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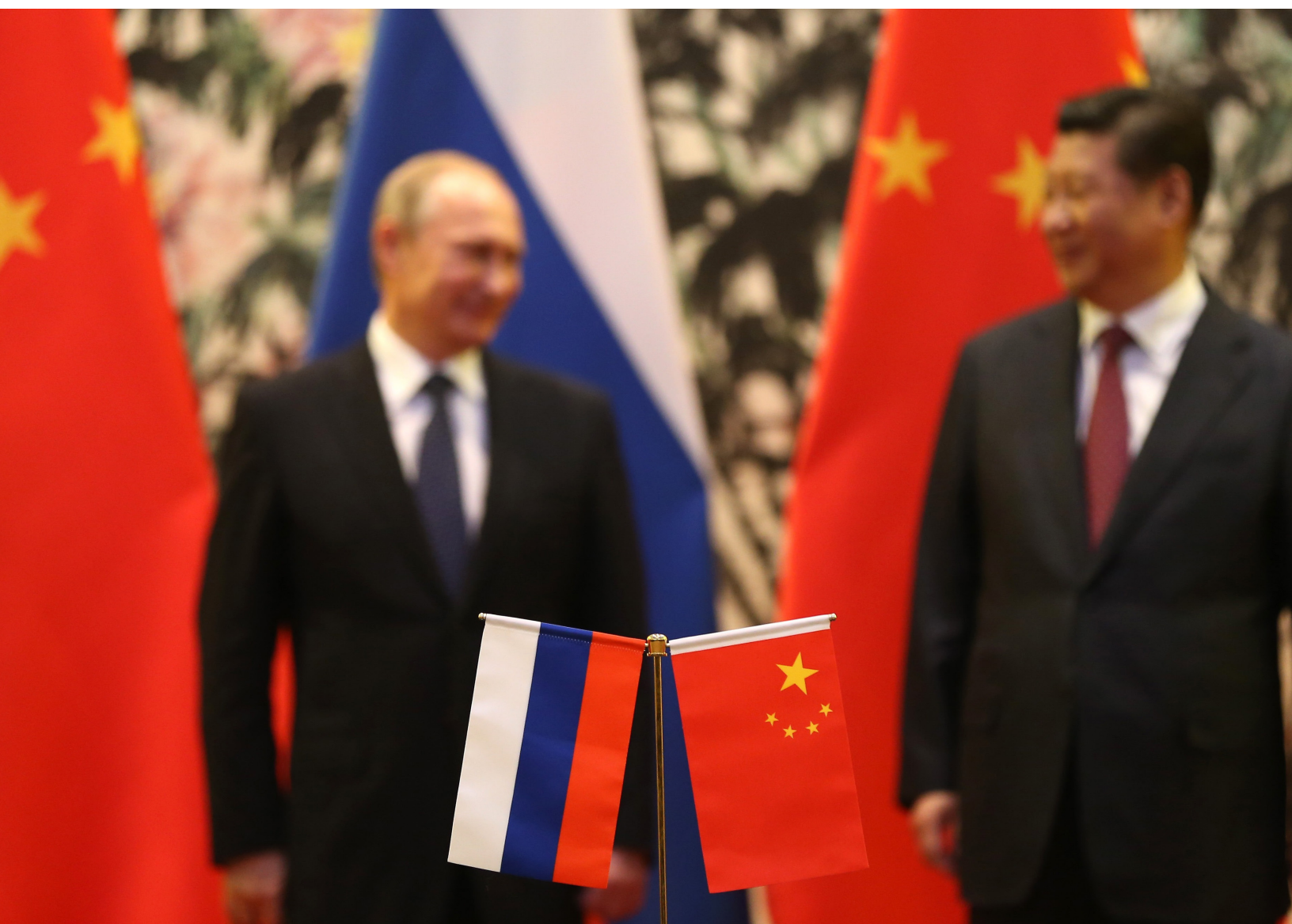
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The Russia-China Gas Deal and the Eurasian Balance of Power

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About the Author

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The author is writing in his independent capacity and the views and opinions expressed in this paper are solely his own.

EXECUTIVE SUMMARY

The \$400 billion natural gas agreement concluded by Russia and China in May 2014 was hailed by both countries' leaders as a game-changing development in international affairs. Many Russian and Chinese analysts also seized upon the deal as evidence of an emerging Sino-Russian partnership set to challenge the U.S.-led global order. Is the gas deal part of a broader shift in Russia-China relations and the global balance of power? Are the two countries ready to construct a formidable alliance to challenge the United States and Europe? Or should the agreement be viewed in simpler economic terms?

The gas deal is the latest in a series of political, economic, and military developments between the two countries over more than two decades that illustrates a stronger and more integrated Russia-China relationship. However, the evolution of the Russia-China relationship over the past quarter of a century has been marked by as many policy failures as successes. Economic ties are not as deep as they could be and continue to be dominated by Russian raw materials exports to China. Diplomatic relations are also characterized by a grandiose rhetoric that overstates the progress made between the two countries and undersells underlying cultural and political differences. Complications continue to surround the implementation of the May 2014 gas deal, reflecting these dynamics as well as wider political and economic events that have transformed the global energy landscape since the gas deal was concluded.

This Policy Report finds that the Russia-China gas deal is a significant strategic development but not a game-changer in Russia-China relations or in the global geopolitical environment. A review of modern Russia-China relations, and a detailed assessment of the gas deal, illustrate that economics are still the main driver in relations for both countries. However, the volume of bilateral trade has actually fallen in 2015, a symptom of an economic slowdown in China and a collapse in global energy prices that threatens the long-term viability of energy cooperation and even the gas deal itself. Should the gas deal ever be fully implemented, Russia would continue to export the vast majority of its oil and gas to Europe, while China's flexible energy policy means that it has developed a range of options across the Asia-Pacific. Rather than a bold strategic transformation in Russia-China ties, the gas deal and its sputtering implementation reflect more closely modern economic and political realities, as well as the delicate and complex nature of modern Russia-China relations.

