

Russian ties with China in the face of Western sanctions

SUMMARY

Since the West imposed sanctions on Russia, in response to its annexation of Crimea and destabilisation of eastern Ukraine in 2014, the country has accelerated its 'turn to the East' and notably to like-minded China, in an attempt to offset its loss of access to Western financial markets and advanced technology. Three years on, the economic outcomes appear to have fallen largely short of Russia's high expectations.

The most visible signs of the incremental Sino-Russian economic rapprochement have been long-term and large-scale deals orchestrated by the two countries' top leaderships in a number of state-controlled strategic sectors. Politically, these highly publicised agreements were meant to signal to the West that Russia under sanctions had ample other options. Economically, the jury is still out on whether they will be beneficial for Russia in the long run, since it has had to make major concessions to China. The asymmetry of their relationship has thus become further entrenched, although appearances may suggest otherwise. Moreover, the state-led deals have so far failed to generate major spill-over effects to other less state-dominated sectors.

China and Russia pursue two competing concepts of regional integration for Eurasia – the China-initiated Silk Road Economic Belt and the Russian-led Eurasian Economic Union – which experts consider incompatible. It remains to be seen what form, if any, their envisaged coordination will take, and how this will reshape the economic order in the EU's neighbourhood. Closer Sino-Russian strategic alignment on global governance issues – despite its limits – is likely to diminish the space for governance concepts developed by Western liberal democracies and the core values associated with them.



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Russia's 'turn to the East' and 'pivot to China'

In the wake of Russia's [annexation](#) of Crimea and destabilisation of Ukraine's eastern Donbas region in 2014, the [EU](#) and [USA](#) imposed sanctions on Russia; the latter responded with [counter-sanctions](#). Cut off from Western financial markets and advanced technology, and [excluded](#) from what used to be the Group of Eight (G8), Russia has accelerated its '[turn to the East](#)', originally aimed at [boosting](#) development of the backward and sparsely populated Russian Far East (RFE) and integrating the Russian economy in Asian markets, as a way to offset the impact of the sanctions.

In practice, Russia's 'turn to the East' has largely been about [forging closer ties](#) with China. However, to balance the growing [asymmetry](#) in its ties with China and to avoid becoming its permanent junior partner, Russia has pursued a [hedging strategy](#). It has [reached out](#) to other Asian countries, such as [India](#), [Indonesia](#), [Japan](#), the [Philippines](#) and [Vietnam](#), to upgrade its economic, military and political cooperation with them. This has been a daunting task, as they all have tensions with China over territorial issues. China, for geopolitical and domestic policy reasons, has been '[marching west](#)', pursuing the [Silk Road Economic Belt](#) (SREB), the land-based pillar of its [One Belt, One Road \(OBOR\)](#) initiative aimed at increasing connectivity between China and Europe. It has thus been keen to make the most of Russia's [pragmatic orientation](#) to new opportunities.

Since 2014, Chinese and Russian rhetoric has portrayed Sino-Russian strategic ties as being '[at the best point in history](#)'. In Russia, this raised high expectations that China could replace the West as an export market and a source of credit, large-scale investment and advanced technology. Three years on, how do China and Russia partner on regional and global governance? How has Russia's pivot to China materialised in key economic sectors?

Partnering on global and regional governance

Sharing similar historical grievances and great power ambitions

The [close personal ties](#) between the current Chinese and Russian [presidents](#) have become the hallmark of a special relationship between what President Vladimir Putin called '[natural partners and natural allies](#)'. They largely [share](#) geopolitical worldviews, including the perception of being constrained by the West. Russia feels both [threatened](#) by NATO's [expansion](#) into its 'traditional sphere of influence', and antagonised by the economic integration model for Russia's neighbours conceived by the EU under its [European Neighbourhood Policy](#). For its part, China has perceived the US [pivot to Asia](#) and the presently [stalled Trans-Pacific Partnership \(TPP\)](#), signed by 12 Asia-Pacific countries, as an encirclement. Both countries' policies are driven by historical grievances against the West, blamed in Russia for taking advantage of its post-Soviet decline in the 1990s, and in China for a '[century of humiliation](#)' (1839–1949), when after the outbreak of the [First](#)

Historical background

Rapprochement between China and Russia [dates back](#) to the end of the 1980s, when relations between the two countries gradually normalised after their ideological split (1960–1989). Russia emerged as the main arms supplier to China, which the West had isolated after the [1989 Tiananmen Square 'incident'](#) by imposing an [arms embargo](#), which remains in place.

