

# Russia and China: A New Model of Great-Power Relations

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The Ukraine crisis and the downturn in Russia–West relations that came in its wake have compelled Russia to turn decisively towards China. Deprived of other options, Moscow has found itself in the position of *demandeur* vis-à-vis Beijing, creating an increasingly imbalanced bilateral relationship. Nonetheless, Russia and China have avoided any turbulence that might have resulted from this asymmetry through mutual accommodation and compromise. Both sides devote significant effort and political capital to managing their bilateral relations effectively; they take a pragmatic, behind-the-scenes approach to resolving disputes and publicly stress the positive elements in the relationship. These ‘relationship management’ efforts have helped to mitigate the potential tensions created by Russia’s relatively weaker position post-2014, leading China not to abuse its stronger position. But the positive dynamic in their relationship is also a natural outgrowth of their shared views on the international order, in particular resistance to US unilateralism and alleged American interference in their political systems.

There are limits to the Russia–China relationship, however. China will not make Russia the centrepiece of its foreign policy, which is increasingly global and multidimensional. Furthermore, the relationship with the US will remain far more central to China’s global and regional interests, both strategic and economic. While historic Russian mistrust of China has abated in recent years, elites in Moscow prize their foreign-policy independence and

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thus continue to search for additional partners in the Asia-Pacific, including some of China's regional rivals. Ultimately, both countries' leaders are unsentimental pragmatists, and when their strategic calculus differs, there are limits to how far they will go to sacrifice for the other.

Relations between Moscow and Beijing have been steadily improving since before the break-up of the Soviet Union. In 1986, Soviet leader Mikhail Gorbachev delivered a speech in the Pacific port city of Vladivostok in which he signalled a desire to create 'an atmosphere of good-neighborliness' with China.<sup>1</sup> His subsequent visit to Beijing in 1989 (the first such summit since 1959) set the two countries on a path to normalisation following the bitter Sino-Soviet conflict that had lasted almost three decades. After the collapse of the USSR, Russia and China – together with Kazakhstan, Kyrgyzstan and Tajikistan, the other Soviet successor states bordering China – focused on finalising demarcation of the border and on demilitarising the frontier areas that had been the *casus belli* in the Sino-Soviet dispute.<sup>2</sup> As tensions eased, the Russia–China relationship was upgraded to full 'strategic partnership'. In 2001, the two countries signed a 'Treaty of Good-Neighborliness and Friendly Cooperation' that articulated five principles to govern ties: 'mutual respect of state sovereignty and territorial integrity, mutual non-aggression, mutual non-interference in each other's internal affairs, equality and mutual benefit and peaceful co-existence'.<sup>3</sup> In 2008, the border issue was fully resolved. As a result, the Soviet-era legacy of mistrust has gradually faded over time.

While the bilateral relationship had dramatically improved before 2014, it was not the top priority for either Moscow or Beijing. For Russia, relations with its former Soviet neighbours and with the West were more important, while China maintained its focus on the US as the main source of economic prosperity and potential strategic peril. The events of 2014, however, were a watershed moment for Russian foreign policy, dramatically accelerating some pre-existing trends and radically altering others. At a basic level, the Ukraine crisis stripped Russian policymakers of alternatives to getting closer to Beijing. Russia's China policy is no longer about reconciling with an important neighbour; instead, China is now Moscow's only viable strategic option. (The terms currently on offer for rapprochement with the West

are seen in Moscow as akin to capitulation.) Having passed the point at which the new dynamic could be altered substantially, Russia has accepted that it will become more dependent on China over time because it sees no credible alternatives to this path.

For China, the Ukraine crisis was not nearly as important. It did not change Beijing's strategic calculus significantly, including its policy vis-à-vis Russia. China has of course seized upon the opportunities that Russia's current situation presents. At the same time, it has been accommodating and mindful of Russia's interests and has refrained from abusing its advantageous position. Russia's actions in Ukraine have also served as an acute reminder of the potential cost – that is, the risk of compromising other relationships with key partners, particularly the US – should China fully embrace Russia. So Beijing has had to take steps to be seen as not veering too close to Moscow.