The United States and Europe should not overreact to the hyperbolic rhetoric which characterizes high-level Russia-China ties and which continues to surround the May 2014 gas deal. Instead, U.S. and EU policymakers must take clear steps to redress the balance-of-power in Eurasia, notably by reducing the EU's dependence on Russian energy. The two countries should keep a watchful eye on relations between Moscow and Beijing. However, they should also be reassured that the Russia-China relationship seems to be creating as many problems as solutions. A little more than a year after the gas agreement was signed to so much fanfare, the case for the deal – and the Russia-China alliance for that matter – looks less and less compelling.

INTRODUCTION

The \$400 billion natural gas agreement concluded by Russia and China in May 2014 was hailed by both countries as a game-changing development in bilateral relations and in international affairs. Described as an “epochal event” by Russian President Vladimir Putin,¹ and “as an important achievement in strengthening the...China-Russia comprehensive strategic cooperative partnership”² by China’s Foreign Ministry, the deal outlined plans for a newly-constructed pipeline from Eastern Siberia to China that would deliver 38 billion cubic meters (bcm) of gas each year when fully operational. Many Russian and Chinese analysts seized upon the deal as concrete evidence of an emerging Sino-Russian partnership set to challenge the established U.S.-led order.³

Moscow and Beijing then announced in November 2014 a non-binding agreement for an additional pipeline from Western Siberia that aimed to deliver further gas to China.⁴ Construction for the Eastern pipeline began in June 2015.⁵ It remains to be seen whether the two countries will be able to come to a formal agreement for the second pipeline, although accounts in the media reported that China had put discussions on hold in 2015 due to pricing concerns and a slowdown in demand for natural gas in China.⁶

The May 2014 gas deal, coming at a time when relations between Russia and the West are at a post-Cold War ebb as a result of the ongoing crisis in Ukraine, seemingly demonstrates that Beijing and Moscow are closer partners than ever. Russia now views China as its “reliable friend” and “undoubtedly [its] diplomatic priority,”⁷ according to Russian President Vladimir Putin. China, for its part, is becoming more self-confident on the international stage as it adjusts to its new role as a global superpower and is increasingly contesting U.S. leadership in a host of areas.

Are these developments part of a strategic shift in Sino-Russian relations and the global balance of power? Could Russia and China be ready to construct a formidable alliance to challenge the United States and Europe? Or should we view the agreement in simpler economic terms? The commodity export-driven Russian economy faces a number of structural challenges, exacerbated by the collapse of the global oil price in late 2014 and the deterioration of its relations with the West. Is Moscow, in moving away from Europe and looking east to China and a rising Asia, making a bold but necessary move to lock in Russia’s future prosperity? For China, meanwhile, the deal should in theory help to meet the voracious energy needs that fuel its economic development. But does a closer relationship with Russia benefit or hinder Beijing? Do the economic drivers of the deal line up for either country?

This Policy Report finds that the Russia-China natural gas deal is a significant strategic development but not a game-changer in either Russia-China relations or the global geopolitical environment. The deal is the latest in a series of political, economic, and military developments between the two countries over more than two decades that illustrate a stronger and more integrated Russia-China relationship. But of far greater significance than the agreement to the global energy landscape and to international relations has been the collapse in energy prices and the slowing energy demand from China that has transformed the landscape since the gas deal was concluded. Rather than a bold strategic transformation, the ongoing difficulties surrounding implementation of the gas deal reflect more closely these seismic changes, as well as the delicate and complex nature of modern Russia-China relations.

The Russia-China relationship isn’t a full-fledged alliance and is unlikely to become one. Fundamental limitations in Russia-China relations make the two countries ill-fitting strategic partners. China’s power and influence now significantly outranks its Russian counterpart. The gas deal and Russia’s growing role as a supplier state to China have merely exacerbated this trend and the country’s growing inferiority complex with China that accompanies it. Competition between the two countries for power and resources in Central

Asia, Moscow's increased isolationism, the precarious state of Russia's economy, the volatile global energy landscape, and a host of other internal and external challenges for both countries mean that Russia and China face a difficult challenge in navigating a bilateral relationship based on cooperation, not conflict.

The United States and Europe must remain attentive to developments in relations between Russia and China. However, they should also react sensibly. The Russia-China partnership seems to be creating as many challenges for both countries as it is common solutions. Meanwhile, the collapse of the global oil price has demonstrated that Russia's foreign policy options are severely limited. The United States and the EU must instead initiate strong policy initiatives to improve their balance of power positions, notably by redressing Europe's energy relationship with Russia which currently constrains a strong European foreign policy, and strengthening the transatlantic partnership to promote global stability.

This report first provides a brief overview of the evolution of the Russia-China relationship since 1991, examining cooperation in diplomatic, economic, and military relations. It then utilizes this historical context to provide an assessment of the May 2014 gas deal, as well as the policy implications for the United States and Europe.

OVERVIEW OF RUSSIA-CHINA RELATIONS IN THE POST-COLD WAR ERA

The evolution of the Russia-China relationship over the past quarter of a century has been marked by as many policy failures as successes. The Russia-China gas deal is the most recent and most high-profile in a series of energy agreements that have formed the cornerstone of the two countries' developing relationship since 1991. Nevertheless, comprehensive bilateral energy cooperation has still not been achieved, while the two countries have mostly failed to expand economic cooperation into other areas. China's rapid growth during this period also means that its size and influence looms increasingly large over its neighbor, even more so as Russia's economy faces a period of sustained decline. High-level diplomatic ties have gone from strength-to-strength under successive administrations, but disguise wider historical, cultural, and political differences that in the future may supersede these achievements. While the two countries have also improved understanding among the two countries' militaries, both countries retain their own distinct security interests which preclude a closer strategic relationship. Despite specific and tangible advances in the past 25 years, the uneven evolution and complex nature of modern relations mean that the long-term future of the Russia-China relationship remains uncertain.

