Energy Neighbours

A look at Sino-Russian Energy Trade between 1993 and 2012

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Abstract

The core of this investigation is the low level of energy trade between China and Russia despite seemingly complementary goals. Despite China’s large appetite for oil and gas imports, Russia is only a minor supplier instead the majority comes from far away suppliers in Africa and the Gulf. This is the starting point of the investigation to understand why a proximate supplier does not have a majority or at least the largest share in Chinese energy imports. The project has chosen the timeline of 1993-2012 because in 1993 China was no longer self-sufficient on domestic oil production and 2012 instead of 2013 to be able to procure complete data.

The project implements Dale C. Copeland’s theory of trade expectations to understand the obstacles to trading in between China and Russia. A critical realist ontological and epistemological position has been adopted in conjuncture with mixed methods.

The investigation finds the following 5 critical aspects of Sino-Russian energy trade in the chosen period – Price, Infrastructure, Mistrust, Other Consumers/Suppliers and the use of Oil as Foreign Policy by Russia. Theses aspects help enhance reasoning when combined with trade expectations theory. The project concludes with the findings that the aforementioned factors created low trade expectations for Russian supply and the dependence levels were too risky for significant trade to occur between 1993 and 2012.
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**Problem Area**

China has been a global industrial powerhouse and this stature also means it has the large energy requirement of one. China was last self-sufficient on domestic oil production in 1993 (Downs in Bellacqua 2010:148 and (USEIA 2012), but since then it has grown to become the second largest energy consumer and the importer of oil in 2013 (IEA 2013). In contrast, its neighbour with whom it shares a 4000km long border is the world’s second largest oil and natural-gas production.(Holtom et el 2011:28)

China and Russia see eye-to-eye on many issues such as countering US hegemony and principles of non-interferences. The two countries also share other characteristics, such as their prominence in the world stage, large economy, vast territorial expanse, UN Security Council seats, long term domestic territorial issues in Chechyna and Taiwan & Tibet, detachment from the western power circle, shared view over multi-polar world order, to name a few. (Lo 2008:38) Despite the similarities and strong military trade accounting for 85% of China’s total arm imports from 1992-2007 (Lotspeich in Ballacqua 2010:114), energy export from Russia only represented 6% of total Chinese energy imports. (Holtom et el 2011:28)

This is a glaring gap between the arms and energy imports from Russia as it specialises in both and was capable of exporting 7.2 million oil barrels per day, in addition to its vast natural gas reserves.(USEIA 2013) This brings the question forward regarding why have the energy import levels remained so low, especially when 80% of Chinese energy import is consisted of African and Gulf exports (Downs in Bellacqua 2010:147). Such high volume import through seaways poses supply challenges to China, as the supply route are external to China’s naval sphere, increase transportation costs and are subject to environmental conditions. (Ibid:151)

Russian energy exports are comprised of 84% oil and 76% natural gas to Europe that are transported primarily through pipelines. (USEIA 2013) Although this dependence of Europe on Russian supply provides Russia with a steady customer, it also makes Russia weary by being dependent on select customers. This also brings in the stigma of Russia being Europe’s energy appendage, when it wants to increase its importance politically.(Downs in Bellacqua 2010:160 and Holtom et el 2011:33) Thus, “diversification of demand”, customers, is as much its interest as is “diversification of supply” for China. (Downs in Bellacqua 2010:151)
Therefore, geographical proximity and compatible energy goals make Russia and China, on paper, almost natural partners in energy trading, but yet this is not reflected in two decades of energy trade with Russia claiming only 10% of energy imports, towards the end, while supply from farther areas remain dominant. This highlights the core interest of the project, which is to understand why Russian import shares of Chinese energy requirement have remained so low despite apparent common interests.

This question is of importance to highlight the possibility of other factors in trading other than the simplification of supply and demand. Therefore to understand this complexity, the project will be employing a Critical Realist (CR) ontology and epistemology in conjuncture with Dale C. Copeland’s Theory of Trade Expectations. This investigation will attempt at showing the importance, if any, of Trade Expectation as outlined by Copeland in Sino-Russian trade relations and uncover primary reasons contributing to the low level of imports from Russia through 1993 till 2012. Additionally it hopes to contribute to the understanding of the energy trade between Russia and China.

**Delimitations**

The investigation takes 1993 as its outset as this was the year after which China was no longer self-sufficient on its domestic oil production. 2012 was chosen to be able to gather complete data from the previous year rather than incomplete information at the time of writing. Although the investigation aims at a holistic approach, it is inevitable to look at certain instances either from Russia or China’s perspective. This continues to the theory, where, sometimes, the consumer is more dominant in the choice of trade. In this project energy will be defined as oil and gas, and will be excluding coal, hydro, solar, and nuclear power. This was done to show the political-economic dimension behind the trade which is most present in oil and gas, as well as they are the biggest deficits of China’s energy resources. China has the largest coal source and already has tapped hydro and nuclear power.
Problem Formulation

Why has Russian oil imports trailed behind Gulf and African supply to China despite their proximity, during 1993-2012?

Research Questions

1. What are the energy related resource strengths and requirements of both the countries?
2. What are the current energy trade volumes and trends?
3. Whether there are any obstacles to energy trade, and if so what are they?

Methodology

Ontology & Epistemology – Critical Realism

Critical realism (CR) is a standpoint similar to positivism, whereby it acknowledges the existence of truth independent to individuals but also the fallible nature of positivist enquiry into reality. Although CR also views truth and reality to exist in one measurable form, but unlike the latter, realists acknowledge the difficulty of judging this reality. (Marsh and Furlong 2002:30) For realists reality is external and independent of human consequences (Delanty and Strydom 2010:376), but discovering this reality requires social scientists to peel through various layers of reality to reach the emergent truth, making the path to observable truth harder and enables the possibility of various perspective of reality. (Ibid and Maxwell 2012)

A differentiating element in critical realism, from positivism or empiricism, is the role of the concept of “cause”. And, sees it playing a crucial role in the functioning of the real world. (Ibid) It believes in the structural dominance in reality, thus seeing causality as a factor in it. But, unlike positivism, they acknowledge that observation of such causal reality may not always be accessible. This layered nature of reality, makes them believe that parts of the reality that cannot be observed but can be substituted with theoretical explanations. (Bryman 2008:15) Realists see theory depicting actual features of the real word, thus giving researchers rules and tools to analyse the observable world. Critical Realists also take into account mental states and attributes as a part of the real world. (Maxwell 2012:8).
As CR stems from Roy Bhaskar’s work his views on human agency can also be seen in CR. Although not as strongly as constructivists, CR believes that humans have a degree of agency in reality but are constrained by structural factors. For an example, Bhaskar views culture as existing independent of individuals but is made possible by humans. (Clark in Given 2008:169) In keeping with this Bhaskar introduced the three realms of reality to resolve epistemological issues and they are The Actual, The Real and The Empirical (Ibid:168). The actual domain refers to events that take place in the world, the real domain pertains to underlying structures and tendencies, and the empirical domain refers to the human element and its scientific inquiry. Thus, the objective reality is formed and caused by the interaction between the actual and real domains but its observation becomes fallible due to the empirical realm. (Ibid)

Even though CR stands close to positivist epistemological considerations, qualitative research methods are in no way incompatible. Clark argues otherwise saying that qualitative research plays to the strengths of CR’s perspective in understanding the complexity of an issue, rather than trying to simply it by controlling the data. Clark draws on qualitative research’s focus on explanation and understanding agency and structure as its source of compatibility with CR. (Ibid:168p) Thus, from an epistemological standpoint both qualitative and quantitative are compatible with critical realism.

**Mixed Methods**

Creswell defines mixed methods as the following “Mixed methods research is a research design (or methodology) in which the researcher collects, analyzes, and mixes (integrates or connects) both quantitative and qualitative data in a single study or a multiphase program of inquiry.” Such a research strategy is meant to be a compromise between qualitative and quantitative methods, while combining them for a better understanding. (Wilson 2013:275) This approach is also compatible with the ontological and epistemological considerations in the project. As mentioned previously, despite the critical realism’s affinity to quantitative data there is still room for qualitative data due to the included strengths. Thus, implementing them as a combination in this project is epistemologically sound.

