

Russia is now one of China's main oil suppliers. The news is that it will soon become a leading supplier of China's gas as well. In the Putin era relations between the two countries have grown enormously, with a

# Putin puts a lot of energy into Beijing visit

STRATEGIES

by Piero Sinatti

strong focus on energy cooperation. But Moscow does not want to stop at supplying raw materials and is now proposing to be an all-round trade partner

**T**he objective of President Vladimir Putin's visit to China in the second half of March was to inaugurate the Year of Russia in China, with a corresponding Year of China in Russia scheduled next year. Moscow and Beijing wanted to stage these two events to improve reciprocal awareness and their respective images. The events merit attention for the economic and strategic considerations and implications they involve. The visit confirmed the "strategic partnership" between the Russian Federation (RF) and the People's Republic of China (PRC) established ten years ago by the then leaders of the two countries, Boris Yeltsin and Jiang Zemin. The partnership has been given a major push during the Putin presidency with the "Good Neighbourly Treaty of Friendship and Co-operation" that Putin and Jiang Zemin signed in 2001. Three years later, the treaty was confirmed and enhanced by the Russian leader and Jiang Zemin's successor, Hu Jintao. It was on this occasion that the conflict over the 4,300 km border between the two countries was definitively brought to a close – a conflict that Beijing described as the result of the "unjust treaties" of the 19th century between the Middle Kingdom and

the Russian Empire.

Soviet-Chinese negotiations began in 1964, only to be interrupted by bloody clashes on the border in 1968 and 1968, during the Cultural Revolution.

Between 1989 and 1991, former Soviet president Mikhail Gorbachev managed to normalise relations with Beijing and gradually move towards a positive solution to the border issue.

After the collapse of the USSR, the new Russia intensified cooperation with China, establishing a solid relationship, particularly in the industrial and military sectors (with sales of Russian arms to Beijing, which has become Moscow's chief client in this sector over the last decade) and the nuclear sector (with an inter-governmental co-operation treaty in place since 1992 – the leading accomplishment being the participation of no fewer than 150 Russian companies and institutions in the construction of the biggest Chinese nuclear power station, Tian Wan in Hunan province).

With Putin as President, Russia has intensified its trade relations with China. In 1996 his predecessor Yeltsin had said that trade between Russia and China would amount to \$20 billion by 2000. This objective

was actually reached in 2005, when trade between the two countries rose to an all-time record of approximately \$29.1 billion. Since 2001, when trade reached the \$10 billion level, trade exchanges have grown consistently – by 11% in 2002, 32.1% the next year, 34.7% in 2004 and 37% in 2005. According to Putin, the objective of trade levels of \$60-80 billion in 2010 “is not unattainable” (in the event of Russian GDP doubling by that year, a prospect that is however judged to be unlikely).

### The March meeting and energy cooperation

Hu Jintao and Putin met on 21 and 22 March for the fourth time since 2005. The frequency of meetings between the Russian and Chinese leaders has been two or three meetings a year since 2001, with annual meetings between the respective Prime ministers and Foreign ministers as well as between regional governors of the two countries. This time, the Russian delegation was certainly the most numerous and representative of all the successive delegations to Beijing in recent years. It was composed of about 900 people representing the Russian administration, industry and finance, starting with the heads of the biggest energy companies (gas, oil, electrical and nuclear power) and the president of the Russian railways (RZhD). Energy cooperation was undoubtedly the central and most fruitful element of Putin’s visit to Beijing. With its extremely high rate of growth over the last 15 years (an annual rate of over 9%), China has now become the world’s second-largest consumer of energy after the U.S. and is preparing to become the second-largest importer after the U.S. The biggest development of the latest Putin-Hu summit was, as expected, cooperation in the gas sector. “Blue gold” has so far accounted for only 3-4% of China’s entire energy consumption, compared to 20-25% in the major industrialised countries. Besides widening and diversifying energy supplies, the aim of China’s gas provisioning is to cut down on the very widespread – although not predominant – use of coal, which is at the root of serious and increasing pollution in the major Chinese industrial centres. According to news accounts of the visit, Putin was clearly satisfied with the agreements reached to build two gas

pipelines from Russia to China. The first will link the fields of Western Siberia to Xinjiang in northern China by 2010, passing through the Russian region of Altai, which will give the pipeline its name. The cost is estimated at \$5 billion. The pipeline will be 3,000 km long.

