

# ISSUE

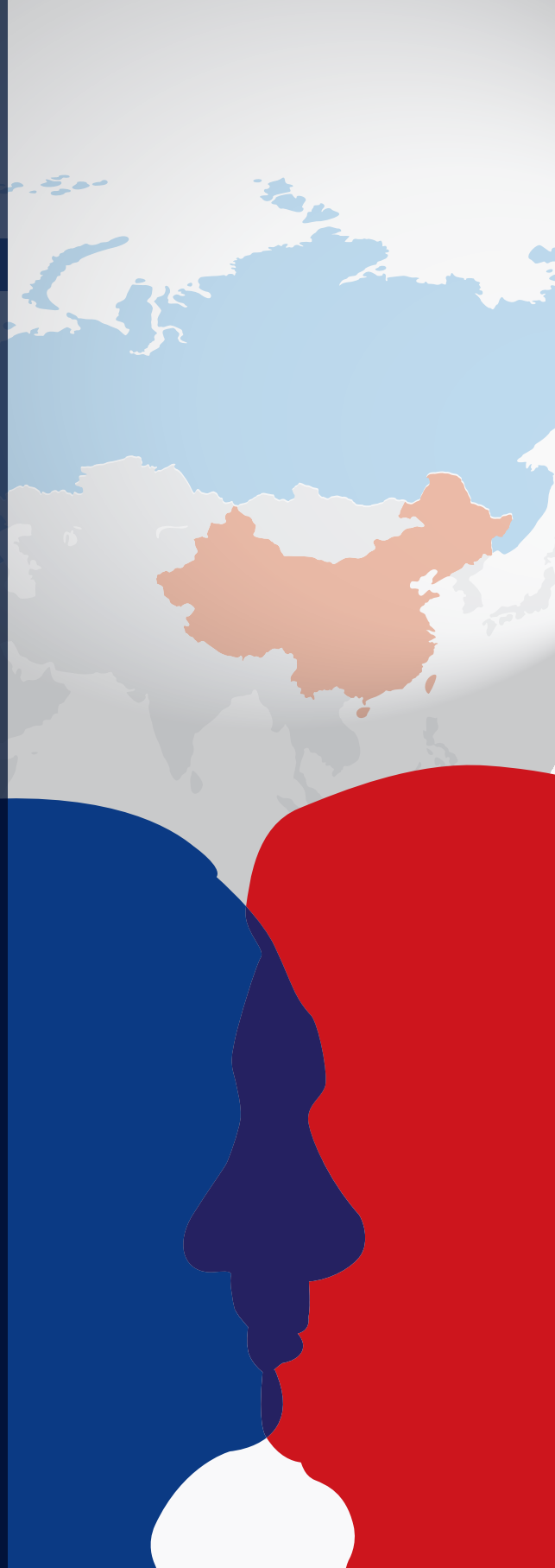
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## China and Russia: an Eastern partnership in the making?

BY

Michal Makocki and Nicu Popescu

### Chaillot Papers



# CHINA AND RUSSIA: AN EASTERN PARTNERSHIP IN THE MAKING?

*Michal Makocki and Nicu Popescu*

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# Foreword

Since US President Barack Obama and then Secretary of State Hillary Clinton launched it almost a decade ago, America's 'pivot to Asia' has struggled to materialise – in part also due to mounting crises and conflicts breaking out in the old Eurasian space, from the Middle East to Ukraine. Moreover, Clinton's and Obama's 'reset' initiative towards Russia has basically failed – not unlike similar moves attempted also by the previous US administration led by George W. Bush. This is only to underline that any planned strategic reorientation – no matter who intends to pursue it – is inevitably confronted with the complexities of an increasingly interdependent and polycentric world and with the reality checks that constitute an integral part of policymaking. In practice, unexpected events or unintended consequences often come in the way and force a readjustment or even a rethinking of initially stated ambitions.

This *Chaillot Paper*, co-authored by Michal Makocki and Nicu Popescu, sets out to evaluate the scope and the actual implementation of another 'pivot' within the America-Russia-Asia triangle – the 'turn to the East' announced by Moscow in the wake of its confrontation with the West over Ukraine. It does so by analysing the stated ambitions, the underlying motivations, and the potential contradictions and inescapable constraints that have characterised that 'turn' to date. In particular, the study dwells on the pivot within the pivot, so to speak, represented by Russia-China relations – which go back a long way, of course, and have evolved significantly since the Cold War and even the end of the twentieth century. The paper highlights the areas of convergence and divergence between Moscow and Beijing, the asymmetries in interests and resources, and their wider implications for Russia's policy in Asia – thus providing an insightful and balanced assessment of bilateral relations and their 'systemic' impact.

The new US administration led by Donald Trump is starting out with a plan to review and recast America's relations with both Moscow and Beijing. The entire world, starting with Europe, will surely keep a watchful (and concerned) eye on how all this will be translated into declarations, actions, and reactions – and their overall repercussions on (and implications for) a constantly changing strategic environment.

*Antonio Missiroli*  
*Paris, December 2016*



# Introduction

Following the annexation of Crimea, the outbreak of the conflict in Ukraine and the imposition of Western sanctions against Russia in 2014, Russia loudly proclaimed its ‘turn to the East’: a reorientation of its foreign and economic policies away from the West. For Russia, a closer partnership with China was supposed to offer a viable alternative to the West and allow it to offset the sanctions regime. China seemed eager to reciprocate, if only because the partnership would strengthen its objective of building a multipolar world. Since then, China and Russia have enjoyed what many have described as ‘a diplomatic honeymoon’.

However, questions abound. What exactly does the ‘East’ signify in Russia’s eastward pivot? Is Russia primarily pivoting to China or to Asia as a whole? How does the pivot work in practice – indeed, does it work at all? How does the pivot manifest itself in the economic, geopolitical, military or regional spheres? While the Russian-Chinese partnership is clearly widening to new areas, is it really deepening? Are the two powers building an alliance which would fundamentally alter the geostrategic landscape in Eurasia and beyond?

This *Chaillot Paper* seeks to answer these questions as it zooms in on the dynamics of the Russian-Chinese *rapprochement*: it explores the factors that bring Russia and China together and those that drive them apart, the economic basis of the relationship and how Russia and China interact in their shared neighbourhood of Central Asia.

In dealing with China, Russia is caught between its perceived needs and fears. Russia feels it needs to pivot to China to capitalise on investment, trade and growth opportunities, to develop its easternmost region, to balance against the US and boost its negotiating power *vis-à-vis* the West. Yet Russia is wary of becoming a junior partner in the relationship or over-dependent on a single partner. That is why Russia has been desperately trying to pivot to all of Asia, not only China. As Moscow made modest advances in expanding its political, security and economic relations with Beijing, in the last few years, it was seeking to balance *rapprochement* with China by engaging in proactive diplomacy with other partners in Asia. However, given the complex relations between China and other Asian powers, Russia’s balancing game has not been easy.

The result is a haphazard policy of Russian pivoting to the East (where the politics of *rapprochement* with China are loudly proclaimed, but slowly implemented), while Moscow simultaneously tries to hedge, balance and dilute its pivot towards Beijing. Russia also faces a geopolitical dilemma in the region. Isolation from the



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West makes engagement with China and other Asian countries more necessary than ever. But at the same time, the inclusion of Japan and, *de facto*, of South Korea in the sanctions regime is slowing Russia's pivot to Asia by effectively reducing the scope of this kind of outreach to working primarily with China, reviving long-term fears of the perils of overdependence. This is clearly hindering Russia's pivot to Asia. Similarly, the lack of balancing options in Asia also weakens Russia's bargaining power in Beijing. But the result is not so much Russia granting unilateral concessions to China, but rather Russia dragging its feet on deep and comprehensive engagement with China.

This paper will argue that in fact, despite the upbeat tone of official statements, the relationship has not lived up to the rhetoric for several fundamental reasons. Most crucially, each side has different expectations of the relationship, making an alliance or even a deep strategic alignment all but impossible. There is also limited scope for synergies between the two countries' economies. Complementarities between Russia's wealth of natural resources and China's energy-intensive growth also tend to be exaggerated, partly because the economic centres of gravity of these two neighbours lie geographically very far from each other.

The divergent geopolitical interests of the two aspiring partners will play out in Central Asia, which Russia perceives as its own backyard and which China courts with a promise of investments under the banner of its ambitious Belt and Road Initiative. This is already making the region a testing ground for both cooperation and competition between Moscow and Beijing. This situation is being handled politely by both sides, but it is likely to be an uphill struggle, especially for Russia.

## CHAPTER 1

# The strategy of rapprochement

China has some 50 strategic partnerships with countries and organisations ranging from the EU as a whole to Angola, Belarus and Venezuela. As a matter of good will, Beijing tends to accept most requests for such partnerships. Naturally, not all of them carry the same weight, and China has around half a dozen categories of strategic partnerships of different intensity, depth and value. Of these, the highest forms are the ‘comprehensive strategic partnership of coordination’ reserved for Russia, and the ‘all-weather strategic partnership’ with Pakistan.<sup>1</sup> Russia is certainly far from being China’s closest international partner, but the relationship has become increasingly close. They have long been united in their opposition to US primacy, but Russian-Western tensions around Ukraine have acted as a catalyst for Russia’s *rapprochement* with China.

## Converging geopolitics?

In 2003, senior officials, including then President Hu Jintao, sought to assuage international fears of China by claiming that its rise will be ‘peaceful’. Within months, the term ‘peaceful rise’ was considered too assertive and dropped in favour of the less threatening slogan ‘peaceful development’. Such language shifts were in line with Deng Xiaoping’s much quoted precept to ‘hide your strength, bide your time’.

Those days are over. Until recently, Chinese foreign policy followed Deng’s prescription to keep quiet. But now the undeclared motto is to continue to ‘keep quiet, but do more’. China in 2017 is much less shy about demonstrating its power, not least around the South China Sea. And while Russia and China still have very different perspectives on the use of military force, they have both invested heavily in the military in the last decade or so.

The two countries behave differently in global affairs. Whereas Russia seeks to exploit global instability to boost its own power and status, China prefers global politics to remain reasonably stable. Yet there have been increasing parallels in how the two countries’ elites see the world. Both countries’ foreign policy debates seem to contain a shared sense of passion for abstract geopolitical constructions, and a view of global affairs in which the US looms large as a waning superpower. In this

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1. Feng Zhongping & Huan Jing, ‘China’s strategic partnership diplomacy: engaging with a changing world’, FRIDE, ESPO Working Paper no. 8, June 2014.

worldview, both China and Russia are driven by a growing feeling of entitlement to great power status, perceived Western hostility and fear of military and economic encirclement. As a Chinese expert, interviewed by the authors in Beijing, claimed: 'China feels pressure in the South China Sea, and Russia feels pressure from NATO in the Baltic Sea. Russia faces anti-ballistic missiles systems in Romania and Poland, and China faces the same in South Korea and Japan. While NATO expands to the East, the US is strengthening its military presence in Asia, while Japan is rewriting the constitution and militarising.'

This sense of encirclement is mostly framed in defensive terms, but it also acquires offensive overtones such as the desire to not only limit, but to 'uproot US hegemony.'<sup>2</sup> Either way, Moscow and Beijing both believe that geopolitical clouds are looming, and in the face of upcoming storms, they might need each other at least as each other's 'quiet' fronts.

## Strategic pessimism

Yan Xuetong is Dean of the International Studies Department at Tsinghua University, chairman of the board of the Carnegie Tsinghua Centre in Beijing and considered by *Foreign Policy* magazine to be among the 100 most influential intellectuals in the world (in 2008). In China, he is regarded as being on the hawkish side of foreign policy debates, not in the mainstream. Nevertheless, his views are widely heard. His recent book, *The Inertia of History*, makes a compelling case for an alliance with Russia, because China and the US are, according to Xuetong, heading towards strategic rivalry in a newly bipolar world.<sup>3</sup> Under these circumstances, China needs allies and it has no better options than Russia. However, rivalry need not lead to war. Yan Xuetong argues that, 'If the US-Soviet confrontation was like a boxing match, with violence as a regular feature, the US-China competition will be more like a soccer match, in which limbs will occasionally collide but violence will not be the main form of competition. US-China will be primarily a team competition in which the objective is to win the support of other countries'. Thus China needs a team, and a quiet northern border that allows it to focus on challenges to its south and east. Such views do not reflect conventional wisdom in Beijing, but they have been gaining ground nonetheless.

Such geopolitical calculations are underpinned by a good dose of geopolitical pessimism. The 'rise' of China has strategic implications for most global powers and military considerations are part of the picture. Militaries are paid to be pessimistic and prepare for worst-case scenarios, and therefore contingency plans are part of

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2. Wang Sheng and Luo Xiao, 'Building a new type of Sino-Russian relationship', *Contemporary International Relations*, vol. 23, no. 5, September-October 2013.

3. Yan Xuetong, *Inertia of History: China and the World in the Next Ten Years* (Beijing: China CITIC Press, July 2013). See also Brian G. Carlson, 'China-Russia relations and the inertia of history', *Survival: Global Politics and Strategy*, vol. 58, no. 3, The International Institute for Strategic Studies, June-July 2016.

US, Chinese and Russian strategic thinking in the region. Consequently, should US-China security tensions ever rise significantly and threaten Chinese transit through the Strait of Malacca – most importantly oil imports from the Middle East – a ‘quiet front’ in Russia and Central Asia would provide China with at least partial alternative resources and trade routes. Such expectations are not necessarily realistic, given that the volume of oil supplied from Russia and Central Asia is not likely to sufficiently cover China’s needs, but such strategic considerations are being voiced in both Russia and China.