Mixed methods can be used for many purposes but the two dominant features are: increasing validity or gain a fuller and deeper understanding (Ibid:276) In this project a similar consideration has been taken during the choice of methods. The project will be relying on the
use of both qualitative and quantitative to be able to dissect the reality from various angles, in keeping with the realist view of reality. This multi-pronged approach will help in a more holistic understanding, so that we can reinforce statistics with political information and expert opinion, which would help in implementing our theories more effectively. The deeper understanding has been the bigger motivation in the choosing of mixed methods, even though the possible side effect of increased validity is welcomed.

Such use of mixed methods is classified as “Completeness” by Bryman and is implemented with the motivation to further the understanding (Bryman 2008:612). In this project the data gathered will not come from focus groups and surveys, which are normally associated with mixed methods, rather secondary data. This secondary data will comprise of expert analysis, newspaper articles, official documents, and energy & trade reports, and cross referenced in a mixed methods manner. The selection of data will be guided through the parameters set according to the theory.

**Deduction**

Bryman simplifies deduction as a process in which a researcher deduces a hypothesis in a particular domain after theoretical considerations and available knowledge. This hypothesis is then tested using empirical evidence. (Bryman 2008:9) Further adds that this hypothesis should also be able to be translated into operational terms. Thus, in conjunction with theory the researcher must be able to collect data relating to the hypothesis (ibid). This research is followed but one characteristic of induction whereby researcher feeds back the knowledge gained and processes it using the stock theory to test the hypothesis. (ibid:9p)

Such a description brings about a hierarchical model for deductive theory, which starts with Theory → Hypothesis → Data Collection → Findings → Hypothesis confirmation/rejection → Revised theory (Ibid:10). This covers the rudimentary form of deduction, but Bryman stresses on the flexibility of this model. For starters, “theories” can be literature on a certain topic rather than a clearly defined theory. Secondly, the creation of hypothesis may not stem directly from the theory, may not be explicit and may change during the investigation. Thus, although the top down structure of Deduction remains one is not obliged to a particular model. (Ibid)
In this project, a deductive approach will be implemented for our findings to be tested against Dale Copeland’s theory to understand the importance of trade expectations in Sino-Russian energy trade. There is no explicit hypothesis but the insinuation is that trade expectations, outline by Copeland, have had some effect on the low energy trade numbers.

This is to be tested by first gathering data and then dissected using the perspective of trade expectations; therefore the project is designed to understand the reality by implementing theory to the data rather than proposing a new or opposing theory.

**Data and Sources of Error**

The data selected in this project is mostly secondary data pertaining to statistics, trade figures, policy papers and expert opinion. Reliability, which is the trust worthiness of data (Seale 1999), has been ensured by cross checking facts with multiple sources. Although this has been attempted to the maximum, there have been exceptions. Internal bias in the policy papers and expert opinion, has been given the same treatment and has helped adopt a more neutral and realistic tone in the project. Reliability issues have plagued trade and energy data, but the most credible sources, like the International Energy Agency, has been chosen in the presence of conflicting data. The cross referencing of quantitative data has also been attempted, but issues of publication date and absence of the most recent data has led to trusting credible sources.

The choice of data has also been thought to be valid. Validity refers to the choice of measures chosen to research the problem formulation (Bryman 2008:151). Trade figures and opinions have helped understand the dynamics between the numbers and trade expectations. The choice of the data complements the theory well, and thus satisfaction has been achieved. But, the author has attempted to use the right measures in the discussion for the reader to grasp the actually picture. An example is Russia’s ranking as the 4th largest oil supplier of China. When presented in this manner, it seems rather significant. But, if this is presented in terms of import share then it only represents 7.7% or 395,000 barrels of oil per day compared to Saudi Arabia’s 19.7% share or 1 million barrels per day.

Therefore both validity and reliability have been kept in mind during choosing the data as well as representing it.
Theory of Trade Expectations (Copeland 1996)

This chapter is designed to explain the Dale C. Copeland’s theory chosen for this project. It is going to introduce the fundamentals and reasoning behind trade expectations, as well as provide insight into how this theory will be implemented in the project.

Copeland bases his theory on historical experiences with Germany and Japan in WWI & WWII. Both relied heavily on import of raw materials, despite attempts at self-sufficiency, and heavy dependence proved to be a vital motivation to go to war. He iterates that liberal and realist reasoning behind motivations to war and trade only explain parts of both the World Wars but not the entire case, thus Dale C. Copeland incorporates the rationale of both the arguments coming from the two camps, while adding a crucial variable of “trade expectations”, in the understanding of consequences of economic dependence.

Copeland draws on historical trends regarding Germany’s motivation to go to war on both the occasions of World War I and II as his foundation for his theoretical claims. He highlights the high dependence of the country on imports of raw materials, but highlights that the motivation for war grew with higher protectionist tendencies of the exporting countries. Copeland therefore insinuates a significant connection between dependence on resources and the long term security of its supply.

This historical evidence is seen in numerous occasions prior to both the world wars. In mid-1890’s, German goods was subjected to tariffs by the United States (US) and France and further invigorated by British and Canadian tariffs despite contradictory trade agreements made in 1865. (Copeland 1996:10) Around the same time Germany was also unable to provide raw materials for its domestic growth and had to rely on imports for 90% of its oil needs and 30% of iron ore (Ibid:11). According to Copeland, such level of dependency combined with dim forecasts for trade expectations can been seen as a motivation for initiating the First World War and possibly be seen even as a preventive war to maintain its resource supply.

The same issues can be identified in Germany prior to the Second World War due to its smaller territorial spans and lack of a large imperial coverage. This is also documented in Adolf Hitler’s vision of Lebensraum or Living Space for the growing German population and its food needs, combined with the need of raw materials. (Ibid:14) Similar tariffs curbed
German exports due to US protectionist treaty in 1930, driving import costs up and reducing foreign currency. All these economic pressures on Germany gave it further reason to secure its needs through war, initiating the Second World War. (Ibid:14p)

This trend in Germany’s history forms the basis of Copeland’s theory. This highlights the discrepancy in Liberal and Realist explanation and show the need for a new variable. Thus, Copeland stresses on the importance of trade expectations rather than trade itself on the effect on relationship between countries.

Copeland formulates the theory with two main proponents: Dependence level and Trade expectations. Therefore, not one or the other are sufficient for dependent trade, but both. The premier is related to the cost of adjusting ones economy to trade dependence and the latter refers to security of long term supply.

Dependence level is calculated through a cost-benefit analysis. As an example, if country A has the GDP of 100 units at the outset and starts trading with country B, which results in a surplus of 10 units, it means that trade results in positive surplus. But, if Country A will lose 20 units after it specialised for trade with Country B, its total dependence level will be 30 units rather than 10 units. Therefore this analysis helps trading countries to asses risks before becoming dependent on the other. (Ibid:7)

The theory, in summary, suggests that states will only trade if there is a surplus in total gains from trading compared to waging war. The understanding of this “gain” also takes into account the opportunity cost of trading i.e. the loss in domestic production a state suffers by specializing in exports it has competitive advantage and relinquishing sectors that have lower competitive advantage and replacing it with imports. (Ibid:7p) Then it further adds that these gains also have to be sustainable over a long period, thus the expectations of long term supply and access to markets also have to be assured for a country to participate in trading with another state and become dependent on it. (Ibid) Copeland adds that this benefit from trading is important even if there is no trade or little trade, but is significant due to the possible gains from expected high value trade. Thus, with low current trade the possibility of welfare being gained from peaceful trading offsets the motivation for war. (Ibid:7)

Firstly, this theory accounts for the extreme reactions in the case of dependence, which is war or peace. Even though a realist view would propagate the legitimacy of war it is also
important to acknowledge the growing cost of war. Thus, in this project war is understood to be a variant of hostility than the absolute chance of war and even the motivation to not trade. Second, this theory is understood to act as an explanation to real world practice, in keeping with critical realist tradition, therefore the theory can be understood in both direction. This being established, in this project Sino-Russian dependence will not be studied using this theory, as there is none, but the lack of it will be scrutinised.

