

Push and Pull: Russia's Pivot to Asia

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March 2016

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ABSTRACT

In the wake of the crisis in and around Ukraine and the subsequent marked deterioration of its relations with the West, Russia has embarked on a new policy direction: its “pivot” to Asia (or rather China), in Russian terms *Povorot na Vostok* (Turn to the East).

In Russia's turn to the East push and pull complement each other. At the same time it is something of everything. It follows the pragmatic need to accommodate a big neighbor (China) and at the same time charges this relationship with broad-based geostrategic objectives (helping multipolarism to come true). It aims at making proper use of unprecedented economic opportunities abroad, and at the same time it calls for decoupling and import substitution. It projects to fully develop the potential of Russia's lands east of the Urals, but at the same time keeps it secluded. It not only turns East but also inwards and backwards.

The Working Paper analyzes these various elements connected with Russia's Asia pivot: It addresses the rationale of Russia's turn to the East, presents the record to date, assesses the problems and risks and provides some concluding thoughts about the prospects.

In conclusion Russia's turn to the East presents a mixed picture. It is certainly not predicated on a modernization or development strategy, but rather amounts to damage limitation. Yet damage limitation entails costs and as a rule does not follow an economic rationale. In this sense the push seems to dominate the pull. Substituting the Western direction by the Chinese rather than complementing it – as originally conceived – is not a promising proposition.

1 INTRODUCTION

A new buzzword has appeared in Russia's international relations discourse: *Povorot na Vostok* (Turn to the East). Less ambitiously it has been labelled *vostochny vektor* (Eastern Vector) and increasingly reference is made to Russia's “Pivot” to Asia. Hence with a time lag of three years Russia seems to follow the US example and is also “pivoting” to Asia, which in essence means to China whose rise is expected to change the overall balance in the region – and beyond.

Ostensibly Russia once again appears to just follow the US lead. The substance of its Asia pivot, however, is quite different. The US essentially considers the rise of China a challenge, if not an emergent threat, to be met by balancing (plus a measure of engagement). “China represents one of the most challenging and consequential bilateral relationships the United States has ever had to manage.” That is how Hillary Clinton as Secretary of State justified the US pivot which amounts to a fairly comprehensive strategic posture, consisting of six elements: strengthening traditional security alliances; building new partnerships with rising powers, preferably including China; engaging with regional multilateral institutions; expanding trade and investment; expanding the military presence beyond the established parameters; and advancing democracy and human rights.¹

Russia, however, is clearly focused on the opportunities posed by the tectonic shifts emanating in that part of the world. These have encouraged engagement (plus some precautionary second thoughts). But whereas originally Russia was attracted by Asia and China and the opportunities which have been opening up in the wake of the dynamic developments there, since the Ukraine

* Working paper based on a presentation at the ICCEES World Congress, Makuhari, Japan, 3–8 August 2015.

1 Hillary Clinton, America's Pacific Century, 1 October 2011, in: <http://foreignpolicy.com/2011/10/11/americas-pacific-century>. This follows the logic: “We both have much more to gain from cooperation than from conflict. But you cannot build a relationship on aspirations alone.”

crisis and the deterioration of the *zapadny vektor* 2014 Russia has become short of alternatives. Hence push and pull complement each other.² But, as the context indicates, this is not yet the whole story: Rather, Russia's Asia/China pivot has become an integral part of a paradigm shift with much broader implications.

Hence Russia's turn to the East is something of everything. It follows the pragmatic need to accommodate a big neighbor and at the same time charges this relationship with broad-based geo-strategic objectives. It aims at making proper use of unprecedented economic opportunities abroad, and at the same time it calls for decoupling and import substitution. It projects to fully develop the potential of Russia's east, but at the same time keeps it secluded. It not only turns East but also inwards and backwards.

The Working Paper sets out to present and analyze these various elements connected with Russia's Asia pivot. It proceeds in four steps. It addresses the rationale of Russia's turn to the East, presents the record to date, assesses the problems and risks and provides some concluding thoughts about the prospects.

2 THE RATIONALE

In principle a combination of push and pull has the advantage of providing an undisputed sense of direction. This is also true for the Asia pivot which by itself, however, does not necessarily lead to the desired result, i.e., mutual benefits. The reason: these – necessary – external conditions are to be met by – sufficient – internal conditions in order to make productive use of such a reorientation. In this respect it can be stated that current conditions are certainly not conducive to achieving the expected economic gains, as the reorientation seems overly politicized – and sometimes fraught with fairly strange prescriptions. There are, for instance, efforts to exploit the current unfavorable push from the West for pushing Russia not just to the East but into a completely different direction. If the current political climate in and around Russia persists, this is bound to get ever more seriously felt.

In principle there is nothing wrong with turning to Asia in general and to China specifically – as this is currently the powerhouse of the world economy. Everybody is eying China in an effort to find new market outlays. In this respect, Russia has much room to improve and expand. Moreover, although essentially a continental power, Russia – as much as the US – is also an Atlantic and a Pacific power. Yet in this respect it is much less balanced than the US: whereas Russia's access to the Pacific is much broader than its Western shores, its center of gravity clearly resides in the western part of the country having left the part east of the Urals well behind (if not neglected). Rebalancing is all the more an urgent task as the US professes to build in the Asia-Pacific what it has achieved in the transatlantic area: a “web of partnerships and institutions”.³ And after all: Russia shares a land border with China of over 4,200 km which incidentally is the largest border with a major power and arguably the most peaceful in Russian history – as opposed to the borders with Europe or with Turkey.

Rebalancing from the very beginning also meant engineering a new development push for the adjacent territories, namely Siberia and Russia's Far East. This on the one hand concerns the concentration of Russia's unique natural resources in the region, the exploitation of which naturally calls for customers in geographical proximity – for the benefit of the whole country. Yet it also concerns a political precautionary element, i.e., external threats from possibly expansionist neighbors and internal threats from separatist moods in the region that to some extent gained currency in the turbulent 1990s.