These theoretical geopolitical constructs have generated some practical outcomes. The number of summits, inter-governmental contacts and mutual attention paid to each other by both China and Russia has increased exponentially. So has the number and geographic scope of joint military exercises, with Russia and China holding naval drills in the Mediterranean Sea, South China Sea, East China Sea and the Sea of Japan. Between 2005 and 2013, Russia and China conducted three naval military exercises; in 2014-2016, they conducted another four.

### **Box 1: China and Russia in international fora**

As permanent members of the UN Security Council (UNSC), China and Russia have regular consultations on the whole range of global issues and they frequently see eye to eye on these matters. Both sides are declaratively attached to a number of principles of international relations that have often pitched them diplomatically against the West. Both China and Russia like to profess (although not necessarily practise) a strong preference for state sovereignty and non-interference in the internal affairs of other states, as well as sharing a high degree of scepticism towards interventionist foreign policies and democracy and human rights promotion.

Yet, the behaviour of China and Russia in the UNSC has also been marked by distinct diplomatic traditions and styles. China has a long record of low-key diplomacy, whereas Russia easily and eagerly resorts to megaphone diplomacy. This manifests itself not just in how diplomacy is conducted in the UN and elsewhere, but also in the number of vetoes applied in the UN. China has traditionally been a veto-shy member, and the one permanent member of the UNSC that used the lowest number of vetoes. Russia is, on the contrary, a frequent veto-wielder. Nonetheless, in recent years, and mostly in the context of the crises in the Middle East, China has increasingly wielded its veto alongside Russia. For example, between 1971 and 2006 China only used its veto power 3 times (on Bangladesh, Central America and Macedonia), but since 2007 it has done so on 7 occasions (5 times on Syria, and once on Burma/Myanmar and Zimbabwe), and every time together with Russia. In this last decade, Russia used its veto power 12 times (of which 5 times without support from China) on issues such as Ukraine, Georgia, Bosnia and Herzegovina and the wider Middle East.

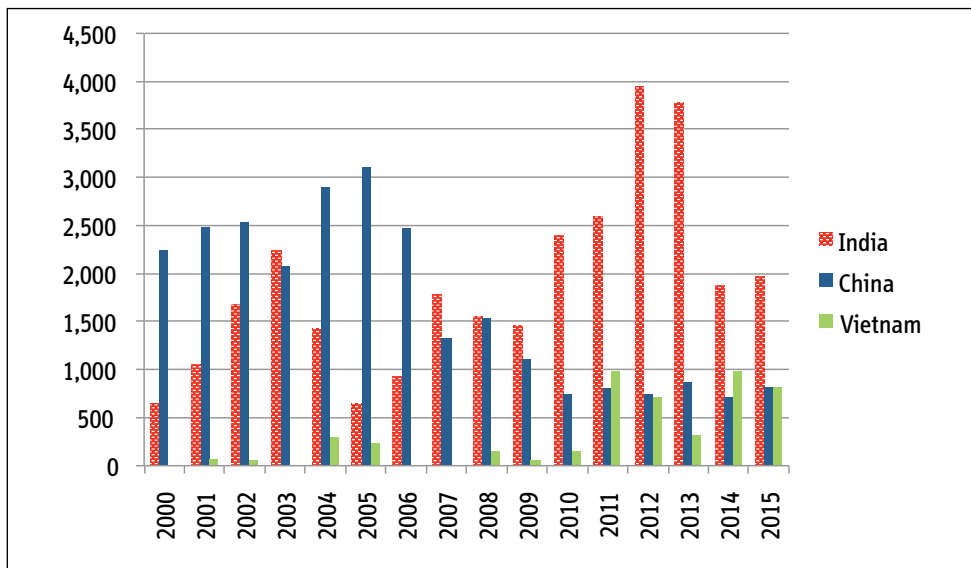
Shared opposition to perceived US hegemony is also pushing China and Russia to embrace closer coordination and cooperation within non-Western multilateral organisations and groupings. For both partners the Shanghai Cooperation Organisation (SCO), created in 2001 by Russia, China and the countries of Central Asia, represents a counterbalance to NATO and a major building block of an alternative non-Western institutional set-up. On the economic front, the BRICS coalition (comprising Brazil, Russia, India, China and South Africa) is portrayed by Russia and China as a viable alternative to the World Bank and IMF. Russia took a particularly active stance in both organisations as its rotating presidency in both groupings (2014-2015) coincided with the peak of hostilities with the West after the annexation of Crimea. However, a closer look at actual interaction within the multilateral settings reveals a complex pattern, whereby the two powers engage as much in cooperation as competition.

As for the SCO, both sides have in the last few years emphasised the usefulness of the organisation as a framework for cooperation on security issues, and in particular on counter-terrorism issues in Central Asia, a shared source of concern. More recently, both Russia and China have tacitly underlined the role of the organisation as a bulwark against the West. The expansion of the SCO membership to India and Pakistan in 2016 has further served this purpose. However, China and Russia differ as regards the future role of the organisation. China would like to see the thematic scope of the organisation to be expanded to include economic cooperation. In particular, China harnesses the forum to showcase the benefits of cooperation under its Belt and Road Initiative. SCO summits are usually preceded by bilateral visits between China and Central Asian member countries, meant to send a signal about the benefits of cooperation with China and forcing Russia to accept a *fait accompli*. Russia in turn is rather defensive about economic cooperation within SCO and sees the danger of Chinese economic domination. The expansion of the SCO has served Russia's interests as the bigger membership will dilute China's negotiating clout within the bloc. Similarly, while the multilateral drills under SCO have expanded in scope, Russia is wary of the organisation encroaching on its security role in Central Asia.

The two partners have also intensified their interactions on economic matters within the BRICS. Russia, which hosted the BRICS Summit in 2015 in Ufa, has exhibited a visibly more cooperative stance towards the organisation than was previously the case. The expectations in Moscow were that the grouping would be able to make up for the diminished flow of investment and finance after the imposition of sanctions. Little progress has been achieved on this front, however, as the coalition is rather diverse and does not wield the same economic clout as the Western economies. As a result, the grouping has not been able to move on substantive geopolitical issues despite the lofty rhetoric of its annual summit declarations.

Defence industry cooperation has also picked up, after a lull lasting half a decade. Throughout the 1990s, China imported up to 50% of Russia's defence exports, in many ways helping the Russian defence industry survive its worst years. By 2007, China was replaced by India as the biggest importer of Russian equipment, while countries like Algeria, Venezuela and Vietnam overtook China in placing new orders. In recent years, however, contacts have started to pick up again – even before the Ukraine crisis, as Russia and China began negotiations on the sale of highly advanced weaponry such as S-400 anti-aircraft weapons systems and Su-35 attack aircraft around 2010-2011. These negotiations were helped by the crisis in Russian-Western relations over Ukraine, and led to the conclusion of actual deals.

**FIGURE 1: RUSSIA'S TOP 3 ARMS EXPORTS DESTINATIONS (IN \$ MILLION, 2000-2015)**



Source for data: SIPRI.

At least a partial reason for this renewed interest in defence procurement (as opposed to China developing its own capabilities) may have resulted from Beijing's desire to rapidly increase its army's fighting capacity in case of a deterioration of the security situation in East Asia. On the other hand, many in Russia do not seem to be too worried because, as a former Russian military officer claimed in a conversation with the authors, 'China is much weaker militarily, and its military infrastructure is mostly developing away from its border with Russia.' That is not necessarily true, but it conveys a certain degree of complacency that is now widespread in Moscow.

Both Russia and China also realise they might not be able to withstand a full-scale conventional war with the US or NATO, and hence have worked to develop an increasing array of asymmetric warfare capabilities. The way China has operated in pursuing its claims in the South China Sea has inspired parallels with Russia's hybrid tactics in Ukraine. The annual US Department of Defense report on Chinese

military power in 2016 claims that ‘China has used low-intensity coercion to enhance its presence and control in disputed areas of the East and South China Sea. China often uses a progression of small, incremental steps to increase its effective control over disputed areas and avoid escalation to military conflict.’<sup>4</sup> The key to such tactics has been China’s Coast Guard, which has been described as aggressive, but in ways that do not threaten naval escalation and allow China to maintain some plausible deniability in the way it presses claims in the South China Sea. In this context, China’s Coast Guard has been dubbed ‘little blue men’, a notion obviously borrowed from Russia’s ‘little green men’ who conducted the military operation annexing Crimea.

### **Box 2: The South China Sea disputes and Russia**

The South China Sea is a hotbed of contested territorial and maritime claims involving China, Indonesia, Malaysia, the Philippines, Taiwan and Vietnam. Given that China lays (unspecified) claims to most of the sea, according to a so-called ‘nine-dash line’, a substantial part (although not all) of the contestation takes place between China on the one hand and the other countries involved on the other.

To strengthen its claims to territorial waters, China has built artificial islands, while the US has conducted ‘freedom of navigation’ operations in the sea, signalling unacceptance of Chinese claims to an extended exclusive economic zone. Over the years, there have been several small-scale incidents between China and other states in the region (but not the US), mostly involving fishing ships. However, as China increases its military presence in the region, and the US (and possibly France) conduct ‘freedom of navigation’ operations, the risk of more dangerous incidents is growing.

In the diplomatic choreography around the South China Sea disputes, China tends to oppose the ‘internationalisation’ of the issue and favours ‘direct diplomacy’ between the states in the region. Most other states in the region, frustrated by lack of progress, growing Chinese assertiveness, and a clear asymmetry of power *vis-à-vis* China, have been inclined to ‘internationalise’ dispute settlement efforts, as well as favour freedom of navigation operations.

Russia’s approach to the disputes has traditionally been ‘passively neutral’ where it has avoided voicing its opinion on the various claims made by the states involved (which did not prevent Russia from developing oil exploration partnerships with Vietnam in the South China Sea). However, Russia seems to be switching towards a more ‘pro-active neutrality’ where its lack of position on the South China Sea disputes appears to be gradually replaced with a pendulum-like policy of signalling support to some Chinese positions (non-internationalisation of the dispute), followed by signals of support to some ASEAN and US positions (freedom of navigation), followed again by support for China in the non-recognition of a ruling by the Hague-based Permanent Court of Arbitration rejecting China’s historical rights to most of the South China Sea.

4. Annual Report to Congress, ‘Military and Security Developments Involving The People’s Republic of China 2016’, Office of the Secretary of Defense, 23 April 2016, p. 13.

## China and the conflict in Ukraine

China has also maintained a (from Moscow's perspective) reasonably favourable posture of neutrality on Russian policies and military actions in Ukraine. The overthrow of Ukrainian president Viktor Yanukovich in 2014, Russia's annexation of Crimea and the war in the Donbass did nevertheless pose diplomatic dilemmas for China. On the one hand, China has a long tradition of emphasising respect for territorial integrity (because of Taiwan and Tibet), and non-interference in the domestic affairs of other states. Thus, in theory, China should be quite disapproving of Russian behaviour in Ukraine. Yet China is as concerned about revolutionary overthrow of governments as it is with territorial integrity. The view that 'coloured revolutions' are staged by the West is not exactly a rarity in China. Thus, even before Crimea was annexed, large-scale protests such as Euromaidan were clearly anathema to Beijing. In other words, China found much to dislike in both Ukraine's and Russia's political dynamics during the crisis.

Below the surface of official diplomacy, Russian behaviour in Ukraine did at least strike a chord with significant parts of the Chinese public. There is a sufficient number of people in China who believe in claiming what is 'yours' through military means if needed, and see that as a legitimate approach to Crimea, but also Taiwan. So the annexation of Crimea was not entirely disapproved of by parts of the Chinese public.

China's government was careful in how it reacted to the events in Crimea. Officially, Beijing adopted the position of neither supporting nor criticising Russia during the crisis in Ukraine. Russia attempted to convince China to signal support for the annexation of Crimea on several occasions by inviting Chinese companies to Crimea, organising investment or trade promotion events for Crimea, or persuading China to continue projects planned in Crimea before the annexation, such as a port agreed with Kiev just a few months before the annexation. China generally resisted such overtures and tried to impose a policy of non-engagement in Crimea on its companies as well. Yet that has not resulted in a blanket policy of non-engagement, given China's participation in building an underwater electricity 'bridge' between Russia and Crimea. As Russia could not produce high-voltage underwater cables and EU and US suppliers refused to provide them, China's Jiangsu Hengtong Power Cable Company stepped in. At the same time, China continued its pragmatic cooperation with Ukraine in multiple sectors (see Box 3 overleaf).

## Equality therapy

An important 'psychological glue' for the Russia-China relationship is a near obsession with emphasising respect for each other and stressing that the relationship is equal. The Chinese tend to make promises of eternal equality with Russia, and Russian foreign policy makers and shapers are constantly calculating what their chances of ensuring equality are – now or in the future (see Box 4 on pages 17-18).



### Box 3: Chinese-Ukrainian relations

China and Ukraine have been in a 'strategic partnership' since 2011. In a programmatic foreign policy article published in *Zerkalo Nedeli* in March 2012, Konstantin Grishchenko, then foreign minister of Ukraine, argued that Ukraine should escape its foreign policy 'dichotomy' of balancing between Russia and the EU, and add a third, Asian, pillar to its foreign relations. Even though this never materialised in political terms, China has gradually become an important trading partner for Ukraine. By 2013, bilateral trade peaked at \$9.7 billion (9% of Ukrainian external trade), but it fell to \$5.6 billion in 2015, as Chinese-Ukrainian trade links became a direct casualty of the war and economic crisis in Ukraine. In 2016, just as Russia and China issued a joint statement condemning the use of sanctions as a foreign policy tool, Russia blocked all transit of goods from Ukraine via its territory – thus impacting on Ukraine's trade with China and Kazakhstan.

