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Russo-Chinese Energy Relations: Never-ending Foreplay?

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As the officially anointed Chinese President Xi Jinping is on his first state visit abroad to Moscow, speculations are abound about a long-awaited breakthrough in energy relations between the two giants. Caution, however is warranted. The honeymoon in Russo-Chinese energy relations has been elusive and progress rather slow and uneven in the past years. China's tactical patience coupled with the division between various Russian interest groups won the upper hand for Beijing in the complex gas price negotiations, which is the key to a potential strategic energy partnership.

No doubt, Russia and China seem ideally placed to develop such a partnership in the field of energy. Russia possesses the world's largest hydrocarbon reserves and has long been planning to diversify its export markets and revenues. China has a vast energy market with relatively few domestic energy resources to satisfy its ever-growing appetite.

There are areas where cooperation is already well under way. Rosatom will start building [two nuclear reactors in Tianwan](#) this year. Oil trade is on the rise. The ESPO pipeline from Eastern Siberia to Kozmino already transits around [36 million tons annually](#) and Russia plans to increase its eastward oil export pipeline capacity to 80 million tons. The [February 2013 visit of Rosneft chief Igor Sechin to China](#) sealed a deal that would make China the largest consumer of Russian oil. Russia's eastern oil fields are not fully developed, so production might struggle to keep up with demand. In the meantime, Russia might be compelled to divert supplies away from its Western Siberian fields: a major concern for Europe in a period of tight oil markets and a volatile Middle East.

The real contentious piece in the energy relations, with far-reaching bilateral and also global consequences, is natural gas however. In theory, Russia is hell-bent to sell gas to a China that needs it badly. Moscow has been so far predominantly relying on the stagnating European gas markets. But its traditional oil-linked pricing formula, yielding high prices, is under growing pressure. And Europe's increasingly integrated gas market and diversification efforts slowly but surely squeeze Gazprom's monopoly. Meanwhile, the role of gas in the Chinese energy mix is ever more important. Gas consumption [grew by an average of 14% annually](#) from 25 billion cubic meters (bcm) in 2000 to 147 bcm in 2012. The [International Energy Agency predicts](#) that consumption will grow to 545 bcm by 2035. Beijing wants to rely more on cleaner burning natural gas instead of dirty coal primarily because of concerns over air quality in major Chinese cities that already translates into a political problem for the Chinese leadership.

Nevertheless, the two parties have been unable to strike a deal on gas supplies due to disagreements over pricing since 2006. Gazprom, backed by the Kremlin pursued a strategy that preferred to supply China partly from its Western Siberian fields that also feed Europe. Moscow's aim was to apply its oil-indexation pricing-formula in China too and to play Europe and China against each other in price negotiations.

But the Chinese refused to dance to this tune and drove a very hard bargain. They pushed back on higher prices and played for time. Beijing's calculation that their leverage is increasing has been spot on. The Chinese cut masterful deals with Central Asian states (primarily Turkmenistan) that already supplies upwards of 30 bcm of gas to China, [soon to be increased to up to 60 bcm](#). China is also eyeing pipeline supplies from Myanmar. Liquefied natural gas (LNG) terminals are moreover being built all along China's coast and LNG import options multiply as new sources from Qatar, Australia, Indonesia, South America and over time, East Africa and perhaps the United States and Canada come online.

The Chinese leadership and state companies are also adamant to increase domestic production from conventional and unconventional resources. According to the US Energy Information Administration, China possesses the [world's largest shale gas reserves](#). The official target to produce [100 bcm from shale](#) alone by the end of this decade may be too ambitious, as large-scale production is hampered by a range of problems, such as water scarcity. But it is likely that over time China will ramp up its domestic shale production significantly.

Russian internal rivalries further complicate the picture. Natural gas export monopoly holder Gazprom is battling against Sechin's Rosneft and Novatek, a rising independent producer reportedly close to Vladimir Putin. Rosneft and Novatek have their own gas export ambitions to China and elsewhere. In exchange they might consider letting Chinese companies buy into their upstream assets in Russia (e.g. Sakhalin and Yamal), a long coveted aim of the Chinese. Gazprom is fighting back as it desperately wants the deal. It gave up the concept of building a pipeline from the [Altai shipping 32 bcm to China's western parts](#) – a lesser interest for Beijing, as the main consumption hubs are in the east along the coast. The company also decided to develop the [Chayanda and Kovykta fields](#) in Eastern Siberia. From these it plans to satisfy the 38 bcm per year via the Eastern route under discussion, along with supplying the Vladivostok LNG terminal under construction to ship gas to Japan and other South East Asian customers.

One thing is sure: the Chinese are in the driver's seat. They could exploit Russian infighting, its weaknesses in Europe and the global LNG market. Any natural gas deal is contingent on the Russians providing significant concessions on pricing. Yet the Kremlin may balk at appearing to be too weak and acquiescing to the further erosion of Gazprom's pricing strategy in both Europe and Asia.

The rationale for growing Russo-Chinese political, trade and energy ties is certainly there. [China already overtook Germany as Russia's biggest trading partner](#) in 2011 (80 billion USD as opposed to Germany with 75 billion) and the potential is huge. The US 'rebalancing towards Asia' along with developments in the Middle East such as the Syrian crisis propel Beijing and Moscow to move closer, despite their [inherent mistrust and disagreements](#). But whether Xi's visit will indeed deliver a breakthrough in the long coveted gas deal and bring about a new momentum in building a truly strategic energy partnership remains to be seen.

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