The theory is intended to be used in reverse, which gives us the variables of trade expectations and possible dependence levels in helping us understand the absence of dependent trade from 1993-2012. Instead of applying Copeland’s theory to two dependant countries and analysing whether peace or war should be expected, like in the case of Germany in the 2 world wars, it will be used to understand the absence of dependence by peaceful trading or at least low levels of trade between Russia and China. This facilitates the data collection process, which will be guided by the reverse direction and makes expectations and dependence levels the primary data targets.

**History and Background**

This chapter is intended to provide a concise history covering most topics so that the reader is primed with the understanding of the nature of Sino-Russian relationship. This is believed to be important in the accurate understanding of motivations in their energy trade.

Russia and China promoted their relationship as “Brothers Forever” in the heights of their relationship in the 1950s. (Wishnick 2001: 798). But, despite this, Sino-Russian relations took a turn for the worse after Stalin’s death leading to incompatible leadership and even culminating in the Sino-Russian split in 1959. This split is credited to the differences between Khruschev and Mao and lead to a hostile relationship lasting over decades and fuelling disputes in the border regions as well as China’s reach to the US as a partner in the 1970s. (Ferdinand 2007: 842)

Prior to 1959, one could have seen a different picture than the one during the split, the Soviet Union helped China craft their five-year plans, provided financing and provided technical and military aid.(Lüthi 2008:114ppp) And, such resurgence was seen intermittently but reconciliation was only seen in 1989 with Mikhail Gorbachev’s visit to Beijing. Russia and
China historically suffered from disputes over border demarcation and this issue was magnified by their split. (Bellacqua 2010: 15). Thus, after their 1989 reconciliation, resolving border disputes was a top priority. This was seen in Sino-Russian talks in 1991, followed by further discussion additionally with Kazakhstan, Tajikistan and Kyrgyzstan. (Lo 2008:29p) This increased communication between the two countries also marked a thaw in their relationship and soon materialised into annual summits held between the two countries during 1992-1999. (Ibid) This continued relationship also saw in the growth of their rhetoric regarding their relationship from “constructive partnership” to “determining the fate of the 21st century” and their communiqués soon included “anti-hegemonism”, “anti-unipolarity” and “multipolarity” as their shared interest against American hegemony grew. (Wishnick 2001: 799 and Lo 2008:29)

Apart from converging views on world order, China increasingly depended on Russian arms transfers, especially after the arms blockade put in place on it after the Tiananmen Square incident. (Wishnick 2001: 799) This large demand of arms also was beneficial, especially after the Soviet Union collapse, as it was helping fund a large sector that Russia was struggling to maintain and brought in valuable financing. This dependence led Russia to be willing to transfer technology to China, which was denied by many western suppliers. Russia transfers technical knowhow of the inter-continental fighter SU-27 in addition to various contracts and scientists. (Donaldson & Donaldson 2003: 715). It is however important to demonstrate the presence of mistrust or suspicion, as Russia was still selective about its military exports. It refused the export of Tu-22M, a supersonic bomber, to China while it did not hesitate to sell India the same equipment.(Bellacqua 2010: 6) Despite this Russian military equipment counted for 78% of total Chinese imports and represented a complementary relationship that allowed Russia to maintain its arms industry afloat while receiving the finances it needed and China was able to access technology and import arms that it was otherwise unable to. (Holtom et el. 2011: 4)

As mentioned above, border issues have been a constant splinter in Sino-Russian relations but with increased communication these tensions have de-escalated and mechanisms have been to put into place to resolve it. The Sino-Soviet Treaty of Friendship, Alliance and Mutual Assistance signed in 1950 was the symbol of such cooperation over border disputes, political and economic collaboration. But, due to the split, it was not renewed in 1979 when it expired.
The two countries since then have signed *The Agreement on Confidence Building in 1996* to resolve border and military issues, leading to the creation of Shanghai Five along with other central Asian countries. (Jing-Dong 2010: 860). The following year Russia and China released a joint statement “*Russian-Chinese Joint Declaration on a Multipolar World and the Establishment of a New International Order***” in April 1997 to reiterate their shared vision of the world order (Lo 2004: 295) and agreed on reducing military presence along the border (Jing-Dong 2010: 860). In 2001, the Shanghai Five was transformed into the Shanghai Cooperation Organisation (SCO) with the inclusion of Uzbekistan. The same year *The Treaty of Good-Neighbourliness, Friendship and Cooperation* was signed as a sequel to the treaty from 1950 that was never renewed under the hostility of the split. (Wishnick 2001: 803)

Apart from increased multilateral cooperation through the SCO, Russia and China took part in further collaboration in ASEAN & APEC (Wilhelmsen and Flikke 2001: 87). Apart from sharing similar policy on non-intervention and view on multi-polarity as the preferred world order, Russia and China are engaged in the Korean peninsula, Iran, Arab Spring and recently in Libya and Syria. It has been observed that they support each other in the UN (Chung 2004: 992) and is actively seen in their actions in the security council leading to less stringent sanctions on North Korea and Iran (Wishnick in Bellacqua 2010: 65pp).

Despite such cooperation, cracks have surfaced intermittently due to the presence of The US. This was shown in Russia’s support for the US’s war on terror as well as limited objection by Russia in US’s unilateral pull out from the Anti-Ballistic Missile Treaty (ABMT). (Lo 2008:51) This foreign influence on Sino-Russian relations is also seen when Russia decided to build the Eastern Siberia–Pacific Ocean (ESPO) oil pipeline, supplying oil to both Japan and China, rather than a direct pipeline to China. There are also further issues with China’s growing influence in the world and in Russia’s sphere of influence, Central Asia. (Lo 2004:308) Despite the SCO, Russia prefers to engage with Central Asia independently (Ibid) and they both have to compete for Central Asian energy resources. (Holtom et al 2011:35) Finally, there linger issues from their past regarding their roles. In the outset Russia had a superior standing but China’s growing influence challenges such assumptions if not reverses it. Such cases of identity and status have been a theme even during cooperation.

But, despite such disruptions the two countries have continued their interactions and held their first joint military exercise in 2005, followed by “The Year of China” and “The Year of
Russia” in 2006 & 2007 to promote each other to its citizens. (Ferdinand 2007: 849pp) These efforts in convergence have borne fruit in resolving border disputes as they were said to be mostly resolved in an agreement in 2008 (Kutchins in Ballacqua 2010: 39)

Trade has also benefitted from the better political relationship, which reflects in the US$56 billion trade of 2008 compared to US$5.4 billion trade volume of 1995 (Lotspeich in Ballacqua 2010:101). In this bi-lateral trade, China still enjoys a trade surplus of US$9 billion (Ballacqua 2010: 7) and is the second largest importer of Russian goods, while Russia only features as the 9th largest importer of Chinese goods. Of these Russian exports, mineral fuels (oil & gas) accounts for 52% followed by wood (12%), chemicals (9%) and base metals (7%). In contrast China exports textiles (19%), machinery (14%), electronics (16%), base metals (10%) and vehicles (9%). (Lotspeich in Ballacqua 2010:101pp) This shows some Russian anxiety over the trade imbalance and China’s superiority in supplying finished goods, while Russia supplies the raw materials (Bellacqua 2010:7.). But, China’s trade surplus can be effectively skewed with potential increase in energy trade, especially with the ESPO pipeline creating an important link between the two countries (BBC 2011).