2 Sometimes the US Asia pivot is also considered a push that drives China into the arms of Russia, but this is clearly an overly alarmistic assessment as China is much more carefully navigating this choppy sea.

3 Clinton, op. cit.

However, Russia's pivot to the East goes well beyond purely pragmatic considerations and occasionally raises fairly high-flying expectations with quite some explicitly "geopolitical" connotations. Thus it has been said:

"Today, the single Eurasian space – China with Southeast Asia and Russia with the Eurasian Union, plus India, the Middle East and Africa, which are also becoming increasingly Eurasia-oriented – is squeezing out the economy of the previously omnipotent trio of the United States, Europe and Japan. The United States is fiercely resisting the process in an attempt to preserve its supremacy in Eurasia, and consequently in global politics and economy."⁴

In the same vein the decision to admit India and Pakistan to the Shanghai Cooperation Organization (SCO) at the UFA summit in July 2015 is said to change the regional and moreover the global map completely. With the new members the SCO would comprise all the leading non-Western powers of Eurasia and could therefore

"be regarded as an emerging cornerstone of the multipolar world in the making, a platform offering a Eurasian alternative to Western Europe. As the Eurasian Economic Union (EEU) strives to come up with an economic alternative to the EU, the SCO could offer a political and ideological alternative."⁵

Much of this has come to the official fore only in the wake of the Ukraine crisis which clearly acted as an accelerator of Russia's turn to the East. On the one hand, seeking refuge in Asia and notably in China is clearly defensive, meant to counter Western efforts at isolating Russia internationally and to mitigate the adverse economic impact of Western sanctions (reinforced and superseded by falling oil prices later on). But on the other, it moves beyond this current concern and follows the Russian aim of doing away with US dominance and the "US-led Western-centric" world by giving substance to a multipolar international order which Putin first alluded to at the Munich Security Conference in early 2007.

According to Dmitri Trenin this has given rise in the Kremlin to a substantially revised political map: Putin's vision of a "greater Europe" from Lisbon to Vladivostok, comprising the EU and the EEU, is being replaced by a "greater Asia" from Shanghai to St. Petersburg.⁶ In this sense Eurasia is considered to become the new center of economic and political gravity where Russia and China set the tone without undue US interference.

Such a vision has familiar geopolitical undertones and – taken as prescription – possibly far-reaching consequences as in the tradition of Harold Mackinder the control of the Eurasian "heartland" is considered key to global supremacy – a proposition which in Russia for years has been propagated by Alexander Dugin and his essentially neo-fascist Eurasian movement. This confluence is one more indicator how close the Kremlin is navigating along the prescriptions of those "patriots" who ultimately detect Russia's future in its past, white and red combined. In the wake of the Ukraine crisis this for a while also seemed to imply complementing the external confrontation by internal formation thereby not only turning East but also emulating what is considered the characteristics of the Chinese development model: authoritarian leadership coupled with state-led capitalism – something Sergei Glazyev has provided the intellectual blueprint for.⁷ In a more mundane version this has been propagated by Glazyev's companion from the Izborsky Club, Alexander Prokhanov, who detected that "Putin's plan for the modernization of Russia consists of the con-

4 Gleb Ivashentsov, *Toward a Peaceful Eurasia*, 14 May 2015, in: <http://bit.ly/1niWNLt>.

5 Alexander Lukin, *Shanghai Cooperation Organization: Looking for a New Role*, Valdai Discussion Club, Special Issue. Allegedly, this also implies a clear break with the SCO's past as originally the SCO was intended by Russia as just an ideological symbol of a multipolar world: "It adopted declarations expressing a non-Western, multipolar view of the world and non-Western values, but did not undertake any serious organizational work."

6 Dmitri Trenin, *From Greater Europe to Greater Asia? The Sino-Russian Entente*, 9 April 2015, in: <http://ceip.org/1auTpa4>.

7 See among many others of his numerous publications Sergey Glazyev, *Moment istiny: Rossiya i sanktsii zapada* (The Moment of Truth: Russia and the Sanctions of the West) 24 June 2014, in: www.dynacon.ru/content/articles/3397.

struction of monasteries and huge defense complexes”.⁸ This, however, can be read as a Prokhanov-style battle cry to endorse Putin’s officially promulgated allegiance to the “traditional values” of the orthodox faith, his rearmament program, his “competitive import substitution” and the all-encompassing *de-offshorizatsiya*.

In this sense Russia’s turn to the East might be considered the culmination of a trend which preceded the Ukraine crisis and started with Putin’s return to the helm of the state in 2011/2012. It implies a fairly comprehensive paradigm shift: What used to be “modernization” became “mobilization”, what used to be “globalization” became “localization” (and “import substitution”), what used to be “democratic” became “traditional” values and what pointed to aligning with the West became turning to the East.

3 THE RECORD

Russia’s turn to Asia has not changed much, its China pivot, however, has accomplished a lot in a fairly short period of time. Whereas the “strategic partnership” between Moscow and Brussels never moved beyond the pale declaratory, between Moscow and Beijing it has given rise to a truly preferential relationship. Putin is quite right when he repeatedly states: “As for the People’s Republic of China, the level, nature and confidence of our relations have probably reached an unprecedented level in their entire history.”⁹ This, however, was also once said about German-Russian relations, but in this case history was much more tumultuous and the mutual understanding was predicated upon the limitations posed by the (widening) value gap (whereas in the case of China this constitutes another point of convergence).