Current trend lines are pointing toward a much closer, albeit highly unbalanced, Russia–China relationship. Russia is much more enthusiastic about ties with China and has significantly less freedom of manoeuvre than before; China is sympathetic and interested in cooperation but has no intention of making Russia the focal point of its foreign policy.

The incoming Trump administration should bear this in mind as it formulates its policies toward these two countries. US President-elect Donald Trump has signalled his intention to take a much more hawkish approach to China than the outgoing Obama administration. At the same time, Trump has consistently stated a desire to improve relations with Russia. If he follows through on both priorities, it is reasonable to assume that he will try to garner Russia's support in the clash with China. This and any other such attempt is doomed to failure. The Russia–China relationship is too important for either country to sacrifice. Barring radical shifts in the international system, the post-Ukraine crisis dynamic is likely to endure, no matter what Washington does.

### **The economic relationship**

Russia's economic pivot to Asia, and especially to China, started before the imposition of economic sanctions in 2014. At that time, it was a matter

of finding additional sources of growth and an opportunity to diversify Russia's economic portfolio. Now, this shift is a matter of necessity, acquiring priority status in Moscow's foreign economic policy. The rationale for Russia's persistent courtship of China is straightforward: it is intended to mitigate, to the extent possible, the negative implications of receding trade and financial flows with the countries that imposed sanctions, including the US, EU, Canada and Australia.

Russia's initial expectations for China's ability to compensate for these losses after 2014 were high, consistent with its significant needs. Moscow quickly relaxed or abandoned long-standing limitations on China's involvement in its economy. Beijing responded positively, helping decisively in certain key sectors such as energy, in which state-owned enterprises, which are generally responsive to political directives, dominate. However, the Chinese government is not in the habit of micromanaging the international activities of its burgeoning private sector. These firms make investment decisions based on a similar calculus as multinational corporations elsewhere; for them, Russia is a peripheral market. Therefore, so far, Russia's embrace of China has not compensated for its lost access to global trade and Western capital markets.

This asymmetry – and Russia's unmet expectations – could create challenges for the relationship, but China is making significant efforts to manage any difficulties and avoid being seen as exploiting Russia's position.

### *Bilateral investment*

The sanctions imposed after 2014 threaten the fundamentals of Russia's international economic strategy, which had been based on deepening trade and financial and technological integration with the West, as well as on participation in institutions, technological platforms and standards that the West directly or indirectly controls. Russia had come to see deeper integration with the EU and the US as the key enabler of its economic modernisation. The immediate concern, after the sanctions were imposed, was to compensate for the collapse in Western investment.

After the Ukraine crisis began, the Russian government adopted an accommodating position vis-à-vis Chinese investment, including in upstream oil

and gas. This is a major departure from a long-standing policy of strict limitations on foreign direct investment in so-called 'strategic sectors'.

The Russian upstream oil and gas industry was a major target of Western sanctions. China has partially compensated for related losses, becoming a key financier of Russia's major oil and gas projects via loans and direct investment. The Yamal liquefied natural gas (LNG) mega-project, led by Novatek (both of which were targeted by sanctions), has received two major Chinese investments. In September 2013 – before the sanctions – China National Petroleum Corporation (CNPC) bought a 20% stake. In March 2016, the Silk Road Fund, a Chinese sovereign fund, acquired 9.9% of the project, bringing the Chinese government's indirect ownership to nearly a third of shares. In December 2015, the state-owned China Petroleum & Chemical Corporation (also known as Sinopec) received approval to purchase a 10% stake in the Russian petrochemical company Sibur (valued at US\$1.3 billion), with the option to buy an additional 10% in the following three years.

Since 2014, several of Russia's large hydrocarbon companies have secured major financing deals from Chinese state-owned banks. In March 2015, Gazprom obtained a five-year, €2bn (US\$2.15bn) loan from the Bank of China to invest in its large-scale infrastructure projects. In April, the Export-Import Bank of China and the China Development Bank agreed to provide loans of €9.34bn (US\$10.6bn) and 9.76bn renminbi (US\$1.5bn) respectively to finance Novatek's Yamal LNG project. Beyond their size, these loans were notable because they did not involve US dollars, but rather euros and renminbi – presumably to minimise sanction-related risks, as well as to reduce the centrality of the dollar to bilateral economic transactions.