Russia is still in an advantageous position when it comes to its energy resources, as it had tried to pursue China to build a pipeline in the 1990s when the crude oil prices were low, but China stalled and were in no hurry due to the low market price for oil. Their main concerns, at the time, were expensive investments in pipeline infrastructure and negotiate prices even lower. This came to haunt China, with its increased energy needs combined with rising oil prices in the 2000s, while Russia established a strong consumer base in Europe. With this new situation, it brought about hesitance in Russia’s part in long-term commitments with China. (Downs in Bellacqua 2010:146-150)

However, recently with the financial crisis and a dip in oil prices, helped the two countries to reach a settlement and sign a deal for a pipeline. The deal included US$ 25 billion loan from China in lieu of a 20-year supply commitment. This should dent the approximately 80% share of Gulf and African of Chinese oil supplies. As of 2006, China imported 8.6% of its total oil imports, and even though this is lower than other sources, it also marks the increase in volume from 1,000 barrels/day in 1995 to 292,000 barrels/day in 2007. (Ibid:147)
As an important part of the choice of the timeline for the project, China was last self-sufficient, in matters of oil, in 1993 but now more than half of its oil demands are met but imports. (Ibid: 148). But, despite Russia’s proximity to China it accounts for 11% while the rest are predominantly supplied by African and Gulf countries. This does pose as a logistical issue as transportation from such distances are unreliable and disruptable, and prior to the ESPO pipeline Russian oil was also transported by the railways that suffered from the same issues (Ibid: 151p).

China’s large demand serves as a perfect opportunity for Russia to obtain “security of demand” as it will not be only reliant on its European customers, helping it also maintain leverage on prices. And, Russia’s energy resources help China in securing “security of Supply” when it is heavily reliant on few supplier that are far away. (Downs in Bellacqua 2010:151) But, as of now these symbiotic goals haven’t led to drastic increase in Russian oil supply and are not helped by mutual distrust, Chinese demands for lower prices and Russia’s use of its resource as a foreign policy tool.

Their shared history covers the spectrum from collaboration to hostility. There has been a constant development of their relationship in all most all spheres, but it is also worth noting the fragility of it in some cases. Experts reiterate that even though it may not be the strongest of bonds, they share a pragmatic relationship that both of the countries rely on when seen fit. (Bellacqua 2010:4) Some major obstacles that have emerged are the mutual distrust, lack of understand, Russia’s affinity towards the West and its confusion over its Asian identity, resource nationalism and threat perception. Despite these both governments have been successful at resolving border disputes, form a stand in the international stage, propagate multi-polarity, and trade.

**Energy Trade**

This chapter is designed to first give the reader an understanding of Russia’s resources and its energy market, then China’s energy status, its requirements and sources, and finally an overview of their bi-lateral trade. These should mark the end of descriptive part, and will be followed by specific aspects that appear to hinder cooperation or at least not further them. They have be broken down to Prices, Other Customers/Suppliers, Priority, Infrastructure,
Mutual Understanding/Mistrust and Oil as Foreign Policy, and will be looked into in more depth to understand how they can contribute to Copeland’s theory.

Russia

Russia is the world’s second largest energy producer with its energy exports contributing 50% of its federal budget and accounting for 70% of its total exports in 2012. It is estimated that Russia produced 10.4 million barrels (bbl) per day while it consumed only 3.2 million bbl/day, leaving 7.2 million bbl/day. (US IEA) Russia uses oil only for 19% of its total energy needs while it relies on natural gas for 56% for the same. This is complimentary as it has the largest gas reserves can rely on it, while it can export the surplus oil for valuable income. This gives Russia an immense opportunity to exploit this resource for income and political leverage, which is also seen in Putin’s vision of Russia as an “energy superpower” (Lo 2008:137).

It currently has explored most of the cost efficient oil fields and predominantly originates in Western Siberia, while fields in the Russia Far East (RFE) accounted for only 3% of total production. Russia has deposits spread around 10 regions of which Western Siberia accounts for 62%, (USEIA 2013) but potential sites have been identified in Eastern Siberia, Caspian Sea, Sakhalin islands and the Russian Arctic. (Ibid) When it comes to gas, Russia holds the largest gas reserves in the world and are mostly also located in Western Siberia. Apart from the existing fields, exploration in Yamal Peninsula, Eastern Siberia and Sakhalin Islands have been initiated. (Ibid)

Much of this production is state controlled and carried out by public companies, while only state run companies are allowed to export this production. (Reuters 2013) Rosneft controls oil production, Gazprom has a monopoly on gas and Transneft controls most pipelines. (ibid) Despite liberalisation of the market, private and foreign companies have struggled to exist. Yukos, a private company, was taken over by state entities after tax fraud allegations and bankruptcy in 2003, BP’s assets in its partnership with TNK were also sold to state-run companies in 2012, and foreign direct investment in energy companies from Western and Chinese sources have been limited. (Lotspeich in Ballacqua 2010:121) Despite this some private and foreign companies continue to exist, such as ExxonMobil, LUKoil and ConoccoPhillips. (Ibid)
As mentioned before, Russia thrives on energy exports. Europe serves as its biggest customer accounting for 84% compared to China’s 5.5% share of total oil exports, although it is the 3rd biggest customer in a country based breakdown. Of these exports, 80% is transported using Transneft pipelines. (ibid) Russia has 9 major pipelines mostly to its west and with the capacity of around 2 million bbl/day, while the ESPO spur running from Skovorodino to Daqing started delivering China with .3 million bbl/day since January 2011 (ibid). Europe’s significance as a consumer is also seen across gas exports, but China’s presence is absolutely miniscule in this sector. Even though Russia relies more on gas than oil, it is still capable of exports that are mostly delivered to Western Europe and Turkey. (ibid)

This overview helps us gain key insights. First, due to relatively low domestic oil consumption Russia runs an oil surplus helping it export it while it can rely more on its immense gas reserves for domestic and foreign supply. Second, the state is closely tied to energy trades as most of the production and transportation is expedited by public companies. The energy market also comes across as restrictive to private and foreign entities. Third, most of Russia’s exports and the infrastructure around it are geared mostly towards Europe with a growing prominence of Asian customers.

**China**

China is the world’s second largest energy consumer and importer. Chinese energy consumption is comprised of coal (70%), oil (19%), hydroelectricity (6%) and gas (4%). Despite the low share of energy contribution, its oil consumption levels were close to 10 million bbl/day while its domestic production was around 4.1 million bbl/day, mostly consumed by the transportation sector. (USEIA 2012) This has left China with a large energy deficit that it fulfils through oil imports. China is also the largest coal producer and consumer, with 70% of its energy requirements fulfilled by it. Despite its large reserves, it has also become a net importer of coal since 2009. China is not too reliant on gas imports or its consumption as it only accounts for 4% of energy production, but its use has been gradually growing and again imports exceeded domestic production in 2007. The use of this form of energy is predicted to exponentially increase due to its cleaner nature versus coal, potentially meaning further energy reliance on imports. (Ibid)

Its current oil suppliers consist primarily of Gulf and African countries. Saudi Arabia, Angola and Iran were the largest suppliers providing China with more than 2 million bbl/day while
Russia was fourth with its supply of 395 thousand bbl/day in 2011. Middle Eastern supply has been consistently strong since 1995 till 2008 averaging around 50% of total imports, while Russian supply has increased from 0.2% in 1995 to around 7.7% in 2011 with a peak of 10% in between. (Ibid)

Following are the details about the major suppliers

**Saudi Arabia:** Strengthening of Chinese and Saudi Arabian ties has also translated into increased oil imports. In 1995 Saudi Arabia contributed 2% of total imports (Lai 2007: 523) but by 2011 it has increased to 19% (USEIA 2012). Apart from increased trade, Sinopec, a Chinese oil company, has gained rights to explore gas basins in Saudi Arabia, as well as technical help from Saudi Arabia in building stockpiles and refineries in China (Lai 2007:523) These imports are transported through sea ways, passing through the Strait of Malacca.

**Iran:** The second largest oil producer in the Middle East is also a significant importer for China. It supplied 11% of all Chinese oil imports in 2011 and showed a similar growth as Saudi Arabia as it only accounted for 5% of these imports in 1995. Mr. Lai observes that Iran and China have shared a strong diplomatic relationship with regular visits. Even here Sinopec struck a 30 year gas deal along with development of oil fields in 2004, apart from a 25 year oil supply deal between the 2 countries (ibid). These imports are also transported via Strait of Malacca and are disruptable due to the sea ways.