Diplomatic Relations

The notion that a Russian president could today call China his country's "reliable friend" and "diplomatic priority" may have seemed fanciful in 1991. Bitter rivals throughout much of the Cold War, the fall of the Soviet Union did not make prospects for relations between the two countries more assured. The new Russian Federation was keen on integrating itself with the West, while China's transition was not yet guaranteed and its mistrustful leaders viewed Russia's embryonic state with some suspicion.⁸ However, both countries recognized that rebuilding bilateral ties could return a range of political and economic benefits. Cooperative efforts may have yielded only a small portion of the bilateral relationship's considerable potential. Nevertheless, in recent years the two countries' interests have begun to converge in some, though not all, areas, providing a more solid base for future ties.

China officially recognized the new Russian Federation on December 27, 1991, beginning a process of diplomatic activism by both countries. Several presidential delegations were led in the early 1990s by both sides, culminating in a "Strategic Partnership Agreement" in 1996 that pledged "a partnership of strategic coordination based on equality and mutual benefit and oriented toward the 21st century."⁹ The rhetoric of

this agreement was not matched by its substantive elements, which were relatively sparse. However, it did establish mechanisms for high-level consultation, including provisions for annual presidential meetings and the creation of a communication hotline between Moscow and Beijing.¹⁰

The agreement set the stage for closer government-to-government ties, later elevated with the bilateral “Treaty for Good Neighborliness, Friendship, and Cooperation” in 2001 that pledged extensive cooperation in energy and military affairs, and vowed to reshape the prevailing U.S.-oriented international order.¹¹ Meanwhile, the formation in 2001 of the Shanghai Cooperation Organization (SCO), a regional security group that recently accepted India and Pakistan as its latest members, deepened cooperation in areas such as counter-terrorism and border cooperation, and provided another vehicle to hedge against U.S. and Western norms and practices.¹² Other regional forums including ASEAN, the Asia-Pacific Economic Cooperation (APEC) forum, and the BRICS grouping have also broadened bilateral cooperation within the framework of Asia’s multilateral institutions.

As Russia’s hopes for integration with the West slowly faded during the 1990s and China became more active on the international stage, the two countries began to cooperate on specific international issues, usually in opposition to Western- or American-led military or diplomatic actions. During the 1990s, the two sides joined forces on issues including opposition to NATO’s intervention in Kosovo and U.S. missile defense plans.¹³ The U.S. invasion of Iraq in 2003 further united the two countries in opposition to perceived American expansionism. This trend continued under the Obama administration with Moscow and Beijing disapproving of various events including NATO’s 2011 intervention in Libya.¹⁴

Bilateral relations took on additional significance in the wake of the unfolding crisis in Ukraine that began in 2013. While not involving itself politically or militarily in Russia’s affairs, Beijing has tacitly endorsed Russia’s actions during the crisis by refusing to take sides in the conflict. Indeed, it has used the crisis to advance its national interest – seeking to deepen its economic and political cooperation with Russia and effectively diverting U.S. attention from the Asia-Pacific.¹⁵ As Moscow has sought to carve out a new role for itself in world affairs in defiance of the West, Beijing has often sided with Russia in various multilateral forums and voiced its support for a “multipolar” international order.

The current geopolitical environment, however, reflects the clear limits of Sino-Russian cooperation. With its weak and fragile economy, Russia is viewed by Beijing as a useful balancer in its relations with the United States, rather than a key player in the future of the international order.¹⁶ With the United States, meanwhile, China has called for a “new type of great power relations.” Beyond trade and investment, Beijing is aware of Washington’s military and diplomatic preponderance in Asia. Its leaders believe that the United States remains the key variable in their ambitions to realize President Xi’s “Chinese dream”¹⁷ to rejuvenate the country. In Russia’s case, it remains a Europe-centric power. While it has much to gain in deepening ties with Beijing, Moscow can ill afford to break away fully from the EU given its deep links with Europe and the precarious state of its economy – in spite of its recent behavior.

Economic Relations

Economic relations between Russia and China have been developed substantially in the post-Cold War era and include significant achievements to elevate trade and investment links. However, where significant cooperation has taken place, it has largely been confined to the energy sphere. Attempts to diversify the bilateral trade relationship have been largely unsuccessful, with Chinese acquisitions of Russian raw materials dominating the trade. China’s extraordinary economic rise during this period, Russia’s accompanied decline, and the wealth of energy options that Beijing now sources throughout the Asia-Pacific have handed Beijing considerable negotiating power. The increasingly unbalanced nature of economic relations could

have negative consequences for the long-term stability of Russia-China ties.

Going back to 1991, the Russian and Chinese economies were almost identical in size, and bilateral trade in that year was valued at a paltry \$3.9 billion. While both countries continued to prioritize relations with the West, they also recognized the value closer economic ties would bring and by 1997, trade value had already increased 50 percent from six years earlier.¹⁸ This trend continued with Russian exports to China soaring from \$5 billion in 2000 to over \$35 billion in 2012.¹⁹ Meanwhile, foreign direct investment (FDI) by Chinese companies in Russia increased forty times between 2004 and 2012 to \$4.9 billion.²⁰

Economic ties have developed predominantly in the energy sector, with Russia seeking to capitalize on rising global energy commodity prices and intensifying demand in Asia. It is no coincidence that Russian mineral fuel exports to China surged from seven percent of total exports to that country in 2000, up to 70 percent by 2012.²¹ Beyond oil and gas, China has also imported large amounts of Russian timber, while Moscow recently outlined plans to quadruple its current coal supply to China.²²

The trade volume between Russia and China touched \$90 billion in 2012, and Moscow and Beijing recently set an ambitious target of elevating the trade volume to \$200 billion by 2020.²³ However, an economic slowdown in both Russia and China in 2015 means that the two countries may struggle to meet even their current targets in the coming years. Bilateral trade reached only \$30 billion in the first six months of 2015, largely because of a reduced Chinese demand for Russian oil.²⁴ In any event, occasional headline-making agreements with China should not disguise the fact that energy and economic ties are unbalanced and overstated.

