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Energy Relations between Russia and China: Playing Chess with the Dragon

Executive Summary

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Russia's relationship with China has a long and complex history, catalysed by the lengthy border between the two countries, the complementarity of their economies and the ambitions of both to be seen as key global geo-political actors. Following periods of tension and friendship in the Soviet era, when the two communist states often struggled to find a mutual understanding, the post-Soviet era has seen a more complicated relationship develop based as much on economic reality as political ideology. In particular the export and import of energy has been at the heart of these developments.

Russia's huge resources combined with its deteriorating relations with the West, and with China's growing energy needs, have encouraged both sides to cooperate, although China would certainly appear to have the stronger bargaining position and has the ability to wait for opportunities to extract maximum value from any deals to emerge. The main aim of this paper is to analyse the development of bilateral energy cooperation between the two countries in the post-Crimea period and to assess the complicated and lengthy negotiating game, which is now emerging as both Russia and China attempt to find compromise solutions on a wide variety of commercial and political issues. These range across topics such as a fair price to encourage long-term investment in energy assets and infrastructure, political influence in Central Asia, potential Chinese investment in upstream assets in Russia, Chinese financing for Russian projects, the sequencing of export projects to meet China's market requirements, the balancing of China's relations with Russia and the West and the commercial requirements of both countries' state oil and gas companies, with all of the above also involving the implicit transfer of strategic messages to the other actors in the global geo-political landscape. Finding a suitable balance within this complicated matrix of concerns would be difficult at the best of times, but in an era of volatile prices and political turbulence the issues are magnified.

We have characterised the developing energy relationship between the two countries as akin to "playing chess with the Dragon", by which we mean to imply that from a Russian perspective it is playing a complex and high risk game against a powerful adversary. China, with its much larger economy, its financial firepower and the benefit of Russia's weakened geo-political status seems set to control the energy relationship with its northern neighbour. However, Russia is not without strengths of its own and is attempting to exploit them wherever it can. China does need Russian oil, and wants access to the Russian Arctic. Over time (perhaps a decade) it may also come to need Russian gas in greater quantities. Nevertheless, with the oil and gas markets becoming more global in nature, it is unlikely that Russia will be able to exploit these opportunities on anything other than competitive terms. The reality is that its assets are, to an extent, stranded in the East with China as their prime market, and as such their output is unlikely to command a premium price, given China's alternative options. As a result, in order to fully benefit from its energy connection to the East, Russian companies need to create their own diversification options in order to ensure that Russia avoids being check-mated by its increasingly powerful southern neighbour.

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