**Angola:** Unlike Russia and Middle East, foreign direct investments (FDI) are welcomed in the oil sector in Africa. This has been a boon for China as it has heavily invested in this market and has forged storing diplomatic ties. China and Angola have had diplomatic ties since 1983 and have blossomed since the mid-1990s with frequent leadership visits. China has helped build low cost housing as well as waved all dues prior to 1999. With these strong ties, Angola has gradually increased in ranking as an oil exporter to China, supplying almost 12% of total imports in 2011 versus the 5.9% in 1995. China has also purchased an oil field in Angola. Similar to Iranian and Saudi Arabian supply, Angola’s supply must also be shipped. (Lai 2007:525p)

**Russia:** Due to disruptions through sea transportation, China is more and more looking towards Central Asia. China and Russia have been working on forging stringier ties and it has
seen an impact on oil trade with Russia’s share increasing from 0.2% in 1995 (Ibid: 523) to 7.7% in 2011 (USEIA 2012). It has also climbed the supplier’s ranking from being the 7th largest supplier in 2003 to the 4th largest in 2011. Most of these supplies were transported using railways apart from 2011 onwards with the completion of the spur from the ESPO pipeline.

Since the 1990s, the two countries have been in discussion over the construction of an oil pipeline to China. In 2004 the Chinese Premier Wen Jiabao promised to invest in the Russian energy sector and supporting Russia’s membership in the World Trade Organisation (WTO), in return of expanding oil exports and creation of the trans-Siberian pipeline. (Lai 2007: 526)

The creation of a direct trans-Siberian pipeline to China was overruled in favour of the ESPO pipeline going to the Pacific coast with a spur to China. This was partly motivated by Japanese interests. But, despite the competition, China had invested a total of USD 25 billion in Rosneft and Transneft in return for a 20 year oil supply deal. (Downs in Bellaqua 2010:147)

**Kazakhstan:** It is the 9th biggest oil supplier with a 4.4% import share in 2011. Kazakhstan and China have had an active energy relationship with China investing USD 3 billion for a pipeline running between the two countries. Chinese companies have also acquired stakes or mergers in Altobemunaigaz and PetroKazakhstan giving it access to substantial oil reserves. (Lai 2007:527)

As China is reliant on foreign supply, most of its major oil companies like Sinopec, CNPC, and CNOOC hold stakes or have acquired overseas resources and companies. Records dating back from 1993 show all the three companies above being involved around the globe. CNOOC has holdings in Australia, Indonesia, Canada, Africa, Norway and Qatar. Sinopec has holdings in South America, Canada and one each in Kazakhstan and Russia. CNPC has the largest portfolio with interests in South America, Africa, Middle East, Central Asia and one in Russia. (Bergsager :11p) China also has lent some energy backed loans (EBL) and predominantly in Central Asia, including Russia, and South America.

This overview shows that China imports various forms of energy, even though it has an abundant reserve of its main source, coal. Even though oil accounts for 19% (USEIA 2012) of its energy requirements and this sounds low, China is the second largest consumer and
importer of oil. Its oil imports are varied by country but are predominantly based in either the
Gulf or Africa, this means more than 75% of its imports are transported through sea ways
which is not ideal for China due to disruptions. Although china has many suppliers Saudi
Arabia, Angola and Iran are quite significant as they supply more than half of the total
imports. Apart from them Russia and Kazakhstan are emerging as important suppliers due to
their proximity and newly established pipelines. This foreign dependence has also seen China
diversify its energy holding around the world.

Bilateral Energy Trade

As mentioned earlier, Russia and China are a perfect fit on paper and despite stressing on the
low levels of energy trade, it has to be mentioned that they haven’t been absent. Russian
imports to China has steadily grown and significantly from the 0.2% of import share to 10%
in 2005 and 7.7% as off 2011. In terms of numbers this increase translates to 292,000 bbl/day
in 2007 compared to only 1000 bbl/day. (Downs in Bellacqua 2010:147)

Sino-Russian trade has always included oil, but it has only been post 2002 that its share of
total Russian exports reached double digits. Data shows that in 2008, oil accounted for 52%
of the total Russian exports to China. (Lotspeich in Ballacqua 2010:101) It has been evident
that energy trade captures the mutual interest of both the countries. One has it and the other
needs. And, this has been acknowledged by both the countries in their discussions of
constructing pipelines since the 1990s.

Before continuing further it must be established the price nature of energy trade, it averaged
around USD 14/bbl in 1998 which increased to over USD 72 in 2007 (Down:154) and around
USD 97/bbl at the time of writing. This fluctuation in price is a big factor in Russian and
Chinese discussions as the negotiating advantage can shift between the buyer and seller
depending on the price.

Discussions for both oil and gas pipelines were initiated by the Russians in the 1990s due to
the low oil prices, but then China was more concerned about stalling and gaining price
concessions as they had an advantage. Price hikes were not predicted and as Russia was
selling oil at the global price, it was in no hurry. Another hindrance was the investment costs
relating to the pipelines as the infrastructure was not already present and would mean more
capital involvement. (Downs in Bellacqua 2010:154) Even though China was no longer self-
sufficient on its domestic oil production, it was not too concerned with gas supplies as it could not absorb levels imported through pipelines in the 90s and has only recently started to import gas (Ibid). Russia had interestingly also offered a 10% stake in Russian Petroleum to CNPC, but was turned down as Russia was thought of as a risky investment and eventually was bought by BP instead. (Ibid)

This relaxed attitude of China towards securing energy suppliers was reversed with increasing oil prices, but by then Russia’s interests started to wane as its resource nationalism started growing and a thriving market in Europe. This price increase changed the market to a seller’s from a buyer’s. This made it harder for China gain leverage on price concessions. (Ibid:155) Also, with time Russia was losing interest in the initial pipeline proposal of Angarsk-Daqing that would connect the two countries. Although it is argued that this pipeline is economically more viable, cheaper, logistically sound and better capacity, Russia wanted a longer pipeline to Nahkodka giving it access to the Pacific coast along with Japan and South Korea (Lo 2004:303). This is partly due to its experience with Turkey and its leverage with the Blue Stream pipeline as it was the primary recipient and did not want the same with China’s aggressive price negotiations (Ibid). Another reason for the change of heart is credited to the fact that the main beneficiary of the first proposal would be Yukos, the largest private oil company before its collapse, and this was not appreciated as they wanted tighter government control over its resources. (Downs in Bellacqua 2010:155) And, finally Japanese lobbying and financing was the nail in the coffin for the Angarsk proposal (Ibid:152). Therefore the ESPO pipeline was selected to be built to its eastern coast with a spur of .3 million bbl/day capacity linking it to China. China then provided USD 25 billion to Rosneft and Transneft soft loans with favourable interest rates in return for a 20 year supply deal. Although the pipeline is being built in stages, the Daqing spur opened in January 2011 and has been operational since.

The new pipeline creates better infrastructure for energy trade compared to railways, which was expensive and disruptable, therefore gave no advantage over the sea transportation by China’s biggest suppliers. Despite this supply still has been relatively low, translating into 395,000 bbl/day in 2011 compared to Saudi Arabia’s 1 million bbl/day in the same period. (USEIA 2012)
As for gas pipelines negotiations are on-going and a 4000km pipeline has been proposed, which could supply China with 20 bcm/year and 10 bcm to South Korea. (Holtom et al 2011:33) But, similarly price negotiations have held back progress. China has been adamant in prices matching its domestic coal prices, which are 40% cheaper than what the European customers for the same gas. (Downs in Bellacqua 2010: ) China has also been able to diversify its gas source by importing from Australia, Qatar and Central Asian countries, giving it further advantage.

Therefore even though energy trade has become a large part of Sino-Russian bilateral trade, it can be seen as a mere natural increase matching international trends. Russia for a long time tried pursuing an oil pipeline but due the missed opportunity relevant infrastructure has not been developed until recently. This has heavily contributed to the low energy trade as the only alternate is railways, which does not hold too many advantages over seaways as it is equally unreliable and disruptable.

Above I have briefly described the existing trade status between the two countries to bring to context the biggest factors. But, below will be discussing these factors. First we will be describing them in depth and then discuss them in conjuncture with the theory of choice.

