



BULLETIN

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China's Interests in Its Cooperation with Russia

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In times of cooling relations with the West, Russia's relations with China have intensified. Big new gas and oil agreements will make Russia the main supplier of energy resources to China. Several other agreements raise the prospects for increased exports of Chinese commodities to Russia and cooperation on important areas (currency settlement, aviation). Beijing also hopes for Russian support in balancing American influences in Asia. The EU Member States should more closely cooperate to enhance their position on energy relations with Russia and to track China's new security initiatives.

Russia has seemingly become a more important strategic partner for China. Xi Jinping's first foreign trip abroad as the new president of the PRC to Russia last year, followed by Russian President Vladimir Putin's visit to Shanghai earlier this month (May 2014) confirm the countries' intent to enhance their cooperation. China wants either closer economic cooperation (to import resources and export to the Russian market) or political cooperation. Although the interests of both countries often diverge (i.e., on Central Asia) and China distances itself from some Russian actions (such as the annexation of Crimea), closer relations are conducive to Chinese objectives to rebalance American engagement in East Asia.

Energy Resources. At the beginning of the last decade, China believed that Russia would be its main major energy resource supplier. However, the difficulties in reaching agreement with Russia meant China has had to carry out activities to diversify oil and gas supplies. The Middle East (40%) and Angola (13%) were its latest main suppliers of oil, but agreements concluded in recent years have increased the importance of Russian supplies. The most important project with Russia was the construction of the Skovorodino–Daqing oil pipeline, through which Russia supplies China 15 million tonnes of oil annually (on a 20-year contract). In June 2013, Rosneft and the China National Petroleum Corporation (CNPC) signed another agreement for 25 years for supplies of an additional 15 million tonnes of oil. The next agreement involved striking up a joint venture between both companies to develop East Siberian oil fields where CNPC holds a 49% stake, which fits into the Chinese strategy of getting access to energy fields abroad.

Much more difficult has been the negotiations on a gas deal. A Russian–Chinese gas agreement has been negotiated since 2006. In line with the preliminary objectives, supplies were to begin in 2011, but the lack of agreement on price hindered implementation of the project. China's position in the negotiations was strong thanks to a number of deals it had with other partners and investments in infrastructure construction to keep its gas supplies well diversified. China's main supplier of gas has been Turkmenistan (which provides 24 bcm a year) through a pipeline opened in 2011. Moreover, in 2013 a second gas pipeline to China, this time from Myanmar and with a capacity of 12 bcm, was opened. But China also has nine LNG terminals, with five more under construction and a few more planned. LNG accounts for about half of China's gas imports. However, gas consumption in China will be increasing (according to Chinese estimates) from 170 bcm today to 420 bcm by 2020. The government has ambitious plans to extract shale gas, but Russia has for many years remained an important potential source to meet the Chinese demand. In the negotiations between China and Russia, CNPC was offering \$235 per tcm, while Gazprom was hoping for \$400 per tcm. This difference in price was overcome during Putin's recent visit to Shanghai, where Gazprom and CNPC signed an agreement for 38 bcm of gas per year for 30 years. Although the price was not disclosed it is estimated at about \$350 per tcm. If so, the price is higher than what China pays for gas imported from Turkmenistan, but the agreement is beneficial to China as the cost of imports from Russia may be about 25–40 % lower than the cost of LNG imports. Thanks to this deal, Russia could become the most significant gas supplier to China after 2020.

Reinforcing Economic Cooperation. Apart from energy resource imports, China is also eager to develop economic cooperation in other areas. Presidents Putin and Xi Jinping, during their meeting in Shanghai, announced an increase in mutual trade to \$100 billion in 2015 and \$200 billion in 2020, from around \$90 billion in 2013. More than 40 new agreements signed by Russia and China contribute to reaching these objectives. From the Chinese perspective, a few of them merit special attention.

