation in the oil and gas sector, including agreements on building the Skovorodino-Daqing oil pipeline, and on the provision of a Chinese bank loan of $25 billion to Russian oil companies "Transneft" and "Rosneft". This loan should be reimbursed by Russia's future pipeline oil deliveries to China (300 million tons within 20 years, starting from 2011). During the 14th regular meeting in October 2009 in Beijing, the two countries' prime ministers reached an agreement on the supply of Russian natural gas to China starting from 2014–2015 (up to 70 billion cubic meters). In the investment sphere, bilateral cooperation has received an additional stimulus: in June 2009, the heads of state approved a plan for Russian-Chinese cooperation in the investment sphere, and in September 2009 approved a program of cooperation between the regions of the Russian Far East and Eastern Siberia, and the Chinese North-East for 2009–2018, including in the fields of resources excavation, manufacturing, and transport facilities construction.

Beyond economic cooperation, a Joint Commission on the rational use and protection of trans-border water resources was established, strengthening cooperation between Russia and China on environmental protection. Cooperation between the two countries in the military field also continued to develop. In December 2008 and November 2009, meetings of the bilateral commission on military-technical cooperation took place. In July 2009 new Russian-Chinese military exercises entitled "Peace Mission – 2009" were organized in China. Culturally, the "Year of Russian Language in China" was the biggest event in the sphere of bilateral humanitarian cooperation, with 2010 proclaimed to be the "Year of Chinese Language in Russia".

### *60th Anniversary of Diplomatic Relations*

In addition to practical agreements, Russia and China celebrated the 60th anniversary of the establishment of diplomatic relations on October 2, 1949 between the newly declared People's Republic of China and the Soviet Union, whose legal successor from the end of 1991 is Russia. Several special events were organized around this anniversary to mark the occasion: exhibitions of archival documents from the 1949–1955 period were held simultaneously in Moscow and Beijing, the 3rd Forum of social scientists in Russia and China took place on June 2009 in Beijing, and a special issue of Russia's leading journal dealing with China *Far Eastern Affairs* (2009, No. 5) was published. In an exclusive interview with the journal, Russian Foreign Minister Sergey Lavrov said that the "strategic partnership established between Russia and China represents an important factor in strengthening stability and security in Eurasia and the world at large." Additionally, Deputy Foreign Minister Alexander Borodavkin pointed out in his article that, now "Russian-Chinese relations, being at the highest level in their history, are making an invaluable contribution to developing the economies of the two countries."

## The Impact of the Global Financial Crisis

However, in spite of a general upward trend in development, Russian-Chinese relations in the past year and a half have also experienced the negative influence of the global economic crisis.

### *Decline in Trade*

The level of bilateral trade between the two countries suffered the greatest impact from the crisis. Turnover in trade between Russia and China had increased from $8 billion in 2000 to $56.8 billion in 2008 – just slightly below the level of $60 billion, which was declared as a target for 2010. However, from September 2008, the volume of trade began to decline. The decrease in Russian–Chinese trade turnover was caused by the deteriorating economic environment and declining investment and consumer demand in Russia, by the depreciation of the ruble, which resulted in the higher cost of imported goods from China and, finally, by lower world prices for oil and petroleum products, which provide over half of Russian exports to China by cost. As a result, in 2009 the volume of Russo-Chinese trade declined, according to Chinese customs statistics, by 31.8 percent – to $38.8 billion. Chinese exports to Russia fell by 47.1 percent – to $17.5 billion, and Chinese imports from Russia declined by 10.7 percent – to $21.3 billion.

Russia's position as a trading partner for China dropped from its previous place of the 8th largest to 11th, and was overtaken by Australia, India and Brazil. Russia's share in China's foreign trade turnover decreased to 1.76 percent compared with 2.22 percent in 2008. In the coming years, the task of restoring the pre-crisis level of bilateral trade will be a priority, pushing into the background the problem of diversifying Russia's exports to China and increasing the share of machinery products, which in recent years was about 1–2 percent.

### *Russian Domestic Economic Pressures*

In Russian domestic economic affairs, the Russian government's desire to protect domestic producers of consumer goods led to the closure in July 2009 of the

wholesale Cherkizovsky market in Moscow, where the bulk of commodities were imported from China under the so-called "gray customs clearance" scheme, that is without payment of full customs duties. Since about 50,000 Chinese merchants were involved in these trade flows to the Cherkizovsky market, it is likely that the total number of Chinese labor migrants in Russia in 2009 decreased (in 2008, according to official statistics, 281,000 of these Chinese laborers were legally registered in Russia). While the situation concerning the closure of the market was formally resolved, it provoked a significant backlash in China. As a consequence, in October 2009 experts based at the Institute of International Affairs of Tsinghua University reduced their evaluation of the standing of Russian-Chinese relations from 8 points at the start of 2008 to 7.8.

### *Wider Impact of the Economic Crisis*

The impact of economic crisis on Russia-China relationship goes beyond trade. The crisis clearly showed the growing economic and technological gap between Russia and the current leading economic powers in the world, illustrating the urgent need to implement a comprehensive modernization of Russia in a short space of time. It is quite natural in this context that leading Russian experts in political economy have devoted a lot of attention to the Chinese experience of modernization. Despite the prevalence of negative opinions regarding the adoption of the Chinese model in Russia, participants in the debate argue that "it still might be beneficial for Russia to adopt certain appropriate and suitable findings or best practices and examples from China's experience of modernization". In my opinion, the very idea of "the Chinese horizon of Russia's modernization" symbolizes the radical change of roles: Russia, seen as the teacher of China for much of the 20th century, has now become a pupil of China.

In 2009 China's GDP growth exceeded 8 percent, while Russia's GDP fell by 7.9 percent. As a consequence, the ratio of the two countries' GDP (in 2008 dollars) rose from 2.63:1 in 2008 to 3.13:1 in 2009 with the prospect of an even larger increase by 2012, when Russia expects to have restored its economy to its pre-crisis level.

It is important to stress the following nuance: If in previous years Russia had consistently outpaced China in the level of its socio-economic development, then more recently there has been an obvious closing of the gap, due to the upward trend of China's development and a simultaneous downward trend in Russia. This pattern can be indirectly confirmed by the "prosperity index", which is calculated in the UK for 104 countries based on an analysis of the variables of economic situation, education, personal security, political freedom, health care, and political institutions. In 2009, Russia was ranked 69th, and China 75th. However, the most significant gap between Russia and China across these variables was the economic component, with Russia ranked 39th and China 29th.

## Prospects for the Russian-Chinese Relationship

In terms of the hierarchy of foreign policy priorities in Beijing, the relative weakening of Russia objectively increases the importance of relations with the West and especially with the United States. Indeed, this factor will most likely have a greater impact on Russian-Chinese cooperation in the future than it has played before. Another important variable likely to impact on Russian-Chinese relations in the upcoming years will be the "2012 factor" – this year will see the election of a new president in Russia, as well as the renovation of the top party and state leadership in China. This consideration should be taken into account with regard to the future prospects of bilateral Russian-Chinese relations.

However, in spite of these negative factors for development, the Russia-China relationship has significant reserves and both countries have the objective need to further improve and deepen their strategic partnership. Therefore, it seems that a positive dynamic will continue between the two countries in the foreseeable future.

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*Recent Publications:*

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Analysis

# Sino-Russian Relations 2009 to 2010: A Perspective from China

By Zhao Huasheng, Shanghai

## Abstract

2009 was a significant year for Russia-Chinese relations. Six events and developments were particularly important: the 60th anniversary of Sino-Russian diplomatic relations, a greater range of economic cooperation, the sinking of the "New Star" Cargo ship, the closure of the Cherkizov market, the emergence of the G2 concept and the opening of the China-Central Asian gas pipeline. These events illustrate a normalisation of Russian-Chinese relations with a growing readiness on both sides to criticise as well as praise one another without the concern of damaging the relationship, suggesting a maturing and potential widening of relations.

The past year was very significant for Sino-Russian relations, with a number of new developments that have impacted upon the relationship, and will have a bearing on 2010. Among these events, six of them have a particular significance.