Further proof of the close alignment is the fact that the Russian embassy in Beijing is second only to the embassy in Washington and that – contrary to standard practice – China boasts four inter-governmental commissions, all overseen by Russian deputy prime ministers.¹⁰ Frequent mutual visits and piles of agreements concluded and signed on these occasions complement the overall picture. The fact that China essentially sacrificed another previously close partner – Ukraine – also testifies to the importance Beijing attaches to its relations with Moscow. Beijing kept silent to Russia’s violation of the once upheld principle of state sovereignty (as does Russia with respect to China’s territorial ambitions in the East and South China Seas which also involve an equally close partner, Vietnam), but it has not hesitated to condemn Western sanctions – and back Russia in its efforts at damage limitation.

The economic exchange – at least as far as trade is concerned – presents a similar picture. Since 2010 China has been Russia’s biggest trading partner with bilateral trade having reached \$95 billion in 2014 (in the 1990s it hovered around a mere \$5–7 billion annually). On the backdrop of this success it became an officially declared objective to increase Russian–Chinese trade to \$100 billion by 2015 and to \$200 billion by 2020 which in light of an average growth rate of around 30% *prima facie* did not look illusionary. In 2015, however, Russian-Chinese trade could neither escape the economic downturn in both countries nor the decline in global energy prices: it recorded a 28% decline (down to \$62 billion with Chinese exports having dropped 34% and Russian 19%, both by and large in line with the decline in Russia’s trade with sanctions-hit EU) and renders the ambitious goals out of reach for the time being.

Mutual investments have been much less advanced: As of the end of 2013, total Chinese investments in Russia approached \$5 billion (of a Chinese total of around \$115 billion), while Russian

8 Aleksandr Prokhanov. Zamkovy kamen’ rossiiskoy gosudarstvennosti. Iz chernoy bezdny vnov’ zarozhdaetsya oblik novoy imperii (The Keystone of Russian Statehood. From the Black Abyss the Countenance of a New Empire Is Re-Emerging), 26 March 2014, in: www.dynacon.ru/content/articles/2794.

9 Plenary session of the 19th St Petersburg International Economic Forum, 19 June 2015, in: <http://bit.ly/1TUmy1e>.

10 See Alexander Gabuev, Russia’s Policy towards China: Key Players and the Decision-making Process, 5 March 2015, in: <http://ceip.org/1FZmVkd>.

investments in China reached \$860 million only.¹¹ Russian informal limitations put on all Chinese investments in sensitive sectors such as energy, mining, and infrastructure have been cited as one reason. Hence, for the last 15 years Chinese companies were not exactly encouraged to bid on large infrastructure projects in Russia. Moscow's concerns allegedly included increased competition for (well-connected) local companies and a possible influx of Chinese migrant workers. In May 2014, this ban was said to have been lifted. Plans for constructing new stations for the Moscow Metro and for a high-speed railway line from Moscow to Kazan – originally negotiated with Siemens – are the first practical signs of an increased Chinese engagement.¹²

A fairly new feature is the financial cooperation, partly a response to Western sanctions, partly driven by the aim to overcome the dominance of the US-Dollar. In 2010, the Moscow Interbank Currency Exchange launched trading in Ruble and Yuan, but sales hardly got off the ground. However, in 2014 the situation changed drastically when in October 2014 the Central Bank of Russia and the People's Bank of China signed a three-year currency swap agreement for about \$24.5 billion. Whereas in 2013 in spite of numerous declarations to the opposite effect, Ruble-Yuan settlement accounted for just 2 percent of bilateral trade the two are now aiming at 50%.¹³

After years of protracted (price) negotiations in May 2014 the first big gas deal was finally sealed. It concerns the so-called "Eastern Corridor". The natural gas from two remote fields east of the Baikal – the Chayandinskoye and Kovyktinskoye deposits – will be delivered via a newly built pipeline called "The power of Siberia" with a contracted final capacity of 38 bcm annually (and possibly to be extended to around 60 bcm at some point in the future). The gas price has not been disclosed but reportedly the terms and the price formula are comparable to what Russia agreed with its European customers.¹⁴

On 10 November 2014 Moscow and Beijing signed one more memorandum of understanding on gas supplies along the "Western Corridor" which would connect fields in Western Siberia supplying Europe via a pipeline through the Altai Mountains with China. Theoretically this would allow Russia for the first time to switch between its customers in the East and the West and it would be the first project in Gazprom's once avowed aim to transform the "European" gas market into a "Eurasian" market which it could randomly service.¹⁵

Contracts on Russian crude oil exports such as the one between Rosneft and the Chinese National Petroleum Corporation in 2013 (on the delivery of 360 million tons of oil during 25 years), complement the picture of a belatedly emerging energy alliance between Russia and China.

Certainly, the natural resource complex of Siberia and the Far East, consisting of oil, gas, coal, metals, timber and others as well as their proximity to Asian countries are the most obvious – and for the time being Russia's most important – asset and competitive advantage. On this basis the region is to become the subject of a more coherent and efficient development strategy than previously. There is indeed a new "Federal Targeted Program for the Development of the Far East and the Baikal Region" for the next five years, a "List of Priority Investment Projects in the Far Eastern Federal District" approved on 3 June 2013 by the Government of the Russian Federation, and not

11 Mikhail Titarenko et al., *Development of Russian–Chinese Trade, Economic, Financial and Cross-Border Relations*, RIAC Working Paper 20/2015, p.4.

12 See Alexander Gabuev, A "Soft Alliance"? Russia-China Relations After the Ukraine Crisis, *European Council on Foreign Relations*, February 2015. Nevertheless, Chinese investment in Siberia and in agriculture remains a highly charged subject: When the news appeared that Russia's Zabaikalsky region would grant 115,000 hectares of land to a Chinese company, many protest ensued, see Alexander Gabuev *Should Russians Fear Chinese Colonization?* 30 June 2015, in: www.themoscowtimes.com/opinion/article/should-russians-fear-chinese-colonization/524739.html.