But this success story does not extend beyond energy and raw materials. Russia was catching up with the rest of the world in terms of attracting Chinese direct outward investment until 2014. Since then, China's share in global direct investment has continued to grow steadily, while its share in direct investment into Russia has stalled.<sup>4</sup> Russia is missing out on the impressive growth in Chinese outward direct investment, which is increasingly in the service and high-tech sectors, where private firms dominate.<sup>5</sup> There is no fundamental reason for a Chinese private-sector rush to Russia, unless and until Russia sells itself so cheaply that it becomes irresistible for

Chinese companies and asset managers. That is obviously not what Russian officials had in mind.

While we have yet to see a major difference in direct investment levels outside of energy and raw materials since 2004, it seems probable that, given the level of political goodwill and the intensification of bilateral relations in all domains, Chinese investors will gradually find more opportunities in Russia and increase their presence. There are promising developments. The Belt and Road Initiative (BRI) should provide new impetus for Chinese investment in Russia's transport and logistics sector. At a structural level, in late 2016 the Russian Finance Ministry was finalising the preparations for a \$1bn equivalent issuance of renminbi-denominated bonds of different maturities to be traded on the Moscow exchange.<sup>6</sup> These bonds would create benchmarks for private renminbi-denominated bonds issued by Russian companies that are shut out of foreign-currency bond markets. The emergence of Moscow as an offshore renminbi market would facilitate Chinese access to Russian debt and, eventually, equity markets.

#### *The Power of Siberia natural-gas project*

During a presidential summit in Shanghai in May 2014, Russia and China signed a 30-year gas purchase and sale agreement reportedly worth \$400bn. CNPC committed to buy 38 billion cubic metres (bcm) of gas annually from Gazprom. This volume amounts to 20% of China's 2014 consumption and 60% of its 2014 gas imports. The 38-bcm annual volume should be attained around 2025 after a ramp-up period of several years. The first exports could happen in 2019 or 2020. On the Russian side, the project involves some \$70bn of investment, including \$20bn for field development, \$35bn for the pipeline itself and \$15bn for a gas-treatment plant at the Chinese–Russian border, in partnership with Russian chemical company Sibur. Field-development and pipeline-construction work are now proceeding apace. In September 2016, Gazprom and CNPC finalised an agreement to build the cross-border section of the pipeline under the Amur River.

The official view in Russia is that Power of Siberia, as the project is known, is only the first step toward building a strategic gas relationship with China, akin to the one it has with Western Europe.<sup>7</sup> Russian reserves

would certainly support a long-term gas trade of 100bcm per year.<sup>8</sup> Power of Siberia will create a physical link between the two countries, worth tens of billions of dollars, supporting a flow of energy worth many times that over three decades.

While this gas relationship between Russia and China necessarily has strategic implications, its significance to the two sides is fundamentally different. The Russian government would like it to be understood as a key strategic bond between the two countries. Energy has been the defining factor of Russia's post-Soviet international economic policy and diplomatic influence. Establishing a gas relationship with China in the aftermath of the Ukraine crisis is perceived as a major success by Moscow. According to the narrative presented by Russia's authorities, Power of Siberia signals the natural complementarity between the two countries and demonstrates Russia's ability to develop new export markets outside of Europe.<sup>9</sup>

For China, the gas relationship with Russia is much more mundane. China does not 'need' Russian gas (though some Chinese analysts see the energy relationship with Russia as an opportunity to reduce, in relative terms, the country's dependence on imports by sea) and is under no pressure to compromise on its interests, economic or political, in order to get it. Some Chinese economic and environmental objectives will be easier to achieve with ample gas supply, but none are dependent on the gas relationship with Russia specifically. Chinese state-owned energy companies have demonstrated their ability to bring energy to China, including natural gas, from a fast-growing number of countries and regions, at prices consistent with (or lower than) international market conditions. Resource holders all over the world are competing to access the Chinese market; Russia is just one of them.