In 1994, the two countries [concluded](#) a 'constructive partnership', which was upgraded in 1996 and 2012, and then [transformed](#) into the current 'comprehensive strategic partnership of cooperation' in 2014. Despite the two countries having concluded the [Treaty](#) for Good Neighbourliness, Friendship and Cooperation in 2001 as well as several border demarcation agreements in [1991, 2004 and 2008](#), which solved all border conflicts, Russian [distrust](#) persists as regards [potential](#) Chinese expansionism to the RFE due to the sharp difference in population density.

China and Russia have coordinated on regional non-traditional security issues in the [Shanghai Cooperation Organisation \(SCO\)](#), created in 2001 jointly with the Central Asian states Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan, to combat terrorism, separatism and religious extremism.

[Opium War](#) parts of Chinese territory stayed under foreign control. However, China and Russia have employed different strategies to pursue their great power ambitions. China privileges economic over military means, since the legitimacy of its one-party state is strongly linked to economic performance. China's focus on economic growth as a source of its great power status [contrasts](#) with Russia's unpredictable use of hard power even at the risk of substantial economic losses.

In recent years, Russia has extended the policy of military power projection to [Syria](#), a policy it previously applied to [Georgia](#) and [Ukraine](#), to assert itself not only as a great regional, but also as a great global power. Since China became the world's second-largest economy in [2010](#) and massively strengthened its [military capabilities](#), it has become more assertive in pursuing its '[core interests](#)' of territorial unity (in response to separatism in its [Tibet/Xinjiang provinces](#)), reunification (with Taiwan) and the incorporation of disputed maritime features in the East and South China Seas. To this end, it has been using diplomatic, economic and (para-)military [coercion](#) to incrementally [change the status quo](#), albeit without provoking military conflict.

Coordinating competing concepts of regional integration for Eurasia

Russia pursues regional economic integration with Armenia, Belarus, Kazakhstan and Kyrgyzstan through the [Eurasian Economic Union \(EEU\)](#), an inward-looking customs union and single market. It is [at odds](#) with China's ambitious but highly vague SREB, an inclusive pro-globalisation initiative aimed at fostering Chinese trade and investment by creating energy and transport infrastructure in Eurasia, and thereby at expanding China's economic and political power. Before the launch of the SREB in 2013, China kept urging the Shanghai Cooperation Organisation (SCO) to step up its [economic](#) dimension, including through a [free-trade zone](#), but Russia [resisted](#), unwilling to pursue economic cooperation in a configuration in which it was likely to end up playing second fiddle to China.

However, faced with new geopolitical and geo-economic realities, Russia made a [U-turn](#) and endorsed the idea of seeking mechanisms for integrating the EEU and the SREB into its [emerging Greater Eurasia](#) geostrategic framework that envisages a number of EEU free-trade agreements, including with the SCO. Work on [coordinating](#) the EEU and the SREB is in its [early stages](#). As a first step, a non-preferential trade and economic cooperation agreement between the [EEU](#) and China is being [negotiated](#) to [address](#) current imbalances in their relationship. As a second step, a still very remote EEU-SREB free-trade area may follow. If these initiatives are realised, their impact on the EU, despite their perceived [incompatibilities](#), is likely to go far beyond the estimates of a 2016 [study](#) by the Bruegel think-tank of a possible decline in competitiveness of certain EU export items in Russia, due to closer Sino-Russian trade ties and bilateral trade liberalisation.