13 Gabuev, A "Soft Alliance"? op.cit.

14 A skeptical assessment has been put forward by Vladimir Milov, *Russia's New Energy Alliances: Mythology versus Reality*, Paris (Russie, NEI, Visions No. 86), July 2015, pp. 7–9.

15 See on this "Europe and Eurasia: towards a new model of energy security. The natural gas aspect", *Valdai Discussion Club*, Position paper for the Berlin conference, 13 April 2015. However, the first such memorandum had been signed back in 2006 and not much progress could be registered so far. Moreover, a third much publicized project, a joint LNG terminal in Vladivostok, equally seems to have stalled.

least Putin's instructions to create points of economic growth in his address to the Federal Assembly of the Russian Federation on 12 December 2013.¹⁶

Five main directions of development are envisaged which all require significant investments:

- Development and modernization of transport infrastructure;
- Mining and processing of mineral resources;
- Power generation;
- Processing of biological and natural resources;
- Development of high-tech industries.¹⁷

Optimism about a turn for the better in the region, however, is limited. Thus the performance of the Ministry for the Development of the Russian Far East, established in 2012, is assessed highly critical by Russian experts: "So far, it has not performed its main function of making the region attractive for businesses as well as for the people. There is still no clear understanding on which country the Far East should focus its cooperation, and the investment climate remains unwelcoming for foreign investors."¹⁸

Military cooperation has considerably intensified during the past years. This concerns exercises such as the "Naval Interaction 2014", the largest ever Russian-Chinese military naval exercise (May 2014), as well as the "Peace Mission 2014" military exercises (August 2014), and the "Sea Cooperation 2015" naval exercises well beyond the Chinese-Russian theater in the Mediterranean (May 2015).¹⁹ The next bilateral naval exercises are scheduled in 2016 in the western Pacific.

Arms delivery and armament cooperation is another field in which previous obstacles and reservations seem to have been overcome. Whereas in the 1990s military-technical co-operation was one of the pillars of mutual trade and China's share in Russian arms export quite sizeable, it gradually declined in the following decade. One of the reasons sounds very familiar to Western business: Russian worries about the Chinese propensity to copy Russian equipment. Hence the last large orders were reportedly placed in 2007.²⁰ However, considering the serious crisis between Russia and the West, well-informed observers expect a further intensification of military and military-technical cooperation which would imply expanding the range of technology that Moscow is willing to supply to Beijing: "By all appearances, the restrictions on supplies of some of the latest technology to China will be eased."²¹

4 PROBLEMS AND RISKS

In spite of the intensification of mutual cooperation and the noticeable achievements, there are a good number of problems, risks and competing objectives which might not peril but certainly complicate and slow down further progress.

Most fundamentally: In many respects China is for Russia and for ordinary Russians *terra incognita*. This is a marked difference to the West where the opening-up happened more than twenty years earlier. Lack of experience and near complete illiteracy are therefore popular expressions in

¹⁶ Titarenko et al., op. cit., pp. 4–5.

¹⁷ L. N. Garusova, *Vozmozhnosti i riski politiki Rossii v Aziatsko-Tikhookeanskogo regiona (ATR): faktor SSHA i Kitaya* (Opportunities and Risks in Russia's policy in the Asia-Pacific Region: the Factor of the US and China), March 2015, MS.

¹⁸ Titarenko et al., op. cit., p. 19.

¹⁹ Ibid., p. 4.

²⁰ Alexander Gabuev, *Russia's Policy Towards China: Key Players and the Decision-making Process*, 5 March 2015, <http://carnegie.ru/2015/03/05/russia-s-policy-towards-china-key-players-and-decision-making-process/i4ek>.

²¹ Sergey Luzyanin, Zhao Huasheng et al., *Russian-Chinese Dialogue: The 2015 Model*, RIAC Report 18/2015, p.9.

the Russian reasoning about the state of affairs. But this impression can equally be found on the Chinese side as there is only very little mutual appeal and understanding.²²

Moreover, whereas in Russia's relations with the West quite often an inferiority complex is at play, vis-à-vis Asia it is rather a sentiment of cultural superiority. Conversely, whereas Russia's "Europeanism" has always been a matter of identity, Russia's "Asianism" is just a pragmatic choice. But even in current circumstances this pragmatic choice is still compromised by a lingering uneasiness about China's rise. Compared to Western allusions to the "yellow threat", Russia's fears are compounded by a pertinent and peculiar concern: the growing economic and demographic asymmetry between China and the sparsely populated Siberia and the Far East.

Finally, the demanding management of such a fundamental and at the same time new relationship requires that Russia addresses what unfortunately is in ample supply back home: "bureaucratic inertia; lack of workable ideas; and high levels of corruption".²³

Economic exchange – unbalanced

The economic relations between Russia and China are characterized by a number of asymmetries of which some pose challenges, other opportunities. One such asymmetry is the gradually increasing gap in both GDPs: Russia's is just 22% of China's – according to Russian observers today "the main challenge to Russian-Chinese relations".²⁴ Even more irritating appears the asymmetry in the dependency ratio since Russia's share of China's foreign trade remains small, at just 1.76 per cent in 2009 and 2.15 per cent in 2013 – whereas China occupies the first place and its share is well above 10%. Hence "China has been diversifying its trade, while Russia has been growing increasingly dependent on the Chinese market".²⁵ In addition, as trade still constitutes the overwhelming part, the economic interdependence of the two countries remains extremely low.

The most significant imbalances, however, can be found in the structure of trade which has undergone a very unfavorable transformation during the past ten years. Whereas in 1999 the structure of Russian imports from China was fairly balanced between processed and unprocessed goods, in 2013 China's export to Russia was clearly dominated by high added value products.

