

Russia's Economic Role in Asia: Towards Deeper Integration.

Peter Rutland

In Ashley Tellis and Michael Wills (eds.), *Strategic Asia 2006: Trade, Interdependence and Security* (National Bureau of Asian Research, 2006), 173-204.

PETER RUTLAND is Professor of Government at Wesleyan University. He would like to thank Derrin Culp, Vladimir Kontorovich and Shinichiro Tabata for assistance with this paper. He can be reached at <prutland@wesleyan.edu>.

EXECUTIVE SUMMARY

Asia is becoming more important in Russian foreign policy, with Moscow embarking on the construction of new pipelines to export Siberian oil and gas to Asia. Work actually started on the Siberian end of the oil pipeline in April 2006.

Main Argument

- With a growing global energy shortage, Russia has a ready market for its Siberian energy resources in China, Japan and South Korea. But further developing Russia's economic integration with Asia will be a long and costly process.
- For the time being Europe is Russia's principal trade partner. However, looking ahead Moscow wants to develop deeper economic ties with Asia, in part because of political differences with its European partners.
- China represents not just an opportunity but also a potential threat for Russia, partly because of Russia's under-populated and strategically vulnerable Far Eastern provinces, and partly because of rivalry for influence in Central Asia.
- Moscow has been playing Beijing against Tokyo in negotiations over the Siberia-Pacific oil pipeline, with a view to getting the best possible deal. Russia now seems intent on building a pipeline with one branch to Daqing, China and another to the Perevoznaya seaport for export to Japan.
- Russia has a strong interest in continuing to sell arms and nuclear technology to China, India and other countries in the region. This helps to maintain Russia's defense industries, but also gives Russia some political leverage in the region.
- Even though President Vladimir Putin has centralized decision-making, there is still a lot of faction-fighting among rival corporations, government agencies and regional leaders, which may further delay the economic development projects.

Policy Implications

- With Sakhalin and Siberian oil and gas coming on stream, Russia's economic presence in Asia will substantially increase. This should be good for the US because it will lower anxiety over energy security in China and Japan.
- Moscow does not seem inclined to tightly link economic interests with strategic goals. This means for example that Japanese hopes that increased trade will lead to resolution of the Northern Territories question may be misplaced.
- US oil companies have a good chance to share in the fruits of this boom, but this will require patience, a long-term perspective, and a willingness to play by Russia's rules of the game.

- With high oil prices and strong economic growth, Moscow is not going to take any risks or embark on any radical policy changes. The US should not take too seriously scare scenarios such as the specter of a close Russian-Chinese alliance. The US is a key partner for both Russia and China and neither country wants to damage its relations with Washington.

Organization of the Paper

Introduction

The Role of Foreign Economic Relations in Russia's National Strategy

Russia's Economic Integration with Asia

Relations with Countries of the Region

Domestic Political Debates

Conclusion

Russia is unique in being a country with a presence both in Asia and Europe. Less than 8 million Russians, a mere 5 percent of its population, live in the Russian Far East – but Russia occupies one fifth of the Asian landmass, and holds immense mineral wealth. It is Russia's energy resources that are the key to its economic and strategic role in Asia.

Russia sees both threats and opportunities in Asia. Western commentary tends to emphasize two extremes: on one side, a vision of a bonanza of Russian resources flooding into energy-starved East Asian markets. On the other side, many analysts offer alarming scenarios of the thinly-populated Russian Far East being swamped by migrants from the 1.3 billion Chinese to the south; or alternatively of a Russo-Chinese alliance challenging the United States for global hegemony.

None of these extreme scenarios is likely to come to pass – certainly not within the next five years. The Russian leadership is not under any pressure to take drastic and risky decisions, so a policy of cautious continuity is most likely in Russia's relations with Asia in the immediate future.

Rising world oil prices have helped fuel a seven-year economic boom in Russia, during which GDP has grown by more than 50 percent. As the world's leading natural gas supplier and number two oil exporter, Moscow is confident that its favorable economic situation will persist into the foreseeable future. As noted by the respected analyst Dmitri Trenin, "The Russian leadership is certain that Russia's energy resources make Russia truly 'irreplaceable' in the

global economy, and consequently in world politics.”¹ This gives President Vladimir Putin the luxury of carefully weighing the options in foreign policy.

On the other hand, in 2006 Russia is definitely feeling politically embattled. The Russian leadership saw the wave of “color revolutions” that swept through Georgia, Ukraine and Kyrgyzstan from 2003-05 as part of a deliberate US strategy to loosen Moscow’s influence over the “near abroad.” This impression was reinforced by the presence of US military bases in Kyrgyzstan and Uzbekistan, set up to pursue the war in Afghanistan.² At the same time Russia finds itself berated by the United States and European Union for its retreat from democracy, and for its “extortion” of higher gas prices from Ukraine by cutting deliveries on 2 January 2006. It is told by American think-tanks that it is headed in the “wrong direction;” even that its military can no longer defend the country from US nuclear attack.³

In response to these challenges, Russia has shed some of its illusions about closer integration with the West, and has started to look more seriously for Asian partners to balance US pressure. Dmitri Trenin bluntly states that “Russia’s leaders have given up on becoming part of the West and have started creating their own Moscow-centered system. Russia has a choice between accepting subservience and reasserting its status as a great power, thereby claiming its rightful place in the world alongside the United States and China.”⁴ Germany’s leading Russia expert, Alexander Rahr, argues that Europe is experiencing a “cold peace,” and that “Russia feels

1 Dmitri Trenin, “The post-imperial project,” *Nezavisimaya gazeta-dipkurier*, no. 2, January 2006.

² The US quit the Uzbekistan base in July 2005.

³ “Russia’s wrong direction. What the US can and should do,” Council on Foreign Relations, March 2006; Keir Lieber and Daryl Press, “The rise of US nuclear primacy,” *Foreign Affairs*, March 2006. Similar warning is to be found in the report from the London-based Foreign Policy Center, “Russia and the G8: A Summit Scorecard,” June 2006. <http://fpc.org.uk/fsblob/796.pdf>. For a reply, see Vitalii Ivanov and Konstantin Simonov, “Russia’s right path,” *Nezavisimaya gazeta*, 2 May 2006. Ivanov is head of the Political Projects Center, Institute of Social Planning, and Simonov is general director of the Political Situations Center.

⁴ Dmitri Trenin, “Russia leaves the West,” *Foreign Affairs*, vol. 85, no. 4, July/August 2006.

rejected by the West and pushed off to Asia.”⁵ Andrew Kuchins even argues that 2005 saw the most serious strategic shift in Russian foreign policy since the collapse of the Soviet Union, in the form of a reorientation of Russian policy towards the East.⁶

Increasingly, this reorientation away from the West is connected to energy policy. In March 2006 Aleksandr Chudodееv wrote “There is every reason to believe that energy cooperation with China is our greatest national project, if only in terms of its cost.” And “Washington is drawing the reasonable conclusion that the Sino-Russian oil and gas alliance will make global energy security somewhat insecure for the United States.”⁷ In April 2006 Gazprom CEO Aleksei Miller warned EU ambassadors that “It would be a mistake to forget that we are actively expanding into new markets like North America and China. What if we reroute to the East? At first, we plan to reroute 30 million tons there. Prices in Europe will rise.”⁸ Speaking in Tomsk after talks with German Chancellor Angela Merkel on 26 April 2006, Putin said “We hear statements about a threat of dependence on Russia, about the need to restrict Russian companies’ access to European markets. What can we do, when we hear the same thing every day? We are beginning to look for other markets.”⁹

At the same time, Russian policy is deeply conflicted. Many Russians are concerned by the growing power of China. They do not want to jump from the frying pan into the fire by aiding the rise of a new rival to the East, in providing Beijing with energy resources and advanced military hardware.¹⁰ Dmitri Trenin argues that “Russia lacks an overall political

5 “Europe experiences a ‘cold peace,’” *Die Welt* (Germany), 20 December 2005.

6 Andrew Kuchins, “New directions in Russian foreign policy: is the East Wind prevailing over the West in Moscow?” Wilton Park conference paper, 29 November 2005. Reprinted in Johnson’s Russian List, no. 9314, 6 December 2005.

7 Aleksander Chudodееv, “Going east,” *Itogi*, no. 13, 27 March 2006.

⁸ Nataliya Grib, “Europe’s raised eyebrows,” *Kommersant*, 25 April 2006.

⁹ Saed Shah, “Putin rails against Western ‘double standards,’” *The Independent* (London), 28 April 2006.

10 Max Verbitz, “Russian-Chinese military cooperation: Can a bear trust a dragon?,” *Perspective* (Boston University), vol. 26, no. 3, May 2006. The author is a Russian, using a pseudonym.

strategy in Asia – something that would outline Russia’s multilateral relations with East Asia and bilateral relations with Asian states.”¹¹

These changes come at a pivotal time in the evolution of Russia’s energy policy. Though Russia has profited from the recent boom in oil prices, its existing oil and gas fields have passed their peak, and there is an urgent need for massive investment to develop new fields. At the same time, Russia’s hydrocarbon export infrastructure is operating at full capacity and new pipelines are needed to shift oil and gas currently being used domestically into the more lucrative export market. Of course, the new interest in China does not mean that Russia will cease being deeply engaged with Europe. Some new pipelines to bring oil and gas to the West will be built. In December 2005 work started on the \$5 billion North European Gas Pipeline, which will carry 27 billion cubic meters of Russian gas to Germany each year.

This chapter proceeds by reviewing the general state of the Russian economy and the role of international economic integration in Moscow’s development strategy. It then outlines the existing structure of Russian trade with Asia, and examines the two main elements in Russia’s Asian trade: energy and arms. The next section examines Russia’s role in regional associations, particularly the effort to turn the Shanghai Cooperation Organization into an effective regional body for security cooperation in Central Asia – and one that tries to limit the US role in the region. The paper continues with a review of Russia’s relations with individual Asian countries, and concludes with a discussion of the policy debates over Russia’s role in Asia.

The Role of Foreign Economic Relations in Russia’s National Strategy

Russia has been going through a period of wrenching political and economic transformation since 1991. The outcome of this transformation is still uncertain, though the contours have become clearer since the consolidation of state power under President Vladimir Putin. Russian foreign policy is still heavily influenced by domestic concerns: the need to

¹¹ Interview with Dmitrii Trenin, Rustem Falyakhov “Continuing the old dispute deprives both sides of potential benefits,” *Gazeta*, 18 November 2005.

maintain political and economic stability, and the state's struggle to assert control over warring factions and implement a coherent policy. These domestic considerations are hindering efforts to deepen Russian engagement with Asia.