## 60th Anniversary of Sino-Russian Relations

Last year marked the 60th anniversary of Sino-Russian diplomatic relations. This landmark is particularly significant because according to Chinese tradition, a period of 60 years represents the end of one cycle and beginning of a new cycle. To mark this anniversary, the two governments organized a series of high profile commemorative activities: the Chinese and Russian Presidents, Hu Jintao and Dmitri Medvedev, attended a ceremony in Moscow, while the Chinese Premier, Wen Jiabao, and Russian Prime Minister, Vladimir Putin, attended a ceremony held in Beijing. These commemorations were intended, on the one hand, to sum up the history of Russian-Chinese diplomatic relations since 1949, but more importantly, they were aimed at injecting a new impetus, especially in promoting non-governmental cooperation and enhancing mutual understanding between the Russian and Chinese populations.

Non-governmental cooperation is an important area for the development of Sino-Russian relations, because at present, non-governmental cooperation is a weak point in their bilateral relationship. Both Beijing and Moscow declare that Sino-Russian relations are currently in the best period of their history. At a political level, this judgment is correct. However, in some other respects, relations should not be seen as superior to those in the past. For example, the sense of camaraderie and friendship between the Chinese and Russian people is currently much lower than was evident during the 1950s. The perceptions of one another within the national consciousnesses of China and Russia are also not as positive as they were during the 1950s. At that time China and the Soviet Union not only regarded each other as a friendly countries and peoples, but both the political elite and wider populations saw the other as their primary partner within the international system. Today, their images of each other are much more complicated. A range of opinion about the other is found in both countries, including both positive and negative images; some people see the other as a friendly country, but some perceive the other as a potential threat and express a lack of trust.

There are many explanations for this situation, including the passing of time and greater social pluralism within both countries, but a lack mutual understanding and misperception of one another is also a factor. This poses a problem for the Russian-Chinese relationship, because without broad popular support it will be difficult to maintain long-term stability. The political leaderships of both China and Russia are aware of this issue, and are paying increasing attention to non-governmental exchanges. In recent years, China and Russia held "The Year of China" in Russia and "The Year of Russia" in China. In 2009 a new round of this cultural exchange began, this time focused on language, with China recently completing "The Year of Russian" in China, and Russia currently holding the "The Year of Chinese" in Russia.

## Continued Economic Cooperation

The second major development in 2009 was that in spite of the world financial crisis, China and Russia made significant progress in economic cooperation, particularly in the field of energy. As a consequence of the global financial crisis, there was a serious drop in the level of Sino-Russian trade, with bilateral trade volume reduced by about 30 percent. In 2008, Sino-Russian trade reached $56.8 billion, while it fell to less than $40 billion in 2009. However, this drop in the total monetary

value of bilateral trade does not represent an equivalent drop in the amount of goods traded, rather the price paid for these goods fell.

Moreover, economic cooperation between the two countries continues to be significant, with cooperation on energy the biggest bright spot of the last year. Future developments look promising as well. In 2009 China and Russia signed a formal agreement exchanging loans for oil. China will provide long-term loans of $25 billion to Russia, with $15 billion going to the Russian oil company "Rosneft" and $10 billion to the Russian oil transportation company "Transneft". In return, Russia will repay the loans by providing China with 300 million tons of oil, at an average annual volume of 15 million tons, from 2011 to 2030. To transport this oil, some of these loans are being used for the construction of a spur from the Eastern Siberia – Pacific Ocean oil pipeline to China. This new pipeline extension is expected to be completed in 2010. If all goes well, Russian oil will flow into China through this pipeline from the beginning of 2011. Meanwhile, the Sino-Russian Energy Investment Company acquired a 51 percent stake in the Russian oil and gas company "Suntarneftegaz" and obtained the development and production rights to two gas fields in East Siberia. Although these deals are not large-scale, they indicate that Sino-Russian energy cooperation goes beyond simply the sale of oil, and extends to cooperation in exploiting gas fields from upstream to downstream industries.

Natural gas cooperation is an area with great potential. After more than five years of negotiations, in 2008 Moscow and Beijing reached a framework agreement on plans to construct two routes (East and West) to China from existing Russian gas pipelines, through which Russia will provide China with 68 billion cubic meters of natural gas annually. The western pipeline will provide 30 billion cubic meters via a West Siberian gas source and the eastern route will provide 38 billion cubic meters, via the Sakhalin natural gas pipelines. In the last days of 2009 China National Petroleum Corporation and Gazprom signed an agreement on the basic conditions for this gas supply and both sides agreed to work towards signing a formal contract in 2010.

Besides energy cooperation, China and Russia approved "The Planning Framework for Regional Cooperation between Northeast China and the Russian Far East and Eastern Siberia" in 2009. This document envisions a large-scale agenda, which involves more than 200 projects for economic cooperation on a regional level.

## Sinking of the New Star

On 15th February 2009, a Russian border patrol gunship off the coast of the Russian Far East sunk the "New Star" cargo ship, which was registered in Sierra Leone, killing 8 crew members, including 7 Chinese citizens. The Russian gunship opened fire on the "New Star" as it tried to escape from Nakhodka, a port in the Russian Far East, where it was being detained because of a commercial dispute. The incident caused a strong response among the Chinese population. The Russian Foreign Ministry claimed that Russian border guards acted within the law. However, many Chinese people considered that Russia's actions in using force to sink a merchant ship, and not actively rescuing its crew, was a barbaric act showing contempt for human life. The Chinese Foreign Ministry also publicly intervened in the matter, holding an emergency meeting with the Russian ambassador to China, after which the Chinese Foreign Ministry officials publicly expressed dissatisfaction with the attitude of the Russian authorities. It is very rare for a civilian incident to cause public dispute between the two countries' foreign ministries. Indeed, in the past the two countries dealt with such problems in consultations behind closed doors.

## Closure of the Cherkizov Market

The fourth event was the sudden closure of the Cherkizov market in Moscow. Cherkizov was Moscow's largest retail market. It was also the main gathering place for Chinese businessmen, with some tens of thousands of Chinese people doing business there. In June 2009, the Russian government suddenly and forcibly closed the market, detaining goods from the market. This incident resulted in a large number of Chinese businessmen suffering huge economic losses. This event also aroused strong feeling in the Chinese media and public. The main reason that the Russian authorities gave for shutting the market was to strengthen enforcement of economic laws. However, many Chinese believe that the closure was intended to protect Russian domestic producers.

The goods that were sold in the Cherkizov market mainly transited through the so-called "gray customs clearance" procedure for exporting goods to Russia. "Gray customs clearance" appeared in the early 1990s. At that time, Russia was suffering from a serious shortage of consumer goods. As a result, a large number of Chinese businessmen became involved in non-governmental trade between China and Russia in order to fill this void, only to find that Russia's cumbersome customs clearance procedures hindered such trade. In or-

der to simplify the customs procedures, the Russian Customs Committee specified that some traders could receive clearance for all their imports under one declaration. In this way, entire consignments of goods delivered by plane could be cleared with a single customs declaration form. Later, this approach was extended to customs clearance for shipping and rail transport. Through "gray customs clearance", the sender simply paid customs duties in China and was able to accept receipt of his goods without having to provide customs declarations. An intermediate agent company took responsibility for all other intermediate links, including transportation, customs clearance, and commodity inspection.

However, the Russian government now claims that "gray customs clearance" is associated with smuggling, and has taken several steps to shut down this procedure, although in practice this form of customs clearance is still allowed to exist. The sudden closure of the Cherkizov market and the declared end to "gray customs clearance" has dragged Chinese officials into the debate. The Chinese state position is that it has no objection to the Russian authorities regulating economic trade, but the historic background against which the practice of "gray custom clearance" developed should also be taken into account and the legal interests of Chinese businessmen should be protected.

