

# Comparative Connections

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## China-Russia Relations: Embracing a Storm and Each Other?

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In contrast to the hectic third quarter of the Beijing Olympics and South Ossetia, the last quarter of 2008 was calmer for Russia and China. Their bilateral relations, nonetheless, seemed to become more substantive. The 13<sup>th</sup> annual Prime Ministerial Meeting in Moscow in late October and the 13<sup>th</sup> session of the Russian-Chinese Intergovernmental Commission on Military-Technical Cooperation in Moscow in early December provided some fresh impetus for the impasse in two important areas of bilateral relations: the long-awaited oil pipeline to China and military relations. Separately, the quarter also witnessed the final, albeit low-key, ceremony for settling the last territorial issue when Russia officially transferred to China control of one and a half islands of the disputed territory near Khabarovsk. However, the world around Russia and China was in turmoil not only because of the financial tsunami that was leaving no nation behind, but also because of regional crises between India and Pakistan as well as Israel and Palestine, and the stagnation in the Korea denuclearization process.

### Back to basics

There were four meetings during the quarter between the top leaders of the two nations. President Hu Jintao and President Dmitry Medvedev met twice in one week: during the Nov. 16 G20 summit in Washington and the Nov. 23 Asia-Pacific Economic Cooperation (APEC) Leaders Meeting in Lima, Peru. The prime ministers also met twice in a matter of days: at the 13<sup>th</sup> annual Prime Ministerial Meeting on Oct. 28 in Moscow and the annual Shanghai Cooperation Organization (SCO) Prime Ministerial Meeting on Oct. 30 in Astana, Kazakhstan.

Frequent high-level contacts came against a backdrop of the end of an extraordinary year for Russia and China as well as their bilateral relations. For the PRC, it was certainly a year of tragedy and triumph: the devastating winter storm, the riots in Tibet, the Sichuan earthquake, the tainted-milk scandal, the Beijing Olympics, and a successful space walk. For Russia, Ossetia and oil prices besieged the change of guard in the Kremlin. The newly installed President Medvedev was soon challenged by a five-day crisis/war with Georgia over South Ossetia in August, which was, in essence, a confrontation with Washington over both geo-politics and petro-politics in northern Caucasus and beyond. Meanwhile, roller-coaster oil prices from an unprecedented high of \$147 per barrel in July to the low of \$38 per barrel at year end also jolted China and Russia.

Facing ripple effect of those hectic domestic and international developments in the first three quarters of 2008, Russia and China turned to each other in the last quarter of the year. The two prime ministerial meetings in late October focused on functional and economic issues at bilateral

and multilateral (SCO) levels. The two presidential meetings in November were largely on multilateral and global issues. Between the two sets of high-level contacts was the third round of Russian-Chinese consultations on strategic security on Nov. 5-6 in Moscow, where Chinese State Councilor Dai Bingguo and Russian Security Council Secretary Nikolai Patrushev used the opportunity to coordinate positions regarding regional and international issues.

Dai's visit was one day after President Medvedev delivered his annual state-of-the-nation address to the Federal Assembly, which was one of the topics of the talks. Medvedev's speech covered major changes in both Russian domestic and foreign policies, including proposals to extend the terms of the president and Parliament to six and five years, respectively, from their current four-year terms, and the deployment of the *Iskander* missile system in the Kaliningrad region to neutralize the U.S. missile defense system in Europe. Other topics included Central Asia, northern Caucasus, missile defense, and the international financial crisis.

"We had a thorough exchange of opinions," said Dai after the talks. The two sides also pledged to strengthen mutual trust, support each other in national sovereignty, security and integrity, and boost cooperation in maintaining world peace and furthering mutual prosperity. Another two strategic dialogues were also scheduled. After the meeting, Dai met Foreign Minister Sergei Lavrov and then President Medvedev on Nov. 7.

### **13<sup>th</sup> Prime Ministerial Meeting in Moscow**

While the other three high-level meetings were all on the sideline of multilateral gatherings, the 13<sup>th</sup> annual Prime Ministerial Meeting in Moscow on Oct. 28 was the most substantive. After eight years as Russian president, Vladimir Putin was "demoted" to the position of prime minister. For the first time, Chinese Premier Wen Jiabao was negotiating with his Russian counterpart who has real, if not final, control of daily management of the vast Eurasian power.