Under both Putin and his predecessor, Boris Yeltsin, Russia has been trying to reform its economic structure and adopt some of the market institutions that have brought prosperity to other countries. This strategy has emphasized increased participation in the international economy through trade and investment. Energy is Russia's trump card. Russia produced 459 million tons of crude oil in 2005, 11.9% of global output, second only to Saudi Arabia with 13.1%. Russia was the world leader in natural gas, with her 215 billion cubic meters of exports accounting for 27% of the world market, well ahead of Canada (13%) and Norway (9%).¹² Between 1998 and 2004, booming oil exports from Russia satisfied half of global demand growth.¹³ Russia already provides 25% of the European Union's energy needs: the question is whether that proportion will increase, and whether Russia should expand the range of its exports to include East Asia and the United States.

In the Yeltsin period, Russia's integration into the global economy proceeded at a rapid but uneven pace, with individual corporate leaders (the oligarchs) often playing the leading role. Putin has taken decisive steps to reassert state control over domestic and foreign economic development. But companies such as the pipeline operator Transneft and the energy giants Gazprom and Rosneft are still to a degree independent players, despite the fact that the state owns a controlling block of their shares and forces them to follow the Kremlin line when required. This means one must be cautious in making generalizations about Russia's "grand strategy," since these debates assume a greater coherence in Russian policy than may in fact be the case.

Development of the energy sector has been the main driver of Russia's economic recovery since the August 1998 financial crisis. The Russian economy has experienced steady

12 IMF World Economic Outlook Database. www.imf.org

13 William Tomson and Rudiger Ahrend, "Realizing the oil supply potential of the CIS," Organization for Economic Cooperation and Development, 18 May 2006. www.oecd.org They estimate Russia's contribution 1998-2004 at 48%, and the other former Soviet countries an additional 12%.

growth, an average 6% a year since 1999.¹⁴ (See Table One) Much of the growth has been led by the surge in exports, which rose from \$72 billion in 1998 to \$183 billion in 2004 and \$244 billion in 2005, when oil and gas accounted for 61% of earnings.¹⁵ (See Table Two) Trade now accounts for 48% of Russia's GDP. The proportion of the population living in poverty has halved 1999-2005, while state revenues have doubled thanks to more effective taxation of the soaring oil and gas rents. The federal budget ran a surplus equal to 7.5% of GDP in 2005. High oil prices also led to a large trade surplus, the accumulation of capital reserves of \$180 billion, and the paying down of some international debts ahead of schedule (\$15 billion in 2005 alone).

[INSERT TABLE 1 AND TABLE 2 ABOUT HERE]

[Note to reader: tables are end of document]

Putin has not rolled back the market reforms laid down by Yeltsin in the 1990s. On the contrary, he has pushed ahead with some institutional reforms, especially in regards to codifying Russian law and reducing bureaucratic obstacles to business, though much work remains to be done. For example, liberalization of domestic gas and electricity prices is still blocked by worries over the popular protests that such a policy would provoke. (Gas still retails at \$30 per 1000 cm for industrial consumers, as against \$230 paid by European customers.) Putin has stripped the oligarchs of their political power by taking over their media empires and putting the State Duma under the control of a single, pro-presidential party, United Russia. Putin has constructed a system of state corporatism in Russia, displacing the model of independent, private corporations controlled by swashbuckling oligarchs that was the pattern of the 1990s. The prime target for this strategy was the energy sector, in the form of the private Yukos oil company, but the past year has seen the model extended to the defense industry, aircraft, engineering and even auto manufacturing. Opinions differ as to whether this state corporatism is compatible with a market economy, and whether it will be able to produce sustainable economic growth in Russia. Within

14 Organization for Economic Cooperation and Development, *Economic Survey Russian Federation 2004* (Paris: OECD, 2004); World Bank, *From Transition to Development*, April 2004; World Bank, *Russian Economic Report*, no. 12, April 2006. www.worldbank.org.ru

15 World Bank April 2006, p. 8. In 2005 imports dropped 25% to \$126 billion, leaving a trade surplus of \$118 billion.

Russia the optimists outnumber the skeptics, while among Western observers the balance of opinion is reversed.

The Kremlin believes that a more market-driven approach would not work given Russia's geographic isolation and resource endowment. They draw upon the chaotic experiences of the 1990s, culminating in the financial crash of August 1998, to prove their point that radical market liberalization was ill-suited to Russia's unique circumstances. The state wants to prevent Russia from slipping into dependency on energy exports by capturing the rents from the energy trade and channeling them back into investment in high-tech research and manufacturing to rebuild Russia's now-outdated industrial base. The rent-capture is taking place both through taxation and through the formation of vertically-integrated state corporations, whose boards headed by loyal Kremlin appointees.

There are several question marks over this strategy. First there is the governance issue: will the Kremlin be sophisticated enough to pull off this *dirigiste* development strategy? Will it be able to prevent faction-fighting between rival elites from derailing the program? What happens after Putin leaves office, when his second and final term as president expires in 2008?

Also, there is uncertainty over whether Russia will be able to generate the energy exports that the strategy requires. Most of Russia's network of 49,000 kilometers of oil pipelines and 150,000 km of gas lines was laid down more than 30 years ago. A massive program of investment is needed to upgrade this infrastructure and add new capacity. At the same time existing oil and gas fields are past their peak and little exploration and development has taken place over the past 20 years. The OECD predicts that Russian oil and gas production will plateau for the next 15-20 years.¹⁶ Investment is hampered by uncertainty over who will own what and hence benefit from these assets. Russian oil firms invested a mere \$7 billion in 2000-03, while gross receipts ran at \$70 billion in 2003 alone.¹⁷

16 Tomson and Ahrend, *op. cit.*, citing the Institute for Energy Policy and the US Geological Survey. Russia has 72 billion barrels of proven reserves, 6.1% of world total, in 2004 they produced 9.3 million barrels/day, 8.7% of world output, of which 5.1 million were exported.

17 "Russian oil: the present and the future," conference in Moscow 18-20 May 2004, RosBusinessConsulting 19 May 2004; Thompson & Ahrend, *op. cit.*

Long term, there is still considerable uncertainty over the cost-effectiveness of investments in Russian energy.¹⁸ If oil stays above \$40 a barrel for 10 years, exploiting the oil and gas basins of central Siberia may be technically feasible and cost-effective. It might even be profitable to build a 3,000 km pipeline to export these resources to China and Japan. But there are many variables in the mix. At that price, oil shale and tar sands may become competitive rival sources; and at any time a world recession could send the oil price plummeting. The Russian government seems to be in no hurry to tackle these challenges, being preoccupied with short-term stability and medium-term institutional reforms. There is also the practical question of who gets to control the export infrastructure, and reap the resulting benefits: how will the projects be divvied up among rival Russian corporations? What share will foreigners be permitted?

Western companies understand that they are now faced with new rules of the game. They are still welcome as partners, especially for the technology and managerial expertise that they bring. But they will be limited to a minority stake in Russian-led companies and joint ventures, and foreign majority ownership of subsoil resources now seems off-limits. Increasingly, Russian state policy has focused on helping Russian companies (both private and state-owned) to become world-leaders, going beyond export sales to include raising capital on international markets and acquiring foreign assets. Western companies interesting in investing in Russia are expected as a quid pro quo to form joint ventures in other countries to help Russian corporations such as Gazprom, Rosneft and Lukoil gain access to more lucrative down-stream markets in Western countries through ownership of refineries and distribution networks.

Integration with global economic institutions is an important part of the Putin strategy, but it is subject to political limits laid down by Moscow. Russia wants the benefits of integration without the constraints that usually come with it. Russia sees itself as a rule-maker rather than a rule taker in international affairs, at least in the areas close to home where it can exert some influence.

Russian integration into international economic institutions has lagged behind the increased role for foreign trade in its economy. Although it is a member of the Group of Eight

18 Leslie Dienes, "Observations on the problematic potential of Russian oil and the complexities of Siberia," *Eurasian Geography and Economics*, vol. 45, no. 4, July 2004.

leading industrial countries (G8), that is mainly of symbolic value.¹⁹ Russia yielded to European Union entreaties and agreed to join the Kyoto Protocol in March 2005 – in return for the EU’s backing for Russian entry to the World Trade Organization (WTO), despite their objections to Russia’s low domestic energy prices. Russia began negotiating WTO entry in 1993, but hopes that Russia would be able to join in 2006 have not born fruit. Russia is the only major economy that is not a WTO member. The main obstacle now are US objections to weak intellectual property protections and limited access to banking and insurance markets inside Russia.

The economic and political challenges of forging a new development strategy are working to slow down an eastward shift in Russia’s foreign economic policy. But strategic considerations – a desire to protect Russia from US encirclement and EU exclusion, and to assert Russia’s pride as an independent power – are pushing Moscow to speed up the collaboration with new partners in Asia. There is a sense that Westward integration has reached its natural limits, for the time being. The idea of Russia joining the European Union, for example, is “fantasy.”²⁰ On the other hand Asia has vast and growing economies, whose demand for resources, arms and capital machinery suit the Russia economy’s strengths. An additional advantage is that Asian political structures are more compatible with Russia’s “managed democracy” – and the Asians have a habit of not making political criteria a condition for trade.

Russia’s Economic Integration With Asia

Trade

Russia is still heavily dependent on trade with Europe, but the prospects are good for a rapid increase in trade with Asia in the next few years. The bulk of Russia’s trade (upwards of

¹⁹ Russia began attending G7 meetings as an observer in 1991. It became a member in 1998, though it continued to be excluded from finance minister meetings. In February 2005 US senators Joe Liberman and John McCain called for Russia’s suspension from the G8, but the Bush administration has rebuffed such calls. Russia will take over as chair of the G8 at the July 2006 summit in St. Petersburg.

²⁰ Vladimir Portyakov, “Russia, China and India in the world economy,” *Russia in Global Affairs*, no. 2, April 2006.

75%) still flows west to Europe. (See Table Three) Her largest trading partners are Germany and Ukraine, with the EU-25 taking 51% of Russian exports and providing 33% of her imports in 2004.²¹ Out of a total trade turnover of \$289 billion, only \$36 billion was with Asia and another \$14 billion with Central Asia.

[INSERT TABLES 3 AND 4 ABOUT HERE]

There is nothing surprising in this pattern. Most of the population lives in European Russia, and the railway and port infrastructure was built for trade with Europe. In the 1960s-1980s oil and gas pipelines were built connecting Russia to her socialist bloc partners in East Europe and to Germany and beyond. Russia has a common border with EU members Finland, Estonia, Latvia and Lithuania, and its Kaliningrad province is an exclave physically located between two Poland and Lithuania. Moscow is three hours by plane from Brussels, but seven hours from Beijing. St. Petersburg is a one-hour flight from Helsinki.

At the same time, there is widespread recognition that over the past decade Asia has become the powerhouse of the global economy, one whose weight will only increase in future decades. Economic cooperation between Russia and Asia needs to be stepped up to adapt to this new reality. Energy is clearly the key: Russia has the resources; China, South Korea and Japan the demand (and the capital); and Japan the technology.