Therefore, the gas relationship does not provide balance to an otherwise asymmetrical relationship; it is an element of the broader asymmetry. Russia needs to export the gas much more than China needs to import it. For Beijing, this asymmetry is a factor to be carefully managed. One key aspect of this management effort was to agree to Power of Siberia in the first place.

Negotiations on the pipeline had lasted for more than ten years amidst a changing geopolitical and international-energy landscape. The Ukraine

crisis made the deal a strategic priority for Moscow, which wanted to signal to the US and EU countries that its energy complementarity with China offered it a real alternative to European export markets and could be a building block for a broader strategic economic partnership with Beijing. However, just as the deal became a top priority for Russia, its importance for China was diminishing. The rate of gas-demand growth in China had declined sharply; prospects for Chinese shale-gas production had improved; Turkmenistan was eager to increase its exports to the east; a gas-supply deal with Myanmar had come on line; and, finally, US LNG exports were just over the horizon, contributing to a much brighter outlook for the global LNG market, at least from a consumer's perspective.

The terms offered by CNPC, the Chinese contracting party, were not acceptable to Gazprom. The project is simply too costly to make Russian gas competitive in China in the current energy market. Eventually, both governments twisted the arms of their national energy companies to sign a deal that makes little commercial sense but is a powerful symbol of the countries' structural complementarity. Gazprom was forced by the Kremlin into a project with extremely low return on capital, if any. The Chinese government, for its part, decided that the cost of offering Moscow such a symbolic achievement was less than the potential blowback from rebuffing Russia. So it forced CNPC to accept a less-than-optimal gas-import contract.

Two months later, the price of oil began to fall from its highs of \$110 per barrel and stabilised at less than half that level. For Gazprom, such a fall, if it lasts after 2020, will transform Power of Siberia from a project providing a small but positive net present value (NPV) into one incurring a loss of up to \$17bn.<sup>10</sup> However, such heavy losses could be significantly mitigated if the Russian government were to waive all or part of the 30% natural-gas export duty and, crucially, if Gazprom lowered its discount rate.<sup>11</sup> If the discount rate were brought down from 10% – typical of commercial energy projects – to 3.5%, Power of Siberia would break even with an oil price of between \$40 to \$60 dollars per barrel, depending on the level of the export duty. This compares to \$110 per barrel required to break even at a 10% discount rate and the current 30% export duty levied on pipeline gas exports.<sup>12</sup>

For the purpose of cementing its relationship with China, the Russian government is essentially using Gazprom as a non-commercial entity, akin to its Soviet-era incarnation: the Ministry of the Natural Gas Industry. At a recent event with foreign investors, Russian President Vladimir Putin, while acknowledging that government-controlled joint-stock companies such as Gazprom had ‘a significant share of private capital, including foreign capital’, admitted that projects such as Power of Siberia are long-term bets that do not reflect short-term market realities.<sup>13</sup> A more accurate description is that the government is directing Gazprom to undertake a project with a very low expected rate of return on capital, which only makes sense because Moscow values its expected geopolitical benefits.

While this de-commercialisation of Gazprom may have created the conditions for the Power of Siberia deal to be signed, it does not provide a guarantee that the long-term gas relationship will be stable. CNPC will be operating in an ever more competitive domestic market, in which the price of gas could be lower than the price it pays under the Russian contract. It would then incur huge losses that the Chinese government would have to absorb, or else the contract with Gazprom would come under severe pressure. Therefore, Beijing’s political decision to accommodate Moscow on Power of Siberia might not be just a one-off concession; it might have to be sustained for years and potentially decades, depending on the evolution of natural-gas markets in Asia.