As usual, the meeting was the culmination of various subcommittee meetings in the areas of trade and economics (Oct. 14), nuclear cooperation (Oct. 17), humanitarian cooperation (Oct. 25), and the second Sino-Russian energy talks mechanism at the vice prime minister level (Oct. 26), which was initiated by President Hu and Medvedev in July. The day of the Prime Ministerial Meeting coincided with the opening of the third Russian-Chinese Investment Forum in Moscow. Energy cooperation topped the agenda of the Wen-Putin talks and Wen made five proposals at the meeting: deepen cooperation in energy and natural resources, boost cooperation in trade and technology, increase cooperation in finance and investment, deepen local and regional cooperation, and boost cooperation in international economic affairs. In all, 14 agreements were signed including:

- A memorandum of understanding on cooperation in the petroleum field between the Chinese National Petroleum Corporation (CNPC) and Russian Pipeline Transport Company on the construction and operation of the crude oil pipeline from Skovorodino to the Sino-Russian border.

- A \$300 million agreement on joint financing of Russian-Chinese projects, particularly machinery and technical products, by the Bank for Foreign Economic Activities and Development of Russia and the China Import and Export Bank.
- A memorandum on the joint development of a civilian heavy-duty helicopter by the Russian Oboronprom and the Chinese company Aviacopter.
- A letter of intent on purchasing civilian-use helicopters from Russia OAO Military Helicopters Corporation.
- A memorandum between Rosatom and the State Nuclear Power Technology Corporation on the construction in China of two expansion blocs of the Tianwan Nuclear Power Plant and a demonstration of a commercial-sized fast neutron reactor.
- An agreement on the cooperation in developing nanotechnologies between Russian Nanotechnologies Corporation and Chinese Science and Technology Ministry.
- An agreement to host a Year of Russian Language in 2009 in China and the Year of Chinese Culture in 2010 in Russia to mark the 60<sup>th</sup> anniversary of the establishment of the diplomatic relations, which will be in 2009.

### **End of longest-running soap opera in oil transportation history?**

The memorandum on cooperation in the petroleum field is a broad framework under which China will grant long-term loans to Russian state oil company Rosneft (\$15 billion) and Russian pipeline giant Transneft (\$10 billion). In exchange, the two Russian companies would construct a 67-kilometer branch line to China from the main Eastern-Siberia-Pacific Ocean oil pipeline and supply China with 15 million tons of oil annually for 20 years beginning from 2010.

Thus, 14 years after its inception by the late Russian President Yeltsin in 1994 and four years since the last Russian governmental decision to build the 67-kilometer branch line to China (an executive order by then Prime Minister Mikhail Fradkov at the end of 2004), the October 2008 memorandum in Moscow indeed sees the light at the end of the pipeline. For this, a leading Russian affairs expert in China hailed the deal as “a strategic breakthrough” in bilateral relations.

Until year end, however, the two sides were laboring through several rounds of negotiations over the loan rate, repayment guarantee, and pricing mechanism for oil shipment to China. The Russian side preferred a floating, or market, price for oil delivery and a fixed rate for loans from China. China insisted on the opposite: fixed pricing for oil from Russia and a floating credit rate to Russia at LIBOR+5 percent. Calling it “absurd lending terms,” Russian negotiators simply broke away from the talks in Beijing on Nov. 13 and did not return until 10 days later. On Dec. 10, the two sides met in Moscow again and by Dec. 15, Rosneft indicated that China has agreed to the principal terms of the Russians. There was, however, no signing of the final agreement by year end. This means that any meaningful talks will not start until February 2009 because of the long holiday breaks for both Russian and Chinese New Year in January (Dec. 31 to Jan. 13 for Russia and Jan. 25-31 for China). Already, Natural Resources and Ecology Minister Yuriy

Trutnev remarked in a TV interview that “in February, the Russian government would once again check if it is capable to fill up the East Siberia-Pacific Ocean oil pipeline to China that is being constructed.” “We must make sure again that ... we are indeed ready to fill up the pipeline... Otherwise, if we have concerns, we shall take relevant measures,” said Trutnev.

