

Russia-China economic relations and the Russian Far East

by Artyom Lukin

Is Russia moving into China's economic orbit?

- ✓ Since 2009, China has ranked as Russia's top trading partner as an individual country.
- ✓ In 2019 Russia-China trade grew 3.4%, reaching a record high of \$111bln. One of the trends is Russia's increasing imports of Chinese autos and industrial equipment. China has surpassed Germany as the top supplier of industrial machinery to Russia.
- ✓ In 2020 China-Russia trade dropped by 2.9%, amounting to \$107.76 bln. The contraction is largely caused by the fall in the price of oil, Russia's main export to China. At the same time, Russia's economic dependence on China showed a noticeable increase during the 2020 pandemic, with China's share in Russia's foreign trade rising to 18.1% from 16% a year earlier.

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- On the one hand, Russia's pull into China's geo-economic orbit is inevitable, driven by the logic of the international marketplace. China needs huge volumes of natural resources and Russia is a major supplier of these. On the other hand, Russia's embrace of China as the main economic partner was a political decision born of the Ukraine crisis and the ensuing confrontation with the West.
- In June 2019, Moscow and Beijing inked an agreement to switch to national currencies in bilateral trade as they ramp up efforts to move away from the US dollar. Russia has become the biggest international holder of yuan-denominated reserves. Notably, the share of renminbi in the reserves of global central banks is only around 2%, of which a quarter is held by Russia.

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- The reality of closer economic relations with China turned out to be more complicated than initially expected. The most disappointing for Moscow is the failure to attract Chinese FDI.
- So far Chinese investors largely demonstrate a wait-and-see approach to Russia. Similar to other foreign companies, they tend to see the risks of entering Russia as high, whereas the profit margins are not substantial enough to offset the risks. To Chinese businesses, Russia is of interest mainly as a supplier of natural resources such as minerals, hydrocarbons or timber. However, most of these resources are not unique and can be imported from elsewhere, as long as maritime routes remain open.

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- As Moscow moves into Beijing's economic orbit, it is still determined to avoid the level of dependency that could pose risks to Russia's political independence and sovereignty.
- Russia's reluctance to accept Chinese loans. The Russian government is careful not to incur sizeable debt to China. This is due not only to the Kremlin's general aversion to accumulating foreign debt, but is also guided by the resolution to deny China financial leverage over Russia.
- Russian officials have repeatedly stated that Russia and its fellow Eurasian Economic Union members are not yet ready to open their markets to China.

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- ✓ A U.S.-China decoupling may be a mixed blessing for Russia. On balance, the divorce of the world's biggest economies will be bad for Russia due to its detrimental effects on the global economy.
- ✓ The negative impact could be partially offset if Russia integrates into Chinese value chains, but Moscow is wary of such integration because it can make Russia dangerously dependent on China.

China and the Russian Far East

- ✓ Despite Moscow's best efforts, the Far East has so far failed to become a magnet for foreign businesses and remains heavily dependent on capital infusions from the government and state-affiliated companies. Foreigners currently account for just 7% of the total investments into the Far East's economy.
- ✓ There are few major projects with foreign investor involvement that have been completed in recent years or are being implemented. The bulk of the Russian Far East's FDI was accumulated in the late 1990s and 2000s thanks to the Sakhalin-1 and Sakhalin-2 oil and gas projects. Since then, no new substantial FDI has come to the Far East.

China and the Russian Far East

- ✓ After 2014, Russia lifted informal and tacit restrictions on investments from China into the Russian Far East in the hope of attracting Chinese money for the region's development.
- ✓ However, as of now, there are few relatively significant projects in the Far East with Chinese FDI.
- ✓ Chinese money is not rushing to the Russian Far East partly because Russia differs from Third World countries like Angola or Laos that allow Chinese companies to exploit natural resources with relatively little oversight and few regulations, as well as let them bring Chinese workers, contractors and equipment.
- ✓ Another factor discouraging Chinese investment into Russia, and its Far East, is Moscow's reluctance to cede control to foreign entities over assets deemed strategic, such as ports.
- ✓ The Russian Far East borders China's northeastern provinces (the Dongbei), the PRC's own "rust belt," which has suffered from a prolonged economic stagnation and depopulation.

China and the Russian Far East

- ✓ Structural trends in the economies of NE Asia do not look particularly promising for the Russian Far East if it continues with its traditional paradigm of resource-based development.
- ✓ Japan, which has historically been a major consumer of the Russian Far East's natural riches, has already passed the peak of resource consumption due to the declining population and increasingly energy-efficient technologies. The country's imports of energy and raw materials have been steadily decreasing. This means the Japanese are now much less interested in the Russian Far East than was the case a few decades ago.
- ✓ South Korea will soon be following the same path of declining demand for natural resources.
- ✓ China's economy is also maturing. Its demand for the Russian Far East's commodities is still growing, but may peak sooner rather than later.

Russia-China cooperation in energy: oil

- In 2019 Russia completed a fresh expansion of its Eastern Siberia — Pacific Ocean (ESPO) oil pipeline system , which connects its east and west Siberian fields with China and Russia's Pacific coast. ESPO allows Russia to ship a third of its total oil exports to Asia-Pacific markets, primarily to China.
- In 2020, Russia's oil exports to China via cross-border pipelines remained at the same level as in 2019 -- 40 mln tonnes. 30 mln tonnes was shipped by the ESPO pipeline in the Russian Far East, while 10 mln tonnes was delivered via Kazakhstan.