#### *The Belt and Road Initiative and the Eurasian Economic Union*

The emerging cooperation between the BRI and the Eurasian Economic Union (EEU) is also indicative of the new Russia–China modus operandi. Historically, Russia has viewed other powers’ economic initiatives in post-Soviet Eurasia with suspicion. Moscow was initially cautious in its reaction to the BRI, worrying about the implications for Russian interests and about potential encroachment from a country that has far more to offer economically to the five post-Soviet Central Asian countries.<sup>14</sup> The BRI emerged at a particularly sensitive time, because the Russia-led EEU had come under strain after the Ukraine crisis began, when the other members of the union refused to go along with Moscow’s economic countermeasures against Kiev

and the West. China could have tried to implement the BRI in EEU member states on a purely bilateral basis. Instead, Beijing agreed to a significant political gesture, first proposed by Moscow, during a presidential summit in May 2015: a joint statement agreeing to 'join up' the BRI and the EEU.<sup>15</sup> In the statement, Russia declared its support for the BRI, while China did the same for the EEU.

Moscow made this proposal for three reasons. Firstly, it recognised its own relative economic weakness. Russia simply cannot build the kind of infrastructure projects on the scale that China is planning as part of the BRI. Nor can it match the foreign direct investment that China seems prepared to offer to Russia's neighbours. Russia itself would like to benefit from BRI projects on Russian territory. As a result, bandwagoning became a logical choice. Secondly, Russia has decided that the strategic complementarity of the two countries' political regimes and foreign policies outweigh any concerns about Chinese involvement in post-Soviet Eurasia. China eschews direct involvement in the politics of the region, and China and Russia share threat perceptions about 'colour revolutions', that is, alleged Western attempts at fomenting popular revolt in order to install more pliable governments. China (unlike the West, in Russia's view) would never attempt to overthrow sitting governments or pursue a democratisation agenda. China also has no intention of challenging Russia's role as the primary security provider in post-Soviet Eurasia. Finally, Russia views the potential of economic development spurred by the BRI as beneficial to regional stability in Central Asia, where economic privation has contributed to popular unrest in the past.

At first glance, it is perhaps less obvious why China accepted the Russian proposal. But the Ukraine crisis – which was partially sparked by the EU's attempt to implement the Eastern Partnership, its regional-integration initiative for six former Soviet states, without seeking Moscow's blessing – reinforced a reality that the Chinese leadership has long appreciated: Russia can and will undermine other powers' plans in post-Soviet Eurasia if it considers them a threat to its interests. Thus, securing Russian buy-in is essential for major projects there. If China had rejected the Russian proposal, Moscow could have responded by using its considerable leverage to block BRI activity in the region. According to Chinese experts, Chinese President

Xi Jinping has established the principle that China must pay attention to Russia's views, especially when it comes to Russia's 'near abroad'.<sup>16</sup>

The BRI and EEU themselves are by no means analogous; the EEU is a regional economic-integration bloc with a supranational governing body modelled on the EU, while the BRI is largely an umbrella for Chinese foreign direct investment. Indeed, much remains murky about the BRI.

Initially, the details of EEU–BRI coordination were discussed via a bilateral deputy foreign minister-chaired channel, as well as at the Eurasian Economic Commission and among EEU member states. By mid-2016, the coordination mechanism had been raised to the level of deputy prime ministers, and the parties identified more than 60 projects to be considered for funding.<sup>17</sup> EEU member states also agreed to begin negotiating an agreement on a trade- and economic-cooperation framework with China at a summit held on 31 May 2016 in Astana.<sup>18</sup> Additional dialogue on the BRI's role in Central Asia is taking place in the context of the Shanghai Cooperation Organisation.

Despite all of this economic activity, little in the way of concrete outcomes has emerged since the May 2015 statement. For the purposes of understanding the trajectory of Russia–China relations, however, the details of the BRI, the extent to which it is a real or virtual project, or the precise mechanisms of EEU–BRI cooperation are of secondary importance. Far more important is the political gesture that the May 2015 statement represents: Russia and China will support each other's efforts in their shared neighbourhood. It is a particularly important case study for how Russia and China have learned to manage their relationship effectively; indeed, it is a hard case because observers have long predicted a Russia–China clash in Central Asia.<sup>19</sup> Based on the evidence available thus far, Russia and China have upended these predictions and succeeded in transforming a potential source of tension into a means of greater cooperation and mutual reassurance.