Russia's energy infrastructure continues to serve the European market, while China has developed a range of cheaper, more reliable energy options across the Asia-Pacific. Russian gas exports to the whole of Asia, for example, accounted for just seven percent of its total gas exports in 2010.²⁵ In the same year, China imported only six percent of its total oil imports from Russia.²⁶ Meanwhile, cooperation in other areas such as manufacturing has been almost non-existent.²⁷ Despite some advances, a poor investment climate in Russia has also restricted largescale Chinese investment in the country, notably in Russia's sparsely populated Far East which remains hostile to Chinese "infiltration."²⁸ FDI by Russian companies in China, meanwhile, has not been in meaningful evidence since 1991.

Moscow has spoken about the unbalanced nature of economic relations, with even President Putin expressing his concern in 2006 over the "raw material bias of Russian exports" to China.²⁹ Reliance on China to import its raw materials leaves Moscow hostage to Chinese demand and diminishes its leverage with Beijing. China's enormous size and heft – as early as 2003, China's economy today had grown to three times the size of the Russian economy, and continues to widen³⁰ – also puts Beijing in a dominant position in economic relations. China became Russia's largest individual trading partner in 2010 (although the EU collectively remains by far its largest), while Russia was only China's 14th largest trading partner, behind all the major global economies and many regional players.³¹

The dramatic collapse in the global oil price in 2014 has further debilitated Russia's economy and its balance-of-power position with respect to China and the world. Forecasts from the European Bank for Reconstruction and Development predict that Russia's economy will contract by around 4.5 percent in 2015 and a further 1.8 percent in 2016.³² This has had a knock-on effect on the value of the Russian rouble, with the country's currency having lost around 50 percent of its value since early 2014. Imports of goods, services and technologies have become more expensive, although the weak rouble has allowed some sectors, such as agriculture, to benefit from more competitive exports.³³ Meanwhile, multilateral sanctions imposed by Western countries in response to the Ukraine crisis have restricted Russian access to Western financing for infrastructure projects.³⁴ These developments place an additional and unrealistic burden on Russia-

China economic cooperation to revitalize the Russian economy. Indeed, if Russia is to deepen its economic partnership with China, it will increasingly have to do so on China's terms. As China's Vice President Li Yuanchao bluntly articulated on a visit to Moscow in May 2014: "You have the land and the resources, and we have the people and the money."³⁵

Finally, Russia and China also find themselves increasingly in competition over resources in Central Asia. Extraordinary Chinese energy cooperation with Central Asian countries in recent years has established it as a significant presence in the region and given Beijing strategic bandwidth in its quest for energy security. In 2012, Beijing's trade volumes with Central Asia were reported by Chinese media to have reached \$46 billion, a 100-fold increase since the region's independence from the Soviet Union a quarter of a century ago.³⁶ Politically, Beijing can extend significant leverage over countries in this region and has been able to negotiate lower prices for gas than those that Russia demands. Given Russia's interests in maintaining or expanding its sphere of influence, Central Asia is likely to be a key battleground for the two countries in the coming decades. As Russian political scientist Dmitri Trenin noted, "Chinese-led projects are changing the face of Eurasia more than anything since the days of Genghis Khan."³⁷

Military Relations

Developments in Russia-China military ties in the post-Cold War era have been tentative and illustrate the cautious evolution of the bilateral relationship. Russia has at various times sold China a range of weapons and helped to modernize China's military. The two countries have also integrated military-to-military ties and worked together on issues of common interest such as counter-terrorism. However, the two countries have made little progress in coordinating overall military doctrine and continue to guard their own military capabilities because of underlying suspicions over each other's long-term intentions.

These misgivings have their roots in history. Fractious relations between the Soviet Union and China during the Cold War brought the two countries to the brink of war in 1969. It was not until a high-level Chinese military delegation travelled to Moscow in 1990 that military ties were formally reestablished, as part of an overall normalizing of relations.³⁸ As part of these efforts, both countries sought to reduce mutual suspicion and instill military-to-military confidence, including by mutually reducing force numbers along the disputed Sino-Russian border and by establishing various mechanisms for high-level consultation.³⁹ Steady progress in military-to-military ties led to the first ever joint military exercises between the two countries in 2005. Further joint exercises have followed in subsequent years that have improved understanding and served as a useful display to the world of their respective capabilities.⁴⁰

The Russian government also identified an opportunity in the post-Cold War era to enhance its military export relationship with China. The country's greatly diminished military and its dire economic fortunes throughout the 1990s meant that Russia's arms industry had to become reliant on foreign contracts to survive.⁴¹ Moscow agreed to contracts with Beijing for advanced aircraft, submarines, weapons systems, and military applications throughout the decade, thereby playing a fundamental role in China's military modernization.⁴² However, Russian arms sales to China began to diminish in the early 2000s as Russia's sustained economic revival gave the Kremlin greater flexibility in its foreign policy. The rapidly enhanced capabilities of Beijing's military may also have revived the historic notion in Moscow of a China "threat" and forced Moscow to rethink its sales strategy. In addition, Russia developed concerns over Chinese "reverse engineering" of its weapons systems, with Beijing accused of acquiring Russian technology purely for research and development purposes.⁴³ While China retained a considerable interest in Russian military technology, it did not place a significant order between 2005 and 2011.⁴⁴ In 2012, however, Russia reversed its export strategy again.

Moscow has concluded several high-profile agreements with China since 2012, including the sale of aircraft and submarines, and its most advanced surface-to-air missile (SAM) defense system, the S-400.⁴⁵ Recent analysis of these sales has suggested they may form part of a concerted Russia-China military strategy aimed at impeding U.S. interests.⁴⁶ A more realistic explanation is that Moscow's options have been limited by its struggling economy, a view supported by the pattern above in which Russia has flip-flopped on its military export policy depending on the overall health of its economy.