The delays in getting an agreement on the details for the loan and price rates also mean that the branch line to China may be further postponed as construction should be carried out in winter conditions when the ground is frozen.

### **Crisis and opportunity**

In the energy business, crisis for suppliers means opportunities for consumers and vice versa. This most recent round of juggling between Moscow and Beijing on the oil business began in early October when the Russian government was reportedly starting to “review” the feasibility study prepared by Transneft and financed by the Chinese. By this time, oil prices were rapidly declining from the peak of \$147 per barrel in July to below \$100 on Oct. 1, \$75 in mid-October, and below \$40 at the yearend. This was, according to Leonid Grigoryev, director of the Institute for Energy & Finance Studies in Moscow, “an unacceptable price as the upper limit of costs stands at \$60 per barrel.” Meanwhile, the Russian government budget, which is heavily dependent on oil revenue, was based on \$95 per barrel. The Russian stock market, too, was heading toward a steep decline and by the second week of October, it had plummeted 69.7 percent from its all-time high in May, the biggest drop among emerging markets since the start of the year. As a result, almost all Russian oil companies were in deep financial trouble due to their massive exposure to foreign loans in recent years. Rosneft has the biggest foreign debt – \$21.4 billion at the end of June and must pay off a debt of \$13.4 billion by the summer of 2009. Worse, the once easy credit was gone. Oil-for-credit with China, therefore, became Russia’s reluctant choice in the 4<sup>th</sup> quarter.

Until this point, working with other sources for its growing energy needs proved to be more productive for China. In the past few years, several large-scale energy projects have been either completed or are in good progress, such as the launch of the China-Kazakh oil pipeline in December 2005, the pending gas line from Turkmenistan via Uzbekistan and Kazakhstan in 2009 (first stage), and the construction of the Burma-China oil/gas lines in early 2009. Meanwhile, “[A]lmost all of Russia’s pipelines now extend to the West, but the fastest growing economies are in the Asia-Pacific region,” remarked Andrew Ostrovsky, deputy chief of the Far East Institute of the Russian Academy of Science in late October. Despite being the world’s number two oil producer after Saudi Arabia, Russia is only the fifth-largest exporter of oil to China. Still, oil from Russia is badly needed as the Chinese economy continues to expand in the next few years, even if the world economy is slowing down considerably. With excessive oil supply, declining demand, and lowered price, China is ready for a final deal.

### **Military cooperation: upturn after three-year interlude**

2008 turned out to be quite extraordinary for military-to-military relations between Russia and China. A military hotline was set up in March. Russia conducted an emergency airlift operation (300 tons of humanitarian aid) to China’s southwestern Sichuan Province for earthquake relief in

May. Toward year end, military technology cooperation between Moscow and China also showed some signs of life after a three-year ebb, during which there were no major procurement orders from China, unlike the previous decade when \$25 billion worth of air, naval, and ground equipment were delivered to China. The last, or 12<sup>th</sup>, Military-Technology Meeting was held in Sochi, Russia, in 2005, co-chaired by then Defense Ministers Sergei Ivanov and Cao Gangchuan.

The triggering event for the three-year stagnation in the military sale area was the \$1.5 billion contract in 2005 for 34 *Ilyushin-76* military transport planes, four *Ilyushin-78* in-flight refueling tankers, and 88 additional *D-30KP-2* engines. Later, the Russian side was simply unable to fulfill the contract due to the inability of the Tashkent plant to meet its commitments on time. Later, China rejected a new Russian proposal for a price hike. As a result, China's share of Russia's military sales has been dropping steadily: from 64.3 percent of total deliveries of \$6.126 billion in 2005, to 38.3 percent of \$6.46 billion in 2006, and 21 percent of \$7.5 billion in 2007. "Our Chinese partners have very much criticized the non-fulfillment by Russia of the terms of a contract concluded in Sochi in 2005 ... on the delivery to China of the *Ilyushin Il-76* military-transport planes and long-range refueling planes *Il-78*. The known stagnation in the bilateral military cooperation in the sphere of the Air Force began from that moment," remarked a representative of the Russian delegation led by Defense Minister Anatoly Serdyukov traveling to Beijing.