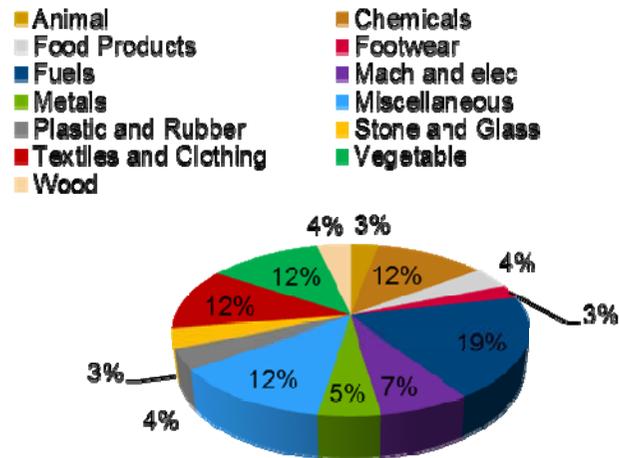
22 Even at the last 2015 Petersburg Economic Forum, hampered by Western neglect, Chinese attendees were seriously underrepresented as a Chinese participant complained: "I am not so sure that your businesspeople are ready to make use of the advantages the Chinese market offers. Just take a look around. How many Chinese are there here in the audience? I feel quite alone here on the stage. How many Russians are there in China? I don't even know. Talking to my Russian friends about all of this over the last couple of days, I came to the conclusion that people here still see Asia as a place they would like to get hold of, but they are not ready to go and commit themselves economically there." Plenary session of the 19th St Petersburg International Economic Forum, 19 June 2015, in: <http://bit.ly/1TUmy1e>.

23 Dmitri Trenin, Bureaucracy and Corruption Stand in Way of Russia's Shift to Asia, 29 March 2015, in: <http://ceip.org/1abN2sG>.

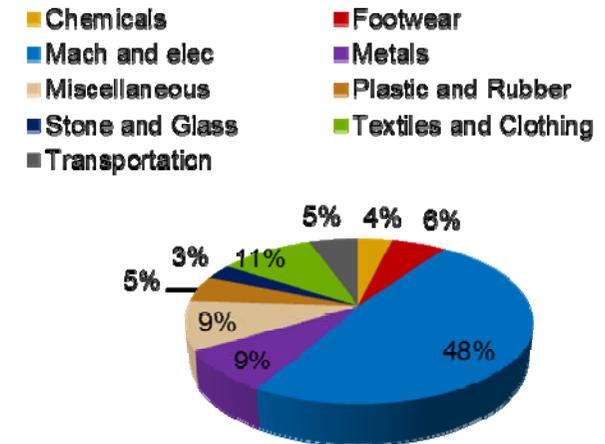
24 Titarenko et al., p. 8.

25 Ibid., p. 10.

All Imports to Russia from China in 1999



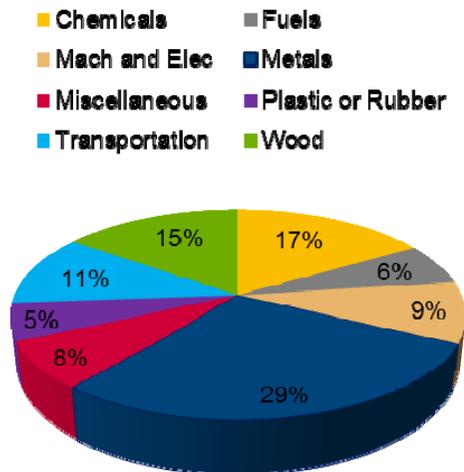
All Imports to Russia from China in 2013



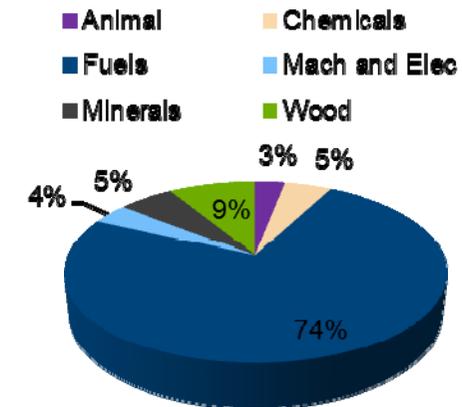
Source: own data collection

On the export side it is just the opposite: In 1999 ferrous metals and machinery accounted for a large share in Russian exports to China, but in 2013 not much was left of it as oil and other energy products reached 74%.

All exports from Russia to China in 1999



All exports from Russia to China in 2013



Source: own data collection

It is obvious that such a large share of oil and gas exports to China makes Russian deliveries dependent on Chinese resource policy and it has been argued that China by addressing Russia is just seeking to minimize its risks in the field of energy imports. At present, oil and gas imports from Russia make up just 6% and 4% respectively of all Chinese supplies of these two energy carriers. In light of this the first Valdai report “Toward the Great Ocean” concluded that getting fixated on oil and gas pipelines exclusively for China should in any case be avoided: “These pipelines should go to the ports of the Far East and from there on to the markets in the Pacific and Indian oceans. The Soviet mistake of building all its gas pipelines to the West should not be repeated.”²⁶

²⁶ “Toward the Great Ocean, or the New Globalization of Russia”, Valdai Discussion Club, Analytical Report, Moscow, July, 2012, p. 64.