The second, called the “Eastern gas pipeline”, will link the gas fields of Eastern Siberia (including, in all likelihood, the recently discovered field of Kovytka in the Irkutsk region) to south-central China (including the Shanghai region) in 2011. The pipeline, which will be over 4,000 km long, is to cost \$10 billion.

Each of these pipelines should be able to supply about 30-40 billion cubic metres of Russian natural gas to China from 2011 onwards. The deal will be worth \$30 billion for Moscow from 2011 to 2015. The two contracts involve the state-owned companies of the two countries, Gazprom and CNPC (China National Petroleum Corporation) and their chief executives, Aleksei Miller and Cheng Geng.

The dual agreement is a strong response from Russia, legitimated by Beijing, to the doubts raised in EU countries regarding Moscow’s reliability as a gas supplier following the crisis in January and February caused by the conflict between Russia and Ukraine on the gas issue on the one hand and the exceptionally cold weather in these months on the other.

This agreement, together with Moscow’s agreement with Turkey and some EU countries (especially Germany and Italy), make the Asia-Pacific region and Europe dependent on Russia for gas. This is no small matter, considering that Putin’s strategy is aimed at turning Moscow into a major player in international politics as an energy superpower.

### Exports of Russian crude to the Pacific

The gas contracts compensate for Beijing’s dissatisfaction after Moscow decided in 2004 to transport crude from Eastern Siberia to the Pacific coast rather than Daqing, China’s largest oil field. Following lengthy and seesawing negotiations between Russia and China, begun in 1999 by the then Chairman of the Russian private company Yukos, Mikhail Khodorkovsky (who is currently in detention) and CNPC, an

agreement on the construction of an oil pipeline from Russia to China (Angarsk-Daqing) able to transport crude from the Irkutsk region to China appeared to be in the offing.

Putin and his advisers decided instead to build another, “northern”, oil pipeline to link this region (starting from the Tajshet oil centre) to the Russian peninsula of Nakhodka on the Pacific and destined principally to serve Japan, South Korea and other Southeast Asian markets.

There were three reasons why the “Japanese option”, chosen in the course of several meetings between Putin and Japanese Prime minister Junichiro Koizumi, won out over the Chinese option. 1) Moscow avoided the risk of building an oil pipeline to China alone and thereby having a single client able to influence the selling price. 2) Moscow diversified and widened the range of importers, the main one, Japan, having been identified by Moscow as being financially



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and technologically more important than China for the renewal and development Russia's Dalniy Vostok region on the Pacific. 3) The pipeline will supply oil to this region, relieving it of its chronic energy shortage.

### The VSTO branch

Following this option, Moscow and Beijing negotiated the possibility of building a branch (*vetka*) of this pipeline, identified by the Russian initials VSTO (Eastern Siberia-Pacific Ocean), to China.

With Angarsk-Daqing no longer a possibility, this is what the Chinese requested of Russia, whose oil is currently supplied to China by rail.

Until now, and ever since China emerged as a

major oil importer in the early 1990s, Russia has been China's fifth-largest crude supplier after Saudi Arabia (14%), Iran (13%), Oman (13%) and Angola (11%).

Russian exports totalled 10 million tons in 2005. The figure is expected to increase to 15 million tons this year and 27 million tons in 2007. By 2008, the VSTO branch from Skovorodino near the Chinese-Russian border on the Amur and northern China should be complete. The 70 km-long branch is expected to cost \$400 million, to be financed by China, which will leave ownership to Moscow.

However, the only decision at the Beijing meeting was to undertake a feasibility study, to be started in a few months by Rosneft and CNPC.

Some Russian observers point out that the *vetka* would damage the Russian railways (RZhD), which are undergoing a phase of major restructuring and modernisation. The Chairman of RZhD, Vladimir Jakunin (who

\_Russian President Putin and Chinese President Jintao appear satisfied with the collaboration agreements. Below: Putin with Gazprom CEO Medvedev and Energy Minister Khristenko



is close to Putin), was also in Beijing to set up an agreement to build a large “railway bridge” between Asia and Europe. This should focus on the Trans-Siberian for goods transport (a million mega-containers a year) from the Pacific to Europe. And yet, not one of the 14 agreements signed by the two parties concerns this project.