Efforts to upgrade strategic cooperation have been similarly uneven. Russia and China have worked together to combat extremist threats in Asia, primarily through the SCO.⁴⁷ However, Russia retains its own regional security bloc, the Collective Security Treaty Organization (CSTO)⁴⁸ – which does not include China – as its preferred mechanism for cooperation in Eurasia, viewing the SCO largely as a vehicle for Chinese ambitions in Central Asia. The two countries have also retained their own distinct military doctrines throughout the post-Cold War period. In nuclear strategy, for example, Moscow has closely guarded its strategic force capabilities and plans in relations with Beijing because of concerns over its defenses against China.⁴⁹ Many of Russia's tactical nuclear weapons are indeed believed to be pointed at China.⁵⁰ Meanwhile, pledges in various treaties to work together to challenge the U.S.-led international order have yielded little meaningful collaboration.⁵¹

The absence of coordination in military strategy stands in contrast to both countries' independent efforts to modernize their militaries. Both countries seek an enhanced role in international affairs, but in pursuing these ambitions their interests are arguably more likely to collide than align. China's interests in expanding its influence in the Asia-Pacific is well documented, and it does not share Russia's proclivity toward open confrontation with the West. Meanwhile, Russia remains uncertain of Chinese intentions – similar to almost all countries in the Asia-Pacific. Strategic competition with China in Central Asia and Russia's ongoing role in helping to drive China's military modernization may exacerbate these fears. In any case, military cooperation between the two countries is likely to be governed in the long run by greater political and economic forces. Considering the power and resources of both countries' militaries, a deterioration in relations could have grave consequences for global stability.

THE 2014 RUSSIA-CHINA GAS DEAL: ONE YEAR ON

The natural gas agreement signed by Russia and China in May 2014 was seen by the two countries as a symbol of a remarkable transformation in bilateral relations in the post-Cold War era. However, the analysis of Russia-China relations above reveals the continued limitations of the bilateral relationship. Economic relations continue to drive the partnership, but these are dominated by Russian energy exports to China. Meanwhile, diplomatic ties are characterized by a hyperbolic rhetoric that overstates the progress that the two countries have made in developing their relations. The gas deal will not significantly affect the status of Russia-China relations or indeed the global economic environment. Russia will continue to export the vast majority of its oil and gas to Europe for the foreseeable future, while China has developed a range of energy options elsewhere that preclude it from relying on any one country. Events that have taken place since the gas deal was concluded, including a precipitous drop in the global oil price and economic slowdowns in both Russia and China, also mean that the gas deal looks far less appealing than in 2014.

Background

The May 2014 deal saw Russia's state-controlled energy giant Gazprom pledge to deliver up to 38 bcm of natural gas from Eastern Siberia to China for 30 years from 2019. The agreement was the product of ten years of negotiations that began in 2004, guided by the framework of an "Agreement of Strategic Cooperation" signed by China's state-owned CNPC and Gazprom in that year. Moscow and Beijing

identified two possible routes to deliver gas to China, from both Eastern and Western Siberia. Although Russia preferred the Western route (which Russia viewed as being easier and less costly to establish), the two parties eventually prioritized the route from Eastern Siberia that could supply 38 bcm of gas per year to China when fully operational.⁵²

Final go-ahead for the pipeline, however took ten years, in large part due to a disagreement over pricing. Gazprom sought to link pricing to its exports to Europe, while Beijing believed it could buy cheaper gas elsewhere and set about expanding its energy cooperation with Central Asian countries, with whom it was able to negotiate gas prices lower than comparative Russian exports to Europe.⁵³

Reports in 2013 indicated that China and Russia had agreed to structural terms on a potential deal, but remained deadlocked over the pricing issue.⁵⁴ However, the crisis in Ukraine that began in late 2013 seems to have provided the impetus to finally conclude the deal. The conflict caused a severe deterioration in relations between Russia and the West, leading to U.S. and European economic sanctions on Russia and increased calls in Europe to reduce its energy dependence on Russia. These developments seem to have prompted President Putin to push through the gas deal with China as a show of strength to domestic and international audiences. Although the official terms were kept secret, media accounts reported that the agreed price was around \$350 per thousand cubic meters – comparable to average prices for Russia's European customers.⁵⁵ The agreement also included stipulations for Chinese investment of up to \$45 billion per year for energy production and exploration in Russia's Far East.⁵⁶

Recent Developments

The agreement was seen by both countries as further evidence of the deepening Russia-China partnership and arguably a gateway towards a full-scale strategic partnership. This was supposedly illustrated in a new November 2014 non-binding framework agreement between Russia and China for a second so-called "Altai" pipeline that would deliver an additional 30 bcm of gas from Western Siberia to China.⁵⁷ Implementation of the second agreement, in addition to the Eastern route, would mark a sizable achievement. However, the "Altai" agreement, being non-binding in nature, must be distinguished carefully from the officially concluded, binding "Power of Siberia" deal. The Western route establishes no firm commitment from either side, while few of the proposed deal's elements appear to line up for both countries. In addition, recent developments for both routes suggest that such grand ambitions are likely to be misplaced.

More than a year on from the May 2014 deal, a number of developments have placed doubt on the long-term viability of the "Power of Siberia" pipeline. First, it transpired that the contract for the Eastern pipeline had not been fully finalized at its signing. Instead, the initial contract was contingent on an intergovernmental agreement that Russia's parliament needed to ratify.⁵⁸ That in itself was not necessarily alarming, but the fact the deal was only approved by the State Duma and the Federation Council a full year after signing in May 2015 should have been of concern. Supposedly a diplomatic and economic priority, construction of the "Power of Siberia" pipeline only began on June 29, 2015.