But it is not at all clear that Russia fully shares this vision of deeper integration. Some parts of the Russian political elite still see Asia more as a source of threats than opportunities. Moscow is aware of the huge potential for growth in the export of resources to Asian markets, but is also aware of the costs of such projects, the political implications, and the need to strike a good deal.

Energy: The Pipeline Puzzle

The key to Russia's new Asia strategy is the building of a new export pipeline for Siberian oil. Substantial new oil and gas reserves have been found in Siberia, amounting to an estimated 17% of global oil reserves. The plan is to build a pipeline to carry 600,000 barrels of oil per day (80 million tons per year) across the continent to customers in East Asia, through

21 Prior to the 10 new members joining the EU in 2004, the EU-15 accounted for only 33% of Russian trade.

what has come to be known as the East Siberia-Pacific Ocean pipeline (VSTO in Russian). This pipeline, together with the projects on the island of Sakhalin, would see the proportion of Russia's oil exports sent to Asia leap from the current 3% to 30% by 2020.

For China and Japan, securing new energy sources that do not depend on the flow of supplies from the Persian Gulf is a major strategic priority.²² China is keen to develop secure overland supply routes from Russia and Kazakhstan, since the sea routes that bring Persian Gulf oil to East Asia through the Straits of Malacca could easily be blockaded in the event of a future confrontation with the US.

China and Russia have been mulling over an oil export pipeline since 1993. The past few years have seen a remarkable back-and-forth between two alternative routes for the pipeline. The original plan was a 2,500 km line from Angarsk in Siberia directly across Mongolia to Daqing in north-east China, the center of China's declining oil industry. Mikhail Khodorkovsky, the ambitious head of Russia's largest oil company, Yukos, won China's agreement to finance the building of the line, and the agreement was signed in the presence of President Putin and President Hu Jintao during a state visit to Moscow in May 2003. This would have been the first privately-owned oil export pipeline in Russia (the others are owned and operated by the state-owned Transneft corporation). The exact track was still not decided: the Russian government preferred a longer route that would follow around the Russian border rather than cross Mongolia.

However, in July 2003 Putin authorized the arrest of five Yukos executives on charges of fraud and tax evasion, and Khodorkovsky himself was arrested in October 2003. Khodorkovsky was seen as a threat to the Kremlin on several fronts. He was believed to be preparing to sell Yukos to a foreign oil major, something that went against the Kremlin policy of keeping natural resources in Russian hands. He was also investing heavily in political representation in the State Duma, and possibly preparing a run for the presidency in 2008. With Khodorkovsky out of the way (he was jailed for eight years in 2005), there was an energetic struggle for control of Yukos assets. The majority-state owned company Rosneft bought the main Yukos production subsidiary in December 2004 for \$9.5 billion (helped by a \$6 billion loan from the Chinese National Petroleum Corporation, or CNPC). Gazprom's plan to absorb Rosneft and form one giant energy

22 Stephen Blank, "China's energy crossroads," *Perspective*, vol. 26, no. 3, May 2006, pp. 2-7.

conglomerate was blocked after months of backroom maneuvering.²³ Gazprom went on to buy the private oil company Sibneft (owned by oligarch Roman Abramovich) for \$13 billion in November 2005, meaning that 60% of hydrocarbon production was now back in state hands. This new model of state corporatism poses a distinct challenge to foreign investors. For example, BP-TNK is now under pressure to share its giant Kovytko field in Siberia. China got a taste of the new approach in December 2002 when it was shut out of the bidding for a Russian oil company, Slavneft. A new subsoil resources bill introduced into parliament in 2006 will bar foreign companies from more than 50% ownership of any field deemed “strategic.”

Meanwhile, debate continued over the route of the export pipeline. Much to China’s chagrin, in the summer of 2003 Russia backed out of the Angarsk-Daqing deal and started entertaining a Japanese proposal for a 4,000 km pipeline all the way down to the port of Nakhodka. That would be more costly, but would enable tankers to ship the oil to Japan or other customers and avoid Russian dependence on a single buyer – China. Both Japan and China offered to lend billions of dollars to finance the project. The start point of the pipeline in Siberia was switched from Angarsk (site of a Yukos oilfield) to Taishet, the location of a Rosneft refinery. The official Russian position as of July 2006 is to favor *both* routes. The first segment of the VSTO will run from Taishet to Skovorodino and will cost an estimated \$6.5 billion. A second phase Skovorodino to Perevoznaya bay (now favored over Nakhodka) will cost another \$5 billion. China is willing to pay for the Skovorodino-Daqing branch.²⁴ It’s not clear if the double line will be commercially viable, or even if there is enough oil to justify the project.

There are still groups within Russia who oppose the building of either pipeline. Environmentalists vociferously protested the potentially devastating impact of the project on the pristine Lake Baikal. In September 2005 the Natural Resources Ministry rejected Transneft’s

23 Both companies are run by close allies of President Putin. Dmitri Medvedev, promoted to first deputy prime minister in November 2005, simultaneously serves as chairman of the Gazprom board, while the deputy head of the Presidential Administration Igor Sechin is in charge at Rosneft.

24 Some analysts complain that Transneft is deliberately exaggerating the costs, others point out that such projects nearly always over-run initial estimates.

plan to have the pipeline travel just 800 meters from the lake's northern shore.²⁵ In March and April 2006 there was a series of protests by environmental groups in Irkutsk and Moscow that draw attention to the issue. Irkutsk governor Aleksandr Tishanin and other provincial leaders want more money spent on developing the infrastructure in Siberia (such as connecting outlying cities to the natural gas grid) rather than see the region's resources shipped out to China in return for money sent back to Moscow.²⁶ There is a strong lobby in favor of investing in the development of the Baikal-Amur railway, a Brezhnev-era extension of the Trans-Siberian railway that runs north of Lake Baikal, that can be used for oil exports by rail as an interim solution. President Mikhail Nikolaev, head of the diamond-rich but isolated northern republic of Sakha (Yakutiya) is among those arguing for more investment in Siberian development rather than in resource exports.

Battles continue between the leading companies for control over the pipelines. Transneft is the main player, but Rosneft, Gazprom and Lukoil are also vying for a piece of the action. These corporations have their own backers in the various agencies: the Ministry of Energy and Industry, the Ministry of Trade and Economic Development, the Federal Energy Agency. For example, Energy Minister Viktor Khristenko reportedly favored routing more Russian oil through the Kazakhstan-China pipeline completed in December 2005, rather than putting all efforts into the VSTO.²⁷ Some industry specialists suggest that Gazprom and Lukoil prefer to focus their resources on building pipelines west to a White Sea port that would export the East Siberian oil and gas to Europe.²⁸ Gazprom may be facing a shortfall in supplies for its European

25 Andrew Neff, "Transneft's options after rejection of Pacific pipeline plans," Prime-Tass, 30 September 2005.

26 V.I. Suslov and A.G. Korzhubaev, "Energy-transport routes in Siberia and the Far East," *EKO*, no. 8, 2005, pp. 47-67; Marina Zabolotskaya, "How to tame the Asian tigers," *Rossiiskaya gazeta*, no. 287, December 2005.

27 Nikolai Vardul, "New quarter-masters of the oil pipeline," *Gazeta*, 10 April 2006.

28 Michael Bradshaw, "Russia and transnational energy companies: conflict and cooperation in Pacific Russia, in Robert Orttung and Andreas Wagner (eds.), *Promoting Prosperity of Conflict? The Role of Russian Business in Foreign and Security Policy*. (London: Routledge Curzon, forthcoming).

customers over the next five years: its West Siberian fields peaked five years ago, and new sources such as the offshore Shtokman fields in the Barents Sea have yet to be developed.

For two years Putin has been unable or unwilling to come down with a clear decision on the project, much to the frustration of his Chinese and Japanese interlocutors. In April 2005, Moscow issued an order for the pipeline to be constructed from Taishet to the halfway point at Skovorodino near the Russian-China border. In remarks during a news conference at the G8 summit in Gleneagles, Scotland on 9 July 2005 Putin suggested that the first extension of the pipeline will be the branch to China. During President Hu Jintao's visit to Moscow the previous week, CNPC and Rosneft signed a long-term cooperation agreement, but a specific commitment to build the Daqing pipeline was conspicuously absent. At the Valdai forum with Western journalists in September 2005, Putin again indicated that the branch of the pipeline from Skovorodino into China would be built first. But during a visit to Beijing on 20-21 March 2006, Putin was still unable to give a firm commitment to the Chinese, saying that a final decision must await the result of feasibility studies dealing with environmental and financial issues. Zhang Guobao, vice-minister of the National Development and Reform Commission, complained "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. This is regrettable."²⁹ A Russian journalist picked up a similar quote from Mr. Zhang: "Look at the pipeline-building issue: one day the weather's overcast but turning fine, the next day it's sunny but turning cloudy. One Russian official says that Russia has made a decision, while another says it hasn't."³⁰ During Putin's March 2006 Beijing visit Gazprom did sign a protocol with CNPC expressing its intention to build by two pipelines to export 80 billion cubic meters of gas to China by 2011 (of which 10% would come from Sakhalin).³¹

Finally, ground was broken on the Taishet-Skovorodino section of the pipeline on 28 April 2006. Speaking at a meeting of Siberian regional leaders in the Siberian city of Tomsk on 26 April, Putin ordered that the pipeline be routed 40 kilometers north of Lake Baikal to avoid

29 Quoted in Carl Motished, "Russia holds the solution to its neighbour's shortage," *Times* (London) online, 21 March 2006.

30 Aleksander Chudodeev, "Going east," *Itogi*, no. 13, 27 March 2006.

31 Irina Reznik, "The great pipeline of China," *Vedomosti*, 22 March 2006.

possible pollution.³² However, in a subsequent meeting with Putin on May 26 Transneft head Semyon Vainshtok said that because of impassable mountains the new pipeline route would in fact have to run 400 km north of Lake Baikal, adding considerably to the cost.³³

Why was Moscow being so indecisive about the final destination of the pipeline? Part of the problem is price. The Chinese, notorious hard-bargainers, were reportedly offering low-ball prices: \$25 a barrel for oil and \$40 per cubic meter for gas.³⁴ These prices are one third and one fifth of what Russia's European customers are currently paying, for oil and gas respectively. According to one report, "the breakthrough came [in September 2004] when the Chinese comrades were persuaded to link the price of Russian gas to petroleum product prices in China, which correspond to world prices, rather than the price of coal."³⁵

At the same time, Russian leaders have occasionally raised the specter of energy sales to Asia to scare European customers into agreeing to their demands – for ownership of downstream assets, for example. In April 2006 Gazprom's Aleksei Miller told the EU ambassadors in Moscow "It would be a mistake to forget that we are actively expanding into new markets like North America and China. What if we reroute to the East? Supply will decrease. At first, we plan to reroute 30 million tons of oil there, and that means that Europe will not receive this amount. Prices in Europe will rise."³⁶ The same month Putin told journalists "We should look for sellers' markets" and "prioritize the Asia-Pacific region."³⁷

While the struggle continues around the VSTO, the development of the oil and gas fields on the island of Sakhalin is proceeding apace.³⁸ The \$10 billion being invested in oil and gas

32 Sergei Blagov, "Putin pleases environmentalists," *Eurasia Daily Monitor*, 27 April 2006.

33 Meeting in Sochi, 26 May 2006. www.kremlin.ru/eng/speeches/2006/05/26. Vainstok had earlier estimated that the detour would cost \$900 million - Ekho Moskvyy, 20 April 2006.