## The Emergence of G2 Concept

The fifth event was emergence of the G2 concept, bringing together China and the US as the most important economies. In the context of the global economic crisis, China's strength and influence has grown rapidly and the idea of the G2 has spread within international politics. The G2 concept was proposed by the US, but its emergence also represents a test for Sino-Russian relations. If the Chinese accept this idea, then the Sino-Russian strategic partnership is bound to collapse. Within Chinese academic and public opinion, the G2 concept caused different reactions. Some take a positive outlook, considering that it raises China's international status and increases its voice within the international system, however, the mainstream view is negative. First, politically, it is not compatible with Chinese political culture. China stands for a multi-polar world and equality and fairness within the international community. The philosophy behind the G2 is clearly contrary to this political principle. Second, despite the increase of China's national strength, China is still a developing country and its GDP per capita remains low; it still faces numerous internal problems, which are not consistent with the G2 position. Third, if China accepts the G2 concept, it will make relationships between China and other countries difficult. More than that, some people believe the G2 idea is a trap, which China must not fall into. Indeed, it should be noted that China's official position in fact rejected the G2 concept. During President Obama's visit to China in November 2009, Premier Wen Jiabao clearly expressed opposition to the idea of Sino-US co-governance.

## Natural Gas Linkages

The sixth major event is the opening of the China-Central Asian natural gas pipeline in December 2009. The pipeline pumps gas from Turkmenistan through Uzbekistan and Kazakhstan to China. According to the agreement, Turkmenistan will provide China with 30 billion cubic meters of natural gas annually for 30 years, of which 13 billion will be produced by a Chinese company based in Turkmenistan, and the other 17 billion will be provided by Turkmenistan.

The China-Central Asia gas pipeline is a project of bilateral cooperation, but it also has an impact on Sino-Russian relations. Until recently, Russia held a monopoly over gas export pipelines in Central Asia and it has tried hard to maintain that position. Apart from a small pipeline from Turkmenistan to Iran, Central Asian natural gas export routes are fully dependent on Russia, owing to the legacy of Soviet infrastructure. In 2003, Russia and Turkmenistan signed a long-term gas cooperation agreement. Russia will buy 2 trillion cubic meters of natural gas over 25 years. In 2007, Russia and Turkmenistan signed a further agreement to build a gas pipeline along the Caspian Sea to Russia.

Objectively, the China-Central Asia pipeline has broken the Russian monopoly on natural gas export routes. However, although China has built a gas pipeline and is purchasing natural gas from Central Asia, it does not have any intention of challenging Russia in Central Asian energy exports. China's interest is solely to serve its domestic energy needs. After the collapse of the Soviet Union, and the resultant fundamental changes in the political structure within the former Soviet space, a change in the economic structure is natural and inevitable, including in terms of energy. The question is only how and when. A multi-actor and more balanced energy structure in Central Asia is in the interests of the Central Asian Republics. In some respects, this kind of structure also serves the interests of importers, because it provides a more stable structure. Russia has a natural gas contract with Turkmenistan, but Russia buys gas in order to re-export it. However, these sales are subject to the highly volatile international market.

Once an international drop in demand of natural gas occurs, Russia does not need this gas. In 2009, due to lower demand for gas in Europe, Russia substantially reduced its purchase of Turkmenistan's natural gas, and has completely stopped buying from April 2009 after an explosion in the pipeline. This development of events placed Turkmenistan in a very difficult economic situation, because gas exports are its main source of revenue. Russia and Turkmenistan reached a new agreement in December 2009 that from January 2010, Russia will resume importing natural gas from Turkmenistan, but in less volume than before, 30 billion cubic meters annually. In this context, the opening of the China-Central Asia natural gas pipeline does not damage Russia's interests directly. In 2008 Turkmenistan produced 75 billion cubic meters of natural gas, and this figure will continue to grow in order to meet the current demand for exports. Indeed, Russia reacted positively to the opening of the China-Central Asia pipeline. In December 2009, Russian First Deputy Prime Minister Igor Shuvalov said in Almaty that Russia supports the project, and Prime Minister Vladimir Putin has also said that the China-Central Asia pipeline would not damage Russia-China energy cooperation.

## Implications

These six events impacted Sino-Russian relations in 2009. They also indicate certain new trends in Sino-Russian relations. First, China and Russia are trying to break through the bottleneck blocking economic cooperation in order to lay a strong economic foundation to their relationship. Second, wider-societal issues are increasingly prominent in Sino-Russian relations, whereby "low politics" has began to affect "high politics". However, these wider low-level issues are becoming the most unstable elements in Sino-Russian relations. Third, sentimental elements are decreasing, and the two governments have begun to manage their bilateral relations in a more practical way. Increasingly, the officials of the two governments feel able to openly ask questions and express their dissatisfaction with one another. In a certain sense, this represents a normalization of the relationship. Fourth, the Sino-Russian relationship has successfully withstood the test of the energy issue in Central Asia. Many analysts predicted that Sino-Russian energy competition in Central Asia would lead to conflict between Moscow and Beijing, however, conflict did not occur.

2010 could be a productive year for Sino-Russian relations. Politically, Sino-Russian relations will maintain their positive dynamic. Besides interaction at international events and meetings, the presidents of the two countries will meet at least four times bilaterally, and at the summits of the Shanghai Cooperation Organization and BRIC grouping. As a result, political cooperation, both at regional and international levels, will be strengthened. Also, a breakthrough in energy cooperation may occur in 2010. If all goes well, significant results in energy cooperation are planned in the form of the completion of the China-Russia oil pipeline as well as gas deals. In 2010 Russia will hold "The Year of Chinese Language" in Russia, which will provide the main framework for Sino-Russian societal and cultural exchange in the next year. This cultural initiative should form the basis for a good atmosphere in Sino-Russian relations, particularly improving the perceptions of one another in both societies.

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Analysis

# Sino-Russian Energy Relations: True Friendship or Phony Partnership?

By Shoichi Itoh, Washington

## Abstract

This article looks at the Russian-Chinese "strategic partnership" via the two countries' relations in the field of energy. East Siberian and Far Eastern Russia possess significant untapped oil and gas resources, while China requires ever larger supplies of energy. However, contrary to a straightforward arrangement of supplier and consumer, diplomacy and negotiations between Moscow and Beijing over the construction of pipelines has been difficult, owing largely to Russian concern about fuelling China's economic growth to its own geopolitical detriment. Thus, Russia has made slow progress in constructing pipelines to China, underscored by a sense of mistrust. Russia will soon complete an oil pipeline to China, but the proposed gas pipelines remain on paper for the foreseeable future.

## A Relationship Characterized by Questions

Over the last decade, China and Russia have devoted increasing attention to what they term as their "strategic partnership." Moscow and Beijing share interests in standing against the predominant influence of the United States and, more broadly, the West. It appears that with the signing of a final agreement in 2004 on the demarcation of the 4,000km-long Sino-Russian border and the completion of the related works in 2008, the biggest seed of historical distrust between the two countries has been removed, at least on the surface.

Recently, both countries' governments have emphasized that the political aspects of their cooperation need to be bolstered by the deepening of economic ties. The energy sector has been highlighted as one of the most promising areas within which to achieve this goal, given the rich hydrocarbon potential in the regions of the Russian Far East and Siberia and China's surging energy demand. Indeed, Russia's exports of crude oil to China by rail have rapidly increased from 572,000 tons in 1999 to more than 15 million tons in 2009. Additionally, in April 2009 Beijing and Moscow finally completed an intergovernmental agreement to construct a spur pipeline from the end-point of the first phase of the ESPO (East Siberia – the Pacific Ocean) pipeline to Chinese territory, in spite of Russia's earlier equivocal attitude concerning the timing of the pipeline's realization.

Do these events imply that mutual trust between China and Russia has grown through cooperation in the energy sector? Is it fair to assume that their bilateral energy partnership will go through a phase of evolutionary consolidation?

## The Paradox of the China Factor

Russia is increasingly striving to develop new energy infrastructure in its eastern flank, in order to capitalize on new market opportunities in the Asia-Pacific region. *The Energy Strategy of Russia for the period up to 2030*, approved by the Russian government in November 2009, outlines a planned acceleration in exploiting oil and gas supplies in eastern Russia, with the aim of exporting these products to the Asia-Pacific region. The strategy stipulates that Russia aims to increase the percentage of oil exports to the Asia-Pacific region, among its total oil exports, from 8 percent in 2008 to 14–15 percent in 2020–22 and to 22–25 percent in 2030 and that of natural gas exports from zero in 2008 to 16–17 percent in 2020–22 and to 19–20 percent in 2030.

