

Moscow and Beijing Play Chess With Energy

di *Astrit Dakli*

Though Russia and China have improved their ties thanks to Beijing's need for nearby energy resources, some of the deals are beginning to fray at the edges. Moscow wants more customers while China is diversifying its suppliers. In the end, it's a dance for Central Asian supremacy.

The young Russian oligarch Mikhail Khodorkovsky was the first to realize that China's fantastic hunger for energy as well as its desire to outstrip the United States as the world's largest economy could work to Russia's advantage. It is Russia, after all, that has the deepest energy reserves on the planet.

In 2001, at the height of his wealth and power, Khodorkovsky, who headed Yukos Oil, began negotiating a deal with CNPC, China's state oil company. Signed two years later, the deal called for Yukos' Siberian fields to provide 30 million tons of oil annually to China for 20 years through a pipeline financed and built by the Chinese.

A few weeks after the signing of that agreement, Khodorkovsky was arrested on corruption charges, the first step in long disgrace set in motion by then-President Vladimir Putin. He was later convicted on charges of fraud, theft, and tax evasion. More than a decade after the

A Russian World War II veteran and a Chinese businessman toast in a Vladivostok restaurant.



China deal, he remains locked in a prison in eastern Siberia. The championing of his cause by the Russian liberal opposition hasn't helped.

But if Khodorkovsky's fate took a desperate turn for the worse, the mega-contract with the Chinese remained intact. In fact, it's remains at the core of the complex relationship between Moscow and Beijing in the field of energy. While working to remove Khodorkovsky, a radical move both in political and economic terms, Putin was careful to preserve a number of key policy ideas as part of his wider plan to rebuild Russia into a major global power and erase the decade-long period of humiliation it endured after the fall of the Soviet Union.

While the China deal, for Khodorkovsky, was predominantly a play for money, Putin transformed it into a cornerstone of his political and economic strategy. It fit the bill for a number of reasons. First, the deal ensured that Russian state coffers would swell as never before, allowing the state to build up cash reserves; second, it stabilized long-fraught relations with Beijing (following decades of reciprocal mistrust and outright hostility); and third, it gave Russian means to depend less on the good will and humors of Western Europe. In essence, the map was re-orientated from west to east and marked a turning point in Russian diplomacy, which from that moment on began the ongoing process of working to seal an unprecedented network of alliances and cooperative relationships in Asia.

Understanding the scope of the Russo-Chinese rapprochement also demands knowing the extent to which relations between the two countries had deteriorated in the Communist period. The Sino-Soviet split grew in the 1950s and culminated in border clashes between Chinese and Soviet troops along the contested Ussuri River, which runs through both Russia and China, in 1969. Seven months of military exchanges left more than 250 dead.

Despite gradual improvement in diplomatic ties, the long border between the two countries has always been essentially closed. As recently as 2005, the Moscow General Staff listed China in joint first-place with the United States as potential enemies of Russia. Nor has the idea of a "Yellow Peril," the idea of Chinese hordes spilling into the empty wastes Siberia, ever really vanished from the

Russian consciousness. As a result Russia, both at a governmental and public level, tended to look toward Europe as a natural political and social going forward. That made Putin's groundbreaking decision to use exported energy as leverage to rebalance the country's strategic and geopolitical fortunes all the more important.

The Chinese also saw the deal in terms that went well beyond its immediate economic import. Strategically, Beijing had long sought a constant and safe supply of oil. A long-term supplier would also help cut down on the need for spot purchases on world crude oil markets. Moreover, a long-term deal with Moscow an issue as fundamental as energy would naturally give all other agreements greater clout and begin to put a damper on the long-simmering border disputes.

The original Yukos agreement stipulated that oil would be transported by rail pending the construction of the pipeline linking Russia's western Siberian oil fields at Khanty-Mansy to large Chinese refinery at Daqing. For years, thousands of Yukos oil containers have gone back

Mikhail Khodorkovsky.



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and forth daily on the line linking Siberia to China, passing through Kazakhstan and Mongolia. The supplies continued even as Khodorkovsky's company went bankrupt (the result of massive tax evasion fines) and split up between state and private companies.

China contributed to the dismembering of Yukos, paying the Russian state company Rosneft \$6 billion to purchase the largest chunk of Yukos in exchange for 50 million tons of oil at well below market value. Meanwhile negotiations for the construction of the pipeline went ahead. When finalized, the deal represented among the most lucrative pipeline deals of all time, with the Chinese supplying \$25 billion loans in exchange 15 million tons of crude per year for 20 years, in addition to bolstering the rail line, part of the deal originally reached with Yukos and confirmed by Rosneft. The pipeline was finished in 2010, and last year the flow of crude went to full capacity, 300,000 barrels a day.

On the Russian side, two substantial improvements were made to bolster the initial framework. The first was the transforming of the Siberia-China pipeline into a piece of a broader project, which saw it double in size and capacity. In addition to China, a branch of the pipeline ran to the oil terminal at Kozmino, a Pacific Ocean port near Vladivostok. The building process was pyramid-like in scope.