Throughout the intervening period, Russia had pushed for the conclusion of an agreement for the "Altai" pipeline. Moscow even argued that the two countries could prioritize the Western route as it could be built "more quickly," since Russia already possesses the necessary infrastructure in that region.⁵⁹ Reuters even reported that Russia could seek to postpone development of the "Power of Siberia" pipeline until completion of the proposed Western route.⁶⁰ However, these plans appeared to have been soundly rebuffed by Beijing. China's state media reported that discussions for the Western route had been put indefinitely on hold, largely due to Chinese pricing and demand concerns.⁶¹

Both deals have also been called into question because of external developments that have occurred since the deal was agreed. The collapse in the global oil price in 2014-15 has put many of Russia's energy projects in jeopardy, including the proposed routes to China. Oil prices fell sharply to lows of around \$50-60 per barrel (down from around \$100 per barrel earlier in the year) in late 2014, severely affecting government revenues which rely heavily on taxes and duties of the country's oil and gas.⁶² The price agreed for the "Power of Siberia" pipeline – like many of Russia's gas contracts with Europe – is believed to be linked to the price of oil.⁶³ If that is the case, the deal no longer looks so smart for Russia and could cost the country a sizable long-term revenue stream. Meanwhile, China also appears to be suffering from an economic slowdown – official figures from Beijing for 2015 recorded growth of 6.9 percent for the first three quarters of 2015, with growth expected to fall again in 2016.⁶⁴ China's slowdown is also sucking the growth out of countries across East Asia⁶⁵ as well as partners such as Russia. Given all these developments, and given the significant investment required to complete the eastern pipeline, it is hardly surprising that some analysts have suggested that the deal could be renegotiated.⁶⁶

Many observers were watching closely during Russian President Vladimir Putin's visit to China in September 2015 for any announcements on the progress of either pipeline. However, in what seemed a neat encapsulation of the effect of recent events on the bilateral relationship, the gas deals were said to have been barely discussed. Instead, coverage centered on the significant reduction in bilateral trade flows between the two countries in 2015, with the slowdown in China having negatively affected Chinese demand for Russian oil.⁶⁷

Expectations and Ramifications

Considering the fanfare among officials from both parties at the signing of the May 2014 agreement, the slow-moving developments for the pipeline ought to have come as a surprise. In reality, these developments accurately reflect the rapidly-evolving nature of the global energy environment and also the complicated nature of Russia-China relations. With the collapse of the global oil price, Russia now looks to be in a significantly weaker position than at the time the agreement was signed. The oil price crash has weakened Russia's economy and the ability of the Kremlin to pursue its preferred foreign policy options, including in energy. This may explain Russia's abortive push for the Western route that is both cheaper and less complicated. China, however, has been able to develop a range of options in the Asia-Pacific and drives a hard bargain. It will only pursue a deal if it makes economic sense.

The May 2014 agreement initially appeared to have provided Russia with a reminder to the West that it has options beyond Europe in today's fractured geopolitical environment – of great importance to Russian President Vladimir Putin from both a domestic and international standpoint.⁶⁸ Agreements with China are particularly important in light of sanctions initiated by Western countries in response to the Ukraine crisis that currently deny Russian companies access to key technologies, services, and loans that are critical to development.⁶⁹ In response, Russia now appears willing to open up its energy sector to Chinese equity investment, a move that could provide a welcome financial and technological boost to the sector but also one that represents a significant break from tradition.⁷⁰

However, the May 2014 agreement will not precipitate a sea-change in the global energy environment nor in Russia or China's energy relations. Should Russia fulfil the demands of the May 2014 deal, it would still only be supplying to China less than a quarter of the natural gas it sells to Europe.⁷¹ China's agreements with countries in Central Asia also significantly outrank the May 2014 agreement.⁷² The fall in global energy prices also means that it is not clear whether the stipulations in the May 2014 deal are still relevant – it is possible that the terms of the deal could actually be renegotiated, a scenario perhaps made more likely in light of the fact that the official price of the contract was never officially disclosed.

Meanwhile, the proposed western route favored by Russia is much less of a priority for Beijing given China's existing agreements with Central Asia. If both pipelines were ever to be finished – and this appears at best uncertain – a combined total of 68 bcm of Russian gas would also pale in comparison to the 160 bcm of gas that Russia supplied to its European customers in 2013.⁷³

Compounding these developments, economic and political disparities that favor China have actually increased following the May 2014 deal. Russia's role as a supplier state is only becoming more entrenched with every energy deal, and China's economic status means that Beijing remains the power-broker in the relationship. The fall in oil prices and the precarious state of Russia's economy only enhances Beijing's position, while hampering Moscow's efforts to restore the country to global superpower status. Russia's heavily integrated economic relationship with Europe also means that Moscow will find it extraordinarily difficult to truly "pivot" to Asia even in the long-term. A little more than a year after the gas agreement was signed to so much fanfare, the case for the deal – and the Russia-China alliance for that matter – looks less and less compelling.

STRATEGIC IMPLICATIONS AND RECOMMENDATIONS FOR US AND EUROPEAN POLICYMAKERS

"Russia, I think, has always had a Janus-like quality, both looking east and west, and I think President Putin represents a deep strain in Russia that is probably harmful to Russia over the long term, but in the short term can be politically popular at home and very troublesome abroad."

– U.S. President Barack Obama, October 2, 2014.⁷⁴

The Russia-China natural gas agreement is the latest in a series of political, economic, and military developments between the two countries over more than two decades that illustrate a stronger and more integrated Russia-China relationship. Reflective of U.S. President Barack Obama's assertion above, the generally positive evolution of bilateral relations seems set to continue in the short term as ties between Russia and the West decline and Moscow looks eastwards to revive its economy. China's interests in challenging the United States and the established international order mean that deepening relations with Russia also makes strategic sense for Beijing.

However, the United States and Europe should not overreact to the hyperbolic rhetoric which characterizes high-level Russia-China ties and which continues to surround the May 2014 gas deal. The Russia-China relationship isn't a full-fledged alliance and is unlikely to become one. Moreover, the economic drivers that govern relations are increasingly in question, with both countries experiencing a slowdown in economic growth which has already hit the bilateral trading relationship. U.S. and EU policymakers must instead take clear steps to redress the balance of power in Eurasia, notably by reducing the EU's dependence on Russian energy and reenergizing the transatlantic relationship. They should keep a watchful eye on relations between Moscow and Beijing, but they should also be reassured that the Russia-China relationship seems to be creating as many problems as solutions. Indeed, underlying structural issues are casting increasing doubt on the long-term viability of ties.