China provides the main consumer market for Russia's eastern energy strategy. China's primary oil demand, for instance, is projected to increase by an average annual growth rate of 3.3 percent in 2007–2030, whereas that of the world is predicted to be 0.9 percent (the reference scenario in the International Energy Agency's 2009 *World Energy Outlook*). Unlike the upsurge in China's energy demand, Japan's energy demand has almost peaked with oil demand already on a gradual decline.

Ironically, however, domestic voices have emerged expressing alarm that the rapid increases in the amount of energy supplied to China might leave Russia as a "resource appendage", which strengthens its historical rival. The share of crude oil in Russia's total exports to China increased from 5 percent in 2000 to 40 percent in 2008. Admittedly, it is true that the Russian government is currently striving to boost the share of value-added products rather than raw materials in the overall structure of exports. Yet, the same kind of concern was never heard with regard to the fact that crude oil accounted for 40 percent of Russia's total exports to Japan in 2007.

Russia's paranoia about China is based on a geopolitical mind-set and has prevented it from adopting a trust-

ing attitude toward its "strategic partner". This mindset actually derives from Russia's own weakness in addressing its vast, yet economically underdeveloped and scarcely populated eastern regions. The population of the Far East is less than 6.5 million people, but comprises about 40 percent of Russian territory, and a trend of further depopulation has remained irreversible for the last two decades. By contrast, the combined population on the Chinese side of the Sino-Russian border, including the three northeastern provinces (Heilongjian, Jilin, Liaoning) and Inner Mongolia, amounts to more than 130 million. Although border control of illegal Chinese immigration into the Russian Far East has been tightened and stabilized compared with the chaotic years following the collapse of the Soviet Union, concerns about "Chinese economic expansion" have continuously smoldered among the Russian power elite against the backdrop of the increasing scale of Chinese economic activities on Russian soil.

It is in this context that the Russians have been reluctant to encourage Chinese investment in hydrocarbon fields in eastern Russia. China's involvement in upstream projects has been limited to only economically questionable ones. Examples include the Zapadnochonsky and Verkhnechersky mining deposits in the Irkutsk region, which possess only small volumes of oil and gas unproven resources, in spite of the involvement of the Vostok Energy joint-venture company, established by the Russian oil company Rosneft and China National Petroleum Corporation (CNPC). Rosneft has held a 51 percent stake in Vostok Energy since 2006.

## Russia's Acceptance at Last

Sino-Russian talks about the possibility of constructing a transnational crude oil pipeline date back to the mid-1990s. In 1998 CNPC and the Russian private oil company, Yukos started negotiations over the possibility of constructing a crude pipeline from Angarsk, in the Irkutsk region, to the Daqing oilfield in Heilongjian Province (i.e. the Daqing route). When Beijing and Moscow signed the Sino-Russian Treaty of Good-Neighborliness and Friendly Cooperation in July 2001, President Jiang Zemin and President Vladimir Putin agreed to construct the pipeline, with the aim of Russia exporting 20 million tons of crude oil to China from 2005 and 30 million tons from 2010. Both governments subsequently signed an intergovernmental agreement on undertaking a feasibility study for the pipeline to Daqing.

Meanwhile, however, the Russian state-owned oil pipeline company, Transneft, coincidently proposed in July 2001 the construction of a pipeline from Angarsk to Nakhodka in Japan (i.e. the Pacific route). With the announcement of Japan's support for the Pacific route during Prime Minister Jun'ichiro Koizumi's visit to Moscow in January 2003, the so-called "Sino-Japanese scramble" over Russia's crude oil began to hit the headlines in media reports around the world.

For about six years after this announcement, Moscow's equivocal attitude with regard to the timing of the construction of the pipeline remained unchanged, despite the Russians' repeated verbal promises to the contrary. Moscow formulated a compromise plan of designating the Pacific route as the trunk pipeline and the Daqing route as a spur pipeline from the former in May 2003. This plan was also endorsed by the *Energy Strategy of Russia for the period up to 2020*, authorized by the Russian government in August of the same year. In February 2004, Transneft announced a revised Pacific route originating from Taishet, about 130km northwest of Angarsk, taking a northern detour from Lake Baikal, running via Skovorodino in the Amur region and terminating at Perevoznaia Bay in the Primorsky region. Subsequently, the would-be origin of the Daqing route became Skovorodino.

However, no reference to the possibility of this spur pipeline could be found in Russia's official documents, including the Government Decree of December 2004, which authorized Transneft's proposal to construct the ESPO pipeline, and the Directive by the Russian Ministry of Industry and Energy in April 2005, which divided the ESPO project into two phases. The latter document stipulated that the first phase of the pipeline construction would enable a maximum capacity of 30 million tons of crude per annum to be transported from Taishet to Skovorodino and that following the second phase, a maximum capacity of another 50 million tons per annum from Skovorodino to Perevoznaia Bay (later to be moved to Kozmino Bay) would be possible. The first phase of the ESPO project commenced in April 2006, and the construction of the 2,700km pipeline was completed in December 2009.

Rosneft, the biggest supplier of oil to China, announced in November 2006 that it would deliver 14 million tons of crude via the spur pipeline upon completion of the first phase of the ESPO project. CNPC and Transneft signed a memorandum to build the spur pipeline in July 2007, and two months later, Minister of Industry and Energy Viktor Khristenko publicly stated that its construction would commence in 2008. Nonetheless, as late as September 2007, Rosneft begun to suggest that Russia should postpone the construction

of the spur pipeline until the second phase of the ESPO project, and also to imply that China was no longer a promising destination for oil exports.

With the global financial crisis beginning in autumn 2008, however, Moscow could no longer delay the signing of an agreement with Beijing, eventually promising the prompt start of the construction of the spur pipeline. The Russian economy was one of the most severely affected by the crisis. Rosneft and Transneft were no exception and faced serious cash-flow problems, including loan refinancing. Against this background, in February 2009, China agreed to provide a $15 billion loan to Rosneft and a $10 billion loan to Transneft in return for Russia's extension of the spur pipeline from Skovorodino to Chinese territory and an annual supply of 9 million tons of crude by Rosneft and 6 million tons by Transneft for 20 years from 2011. These agreements were finalized in the form of a Sino-Russian Intergovernmental Agreement on the Oil Sector in April 2009. The spur pipeline, running 70km from Skovorodino to the Chinese border, and more than 900km within Chinese territory to Daqing, is scheduled for completion by the end of 2010.

Initially, Russia hoped that it could maximize Japanese investment in its ESPO pipeline project, in order to counterbalance China's influence from the standpoint of geopolitical calculations. However, contrary to Russia's expectation, rivalry with China has not always been a crucial factor in Tokyo's decision-making. Neither the construction of the pipeline, nor oilfield development, could attract massive inflows of Japanese capital. With crude oil prices hitting historical highs up until summer 2008, the Russians made no effort to improve a variety of unfavorable conditions for foreign investors, believing that time was on their side, and aiming to play China and Japan off against another. However, with the financial crisis, Moscow's geopolitical maneuvering was quickly swept away.

## Natural Gas Cooperation in Disguise

Russian-Chinese talks on cooperation in the gas sector also reflect an uneasy development in their energy nexus. The proposed project of constructing a pipeline from the Kovykta mining deposit in the Irkutsk region (one of the biggest gas fields in eastern Siberia) to China was one of the biggest symbols of their bilateral partnership since the mid-1990s. As late as autumn 2003, RUSIA Petroleum (the Kovykta mining deposit's operator) and CNPC, together with their Korean partner, Kogas, concluded a trilateral international feasibility study of the proposed 4,900km pipeline to the Korean Peninsula via Chinese territory. Beijing and Seoul accordingly approved the results of the study. Moscow, however, refused to clarify its position despite agreeing to evaluate the feasibility of the Kovykta project in the "Action Program for Implementing the Sino-Russian Treaty of Friendship for 2005–2008" in October 2004. Indeed, Gazprom and CNPC signed an agreement of strategic partnership in the same month.