Russia-China cooperation in energy: gas

- In December 2019, Vladimir Putin and Xi Jinping inaugurated a huge pipeline system, the Power of Siberia, that will supply natural gas from the Russian Far East and Eastern Siberia to northeastern China.
- Until recently, all Russia's export gas pipelines ran west and south, to Europe and Turkey. The Power of Siberia trunk line became the first one pumping gas to Asia. The 30-year contract, expected to generate \$400 bln for Russia's Gazprom, is the energy company's largest export contract ever. The project has clear geopolitical undertones, accentuating the deepening strategic entente of Russia and China.
- The Power of Siberia will be followed by a second pipeline that will bring to China natural gas from Western Siberia. The initial plan was to build that pipeline through the Altai mountains into China's Xinjiang. In 2019, the plan was changed in favor of a route via Mongolia. Although the pipeline's route will be longer, it should be easier to build thanks to Mongolian steppes and will allow to deliver gas right into China's core industrial areas.

Russia-China cooperation in energy: coal

- Russia has been increasing its coal exports to China. In 2008, Russia's coal exports to China amounted to just 0.3 mln tons. In 2019, they exceeded 30 mln tons, accounting for 14% of Russia's total coal exports and 10% of China's coal imports. Within ten years, Russia aims to increase its China-bound coal exports to 55 mln tons.
- Two thirds of the China-bound Russian coal is shipped via sea ports in the Russian Far East, with the remaining part going through railway border crossings, mainly the Zabaikalsk – Manchuria.

Russia-China cooperation in energy: electric power

- Russia started small-scale electricity exports from the Far East (via the Amur Territory) to China in 1992. In 2011 Russia and China built a more powerful inter-state transmission line across the Amur River near Blagoveshchensk, allowing the Russian Far East to considerably increase electricity supplies to the neighboring Heilongjiang. However, in recent years the volume of Russian electricity exports to China has been stagnating and even somewhat decreasing.
- The possible reasons for China's reluctance to buy more electricity from Russia include the slowing economic growth in China, reducing demand for electric power.
- Of note, since the beginning of 2019 Russia and China switched to payments in yuan for Russian electricity.

Russia-China cooperation in agriculture

- Agriculture is a major promising area of cooperation between Russia and China. Food is now Russia's second biggest export item to China after oil.
- A major stumbling block in the Russia-China agriculture trade is Beijing's continued refusal to allow imports of Russian pork. If the Chinese pork market were open to Russia, it would give a boost to Russian meat industry, including in the Russian Far East, where major Russian agriculture companies are building large pig complexes. Moscow is unhappy with China's reluctance to allow Russian pork. Possibly as a retaliatory move, in 2019 Russia suspended imports of citrus fruits and some other fruits, such as apples, from China, citing phytosanitary concerns. Russia also halted imports of a range of Chinese aquaculture products.

Transport

- There have been some significant advances in the development of transport infrastructure connecting the Russian Far East and China. Two trans-border bridges across the Amur River are the most significant accomplishment in this respect. They will become the first ever permanent bridges linking Russia and China across their main natural boundary, the Amur.
- The automobile vehicle bridge, which links Blagoveshchensk and Heihe, was ready in the spring of 2020, but is still not in operation due to the pandemic restrictions.
- The rail bridge across the Amur, linking Nizhneleninskoye on the Russian side with Tunjiang on the Chinese side, is in the final stages of construction, expected to be completed in 2021. Its initial capacity is 5.2 mln tons a year, which can be expanded to 20 mln tons. The bridge will mostly be used to export to China commodities from the Russian Far East, mainly coal, iron ore, and timber.
- Both bridges have been constructed on the basis of parity. China did the construction works on its side of the border, while Russia was responsible for the building on its side.

Transport

- While China has invested money in the trans-border bridges, it is still reluctant to commit to transport infrastructure projects inside the Russian territory. Despite efforts by the federal government and Far Eastern regional governments to attract Chinese investment into the development of transport infrastructure, China has not yet spent a single yuan on transport infrastructure in the Russian Far East, as well as in the rest of Russia.
- A case in point is the continued absence of Chinese investments in the international transport corridors Primorye-1 and Primorye-2 that are mainly designed to give the provinces of Heilongjiang and Jilin direct access to Russian ports on the Sea of Japan's coast.
- One major reason for Chinese reluctance to get involved in Russian infrastructure projects is China's desire to have ownership and management control over them, which Russian authorities are still unwilling to accept.

Risks of overdependence on China: the case of the current pollack crisis

- Over 60% of Russian fish exports goes to China, but in December 2020 Chinese ports stopped accepting Russian fish, apparently due to covid concerns.
- Russia's main fish export to China is pollack from the Russian Far Eastern seas. This is high-value fish similar to the North Atlantic cod. Without China, there is no alternative market Russian fishing companies could profitably sell it to.
- Chinese officials explain the halt of imports of Russian fish by covid concerns, citing a few cases when the virus was allegedly detected on the outer packaging of pollack batches from Russian ships.
- The desperate situation with Russian fish exports to China shows how risky it is to rely on one major buyer, even if this buyer is a country that is Russia's main "strategic partner."
- The best way to fix this problem would be to process all the fish in Russia, rather than sell raw fish to China. But developing such processing facilities in Russia will take years and a lot of investment.