Jointly re-shaping the current world order

China and Russia have both voiced their displeasure with the current unipolar world order featuring US military and economic leadership and a dominant role for the US dollar. They are eager to transform it into a multipolar world order that empowers emerging countries. However, the two countries [differ](#) in their attitudes towards cooperation with the USA and vision of their role in this new world order. To boost change, they have partnered in calling for reforms of the Bretton Wood institutions (the IMF and the World Bank), and – since reforms were not forthcoming as expected – in creating new multilateral structures that exclude the USA, such as the [BRICS](#) (Brazil, Russia, India, China and South Africa) and the [Asian Infrastructure Investment Bank \(AIIB\)](#).

However, these platforms are of different relevance to China and Russia. After its diplomatic isolation in 2014, Russia has [used](#) BRICS summits [to signal](#) to the West that it

has alternative options. At the 2015 Ufa (Russia) summit, it [achieved](#) a diversification of the [BRICS agenda](#); so far, this has yielded few deliverables. For its part, China has privileged the AIIB and the SCO to foster its [OBOR-related](#) economic diplomacy and to showcase its embrace of multilateralism, while relying on its economic clout in bilateral deals.

Teaming up on major global security issues on a case-by-case basis

Since 2011, Sino-Russian policy coordination has been particularly prominent as regards (in)action of the United Nations Security Council (UNSC) over the **Syrian civil war**, based on geopolitical interests (e.g. Russia's strategic interest in the Syrian port of [Tartus](#)) and on the adherence (stricter by China than by Russia) to the principles of territorial sovereignty and [non-interference](#) into the internal affairs of other countries, as enshrined in the UN Charter. The adherence to these principles also serves to rule out the risk of UN-led interventions on humanitarian grounds possibly turning into '[colour revolutions](#)'.

Regime change in **Libya** and ensuing [instability](#) following the 2011 UN-mandated military intervention in the country under the emerging but controversial principle of the [responsibility to protect \(R2P\)](#), which China and Russia [allowed](#) to go forward, has cemented their hostility to similar efforts in Syria. The two veto-wielding powers have repeatedly supported the incumbent Syrian President, Bashar al-Assad. [China](#) vetoed six of [eight](#) draft UNSC resolutions on Syria in tandem with Russia, twice signalling partial disagreement by [abstaining](#). However, Russia's 2015 [military intervention](#) in Syria, although at the request of the Syrian president and thus formally in line with international law, is an example of Russia's unpredictable behaviour being at odds with China's [opposition to the use of force](#) for political gains under its '[peaceful development](#)' concept.

As for the security situation on the **Korean Peninsula**, in the past, China and Russia took part in the stalled [Six-Party Talks](#) and supported the often [watered-down](#) sanctions in [UNSC resolutions](#) against North Korea for its nuclear and missile programmes, while guaranteeing the survival of the totalitarian regime to different degrees (through [trade](#), [supply support](#), hosting of North Korean [migrant workers](#) and granting of free [transit](#) to North Korean suspects). Although China, Russia and the USA share an interest in the denuclearisation of North Korea, their pathways to achieve this differ significantly. While the USA [believes](#) that China and Russia are the key economic enablers of North Korea's nuclear weapon and ballistic missile programme, and that economic pressure on the country is the best form of deterrence, China and Russia are unwilling to risk North Korea's regime collapse and the ensuing instability, with China worrying about millions of North Korean refugees entering its north. They privilege [economic engagement](#) with the hermit regime to ensure North Korea's survival as a buffer zone to US troops deployed in South Korea and to prevent a US-led reunification of the two Koreas.

After North Korea's July 2017 intercontinental ballistic [missile launches](#), [Russia and China](#) made a [joint statement](#) calling on North Korea to halt its missile and nuclear tests, and on the USA and South Korea to stop their joint military drills, which the USA considers [defensive](#), but North Korea perceives as preparation for invasion. China and Russia endorsed tougher UN sanctions in [August](#) and [September](#) 2017 which ban North Korean exports worth US\$1 billion out of a total of US\$3 billion a year, but [stop short](#) of prohibiting all North Korean oil imports. In the meantime, UN [monitoring](#) of the sanctions' implementation has increased. Before the '[double-freeze](#)' proposal, China and Russia [aligned](#) their stances against the USA's deployment in South Korea of the Terminal High Altitude Area Defence ([THAAD](#)) anti-missile system, saying it [infringes](#) on their strategic security interests.