Ukrainian and Chinese defence industry cooperation has been significant, and included aerospace, naval and air defence cooperation. Throughout the last two decades, China often tried to circumvent Russian restrictions on the sale of sophisticated military equipment by going to other post-Soviet states like Ukraine or Kazakhstan. The Chinese also reverse-engineered two Russian fighter jets, the SU-27sk and SU-33, with the alleged help of Ukraine. Until the 2014 annexation of Crimea, Russia's close cooperation with the Ukrainian military-industrial complex gave it some leverage to limit the transfer of technologies to China. After 2014, Ukraine is likely to feel much less constrained in technologies transfer to China and will sell China 'anything they want', as a Ukrainian diplomat told the authors of this publication.

Despite conflictual Russian-Ukrainian relations, Beijing's approach to Kiev is underpinned by pragmatism. Even though trade with Ukraine contradicts Russia's embargo on its Slavic neighbour, Ukraine's trade in agricultural goods with China increased by 56 % in 2014, and Ukraine is on course to become one of China's top food suppliers. Similarly, Eurasian rail connections, supported by China under its Belt and Road Initiative, offer Ukraine a way around the ban on transit through Russian territory. In January 2016, the first freight train bypassing Russia departed from Ukraine to China.

The Russian version of 'respect diplomacy' is characterised by a mix of respect and fear. In striking contrast to the tone of Russian relations with the West, President Putin and Russian diplomacy on the whole suddenly lose any traces of abrasiveness whenever it comes to dealing with China. Russia is not afraid of verbally abusive rhetorical ping pong with the West, but would never dare adopt a similar tone towards China. That is not only because it is less irked by China, but also because of a belief that China would never tolerate the kind of bellicose foreign policy rhetoric that Moscow regularly directs at the West. That is clearly visible in the nearly daily foreign policy statements of the Russian Ministry of Foreign Affairs,

but also in documents such as the military doctrine where NATO is mentioned five times as the primary threat, while China is mentioned only once – as a friend. That is the case despite the fact that Russia's armed forces have defensive and offensive contingency plans for both.

The Chinese mostly retain similar levels of politeness. Their emphasis on equality in dealing with Russia is clearly rooted in the realisation that Russia feels disrespected, and even humiliated, by the West, and China consciously plays up the card of being the more respectful partner. And even though the West has invested a lot in showing respect for Russia over the last two decades as well, by offering G8 membership, holding bi-annual summits with the EU, making regular visits to Putin's summer residence in Sochi and marching at Russian military parades, Chinese assurances of respect seem to have been sweeter to Russian ears than Western ones. China's 'respect diplomacy' has thus played a certain therapeutic role in Sino-Russian relations and helped grease the wheels of *rapprochement*. And yet, enough sand in those wheels remains for Russian-Chinese *rapprochement* to still move slowly.

#### **Box 4: Direct quotes: *Chinese respect ...***

Dai Bingqin, former member of China's State Council and chairman of the Chinese chapter of the China-Russia Committee for Friendship, Peace and Development: 'Russia and China are not simply cooperating, but are cooperating to bring prosperity to the whole world, and the relationship is not anything like the Soviet-Chinese brotherhood, but a true partnership of equals.' (31 May 2016, Russian International Affairs Council conference on Russian-Chinese relations, Moscow).

Wang Sheng and Luo Xiao: 'China should put itself in Russia's position and be modest, prudent, honest and sincere. China itself should use legal means to control Chinese migration to Russia. It should recognise Russia's traditional influence and special interests in the region.' (Wang Sheng and Luo Xiao, 'Building a new type of Sino-Russian relationship', *Contemporary International Relations*, vol. 23, no. 5, September-October 2013.)

#### ***... and Russian thinking***

Igor Ivanov, former foreign minister of Russia: 'It is useless to talk about smaller or bigger partners. Of course Russian-Chinese relations are not symmetrical, but existing asymmetries do not create hierarchies, where the stronger partner imposes its will on the weaker one.' (*Rossiiskaya Gazeta*, May 2016.)

## China and Russia: an Eastern partnership in the making?

Boris Titov, chairman of the Russian chapter of the Russian-Chinese Committee of Friendship, Peace and Development: 'The USSR and China sang the same songs in the same language in the early years of the Cold War. But the USSR was perceived in China as the elder brother. But it was a one-way street. Then there was a cooling of relations and estrangement. In the 1990s, Chinese goods and companies were penetrating the Russian market, but they faced a tough attitude from our government, they faced corruption and unfriendliness. But since 2014, there are preconditions for a new period of relations. Today, Russia is no longer a weak and inefficient country. Russia is much stronger. And today it is no longer a one-way street.' (31 May 2016, Russian International Affairs Council conference on Russian-Chinese relations, Moscow).

Fyodor Lukyanov: 'The West tells Moscow that Russia must or should do something. China says "this is complicated. Let us work on it."' (Remarks at Valdai Club event, 2 June 2016, Moscow).

Russian senator (speaking under Chatham House Rule): 'Russia and China? We don't have any unresolved conflicts. But the Chinese are arrogant. They are the stronger partner and can force us. And we are the weaker partner. But all is up to negotiations. Bad relations with the West are weakening our hand on China, and that motivates us to make deals with them. Confucius said that a cornered cat turns into a tiger. We are not cornered, but we don't have many options.'

Alexander Gabuev, Carnegie Moscow Centre: 'Russian foreign policy is so fixated on the idea of equal partnership that it has lost sight of the pragmatic task of how to benefit from the partnership most effectively. If Beijing had devoted its energy to thinking about how not to end up as the "little brother" of the United States instead of integrating into the global economy, there would have been no Chinese economic miracle.' ('Russia and China: Little Brother or Big Sister?', CMC, 5 July 2016.)

## CHAPTER 2

# Second thoughts?

At a major Russian-Chinese forum in a luxury hotel in central Moscow in June 2016, Russian foreign minister Sergey Lavrov announced to an audience of several hundred businessmen, diplomats, military personnel, scholars and journalists that Russian-Chinese relations were at the best point ever in the history of the two countries, and a model of cooperation in the twenty-first century. But as is often the case, lofty rhetoric hides choppy waters.

For now, the mainstream view in both Moscow and Beijing is that the two countries need not and will not build an alliance. Rather, they should build a relationship that is ‘more than a partnership, but less than an alliance’, as a Chinese expert puts it. The fact that China does not do ‘alliance politics’ – which is considered to be an outdated, exclusionist, and Western geopolitical concept – is something of a mantra in Beijing. Yet this explanation is only partial.

Doubts about Russia’s reliability as a partner also lurk not far below the surface. A recent article on Russia by Fu Ying, chairperson of the Foreign Affairs Committee in the National People’s Congress of China and former deputy foreign minister, is a case in point.<sup>5</sup> The article certainly extols the virtues of the Sino-Russian relationship (mutual respect and equality are hailed as the most esteemed values in the partnership), but is open about the attendant problems in ways which are almost unprecedented in the publicly displayed honeymoon mood between Beijing and Moscow.

Part of the problem, in her view, is that in the last century and a half, China signed three alliance treaties with Russia, ‘all of which were in vain’. The first alliance, created in 1896, ‘failed to live up to its name as it ultimately whetted Russia’s appetite for acts of encroachment on China’s interest’. Only a few years into the alliance, Russia joined forces with Western colonial powers in ‘invading Beijing and going on a killing and plundering spree’. Almost immediately after creating another alliance, in 1945, Russia ‘forced China to recognise the independence of Outer Mongolia’. The third alliance of 1950 did not last long either. Such history lessons are not the only factors weighing against too close an alliance with Russia.

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5. Fu Ying, ‘Are China and Russia Axis or Partners?’, *Contemporary International Relations*, vol. 26, no. 1, January/February 2016.

## Geo-economics vs geopolitics

Both powers want a bigger share of global influence, but their strategies for achieving that are diametrically opposed. Even if both China and Russia share a passion for geopolitical constructs, geopolitics occupies different places in the hierarchies of ideas in Moscow and Beijing. For Russia, economics matters, but it is subordinated to geopolitics. In China – even though geopolitical considerations have been gaining ground, geo-economic thinking still takes precedence. That is partly a reflection of how the two countries fit into globalisation.

China has not simply been a beneficiary, but probably the single biggest beneficiary of globalisation. China's geopolitical, military, technological and soft power rise started first and foremost due to its economic ascendancy. In China's view, without economic development, there is no development. Reasonably good relations with the West are also a key ingredient of China's rise. This results in a mainstream belief that it is not in China's interest to challenge, let alone overturn, the existing international order. Even Yan Xuetong, a very geopolitically-minded thinker, argues that the 'basis of great countries' comprehensive power is political strength, and the core of political strength is leaders' ability to implement reform'.<sup>6</sup>

For Russia the opposite is true. It thinks of itself as a loser of the last three decades: its economy is smaller than that of Spain or South Korea, and its great power status is due to its nuclear and military power as well as globally-minded diplomacy, not its economic weight. It has also learned in recent years that rocking the global boat gets Russia attention and greater influence in world affairs than so-far half-hearted attempts at economic modernisation.

Russia uses strategic surprises while China prefers strategic calm. Whereas Russia seeks to achieve its re-assertion of great power status through military action in Ukraine or Syria, China has a deep consensus in favour of the need for a peaceful external environment that allows for continued economic development. In this context, Russia's approach does not seem to spark much enthusiasm in Beijing.<sup>7</sup>

## Needs and nightmares

In dealing with China, Russia is caught between needs and fears. Russia needs to pivot to China for investment, trade growth opportunities, for a chance to develop its easternmost region, to balance against the US, to work towards a (more) multipolar world, to boost its negotiation leverage with the West and for many other reasons.

At the same time, Russia is afraid of China. There have been recurrent fears of Chinese demographic expansion and the 'yellow peril', particularly in the 1990s, when

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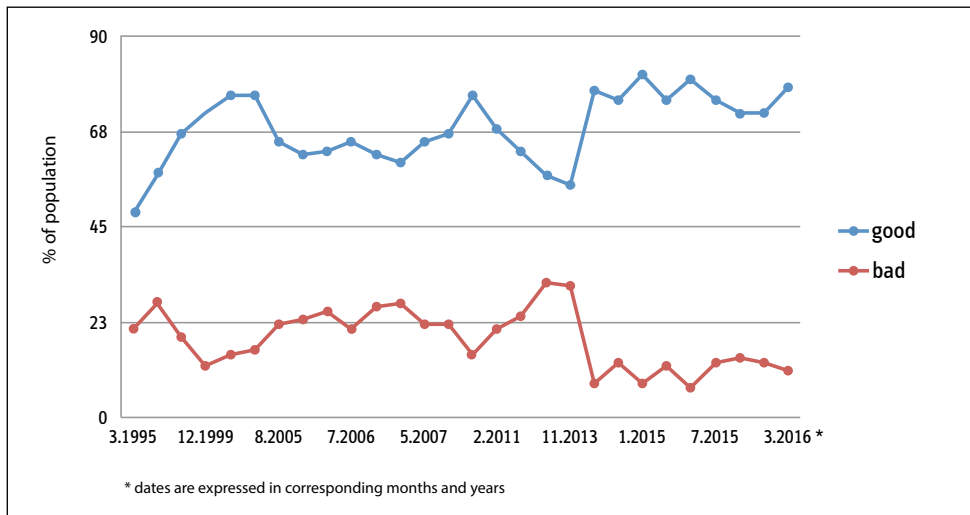
6. Yan Xuetong, *op. cit.* in note 3.

7. In the words of former deputy minister Fu Ying: 'Russia's foreign policy style is more on the tough side, and sometimes more in an unexpected direction. This may lead to confrontations and strains in foreign relations.' Fu Ying, *op. cit.* in note 5.

the formerly closed Russian borders were opened and Moscow lost control of former Soviet territories, at the same time as the country plunged into a deep economic and institutional crisis. Even well before, Khrushchev once issued a request for Chinese labour to Mao Zedong which he then subsequently retracted. Chinese disinterest in a demographic expansion to Siberia is explained by one expert who claims: ‘The Chinese population migrates south from the border with Russia. Northern China has a shrinking population. In Chinese tradition, only criminals get sent to Siberia. Chinese talent goes to the EU and US, not Russia, because Russia is not attractive’.

But such fears are marginal now. They do resurface once in a while over issues such as Chinese investments in agriculture (and the leasing of land) in Siberia. But by and large, mass fears about Chinese demographic expansion have given way to fears among political elites of becoming Beijing’s weaker partner. As one of the most Sino-friendly Russian high-level officials, a deputy minister, said in a private conversation: ‘China will begin to be more aggressive and what we see is only the beginning. Their ambition is to have the yuan used as a key currency from Lisbon to Jakarta’.

**FIGURE 2: RUSSIAN ATTITUDES TOWARDS CHINA**



Source: Levada Centre, Moscow. ‘Attitudes towards third countries’ (‘Otnosheniia k stranam’), 2016.

Defence industry cooperation and sales provide an interesting example. China and Russia are starting to overcome a lull in defence trade. But at the same time, both want self-reliant, not interdependent, defence industries. A new lull might thus be just around the corner. Beijing’s ‘Made in China 2025’ plan assumes independent capacity to produce key military components within the next decade. Chinese technological nationalism has already led to less reliance on Russian arms supplies across a wider spectrum of weapons needs than ever before.<sup>8</sup>

8. Richard A. Bitzinger, ‘Defense Industries in Asia and the technonationalist impulse’, *Contemporary Security Policy*, vol. 36, no. 3, 29 January 2016. See also: Richard A. Bitzinger, ‘Russia’s arms transfers and Asian military modernisation’, S. Rajaratnam School of International Studies, Policy Report, December 2015.