The *Ilyushin* episode, however, is only the most visible problem in Sino-Russian military technology transactions. For a long time, Chinese have complained about Russia's poor after-sale servicing of armaments and military equipment and Russia's inability to fulfill some concluded contracts. Russia, in turn, is quite bitter about China's illegal copying of Russia's military technology.

On Dec. 9-11, the 13<sup>th</sup> session of the Russian-Chinese Intergovernmental Commission on Military-Technical Cooperation was held in Beijing and co-chaired by Russian Defense Minister Anatoly Serdyukov and his Chinese counterpart Gen. Liang Guanglie. It was the culmination of several separate steps during the 4<sup>th</sup> quarter for renewed effort on military-to-military relations. Apparently, consensus was reached during the October Prime Ministerial Meeting in Moscow to boost the military technology cooperation.

President Hu, in his Nov. 14 meeting with President Medvedev at the sideline of the G20 meeting in Washington, had expressed hope for a successful meeting of the Chinese-Russian Commission on Military-Technical Cooperation. This high-level attention to military relations was picked up by the 12<sup>th</sup> round of strategic consultations between the general staff departments of the two armed forces in Beijing on Nov. 24-25, which was co-chaired by PLA's Deputy Chief of General Staff Ma Xiaotian and Lt. Gen. Burutin, first deputy chief of general staff of the Russian Armed Forces. According to an official press release, the two sides conducted a candid exchange of views on current international political and military situations, regional hotspot issues, antiterrorist and peacekeeping operations and other issues of common concern, and carried out in-depth consultations on further strengthening the relations between two militaries and reached broad agreement. The Chinese believed that the two armed forces should tap the potential for and widen the channels of cooperation.

By the time the 13<sup>th</sup> Russian-Chinese Intergovernmental Commission on Military-Technical Cooperation met in Beijing, Russia's military-industrial complex, like Russian oil companies, faced growing financial constraints. A breakthrough in military sales to China would definitely alleviate the dire situation. For the PLA, the time is perhaps right for another major transfer of Russian military technology to China as the PLA is working for its next "big items" such as a large transport plane, heavy-duty helicopters, large naval vessels including carriers, and carrier-based jet-fighters. The meeting also took place on the eve of the 60<sup>th</sup> anniversary of China-Russia ties in 2009. The two sides therefore agreed to make the best of this opportunity to improve military ties. For these reasons, among others, Russian Defense Minister Serdyukov led a team of heavy-weight participants to Beijing: Director of the Federal Service for Military-Technical Cooperation Mikhail Dmitriyev, Deputy Foreign Minister Alexei Borodavkin, Director General of the Rosoboronexport state-owned weapons trading company Anatoly Isaikin, Director of Armaments and Deputy Defense Minister Vladimir Popovkin, Director of the Department for Defense Industry and High Technologies under the Russian government Nikolai Moiseyev, and Sukhoi Chief Executive Officer Mikhail Pogosyan.

During the meeting, the two sides exchanged views on major international and regional issues including missile defense, NATO expansion, north Caucasus, Korea, Taiwan, etc. Several agreements were reached including a joint antiterror military exercise in 2009, a Defense Chiefs Meeting in April 2009, and an intellectual property protection agreement between Russia and China that would significantly simplify and speed up Russia's transfer of military equipment and technology to China. Beyond that, there was a general upbeat sentiment.

In the joint press conference, Defense Minister Liang Guanglie said that the two sides reached wide-ranging consensus on further strengthening friendship and cooperation between the two armed forces. He hinted that 2009 – the 60<sup>th</sup> anniversary of the establishment of diplomatic relations between the two countries – would be a turning point to elevate bilateral relations to a new level.

To this end, Defense Minister Liang put forward a five-point proposal: continue to maintain the momentum in high-level exchanges between the Chinese and Russian armed forces, implement well the existing cooperative projects between the two armed forces in various fields, strengthen exchanges in the training of personnel and in other specialized areas, jointly discuss expanding the field of cooperation, and make the joint antiterror military exercise between the Chinese and Russian armed forces next year successful.