34 Vladimir Milov, "How sustainable is Russia's future as an energy superpower?," Carnegie Endowment, Washington DC, 16 March 2006. www.carnegieendowment.org

35 Chudodeev, *op. cit.*

36 Nataliya Grib, "Europe's raised eyebrows," *Kommersant*, 25 April 2006.

37 RIA-Novosti, 26 April 2006.

38 Michael Bradshaw, "Sakhalin projects show why Russia still needs foreign investors," *Pacific Russia Oil and Gas Report*, winter 2005.

extraction on Sakhalin represents the largest single foreign investment in Russia ever (and the final total invested may rise to \$50 billion). Exxon's Sakhalin 1 has about 300 million tons of oil reserves, and Sakhalin 2, 150 million.³⁹ Each has some 500 billion cubic meters of gas. Sakhalin 1 started pumping oil on a modest scale in 2005. Royal Dutch Shell is managing the challenging offshore development Sakhalin 2, which is 60% complete.⁴⁰ Ecological concerns, geological difficulties, and some renegotiation of licenses have delayed the projects by several years. Once extracted the oil and gas will be piped 800 km to ice-free ports at the island's southern tip, where an LNG facility is being built with a capacity of 10 billion cubic meters a year (8% of current world demand). In January 2004, the Russian government cancelled the license for the development of the Sakhalin 3 field, which had been won by ExxonMobil back in 1993. Now Rosneft holds a 75% stake in Sakhalin 3. Shell is under pressure to bring Gazprom into its Sakhalin 2 project. Given the political and ecological uncertainties surrounding ocean-floor pipeline construction to Japan or land-lines across North Korea, it looks like LNG will be the main vehicle for natural gas exports from Sakhalin.

Arms Trade

The arms trade remains a significant source of revenue to Russia, with China and India as the leading partners. Russian arms sales recovered from \$2.9 billion in 1998 to \$5.6 billion in 2004. In the period 2001–2005, 43% of Russia's deliveries went to China and 25% to India.⁴¹ Russia sold \$6.13 billion worth of arms in 2005, of which 70% went to China and India, and has some \$23 billion in booked orders.⁴² It is important to remember that throughout the 1990s arms

³⁹ Exxon is the lead operator with a 30% stake, its partners include India's ONGC (20%), Japan's Sodeco (30%) and Rosneft (20%). <http://www.sakhalin1.com/>

⁴⁰ Shell has a 55% stake in Sakhalin 2, along with Mitsui (25%) and Mitsui (20%). www.sakhalin-2.com/. "Make or break for Shell in Russia," *Sunday Times* (London), 12 March 2006.

⁴¹ www.sipri.org; Bjorn Hagelin et al., "International arms transfers," ch. 10 in *SIPRI Yearbook 2006* (Stockholm International Peace Research Institute, 2006).

⁴² *Nezavisimaya gazeta*, 10 February 2006; Konstantin Lantratov, "One billion in four days," *Kommersant*, 20 February 2006.

accounted for a mere 5% of Russia's total exports, and as oil prices boomed the proportion shrank still further. However, this revenue has been vitally important in keeping Russia's once-proud defense industry afloat, since the cash-starved Russian armed forces were not buying any new weapons for most of the 1990s. "The exports of arms to China in the 1990s ensured the survival not just of individual plants, but whole regions."⁴³ Russian defense procurement has doubled since 2000, reaching \$6.5 billion in 2005 and \$8 billion in 2006, but in spring 2006 Russia's defense plants were operating at only 40% of capacity.⁴⁴ Hence the sector still needs foreign sales to survive – and to fund the development of next-generation weapons. (To date, Russia has been selling mainly 1980s-era technology.)

[INSERT TABLE 5 ABOUT HERE]

The Russian arms trade bureaucracy has been ridden with corruption, which Putin's centralization efforts have not totally eliminated. Five years ago Putin created the Rosoboronekспорт corporation to coordinate arms production, and it now handles 85% of overseas sales. Some 20 firms still have the right to sell arms abroad directly, mainly parts and servicing.

China began buying arms from Russia in 1992 after a 30-year hiatus. It has since received 12 kilo-class submarines; four Sovremennyi class destroyers equipped with SS-N-22 Sunburn anti-ship missiles; 12 S-300 and 27 Tor M-1 air-defense complexes; 200 fourth generation fighters (SU-27 and SU-30) and a license to produce 450 more domestically.⁴⁵ Two of the subs will be built at Komsomol'sk-na-Amur, in Russia's Far East, providing a vital source of revenue

43 Aleksandr Golts, "Trade partner, military ally. The evolution of military-technical cooperation between Russia and China," *Pro et Contra*, vol. 9, no. 3, 2005.

44 Viktor Baranets, "Why would Russia equip foreign armies?," *Komsomol'skaya pravda*, 9-16 March 2006; Viktor Myasnikov, "Military industry slides into bankruptcy," *Nezavisimoe voennoe obozrenie*, no. 14, 28 April 2006.

45 Golts, op. cit. See also Stockholm International Peace Research Institute, Trade Register.

for the Amur shipyard.⁴⁶ A year ago, Chair of the State Council of China Wen Jiabao announced that the practice of buying finished arms supplies from Russia had exhausted itself, and called for more licensing agreements.⁴⁷ In the past, aircraft accounted for more than 60% of exports, but naval sales accounted for 45% of total Russian arms exports in 2005, due in part to the delivery of two Kilo-class submarines to China, earning \$450 million. Future deals with China include the sale of 34 Il-76MD military transport planes and 4 Il-78 refueling tankers worth \$1.2 billion.⁴⁸

Russia has \$7 billion orders booked with India. The largest deals include a contract to sell three frigates (worth \$1.56 billion), 30 MIG-29Ks for the carrier Vikramaditya (\$1.5 billion), six Amur-1650 submarines (\$2 billion), and joint development of a transport plane (\$1.5 billion).⁴⁹ In 2004 Russia started delivering parts for 140 SU-30MKI fighters that will be assembled in India, which will earn Russia \$3.5 billion.⁵⁰

Russia is striving to find new customers beyond China and India. In 2003, President Vladimir Putin signed a \$900 million contract for 18 Su-30MKM fighters with Malaysia.⁵¹ In 2005 Russia sold ten Ka-32 helicopters to South Korea, and two S-300PMU1 air defense systems to Vietnam, worth \$250 million. Russian arms sales dipped in 2005 due to a variety of factors, such as financial problems in Indonesia and Thailand following the tsunami.⁵² Still, Indonesia plans to buy six Kilo-class submarines worth \$1.9 billion by 2010. Russia is happy to

⁴⁶ Since 1992 the Amur shipyard has not completed a single sub for the Russian navy, lacking funds to finish the three boats under construction. See “Komsomol’sk-na-Amur,” www.globalsecurity.org

⁴⁷ Aleksei Khazbiev, “Arms reconfiguration,” *Ekspert*, no. 46, 5 December 2005. Interview with Aleksander Denisov, Senior Deputy Director of the Federal Military Technology Cooperation Service.

⁴⁸ Lantratov, “One billion”, *op. cit.*

⁴⁹ Konstatin Lantratov, “Russia will flood India with military hardware,” *Kommersant*, 3 February 2006.

⁵⁰ Konstantin Lantratov, “Let down by the wings,” *Kommersant*, 1 December 2005.

⁵¹ Dmitri Litovkin, “Russia dilutes the military aircraft market with civilian planes,” *Izvestiya*, 7 December 2005.

⁵² Khazbiev, *op. cit.*

sell weapons to countries on the Pentagon's black list, such as Sudan or Venezuela.⁵³ In April 2006 Russia hosted a delegation from Myanmar after a three-year hiatus in sales to that country: Russia is interested in selling arms in return for oil and gas concessions.⁵⁴ China has been the main trade partner and arms supplier for Myanmar.

In 1995 Russia made a secret agreement with the US not to sign any new contracts for arms sales to Iran (the "Gore-Chernomyrdin pact") They withdrew from the arrangement in 2000, but only sold \$300-400 million of arms over the next five years. In December 2005 Russia signed a contract with Iran for the delivery of 29 Tor-M1 and Pechora-A2 air defense systems (less sophisticated than the S-300), worth \$700 million.⁵⁵ Kupol, the factory in the town of Izhevsk where Tors are assembled, had only \$30 million of sales in 2004.

The Russians have been wary of selling top-of-the-line technologies to China and India (such as airborne radar aircraft or AWACs) for fear of disturbing the strategic balance in ways that might threaten Russian interests. Academic Viktor Baranets asked: "Where are the guarantees that this military might, enhanced with Russia's help, will never be turned against Russia itself?"⁵⁶ Thus for example in November 2005 Igor Reshetin, director of the TsNIIMASH-Export company, was arrested along with two of his deputies for illegally selling space technology to the China. When asked about the wisdom of selling advanced weapons to foreigners, Rosoboroneksport Director Sergei Chemezov bluntly replied: "Let's face it: if we do not do it, somebody else will."⁵⁷ In April 2006 Defense Minister Sergei Ivanov said "I don't rule out that we might discuss selling the Su-34 [bomber] to China in the future. There are no such negotiations yet. The same is applicable to the fifth-generation fighters. To begin negotiations we need to settle a very important judicial issue, that is to sign an agreement on protection of

53 Igor Dmitriev, "Hello to arms," *Versiya*, no. 19, 22-28 May 2006.

54 Konstantin Lantratov, "Air-to-minerals missiles," *Kommersant*, 4 April 2006.

55 Aleksei Nikolskii, "Revenue from a rogue," *Vedomosti*, 2 December 2005.

56 Baranets, *op. cit.*

57 Andrei Vandenko, "An armed man," *Itogi*, no. 44, October, 2005, pp. 22-24.

intellectual property.”⁵⁸ Despite these reservations, some weapons sold to China (such as Sunburn anti-ship missiles) substantially augment China’s ability to threaten Taiwan.