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The growing consolidation and sophistication of the Chinese armaments industry has also led to increasing competition in third country markets. China has moved from ninth to fourth place in terms of global arms exports (with a 143% growth of exports in 2014). The Centre for Analysis of Strategies and Technologies, a leading Russian think tank working on defence industry issues, claims that Russia loses out to Chinese military-industrial development on two counts: it simultaneously loses a customer and acquires a powerful competitor.<sup>9</sup> Furthermore, China tends to occupy the same market niche as Russia: not very expensive, good enough for the price, and without political conditionality attached or significant end-user restrictions, as Richard Bitzinger argues. As a result, China has started taking over some 'traditional' Russian markets in Africa and even Central Asia, with Kazakhstan recently buying Chinese drones, and Turkmenistan buying Chinese missiles and drones.

Russia is also afraid of irreversible entanglement. For all of Russia's fraught relations with the West, Russia has more bargaining power in its relations with any single European country than it does towards China. According to one Russian expert explaining Moscow's approach, 'Russia can talk to Europe from a position of force. But *vis-à-vis* China it is bound to be structurally weak. For Moscow, it is better to be a leader in Europe than a subordinate to China. But for this, Russia has to force itself into Europe from a position of strength.'

When dealing with Western politicians or companies, Russia can choose to be friendly or aggressive, depending on the circumstances. But it can only be nice to China. Putin would never give a 'Munich speech' on China and no Russian military doctrine would be as sincere about what the Kremlin thinks about China as it would be about NATO. Thus, Russia tries to keep the relationship with China high on rhetoric but low on substance – or at least not much deeper than its other partnerships. Part of this strategy is making sure that Russia's turn to the East is a pivot to Asia as a whole, not just to China.

## What is the pivot to the East?

Russia is pivoting to the East. But which East is less clear. Beijing's gravitational attraction – economic or political – is so large that the pivot to the East is almost by default a pivot to China. But Russia certainly does not want to exchange a significant degree of dependence on the West for a similar degree of dependence on China.

Diversification is desirable for Russia, and a flurry of diplomatic activity can create the illusion of such diversification, but achieving it in practice is far from easy. In recent years, the more Russian and Chinese leaders met, the more active Moscow became in diplomatically courting other Asian powers. A Russian-Japanese *rapprochement* took place throughout most of 2016. Even if Japan joined Western sanctions on Russia, Putin and Abe have been experiencing a diplomatic honeymoon of their

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9. Mikhail Barabanov, Vasilij Kashin & Konstantin Makienko, *The Defense Industry and Arms Trade of the PRC*, Center for Analysis of Strategies and Technologies, 2013 [М.С. Барабанов, В.Б. Кашин, К.В. Макиенко, *Оборонная промышленность и торговля вооружениями КНР*, 2013].

own, partly based on Japanese hopes of regaining control of at least two Kuril Islands. Yet in reality, there is little substance to this *rapprochement* and its durability, as it is not likely to yield progress on the Kuril Islands. From a Russian standpoint, it is close to impossible to imagine President Putin, who portrays himself as the 'reuniter' of lands, giving away territory.

The fate of the Shanghai Cooperation Organisation (SCO) is also revealing. The closer Russia and China have supposedly become, the more assertive Russia has been about the need to expand the organisation towards India and Pakistan at least. This has led to something of a clash of visions. Whereas China wants a regional role for the organisation focused on Central Asia and preferably the addition of a stronger economic dimension to the SCO, Russia has pushed for a more global role and is reticent about an economic dimension. The two partners have also gone through a sort of diplomatic misunderstanding about the SCO's enlargement.<sup>10</sup>

Trade and investments are no exceptions to Russia's hedging strategy. In 2016, Russia considered selling 19.5% of Rosneft, the country's state-owned oil giant. China's CNPC seems to have signalled interest in buying the entire stake and claiming corresponding representation on the board of directors, which worried Russia. In the end, the shares did not go to China, but to the Qatar Investment Authority and commodities trader Glencore (possibly acting in partnership with Russian beneficiaries). The Russian internal debate on the privatisation of Rosneft was indicative of Russian worries *vis-à-vis* a potential Chinese stake in Rosneft, which contrasted sharply with Moscow's few strategic qualms about offering another 19.75% of Rosneft to British Petroleum (BP) in 2012.

Similar balancing happens in the security sphere. As Russian-Chinese arms trade picked up both in absolute numbers and in the quality of weapons, so did Russia's arms sales to other countries. It is only natural for Russia to want to sell more weapons to China and elsewhere. But arms sales are not just a buy and trade exercise. The upgraded quality of Russian weapons sold to China worries Russia's other partners such as India and Vietnam, because it further upsets an already fragile regional military *status quo*. Such arms races can be advantageous to arms suppliers of course, but playing at both ends has been irritating for virtually all of Russia's regional partners and does not increase trust in the predictability of Russia's future behaviour, even though it makes Russia more of a player in these regions. Shyam Saran, India's former foreign minister, recently argued that since the end of the Cold War, Russia and India had lost the 'strategic glue' that held their partnership together, and that Russia moved from being a 'strategic partner' to simply a 'friendly power' especially due to Russian decisions to sell China sophisticated weapons like the S-400 missile system and Su-35 fighter aircraft (followed by a declaration by India of its intention to buy S-400 systems as well).<sup>11</sup>

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10. Denisov Igor Evgenevich & Safranchuk Ivan Alekseevich, 'Four SCO Enlargement problems', *Vestnik Mgimo-Universiteta*, vol. 3, no.48, 2016.

11. Shyam Saran, 'China shadow over India-Russia Relations', *Business Standard*, 2 August 2016.



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In the context of the South China Sea, Russia's foreign policy strategy is also confusing its partners. Technically, its position is not to have a position on the territorial disputes in this contested sea. Moscow also supposedly plans to maintain some (diplomatic and arms supplies) equidistance between China on the one hand, and Vietnam and other countries on the other. Yet Russia's declared neutrality does not work well in practice. Vietnam is worried that Russia upgrades the weapons it sells to China. China is upset that Russia sells Vietnam weapons which are more sophisticated than those China can obtain. In the words of Chinese analysts Wang Sheng and Luo Xiao, 'The biggest conflict is without doubt Russia's close military ties with Vietnam. It is like a covert containment of China because it is helping Hanoi have a stronger hand in the South China Sea issue.'<sup>12</sup> Navigating these regional contradictions has certainly not been easy for Russia.

## A cautious welcome to Russia

From the perspective of most states in Southeast Asia, often locked in delicate relations with China, Russia's outreach in the region has been welcome. They want to avoid a diplomatic squeeze between potentially tense US and Chinese relations, and would certainly not like Russia to take sides should regional geopolitics deteriorate further. But, besides a certain degree of psychological comfort, there is little Russia can actually offer the region. In the words of Anton Tsvetov, a Russian expert on Southeast Asia, 'Russia still does not play a central role in Southeast Asian regional institutions, but will not settle for a peripheral one.' Russia's trade links with the region are also modest.

In addition to the obvious limits of such foreign policy diversification in an increasingly polarised region, Russia has also played its cards clumsily. Russia first spent considerable energy trying to remain neutral in regional disputes, especially around the South China Sea and Chinese-Japanese divergences. Then it started being all things to all partners. On the one hand, it invested energy in a *rapprochement* with Japan, even hinting at possible concessions over its territorial issues with Japan in the Kuril Islands. It also expressed solidarity with ASEAN's (and the US's) position on support for the freedom of navigation in the South China Sea during a Russia-ASEAN summit in Sochi in May 2016. This position is certainly close to Russia's own interests and traditions as a naval power flying its flag across the globe, but in the context of the South China Sea, this position is clearly at odds with Chinese preferences.

The Russian pendulum then swung back towards Beijing as Russian and Chinese naval forces undertook joint military exercises in the South China Sea, thereby irking ASEAN, even though these drills were held in uncontested waters. At times, it looked as if Russian politicians, military officials and diplomats were working at odds with each other. The conclusions the states of the region seem to be drawing is that it is good to talk and engage with Russia and prevent it from allying with the regional adversaries, but not more than that.

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12. Wang Sheng and Luo Xiao, *op. cit.* in note 2.

Beyond such diplomatic manoeuvring, geographic and economic realities make Russia's pivot to the East primarily a pivot to China. For Russia, ASEAN is too far away and economic links are limited, while Japan is on board with the West in implementing sanctions, and India has limited resources to offer Russia as either loans or investments. Hence for Moscow, most roads to the East almost inevitably end in Beijing.

## Chinese irritation

Russia's hedging strategy is certainly being noticed in Beijing. A certain degree of irritation is regularly expressed in private conversations, but sometimes bubbles up into the public domain as well. Li Fenglin, a former Chinese ambassador to Moscow, complained in public that Russian attitudes to China go 'from one extreme to another. From talk of alliance with China, to wariness, and the need to rebalance relations with China, by developing relations with China's neighbours, and then it is completely unclear what Russia's interests are'.<sup>13</sup>

Recently *Global Times* – China's belligerent political tabloid which normally rails against the West – turned on Russia, a rare occurrence in the (state-controlled) Chinese media. Han Kedi, a researcher from the Chinese Academy of Social Sciences, criticised Moscow for 'aiming to contain China by using India' and joining hands with the US in 'fostering another regional power to offset China'.<sup>14</sup> Such views are not party policy in China, but they do reflect certain concerns. The Russian embassy even had to respond with another opinion piece extolling the virtues of the partnership.

There is also a palpable sense in Beijing that Russian thinking continues to be primarily focused on its interactions – however hostile – with the West, including over issues such as Ukraine or Syria, while its pivot to Asia is almost a spare-time activity. Putin's initiative for economic integration in greater Eurasia is also dismissed. As a Chinese scholar put it, 'Putin always has new ideas, but is less active when it comes to concrete cooperation'. Yet such outbursts of irritation are not only rare. They are also kept in check by a focus on the bigger picture and a certain 'strategic calm' about Russian foreign policy volatility.

## Keep calm and carry on

Despite closer relations, the list of bilateral frustrations remains long. Beijing suspects the Russian pivot to the East of being more of a pendulum (that will swing back to the West), than a pivot. Thus, China's hope is that the pendulum could be pinned down or availed of to forge stronger economic links. Consequently, Beijing is willing to suppress occasional irritations and focus on the bigger picture. As a Chinese scholar explained: 'of course we are irritated by Russia supplying arms to Vietnam, but we would rather have Vietnam buy arms from Russia than from the US, which are better'.

13. Russian Council Plenary Session: 'Eurasian Vector of Foreign Policy of Russia and China' (Пленарная сессия 'Евразийский вектор внешней политики России и Китая'), 31 May 2016.

14. Han Kedi, 'Russian Suspicions on China Hold Back Ties', *Global Times*, 24 July 2016.

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In parallel, stronger economic links should also help both sides gain more from their ‘friendship with benefits’, as Alexander Gabuev argues.<sup>15</sup> Both sides seem to want that. Russia wants an alternative to Western capital, technologies and markets. And China hopes to use the current political *rapprochement* to build a solid economic foundation for the future, so that Russian-Chinese economic interdependence acquires a logic of its own, rather than be at the mercy of Russia’s tactical geopolitical realignments. As a Chinese expert argues: ‘China likes to trade with other nations, not take their territory, and Russia has the opposite tradition. Russians prefer to do strategy instead of trading, including with China. We want to build an economic basis for our partnership to safeguard against future geopolitical changes possible in Russia.’ That process is advancing already, but is not exactly smooth.

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15. Alexander Gabuev, ‘Friends with benefits: Russian-Chinese relations after the Ukraine crisis’, Carnegie Moscow Center, June 2016.

## CHAPTER 3

# Pivot economics

In one of the luckiest accidents of geographical fortune, the world's biggest consumer of energy, China, finds itself sharing a border with one of the largest producers of fossil fuels: Russia. But the two countries have been very reluctant to grasp the gift that geography bestowed upon them, and despite apparent progress in recent years, there is less to their new alliance in this domain than meets the eye.

After ten long years of negotiations, it was not until the West imposed sanctions on Russia over the annexation of Crimea that the two countries agreed in May 2014 on a gas supply agreement – later to be touted as ‘the world’s largest gas deal’, a ‘megadeal’ that heralded a reshaping of global energy markets. The contract was advertised as putting a seal on the geostrategic partnership between two of the world’s major powers. But even more crucially, for Russia the partnership was depicted as the materialisation of a partnership which would offer a viable alternative to the West and allow it to offset the sanctions regime. The Power of Siberia pipeline would only be the start. Li Fenglin, a former Chinese ambassador to Moscow, has articulated an even bolder vision: ‘Russian-Chinese relations are the best in 400 years. But they are good at the top, and very thin at the bottom. We need to change the model of our partnership from a government-dominated to a market-based relationship. We need integrated energy relations: gas extraction, exploration, distribution, not just buying and selling. This could create a community with a common destiny.’<sup>16</sup>

Has this new Sino-Russian partnership lived up to its expectations? And more importantly, are the economic aspects of this partnership lending any credence to Western fears that a Sino-Russian alliance between two of the continent’s preeminent powers would fundamentally alter the geostrategic landscape in Eurasia?

## Uneven trends

Two and a half years since the gas megadeal, Sino-Russian economic relations offer a mixed picture at best. Trade between the two countries has dropped by 30%, from \$88 billion in 2014 to \$64 billion in 2015, due largely to the dramatic decline in fossil-fuel prices and Russia’s recession. As a result, Russia now ranks as China’s 17<sup>th</sup>-largest trading partner, down from tenth a year ago.