Oil cooperation also envisages the setting up of a mixed Russian-Chinese company meant to operate in both countries. It is worth remembering, however, that between 2002 and 2005, Russia thwarted China’s desire to acquire significant stakeholdings in two Russian oil companies, Slavneft and some “pieces” of the dismembered Yukos – another reason for Chinese resentment.

### Electricity and nuclear power

The Russian electricity monopoly EES (headed by Anatoly Chubais, known for his involvement in privatization) will increase supplies to China, from 0.5 billion kWh in

2005 to 60 billion kWh, to be supplied in three phases to 2015. Finally, as regards the nuclear sector, the visit of Sergei Kirienko, the head of Rosatom, the State-owned Russian atomic energy agency, to the Wan Tian and Lian Yung Gang (Jiangsu province) nuclear stations – built mainly with Russian aid – did not result in new agreements or new commissions.

This is a defeat for the Russian nuclear sector in China after its recent setback in India following the U.S.’s very recent entry into New Delhi’s nuclear programme. Moreover, France has signed an agreement to collaborate with Beijing in this sector. There are no formal treaties between Russia and China in the military field and neither are there structures similar to those that, for example, link Russia to NATO (albeit on paper rather than in concrete terms), the Russia-NATO Council.

Nevertheless, close and operational links have been set up. In August 2005 the



Russian and Chinese armed forces conducted their first joint land, naval and aerial exercises, called "Peace Mission 2005", in the Shandong peninsula and the Russian Primor'e. Latest generation arms (including strategic aircraft and powerful landing vehicles) and thousands of men and special troop units were involved. The manoeuvres caused considerable alarm in Tokyo, Taiwan and the U.S.

China has been strengthening its military potential since the 1990s by purchasing arms from the Russian VPK (military-industrial complex).

The figures speak for themselves. From 1992 to 2005 Moscow sold Beijing 281 fighter planes, including 105 in *komplekty* (knock-

down kits) to be assembled in China. These are all recent models, such as the SU 27 30. Beijing bought four A50E spy planes in 2004, and Russia will sell China licenses to produce its own fighter aircraft from 2005 to 2010. China in its turn exports arms, particularly to rogue States such as Iran, another excellent client of Moscow's in the arms sector.

VPK has supplied Beijing with over 300 combat helicopters, mainly Mi-8s, but also 80 of the latest model Mi-17, able to fly at altitudes of up to 4,000 m. China's array of arms supplied by Moscow includes torpedo and missile launch attack submarines and torpedo boats, also equipped with missile launchers.

In late 2005 China ordered 14 IL 76 military transport aircraft and four IL 78 refuelling planes from the VPK. However, Rosoboronexport, the Russian arms export monopoly, will soon have to face up to redoubtable competition from European and

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Western manufacturers (who are already leaders in the civil aviation sector with the Airbus) once the EU lifts its embargo on arms exports to Beijing (the U.S. is in favour of keeping the embargo).

### The limits of trade and Russia's shortcomings

However, there are objective limits to the Russian-Chinese partnership. On the eve of his trip to Beijing, in a long interview to the Chinese official news agency Xinhua, Putin himself emphasised the need to change the structure of trade exchanges between the two countries. In fact, 88% of Chinese imports from Russia are raw materials, starting with energy sector products such as wood (for which Russia is the second-largest exporter to China) and ferrous metals. Next come arms, for an average of \$1.5-1.7 billion per year.

Russian manufacturing exports to China make up only 3% of the total and are mainly composed of machinery for the oil and gas industries.

Putin complained about the fact that exports of Russian industrial manufactured goods to China dropped by 44.4% in 2005 despite the overall increase in trade exchanges – with the strong growth in 2005 due in part to the increase in international crude and raw material prices.

China, on the other hand, has increased exports of manufactured goods to Russia by 20%: these include high-tech goods (computers and electronic goods, particularly audiovisual), industrial machinery, transport (buses and trucks), health products, chemical products (fertilizers) and convenience goods (clothing, hosiery, furs, toys) – making it a competitor rather than a partner.

Putin mentioned a monokulturnaja structure for Russian exports because of the overwhelming predominance of raw materials.

At the end of the visit, speaking at the Russian-Chinese economic forum, the Russian president once again complained about the “monocultural” structure of trade exchanges, which “creates a dangerous instability for our trade... left open to the oscillation of international raw material prices”.