### **Implications for the international order**

Russia and China's cooperation at the UN Security Council and in other global forums has been a fact of life in international politics for years. Cooperation has accelerated recently, but this trend predates the Ukraine

crisis. Part of the positive turn in post-Cold War relations has been driven by a fundamental like-mindedness about the nature of the international order and international norms. Beijing and Moscow believe that the international order is undergoing a fundamental shift away from Western-centricity and towards a more ‘balanced’, ‘multipolar’ system, and that the West is resisting this shift. They share a view that the end point of this shift should be a world governed by bargaining and compromise between centres of power to arrive at new arrangements.

In recent years, Russia and China’s positions on key international norms have converged as the countries have moved closer domestically

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*Both systems  
are proudly  
authoritarian*

to what could be called non- and anti-revolutionary authoritarianism. Russia’s rejection of communism after the dissolution of the Soviet Union was initially a major roadblock to bilateral relations; the Chinese Communist Party leadership at the time saw this development as a rejection of its core ideology. In the 1990s, Moscow’s embrace of democracy and integra-

tion with the West was a function of the Russian establishment’s view that its domestic political system would benefit from outside influence. Since then, the Chinese leadership has tended towards affinity with authoritarian states of all ideological stripes, and Russia under Putin has thoroughly rejected the legacy of the 1990s: both systems today are proudly authoritarian, and both leaderships share the view that their domestic political models are fundamentally different from Western ones. They are ‘non-revolutionary’ in the sense that, unlike their Cold War-era predecessors, today’s Russian and Chinese leaders do not seek to export their political systems. They are ‘anti-revolutionary’ in that they oppose (some imagined, some real) Western efforts to foment revolution in those countries where governing elites are opposed to Western policies. Both countries have also kept a wary eye on US-led regime-change efforts in the Middle East and beyond, and have concluded that they are not immune from similar attempts to undermine their rule.

Highlighting this shared view, they released a Joint Declaration on Promotion and Principles of International Law in June 2016, which stated

that they support 'the principle of non-intervention in the internal or external affairs of States, and condemn as a violation of this principle any interference by States in the internal affairs of other States with the aim of forging change of legitimate governments'. Additionally, the two countries promote norms, particularly on cyber issues and human rights, which reinforce internal control and limit external oversight or capacity to influence events across borders. For example, the June 2016 declaration goes on to say that they 'condemn extraterritorial application of national law by States not in conformity with international law as another example of violation of the principle of non-intervention in the internal affairs of States'. They also attempt to shape the activity of international organisations to focus on reinforcing the role of states, as opposed to non-state actors.<sup>20</sup>

Yet Sino-Russian cooperation on global governance has fallen short of an overtly anti-American axis. Russia and China will not form some sort of 'authoritarian International' to spread an alternative political model or block all Western projects. On issues where either country shares interests with the West, it has and will continue to cooperate. And neither country wants the other to have direct influence over its ties with other important partners, including the US. China sees the US as both necessary for its economic development (far more important than Russia) and the only potential adversary that poses an existential threat. Beijing understands that, if it tilts too overtly to Moscow, it will create unnecessary problems in its relationship with Washington.<sup>21</sup> Even if both countries enter into a period of confrontational ties with the US, they are both unlikely to provide unconditional backing to the other as treaty allies are obliged to do. While they would support each other in public statements and help each other in ways that are mutually beneficial – for example, assisting in sanctions evasion – they would not be likely to assist each other in such a way that further undermined their respective equities with the US.

But the core convergence between Russia and China – and their fundamental divergence with the West – is on the role of great powers in the international system. For Beijing and Moscow, deals among the great powers should be the prime determinant of that system. In their understanding, great powers are permitted to violate the formal rules, particularly when it

comes to their immediate neighbourhoods. And no other state can penalise a great power for such violations, even if they disagree. From their perspective, this is a traditionalist, not a revisionist, approach to international affairs. The West, by contrast, has after the Cold War frequently proclaimed that great-power politics has given way once and for all to a 'rules-based' or 'principled' international order, and has sought to isolate or punish Russia and China for allegedly undermining that order, particularly in their respective neighbourhoods.