Yet as in the case of Europe, there is a growing concern that Russia might become a mere resource appendix of China. This is all the more true as the ambitious goals for expanding mutual trade are said to be reached only when the current structure of bilateral trade will be preserved: by increasing Russian (commodity) exports and Chinese (machinery) imports.²⁷

Russian trade with China is an exact replication of Russia's trade with the West, notably the European Union. In this sense it does not help structural change but rather cements the status quo. Since 2014 there have certainly been exchange rate effects – the detrimental effects of the Dutch disease on Russian exports might be rectified by the marked weakening of the Ruble in the wake of declining oil prices – but Russia's trade pattern first and foremost reflects structural deficiencies. Andrei Kortunov has clearly pointed out what is at stake:

“If Russia doesn't modernize and diversify its economy, increase its innovation potential, the ties with China will remain one-sided: Russia will export raw materials, energy resources, military equipment and, in return, receive consumer goods, car manufacturing products and so on. In order to avoid that and proceed to more complex cooperation projects, we need to restructure our economy.”²⁸

In other words, it is not economic cooperation with China that helps rectifying Russia's economic woes, but rather the other way around – a prescription that has been echoed by Chinese representatives in no uncertain terms. Thus it has been pointed out that except for large energy and infrastructure projects, “companies will need to act as the agents of bilateral trade and economic cooperation” and that Russia needs to “develop market mechanisms” without which “a large-scale breakthrough is unlikely to happen in trade and economic cooperation, particularly when it comes to mutual investment”. Such advice sounds very familiar and has time and again been put forward at EU-Russia gatherings (where it was increasingly perceived and criticized as undue lecturing by the Russian side). The same goes for Russian “technology clusters” which do not properly function for reasons which again sound familiar: “Unfortunately, Russia has chosen to set up technology clusters in remote regions with small populations and underdeveloped economies. As much as Russia hopes that foreign capital will develop those regions, they offer little appeal for foreign businesses.”²⁹

Meant to preserve established patterns of economic exchange, Russia is facing in its turn to the East the same adaptive pressures as in its time-tested relations with the West. In light of this it remains to be seen whether the “Modernization Partnership” between Moscow and Beijing will produce more tangible results than the ones it concluded around the same time with the EU and most of its member states.

Import Substitution – a patchy record

Since the onset of the Ukrainian crisis an integral part of the paradigm shift and conceived as a means to overcome the lopsided dependence on raw materials has been import substitution. There is currently much talk about “competitive import substitution” as Putin labeled it at the St. Petersburg Economic Forum of 2014 – as an indispensable means to counter Western sanctions and thereby as a complement to Russia's turn to the East. On that occasion Putin announced that certain goods should be purchased “for government and public purposes solely or preferably from Russian producers” and revealed plans to establish “a special fund for the development of Russian industry”. This was aimed at granting investors “long-term loans on easy and flexible terms. The final cost of such loans should not be above the inflation rate plus one percent” – which, however,

²⁷ Luzyanin/Huasheng et al, op. cit., p. 26. Others point to the urgent need to expand the transport capacity, see Titarenko et al., op. cit., p. 19.

²⁸ Ksenia Zubacheva, Pivotal questions about Russia's China pivot, 3 June 2015, in: www.russia-direct.org/debates/pivotal-questions-about-russias-china-pivot

²⁹ Luzyanin/Huasheng, et al., op. cit., pp. 15, 21.

within months of the announcement amounted to a staggering 17% – in spite of the “instructions” which according to Putin the government and the Central Bank had received. This rendered the overall objective obsolete: “We must carry out the largest technological upgrade of our enterprises in the past half century.”³⁰

Putin’s announcement of May 2014 corresponded to the strategic meander which according to foreign complaints East and West prevented Russia from the “significant progress” and “notable results” which Putin boasted one year later on the same occasion – without, however, providing any details. Instead he once again reverted to the “tremendous potential in our engineering and petrochemicals sectors, in light industry, the processing sector, pharmaceuticals, and a number of other sectors.”³¹ None of these have been tapped so far and it is only growth in the agricultural sector which since has been regularly cited as proof of the right approach.

A brief look at what import substitution as a strategy entails, reveals the – systematic – shortcomings of what Russia pertains to be doing under this label. In principle import substitution is nothing special: After Great Britain’s entry into the industrial age in the 18. Century every country in economic history had to pass through some sort of import substitution. This happened in Germany in the 19. Century with Friedrich List’s “Zollverein”, it was true for the Soviet industrialization of the 1930s, and it also came about to some extent in the wake of the Ruble crisis of 1998.

Yet as a development and modernization strategy it was systematically employed from the 1950s until the late 1970s in the big countries of Latin America (and for shorter periods elsewhere). The background was Raul Prebisch’s concern about the deterioration of the terms of trade between the industrial and nonindustrial countries.³² Looking at the price volatility on energy markets – with oil prices nose-diving again – Russia has every reason to think about a substantial improvement of its industrial record and its export portfolio.

The principal policy instruments used to promote import substitution used to be:

- Protective tariffs and/or foreign exchange controls to protect selected branches of domestic industry and to facilitate the importation of equipment and inputs for them (introduction of multiple-exchange-rate systems, i.e., preferential exchange rates for the import of industrial raw materials, fuels and intermediate goods);
- Special preferences for domestic and foreign firms importing capital goods for new industries;
- Cheap loans by government development banks for favored industries;
- Construction by governments of infrastructure especially designed to complement industries;
- Direct participation of the public sector in certain industries, especially the heavier industries, such as steel, where neither domestic nor foreign private capital was willing or able to invest.

Taken this into consideration there are some obvious limitations for today’s Russia: membership in the WTO impairs the tariff instrument, the monetary policy by the Central Bank is not exactly geared towards exchange rate management and the sanctions pose problems with raising sufficient amounts of credit. What remains are local content rules which, however, according to the WTO accession agreement will also have to be phased out within a few years. Yet these instruments were equally crucial in previous import substitution strategies as was foreign direct investment.³³

30 St. Petersburg International Economic Forum, 23 May 2014, in: <http://eng.kremlin.ru/news/7230>.

31 Plenary session of the 19th St Petersburg International Economic Forum, 19 June 2015, in: <http://en.kremlin.ru/events/president/news/49733>.