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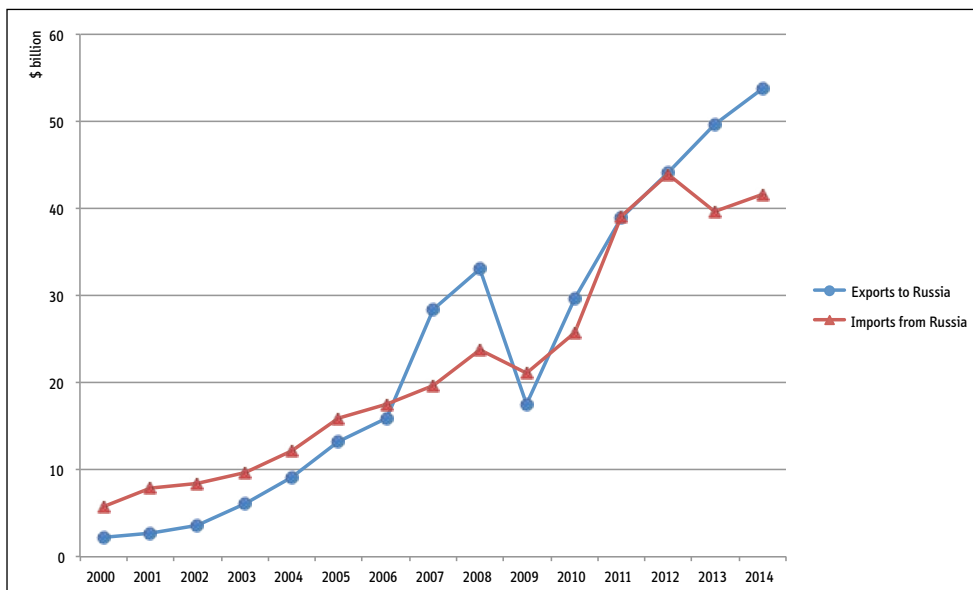
16. Li Fenglin, remarks at the Russian International Affairs Council conference on Russian-Chinese relations, Moscow, 31 May 2016.

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Sales of oil have been the bright spot in the trade relationship, and Russia is on track to become China's largest supplier of crude oil. However, falling energy prices and a downward revision of Chinese projections for gas demand may be contributing to the lack of progress on the gas deal. More than anything, slow advancement on co-operation with China is a reflection of Gazprom's true priorities: it is investing more energy and precious capital in the Nord Stream 2 and Turkish Stream pipelines to Europe than in the Power of Siberia pipeline to China's industrial Dongbei region, in the north-east of the country.

Chinese foreign direct investment (FDI) into Russia more than doubled in 2014, even though it still accounted for only 5.6% of total FDI into Russia. The following year, according to data from Russia's central bank, Chinese FDI actually fell to less than half that level, driving home the point that the actual condition of Russia's economy is a more important factor for Chinese FDI than announcements at summits between Vladimir Putin and Xi Jinping. Due to difficulties in tracking Chinese FDI, however, this figure might understate the volume of Chinese FDI into Russia, which may have been channeled through such offshore centres as Hong Kong or the British Virgin Islands. But even if that is the case, the indicated negative trend would have been maintained.

**FIGURE 3: SINO-RUSSIAN TRADE (IN \$ BILLION, 2000-2014)**



Source for data: IMF.

Admittedly, some of China's investments in Russia have been sizeable, including Sinopec's \$1.3 billion acquisition of a 10% stake in the chemical producer SIBUR, Silk Road Fund's investment of \$1.2 billion for 9.9% in the Yamal LNG project, Beijing Enterprise's 20% stake in 'Verkhnechonskneftegaz', an oil field in Eastern Siberia, for \$1.1 billion, and another deal totalling about \$1 billion for Norilsk Nickel's Bystrinsky gold and copper project. Indeed, Russia offered Chinese investors increased opportunities for participation in the upstream energy sector, although highly publicised promises to sell controlling stakes to Chinese investors have not yet materialised. Additionally, China and Russia agreed to launch a \$2 billion investment fund to develop agricultural projects in both countries, and another fund with a focus on Russia's Far East. Yet despite the sanctions regime and the difficult political environment, Europe continues to be the most significant source of FDI for Russia, accounting in 2015 for ten times more projects than China, according to a recent report from Ernst & Young.<sup>17</sup>

After sanctions were imposed, Russia learnt that its reliance on the US dollar and Western capital markets are sources of vulnerability. But the next lesson it learnt was that there is hardly any alternative. Expectations that China would become a source of capital for Russian firms blacklisted by the West had to be scaled back. This is unlikely to change; despite China's formal opposition to the sanctions, its commercial banks are quietly complying with them, probably out of fear that they will be shut out of much more lucrative US financial markets. Chinese policy banks (such as China Development Bank and China Exim Bank) may offer an alternative source of capital as they are not dependent on access to Western markets, but the problem with them is that their loans are tied to the provision of Chinese equipment and services – a key constraint on the procurement choices of Russian borrowers.

The vice-president of VTB, one of Russia's biggest state-owned banks, complained in a June 2015 op-ed in *Finance Asia* that 'China's ambiguous position regarding Russian banks in the wake of US and EU sanctions is a key issue holding back progress toward greater bilateral cooperation. Most Chinese banks will currently not execute interbank transactions or provide trade finance to their Russian peers'.<sup>18</sup> China became Russia's largest lender in 2015, but only because other sources of capital slowed to a trickle (in 2015, China disbursed to Russia's non-banking corporations as much debt as tiny Luxembourg did in 2013, before the sanctions were imposed). Chinese loans also come at prohibitive cost. As a Beijing-based Russian businessman explained, 'Chinese loans come at 6-7% interest and they are pegged to the US dollar, whereas inside Russia you can get loans in roubles at 13% which is mostly eaten by inflation. Western or even Russian loans are cheaper than Chinese ones'. As a result, China did little to help reduce the dominance of the dollar and the euro in Russia's external transactions, and only 7% of bilateral trade was conducted in yuan. Furthermore, the Chinese alternative to the SWIFT transaction system is at a nascent stage, and the yuan still has some way to go before it challenges the position of Western currencies.

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17. 'Foreign Investors return to Russia', Moscow, EY Press Release, 16 June 2016.

18. Yuri Soloviev, 'Unlocking the Potential of Russia-Asia Cooperation', *FinanceAsia*, 16 June 2015.

## **Trade frictions**

The two countries have worked hard to develop their relations, and even harder to use just about any agreement to send strategic messages to the West about their new alliance. But despite the hype, economically China and Russia are not hugely important for each other. Their geographical complementarity tends to be exaggerated. They may share a border, but their economic centres (European Russia, and coastal areas of China) are far from the border regions. Inter-dependency between Russia and China is low, and each is more dependent on third countries than on the other – Russia on the EU, and China on other Asian countries and the US.<sup>19</sup> With the exception of energy, their economic models are hardly complementary. China cannot match Europe's potential as a driver of economic modernisation for Russia, nor can Russia provide this for China. Chinese FDI into Russia has been concentrated in the energy sector rather than industries such as high-tech manufacturing, utilities, construction or financial services – sectors with better opportunities for technology transfer and productivity gains.

Even more importantly, as Chinese and Russian non-energy exports often compete in the same market segments, China will challenge Russia's efforts to diversify away from hydrocarbons. Chinese competitiveness is best manifested in bilateral trade structures. Russia's current trade balance with China is dominated by hydrocarbon exports, with energy resources accounting for as much as 67% of total exports to China, while the share of machinery and equipment supplied by Russia to China fell to less than 2% of total exports. China will grow as a challenge to Russia in post-Soviet markets, the only ones where Russian non-energy exports are still competitive – particularly in Central Asia, which is a key destination for Chinese trade and investment expansion under the flagship Belt and Road Initiative and the so-called capacity cooperation strategy, which aims to export Chinese over-capacity in capital-intensive industries. Naturally, this China-led project will create friction with the Russia-led Eurasian Economic Union (EEU) – an issue that will be further explored in the chapter on regional competition in Central Asia.

## **Divergent aspirations**

Russia and China have been working energetically to find compromise solutions on a number of commercial and political issues, but their shared resentment of Western domination cannot make up for divergent geopolitical goals. For neither of the sides can the proclaimed alliance justify the loss of strategic flexibility that would be incurred by deepening mutual economic dependency.

Domestic development defines China's global strategy; for Russia, geopolitics trumps commercial considerations and domestic development. Russia has priori-

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19. Heli Simola, 'Economic Relations Between Russia and China – Increasing interdependency?', BOFIT Policy Brief, no. 6, June 2016.

tised strategic messaging to other actors on the global stage rather than real solutions to the problems that are limiting its progress with China. Even more importantly, Russia's fear of being eclipsed by Chinese economic growth has precluded many opportunities that closer ties with its neighbour could offer.

That foreign policy starts at home is evident for any country, but this is even more the case for China. Domestic development is the overarching priority that frames the goals of its foreign policy. The usefulness of any given partner for the country's economic development determines its significance. Politically, Russia might have the highest ranked partnership with China, but that designation leads to surprisingly few exceptions from China's hard-nosed approach. Russia is worth only as much as it is able to contribute to Chinese domestic modernisation, and here it offers very little.

## **Business versus politics**

More than anything, China is motivated by mercantilist opportunism, and is striving to take advantage of Moscow's tensions with the West. China is exploiting Russia's strategic weakness, while remembering that it has a much broader geopolitical agenda that should not be undermined by Russia's geostrategic aspirations. At almost no cost, rhetorical opposition to sanctions increases China's bargaining power with Russia. China may need Russia's East Siberian gas to meet its energy needs and alleviate environmental damage in its north-eastern provinces (through the Power of Siberia pipeline), but in May 2014, when Putin needed China's support most, to his dismay Beijing prioritised the economic fundamentals of the deal over its geopolitical value, fully taking advantage of Russia's weakened bargaining position under the sanctions. For Putin, the project was supposed to send a signal to the West about the futility of targeting Russia with sanctions following the annexation of Crimea. For China, the project was useful, but not at any cost, and domestic commercial considerations turned out to be more important than geopolitics. (In fact, when the deal was 'concluded' a number of outstanding issues had still not been resolved, such as, crucially, the financing agreement for the cost of the pipeline.)

To Putin's even greater dismay, China is adamant in its rejection of another supply route, the more westerly Altai pipeline. This project is even more strategically important for Putin, as it would use gas fields that supply Europe, thus allowing Russia to arbitrage between the European and Chinese markets. (Power of Siberia will source gas from fields that cannot realistically be linked to Europe.) The Altai project would offer Putin immediate leverage over Europe by creating a credible threat to security of supply. The gas fields are already developed, meaning deliveries to China could start as soon as the pipeline is built. But oversupply in the Chinese gas market has removed any incentive for the country to sign up for the Altai pipeline.



FIGURE 4: THE POWER OF SIBERIA PIPELINE



Source: Gazprom.

## Russian fears of a Chinese monopsony

The tension between Russia avoiding dependence on the Chinese market and China's reluctance to become dependent on its politically sensitive neighbour is especially visible in energy relations. In Europe, because of the fragmentation of European gas markets and different routes for gas delivery, Russia was in a position to take advantage of arbitrage between different markets. It could also use energy as an instrument of foreign policy, and exert pressure on Ukraine and the EU. Getting locked into a long-term gas contract with China would strip Russia of that leverage. The size of the Chinese market would also put Beijing in a monopsonistic position, tilting the balance of power towards China. But this could be prevented if Russia has alternative markets for its gas. The basic idea underlying the Power of Siberia pipeline was to connect it not only to the Chinese market, but also to Japan and South Korea through a planned LNG port in Vladivostok. This would let Russia regain the upper hand in the game with China, allowing price discrimination between different markets (note the similarities to the geostrategic advantages of the Altai pipeline, indicated above).

However, because of low oil prices (to which gas prices are linked), the economic fundamentals of the projects no longer hold. Furthermore, with the diversification option through Vladivostok now off the table (Gazprom indefinitely postponed the project in early 2016), China has become the only option for Russia to profit from its Eastern Siberian gas.<sup>20</sup> China Development Bank was eager to finance and build the pipeline to connect those fields – including the portion of

20. James Henderson & Tatiana Mitrova, *Energy Relations between Russia and China: Playing Chess with the Dragon*, The Oxford Institute for Energy Studies, August 2016.

the pipelines on Russian territory – but Gazprom did not agree to this despite its financial troubles. Instead, it dragged its feet on the execution of the projects, and press reports suggest that by September 2016, only 200 km of pipes were laid, despite an initial intention to lay 800 km of pipes in 2016 (of the 4,000 km total length of the pipeline).

There may be a strong commercial logic for the deal, but at the current pace of construction the first deliveries may not take place until 2021 or even later. Russia may be interested in the Chinese and other markets in Asia, but strategic distrust prevents Gazprom from accepting that dependence on China is the only option to monetise its East Siberian assets. Dependence on a single strategic partner is not a route Russia is eager to take. The lack of significant engagement on the part of Russia in this supposedly strategic project raises questions about whether Putin was ever serious about the pipeline's commercial goals. In the words of a businessman with insider knowledge of the deal: 'Putin is a tactician rather than a strategist. From the very beginning, the deal with China was more about sending a message to the West than about working with the Chinese.' But the longer the project is delayed, the less useful it will be for Russia's diversification away from European markets or, indeed, for geostrategic messaging by Putin.