This dynamic has played out vis-à-vis both Ukraine and the South China Sea (SCS). In the aftermath of the Crimea annexation, Washington launched an attempt to bring China onside to its diplomatic strategy of 'standing up and mobilizing the international community to isolate Russia'.<sup>22</sup> The White House stressed that both countries were on 'the same page' and 'agreed on the importance of upholding principles of sovereignty and territorial integrity'.<sup>23</sup> But the Chinese government had no intention of partnering with the US to punish Russia. It did not support US efforts to condemn Russia's actions at the UN, and certainly did not support the sanctions. At the same time, China did not fully endorse Russia's actions in Crimea. Further, China has not followed Russia's lead in economically squeezing Ukraine; in fact, it has continued business as usual, including its orders from Ukraine's beleaguered military industry.

While China's actions in the SCS do not touch upon core Russian interests, Moscow is not overtly supportive of Beijing's activities there. Vietnam, one of the main opponents of China's behaviour, is a key regional partner for Russia. Russian energy companies also have operations in the SCS. In joint Russia–Vietnam statements, Moscow actually seemed to adopt Hanoi's position on SCS disputes.<sup>24</sup> Gazprom has been a victim of disputes between China and Vietnam over offshore deposits, such as when Chinese vessels cut an offshore exploration cable in an area that Hanoi had auctioned to the Russian company in late 2012.<sup>25</sup> That said, many in the region are concerned that Russia will tilt toward more direct support for the Chinese position as their relationship grows closer.

As with Crimea, the US had attempted to persuade Russia of its position on China's SCS activities, including its public denunciation of the

so-called 'nine-dash line' and open support for the Permanent Court of Arbitration's decision regarding China's SCS dispute with the Philippines. Unsurprisingly, Moscow demurred. After the court's ruling against China, Russia declined to support the decision. As Putin put it, Russia considers the 'interference of third parties, particularly extra-regional powers, harmful and counterproductive'. Further, he said, Russia stands 'in solidarity and support of China's position on the issue of non-recognition of the court's decision'.<sup>26</sup> At the same time, Russia has continued to enhance military cooperation with Vietnam, delivering the fifth of six promised *Kilo*-class submarines in February 2016.

In both the Crimea–Ukraine and SCS–Vietnam cases, Russia and China neither offer unconditional support of each other's positions, nor do they publicly criticise or directly oppose each other. Neither refuses to cease 'doing business' with third parties (for Russia, Vietnam; for China, Ukraine) in order to please the other. Instead, they accept each other's foreign-policy independence, and they will not allow these divergences to threaten their partnership.

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Beijing has so far been unsuccessful in its attempts to form what it has called a 'new model of great-power relationship' with Washington. In fact, such a model already exists in the Russia–China relationship.<sup>27</sup> China and Russia have learned how to work with each other and accommodate each other's interests. These two great powers treat each other as equals and prioritise positive-sum interactions. By accommodating each other's strategic interests, they have achieved an effective partnership despite significant imbalances between them. Over time, Russia will be less capable of asserting its strategic independence vis-à-vis China. Beijing is unlikely to abuse its position in the short term, but whether it will exploit its upper hand in the future remains to be seen.