Managing a 'marriage of convenience'

Cases where Russia's and China's behaviour violates the principles of international law, to which both countries claim to adhere, have revealed the limits but have also proved the resilience of the Sino-Russian strategic alignment. China adopted a [neutral position](#) on Russia's war against **Georgia** in 2008. It [abstained](#) from voting on a [draft-UNSC resolution](#) related to the issue, while [not](#) recognising Abkhazia and South Ossetia as independent states. Its response to Russia's annexation of Crimea in 2014 was similar. China [abstained](#) in the vote on a [draft](#) UNSC resolution on the referendum in Crimea. It did not recognise Crimea as Russian territory, but criticised Western sanctions against Russia. This allowed it to build Crimea's underwater '[energy bridge](#)', while at the same time consolidating [Ukraine](#) as a major [SREB transit hub](#) and expanding [arms trade](#), [space](#) and [agricultural](#) cooperation with it. China, which faces unsolved territorial integrity issues of its own, has been [unwilling](#) to back Russia's military aggression or to denounce it as a violation of international law, as this might have been understood as China's indirect backing of what it has perceived to be a [West-orchestrated](#) 'colour revolution'.

In return for China's '[amicable neutrality](#)' on Ukraine, after the 2016 [ruling](#) of the Permanent Court of Arbitration against China in favour of the Philippines' maritime claims in the **South China Sea**, Russia made [statements](#) and held [naval exercises](#) in the region with China, which China has been able [to interpret](#) as Russia siding with it.

Overall, the Sino-Russian strategic alignment on global governance issues post-2014 has remained selective in scope (and has therefore been dubbed an '[axis of convenience](#)'), with no common ground on UN peacekeeping and climate change, areas in which Russia is keeping a low profile, while China is [in](#) or is [heading towards](#) a leadership position. Notwithstanding this, closer Sino-Russian strategic alignment on global governance issues – despite its limits – is likely to diminish the space for governance concepts developed by Western liberal democracies and the core values associated with them.

Forging closer economic ties in an asymmetric relationship

Western sanctions have further [entrenched](#) the [asymmetry](#) of Sino-Russian ties and have weakened Russia's bargaining power to China's advantage. This has had a major impact on the terms of the large-scale and long-term deals between the two in a number of state-dominated strategic sectors. Next to Russia's key aim to establish a strategic energy partnership with China, a shared vital goal has been to pool research and technologies to build joint indigenous production capabilities so as to challenge Western dominant positions on global markets in fields such as [civil aircraft](#), where significant future demand is expected. Similar to the military field, Sino-Russian cooperation in the [nuclear energy](#) sector could be challenging, given the potential for competition in [third](#) markets.

Gas supplies

Western sanctions have catalysed the conclusion of a flagship Sino-Russian natural-gas-supply deal between state-owned China National Petroleum Corporation (CNPC) and Russian monopolist Gazprom. This deal envisages the export of over [38 billion cubic metres](#) (bcm/year) of East Siberian gas worth [US\\$400 billion](#), from 2025 on over a period of 30 years, initially starting with smaller volumes, as well as the construction of the [Power of Siberia Pipeline](#) (see Figure 1). To put the figure in context, natural gas from western Siberia supplied to European markets was [178 bcm/year](#) in 2016. Russia hailed the agreement as a breakthrough in concluding a strategic gas partnership with China after more than two decades of negotiations, which had stalled due to [price disagreements](#).

Repeated delays and [financial shortages](#) have since arisen and scepticism has grown as to the project's [profitability](#) for Russia. Moreover, Russia has [not been able](#) to realise its plan to construct a second gas pipeline, the Altai Pipeline, set to conduct West Siberian gas, mostly used for European markets, through the Altai

Figure 1 – Gas export routes from Russia to China and to the Asia-Pacific region



Source: [Playing Chess with the Dragon](#), Oxford Institute for Energy Studies, August 2016, p. 53.