The Kozmino line was some 5,000 kilometers long, making it the longest such oil artery in the world. It was created to supply energy to the region of Primorye but also to make it easier for Moscow to supply affordable oil to other eager Asian customers, including Japan and South Korea, which both have massive oil requirements and had previously been almost totally dependent on oil from the Persian Gulf and Africa. That meant long, costly and risky maritime transport. By enlarging its initial project, Moscow has leveraged its bargaining power not only with Beijing but other potential Asian customers. Suddenly, Beijing was no longer Moscow's lone oil customer. But there are growing problems. Despite the pipeline, Russia is finding it increasingly difficult to meet China's demands, which puts in jeopardy any efforts to extend its client base. Western Siberia production has peaked in the last two years and most analysts see it heading for a fairly rapid decline in output. The situation is

THE CHINESE 'THREAT'

Though Russian politicians, demographers and large segments of public opinion have long worried about a potential Chinese invasion, none seems in the cards.

At the same time, all is not reassuring to Russia when it comes to life on the front. The number of Russians living along the massive border with China, largely unspoiled land rich in natural resources, is in steady decline. An estimated 10 million Russians reside in the outland border areas, compared to 100 million Chinese on the other side of the border. In direct contrast to the Russian side, China's border acres are packed, polluted and poor.

The profound imbalance between the two sides has led Russians to fear the worst, namely large-scale Chinese movement over the border to escape inhospitable circumstances. In recent years, alarmist voices in Russia have advanced the idea that at least two million Chinese, perhaps as many as five million, have already made their way illegally into Russia. Putin himself, in calling for an increase in the Russian birth rate, has issued ominous rumblings. "If our population continues to decline, others will take our place," he said recently, without elaborating.

So far, however, the alarms haven't been born out by objective data. Visa rules have in fact been eased in an effort to attract tourism and investment from China.

The number of Chinese officially considered resident on Russian territory is 200,000; probably well below the actual figure. Still, it's well short of an invasion. But from the perspective of Russians in the Far East, the number seems high and threatening. In the Russian Far East, most markets are Chinese-run. Most shuttled back and forth between China and Russia. Chinese workers are also abundant in construction and forestry, albeit on a seasonal basis. A more regular Chinese presence is visible in central Siberia, where the climate is gentler and the land are suitable for farming, attracting migrant workers.

worsened by Russian failure to invest in exploration and mining of new oil eastern Siberian deposits, which exist but have yet to be drilled.

In 2011, the pipeline oil headed for China was not supplemented by the constant rail supply, as called for by the



Outgoing Russian President Dmitri Medvedev and his Chinese counterpart Hu Jintao two years ago in Beijing, honoring the completion of a Siberia-China pipeline.

2003 agreement, which expires next year and won't be renewed. From a Chinese vantage point, doubts about the worth of having participated in building the pipeline are beginning to creep in. Not only is Russia unable to meet agree-upon Chinese requires, but it's also seeking other customers, which hasn't gone over well in Beijing. Russian officials have tried to dull the blow by offering natural gas in exchange for any oil shortfalls.

As if stealing a page from the Khodorkovsky era, Russian officials have repeatedly dangled a massive offer to the Chinese. The galactic offer, on the table since 2008, calls for state gas monopoly Gazprom to sign a 20-year deal with China that would see 68 billion cubic meters of gas annually through a pipeline to be built through Chinese loans, in tandem with the just-finished oil pipeline. In essence, a trillion dollar deal.

Negotiations have been ongoing. Putin traveled to Beijing last October hoping to bring home a Chinese agree-

ment, but left empty-handed. The Chinese want a fixed price structure while the Russians want the prices tied to oil-price fluctuations. But Beijing, chastened by the ups and downs of the oil deal, is edgy about going through with the agreement.

While Beijing knows Russian gas reserves are ample and layered, more so than its oil production, and is aware of the need to convert its power stations from coal to gas to reduce polluting emissions, it is no longer comfortable with the idea of relying on a single supplier. While negotiations with Moscow have dragged on, China has swiftly reached separate agreements with Turkmenistan, Uzbekistan and Kazakhstan for a pipeline that would run through Central Asia and supply most of China's western regions. At the same time, China has also begun construction of a number of re-gasification plants along the Pacific coast, where the country can get boatloads of liquefied natural gas purchased on the spot market from any number of suppliers, including the United States, Canada, Qatar, and Algeria.

With advanced technical assistance from United States, is also studying ways of potentially exploiting shale gas reserves. Shale gas has become an increasingly important source of natural gas in the United States over the past decade, producing a global ripple effect. In 2009, U.S. President Barack Obama and Chinese President Hu Jintao announced the launch of a joint shale gas initiative to help China reduce greenhouse gas emissions, promote energy security and create commercial opportunities for U.S. companies.

These steps have buttressed China's position in its talks with Russia, making gas needs less urgent. Putin's counterpunch has been a re-upping of the stakes. He recommended yet another new pipeline, this one moving gas from Russia's offshore field at Sakhalin to the mainland, running through Primorye and Khabarovsk to Vladivostok. From there, a shorter branch of the same pipeline could route gas to China, or to South Korea. It could even assist North Korea, albeit in passing.

The message to China is explicit. If you don't hurry up, we'll send our gas elsewhere, and at some point you'll run out. In the meantime, the so-called deal of the century sits unsigned. ●