The Russians showed equal, if not more, enthusiasm for future development. "The Beijing session was the beginning of a new stage in bilateral military characterized by the focus on new high technologies and new models of arms and military hardware," remarked Mikhail Dmitriyev, director of the Federal Service for Military-Technical Cooperation. "The commission has decided not just to step up our cooperation but also to raise it to a higher, new level of quality, including joint development of high-tech military products," he said. The understanding was that China would not only continue the licensed production of Su-series jet fighters but would also work with Russia on the development and sale of *Su-35* multi-role fighter and *Su-33* carrier-based jet fighter, and even the *Yak141* vertical takeoff fighter. Indeed, "[A]n inventory of all current and future project in all areas of our cooperation, including aircraft building, engines,

ships, missile defense and armor without a particular emphasis on any of them, was carried out ...,” said Mikhail Dmitriyev, director of the Federal Service for Military-Technical Cooperation.

The positive outcome of the 13<sup>th</sup> Military-Technology Commission led to the meeting between President Hu Jintao and Defense Minister Serdyukov. Hu spoke highly of the meeting. “I know that you have done a lot of work on your two days visit here. ... As a result of the commission’s work, important documents were signed,” Hu told Serdyukov. “We have worked fruitfully with Chinese Defense Minister Liang Guanglie for two days and conducted the 13<sup>th</sup> meeting of the Russian-Chinese Inter-governmental Commission on Military-Technical Cooperation,” the Russian minister said.

### **The future**

By the end of 2008, Russia and China found that the world has changed much, yet so little: so much because of their respective rise in the form of the Olympics and Ossetia after decades or centuries of decline; so little in that the oscillating oil prices leading to global recession are eroding the very environment and foundation of their success. What lies ahead remains uncertain even for the world’s most powerful nation (the U.S.) with the pending Obama administration in a world of ongoing crises in the world economy, South Asia, and the Middle East. Because of this uncertainty, Moscow and Beijing may increasingly turn to one another in the coming Year of the Ox, a year in which, according to Chinese mythology, would reward, albeit modestly, those with endurance.

## **Chronology of China-Russia Relations October-December 2008**

**Oct. 14, 2008:** In a low-key ceremony, Russia officially transfers control over half of Bolshoi Ussuriysky Island (*hei xia zi dao*) and all of Tarabarov Island (*yin long dao*), in total about 375 square km, to China. Zhao Xidi, an ambassador-level official with the Chinese Foreign Ministry, and Vladimir Malyshev, deputy director of the Russian Foreign Ministry First Asian Department, jointly unveil the boundary markers. Russia and China reached an agreement on dividing the disputed islands in the Amur River in 2004. The border was legally established in July 2007 in a supplemental protocol. The transfer was the final settlement of the border issue after more than 40 years of negotiations between the two governments.

**Oct. 14, 2008:** The 11<sup>th</sup> meeting of the Sub-Commission for Trade and Economic Cooperation is held in Moscow and co-chaired by Minister of Economic Development Elvira Nabiullina and Minister of Commerce Chen Deming. A joint statement pledged to enhance coordination in solving problems in market access and trade.

**Oct. 14-18, 2008:** A Chinese naval squadron consisting of destroyer *Tai Zhou* and guided missile frigate *Ma An Shan* arrive at the port of Vladivostok for a four-day visit. The Chinese squadron is led by the PLAN East Sea Fleet Commander Vice Adm. Xu Hongmen and hosted by Deputy Commander-in-Chief of the Russian Navy’s Pacific Fleet Vice Adm. Sergei Viktorovich Avramenko.

**Oct. 17, 2008:** The 12<sup>th</sup> Meeting of the Russian-Chinese Nuclear Issues Subcommittee for the regular Russian-China Prime Minister Meeting is held in Beijing. A protocol is signed for building the third phases of the gas centrifuge plant and two additional units of the Tianwan nuclear power plant.

**Oct. 25-28, 2008:** Vice Premier Wang Qishan visits Russia to attend a session of the Sino-Russian energy talks mechanism prior to the 13<sup>th</sup> meeting of the Chinese-Russian Prime Ministers Regular Meeting.

**Oct. 25-30, 2008:** State Councilor Liu Yandong visits Russia at the invitation of Deputy Prime Minister Alexander Zhukov for the ninth session of a China-Russia Committee on Humanitarian Cooperation.