Most analysts see Russia’s arms trade as mainly driven by the need to generate revenue for its arms industry, rather than serving as part of a grand strategy to build up a multipolar alliance with China and India. It is hard to separate the strategic from the economic logic behind the arms trade. For example, with respect to the military exercises between Russia and China that took place in August 2005, Defense Minister Sergei Ivanov candidly remarked “We consider the maneuvers to be like a testing range for Russian military hardware, a wonderful opportunity for advertising.”⁵⁹

Relations With Countries of the Region.

After taking office in 2000 Putin repeatedly signaled that he saw Russia as primarily a European power, reflecting the realities of geography, history and culture. He developed close personal ties with European leaders such as Tony Blair, Gerhard Schroeder and Silvio Berlusconi. Russian foreign policy priorities generally ran in a West to East direction: the top priority was Europe, then the western former Soviet countries (Ukraine, Belarus, Caucasus), then Central Asia, then North East Asia, then south/south east Asia. However, this pattern of priorities has started to shift over the past two years, as Moscow has focused more attention on Central Asia and East Asia. Russia has ambitious plans to boost trade with China, and in the past two years has held military exercises with China and India for the first time ever.

Regional Cooperation

Putin has been a frequent visitor to Asia and an enthusiastic participant in multilateral bodies such as the Asia Pacific Economic Cooperation forum. The most important vehicle for

58 Dmitri Litovkin, “The Shanghai cooperation organization is not NATO,” *Izvestiya*, 3 May 2006.

59 Dmitri Litovkin, “Any large scale maneuvers are a show of strength,” *Izvestiya*, 2 November 2005.

promoting Russia-China cooperation is the Shanghai Cooperation Organization (SCO).⁶⁰ The SCO was created in 2001, and grew out of the meetings that led to a border agreement in 1996 between the “Shanghai Five”: Russia, China, Kazakhstan, Kyrgyzstan, and Tajikistan.⁶¹

Although Russia would presumably have preferred to have exclusive leadership of security efforts in the former Soviet Union, it has reconciled itself to cooperating with China via the SCO.

One of the main goals of the SCO is to fight terrorism and separatism, with the Chinese particularly interested in suppressing the Uighur separatist movement in Xinjiang. Uzbekistan joined in 2001; Mongolia, Iran, India and Pakistan have observer status. The SCO does not welcome the idea of a permanent US military presence in the region. Shanghai academic Zhao Huashen denies that the SCO is an anti-American alliance, though he does complain about US “double standards” in allegedly supporting Uighur separatists, and cites Zbigniew Brzezinski’s enthusiasm for a new “great game” to contain China.⁶²

The SCO has created a Regional Anti-Terrorism Structure headquartered in Tashkent. Members of banned organizations may be arrested and sent to another member country. For example 19 Hizb-ut-Tahrir activists were extradited from Russia to Uzbekistan.⁶³ However the SCO charter does not have the equivalent of NATO’s Chapter Five, committing the members to mutual defense in case of an attack by any third party.⁶⁴

According to commentator Aleksandr Gabuev writing in May 2006, “The last twelve months have probably been the most productive period in the development of the SCO. This activization peaked at the SCO summit in Astana on 5 July 2005, where the heads of state issued

60 Zhao Huasheng, “China’s interest in Central Asia and the future of the Shanghai Cooperation Organization,” Center for Strategic and International Studies, August 16 2005; Konstantin Lantratov, “Transforming the six into a bloc,” *Kommersant*, 27 April 2006.

61 Chzhao Khuashen, “China, Central Asia and the Shanghai Cooperation Organization,” Carnegie Center, Moscow, Working Paper no. 5, June 2005.

62 *Ibid.*

63 Mikhail Vinogradov, “Fighters with terrorism agree to cooperate,” *Izvestiya*, 4 April 2006.

64 Dmitry Litovkin, “The Shanghai cooperation organization is not NATO,” *Izvestiya*, 3 May 2006.

a resolution all but demanding withdrawal of US military bases from Central Asia.”⁶⁵ In the face of Western criticism for its handling of the Andijan uprising in May 2005, Uzbekistan ordered the US to quit its Karshi-Khanabad airbase in July. Kyrgyzstan managed to persuade the US to increase the rent paid for its Manas airbase, by hinting that it would follow the Uzbek example.

The first SCO joint exercise, involving a scenario of a hijacked airliner, took place in Kazakhstan and China in 2003.⁶⁶ August 2005 saw large-scale military exercises between Russia and China for the first time in history. The “Peace Mission” program, which was not part of the SCO framework, involved 70 ships and 10,000 Chinese and 1,800 Russian troops. They practiced amphibious landings on Shandong peninsula, a hypothetical peacekeeping intervention in an ethnic conflict.

The fifth anniversary SCO summit took place in Shanghai on 15 June 2006. To Washington’s chagrin, Iranian President Mahmoud Ahmadinejad attended the summit as an observer, and broached the idea of Russian-Iranian cooperation to stabilize international natural gas prices. Russia and China reportedly disagree over whether to expand the SCO to include countries such as India and Pakistan.⁶⁷

In December 2005 the leaders of 16 countries – excluding Russia – gathered to sign the inaugural declaration of the East Asia Summit. The organization was initially proposed by Malaysian leader Mohamad Mahatir back in 1991, and was revived at the ASEAN plus three (China, Japan and Korea) summit in 2004. China sees the EAS as a vehicle to exert its influence through a new regional organization that conspicuously excludes the US. The EAS comprises the ten ASEAN countries plus China, Japan, South Korea, India, Australia, and New Zealand. The December 2005 meeting was marred by sparring between China, Japan, and India. Although Malaysia suggested adding Russia as a member, Australia and Indonesia reportedly objected to the idea.⁶⁸ Given the lack of progress in trade liberalization in the World Trade Organization’s

65 Aleksander Gabuyev, “The wall of Shanghai,” *Kommersant*, 16 May 2006.

66 Golts, op. cit.

67 Aleksander Gabuyev, “Path to SCO blocked for Iran,” *Kommersant*, 17 May 2006.

68 Petr Iskenderov, “Despite Australia,” *Vremya novostei*, 15 December 2005; Mohan Malik, “The East Asia Summit: More discord than accord,” *Yale Global Online*, 22 December 2005.

Doha round of talks, the Asia-Pacific Economic Cooperation (APEC) forum in Pusan, Korea in November 2005 limited itself to preparatory work on tariff reduction.⁶⁹

China

Russia and China are firm allies. China, like Russia, has nuclear weapons, a seat on the UN Security Council, and an authoritarian regime that is the target of frequent Western criticism. The last remaining unresolved issue in their relations, the drawing of their 4,000 km mutual border, was agreed in 2004. (Though delimitation of three islands in the Ussuri river remains to be completed.)

Russia is acutely aware of China's growing role in the world economy, and the business opportunities that this opens up. China's share in world trade rose from 0.8% in 1978 to 7.7% in 2005, while that of Russia fell from 3.4% in 1990 to 1.8% in 2005.⁷⁰ At the same time Russia is somewhat wary of making China stronger, and of becoming more economically dependent on its giant Asian neighbor. Moscow sees China as an economic rival in developing Central Asia energy, but also recognizes Beijing as a strategic partner interested in preserving stability in Central Asia and limiting the US presence in the region.

During President Hu Jintao's visit to Moscow in July 2005 the leaders issued a grandiose joint declaration on "World Order in the 21st Century."⁷¹ The document stressed the role of "multipolarity" and the importance of "non-interference in internal affairs" and "mutual respect" for other nations' sovereignty. Beijing has declared 2006 as "The Year of Russia" in China, and 2007 will be "The Year of China" in Russia.

However, the rhetoric may be running ahead of reality. There is a distinct gulf between professions of strategic partnership by the nations' leaders and the anemic economic relations between the two countries; a "gap between 'hot' contacts at the top and 'cold' contacts further

⁶⁹ Formed in 1989, APEC now has 21 members: Australia, Brunei, Canada, Chile, Hong Kong, China, Indonesia, Japan, Korea, Mexico, Malaysia, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, "Chinese Taipei," Thailand, USA, and Viet Nam.

⁷⁰ Giorgio Navaretti, "Patterns of trade and protection," World Bank, May 2004; World Trade Organization, "World Trade 2005," 11 April 2006.

⁷¹ Text is available in Russian at: www.kremlin.ru/interdocs/2005/07/01

down.”⁷² Russian-Chinese trade was \$29.1 billion in 2005, up 37% on the previous year and well up from the \$11 billion logged in 2001.⁷³ The trend is encouraging, but that still pales compared to China’s \$210 billion annual trade with the United States or \$185 billion with Japan. Russia accounts for less than 2% of China’s trade, and China provides about 8% of Russia’s trade. At their meeting in 2004 Presidents Putin and Hu Jintao set the goal of quadrupling trade turnover to \$60-80 billion by 2010.

Not all is plain sailing. In November 2005 Prime Minister Mikhail Fradkov visited Beijing to try to clear up what he diplomatically called “current difficulties” in the trade relationship.⁷⁴ “Russia’s caution in military-technical cooperation or in permitting expansion of Chinese capital into Russian innovation zones and the construction market, all of that irritates Beijing immensely.”⁷⁵ In 2003 China, which has been a member of the WTO since 2001, launched four anti-dumping suits against Russia, regarding \$500-600 million of steel imports. Russia-China talks regarding Russian entry to WTO were suspended January-September 2003, but concluded in 2004, when China agreed terms for Russian entry.⁷⁶

On the Russian side, the main concern is to diversify exports away from their current dependence on fuel and raw materials. During his March 2006 visit to Beijing, Putin complained that “Deliveries of machinery and equipment to China almost halved in 2005.”⁷⁷ Russia’s imports from China are led by electrical equipment (30.4%), consumer durables (23.3%) and shoes (4.9%), while Russian exports consist of oil (33.7%), ships (9.9%), timber (9.5%), weapons (5.5%), fertilizer (5.5%), and ferrous metals (5.2%).⁷⁸ Russia delivered 5.18 million

72 Aleksander Lomanov, “Oil and gas mediation,” *Vremya novostei*, 23 March 2006.

73 In the first three months of 2006, Russia-China trade hit \$12 billion, or up 53% year-on-year. RIA-Novosti, 15 June 2006.

74 Mikhail Vorobiev, “Political necessity,” *Vremya novostei*, 7 November 2005.

75 Yevgeny Verlin, “What kind of China we need,” *Profil*, No 10, March, 2006.

76 *Delovoi Kitai*, vol. 4, 2004.