**Analysis**

**Prices**

Price negotiations have been a constant factor in both oil and gas deals and have hindered progress. China has constantly asked for price concessions and has offered up to 40% lower than what Russia receives from its European consumers.(Downs in Bellacqua 2010:156) China maintains to follow a pricing model tied to its coal prices as it argues Russia has lower costs in dealing with China, whereas Russia insists on prices tied to oil and similar to the ones paid by its European customers.(Bersager 2012:8)

Prior to the pipelines, rail and sea transportation of oil to China were the only alternatives but were viable only when prices were high as railways costs Russian suppliers three times as much as pipelines (Downs in Bellacqua 2010:152) Therefore from the Russian side, trading with China make most sense when global prices are high because it would not be feasible to divert European bound oil to China when European customers paid more and was easier and
cheaper to transport the oil. Whereas the high transportation cost and little concession on prices do not make Russian supply any more attractive to the Chinese than Gulf or African sources.

Taking everything as equal, this poses as a problem loop because if neither party is willing to compromise on price, then Russian companies will not be able to trade and raise capital for infrastructure investment and without proper infrastructure it would not be able to provide China with cheaper prices. (Holtom 2012:35)

Even with completed deals, price issues have still crept up. Two months after the ESPO spur completion, Rosneft accused China of unilaterally cutting prices and threatened it with legal action (Holtom et al 2011:31). This exposes fundamental differences between the two as Russia is used to steady and high prices from its European customers while China expects preferential treatment and puts long term commitments under strain when global prices fluctuate. Such fluctuation can make China rethink its USD 25 billion investments in Russian oil and Russia might be unwilling to trade if the ESPO blend’s price falls relative to the European rates. (Holtom et al 2011:31)

From Copeland’s perspective this brings in a major issue of reliability. The price modelling of the two countries seem incompatible to a large degree, therefore even after the completion of deals price fluctuation can put long term deals under stress. As both the countries are not completely reliant on each other and represent only a fraction of total import/exports, they are more likely to back out or want to change deals. This is addressed in the mistrust sub-section below, but simply put it brings in reliability issues in long term deals. Such insecurity heavily impacts trade expectations. Copeland’s theory is fundamentally rooted in the argument that foreseeable stable long-term deals are essential to peaceful dependant trading, but due to the insecurity brought in by the price pressure such trade security is hard to achieve.

This volatile nature of the oil market combined with aggressive price negotiations can partly explain why oil trade values between the two have been so low, and lagging behind other partners, in the past two decades. This is especially so with older infrastructure and prior to the 2011 opening of the pipeline. The railways simply did not add any advantage in trading, instead increased costs, which was core to the issue of negotiating deals.
China’s demand for lower prices also has an effect on the perceived dependence level for Russia. Since, China is a net importer of oil, any increase in supply helps affect its dependence level positively, especially with its large number of suppliers. But, for Russia, exports to China require investments in infrastructure, possibility of disrupting European supplies and accepting lower prices. These all seem to have a negative impact on Russia’s dependence level with China.

If we say that Russia starts with 110 units and then gains 20 units for trading with China, but loses 5 units in European sales and loses 2 units due to lower prices. Therefore the total dependence level would be 27 units, so if they trade Russia could be enjoying a surplus of 13 units adding to 123 units in total, but severing of trade would lead to Russia losing 25 units and bringing its total value post severing to 85 units. Of course, during trading the surplus is beneficial for Russia but the opportunity cost is also quite high. And with a risky dependence level, low trade expectations cannot further trade. Although this is just a simple illustration and the values are speculative, they are inspired by the data. This can serve as additional reasoning behind low trade during 1993-2012.

**Other Customers/Suppliers**

Another dimension that is forgotten in the discussion is the existence of other customers and suppliers. It has already been detailed above the various sources both Russia and China have as energy partners apart from each other. Although in a country breakdown Germany leads the charts while China features as Russia’s 3rd largest energy partner and Russia is China’s 4th largest supplier in 2011-2012. These rankings do look promising but the cumulative supply to Europe comprises of 84% of the total Russia oil exports, where as China accounts for roughly 6% of the same share. A similar pattern is seen with Chinese imports that get the bulk of it from the Gulf and Africa and the Russian contribution accounts for only about 7.7%. (USEIA 2012)

The presence of so many suppliers and consumers can also been seen as a hindrance, especially for Russia due to capacity and infrastructure limits combined with long term commitments making it harder to commit higher supplies to China. Although China still would like oil from Russia, they have better investments and long term partnership with countries like Iran and Angola, which makes it easier to obtain larger volumes due to the established relationship and infrastructure towards China.
Gas is a bit different because although Russia supplies Europe with gas, it is dominated by
Germany, United Kingdom, France, Italy and Turkey. (USEIA 2013) These means that
Russia has, by slightly, fewer clients to rely on and being European countries their
consumption has stagnated and may decrease due to efficiency reforms. (EuroStat 2012) The
other big consumer is Turkey, but Russia has a harder time extracting European level prices
as the Blue Stream pipeline makes it the primary consumer which means better leverage. (Lo
2004:303) With these elements in mind combined with Russia’s vast reserves, China is a
more attractive client when it comes to gas. But, again China has diversified its sources and
primarily from Australia, Iran and Qatar (Holtom 2012:35). It has also recently secured deals
with many of the central Asian countries, breaking Russia’s monopoly of gas supply in the
region. (Ibid) It has secured a 30bcm supply deal until 2030 with Turkmenistan, which is half
of China’s current demand. Another gas pipeline from Kazakhstan will be supplying China
with 5-10bcm of gas annually. In 2010, China secured Uzbekistan to supply it with 10bcm of
natural gas annually and expects 13bcm from China’s pipeline with Myanmar. (Ibid)
Meanwhile, the 2 agreed gas pipelines in 2006 still have not materialised or construction
started. All of these combined have decreased Russia’s advantage and currently China is
trying to take advantage of it by offering only USD 100 per 1000 cubic meters versus the
USD 350 that Europe pays. (Lo 2008:149)

Priority

Price
Another aspect of having such a large number of customers and suppliers is the importance of
each country. Russia has been an energy supplier to Europe for decades and has the
infrastructure in place to provide them and in return Russia enjoys high prices, or at least
market prices, for both oil and gas. Therefore, Europe is automatically favoured. Similar
competition is seen even with the ESPO blend prices as Japan, US, and South Korea which
buys 60% of the capacity at a USD 5 premium per barrel compared to China’s price. (RIA
2012) Thus, despite China’s demands of consuming the full capacity, even here other
countries are favoured due to profit incentives, and China’s reliability is not helped when

China also perceives that Russia prefers western companies and investments over Chinese
ones, due to its negative experiences when attempting to cooperate. This has lent to the
notion that Russia looks to China only when capital is required leading to unequal partnership. (Holtom et al. 2011:36)

The buyer vs seller market is another reason for priority unevenness. China is only attractive to Russia when prices are high, at least with the rail transportation being the only infrastructure. Whereas China would see cheaper prices as the main attraction because otherwise it would be comparable to its existing suppliers further away.

*Gas vs Oil*

Due to Russia’s commitments in Europe it is harder for it commit to higher volumes of oil to China, but because of stagnating gas demands in Europe Russia wants to diversify quickly. This is seen in Russia’s attempt at pushing gas to China more than oil. One can see the priority mismatch when China wants to buy oil, Russia wants to sell it gas (Lo 2008:134) This is another hindrance and a clear sign that Russia can supply gas, but oil may be harder.

The European consumer base is quite large and profitable but it also makes Russia more dependent on it. If we take the previous example of dependence, we take Russia’s current level at 110 units with European trading, but the infrastructure (10) and trade account (20) for 30 units. So if Europe stops trading with Russia, it will decrease to 80 units and the entire infrastructure will be useless even though Russia could make up the European trading units (20) by trading with Asia or shipping exports. This would further mean more investments. This dependence with Europe exhibits Russia’s inability to alienate Europe and the importance to keep it satisfied. Of course the above is an extreme scenario, and trading with China will not result to such extreme consequences, but Russia will have to be able to trade with China without disrupting European supplies, which some experts doubt (see infrastructure sub-section). This dependence and the importance of it, also acts as an indicator for China to understand trade expectations from Russia. Due to the importance of supply to Europe being so high, and doubts over Russia’s supply capacity, trade expectations for China automatically are not too positive.