It appears, in retrospect, that the Russian government had no intention of considering this proposal from the outset. As early as July 2002, Moscow designated Gazprom to draft the Eastern Gas Program, including a plan of natural gas exports to China. The final version was officially authorized in September 2007, ending the option of exporting gas from the Kovykta mining deposit to China. At the same time, the program has no concrete picture as regards specific pipeline routes, even though it notes a plan to export 25–50 billion cubic meters of gas per annum to China and South Korea after 2020. Gazprom disagrees with Exxon, the operator of the Sakhalin-1 project, on the idea of extending a natural gas pipeline through the Khabarovsk region to Chinese territory, and instead, currently proposes to build a new LNG plant at the southern edge of Primorsky region. The economic viability of Gazprom's plan remains questionable.

The so-called "Altai Pipeline" project, proposed by President Putin during his visit to Beijing in March 2006, was another half-baked concept. This proposed 3,000km pipeline from western Siberia to Xingjiang Uighur Autonomous Region, aims at 30–40 billion cubic meters per annum. However, prior to Putin's announcement, Moscow had neither estimated the costs nor reached an agreement on the price of gas with Beijing. During this period, the Russians ascribed their procrastination regarding a decision on the Kovykta pipeline to disagreement on China's purchasing prices, but the story of the Altai project demonstrates that this is not necessarily the case. Moscow merely sought to brandish the "China card" in order to influence its negotiations with the EU, which gradually became critical of Moscow's high-handed approach in energy diplomacy. Thus, it had nothing to do with the consolidation of Sino-Russian energy linkages. Indeed, in August 2009 Gazprom officially shelved the Altai project due to its economic non-viability.

## Conclusion

A large part of the Sino-Russian energy partnership is rhetorical rather than substantial. China's skepticism about Russia may well have been aggravated by the lat-

ter's wavering attitude towards cooperative oil and gas projects with Beijing. Cooperation with China on energy has the potential to become an irreplaceable factor in Russia's development plans for its eastern regions, by exploiting its hitherto untapped energy resources on commercial terms. However, Russia has yet to make the most of this opportunity due to its own deep-rooted geopolitical mind-set. The completion of the transnational oil pipeline between the two countries will soon be realized. Yet, Russia's proposed project of constructing a gas pipeline to China will require several years before it becomes a tangible prospect. This is because mutual distrust will continue to lie beneath the politically inflamed Sino-Russian strategic partnership.

*About the Author:*
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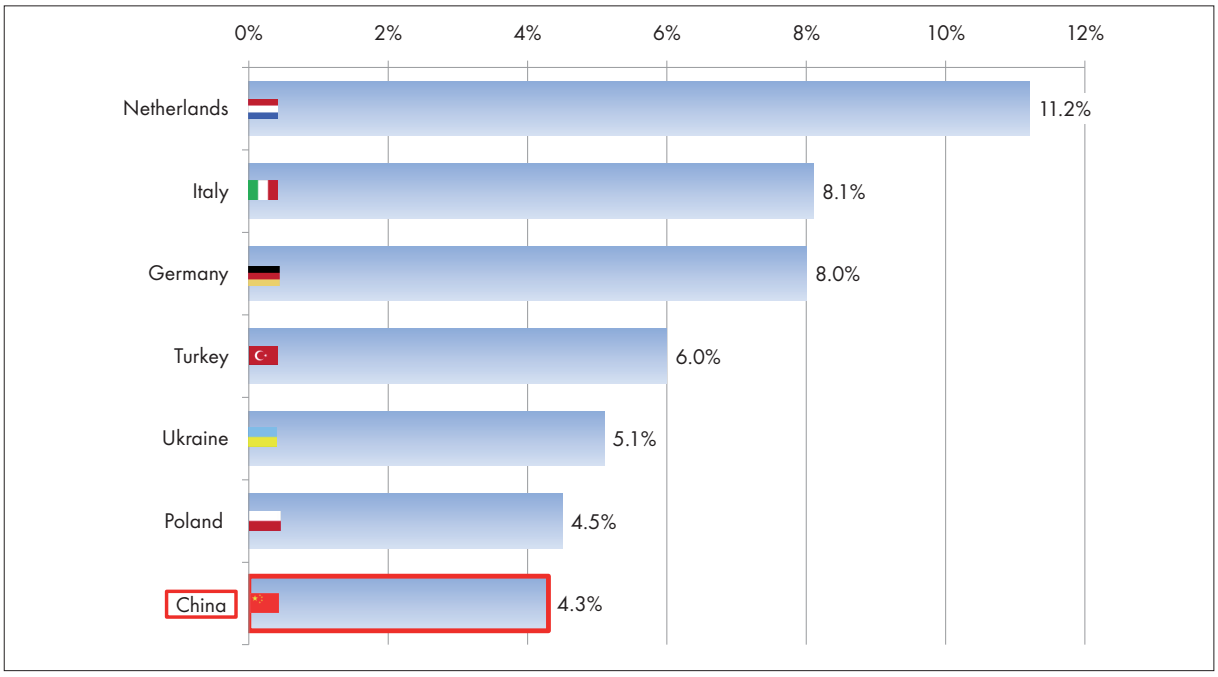
## Statistics