32 He was Secretary General of the UN Economic Commission for Latin America.

33 Even the cradle of Soviet industrialization – Magnitogorsk – would hardly have come about without US technology and US engineers.

Without serious structural reforms pertaining as much to the workings of the state apparatus as to the investment climate, a broad-ranging Russian import substitution will hardly come by. Moreover, import substitution has proved as much a necessary stage in economic development as it easily amounted to a dead end. In Japan and South Korea the record was clearly positive, not least because of the feedback of global markets. Yet in Latin America after an initial upswing this strategy had very mixed results at best – in the absence of serious structural reforms and a (gradual) opening up to global markets.³⁴

In addition it should be borne in mind that 40% of Russian imports from the EU consist of machinery which cannot easily be substituted – in spite of the (ongoing) sharp drop in imports from that direction since 2014. Apart from technical specifications, for a number of reasons China is hardly a (short term) replacement. Hence China has not really shown a propensity to share its technology with others, nor does it dispose of the appropriate technological potential or appears willing to seriously invest into the Russian economy.³⁵

Project Siberia – badly needed

In most of Siberia and in the Far East essential conditions for a meaningful import substitution are clearly lacking: a small population and consequently a small market (which puts limits on an import substitution that produces for the local market), long distances combined with perm frost (which makes transport a problem and exceedingly expensive) and compared to the neighboring countries in Asia relatively high labor costs (combined with, in some parts, a dwindling population and inhospitable living conditions). For foreign investors these conditions are equally unattractive.

But there are certainly comparative advantages such as a unique resource endowment and in addition about 16% of the world's fresh water (excluding groundwater), about 21% of the world's forests, and in Siberia and the Far East 22% of Russia's arable land are located.³⁶ Any strategy of rejuvenating the economy has to be based on these assets.

This, however, has proved an outstanding challenge as the fate of the many master plans of the Russian government exemplify. This is true for the "Long-term state program for the integrated development of the productive forces of the Far Eastern economic region, the Buryat Republic and Chita region for the period until 2000" which was adopted in 1987 and never materialized. The same fate happened to the presidential program "Economic and social development of the Far East and Trans-Baikal for the period to 2013" that focused on the export of natural resources, the formation of basic infrastructure and an improvement of the investment climate for the development of priority sectors. It aimed at a regional growth rate significantly higher than the Russian average which again never materialized. Moreover, only a fraction of the envisaged measures were realized, variously estimated at only 10% or 37%.³⁷

According to Chinese complaints not even the most elementary preparatory efforts for creating conducive investment conditions by the Russian state have been fulfilled. Neither are there appropriate transport links along the border nor has Russia managed to build its part of the 2.2 km

34 There is broad agreement among different schools of thought that import substitution in the past tended to create a highly protected, oligopolistic or monopolistic and overall inefficient manufacturing sector, characterized by substantial underutilization of capacity and dependent capital-intensive technology with low employment generation. Furthermore, industrialization quite often was pursued at the expense of the agricultural sector, along with a significant bias against exports of both primary and manufactured goods. Quite often, the dependence on imports was not reduced and a shift in their composition towards intermediate and capital goods even increased the vulnerability to foreign exchange crises. Therefore, following a typical import substitution model carries the risk of sacrificing comparative advantages in the use of labor and natural resources.

35 See on these reservations, e.g., "Russia and China: Towards a Bright Future?" 9 June 2015, in: <http://bit.ly/1Qn7maA>.

36 "Toward the Great Ocean-2, or Russia's Breakthrough to Asia", Valdai Discussion Club Report, Moscow, February 2014, p. 41.

37 Garusova, op. cit.; S. K. Pestsov, Vneshnepoliticheskiy povорот Rossii: kuda vedet novaya doroga? (Foreign policy turn of Russia: where does the new way lead to?), March 2015, MS.

bridge across the Amur River promised since 2007 and last time reiterated in 2014 with not much activity on the Russian side since. Chinese critics attribute this to the still prevalent suspicion of Chinese participation in the development of Siberia and the Far East, be it Chinese capital or the influx of Chinese migrant workers.³⁸

Geo-Strategy: preserving the own backyard

Whereas in Europe – much to Moscow’s chagrin – Russia is confronted with a fairly unified front which provides only scant opportunities to play one against the other, the situation in Asia is completely different: there Russia is operating in a true minefield of competing territorial claims, historical animosities and shifting alliances. Such a situation might become even more uncomfortable than the one in Europe as Russia might be forced to take sides – in particular since in most cases China is more or less directly involved, and not necessarily in an “harmonious” way. This concerns relations between China and India, the latter Russia’s time-tested partner and prime weapons customer. It concerns the even more strained relations between China and Vietnam, the latter not only once the subject of a Chinese military incursion but also engaged in a bitter struggle over the Spratly islands in the South China Sea. And it concerns the deteriorating relations between China and Japan with which Russia is trying to overcome the remnants of the Second World War in its – currently suspended – “two plus two” talks on what Japan calls “Northern Territories” (part of the Kurile islands).

Chinese representatives have made it clear that in spite of diverging views Beijing expects Russia to at least remain neutral and sensitive to its interests. And they have indicated that there are no less Russian interests at stake which can be acted upon in very different ways.³⁹

An area which for some time appeared ripe for open conflict is Central Asia where Russia harbors special interests – and where China exerts a growing influence. China’s presence in the region has steadily expanded, but it got a possibly far-reaching boost when at the end of 2013 President Xi Jinping announced the two Silk Road proposals: the “Silk Road Economic Belt” (in Astana on 7 September) and the “21st Century Maritime Silk Road” (in Jakarta on 3 October).⁴⁰ Both initiatives are planned to establish a connection between China and Europe. This implies building along the belt proper and along economic corridors that link adjacent regions to the belt the necessary infrastructure and “key economic industrial parks as cooperation platforms” as well as removing trade and investment barriers.⁴¹ Additionally in November 2014 Xi Jinping announced to set up a \$40 billion development fund which is destined to facilitate the necessary investments.

