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Moscow-Beijing Ties: An Axis of Necessity

Richard Weitz reports that the recent Russia-China presidential summit in Moscow yielded a clear message. Both governments want a comprehensive relationship, but they want one that is practical and based on common interests. Shop-worn Cold War ideology has nothing to do with it.

By Richard Weitz for ISN

At their late March summit in Moscow, Russian President Vladimir Putin and Chinese President Xi Jinping met together for more than seven hours. They hailed their historically unprecedented close ties, pledged solidarity regarding many important global issues, and signed several dozen intergovernmental agreements to expand their cooperation in such areas as tourism, health care, outer space, and jointly developing the Russia-China border region.

Russian press commentary suggests that many of these deals are framework agreements rather than detailed contractual commitments, but if most are realized then they hold the potential to elevate the relationship to a significantly higher level. Bilateral trade has already doubled in the past five years, to almost $88 billion in 2012. The two nations’ financial institutions will also try to use more of their own currencies in direct transactions rather than dollars or euros. After meeting Xi, Putin said that, "The large number of joint projects gives us confidence that we will soon bring our bilateral trade up to the $100-billion mark, and in the not-too-distant future will see it reach $150 billion".

Energy and Investment

Following many years of false hopes and frustrated deals, Russia and China are also beginning to make progress in establishing their long-anticipated energy partnership. Russia’s large oil and natural gas production and China’s growing dependence on imported hydrocarbons make the two countries natural energy partners. But, until recently, technical obstacles, pricing conflicts, inadequate transportation infrastructure, and mutual suspicions have kept Chinese purchases of Russian energy at relatively low levels.

Now that China has become the world's leading importer of energy, PRC policy-makers have become more interested in acquiring Russia's oil and gas to reduce their dependence on Persian Gulf supplies, which are vulnerable to maritime interdiction. Meanwhile, the growth of LNG and unconventional energy sources like oil sands, shale oil, and gas fracking has reduced Russia's energy sales opportunities in the West, even as they desire to rebalance the terms of their trade with China, to sell more high-value products along with more natural resources. Russia now seems likely to become China’s largest oil supplier in coming years. Even their negotiations over a direct natural gas pipeline may finally reach fruition.

In their March 22 deal, the China Development Bank agreed in principle to lend Russia's Rosneft energy conglomerate $2 billion in return for 25 years of guaranteed oil deliveries, amounting to at least 37 million metric tons of crude annually starting in 2018. Rosneft aims to triple its oil shipments to China to about 50 million tons by that year. Russia and China will build a refinery in Tianjin with a yearly capacity of 13 million tons of oil.

Furthermore, the two countries will explore how Russia can supply China with large quantities of electricity. The Chinese National Petroleum Corporation (CNCP) has also acquired the right to join Rosneft and other foreign companies in exploring three of Russia's Arctic territories thought to have hydrocarbon deposits. Having Chinese firms contribute capital to generate new Russian energy production is "win-win" for both countries. China is expected to become the world's leading oil importer sometime next year and the new deals would enable Russia to provide almost 10 percent of China's imported oil, likely making China the largest importer of Russian oil (it is only the fourth-highest now).

Russia and China might even consummate their long-sought natural gas deal soon. For years, this issue has been a prominent agenda item at their summits. Russian energy giant Gazprom and the CNPC have been negotiating possible deals since 2004, when they signed a strategic partnership agreement. But Gazprom has delayed starting construction of an enormously expensive gas pipeline because Chinese and Russian negotiators have proved unable to agree on a price formula for the deliveries. In essence, Russian negotiators want Beijing to pay the same price as the European customers, whereas the Chinese want to buy the gas at the lower price that Chinese utilities charge their domestic consumers. Given the large volumes involved, in which a single dollar difference could amount to billions of dollars over the life of the contract, each side is naturally fighting hard for their positions.

After meeting Putin, Xi said that, "Chinese-Russian cooperation in energy is manifold, comprehensive and full-fledged. In our cooperation, we always meet each other halfway with the goal of achieving reciprocal advantage and mutual benefit." Shortly before the summit, Chinese and Russian negotiators pledged to reach a price deal at the end of the year. A new idea to break the deadlock is to have CNPC make a large advance payment of at least $25 billion, which would effectively become an interest-free loan. In return, Russia has accepted China's preferred eastern route for the envisaged "Power of Siberia" pipeline, which saves money by proceeding along a shorter more direct path to the Chinese border. If these two concessions break the deadlock, then some 38 billion cubic meters (bcm) of gas would begin flowing to China in 2018, along a 2,500-mile pipeline from Yakutia (Chayanda field) via Khabarovsk and Vladivostok to China. The amount could eventually reach 60 bcm annually.

Furthermore, Russian and Chinese officials continued their efforts to increase mutual investment. Russia's State Bank for Foreign Economic Affairs (Vnesheconombank), the Russian Direct Investment Fund (RDIF), China Investment Corporation (CIC), and the China-Russia Investment Fund signed a memorandum in which they agreed to invest large sums in both countries' transportation and other infrastructure, natural-resource processing, and in leading manufacturing and services companies. The RDIF and CIC, designed primarily to spur investment within their home countries, created the RCIF last June, when Putin visited China. With its initial $4 billion in start-up capital, the RCIF will focus on investing in the transportation, agriculture, and forestry infrastructure in eastern Russia to create goods that China is likely to buy—though 30 percent of the RCIF funds must be invested in China [http://news.xinhuanet.com/english/business/2012-09/07/c_131834312.htm.]. The RCIF has so far invested in a $200 million in Russia's second-largest forestry enterprise, Russia Forest Products. The Director and CEO, Kirill Dmitriev, has said that the fund wanted to launch a few successful joint projects that would then generate considerably more mutual investment. Other projects were also announced at the summit. For example, China's Shenhua Group and Russia's EN+ Group have agreed to develop the coal resources in eastern Russia and related infrastructure, which they would then sell to China.

Arms and Institutions

The latest figures released by the Stockholm International Peace Research Institute show that Russia and China are the only two world major powers that increased their defense spending last year. Following several years of decline, China has resumed buying major Russian weapons systems. After reaching a high of nearly $4 billion in 2005, China's purchases of Russian weapons decreased to $800 million in 2009, but rebounded to more than $2 billion in 2011. According to media reports, Russia and China are finalizing a deal for the PLA Air Force to purchase 24 fourth-generation plus Sukhoi-35 Super Flanker multi-role fighters as well as four Lada (Amur)-class 1650 diesel submarines, a more advanced version of the Kilo-class submarines that China bought from Russia in the 1990s.The combined value of the two contracts could exceed $3 billion.

After their Moscow summit, Putin and Xi attended the Durban summit of the BRICS (Brazil, Russia, India, China and South Africa) countries. Russia and China are working through the BRICS group to develop new international institutions whose norms and procedures will differ from the existing global institutions currently dominated by the West. For example, they are discussing how to reduce the role of the dollar in international currency transactions and establishing a joint development bank, a ratings agency, and a business council in which their weight in decision making would be greater than in the World Bank and the International Monetary Fund.

China has clearly emerged as Russia's most important trading partner, as well as its gateway to other Asian markets, and soon might become its main source of foreign investment. Meanwhile, Beijing is eager to benefit from Moscow's growing interest in Asian affairs and to maintain good political ties with Moscow as it manages its disruptive North Korean neighbor and the uncertainties generated by the U.S. 'Asia Pivot.'

For additional reading on this topic please see:
China and the Politics of Oil
China's Strategic Petroleum Reserves
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