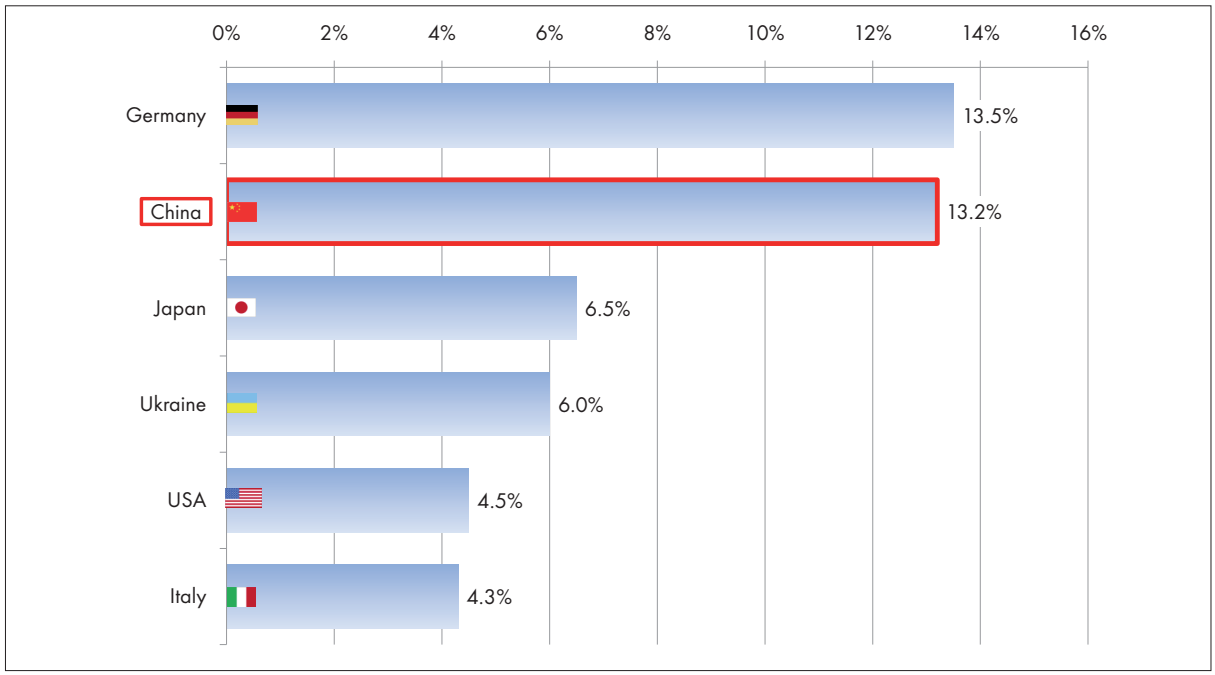
# Foreign Trade Relations

### Diagram 1: Russia's Main Export Partners in 2008



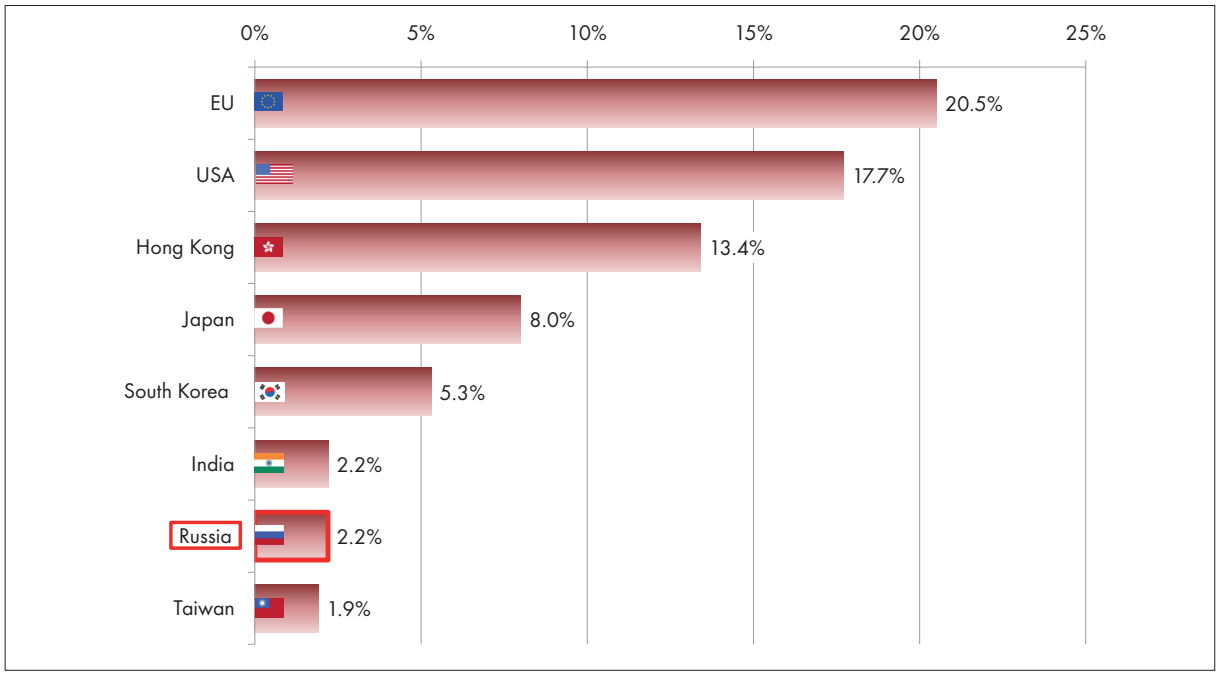

*Source: CIA Factbook,* https://www.cia.gov/library/publications/the-world-factbook/geos/rs.html

**Diagram 2: Russia's Main Import Partners in 2008**



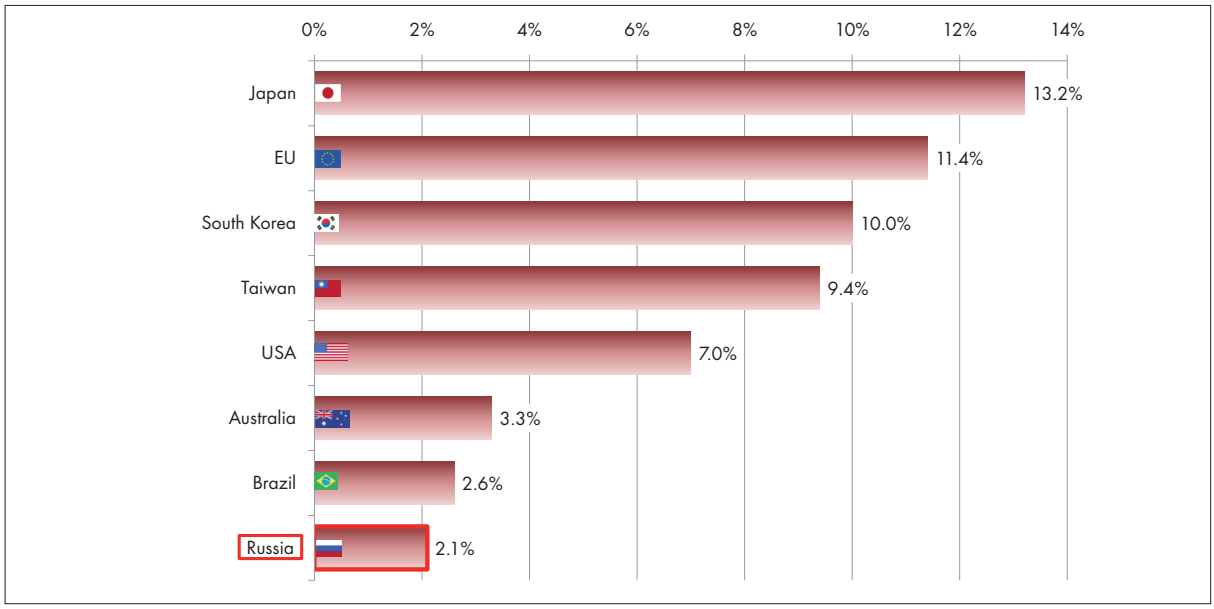

*Source: CIA Factbook,* https://www.cia.gov/library/publications/the-world-factbook/geos/rs.html

**Diagram 3: China's Main Export Partners in 2008**




*Source: Ministry of Commerce of the People's Republic of China,*
http://zhs2.mofcom.gov.cn/aarticle/ie/statistic/200901/20090105999708.html

### Diagram 4: China's Main Import Partners in 2008

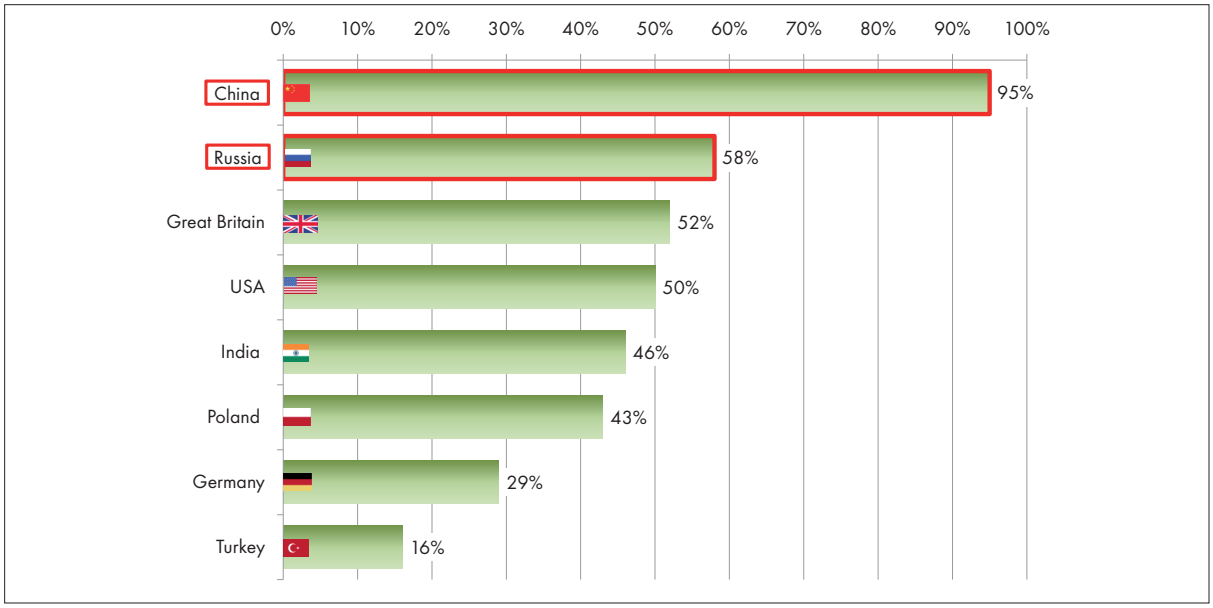



*Source: Ministry of Commerce of the People's Republic of China,* http://zhs2.mofcom.gov.cn/aarticle/ie/statistic/200901/20090105999718.html