### **Acknowledgements**

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## Notes

- 1 'Excerpts from Gorbachev's Speech', *New York Times*, 28 June 1986, <http://www.nytimes.com/1986/07/29/world/excerpts-from-gorbachev-s-speech.html>.
- 2 This confidence-building process among the five countries – the 'Shanghai Five' – led to the creation of the Shanghai Cooperation Organisation.
- 3 'Treaty of Good-Neighborliness and Friendly Cooperation Between the People's Republic of China and the Russian Federation', 24 July 2001, [http://www.fmprc.gov.cn/mfa\\_eng/wjdt\\_665385/2649\\_665393/t15771.shtml](http://www.fmprc.gov.cn/mfa_eng/wjdt_665385/2649_665393/t15771.shtml).
- 4 Analytical Credit Research Agency (ACRA), 'China No Longer Invests in Raw Materials – China's Foreign Direct Investment Analysis', August 2016, <https://www.acra-ratings.com/documents/56>.
- 5 *Ibid.*
- 6 Stefanie Linhardt, 'Russia Close to Issuing First Renminbi Bond', *Financial Times*, 7 December 2016, <https://www.ft.com/content/2298889a-b89a-11e6-961e-a1acd97f622d>.
- 7 Authors' interviews in Moscow, November 2015.
- 8 There are additional pipeline options beyond Power of Siberia that would allow Gazprom to serve the Chinese market at lower capital expenditure per unit of gas exported. These include the so-called 'Western route', bringing gas to Western China from West Siberia and the Yamal peninsula, on which negotiations are being actively pursued; and the Vladivostok route, bringing gas from fields on Sakhalin Island.
- 9 See, for example, 'Speech at a Ceremony to Mark the Joining of Power of Siberia Gas Pipeline's First Section', 1 September 2014, <http://en.kremlin.ru/events/president/transcripts/46529>.
- 10 We analysed the sensitivity of the project's NPV to changes in the price of oil, the Russian export duty and Gazprom's discount rate. This sensitivity analysis is based on a financial model of Power of Siberia developed by analysts from UBS. Responsibility for the results and interpretations presented here rests solely with the authors.
- 11 The discount rate is a key financial variable that determines the relative value of a dollar today compared to a dollar in the future. The higher the discount rate, the greater the preference for the present. A low discount rate makes a capital-intensive, long-lived project such as Power of Siberia look better financially, but minority investors in Gazprom would object that there are much better uses for their capital, at comparable risk levels, elsewhere in the market. Typically, governments use lower discount rates for infrastructure investment than do for-profit corporations because they can borrow at cheaper rates (reflecting lower risks), and they can take into account the social benefits that accrue to the wider economy.
- 12 See Pierre Noël, 'The Power of Siberia Project', *Politics and Strategy: The Survival Editors' Blog*, 17 January 2017, <http://www.iiss.org/en/politics-s-and-s-strategy>.

- 13 'Russia Calling! Investment Forum', 12 October 2016, [en.kremlin.ru/d/53077](http://en.kremlin.ru/d/53077).
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- 21 As the quasi-official *Global Times* newspaper warned, 'it is not wise for China to fuel confrontations with the West' by siding with Russia. 'Russia's Path Not Suitable for China', *Global Times*, 22 March 2014, <http://www.globaltimes.cn/content/850019.shtml>.
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- 23 *Ibid.*; 'Readout of the President's Call with President Xi of China', 10 March 2014, <https://www.whitehouse.gov/the-press-office/2014/03/10/readout-president-s-call-president-xi-china>.
- 24 In 2014, for example, the two countries stressed the importance of adherence to the Law of the Sea and the 2002 Declaration on the Conduct of Parties in the South China Sea, and urged the adoption of a code of conduct. 'Sovmestnoe zayavlenie o postupatel'nom prodvizhenii vseob'emlyushchego strategicheskogo partnerstva mezhdru Rossiiskoi Federatsiei i Sotsialisticheskoi Respublikoi V'etnam', 25 November 2014, <http://www.kremlin.ru/supplement/4785>.
- 25 Ben Bland and Leslie Hook, 'Vietnam Accuses China of Maritime Sabotage', *Financial Times*, 3 December 2012, <https://www.ft.com/content/36745ce4-3d43-11e2-9e13-00144feabdco>.
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- 27 In March 2013, before the US–China Sunnylands summit at which China introduced the phrase, Putin and

Xi issued a joint statement in which they called the Russia–China relationship an ‘example of harmonious coexistence of great powers, playing the most important stabilizing role in the contemporary world order, promoting peace and security in the region and the world at large’.

‘Sovmestnoe zayavlenie Rossiiskoi Federatsii i Kitaiskoi Narodnoi Respubliki o vzaimovыgodnom sotrudnichestve i uglublenii otnoshenii vseob’emlyushchego partnerstva i strategicheskogo vzaimodeistviya’, 22 March 2013, <http://kremlin.ru/supplement/1423>.