## The geopolitics of Russia's pivot

The fear of being eclipsed by the meteoric rise of China is driving Russia's reluctance to fully embrace economic opportunities offered by the world's most populous country, because they could end up limiting Russia's strategic flexibility. The importance of maintaining that flexibility was put in the spotlight when the Western-led post-Ukraine sanctions highlighted Russia's economic dependence on Europe. The idea underlying the Russian pivot to Asia was to capture the economic possibilities offered by China's rise, without necessarily replicating the same overdependence on one market as was the case with Europe.

In particular, Japan and South Korea, because of the considerable size of their markets, were supposed to allow Russia to avoid dependence on China's enormous market. However, their inclusion in the sanctions regime has left Russia with few options that could serve as a counterbalance. With China as Russia's only meaningful option in Asia, Russia's fear of overdependence works as a brake on the pivot. Contrary to how it may appear, Russia will not accept a junior role in its relationship with China. It would prefer to forgo economic opportunities offered by its neighbour than irreversibly tie itself to the Chinese market, or become China's natural resource appendage.

That explains why despite Russia's significantly weakened position in relation to China, the Kremlin has not been prepared to complete deals at any cost, and has started to seek alternative partners to demonstrate that it has other options. That also explains the flurry of diplomatic activity towards India, Japan and to a limited

## China and Russia: an Eastern partnership in the making?

extent Vietnam. Engaging these partners would fit into Russia's strategy of hedging against dependence on China, not least because it also offers a valuable bargaining chip with China.

## India, Japan and Vietnam as a counterweight

Due to Japan's inclusion in the sanctions regime and South Korea's *de facto* compliance, India has emerged as the partner of choice for Russian attempts to balance its pivot to China. This approach has intensified since Putin's visit to New Delhi in late 2015, which touted a close Russian-Indian energy partnership, mirroring many of the objectives of the Sino-Russian partnership. Indian and Chinese companies have indeed found themselves competing for the same energy assets in Russia. A 15% stake in the Vankor oil and gas field was sold to ONGC, an Indian company, after Chinese investors backed away from the deal. An Indian consortium emerged as the buyer of a 29.9% stake in the Taas-Yuriakh field, which was also offered to Chinese state companies. Partial privatisation of Rosneft (a 19.5% stake) was also an object of intense competition between major oil companies from China and India until the stake was finally offered to other investors (Qatar Investment Authority and Glencore).

The pattern that has emerged is that Russia courts China for its investments but wants to give as little as possible in return, and certainly does not want to lose any control over its major assets. This is not to say that agreements envisaging Chinese firms' participation in Russian upstream oil and gas projects will not materialise, but they will come after lengthy negotiations, and accusations that Russia is trying to play China not only against the West but also against India. Russia will only move on with the deals when it feels that it is maintaining strategic flexibility. From this perspective, Chinese investments in Rosneft and Yamal LNG might actually be exceptions rather than a new rule.

Stronger relations with Vietnam, one of Russia's traditional allies, are another element in Moscow's game to balance relations with China. Vietnam has emerged as a key partner not only for the sale of military equipment (as has been described in the previous chapter) but also for economic engagement, particularly in the transport infrastructure and nuclear power sectors. Yet cooperation on energy issues with Vietnam puts Russia at odds with China's claims in the South China Sea. Rosneft is drilling its first international offshore well off the south coast of Vietnam, while Gazprom's exploration and drilling operations in the disputed hydrocarbon blocks have supported Vietnam's claims.

**Box 5: Has the pivot been detrimental to EU interests?**

Russia's economic relations have traditionally been oriented towards Europe. Despite the rhetoric of the pivot to China, Europe continued to account for 48% of Russian exports in 2015. That may be down from 52% in 2014, but the Russian pivot to China is not the reason for that; China's share in Russia's exports has been more or less stable, and in 2015 stood at 8.3%.

In turn, Russia's economic recession, with a contraction of 3.7% in 2015, contributed to a 36% drop in Russian imports from China (in both the industrial and the consumer sectors). EU and Chinese exports to Russia are substitutable, but because China and the EU compete at different ends of each market segment, Chinese sales have not been able to displace EU exports. The only categories in which China's exports to Russia were growing in 2015 were meat (up 297%) and vegetables (up 14%), as a consequence of the imposition of Russian sanctions against EU food producers, and those impressive growth figures were largely due to a low base. More importantly, import substitution policies affect all of Russia's trading partners. Russian imports declined by 37% in 2015 from 2014 (machinery and vehicles, pharmaceutical products and food items led the decline), and imports from China in these sectors have decreased by the same proportion.

As for Russia's strategy of diversification of exports towards Asia and away from Europe, the only bright spot has been the sales of oil. In 2015, Chinese purchases of Russian oil registered an increase from 24.4 million tons to 41.3 million tons. With Rosneft already aiming to triple oil supplies to China from 300,000 barrels per day in 2013, it is on course to become China's biggest foreign energy supplier. However, because of the depth and flexibility of international oil markets, which are dominated by spot transactions, as opposed to the gas market, which continues to be based on long-term supply contracts, the strategic dimension of this shift should not be overestimated. In European oil markets, competing suppliers were quick to step in and take over Russia's share. Europe's security of energy supplies has not deteriorated. Nor is Russia entering into an irreversible dependence on China; it is increasing oil sales to Japan and other Asian markets as well.

Conversely, because of current dynamics in the global gas market, including the effect of emerging supplies of US shale gas, as well as legislative changes stemming from the EU's Third Energy Package, Russia is losing its hold on European markets, while Europe is diversifying its suppliers. In the meantime, Europe continues to dominate Russia's gas sales, with only 8% of Russian gas exports destined for Asia. Despite significant growth, the Chinese market cannot completely replace Europe. Russia pumped 162 billion cubic metres (bcm) of gas to the EU last year, whereas China's total imports were 28 bcm of piped gas (mostly from Central Asia) plus a further 25 bcm of Liquefied Natural Gas (LNG) – of which Russian gas has only accounted for a small proportion so far.

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Even the successful implementation of the Power of Siberia deal with China will not greatly affect European supply security. The deal has been portrayed as allowing Russia to alleviate dependence on European markets. Yet while it does provide Gazprom with alternative sources of revenue in the medium term, it does not vastly expand the company's room for manoeuvre in Europe. Selling East Siberian gas to Europe would by no means be commercially viable (because of the cost of transport through the entire Russian landmass), and the existing pipeline infrastructure would not allow Russia to switch gas supplies from Eastern Siberia between Europe and China. That would be possible only if the China-Russia gas deal involved supplies from Western Siberia to Western China via the Altai pipeline, a route which Russia has proposed but which does not make commercial sense for China. As a consequence, Europe will remain the key strategic market for Russian gas from the fields in Western Siberia and Yamal, thus prolonging Gazprom's dependence on European demand. Even in the most optimistic scenarios of Russian diversification of gas sales to Asia, Europe will still be the biggest market for Russia, accounting for 85% of its sales, according to projections for 2030.

The few investment deals that have actually been signed are evidence of the mismatch between high-level rhetoric and reality, rather than China overtaking Europe as a key partner. True, without the sanctions regime and the resulting pivot to China, such deals as Yamal LNG or potential Chinese participation in Russia's high-speed railway project may not have happened at all. But because they are so rare, they do not really suggest any sort of robust partnership.

Chinese investments in Rosneft and Yamal LNG might actually be exceptions rather than a new rule. Rosneft is in a particularly difficult situation due to low oil prices, and has few options to build up its balance sheet other than with Chinese prepayments for ever increasing amounts of oil flowing to China. Indeed, some question whether the corporate interests of Rosneft are compatible with Russia's strategic objectives, given that the increasing extent of Rosneft's financial reliance on China is creating a level of dependency for Russia as a whole.

The Silk Road Fund's investment in Yamal LNG and the subsequent financing for the project extended by China Development Bank and China Exim Bank does not herald a new approach either, and appears to be another exception. In fact a number of aspects make the deal hard to replicate. Firstly, China was already invested in the project: CNPC acquired a 20% stake earlier. Secondly, Russia had to accept onerous conditions imposed by Chinese banks, with almost 80% of their financing tied to Chinese procurement. And most importantly, Novatek, the Russian owner of the project, is nominally a private company owned by Gennady Timchenko, a close ally of the Russian President, making the deal almost a personal favour from Xi Jinping to Vladimir Putin.

## The cost of doing business in Russia

The business environment in Russia is turning out to be as great an impediment for Chinese investors as it has been for Westerners. Despite the presidential-level honeymoon in relations between the two powers, the picture is different at the local or working level, where distrust of the Chinese still permeates business and government, giving rise to open hostility towards Chinese investors and workers. ‘Russia needs investments, but not investors’, has been a recurring description of the situation on the ground. This will especially limit the potential for Chinese infrastructure investments, on which China relies in order to export labour. In the words of an analyst from an official think tank in Beijing, ‘even Chinese investors are dismayed by the lack of rule of law in Russia,’ (despite the rather peculiar standards in their own domestic market in this regard).

According to a 2014 study by Global Trade Alert, Russia enacted more protectionist trade measures the year before than any other country, and such restrictions are even more prevalent now, as economic policy becomes subordinated to broader national security concerns. The Russian National Security Strategy adopted in 2015 promotes the doctrine of self-reliance. The rupture with the West has deepened Russia’s concerns about the structure of its trade with the West, and its economy’s dependence on hydrocarbon exports and imports of processed goods and foodstuffs. It has therefore increased its reliance on import substitution policies to boost indigenous production and diversify its economy away from hydrocarbons. The dramatic depreciation of the rouble had a similar effect, by raising the cost of Chinese imports, in particular cars, for Russian consumers. This has prevented Chinese competitors from seizing business opportunities, even in sectors targeted by EU sanctions – yet another reason why Russia’s imports from China declined so dramatically.

Political *rapprochement* cannot make up for a dearth of commercially viable deals in a stagnant Russia. Chinese companies have become more cautious about entering the Russian market, as it presents fewer opportunities during the economic downturn than before. Risk aversion among Chinese companies has also increased due to an ongoing anti-corruption campaign in China, particularly in the energy sector.

The economic reality in Russia is such that expectations of Chinese investments in the Russian Far East are often overblown. Dongbei, the region of China directly bordering Russia’s easternmost territory, lacks investment itself, and one of its provinces, Liaoning, registered negative growth in the first half of 2016. It also lacks employment opportunities, but the outflow of labour is directed south, to the more affluent regions of coastal China, rather than north to Russia. The bottom line is that despite the upbeat tone from Russian officials, Russia’s Far East is a backward, underdeveloped and underpopulated region which simply offers very few investment opportunities.

Similarly, Chinese banks have not been able to fill in the gap in financing for Russian companies, as their *modus operandi* is different from that of Western banks. Chi-

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nese banks mainly finance projects with Chinese content, and as a rule do not offer long-term capital financing for transactions that do not include Chinese subcontractors. This is particularly true of infrastructure investments, for which Chinese banks tend to impose onerous conditions.

For Russia, this would require accepting that infrastructure procurement is limited to Chinese companies relying on Chinese labour. The Moscow-Kazan railway seems to be one of the few exceptional cases in which Chinese contractors were allowed to participate in a tender for a public procurement project, but even there, cooperation has not progressed beyond the level of a non-binding Memorandum of Understanding. Despite the steady drumbeat of anti-Western narrative coming from Moscow, the West's usefulness is not forgotten, at least when it can be harnessed as a counterbalance to Russia's supposedly most important strategic ally. Indeed, Russian authorities are making every effort to make sure that a German competitor, Siemens, participates in the Moscow-Kazan tender, giving Russia the ability to play the two sides off each other. But according to one European businessman working in Russia, 'Russia has completely unrealistic expectations about Chinese banks' financing offer. It is only available if Chinese equipment is sourced from China. But that would run against Russia's expectations for localisation of production of equipment for the project in Russia'.

That is partly the reason why Viktor Vekselberg, a Russian oligarch involved in Russian-Chinese trade, claims the two countries' 'economic, investment, and trade relations, especially when they are not about energy... are at a catastrophic level'.<sup>21</sup> Thus in many ways, the Russian-Chinese dynamic, however good it is for political reasons, falls into the same dilemma as EU-Russia cooperation. Without improved governance and a business-friendly environment inside Russia, neither Western nor Eastern pivots will help Russia become a world-class economy. As an expert from Renmin University of China remarks: 'A reorientation towards China does not solve Russia's economic model. It would still remain a raw materials supplier. And it could even aggravate the problem by offering a lifeline to perpetuate Russia's dysfunctional economic model'. Overcoming that dilemma will be complicated, even if both China and Russia have high expectations about another vehicle of economic cooperation: coordination between the Eurasian Economic Union and the Belt and Road Initiative.

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21. Speech by Viktor Vekselberg at the International Conference 'Russia and China towards new quality of bilateral relations', Russian Council of International Affairs Video, 31 May 2016. Viktor Vekselberg is chairman of the Russian chapter of the Russian Chinese chamber for commerce in machinery and high technology products.

## CHAPTER 4

# Russia and China in Central Asia

Central Asia is in many ways at the heart of Russian-Chinese relations. Russia clearly wants to retain influence in Central Asia, and it is equally clear that the only real challenge to its dominance is China. Both sides compete for influence over the region with their respective regional integration projects, each of them with their own set of rules. China is promoting its Belt and Road Initiative, a Sino-centric economic project based on improvements in inter-connectivity, mainly between China and Europe. Russia's response has been the Eurasian Economic Union (EEU), an integration project with Russia at its centre and covering a large part of the post-Soviet space. While similar in terms of their goals of economic integration, modernisation and market expansion, the two projects are developing in different ways.

With the EEU, Russia intends to copy European integration, with its focus on supranational institutions and common rules. Integration is incentivised by access to Russia's large internal market (as was the case with Belarus and Kazakhstan), labour opportunities (Kyrgyzstan's main motivation for joining) and some coercion (as was the case with Armenia). Russia's project aims to dismantle internal barriers, but ring-fences that internal market with protectionist tariffs.