He added: “President Hu Jintao has spoken of China’s massive purchases of industrial



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goods from abroad. I am counting a great deal”, Putin concluded, “on the increase of Russian business structures in this process”. Setting aside diplomatic language, Putin invited the Chinese not to limit Russia to the role of an energy and raw materials supplier, and hence to buy Russian industrial manufacturing goods, from capital goods and big machines for nuclear power to medical supplies, material for the space and civil aviation sectors, agro industry products and bioresources.

Putin’s visit didn’t stop at economic issues. During the visit, the two governments reiterated their common position on international political issues. These include a commitment to support multipolarism in international relations, with a strengthening of the role and structures of the U.N.; the withdrawal of Anglo-American troops from Iraq; negotiations and compromise on the Iranian nuclear programme and no sanctions against Teheran; a road map and resolution by the U.N. of the Israeli-Arab conflict, a common project to denuclearise the Korean peninsula, with joint mediation with North Korea and a common declaration on the unity and indivisibility of China (with reference to Taiwan and Tibet). Finally, the two leaders emphasised their “shared commitment to fighting terrorism, extremism and separatism” to be carried forward within and outside the Shanghai Cooperation Organisation (SCO), which includes Uzbekistan, Kazakhstan, Kyrgyzstan and Tajikistan as well as China and Russia.



\_Above: the chairman of KazMunalgas, Uzakbai Karabalin and the VP of China National Petroleum Corporation, Zhou Ji Pin, at the inauguration of a new plant

### Primary partner, competitors and bitter figures

Figures show that Moscow is a double-sided partner for China. Its importance as regards energy matters (and, so far, arms) is certainly primary. However, Beijing is successfully trying to diversify its gas and oil provisioning.

Beijing recently signed wide-ranging agreements in terms of financing and timing, with Iran for a joint 25-year exploitation of the Yahavaran gas and oilfields for a total of \$100 billion, and with Kazakhstan.

Beijing and Astana have decided on the construction of the Sino-Kazakh Atasu-Alashankou oil pipeline with an estimated potential of 20 million tons of crude per year. The 1,000 km-long pipeline is to cost \$800 million. CNPC and the Kazakh KazMunajGaz have set up a mixed company for this purpose and the transport of crude will begin in 2006.

A year ago, CNPC also organised a successful takeover of a Kazakh-Canadian company called PetroKazakhstan, which manages some major Kazakh fields.

Finally, besides having renewed a major agreement with Saudi Arabia in January (Sinopec signed a deal to develop a large

Saudi Arabian oil field), Beijing is active in the research and exploitation of oil fields in Angola and Sudan.

The other side of the partnership is that of Russia as junior partner. While trade exchanges between Russia and China have grown significantly in recent years, Russia's share of Chinese foreign trade climbed only marginally, from 1.84% to 2.5%, in 2005. Russia's trade surplus dropped from \$3.03 billion in 2004 to \$2.68 billion the following year. While Russian exports to China have grown by 31%, raw materials make up the lion's share. The share of finished industrial goods dropped from 20% in 2002 to 2.1% in 2005.

Chinese exports to Russia, on the other hand, have increased by 45.2%, a win-win situation for China's manufacturing industry.

And a comparison of the respective GDPs and foreign investment reveals the extent of the difference between the two economies. Chinese GDP is \$1.98 trillion against Russia's \$581 billion. Foreign investments in China totalled more than \$600 billion over a period in which Russia received one-tenth that figure, directed for the most part to the gas and oil sectors. This imbalance causes fear and diffidence in Russia's relations with Beijing.

There is another aspect to be considered. Russia fears the demographic pressure exercised by the poor and densely populated Chinese provinces on the border with Russia in the Dalnij Vostok region (Khabarovsk and Vladivostok) and eastern Siberia, even if legal immigration from China officially appears to be contained (illegal immigration, on the other hand, is uncontrolled).

The Eurasian orientation of the Russian president is a card that Moscow, counting on its energy reserves, plays skilfully on the international chessboard. Russia's weak point, however, is lack of diversification of its economy. And it is not China that Putin should rebuke, but rather the lack of competitiveness and stagnation of the Russian manufacturing industry – and not only that – which confines Russia to the role of junior partner of Beijing.