The Russia-China relationship is, at its core, a limited partnership based on pragmatism and economic interest. Where their interests converge, for example in energy, the two countries have struck up a useful – if imperfect – relationship. Limited developments in other areas, such as in military coordination, further evidence the difficulties the two countries face in working together when faced with separate or conflicting interests. Moreover, increased Russian isolationism from the West could have negative long-term implications that China is unlikely or even unwilling to compensate for.

Fundamental limitations in Russia-China relations make the two countries ill-fitting strategic partners. For Russia, the May 2014 gas deal and the non-binding follow-up “Altai” agreement are attempts to illustrate to the United States and Europe that it has some degree of flexibility in its foreign policy. However, the events of the following twelve months have bluntly demonstrated that these options are limited. The collapse in the global oil price means that the Kremlin must now make up shortfalls of billions of dollars of revenue. And arguably Russia’s most important financial asset, Gazprom, now faces unprecedented challenges: falling energy prices, lack of investment, and weak global demand mean that the energy giant is expected to produce an all-time low volume of gas in 2015 as a public company.⁷⁵ In any case, Russia will continue to export the vast majority of its oil and gas to Europe for the foreseeable future and cannot afford to pivot away from Europe. Its efforts to use China as a foil for competition with European markets remain unconvincing and may even have unnerved Beijing, potentially leading to further delays in Russia’s grand energy plans with China.⁷⁶

Chinese foreign policy, after all, is predicated along narrow, self-interested lines. In assuring its energy security, China has pursued a variety of options throughout Asia, but has generally bypassed Russia in favor of cheaper, more reliable and less complicated options. The problematic negotiations that continue to surround both the “Power of Siberia” and “Altai” pipelines illustrate the complexity for China of doing business with its Russian counterpart. In the security realm, Beijing’s assertive actions in the East China and South China Seas illustrate that it is willing to pursue its own security interests even at the expense of its international reputation. But few, if any, Russian and Chinese security interests coalesce in this manner, and in some cases they are actively hostile to each other. To be sure, neither Russia nor China would consider significant economic or political sacrifices in the name of their bilateral relationship, in contrast to some Western political alliances.

Other challenges complicate developments. Russia’s fear and mistrust of China is a product of history but, given China’s recent rise and Russia’s declining population, is a modern problem too. China’s behavior in the coming years is also likely to become more unpredictable as it shores up its regional economic and security interests, potentially stoking fears in Russia and throughout the Asia-Pacific about its intentions. Chinese President Xi Jinping’s strong stance in foreign affairs has already taken many in the international community by surprise.⁷⁷ This is also true given that China’s new status as the leading economic rival to the United States has put Russia definitively in the shade. As Bobo Lo, associate fellow at Chatham House, argues, “the real threat [for Russia] is [that] China’s rise will lead to Russia’s steady marginalization from regional and global decision making.”⁷⁸

President Putin’s actions in Ukraine – which are economically and politically self-inflicting – may well be a reflection of his own desires to return Russia to its traditional rank of global superpower. Another explanation could simply be that the Kremlin requires an external enemy to rally the domestic elites and population around it.⁷⁹ Regardless of its motivation, Russia has consistently been willing to go to extraordinary lengths to preserve its political power in countries within its sphere of influence, as seen in Ukraine. It may do so again, possibly in direct competition with China – Central Asia, for example, is a venue that is already inviting competition between the countries and is likely to be a key battleground in the future. The uncertainty of China’s long-term intentions could also stoke fears in Russia’s Far East, where it shares a border with China.

Developments in Ukraine and the Middle East continue to require immediate, high-level attention for U.S. and European policymakers. Nevertheless, Western leaders must also consider the broader strategic picture. The crisis in Ukraine has altered the geostrategic landscape, but the outcome of the crisis and the course of future Russian behavior is likely to depend on the balance of power. Correctly charting the course of Russia-China relations, therefore, could have a profound impact on the future of the international order.

The recommendations below seek to address these concerns.

Prospects for Russia-China relations: Considering China's rise and Russia's accompanied decline, Russia's role in fueling the Chinese economic miracle as a supplier state, and increasing Sino-Russian competition in Central Asia, growing tensions in the bilateral relationship can be expected in the decades to come. The United States and Europe should be attentive to developments in Russia-China relations – especially in energy – but they need not panic. Russia and China may no longer consider themselves ideological rivals, but both seek an enhanced role in international affairs – possibly at the expense of each other. Still, Russia and China are thinking strategically about their interests and their long-term plans. The United States and Europe should do the same, in particular by improving the EU's energy balance-of-power relationship with Russia and reenergizing and providing greater direction to the transatlantic partnership. Establishing a more unified transatlantic voice in international relations would provide the foundation for a sensible, long-term approach to the Russia-China relationship.

Strategic Response: Russia's aggression in Ukraine and its approach to the crisis in Syria are issues that continue to require immediate, high-level attention. However, U.S. and European leaders must also focus on the broader picture. The outcome of the Ukraine crisis and the course of future Russian behavior will depend on the balance of power. Russia in the short term has been severely weakened by the collapse in the global oil price. However, its long-term power position will be shaped by its energy position and its relations with Europe and China. Moscow in particular has declared its intent to make use of the advantages presented in Asia at the expense of Europe. U.S. and European leaders must focus on these strategic issues as well.

The Balance of Energy Power: The United States and Europe should work harder and act more decisively to improve their balance of power positions with respect to energy. The United States is in good shape, given its energy prospects. The EU is not in a good position;⁸⁰ addressing this must be a strategic priority. Dependence on Russian energy exports makes it difficult for many European countries to support strong responses to Russia's aggression. The anti-trust case brought by the European Commission against Gazprom in 2015 over alleged abuse of competition rules in the EU energy market,⁸¹ commitments to solidify Europe's gas storage capacity as a hedge against potential Russian supply disruptions,⁸² and the unveiling of the EU "Energy Union" strategy⁸³ in February 2015 suggest that EU leaders are already heading in this direction.