77 Dmitri Zhantiyev, “A bridge to the celestial kingdom,” *Rossiiskie vesti*, 23 March 2006.

78 Data, presumably from the State Customs Service, is for the fourth quarter 2005. *Rossiiskaya federatsiya i strana mir. Kitai 2005 Oct-December* (April 26, 2006). Accessed through ISI

tons of oil to China by rail in 2005, and hopes to boost that to 15 million tons by 2010 (10% of China's import demand). The main companies handling Russian exports as of the fourth quarter 2005 were Rosneft (31.4%), Tomskneft (8.6%) and Rosoboroneksport (8.0%). In the first quarter 2005 the three leaders were Lukoil (7.4%), Yukos 7.4% and the steelmaker Magnitogorsk MK (8.5%). The city of Moscow books 34.0% of the exports, followed by Arkhangelsk (30.3%), the Siberian provinces of Tomsk (5.8%) and Irkutsk (4.2%). The two Far East provinces of Khabarovsk and Primore account for a mere 3.4% and 2.8% respectively. Arkhangelsk (32.6%), Moscow (31.8%) and Petersburg (11.1%) were the main import regions, with Primore trailing at 5.5%. Although this trade is not of major importance at national level, it is vital on a regional scale. China accounts for one third of Russian Far East (RFE) imports and one quarter of RFE exports. Heilongjiang sends 56% of its exports to Russia (one fifth of total China-Russia trade).⁷⁹

Chinese businesses have invested about \$2 billion in Russia, and Russian firms have invested some \$500 million in China – although most of these are reportedly run by Chinese returning from Russia. These sums amount to just 1.8% of Chinese investment abroad and 0.8% of all FDI in Russia, and 6.3% of Russian investment abroad and 0.09% of all FDI in China.⁸⁰

Energy and arms remain the two principal elements in Russian exports. Apart from plans to build oil and gas pipelines, Russia is currently building the two reactors at the Tianwan nuclear power station, and a tender for two new reactors will be held in 2007. China intends to build 30 new reactors by 2020, and Russia is keen to share in that market. Russia sells 500-900 million kilowatt/hours of electricity to China each year, and there are ambitious plans to raise that to 18 billion kilowatt/hours per year by 2010.

China's economic rise causes some anxiety in Moscow. There is a growing realization that "China is well ahead of Russia and India as to the degree of its engagement in the global economy."⁸¹ From 1978-2004, China attracted foreign direct investment amounted to \$562

Emerging Markets database. The proportions were roughly the same in previous quarters, though ferrous metals dropped from 17% in the first half of the year to 8% in the second.

79 In Tselyanin, "Regional cooperation of China and Russia," *EKO*, no. 10, 2005, pp. 126-33.

80 Li Tseyan'min', "China as investor," *EKO*, no. 9, 2005, pp. 105-11.

81 Portyakov, op. cit.; Kseniya Yudaeva, "How can we diversify our exports?," *Pro et Contra*, vol. 9, no. 3, 2005.

billion, including \$61 billion in 2004, while Russia attracted just \$9.4 billion towards a cumulative total of about \$30 billion. China's aggressive policy of deep integration with the global economy means that Moscow may no longer have an advantage in R&D from its days as the Soviet superpower. "Russia's current share on the global innovations market stands at 0.5 percent versus China's share of 6%."⁸² The World Economic Forum Competitiveness index ranks Russia 75 out of 117 countries, lagging behind China (49) and India (50).⁸³

Russia still leads in overall economic development. Russia's GDP per head corrected for PPP rose from \$6,000 in 1993-98 to \$11,000 in 2005, while China is \$6,000 and India \$2,800. With its low birth rate and high male mortality, the World Bank projects Russia's population to fall from the current 144 million to 119 million by 2050. This presumably means an increasing reliance on immigrant workers, and China is a likely source. Public opinion is not reconciled to this idea. Russians have the lowest opinion of immigrants from the Caucasus (50% of the respondents), but China is in the second place of opprobrium (46%), followed by Vietnam (42%) and Central Asia (31%).⁸⁴ Although many Russians see China as Russia's strategic partner (34%) and even ally (22%), the majority favors restrictions on Chinese imports (61%), businesses (66%) and immigrant labor (69%).⁸⁵ Only 8% said trade was more advantageous for Russia, whereas more than 50% said the benefits mostly went to China.

Most of the Chinese immigration is likely to head into the Russian Far East (RFE), where the economic situation is much worse than in the rest of Russia. The 7 million residents of the RFE (density 1.1 persons per square kilometer) face the 125 million inhabitants of the three north-west provinces of China (with a density of 124 per square kilometer).⁸⁶ The RFE was developed as a kind of military outpost of the Soviet empire, and after the Soviet collapse 1991

82 *Ibid.*

83 Augusto Lopez-Claros, "Russia: Competitiveness, economic growth and the next stage of development," World Economic Forum, Global Competitiveness Report 2005, 28 September 2005, chapter 2.6. <http://www.weforum.org/>

84 Vasily Zubkov, "Immigration to Russia, a boon or a curse?," RIAN, 16 November 2005.

85 Interfax, 15 August 2005. According to a VTsIOM poll.

86 Yuri Aleksandrov, "The new non-residents," *Novoe vremya*, no. 49, December 2005, pp. 11-13.

the funding and ideological commitment to this region evaporated. Roughly one quarter of the residents have left the region since 1991, and many more would like to leave but lack the opportunity.⁸⁷ Although some estimates of the number of Chinese immigrants range up to one million, according to Vilya Gelbras “the Chinese population in the Far Eastern district cannot exceed 100,000 people.”⁸⁸

Since the Soviet collapse there has been a revival of informal cross-border trade with China with exports of commodities such as fish and timber matched by imports of consumer goods from clothing to cars. This border trade accounts for an estimated \$10-12 billion a year, and much of it goes unreported and untaxed.⁸⁹ The transportation infrastructure is being expanded, and Chinese entrepreneurs are leasing Russian forests, farmland and factories. It is unclear how willing are Russian officials at national or local level to accelerate this process. Akihiro Iwashita argues that by 2002 the China threat perception in the Russian Far East had subsided in comparison to that of the early 1990s.⁹⁰ Cross-border relations were damaged by the December 2005 benzene spill from a Chinese factory into the Sungari river, which threatened the water supply of Khabarovsk and triggered some anti-Chinese protests.⁹¹

A startling reminder of the criminality of the cross-border trade came with the May 2006 dismissal of a dozen senior officials from the State Customs Service and their alleged high-level “protectors” in the procuracy, Interior Ministry and Federal Security Service. The scandal also forced the resignation of four members of the Federation Council (the upper house of the

⁸⁷ Adding to the sense of isolation is that increased rail and air tariffs have cut travel with ‘mainland’ Russia 30-fold since 1991. Leonid Blyakher, “The Russian Far East,” *Politicheskije nauki*, no. 3, 2005, pp. 102-118.

⁸⁸ Vilya Gelbras, “Chinese migration to the Russian Far East: A view from Moscow,” Center for East Asian Studies, Monterey Institute of International Studies, January 2003.

<http://gsti.miis.edu/CEAS-PUB/200208Gelbras.pdf>

⁸⁹ *Delovoi Kitai*, vol. 4, 2004.

⁹⁰ Akihiro Iwashita, “The influence of local Russian initiatives on relations with China,” *Acta Slavica Iaponica*, vol. 19, 2002, pp. 1-18.

⁹¹ Igor Verba, “Campaign chemotherapy,” *Nezavisimaya gazeta*, 30 November 2005.

national parliament), including Igor Ivanov from Primore. The affair was the result of a sting operation involving boxcars of unregistered Chinese goods.⁹²

Japan

Russo-Japanese relations are still stymied by Japan's refusal to accept the Russian occupation of the four southern Kurile islands (what the Japanese call the "Northern Territories") that Stalin seized in 1945. The absence of an agreement means that there is still no peace treaty between the two countries. The Japanese assume that Russia will eventually be obliged to return all four islands.

At various points Russia has hinted that it might be willing to a compromise. In November 2004 for example Foreign Minister Sergei Lavrov said that Moscow recognized the 1956 declaration, in which the Soviet Union said it was prepared to negotiate with Japan on handing over the two southern islands of Shikotan and Habomai. But due to a 2002 political scandal over a possible backdoor compromise deal with Russia, Japan has now returned to an insistence on the eventual return of all four islands. With Russia becoming stronger politically and economically with each passing year, it hard to imagine that Russia will return any of the islands. During a 2005 visit to the Kuriles, Defense Minister Sergei Ivanov said, "We do not intend to make any territorial concessions; we do not intend to leave."⁹³ Putin is keen to resolve the issue and move on.⁹⁴

Moscow cannot really figure out why Japan is so obstinate over the Kuriles. Japan apparently believes that economic involvement with Russia, such as their investments in Sakhalin and the VSTO pipeline, will bind Moscow closer to Tokyo, and make Putin more likely to compromise. Russia however regards these as mutually beneficial projects that do not require a political quid pro quo.

Despite an "Action Plan" signed with Prime Minister Junichiro Koizumi in 2003 there has been a distinct lack of progress in the relationship. During a visit to Japan in November 2005

92 Maksim Agarkov, "Resignations," *Profil*, no. 19, May, 2006.

93 *Taipei Times*, 31 July 2005.

94 Marat Khairullin, "Purely business, nothing personal. Japan gives Russia some lessons in diplomacy, *Gazeta*, 8 February 2006

Putin signed a package of agreements, including LNG purchases from Sakhalin and confirmation of the Taishet-Perevoznaya oil pipeline “Koizumi also achieved his objective: a public assurance from Putin that the search for a solution to the territorial dispute will continue.”⁹⁵ Meanwhile, Japan’s trade with Russia rose from \$3.2 billion in 2001 to \$7.4 billion in 2005. Japanese investment in Russia also increased sharply, from \$117 million in 2000 to around \$1 billion in 2003. For example, Toyota is opening a \$150 million assembly plant in Petersburg.

Moscow was not thrilled by the conclusion of an agreement in April 2006 to relocate US military bases in Japan and increase military cooperation. “The United States is drawing Japan into its policy of global dominance in all regions of the world – with the intention of using Japan as a shield to absorb a first strike.”⁹⁶ Still, in contrast to the ambiguity regarding China, the Russian public does not see Japan as a threat. According to a VTsIOM survey 61% of respondents had positive views of Japan (as a friend or partner) while only 12% saw it as a rival and 6% as an enemy. Nevertheless, 73% said it was time for Russia to stop discussing the territorial problem.⁹⁷

India

The Soviet Union enjoyed good but somewhat distant relations with India. They were both wary of the US and China, and India was a regular purchaser of Soviet weapons. India bought more than \$7 billion worth of weapons from Russia in the last five years, and up to 70% of the military hardware in the Indian armed forces was made in Russia or the former Soviet Union.⁹⁸ Between 1992 and 2004, Russia sold India 60 fighters (MIG-29s, SU-30MKIs, and SU-30Ks) and upgraded 125 previously delivered MIG-21s. Components for the assembly of 140 SU-30MKI aircraft are being delivered. India also bought six IL-78MKI flying tankers and three A-50 AWACS-type planes, and is in discussion with Russia for the joint development of a

95 Aleksander Sadchikov, “Gas today, islands tomorrow,” *Izvestiya*, 23 November 2005.

96 Andrei Fesyun, “Will Japan and the US go to war together?,” *Vremya novostei*, 4 May 2006.

97 Dmitri Polikanov, “Japan as an important alternative power,” *Nezavisimaya gazeta*, 21 November 2005;

98 Interview on Russian-Indian military technology cooperation with Defense Minister Pranab Mukherjee by Aleksander Lomanov, *Vremya novostei*, 18 November 2005.

transport aircraft.⁹⁹ The visit of President G.W. Bush to India in March 2006 sparked fears that the US might take over as a primary supplier, for example of F-16 fighters. And the Indian-American accord on nuclear cooperation that was signed during that visit raises a question mark over future Russian nuclear sales. Russia is currently building two reactors at a nuclear power plant in Kudankulam.