Meanwhile, the Belt and Road Initiative<sup>22</sup> is to a large extent a repackaging of Chinese companies' already substantial overseas expansion under the previous 'Going Out' policy. It is based on activist economic diplomacy, whose main objective is to further regional integration and open new markets for Chinese companies. The goal is to boost regional integration through increased connectivity thanks to new physical links such as roads, railways, fibre-optic cables and pipelines. There is no formal accession procedure to join the Chinese project. Instead, it is enough to express the desire to tap into China's vast currency reserves, while accepting the Chinese conditions that come with them – most importantly, reliance on Chinese labour, equipment and construction services. Central Asia will be a key focal point for Chinese expansion under one of the two branches of the Belt and Road Initiative: the Silk Road Economic Belt (SREB).

Taking the broadest possible view in terms of Russian geopolitical thinking, what is happening in Central Asia is an oriental version of the gradual erosion of Russia's

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22. The Belt and Road initiative consists of a number of economic corridors, but draws its name from the two most publicised ones, namely the Silk Road Economic Belt and the twenty-first century Maritime Silk Road. The former is a land-based connection between China and Europe, while the latter connects South East Asia, South Asia and Western Africa through a network of ports.



influence in Eastern Europe. The interplay between the Belt and Road Initiative and the EEU, asymmetrical as they are, will provide the framework for the two powers' interactions in Central Asia for at least the next decade.

## **China erodes Russia's role in Central Asia**

On the surface, the two sides are supportive of each other's regional projects, as they have announced they will 'seek conjunction points between the Silk Road Economic Belt and the Eurasian Union.'<sup>23</sup> Yet by promising a qualitatively new level of engagement and the resulting interconnectedness between China and Central Asia, which Russia perceives as its backyard, the SREB will challenge Russia's incumbent position in a number of ways.

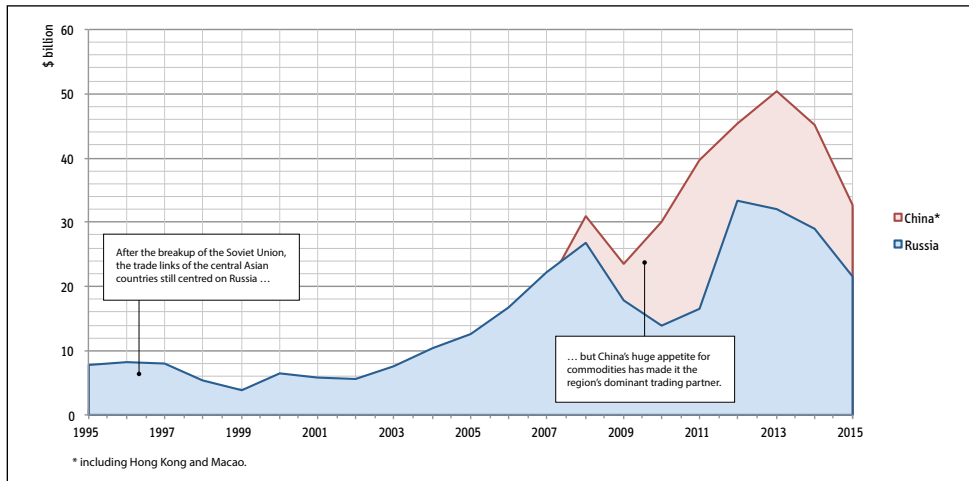
Firstly, China's plans under the SREB for multiple transport corridors, including many that would circumvent Russia, will challenge Russia's role as a transit country between China and Europe and will erode the established position of the trans-Siberian railway. Before the recent crisis, Russia invested millions in track upgrades and capacity increases, so it will not be happy to see competing China-led corridors such as the Trans-Caspian route (through Kazakhstan, with a Caspian ferry linking Europe through the Caucasus and Turkey), or the land connection through Kyrgyzstan, Uzbekistan, Turkmenistan, Iran and through Turkey to Europe.

Secondly, China aims to tap into Central Asia's vast resources and is thereby challenging Russia's energy monopoly in the region. Chinese energy companies have already acquired stakes in oil and gas fields, and built a network of pipelines from the region to China. This reduces the power of Russian energy policy as a source of political influence.

Thirdly, infrastructure is being built for the purpose of boosting trade. This will increase competition not only for domestic producers in Central Asia, but also for Russia. Post-Soviet countries are the only destinations where Russian exports of machinery have maintained some level of competitiveness. It is striking to note that Kazakhstan absorbs four times more Russian machinery exports than the enormous Chinese market. Chinese goods, which are low-priced but of acceptable quality, will potentially outcompete Russian exports in the future. In 2015, the five Central Asian states traded almost 50% more with China than they did with Russia, which had been their dominant trading partner as recently as 2008.

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23. Russian version: *Joint Statement of the Russian Federation and the People's Republic of China on cooperation of the Eurasian Economic Union and the Silk Road Economic Belt*, 8 May 2015 [Совместное заявление Российской Федерации и Китайской Народной Республики о сотрудничестве по сопряжению строительства Евразийского экономического союза и Экономического пояса Шелкового пути].

**FIGURE 5: TRADE WITH CENTRAL ASIAN COUNTRIES**

Source: IMF.

Lastly, China's engagement with the region goes much deeper than just infrastructure. Infrastructure is but one of the five areas of connectivity under China's Silk Road vision; the others are policy coordination, local currency settlement, trade facilitation and people-to-people contacts. China is already the region's lender and investor of choice, especially now that Russia's economy is mired in crisis. The growing Chinese financial footprint will challenge the role of the rouble, and will undermine any plans that Russia might have for monetary union within the EEU (even though other members of the EEU oppose such plans anyway). In Chinese diplomatic parlance, people-to-people contacts mean an expansion of Chinese media and culture. Having overwhelmed Russia in the region economically, China, under the banner of its Belt and Road Initiative, is likely to challenge Russia's cultural presence and soft power as well.

## Russia's response

Both sides understand these dynamics well. As a Chinese expert put it in rather stark terms: 'Russia is weakening and cannot block Central Asia from our pull anymore. Moscow cannot give Central Asia what the region needs most: infrastructure and investments. So Russia will have to accept China in the region because it is not strong enough to oppose it.' Yet this is not a position Russia is eager to adopt.

Russia's response to China's rise in the region has been to revive the Soviet pattern of integration. Something that is not acknowledged amid the talk of synergies between the two regional projects is that the EEU (and its predecessor, the Customs Union) was established specifically to limit Chinese expansion in Central Asia (as much as to counter the EU's Eastern Partnership in Eastern Europe). By raising

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external tariffs, the Customs Union has already diverted Kazakh and Kyrgyz trade away from China, towards Russian goods that would otherwise not be competitive. Russian certification standards and increased external border controls resulted in decreased activity in Kyrgyzstan's vast Dordoi Bazaar, which serves as a regional centre for re-exports of Chinese goods. The integration of Kyrgyzstan and, imminently, of Tajikistan into the EEU may not make much sense from an economic point of view (and was only reluctantly accepted by Kazakhstan and Belarus, which preferred to deepen integration within EEU before its further expansion), but for Russia, it serves the political purpose of having a say on the way the entry points between China and Central Asia operate.

## Central Asia as a second Ukraine?

Russian concerns about China's plans in Central Asia were similar to its worries about Ukraine's drift into the EU's orbit, particularly as the announcement of the Belt and Road Initiative vision roughly coincided with former Ukrainian President Viktor Yanukovich's most intensive manoeuvring between Russia's Customs Union and the EU's Association Agreement. Mirroring Russia's concerns about the successful implementation of the EU's Deep and Comprehensive Free Trade Area (DCFTA) in Ukraine, Chinese economic success in Central Asia would lend credibility to the Belt and Road Initiative's unspoken objective of building Sino-dependent regions around China. Furthermore, Chinese economic expansion based on bilateral formats challenges Russian-led integration based on the EEU, a project essential for Russia's economic and political survival as it allows Moscow to pursue the image of being one of the poles of integration in a multipolar world.

Beijing initially mostly ignored Russia's concerns about China's rising influence in the region and Russia was left out of the Silk Road project. This alarmed Moscow to such an extent that in March 2014, President Xi had to send his chief of staff to offer explanations. Moscow's place in China's plans was assured at the Boao Forum in April 2014, during which China presented its grand designs for the Silk Road project. Russia's message was further driven home during Putin's visit to China in May 2014, when Beijing formally acknowledged Russia's role in the region and conceded that it would consider 'the interests of Russia during the formulation and implementation of Silk Road projects'. In the bilateral competition for influence in Central Asia, Russia has for the moment retained the upper hand. Russia's increased assertiveness, and its willingness to defend what it considers to be its sphere of influence with military force, as shown through the intervention in Ukraine, significantly raises the stakes for China in Central Asia. Putin's comments in the aftermath of the Ukraine crisis about the fact that 'Kazakhs never had any statehood' seemed to suggest Russian readiness to intervene in the region to defend its interests, just as it did in Ukraine. But it was also a veiled warning for the region that it should prioritise integration with Russia, rather than pursue other partnerships.

The formal acknowledgement of Russia's role in the region was further cemented in May 2015, when both sides signed an agreement<sup>24</sup> on linking the EEU and the Belt and Road Initiative. Curiously, Russia signed the cooperation agreement between the EEU and Silk Road without consulting with other members of the EEU – which, unlike Russia, happened to be more likely beneficiaries of Silk Road projects (this in itself provides some insight into how Russia envisions integration within the EEU). Yet as a Russian expert notes: 'Talking to and acknowledging the EEU is not a veto offered to Russia, but a bow to Russia. But China will do what it thinks is necessary in Central Asia. Talk is cheap. And so is paying lip service to the EEU'.

The lack of official details on the practical arrangements between the two projects underscores the fact that the two sides might actually have a different understanding of the scope of cooperation. China is now in the middle of a debate on whether and to what extent it should open its Central Asian priorities to Russian influence. As a Chinese expert explained: 'The EU stumbled into war over a trade treaty in Ukraine and China will have to find out carefully what Russia's red lines in Central Asia are.' One lesson from that, according to the expert, is the need to 'avoid confrontation with Russia even on geo-economic issues. The Ukraine crisis also meant we engaged with the EEU. In Central Asia it will be difficult to do projects against Russian will and we will need to negotiate. But we will not give a veto, but will try to give sweeteners to Russia through over projects.' Russia, in turn, will energetically try to block Silk Road projects which run against its interests, as it is afraid that the Chinese initiative can potentially build even stronger dependencies between China and Central Asia than the DCFTA between the EU and Ukraine. At the same time, it will promote projects which are actually beneficial for it or support Russian-led integration in the region, but few of these initiatives will actually make sense for China.

Russian support for any Chinese initiative will be based on Russia's own geographical and domestic priorities. Russia will prioritise Silk Road projects that transit through Russia, rather than circumvent it, bringing transit revenue for its own railway operators. The existing Trans-Siberian Railway maintains potential for transporting Asian goods to Europe, while the Russian state railway company is reforming its tariffs, and aims to facilitate Russia's role as a transit country between China and Europe. One of the latest pilot train connections will use the Trans-Siberian railway to connect Yiwu, a commercial hotspot in Eastern China, and Riga's port on the Baltic coast with potential intermodal connections to Scandinavia. If Moscow has its way, railway routes promoted by China which cross Kazakhstan and Russia on the way to Europe may have a chance to be upgraded, while the alternative routes which circumvent Russia, such as those designed to pass through Kyrgyzstan or Trans-Caspian routes, would not receive Russia's support.

24. The actual words used in the official agreement for connecting the two initiatives are interesting in themselves. The Chinese version speaks of *duijie* (对接), that is, 'docking'. In China this has some connotation with low-level Asian integration. Chinese scholar Wu Zelin has suggested a broad distinction between the current Asian and European styles of regional cooperation: Europe focuses on integration, which reflects European states' higher level of economic development, while Asia, with its greater diversity, puts a higher priority on connectivity and joint 'docking' (*duijie*) of nation-states still attached to their sovereignty. Wu Zelin, 'Tanxi Ou Ya liangzhong butongde quyu hezuo moshi' ['Exploring Europe's and Asia's two different models of regional cooperation'], *Zhongguo guoqing guoli*, no. 3, 2016, pp. 69–71, as quoted in 'Westward ho—the China Dream and One Belt, One Road: Chinese Foreign Policy Under Xi Jinping' by Peter Ferdinand, *International Affairs*, vol 92, no. 4, 2016, pp. 941–947.

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Furthermore, Russia's interest in the Silk Road project will continue only so long as it fits with Russia's domestic development plans, especially for its easternmost regions. China may be welcome to invest in trans-border infrastructure in the region according to potential plans to connect China's north-eastern region (Dongbei) with Russian ports on the Sea of Japan.

Another challenge to cooperation between the Belt and Road Initiative and the EEU is that China will be asked to support EEU integration. This would mean investing in north-south corridors (connecting Siberia and the Russian Far East with China, and onward through Central Asia with Iran, India, and Pakistan) rather than the east-west routes envisaged under the Belt and Road Initiative to connect China with its largest markets, Europe and the Middle East. This would counter the entire rationale of Chinese engagement in Central Asia.