Adding to this argument are the factors of price and resource capacity. As highlighted above, it is favourable for Russia to supply Europe, Japan, the U.S and South Korea over China due to its profitability. And, Russia is already showing signs of its capacity by trying to push gas than oil to China, exposing further weakness in trade expectations for China.
With such high levels of dependence on Europe and questionable capacity of Russia, the low trade expectation for oil trade with China is evident. With Copeland arguing for strong trade expectation for trade to occur, the low trade levels between 1993 and 2012 can be explained by the dim trade expectation between Russia and China due to Europe’s importance.

**Mutual Misunderstanding and Mistrust**

There is a large gap between business practices between the Chinese and the Russians. One of the most evident examples is China’s willingness to construct pipelines without supply deals and its expectation of Russia to do the same. Just as China started constructing the West-East Natural Gas pipeline and Kazakhstan-China oil pipeline without firm supply deals, it was comfortable constructing the spur to the ESPO pipeline before the deal was finalised while Rosneft insisted on finalising the deal before any construction began. (Downs in Bellacqua 2010:163)

Apart from business practices, there is a larger weariness over decision making in the Russian energy market. This is captured in the following quote by Zhang Guobao, the Vice-Minister of National Development and Reform Commission “One moment Russia is saying they have made a decision, the next saying that no decision has been made. To date, there has been no correct information...just like weather forecasts” (Lo 2008:132) and further goes on to say “We don’t know who can make decisions” (Downs in Bellacqua 2010:163) This opaqueness combined with inaccessibility through FDI foster misunderstandings among the two countries. Such uncertainty is not helped by the perception that Russia takes part in “legal nihilism” (Holtom 2012:32) and that “Russia always finds all kinds of ways to terminate or alter contracts and change laws unexpectedly” (Ibid) Such lack of transparency is a major obstacle to Chinese cooperation in Russia. (Ibid)

Upstream investments in foreign supply helps China be secure about its supply as well as profit from it, like it has done primarily in Latin America and Africa as well as Iran and Saudi Arabia. The bureaucratic obstacles to upstream investments in Russia have proven to be quite strong on previous attempts. Previous unpleasant experience has fuelled Chinese beliefs that the Russian energy market is restrictive and tightly controlled.
In 2002, CNPC tried to gain controlling shares in Slavneft, a Russian oil company, but failed because parliamentarians thought of it to be against national interest. Despite offering USD 3 billion for 74.59%, it was unable to buy stakes and eventually the company was sold to a Russian company for just USD 1.86 Billion. (Downs in Bellacqua 2010:162p) Sinopec’s cooperation with Yukos, once the largest private oil company, was disrupted when it was charged with fraud and later collapsed. This was seen as the Government targeting the private company as it was a threat to the state run companies (Lo 2008:144). Rosneft and Sinopec’s joint exploration of Sakhalin ended with Sinopec’s withdrawal in 2005 after it used millions to no avail. (Holton et al 2011:37) China-Rus Energy Investment Limited had gained 51% stake in Suntarneftegaz that held exploration licenses in East Siberia, but even this venture came to a screeching halt when a rival company charged it with fraud and exposed that its licenses were terminated. (Holton et al 2011:37)

Such experiences make it harder for the Chinese to understand the process in Russia and the reliability of the industry. In some cases, it also affects the morale and questions the nature of the partnership. This is seen in Chinese analysts perception of Russia “Russian energy companies are only willing to cooperate when they need capital” (Ibid:36). This has also brought up beliefs that Chinese companies and their investments are not as prioritised as the ones from Western companies (Ibid:32)

The opaqueness of the Russian energy sector makes it hard for the Chinese to gauge the processes and its progress. The pipeline deal was largely delayed by due to the government decision making, apart from price negotiations. But, frustrations over the pipeline can be seen from the Chinese perspective in the quote mentioned above. Such difficulty in measuring supply and the progress of it makes it hard for consumer to be secure about long term supply. The same plagues China’s understanding of trade expectations from Russia. In addition to this, the difficulty of Chinese companies to get involved in the upstream activities, through FDI, like drilling and exploration blinds Chinese understanding further. To begin with the Russian decision making is unclear, on top of that the Chinese are unable to join the process which makes measuring the trade expectation much harder.

Copeland mentions that trade expectations are important even when trade is low or non-existent, as it can foster future partnerships. Apart from hindering progress in the last two
decades, this opaqueness makes China question long term deals in the future with Russia as it is insecure about them.

The tight control over the energy market and difficulties of Chinese companies getting involved also has its effects on the possible dependence level. To illustrate this, we assume China starts with a 100 units before trading with Russia. Trade brings in 10 units of benefit to China, but if it also controlled upstream assets, then China would be able to gain an additional 5 units of gain. This investment in upstream activities help China secure trade expectations as well as help efficiency and explorations, which may lead to an additional surplus of 5 units. Therefore, China would gain 20 units if it was allowed to participate in upstream activities along with trading, but since it has had such difficulties in the past 2 decades the trading benefit remains only 10 units. We can compare this to the situation in Angola, China’s 2nd largest oil source, where apart from gaining 10 units from trading China also has investments gaining it the same 10 units. Thus, the total gain with Angola is 20 units compared to Russia’s 10 units.

Thus the above is a clear example that Russia’s closed energy market hinders China’s possibility of a higher surplus and the opaqueness makes securing trade expectations harder. Therefore, in comparison with a supplier like Angola or Iran, Russia might not seem as attractive from Copeland’s perspective.

**Infrastructure**

Despite vast energy reserves Russia is unable to properly serve to Asia due to the lack of proper infrastructure. Apart from pipelines, railroads are the only alternative, but they drive up costs by 3 times of pipeline transportation costs. Russia has 9 pipelines, but only one towards the pacific. This lack of cost efficient infrastructure has been a major hindrance to supplying Asia and China with more oil. As off 2011, Asia accounted for only 18% of Russia’s total energy exports. (USEIA 2013)

But, apart from the transportation constraints, experts also question the capacity of Russian fields. Even though the West Siberian fields are explored and vast, they are mostly geared towards Europe, therefore more explorations in the eastern region must be conducted. But, it is supposed to come at the cost of USD 8.5 billion. (Holtom 2012:31) Experts say that Russia will not be able to increase its supply to China by large margins without putting
European supply at risk, if it does not explore the eastern fields. (ibid) New exploration and equipment is expensive and requires large capital invests that Russia is does not have or is unwilling to dispense of. (Ibid:35) The unprofitability can be seen in the cost of drilling in certain parts of Russia where it costs Exxon Mobil as much as USD 26.94/bbl where as it drills for as little as USD 3.74/bbl in other parts of Asia. (Bloomberg 2013) Moreover, there haven’t been any new oil fields discovered in the past decade (Downs in Bellacqua 2010:150)

Also, as highlighted above due to FDI constraints in the energy sector foreign technology and capital needed to carry out such explorations is limited, thus bringing further questions about Russia’s capability of harnessing its vast energy resources. (Holton 2012:31)

Although Russia is the second largest oil producer, many have questioned its capacity and the availability of cost-efficient fields. Even though some unexplored fields exist the investment needed and the high costs of drilling are seen as obstacles to increased capacity, anytime soon. This is a clear negative impact on trade expectations for China. With speculation of limited capacity and Sinopec’s experience with unfruitful explorations, the perceived trade expectations from China will be low. This again argues for why the trade levels have been low but also contributes to China’s future intentions with Russian supply.