## Opinion Poll

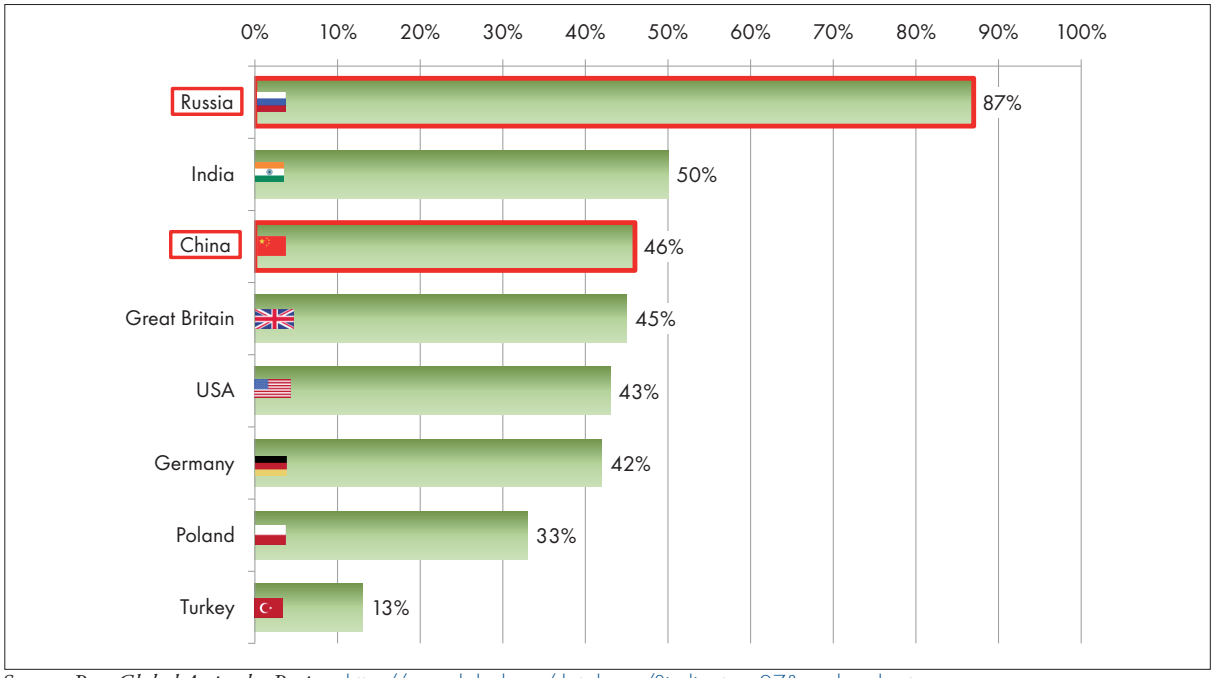
# Mutual Perceptions

### Diagram 1: Share of the Population with a Favorable View of China (2009)



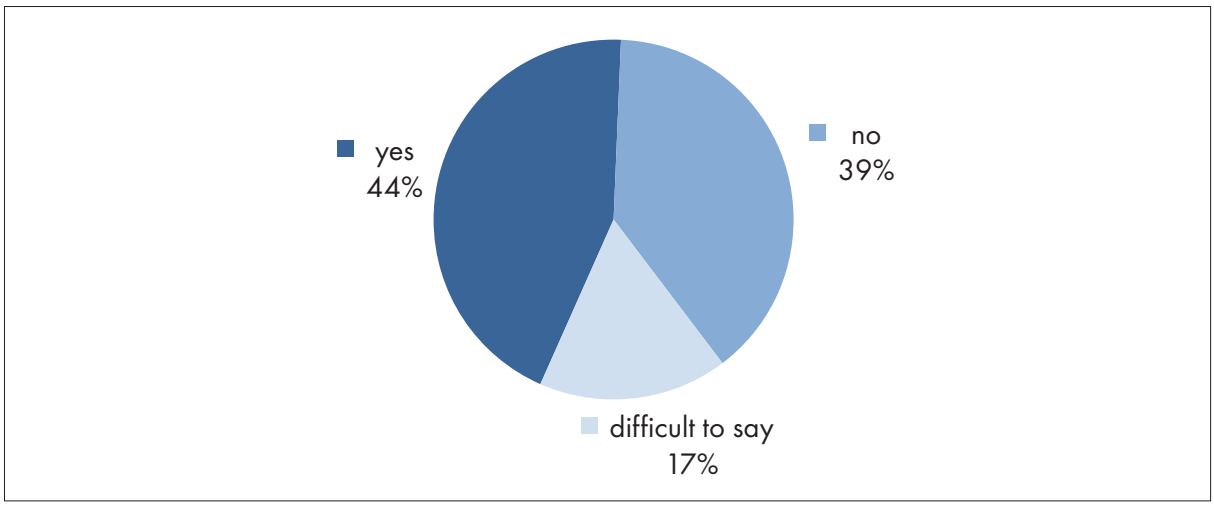

*Source: Pew Global Attitudes Project,* http://pewglobal.org/database/?indicator=24

**Diagram 2: Share of the Population with a Favorable View of Russia (2009)**



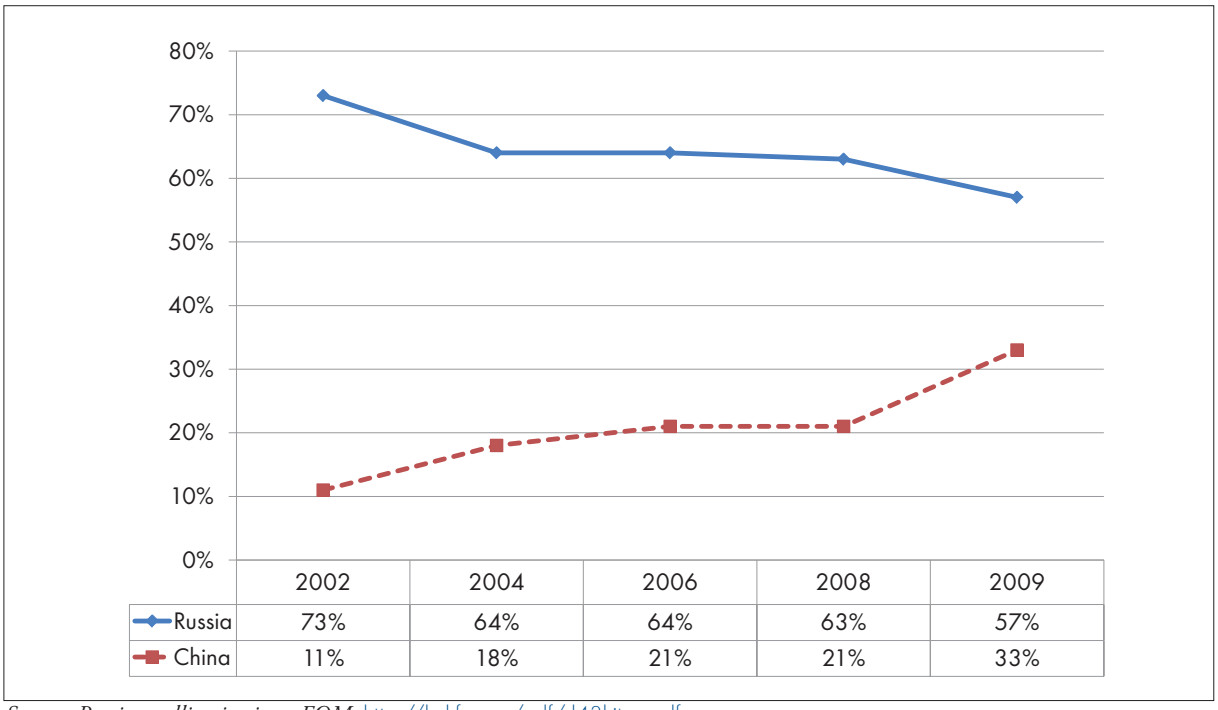

*Source: Pew Global Attitudes Project,* http://pewglobal.org/database/?indicator=27&mode=chart