**Oct. 27-29, 2008:** Premier Wen Jiabao visits Moscow for the 13<sup>th</sup> regular meeting of the Russian and Chinese heads of governments on Oct. 28 with his Russian counterpart Vladimir Putin. In Moscow, Wen meets President Medvedev and State Duma speaker Boris Gryzlov and co-chairs with Putin the opening session of the third Russian-Chinese Investment Forum. Several commercial documents are signed in the areas of oil pipelines, nuclear power, helicopter sales, banking, and joint development of a heavy civilian helicopter.

**Oct. 30-31, 2008:** The seventh annual Council of the SCO Heads of Government (prime ministers) meets in Astana, Kazakhstan. Several documents are signed including a protocol between the customs services of the SCO member states to exchange information on transfer of energy resources, the SCO budget for 2009. The action plan for implementing the multilateral trade and economic cooperation agreement is also updated.

**Nov. 5-7, 2008:** State Councilor Dai Bingguo visits Russia at the invitation of Russian Security Council Secretary Nikolai Patrushev. They hold the third round of Russian-Chinese Consultations on Strategic Security on Nov. 5-6. Dai meets Foreign Minister Sergei Lavrov and President Medvedev on Nov. 7.

**Nov. 16, 2008:** Presidents Medvedev and Hu meet in Washington following the G20 summit on the world financial crisis.

**Nov. 20, 2008:** Sun Xiaoqun, member of the CPC Central Committee, attends the 10<sup>th</sup> National Congress of the United Russia, Russia's ruling party holding two-thirds of the seats in the State Duma. Sun pledges to enhance exchange and cooperation with the United Russia.

**Nov. 23, 2008:** Presidents Medvedev and Hu meet in Lima, Peru, on the sideline of the annual APEC forum. Foreign Minister Yang Jiechi and Russian counterpart Sergei Lavrov also hold separate talks during the meeting.

**Nov. 24-25, 2008:** The 12<sup>th</sup> round of strategic consultations between the Chinese and Russian general staff departments of the two armed forces are held in Beijing.

**Nov. 26, 2008:** The 19<sup>th</sup> session of the Joint Control Group to promote confidence building measures is held in Beijing with participants from Kazakhstan, Kyrgyzstan, Russia, Tajikistan, and China.

**Nov. 27, 2008:** Jing Zhiyuan, commander of the Second Artillery Force of the PLA, meets Lt. Gen. Burutin, first deputy chief of general staff of the Russian Armed Forces at the Second Artillery Force Headquarters.

**Dec. 4, 2008:** The Russian-Chinese Sub-Commission on Banking Cooperation discusses in Beijing the possibilities of using national currencies in bilateral trade.

**Dec. 9-11, 2008:** Defense Minister Serdyukov visits Beijing for the 13<sup>th</sup> session the Russian-Chinese Intergovernmental Commission on Military-Technical Cooperation.

**Dec. 18-19, 2008:** Minister of Culture Alexander Avdeyev visits China and meets his counterpart Cai Wu.

**Dec. 23-24, 2008:** The third session of the Joint Russian-Chinese Border Commission is held in Beijing. The complete and final establishment and legal formalization of the border on Oct. 14, 2008 has turned the commission's work from border demarcation to checking of existing border along the border line.

**Dec. 29, 2008:** PLA Chief of General Staff Chen Bingde and Russian counterpart Nikolay Makarov hold their first-ever conversation via direct phone link.

**Dec. 29, 2008:** Foreign Minister Yang Jiechi initiates a telephone conversation with his Russian counterpart Sergei Lavrov. In addition to discussing bilateral issues, they exchange views on relations between India and Pakistan, express serious concern over tension in South Asia, and agree that Russia and China would coordinate their actions and do their best to ease tension by political and diplomatic means.

**Dec. 30, 2008:** President Medvedev sends a New Year eve message to President Hu, expressing deep satisfaction for the Russian-Chinese strategic partnership relations.

**Dec. 31, 2008:** President Hu sends New Year message to President Medvedev and announces the start of the Year of the Chinese and Russian Languages in China.