## **Roping China into multilateral settings...**

Similarly, even before suggesting any joint projects between the EEU and the Belt and Road Initiative, Putin had already worked on an even more ambitious plan to expand the scope of Sino-Russian cooperation throughout the entire Eurasian region. His idea is not to limit China and Russia to the agreement on linking their two integration projects, but rather to expand this relationship to include member states of the Shanghai Cooperation Organisation (SCO) and ASEAN, thus building a 'greater Eurasia'. With greater Eurasia, Russia proposes a multilateral setting which will provide it with increased possibilities to manoeuvre against China's ambitious economic plans in the region, but also to delay talks on an EEU-China Free Trade Agreement. In recent years Moscow has also promoted a rapid expansion of the SCO. By admitting India and Pakistan, China's economic power can be further diluted, and Chinese proposals for an ambitious economic agenda watered down.

## **...which China continues to ignore**

So far, none of these challenges have discouraged China from pursuing its plans in the region. Beijing continues to use the SCO to showcase the benefits of cooperation under the Belt and Road Initiative. SCO summits are usually preceded by bilateral visits between China and Central Asian member states, and are meant to send a message about the benefits of cooperation with China while forcing Russia to accept a *fait accompli*. Yet in all of this, the states of Central Asia are not static objects. They also have preferences, a certain degree of bargaining power and room for manoeuvre, and will exploit this in order to retain maximum control of how they deal with either Beijing or Moscow.

Despite the agreement with Russia on consultations about Silk Road projects with Moscow, China continues to pursue bilateral deals. China and Kazakhstan signed a separate agreement on cooperation between the Silk Road and Kazakhstan's 'Nurly Zhol'

(Bright Way) project just a couple of months after the Sino-Russian agreement of May 2015. Adding insult to injury, the agreement signed on 31 August 2015 in Beijing was announced during Putin's visit to the Chinese capital, which started the following day.

China may welcome the dismantlement of customs controls between EEU countries (partial as it may be), as it facilitates transit for its land-based logistics connection to Europe. But overall, China sees little value in the EEU, and recognises the geopolitical rather than economic rationale of the project. It therefore has no reason to forgo bilateral relations; thanks to its size, China naturally has the upper hand in any relationship. Competition in the region for Chinese investments and transit routes allows Beijing to exploit this leverage in its bilateral relations. Internal contradictions within the EEU, competing goals of individual members and lack of robust coordination mechanisms further strengthen China's hand in the region. That also suits the states of Central Asia, which are unlikely to want too much coordination of projects via the Eurasian Economic Union or Moscow. In the words of a Kazakh expert, 'many powers compete for us, but only China puts money on the table'.

## Dismantling the security division of labour

The question of security also lurks behind and above Russian-Chinese interaction in Central Asia. For now, popular opinion in Moscow sees China as inevitably becoming the main economic power in Central Asia, while Russia is and will remain the security power in the region. Yet in practice, things are more complicated. China can count on Russia's help in maintaining stability in the region, which is important for Beijing because of security concerns linked to its fears that political instability in Central Asia could spill over from the region into China's restive western Xinjiang province. Similarly, both leaderships have been wary of any American presence in the region, and share a disdain for 'colour revolutions', which they believe are backed by the US. With its economic expansion into the potentially unstable region, China may be forced to change its foreign policy *modus operandi* based on non-interference. Infrastructure projects and investments under the Belt and Road Initiative will be an important reason for China to step in to shape regional security arrangements and provide the physical protection of critical infrastructure. As a foreign policy expert in Beijing argues: 'If we have pipelines, we will need to provide their security. We better do this with Russia, but we will have to do it with it anyway – either directly, or through private military companies'.

China is already becoming a bigger security player in the region, with or without Russia's consent. It has already established a quadrilateral format for cooperation on security issues with Afghanistan, Pakistan and Tajikistan. It is helping to fortify and secure Tajikistan's border with Afghanistan and sells sophisticated arms to Turkmenistan and Kazakhstan – Russia's traditional arms export markets. This is all challenging the stereotype about the neat division of labour in the region between China and Russia, with the former providing economic opportunities and the latter security.

## China and Russia: an Eastern partnership in the making?

There is also a Chinese suspicion that Russia might use security crises to strengthen its influence in the region. Chinese experts have argued that Russia (along with the US) played a crucial role in destabilising politics in Kyrgyzstan and overthrowing Kyrgyz President Bakiev during the 2010 crisis.<sup>25</sup> There also is a Chinese suspicion that Moscow could put pressure on labour migrants from Tajikistan or Uzbekistan inside Russia in order to persuade these countries to join the EEU, and destabilise these countries in the process. In fact, Russia is playing on fears of Chinese dominance, and promotes the view that only a unified front of post-Soviet republics under the EEU will allow them to bolster their bargaining position and extract concessions from China (coincidentally, that was also Russia's message to Ukraine in relation to negotiations with the EU).

This will not necessarily push the relationship to breaking point. Both Russia and China will tread carefully in Central Asia. One of the lessons of the Russian-Ukrainian crisis for Beijing is, according to a Chinese think-tanker, that an economic matter like the EU-Ukraine free trade agreement can quickly become a major geopolitical problem. The crisis in Ukraine also accelerated Chinese acceptance, no matter how reluctantly, of Russia's role in the region, and the need to engage the EEU, at least superficially, as a way to assuage Russian fears. Russia on the other hand has always been less bold *vis-à-vis* China than the West, and is not likely to engage in belligerent rhetoric, let alone actions. China will not be able to displace Russia in the near future, so Beijing will refrain from acting against incumbent regimes in the region, trying to install leaders of its own liking or challenge their current political systems, which are so amenable to Russian pressure. This will set the stage for a polite, slow and muted erosion of Russian power in Central Asia, at least until Russia feels it has to regain the upper hand. If nothing else, Russia wields enormous power of destabilisation, as shown in Ukraine, and that will affect China's political risk calculus in the region.

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25. Jia Lihong, 'The importance of Kyrgyzstan and the influence of its current situation on China', *Xinjiang Daxue Xuebao – Journal of Xinjiang University*, vol. 38, no. 6, November 2011, pp. 91-96; Zhao Huirong, 'The hidden reasons behind the troubles in Kyrgyzstan', *Dangdai Shijie – The Contemporary World*, no. 8, August 2010, pp. 23-25.

# Conclusions

In recent years Moscow and Beijing have been engaged in a highly publicised *rapprochement*. Official statements have been dominated by upbeat rhetoric about the Russia-China *entente*. Political links – from summits and military parades to bilateral working-level contacts – have intensified exponentially. Joint military drills have become more frequent, and their geographical range expanded. Russia has also upgraded the quality of the weapons it makes available for sale to China. New business deals have been signed. The relationship has, therefore, widened in significant ways. Yet this widening of contacts and contracts has not necessarily led to a strategic deepening of the partnership. Russia and China are not likely to forge a strategic alliance any time soon.

For various reasons, both sides – and in different areas of potential collaboration – are pressing gently, but perceptibly, on the brakes of cooperation. Despite a strong (geo)political push for deeper engagement, there is enough sand in the wheels of cooperation between the two powers to slow down implementation of political commitments at the working level. As a result cooperation is expanding to new areas, but still remains shallow overall.

Beyond summitry, military parades, drills and apparently positive chemistry between the leaders, neither of the two sides is really betting on building a military-political alliance. Elites in Moscow and Beijing share some assumptions about global politics and want a greater role for their countries in international affairs. However, they have different views of the route to global pre-eminence. For China, the route to greater power status is through domestic economic development, and geostrategic objectives are put on the back burner – for now at least. For Russia the opposite is true: economic development generally takes a back seat to geopoliticking. The result of this mismatch is that despite significant sympathy towards each other's foreign policy plights, neither Beijing nor Moscow want to take sides in potential disputes with the US or the EU. China treaded carefully around the recent crisis in Russian-Western relations over Ukraine; and Russia will tread even more carefully around US-China relations under Donald Trump. Both sides can face up to tensions in relations with the West, but are not necessarily willing to stick their necks out for the sake of each other.

For its part, Russia has a deliberate policy of drumming up the rhetoric of its alliance with China for strategic purposes, while in reality it is hedging its bets against its ever more powerful neighbour. Moscow wants Chinese support on a wide array of issues and suggests it is ready to reciprocate with political support and access to energy resources. The mood in the relationship at the highest level is more than good, and China's respectful diplomacy *vis-à-vis* Moscow seems to strike the right chord, bolstering Russia's geopolitical self-esteem. Moreover, the abrasive and at times even bellicose approach that has characterised Russian interaction with the



## China and Russia: an Eastern partnership in the making?

West in recent years is not replicated when it comes to interaction with China. Extreme courtesy, not straight talking, sets the tone of Russian-Chinese diplomacy. Conveniently, this mutual exchange of respect fits well also with the domestic discourse of national revival propagated by both powers.

And yet, Moscow is not ready to forgo the loss of strategic flexibility which would inevitably result from a closer embrace of its would-be ally. In all aspects of its relations with Beijing, Moscow has been careful not to embark on a trajectory that would entail excessive dependence on its partner. Indeed it has manoeuvred desperately in order to avoid such an outcome. Russia has been going out of its way to ensure that its rebalancing to the East does not become a pivot to China exclusively, but a pivot to Asia more broadly. To this end, it has been systematically engaged in a policy to dilute and hedge its deepening engagement with China via attempts to boost relations with other key Asian players – ranging from Japan to Vietnam and India.

Nowhere have Moscow and Beijing's divergent outlooks been as obvious as in the sphere of the economy. Despite frequent claims regarding the supposed complementarity of the Russian and Chinese economies, these potential synergies are exaggerated. Although the two countries share a border, their economic centres of gravity lie half a globe away from each other. Apart from in the energy sector, the economic models of the two countries can hardly be described as complementary. China cannot match Europe's potential as a driver of economic modernisation for Russia. Beijing has not stepped in to replace the West as the main source of investments, technologies or financing, partly because its companies are discovering, like their Western counterparts, that Russia is not an easy place to do business. In the last few years, Russia has been slightly more open to some Chinese investments, but has not exactly welcomed them with open arms. Chinese investments continue to be dwarfed by Western FDI, even in the context of sanctions.

Just as the geopolitical row with the West spurred Russia's turn to the East, geopolitics has begun to constrain the Russian-Chinese partnership as well. If Moscow were driven by purely economic considerations, it would have been more open to deeper economic partnerships with China. However, a geopolitically-minded Russia also means that Moscow is reluctant to fully embrace economic opportunities offered by the world's most populous country, for fear of having its strategic flexibility limited. Even the crown in the jewel of Russian-Chinese economic interaction – the Power of Siberia gas pipeline – is indicative in this respect. Russia has dragged its feet on the implementation of the contract, which strikingly contrasts with Moscow's sustained high-level political and economic investment in the building of the Nord Stream 2 pipeline to the EU. Bilateral trade is likely to rebound from the trough, as oil prices are picking up. But this will only exacerbate Russia's reliance on the sales of hydrocarbons while China continues to expand its high-tech exports. This will challenge Russia's efforts to diversify away from hydrocarbons, as China expands to post-Soviet markets, the only ones where Russian non-energy exports are still competitive – particularly in Central Asia, a key destination for Chinese trade and investment expansion under the flagship Belt and Road Initiative.

Indeed, Central Asia has become a testing ground for the depth of Sino-Russian relations but also the arena in which their competing regional initiatives – Russia’s Eurasian Economic Union (EEU) and China’s Belt and Road project – are played out. The Chinese strategy in the region has been successful so far, allowing it to become the economically dominant partner in this part of the world. However, while Russia may not be a source of economic dynamism or prosperity for Central Asia, it still has important points of leverage. The EEU, if its institutions are strengthened, may be one of the strongest of these, giving Russia the ability to check Chinese economic advances in the region. However, in the mid-to-long term, China’s Silk Road project may be more ambitious and attractive than either the EEU or the EU’s association offer to Ukraine, which triggered such a forceful reaction from Russia. China’s expanding economic presence, coupled with more skilful diplomacy, may eventually herald growing political influence in the region. Thus Russia will face a dilemma between gradually yielding to Chinese advances in the region or using its enormous power of destabilisation in Central Asia as well.

Paradoxically, Russia’s conflictual relations with the wider West both drive and constrain its pivot to Asia. Isolation from the West makes engagement with China more necessary than ever. But at the same time, bad relations with the West have weakened Russia’s bargaining power in Beijing, thus putting significant brakes on Russia’s pivot.

It has always been the case that the state of both countries’ relations with the US was *de facto* a more important driving factor of Sino-Russian bilateral relations than this relationship’s own dynamic, but that is likely to become even more salient with the advent of Donald Trump’s new administration in Washington. On the surface, it will be business as usual: both Russia and China will continue to maintain their publicly displayed attachment to each other, and Moscow will not loudly proclaim a ‘pivot back to the West’. But Russia has every incentive to pursue a wait-and-see approach in Asia, hoping that a potential thaw in relations with the US and/or a deterioration in Sino-American relations might improve its bargaining power in the region. The result is a paradoxical situation, where, as long as Moscow’s geopolitical calculations trump economic priorities, the pivot to Asia will be constrained either by the lure of a new *rapprochement* with the West, or by fear of excessive and unconditioned engagement with China. Either way, Russia’s pivot to Asia remains in slow motion, as Russia continues to hedge its bets.

# Annex

## Abbreviations

ASEAN	Association of Southeast Asian Nations
bcm	billion cubic metres
BRICS	Brazil, Russia, India, China and South Africa
DCTFA	Deep and Comprehensive Free Trade Area
EEU	Eurasian Economic Union
FDI	Foreign Direct Investment
IMF	International Monetary Fund
LNG	Liquefied Natural Gas
NATO	North Atlantic Treaty Organisation
PRC	People's Republic of China
SCO	Shanghai Cooperation Organisation
SREB	Silk Road Economic Belt
UNSC	United Nations Security Council
USSR	Union of Soviet Socialist Republics



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