EU leaders should redouble these efforts. The scope for greater European oil and gas production is limited, especially given the expected difficulties in extracting European shale gas reserves. However, capacity exists to increase Europe's Liquefied Natural Gas (LNG)-importing capacities, including from the United States. Europe should prioritize new energy routes from Eastern Europe and Western Asia that exclude Russia, and also discourage new Russian initiatives – under pressure from the EU, Moscow has already been forced to cancel its proposed "South Stream" pipeline which aimed to transport Russian gas through the Black Sea to Eastern Europe.⁸⁴ Many EU gas contracts with Russia are also set to expire in the next few years, which will provide member states with the option to diversify their supply.⁸⁵

Meanwhile, the historic accord struck in July 2015 between leading world powers and Tehran to limit that country's nuclear capability, in exchange for the lifting of international sanctions, will free up additional capacity to import energy from Iran. The U.S. Congress is also deliberating the lifting of the U.S. oil export ban, which could also help Europe to diversify its oil supply, although its prospects are uncertain.⁸⁶

Room for Diplomacy: The United States and Europe must continue to push for a diplomatic solution to the conflict in Ukraine. With a ceasefire finally in place, the two parties should work with Russia to implement measures that prevent a re-escalation of hostilities, and look to establish a clear roadmap towards long-term

peace in Ukraine. To make these efforts more credible, the United States and Europe should avoid actions that unite Russia and China in opposition to Western interests. For example, economic sanctions against Russia over Ukraine were important measures to deter Russia but have had the consequence of pushing Russia and China closer together. Bolstering NATO's presence in Eastern Europe was also an important and reassuring strategic move but may cause greater long-term instability by triggering a counteractive Russian response – unless these moves are matched by increased diplomatic efforts.

The nuclear deal struck with Iran in July 2015 was an example of cooperation between Western powers and Russia on an issue in which their respective interests converge that could serve as a model for improving relations – although Russia's unilateral actions in Syria are a separate demonstration of the complexity of modern Western ties with Russia. The United States and Europe should explore various avenues for cooperation with Russia, including in the Middle East, that could improve global stability and restore trust. Reestablishing forms of cultural cooperation with Russia that have been cut in tit-for-tat measures by both sides could also help. The restoration or expansion of student exchange programs, simplification of tourist travel requirements, and similar forms of public diplomacy could promote cultural understanding and reduce the prospects for a long-term deterioration of relations.⁸⁷

Concluding TTIP and TPP: U.S. and European leaders should re-double their efforts to complete the Transatlantic Trade and Investment Partnership (TTIP) and the Trans-Pacific Partnership (TPP), proposed multilateral trade accords. TTIP and TPP will mean the expansion of free-trade and international economic standards across the breadth of Europe and the Asia-Pacific in line with Western interests. From a geopolitical standpoint, the former deal should strengthen trans-Atlantic and intra-European political solidarity, in particular by giving the West a more united front with respect to Russia.⁸⁸ TTIP can also bolster European energy security, by facilitating U.S. LNG exports to Europe largely restricted under current U.S. regulations.⁸⁹ Negotiations for the TPP were concluded in October 2015, with the deal now awaiting ratification by the countries involved. Prospects for TTIP are more uncertain, although negotiators still hope to conclude the agreement under the current U.S. administration. Moving ahead on TTIP would be an important display of unity between the United States and the EU and demonstrate the continuing strength and relevance of the transatlantic relationship.

CONCLUSION

The Russia-China natural gas deal agreed in 2014 is a significant strategic development that forms part of a deeper, broader Russia-China relationship in development since 1991. In cultivating their bilateral relations, both countries are engaging in sound strategic policy. Russia is expanding its energy and security options by developing its relations with Asia. China, for its part, is increasingly self-confident on the world stage and has established a region-wide energy policy that supports this strategy.

But the ongoing difficulties surrounding the gas deal are symptomatic of the delicate and complex nature of modern Russia-China relations. It is no longer clear that the deal meets the interests of both parties, which may explain its complicated recent history. The Russia-China partnership is not, after all, one bound by a common vision, but rather one borne of expedience. It is uncertain whether Russia and China will remain friendly in the future, especially given the range of political and economic challenges that the two countries already face.

Russia has identified its relations with China and Asia as critical to its future. However, should this be at the expense of its economic relationship with Europe, it is difficult to see how Russia will benefit in the long-term. Russia's economic security will continue to be linked with Europe, a situation made more complex by the collapse in oil prices. The loss of revenues resulting from the oil price crash has and will continue

to limit Moscow's foreign policy options until it either successfully diversifies the country's economy or energy prices recover to previous levels. The former will be difficult; the latter is uncertain.

As Russia faces the possibility of a sustained economic recession, the balance-of-power between Russia and China – and Russia and the rest of world – is tilting away from Russia at the very time that its president seeks a more powerful role in world affairs. In response to the Ukraine crisis, the EU is seeking to reduce its dependence on Russian energy that limits European countries from supporting strong, unified responses along with the United States in the face of Russian aggression. In addition, Russia's gas agreements with China will not come online for several years; while figures indicate that gas sales of Gazprom, Russia's largest supplier, to Europe, declined by 8.5 percent in 2014.⁹⁰ With overall trade between Russia and China down significantly in the first half of 2015 due to a fall in Chinese demand, the health of the two countries' economic relationship is increasingly open to question.

The United States and Europe should keep a close eye on relations between Russia and China. However, they should adopt a measured policy approach, identifying ways to redress Europe's energy relations with Russia and working to revitalize the transatlantic partnership. The Russia-China relationship, after all, is one built on shaky foundations and it faces an uncertain future. A little more than a year after the gas agreement was signed to so much fanfare, the case for the deal – and the Russia-China alliance – looks less and less compelling.

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