

## 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, coincidentally 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.

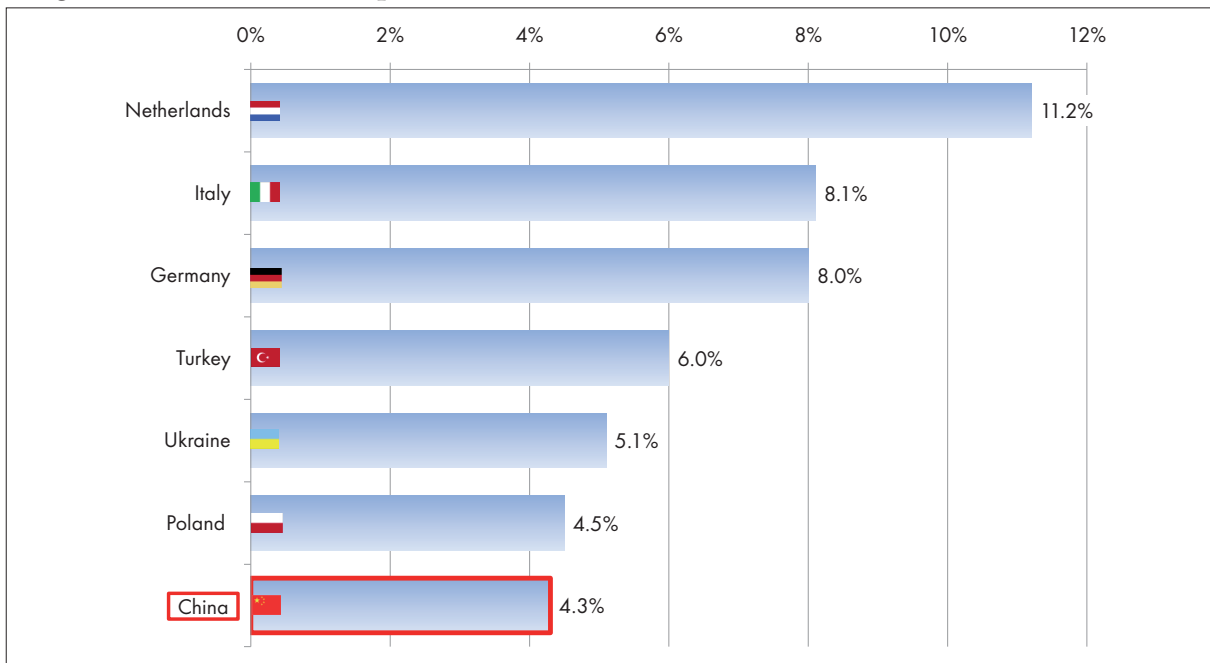
*About the Author:*

Shoichi Itoh is currently a visiting fellow at the Center for Strategic & International Studies (CSIS), Washington, DC. He is also an associate senior researcher at Economic Research Institute for Northeast Asia (ERINA) in Japan and a non-resident fellow at the Institute for Security and Development Policy (ISDP) in Sweden.

**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>