Weapons aside, mutual trade is anemic, at just \$3.1 billion in 2004. In March 2006 Prime Minister Mikhail Fradkov visited India to discuss the \$2.3 billion in Soviet-era debt which India still owes. The debt is being repaid at about \$100 million a year in goods, such as tea and textiles, that Russian firms do not want to take.¹⁰⁰

Russia held military exercises in India for the first time ever in October 2005, and they are helping the Indians build their presence at the Aini airbase in Tajikistan. India has been training the Tajik airforce under an April 2002 agreement, and they began construction work at the disused airport in 2005. In December 2005 they started discussing plans for basing Indian military aircraft there.¹⁰¹

Korea

When Putin came to office in 2000 he had high hopes that Russia could play the role of an honest broker in resolving the dispute over North Korea's nuclear program, and proposed six-party talks with Pyongyang. However, it turned out that Russia had no special influence over Kim Jong Il, and Beijing effectively marginalized the Russian role in the negotiations.¹⁰² Under the agreement announced in September 2005 North Korea vaguely committed itself to giving up nuclear weapons but with no specifics on verification procedures, energy assistance, or non-

99 Arthur Blinov, "Cold war with a trade sub-text," *Nezavisimaya gazeta*, 7 April 2006.

100 Kommersant, 20 March 2006.

101 Vladimir Ivanov, "Moscow style triple-shot," *Nezavisimaya gazeta*, 7 December 2005; "IAF to station MIG 29s in Tajikistan," 20 April 2006. www.defenceindia.com/17-apr-2k6/news17.html;

Viktor Myasnikov, "New Delhi is elbowing Russia out," *Nezavisimaya gazeta*, 25 April 2006.

102 "China-Russia: Underwater reefs in their relations," *Information-Analytical Bulletin*, no. 10, 2005, Center for Political Information (Moscow).

aggression guarantees from the US. The diplomatic standoff over North Korea has dashed ambitious plans to build new railways and oil and gas pipelines from Russia to South Korea.¹⁰³ Despite some expectations, President Putin did not come away from the APEC summit in Pusan in November 2005 with a commitment from South Korea to buy Sakhalin gas, neither by building a pipeline across North Korea, nor through LNG deliveries.¹⁰⁴

Central Asia

Russia has tended to take Central Asia for granted, and has not expended a lot of effort in trying to improve relations with its Eastern “near neighbors.”¹⁰⁵ This has started to change over the past two years, as Russia has encountered problems in its dealings with the Western members of the Commonwealth of Independence States: democratic revolutions in Georgia and Ukraine; unsolved conflicts in Moldova, Georgia and Azerbaijan; and a recalcitrant dictator in Belarus. The main elements in Russian policy towards Central Asia have been energy trade, fighting terrorism, and preserving political stability through support for incumbent dictators. Its strategic goal is to preserve the status quo: rebuilding hegemonic control over the region is neither feasible nor particularly desirable for Moscow.

Islamist terrorism has been a serious threat to the regimes in the region. Russia played a fairly positive role in negotiating an end to the Tajik civil war in 1997 (alongside Iran). After 9/11, Kyrgyzstan and Uzbekistan welcomed the introduction of US military bases, hoping to distance themselves from Moscow. However, their relationship with Washington soured over their poor record in human rights and democracy, so both countries gravitated back into a closer relationship with Moscow. The switch in Uzbekistan’s orientation over the past year has been particularly dramatic.

¹⁰³ Hiroshi Kimura, “Putin’s policy towards the Korean Peninsula: Why Has Russia Been losing its influence?” Paper delivered to the International Conference “Comparing different approaches to conflict prevention and management: Korean Peninsula and the Taiwan Strait,” Uppsala University, 16-17 December 2005.

¹⁰⁴ Anna Nikolaeva, “No gas deal,” *Vedomosti*, 21 November 2005.

¹⁰⁵ This is now the preferred formula for referring to the former Soviet states, in place of the imperial-sounding “near abroad.”

Thanks to its location astride the main export routes for Central Asian oil and gas to Western markets, Russia can extract rents in the form of transit fees. Turkmenistan has been the main victim of such policies, being forced to sell its natural gas to Ukraine through Russian intermediaries at a steep discount. In April 2006 Turkmenistan's President Saparmurat Niyazov traveled to China, inking a deal to build a pipeline that will supply 40 billion cubic meters of gas a year.¹⁰⁶

[INSERT TABLE 6 ABOUT HERE]

Russia's most important partner in Central Asia is Kazakhstan. Trade with Russia hit \$10 billion in 2005, and Kazakhstan currently ships 16 million tons of oil a year across Russia, through the Chevron-led Caspian Pipeline Consortium. The official line in Moscow and Astana is there are "almost no difficult unresolved questions" in relations between the two countries.¹⁰⁷ Meanwhile, Kazakh ties with China are growing apace. Mutual trade reached \$6 billion in 2005, and in December 2005 China completed construction of the \$700 million, 988-km long Atasu-Alashankou pipeline, with an initial capacity of 10 million tons per year.¹⁰⁸ The oil will come from Kumkol fields in south Kazakhstan, which China gained after the acquisition of the PetroKazakhstan oil company, but there is not enough oil there so Kazakhstan is looking to oil from Russia to fill the pipe in the interim. In 2003, the Western consortium operating the super-giant Kashagan oilfield on the Caspian blocked the Chinese state-owned company Sinopec's bid to acquire a stake.

Russia has made a common cause, of sorts, with China in regard to Iran's program to acquire nuclear weapons. Russia's abstention during the 24 September 2005 meeting of the International Atomic Energy Agency made it possible to refer Iran to the UN Security Council, but Russia and China have consistently opposed the threat of sanctions. A visit to Moscow by US Secretary of State Condoleezza Rice in October 2005 failed to dislodge them from this

¹⁰⁶ *Kommersant*, 3 April 2006.

¹⁰⁷ Dmitri Yermolaev, "A snow leopard in bear's clothing," *Rossiiskie vesti*, 6 April 2006; *Nezavisimaya gazeta*, 11 January 2006.

¹⁰⁸ Andrew Neff, *Oil and Gas Journal*, 6 March 2006, vol.104, no. 9, p. 41.

position. Foreign Minister Sergei Lavrov explained that “sanctions against Iran are not going to solve the problem of its nuclear program.”¹⁰⁹ Instead Russia floated the idea of a joint venture in Russia that will enrich uranium for Iran’s power plants. In February 2005 Russia had signed a nuclear fuel supply agreement for the Bushehr nuclear plant that Russia is building for Iran, and that is close to completion. Under the deal Iran has to return spent nuclear fuel from the reactor.

Domestic Political Debates.

There is no strong “Asia lobby” discernable in the Russian foreign policy-making process. The most easily identified group would be the arms exporters that depend on sales to China and India. More broadly, it has been argued that the security clan in the presidential entourage, the *siloviki*, can strengthen their domestic political position by pursuing closer ties with China as opposed to the West.¹¹⁰ But this is quite speculative.

As far as trade and investment goes the key players are the large state-owned corporations, such as Gazprom, Transneft and Russian Railways, and private companies such as Lukoil. These companies are currently locked into the European market, and they are still recuperating from the bitter political struggles surrounding the dismemberment of Yukos and Gazprom’s absorption of Sibneft. But they are actively seeking to establish a global presence and in due course will become more engaged with Asian partners.

There is a lively debate amongst geopolitical thinkers in Russia, and this policy community is deeply divided over whether closer ties with China serve Russia’s long-term national interests. Clearly, Beijing was a major beneficiary of the Soviet power collapse, along with the United States. Some want Russia to continue the policy of the 1990s – that is, to effectively “bandwagon” with the US superpower. Others encourage Russia move in the direction of balancing the US by allying with China.

Sinophiles range from the right to the left of the political spectrum.¹¹¹ Thus the liberal former Yabloko deputy Vyacheslav Igrunov writes “the West depicts China as a horrible communist monster that jeopardizes democracy. As a corollary, the West urges Russia to sell oil

¹⁰⁹ *Nezavisimaya gazeta*, 16 February 2006.

¹¹⁰ Konstantin Simonov, “Property as key to success,” *Vedomosti*, 14 July 2005.

¹¹¹ Alexander Anisimov, “Teeth of the dragon,” *Zavtra*, 21 March 2006.

to Japan and not to China.”¹¹² Konstantin Simonov and Vitalii Ivanov argue in response to the Council on Foreign Relations “Wrong Direction” report that the US will try to block the VSTO pipeline since “China is considered the United States’ main opponent in the medium term. How could Uncle Sam beat the dragon? That is very simple – by depriving it of fuel.”¹¹³

But these voices are engaged by other strategists who see China as a bigger threat than the US in the long-term. They cite its growing economic power; massive population including a surplus of young males; and sustained military build-up.¹¹⁴ These writers also play into some Russian racist stereotypes about the “yellow peril.”¹¹⁵ There is also the uncomfortable fact that Russia’s far eastern territories were expropriated from the Chinese empire in the 18th-19th century.¹¹⁶ Chinese officials never mention the question of territorial claims on Russia, but their silence on the issue does not reassure the Russians. United Russia Duma deputy Nikolai Bezborodov pointedly noted that China has 109 divisions in the Trans-Baikal area, while only one Russian division is deployed there.¹¹⁷ Sometimes it is liberals who play up the China threat to justify closer cooperation with Washington.¹¹⁸ A reporter asked Nikolai Bordyuzha, the Secretary General of the CIS Collective Security Treaty Organization (CSTO), “Do you think that China is our strategic ally or a potential opponent?” To which Bordyuzha replied: “Nothing

112 Vyacheslav Igrunov, “What is happening in the triangle formed by Moscow, New Delhi and Beijing?,” *Izvestiya*, 1 November 2005.