One is a contract between Russian bank VTB and the Bank of China on mutual settlements in the yuan and ruble. This agreement is another step in China's efforts to internationalise its currency. After the financial crisis of 2008, China has repeatedly stressed the need to reduce the role of the U.S. dollar in international settlements and has undertaken actions to increase the importance of its own currency. Therefore, it has signed more than 20 "swap agreements" recently and the Chinese authorities are promoting similar agreements between domestic and foreign commercial banks.

Another major contract was an agreement between the Commercial Aircraft Corporation (COMAC) and the Russian United Aircraft Corporation to assume joint work on a new wide-body passenger aircraft (400 seats), which, in the future, could become a rival to Boeing and Airbus. Russia's experience with aviation technology has long been of interest to the Chinese due to their plans to build large passenger aircraft. Although it is difficult to expect that in the next few years all of these plans in common will come to fruition, cooperation with its Russian partner can help COMAC implement another project—the construction of the C919 passenger aircraft (158–174 seats), which has been delayed.

Among other interesting agreements is a contract for the supply of equipment by Chinese companies to six new cement plants in Russia (worth \$500 million), and the construction of a car factory in Tula by the Great Wall Motors Co. (with assumed production of 150,000 cars per year), which would contribute to the expansion of China's automotive brands in foreign markets. Russia is only the 12th largest export market for China (behind the Netherlands, Canada and Mexico) and is looking for opportunities to increase exports to this large market.

Regional Security and Geopolitics. China wants to strengthen its position in Asia-Pacific, which will not be an easy task with rising tensions related to maritime disputes and the U.S. "pivot" to the region. In the maritime disputes, the U.S. has clearly sided with Japan and the Philippines, confirmed by President Barack Obama's visit in April, a move against China from Beijing's perspective. Although the Chinese government is far from engaging with Russia in these disputes—emphasising on many occasions that such disputes should be settled through bilateral talks between the parties involved—common initiatives, including joint military drills, would serve as evidence that China has a strong partner with whom it is developing cooperation in security matters.

China also would like to have Russian support for its political initiatives. The newest of these was presented by Xi at a Conference on Interaction and Confidence Building Measures in Asia (CICA) attended by President Putin where he announced his own concept of security for Asia. Xi's concept involves the construction of a new regional security framework based on cooperation among Asian states alone. Xi also criticized military alliances "directed against third countries," which can be read as a critique of U.S. involvement in the region. The grounds for the construction of a new security framework is to be CICA, an organisation previously little known, which includes 26 Asian countries (Japan, the U.S. and the Philippines have observer status). China will preside over CICA's work until 2016, and it can be expected that they will seek to implement Xi's concepts. Russia can be an important partner with which to implement the initiative and to the Chinese efforts to limit U.S. influence in the region.

Conclusions. The relationship with Russia plays an important role in terms of both the economic and political interests of China. Russia is not an easy partner to work with, as its actions can be unpredictable and could undermine China's confidence in Russia. However, such things as Russia's spat with the West over Crimea and U.S. engagement in Asia-Pacific seem to improve Russian–Chinese relations. China can hope for Russia's support in rebalancing American influence in the region, although it's hard to expect unconditional backing for the new Chinese security concept for Asia. Russia's complicated geopolitical situation after the crisis in Ukraine provided a good opportunity to overcome the impasse in the gas agreement negotiations. China not only secured significant new gas supplies for the future but also signed many other agreements to facilitate trade and investment expansion in Russia.

The gas deal with China only in theory enhances Russia's position in energy cooperation with the EU. Supplies to China would come from other gas fields (in Eastern Siberia) than the ones that supply Europe, hence the threat of redirecting of Russian gas from the EU to China seems unrealistic. Nevertheless, the EU should strive to reduce its dependence on Russian supplies through the diversification of gas sources. The lower price for gas for China should be an additional argument for considering common EU gas purchases from Russia, which could contribute to the enhancement of the EU position in negotiations with Gazprom, increase the chances to achieve a better price overall, and save several billion euro annually. The EU should also monitor implementation of the new Chinese security concept for Asia and the scope of engagement of Russia in that project.