Mountains to western China. Low gas prices and uncertainties about future Chinese gas demand are major obstacles. The project would have allowed Russia to act as a '[swing supplier](#)', potentially pitting its European and Asian customers against one another.

Oil deals

In 2013, Russian state-controlled oil company Rosneft concluded a landmark supply deal with CNPC worth [US\\$270 billion](#) for 25 years. The amount of the supply, covering about half of Rosneft's total crude oil exports, would be delivered through the Daqing branch of the Eastern Siberia-Pacific Ocean (ESPO) pipeline, whose main spur leads to the Pacific supply centre of Kozmino (see Figure 2). In 2016, China alone absorbed [70 %](#) of ESPO oil, and Russia became China's [largest](#) oil supplier followed by Saudi Arabia, Angola and Iraq. Although China may, on energy security grounds, prefer land-based oil supplies to maritime supplies passing through US-controlled choke points like the Malacca Strait, the deal has been politically and financially more important for Russia than for China. China has a broad range of oil suppliers, with Russia accounting for only [13 %](#) of total Chinese oil supplies in 2015. Nor has the deal changed much for Russia's dependence on oil deliveries to the West. As a percentage of total Russian exports, China accounts for 16 %, the EU for 61 %, Japan for 6 % and South Korea for 5 %.

Figure 2 – Eastern Siberia-Pacific Ocean (ESPO) pipeline



Source: [Petroleum Intelligence Weekly](#), 2013.

Despite sizable Sino-Russian hydrocarbon trade, Chinese equity investment in Russian assets accounted for only [2.5 %](#) of Chinese overseas oil and gas production in 2013. Investment barriers and mistrust remain. As Russia is reluctant to allow China to acquire any controlling stakes, in 2016 a 49.9 % stake in Russia's new Vankor oil field ultimately [went to](#) Indian rather than Chinese investors. India has emerged as a major country in Russia's energy diversification strategy, as evidenced by Rosneft's [acquisition](#) of a stake in Indian [Essar Oil](#) and Vadinar port allowing for new oil flows from the Russian east.

Military cooperation

Since 2014, Sino-Russian military ties have [deepened](#), with the two militaries staging more complex exercises whose geographic reach has expanded into strategically important areas (the Mediterranean in [2015](#), the South China Sea in [2016](#) and the Baltic Sea in [2017](#)), fuelling a [debate](#) about an emerging military alliance. As for military-technical cooperation, two high-profile deals on the sale of advanced-weapons systems from Russia to China were signed in 2015 after years of talks. The [agreements](#) cover the supply of six battalions of Russian [S-400](#) anti-aircraft missile systems – designed to destroy aircraft as well as ballistic and cruise missiles at a range of up to 400 km – and 24 Sukhoi [Su-35](#) combat aircraft. China and Russia have also launched strategic industrial partnerships and joint production deals (e.g. [advanced heavy-lift helicopters](#)).

Some [analysts](#) consider these sales a major shift in Russian policy towards China, away from Russia's long-standing concerns about China [reverse-engineering](#) Russian technology and selling cheaper versions of Russian products in third markets. Due to an informal Russian ban on sales of advanced technology items to China, Russian arms sales to China have declined after - 2005 (see Figure 3), and have featured components such as aircraft engines, but not complete weapon systems. Some experts have explained these sales with Russia's strategic interest in [weakening](#) the USA by upgrading China's capabilities, and Russia's need to [strike a deal](#) before China's indigenous capabilities match its own making further sales futile as well as to fund Russia's own development of next-generation arms technology. The sales have also been seen as a [threat](#) to [India](#), Russia's [biggest client](#), and the regional power balance.