113 Ivanov and Simonov, op. cit.

114 Andrei Milovzorov, “China versus the rest of the world,” www.utro.ru, 17 August 2005.

115 For example, B. Fedortsev quotes a 19th century traveler, Aleksandr Maksimov, on China’s “phenomenal evil, hidden behind a smile.” “Russia and the China syndrome,” *EKO*, no. 10, 2005, pp. 134-9.

116 “China-Russia: Underwater reefs in their relations,” *Information-Analytical Bulletin*, no. 10, 2005, Center for Political Information (Moscow).

117 Vladimir Mukhin, “United Russia starts fighting for the military vote,” *Nezavisimaya gazeta*, 15 December 2005.

118 Vasili Mikheev, “The Chinese riddle,” *Pro et Contra*, vol. 9, no. 3, November 2005.

in this world lasts forever.”¹¹⁹ Similarly, Vladimir Portyakov argues that blueprints for the creation of a Russia-India-China axis “will continue to gather dust” unless a major crisis transforms these existing relationships.¹²⁰

For what it is worth, the Russian public seems to identify more with Europe than with Asia, but few see China as a serious threat. According to a November 2005 VTsIOM poll, 58% think Russia is closer to Europe in culture and way of life, only 13% said it was closer to the East, and only 7% selected the US. The US was seen as a threat by 30% of respondents, followed by China (chosen by 17%) and Japan a distant third (6%).¹²¹ According to a VTsIOM poll in November 2004, 40% of respondents regarded relations with China as normal, 34% saw them as friendly, and only 4% saw China as an enemy. In the event of a US-China conflict, 36% would support China, and 21% the US.¹²² Similarly, a US-sponsored international poll found that Russian respondents had a favorable attitude towards China’s economic system (by 67% to 12%) and political system (56% to 14%).¹²³

In the 1990s there was much talk in the West about Russian foreign policy being driven by regional leaders. For example, there was a perceived rift between the federal authorities favoring ties with Beijing and regional leaders in the Russian Far East favoring ties with the US, Japan, and Korea. This all led to the hope that outside countries and corporations could deal directly with the regions in the RFE, bypassing Moscow. But this proved to be largely wishful thinking. Putin’s centralizing reforms, the creation of the federal districts, the reform of the

119 Stepan Sidorchuk, “People remember the CSTO when a threat arises,” *Rossiiskie vesti*, no. 3, January 2006; Sergei Permyakov, “NATO reluctant to cooperate with CSTO,” *Voennopromyshlennyi kurier*, no. 2, January 18, 2006.

¹²⁰ Portyakov, *op. cit.*

121 “Russia between east and west,” VTsIOM press release 361, December 2005.

www.vciom.ru. Petr Grinev, “Russians see America as the enemy,” 22 December 2005. utro-ru

122 Dmitri Polikanov and Valeri Fedorov, “Public opinion and Russian foreign policy,” *Politiya*, no. 1, 2005, pp. 22-40.

¹²³ Stephen J. Weber, “How Russians and Americans view each other, themselves, China and Iran,” Carnegie Endowment for International Peace, 31 May 2006. Weber is the editor of WorldPublicOpinion.org.

Federation Council, and the taming of the State Duma, have gone a long way towards restoring federal control over the regions. Still, the leaders of mineral-rich regions in Siberia such as Yakutiya and Krasnoyarsk are powerful political and economic actors whose views Moscow must take into account.¹²⁴

Conclusion

Economic and strategic trends over the past few years are pushing Russia towards deeper integration with the countries of Asia. But this raises political and even psychological challenges for the Russians, who still see themselves as a European power. Russia is not counting on economic integration with either the West or the East to guarantee their national security, rather they are using economic ties to boost the Russian economy while maneuvering between the various sides.

Even as Russia moves towards closer integration – by pushing ahead with building oil and gas pipelines to bring Siberian resources to China and Japan – there are still many economic and political barriers to be overcome between commitment and completion. Both Russia and China are countries in the process of transition from a failed command economy model, and the stability and future viability of their political and economic institutions are still in doubt. In Russia there is the Y2008 problem: finding a replacement for President Vladimir Putin. There is a danger that the leadership succession will open up divisions within the ruling elite. The “statist” lobby of security officials and the leaders of state corporations has grown in influence during the last few years and will presumably exert a powerful influence over the choice of a presidential successor. They would probably favor continuing the current course of deepening the economic and strategic partnership with China. But it is important to bear in mind that Russia is still dependent on the Europe for three quarters of its current trade. The same is true for China and India – the US and the EU are their main trading partners.

Although some Western commentary has become alarmist about Russia turning its back on the West, there are grounds for cautious optimism. Putin has brought a kind of stability to Russian politics and foreign policy. This is not the kind of stability that the West wanted, but it

¹²⁴ Elizabeth Wishnick, “One Asia policy or two? Moscow and the Russian Far East Debate,” *NBR Analysis*, vol. 13, no. 1, March 2002

may work for Russia. And growing Russian ties with Asia do not necessarily mean that it will be severing ties with the US and Europe.

TABLE ONE **MACROECONOMIC INDICATORS**

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
GDP, %	-3.6	1.4	-5.3	6.4	10.0	5.1	4.7	7.3	7.2	6.4
Industrial production, %	-4.5	2.0	-5.2	11.0	11.9	2.9	3.1	8.9	7.3	4.0
Fixed investments, %	-18.0	-5.0	-12.0	5.3	17.4	10.0	2.8	12.5	11.7	10.7
Unemployment, % (end of period)	9.3	9.0	13.2	12.4	9.9	8.7	9.0	8.7	7.6	7.7
Exports of goods, \$ billion	89.7	86.9	74.4	75.6	105.0	101.9	107.3	135.9	183.5	245.3
Imports of goods, \$ billion	68.1	72.0	58.0	39.5	44.9	53.8	61.0	76.1	96.3	125.1
Current account, \$ billion	10.8	-0.1	0.2	24.6	46.8	33.9	29.1	35.4	58.6	84.2

Source: Rosstat and Central Bank, as reported in Bank of Finland, *Russia Review*, no 4, 2006, 12 April 2006. <http://www.bof.fi/bofit/eng/4ruec/index.stm>

TABLE TWO **RUSSIAN EXPORTS AND IMPORTS (\$ million)**

	Exports								Imports							
	1995	1998	1999	2000	2001	2002	2003	2004	1995	1998	1999	2000	2001	2002	2003	2004
Total	78217	71314	72885	103093	99969	106712	133656	181634	46709	43579	30278	33880	41883	46177	57347	75581
Of which																
Within CIS	63687	57614	62179	89269	85352	91001	113157	152248	33117	32266	21935	22276	30681	36014	44207	57847
Outside CIS	14530	13699	10707	13824	14617	15711	20498	29386	13592	11313	8343	11604	11202	10163	13139	17733

Source: Rosstat (Federal State Statistics Service), www.gks.ru

TABLE THREE**RUSSIA'S MAJOR TRADING PARTNERS**

	EXPORTS (\$ mn)			IMPORTS (\$ mn)		
	1998	2001	2004	1998	2001	2004
Germany	5,697	8,178	13,295	5,404	5,716	10,571
Ukraine	5,531	4,931	10,633	3,219	3,777	6,097
Netherlands	3,930	3,870	15,207	905	840	1,373
China PR	3,144	4,021	10,020	1,146	1,611	4,733
Italy	3,203	6,844	10,271	1,787	1,341	3,197
USA	5,995	5,944	8,354	4,052	3,199	3,205
Switzerland	3,216	1,522	7,798	426	394	650
Turkey	1,923	2,980	7,200	512	509	1,225
Finland	2,063	3,032	5,764	1,432	1,275	2,331
Poland	2,173	3,952	5,682	1,032	950	2,302
UK	2,927	3,182	5,645	1,205	980	2,064
Japan	2,171	2,438	3,471	810	813	3,937
Cyprus	375	1,398	5,310	27	28	22
EU total	32,280	46,798	88,325	18,828	17,544	33,967
Total trade	74,884	101,884	183,452	63,817	59,140	105,938

Ranked in order of 2004 turnover.

Source: IMF *Direction of Trade Statistics 2005*, (Washington D.C. 2006)

TABLE FOUR RUSSIAN TRADE WITH ASIA**EXPORTS (\$ mn)****IMPORTS (\$ mn)**

	1998	2001	2004	1998	2001	2004
China PR	3,144	4,021	10,020	1,146	1,611	4,733
Japan	2,171	2,438	3,471	810	813	3,937
India	580	695	2,461	660	541	643
S. Korea	516	842	1,963	1,004	782	2,025
Taiwan	142	263	1,999	74	163	342
Vietnam	275	164	706	56	79	100
Thailand	32	69	372	61	105	355
Malaysia	117	261	114	120	157	423
Mongolia	133	211	363	50	35	21
Indonesia	13	30	145	88	95	221
Singapore	56	719	186	104	106	162
Hong Kong	144	126	318	8	15	10
Philippines	33	45	217	9	22	50
Pakistan	21	57	227	14	26	25
N. Korea	54	58	205	8	16	5
Afghanistan	14	8	76	7	3	4
Bangladesh	49	24	60	11	4	11
Asia total	7,479	10,060	22,958	4,297	4,640	13,230

TABLE FIVE RUSSIAN ARMS EXPORTS (\$ million)

	2000	2001	2002	2003	2004	2005
China	1457	2600	1943	1511	1771	1350
India	431	463	1148	1948	1377	485
Yemen	53	14	521	-	329	239
Algeria	226	365	84	143	246	103
Greece	245	117	39	20	22	257
Viet Nam	-	6	121	12	259	212
Sudan	-	134	55	90	270	-
Iran	84	114	74	162	-	87
Kazakhstan	144	31	83	62	27	68
Eritrea	-	60	-	-	202	276
Ethiopia	72	-	-	193	192	-
Syria	420	-	-	-	-	-
Burma	-	125	185	-	-	-
Total*	3250	4680	4545	4546	4963	3581

* Total for all 48 countries reported receiving Russian arms 2000-05.

Source: Stockholm International Peace Research Institute, Arms Transfers Database, accessed 6 July 2006.

TABLE SIX RUSSIAN TRADE WITH CENTRAL ASIA**EXPORTS (\$ mn)****IMPORTS (\$ mn)**

	1998	2001	2004	1998	2001	2004
Kazakhstan	1,881	2,544	4,648	1,877	1,834	3,457
Iran	489	894	1,892	28	34	111
Uzbekistan	485	364	767	521	580	612
Kyrgyzstan	131	83	265	129	61	150
Turkmenistan	94	139	242	43	39	43
Tajikistan	77	69	183	59	129	76
Central Asia Total	3,157	4,093	7,997	2,657	2,677	4,449

Ranked in order of 2004 turnover.

Source: IMF *Direction of Trade Statistics 2005*, (Washington D.C. 2006)