**Diagram 3: Russian Population: Do You Think That the Growth of China is a Threat to Russian Interests? (Oct. 2009)**




*Source: Russian polling institute FOM,* http://bd.fom.ru/pdf/d43kitay.pdf

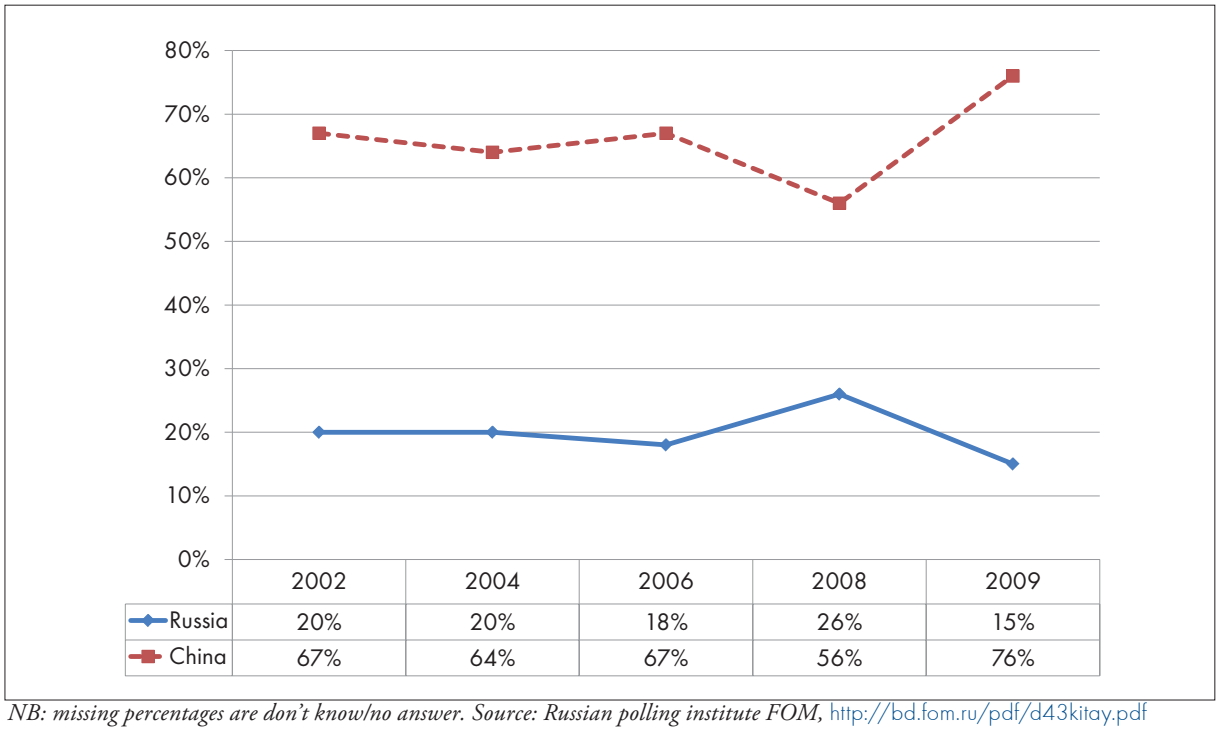
**Diagram 4: Russian Population: In Your Opinion, Which Country Has Today More Influence in the World: Russia or China?**




| | 2002 | 2004 | 2006 | 2008 | 2009 |
|---|---|---|---|---|---|
| Russia | 73% | 64% | 64% | 63% | 57% |
| China | 11% | 18% | 21% | 21% | 33% |

*Source: Russian polling institute FOM,* http://bd.fom.ru/pdf/d43kitay.pdf

**Diagram 5: Russian Population: If We Compare Russia and China, in Your Opinion, Which Country is Developing Today More Successfully: Russia or China?**

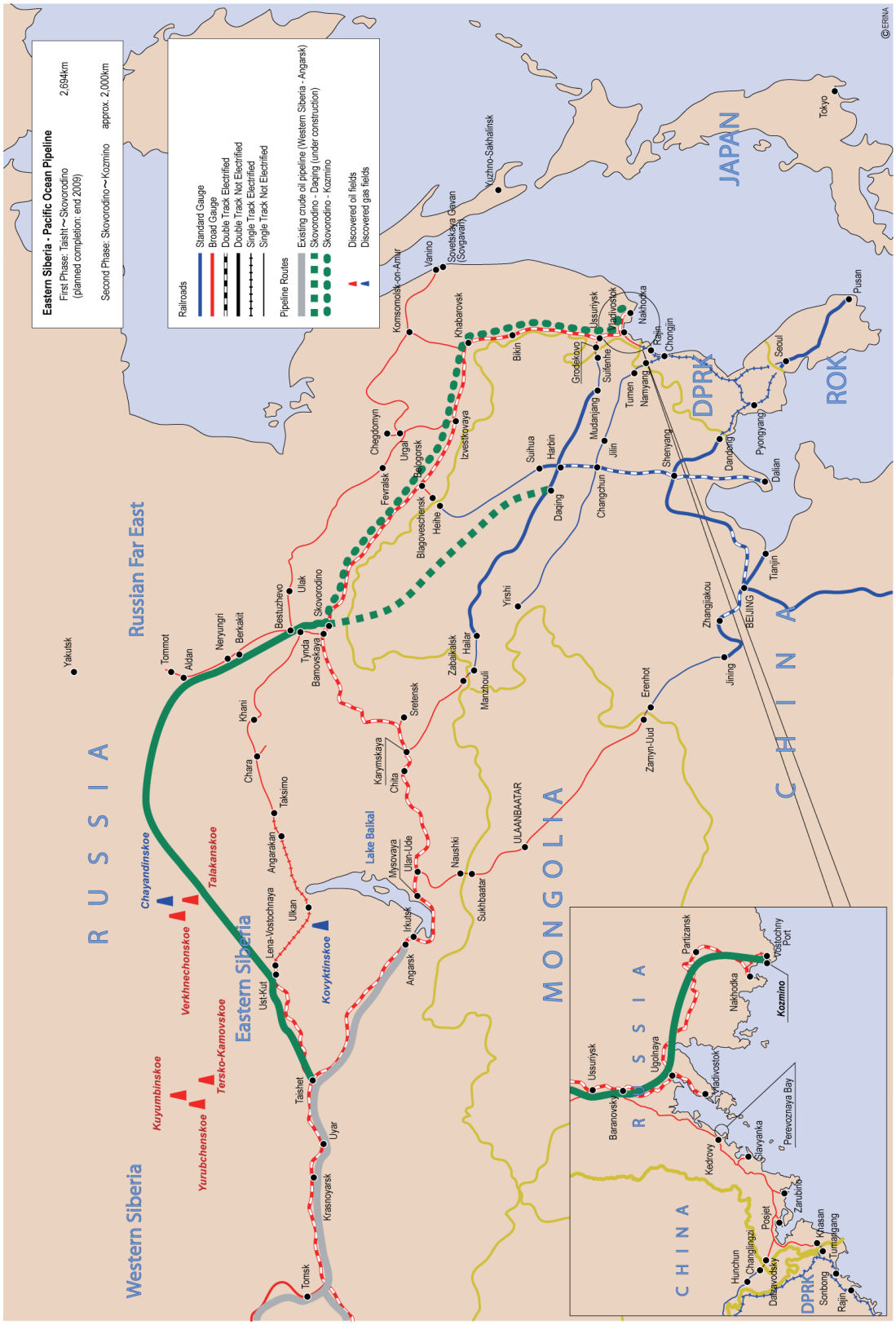



| | 2002 | 2004 | 2006 | 2008 | 2009 |
|---|---|---|---|---|---|
| Russia | 20% | 20% | 18% | 26% | 15% |
| China | 67% | 64% | 67% | 56% | 76% |

*NB: missing percentages are don't know/no answer. Source: Russian polling institute FOM,* http://bd.fom.ru/pdf/d43kitay.pdf

## Map

Eastern Siberia – Pacific Ocean Pipeline



## About the Russian Analytical Digest



The Russian Analytical Digest is a bi-weekly internet publication jointly produced by the Research Centre for East European Studies [Forschungsstelle Osteuropa] at the University of Bremen (www.forschungsstelle.uni-bremen.de), the Center for Security Studies (CSS) at the Swiss Federal Institute of Technology Zurich (ETH Zurich), the Resource Security Institute and the Institute of History at the University of Basel (http://histsem.unibas.ch/seminar/). It is supported by the German Association for East European Studies (DGO). The Digest draws on contributions to the German-language Russland-Analysen (www.laender-analysen.de/russland), the CSS analytical network on Russia and Eurasia (www.res.ethz.ch), and the Russian Regional Report. The Russian Analytical Digest covers political, economic, and social developments in Russia and its regions, and looks at Russia's role in international relations.

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**Resource Security Institute**
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