**Oil as Foreign Policy**

Russia’s immense energy sources help economically but due to the tight government control also helps in foreign policy matters and power projection. (Lo 2008:138p) Putin has already outlined his vision for Russia to be an energy super power and not just a supplier. This brings us to the first concern of Russia. It does not want to be seen as an energy appendage, either to Europe or China (Downs in Bellacqua 2010:160) But, with 84% reliance on Europe it wants to use its resources for closer ties than just a supplier. Similar thought plagues Russia’s involvement in China, and therefore it is weary of being dependant on Chinese consumption as its economic growth can eclipse Russian standing. This can be seen Russia’s choice in the ESPO route to gain access to Japan and South Korea and not be completely tied to China. The choosing of the ESPO route was also seen as leverage in better ties with the Japanese, although that did not seem to bear fruit. (Lo 2008: 144) Thus, Russia’s greater ambitions, marginally, influence its choice of consumers and not necessarily on market forces.
Russia’s use of its energy as power projection instils a sense of unreliability. Mostly caused by the disputes with Ukraine from 2005-2009 and the disruptions caused by it. Even though the disputes were financial, it is believed that Russia tried to use the opportunity to project power. (Lo 2008: 139p) This dual nature of the resource comes as a worrying factor for dependant countries on its reliability.

With growing importance of energy, Russia has also started showing signs of resources nationalism (Downs in Bellacqua 2010:160). Its liberalised market post-soviet collapse has been steadily turned into a tightly controlled sector. The largest private oil company, Yukos, was said to have been a target of the government and collapsed in 2004 under fraud charges. Since, then most of the energy trade is controlled by the state monopolies- Rosneft, Transneft and Gazprom. This nationalism has also brought in the above concerns over being an energy appendage and also fuelling China’s threatening growth.

Furthermore, due to Russia’s reliance on European consumers it needs to diversify its demands and sees ample opportunity in China in doing so. Having China as a stable customer can ensure leverage in negotiations with European consumers. But, this also adds additional pressure with political consequences if China were to be actively or passively involved in such a situation. Questionable reliability combined with the possibility of getting caught in between Russian and European conflicts could be an additional explanation to China’s hesitance in dependant energy trade with Russia, explaining the low import levels.

Russia’s use of energy as more than a commodity brings in reliability concerns. The same concerns were flagged during the disruptions caused by disputes with Russia. Treating oil as a foreign policy tool also has its effect on decision such as the construction of the ESPO pipeline, rather than the direct one. This choice compromised with the long term supply and capacity of supply to China. If Russia is expected to account for more variables than price and supply, it makes it slightly unreliable to consumers.

This unreliability brought in by resource nationalism affects trade expectations negatively for China as it is also dependent on the surrounding countries and Russia’s foreign policy decisions. This in part can explain the absence of high volume trade between 1993 and 2012.
Discussion

Therefore, we can see that the sections above have detailed the possible obstacles to increased trade during 1993-2012, and with some theoretical context. From the history and the analysis, it is clear that price has been a large factor in creating a volatile partnership. Price has acted as an obstacle to sealing deals as well as straining it after completion. The market volatility combined with constant Chinese requests for concessions have strained relationships. The gas and oil pipeline delays, at least in the beginning, can be credited to unreasonable Chinese demands for price. This has created heavy unreliability over long term deals, affecting trade expectations and decreasing Russian motivation for cooperation. The issues stemming from prices are magnified by the lack of infrastructure geared for China. Throughout most of 1993-2012 railways has been the only mode of transportation, until the pipeline in 2011. This has meant that the cost of transportation has remained high, making it viable to trade only when the global oil prices are high. This is seen in 2005 when oil prices shot up to USD 51.7/bbl, this is also the same year when Russian share of imports was the highest (11%). Such an unstable incentive to trade has not been fruitful in the last two decades, as the interest of the seller is in direct conflict with the buyer’s interests. It is also a paradoxical situation because the prices can only be lowered though investment in infrastructure, but without the extra income from sales to China these investments cannot be made.

Trade expectations have been further damaged by the absence in recent and cost effective explorations. As most of the West Siberian fields have been explored and supply Europe, more exploration needs to be done in the Russian Far East to be able to supply China and the Pacific Coast. Such explorations have been thought too expensive without investment in equipment, which Russian companies do not have the capital for. Thus, the European market seemed to be the most convenient one between 1993 and 2012. This lack of motivation on the Russian’s part damaged the trade expectations for a long term supply to China making it look to other suppliers.

Mistrust has emerged as another big factor in negative trade expectations. The Russian energy sector is hard to understand, foreign companies have had a hard time entering and cooperating and the process of decision making is blurred. The same issues have plagued Chinese attempts at increased cooperation as they had poor experience with attempts to
cooperate, decision making saw unclear and did not know where to get their answers and at times felt used by the Russians. Trust and reliability is a significant part of Copeland’s theory but if China is unable to measure and decipher Russia, it puts its trade expectations at risk. The closed Russian energy sector made it hard for China to understand and trust it leading to explore venues elsewhere.

Long term supply possibility for China has been hampered by Russian dependence on Europe. This large dependence takes a lion’s share of Russian production making it hard for Russia to diversify its demand. Even though it is in its interests, diversification means more commitments and investments which are inconvenient when compared to its current status. Europe being a more stable and high source of revenue, it is harder for Russia to diversify too much without risking its relations with its primary consumer. This automatically decreases the trade expectations for China and thus hindering the furthering of their energy trade in the period of 1993-2012.

Finally, Russia’s treatment of oil as a tool of power projection and foreign policy affects trade expectation and dependence unreliable and risky. Russia does not treat energy as a commodity, which made China question its reliability. This was seen in Russia’s choice of building the ESPO pipeline despite discussions of a direct pipeline, as well as the disruptions caused by dispute with Ukraine. Such a move discredited Russia’s ability to supply it energy without considering its foreign policy.

**Conclusion**

In conclusion, I have identified the major obstacles to increased trade to be the following and in order of importance. – Price, Infrastructure, Mistrust, Other Consumers/Suppliers and the use of Oil as Foreign Policy by Russia. These obstacles have all shown a contribution to trade expectations and dependence level. Despite being hindrances to trade in general they have been able to explain the low levels of trade in conjuncture with Copeland’s theory of trade expectations. The Sino-Russian case in itself is quite compatible with the realist and liberal argumentation implemented in Copeland’s perspective. As the project set out to do, it is quite evident now that the Sino-Russian energy trade has not only been stifled by economic reasoning but also political behaviour. Price and Infrastructure have been the biggest contributor to the hindrances, but lack of political will has not helped resolve these problems.
While liberal arguments account for the price and infrastructure, realist approach to mistrust, power projection and dependence also provide insight.

From Copeland’s perspective Russia does not project positive trade expectations for China due to its large dependence on Europe, but simultaneously China’s price bargaining reduces the foreseeable gains for trading with China, which makes it more risky due to the European factor. Russia can also be seen to believe that Chinese dependence is risky, same as Turkey, in its move not to create a direct link or expanding exploration and production for it. Russia was observed to have wanted to tap the Chinese market in the 1990s when the prices were low, but since then it has found Europe more convenient. Also, China’s large number of suppliers makes dependence with China more risky, as the initial costs and opportunity are quite high. But besides these, Russian trade expectation for China seem quite low as doubts over supply, resource nationalism and power project through oil did not instil much confidence in China’s expectations from Russia during 1993-2012.

After Thoughts

This project is limited with resources and page limitations, but the subject area still remains fascinating. Even though the project is satisfactory further exploration in this relationship has potential. The period from 1993-2012 has been interesting and trade expectations can clearly been seen at play here, but the future is even more interesting. The chosen period had some major blockades such as price, infrastructure and European dependence, which makes the analysis more clear cut. With the new developments in infrastructure, it might be interesting to speculate if it will have a positive effect on further cooperation. With some infrastructure in place, European demands stagnating, and China’s gas needs rising, Copeland’s theory has large potential in this area.

Russia’s use of energy as foreign policy was seen at play the day before project submission when it offered Ukraine a partnership agreement to counter closeness with EU. In the agreement, apart from financial benefits, Russia offered to discount its gas prices by a third. Apart from this gas and oil deals were made in October 2013 between Russia and China. Therefore, the future marks a new scenario which is markedly different from the one analysed in this project. This opens up larger scope for research and even different results if this investigation were to be repeated in the future.
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