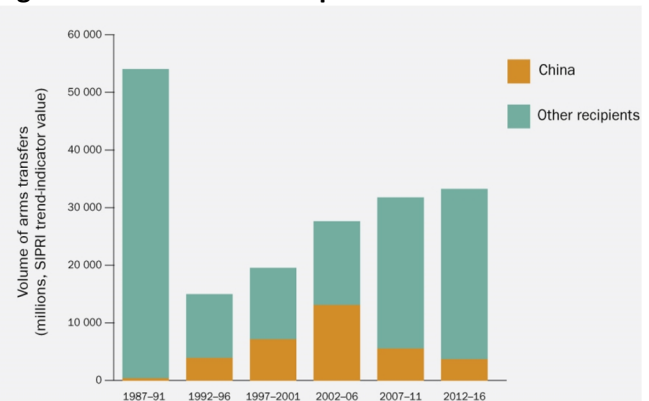
Financial cooperation

China-Russia financial cooperation aims [to replace](#) the use of the US dollar in bilateral transactions with the two countries' currencies and [payment systems](#). As for the currency swap agreement concluded in 2014, it appears to have so far [failed](#) to work as envisaged.

According to Central Bank of Russia [data](#), Chinese loans to the Russian 'non-financial sector and households' increased to [US\\$11.6](#) billion and US\$14.9 billion in 2014 and 2015 respectively, but dried up dramatically in 2016 (US\$-0.7 billion). Chinese financial support has come chiefly from China's main state-owned [policy banks](#), the China Development Bank (CDB) and China Exim (export-import) Bank, for the creation of [joint development funds](#) that have been used for energy, [transport infrastructure](#), [agriculture](#) and the RFE. For example, the funding of the Russian liquefied natural gas (LNG) [project](#) at Yamal in the Arctic was at [risk](#) when Russian Novatek was placed under Western sanctions in 2014. China seized this opportunity to foster its [Arctic ambitions](#) by entering the project via CNPC and the state-led [Silk Road Fund](#), and by injecting US\$13 billion from CDB and China Exim Bank into it. In line with their typical lending practices, these two banks have tied the loans to a requirement that [80 %](#) of equipment comes from China.

To Russia's surprise, Chinese commercial banks have been [reluctant](#) to provide loans to Russian projects targeted by sanctions out of fear they could be barred from operating in Western markets. This reflects a broader issue: China's strong economic interdependence

Figure 3 – Russia's arms exports to China and others



Source: [China, Russia and the shifting landscape of arms sales](#), Sipri, 2017.

with the [USA](#) and the [EU](#) has set limits to Sino-Russian economic ties. China has not been willing [to sacrifice](#) its ties with its major trading partners, the USA and the EU, for the sake of closer cooperation with its minor trading partner, Russia.

Trade relations

Sino-Russian trade has remained focused on Russian exports of hydrocarbons in exchange for Chinese manufactured goods. Figure 4 shows the significant contraction of trade levels between 2013 and 2016. The value of Russian oil exports dropped mainly due to the global oil-price decline, even though exports had actually increased in volume. The sharp oil price-induced [depreciation](#) of the rouble resulted in a loss of purchasing power in Russia

and – coupled with Russian [import-substitution policies](#) including [agriculture](#) – led to a strong drop in imports of manufactured goods from China. Russian [farm](#) and machinery exports may have benefitted from a devalued rouble, as they grew slightly, suggesting a possible incipient diversification of Russian exports to China.

Geographical distance, different laws, regulations and standards, business practices, consumer preferences and mutual distrust continue to pose major [challenges](#) to economic rapprochement. The lease of [agricultural land](#) in the RFE by Chinese farmers has remained too politically sensitive, due to [historically rooted](#) mistrust among the Russian population as well as [environmental and food-safety concerns](#). A joint cross-border cooperation programme for East Siberia and the RFE (2009-2018) has faced [weak implementation](#) in Russia for lack of capital and workforce, but runs smoothly in China. The economic impact of Russia's pivot to China has thus largely [fallen short](#) of Russia's high expectations. The low volume of Chinese [foreign direct investment](#) (FDI) flows to Russia is a case in point. As for trade, in 2016, despite sanctions, the EU-28 still accounted for a [43.3 %](#) share in Russia's trade, while China's share stood at 14.1 %.

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eprs@ep.europa.eu

<http://www.eprs.ep.parl.union.eu> (intranet)

<http://www.europarl.europa.eu/thinktank> (internet)

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Figure 4 – Sino-Russian trade structure prior and post-sanctions



Graphic by Eulalia Claros, EPRS, based on [Comtrade](#) data.

