

THE EMERGING RUSSIA-ASIA ENERGY NEXUS

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Essay

China-Russia Energy Relations: Better Than Ever

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China-Russia Energy Relations: Better Than Ever

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NOTE: This essay reflects the author's own views and not those of the institutions with which she is affiliated.

EXECUTIVE SUMMARY

This essay examines the factors that have contributed to the deepening of the China-Russia energy relationship since 2008 and draws implications for the U.S.

MAIN ARGUMENT

The China-Russia energy relationship is more robust than it has been at any other time over the past decade. Russia's crude oil exports to China more than quintupled between 2008 and 2017, with the country displacing Saudi Arabia as China's top crude supplier in 2016. Meanwhile, Russia is poised to become a major supplier of natural gas to China within the next decade as new export projects commence operations and ramp up to full capacity. The primary driver of the deepening bilateral energy relationship has been the strategic provision of capital by Chinese financial institutions to Russian energy companies both to secure large-volume, long-term contracts for oil and natural gas supplies and to develop the infrastructure to deliver them to China. These institutions provided this support not only to enhance China's energy security by diversifying its oil and natural gas suppliers and import routes but also to advance other national objectives, such as transforming the country into an advanced manufacturing superpower and gaining access to Arctic shipping routes. A secondary driver of the deepening energy relationship is the emergence of new Chinese crude importers.

POLICY IMPLICATIONS

- Despite the substantial growth in Russian crude oil exports to China over the past decade, seaborne oil imports will remain a vulnerability likely requiring substantial Chinese resources to address.
- The growth in Russian energy exports to China over the past decade has not prevented the U.S. from selling crude oil and liquefied natural gas (LNG) to the country. However, the extent to which U.S. exporters will be able to compete for larger shares of China's crude oil and LNG imports may depend in part on how the ongoing bilateral trade dispute plays out.
- Uncertainty over whether U.S. tariffs on Chinese LNG imports will increase may prompt Chinese leaders and national oil companies to view Russia as a more reliable natural gas supplier and increase Chinese interest in the development of a second cross-border natural gas pipeline and Russia's Arctic LNG-2 project.

What a difference a little more than a decade makes. In the mid-2000s, the China-Russia energy relationship was one of unfulfilled potential. To be sure, Russia had already emerged as one of China's top oil suppliers, but the two countries lacked the infrastructure needed to substantially increase deliveries of Russian crude oil and to start shipments of natural gas. Moreover, China's national oil companies felt unwelcome in the Russian upstream after political opposition prompted China National Petroleum Corporation (CNPC) to abandon its bid for the Russian oil company Slavneft in 2002.¹

Zhang Guobao, a former head of China's National Energy Administration and a veteran of energy negotiations with Russia, expressed his frustration with the state of the bilateral energy relationship in a lengthy interview with Russian media in 2006. He said that "the Sino-Russia [oil] pipeline is one step forward, two steps back." He also lamented the lack of headway in discussions about a cross-border natural gas pipeline, noting that "even though there have been a lot of promises expressing Russia's interest in exporting natural gas to China, in truth no real progress has been made." Zhang was just as blunt in responding to a question about whether China had any plans to invest in the development of Russian oil reserves, stating that "Russia wouldn't let China purchase a small, little-known oil company....We've shown our willingness to cooperate with and invest in other countries, but Russia isn't willing to let us invest."²

Today, Zhang may have a different view of the energy relationship. In 2016, Russia surpassed Saudi Arabia to become China's largest supplier of crude oil on an annual basis, a position it retained in 2017.³ Russia is also poised to become a major supplier of natural gas to China within the next decade as new export projects commence operations and ramp up to full capacity. Moreover, Moscow has opened the door wider to Chinese investment in the Russian upstream.

Consequently, the bilateral energy relationship is now more robust than at any other time over the past decade. China has taken advantage of the needs of Russian energy firms for cash—both to pay down debts and to replace capital lost from the West due to U.S. and European Union sanctions—not only to secure large-volume, long-term contracts for oil and natural gas but also to pursue other national interests. These include creating business opportunities for Chinese firms in line with China's ambition to become an advanced manufacturing superpower and expand its access to Arctic shipping routes.

The first section of this essay details the increase in Russian oil exports to China over the past decade and the large volumes of natural gas that are set to be shipped from Russia to China over the next decade. The second section examines the main drivers of the burgeoning bilateral energy relationship. The essay then concludes by discussing implications for the United States and other exporters of oil and natural gas.

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¹ The best account of this is Bo Kong, *China's International Petroleum Policy* (Santa Barbara: Praeger, 2010), 104–7.

² "Interview with China's NDRC Vice Director Zhang Guobao," reprinted by *Hard Assets*, March 8, 2006, <http://www.resourceinvestor.com/2006/03/07/interview-chinas-ndrc-vice-director-zhang-guobao>.

³ Oceana Zhou and Sambit Mohanty, "In Race for China's Crude Market, Russia Wins Gold, Yet Again," S&P Global Platts, February 4, 2018, <https://www.spglobal.com/platts/en/market-insights/latest-news/oil/020418-analysis-in-race-for-chinas-crude-market-russia-wins-gold-yet-again>.