These two initiatives signaled that China was ready to unilaterally embark on a much more activist course which certainly was not aimed at Russia but nevertheless seriously touched upon Russian vested interests, at least in the on-shore variant. As Chinese motives have been listed: the pressing need to develop the western and central provinces in China which inevitably points to adjacent territories; its growing foreign policy clout which has led China to “gain more control over regional agreements and institutions and progressively position itself *vis-à-vis* the US, as well as Japan, as

38 Luzyanin/Huasheng et al., op. cit., p. 16.

39 Ibid., pp. 24, in careful diplomatic wording: “In the framework of this trust-based partnership, Russia and China should approach certain sensitive topics in their domestic and foreign policies with patience and understanding. Those topics are Taiwan, the South China Sea, the East China Sea, and Tibet for China, and they are Ukraine and the Crimea, the spread of Orthodoxy in China, and other topics for Russia.” (p. 25)

40 See the proposals in greater detail at “Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road”. Issued by the National Development and Reform Commission, Ministry of Foreign Affairs and Ministry of Commerce of the People’s Republic of China, March 2015, in: <http://bit.ly/1FKMp5o>.

41 “Vision and Actions on Jointly Building Belt and Road”, Xinhua, 29.3.2015, in: <http://bit.ly/1TUx7l7>.

the uncontested regional leader”.⁴² And Beijing’s disappointment about the stalled economic component of the SCO possibly also played a role.⁴³

Originally, Russia was accorded only a peripheral role in the concept as the major part was geared towards the region south of its border. This was not only politically disturbing, but also economically as Russia expected its territory to become the main corridor for transit between Asia and Europe – currently lacking capacity notwithstanding. It took therefore some time and apparently “painful internal discussions” for Russia to come to terms with the Silk Road project.⁴⁴ On 9 May 2015 Putin and Xi Jinping finally signed a joint declaration “on cooperation in coordinating development of the Eurasian Economic Union and the Silk Road Economic Belt.” Moscow and Beijing confirmed their intention to coordinate the two projects in order to build a “common economic space” in Eurasia, including a Free Trade Agreement between the EEU and China – previously put on hold in the framework of the SCO.

So far it is only a declaration of good intentions, not even a road map, but the document signals that the two do not want the contentious issue to escalate to open conflict – as in other cases further west.⁴⁵ Positive-sum is therefore the term most often applied in characterizing the project. China is ready to accept the EEU as negotiating partner in addition to individual member-states, even though it will hardly resort to a “Moscow-first” policy (which, by the way, is equally unpopular in Central Asia as in Central Europe). Similarly, Moscow has put its security concerns and its claim for an exclusive sphere of interest on the backburner, without, however, forfeiting its suspicion about undue foreign mingling in its backyard. This too is reminiscent of Russian concerns in the western part of what used to be the Soviet Union, but it should be noted that conflict management by the parties involved so far has been vastly different – and consequently its outcome.

Whether this arrangement will eventually lead to a Russian-Chinese “condominium” in Central Asia, in which Russia will be the guarantor of security and China the largest economic player, is probably too rosy an image of division of labor, not to mention the regional interests involved.⁴⁶ Those engaged in propagating the accord seem to be torn between the high-flying impression that Moscow’s activities in this respect are “one of the most important indicators of Russia’s comeback as a global power” and the more down-to-earth assessment that the cooperative taming of the Silk Road is “an effective instrument of trade protection for the national market” of the EEU member states.⁴⁷

Taken together: The ambiguities and ambivalences of Russia’s current turn to the East reinforce the impression that the major driving force is (political) demarcation from the West and its main impediment the factors that have limited the (economic) exchange with the West compounded by

42 Alice Ekman, China: setting the agenda(s)? European Union Institute for Security Studies, Brief 4, March 2015.

43 This, for instance, concerns the SCO Development Bank which was proposed in November 2010 by Beijing. In addition to providing loans for specific projects (in the tune of \$10 billion), China proposed setting up an anti-crisis fund, to be managed by the bank. The bank’s authorized capital should be formed from proportional contributions by each participating state depending on the size of its respective GDP, which would also determine voting rights. Russia turned a blind eye to the proposal and instead suggested to expand its Eurasian Development Bank, established in 2006 and largely controlled by Moscow and Astana. Other financial instruments of which both China and Russia are members – on a more equitable basis – are the BRICS “New Development Bank”, expected to allocate an equal share of the \$50 billion startup capital that will be expanded to \$100 billion (the bank’s board had its inaugural meeting on 7 July 2015; and the BRICS “Contingency Reserve Arrangement” with commitments of \$100 billion of which China provides the lion share of \$41 billion. These two not only mirror the Western-dominated IFIs but would perform the task originally set for the SCO Development Bank. See Alexander Gabuev, Taming the Dragon: How Can Russia Benefit From China’s Financial Ambitions in the SCO? 19 March 2015, in: <http://ceip.org/1FHsi97>.

44 Alexander Gabuev, Eurasian Silk Road Union: Towards a Russia-China Consensus? 5 June 2015, in: <http://ceip.org/1p15I61>.

45 As a first step, on 8 May the Eurasian Economic Commission was mandated by Russia, Kazakhstan, Belarus and Armenia to start negotiations on a trade and investment agreement with China.

46 That is what Alexander Gabuev expects (Russia-China Talks: Silk Road Leads to Eurasia, 15 May 2015, in: <http://carnegie.ru/2015/05/15/russia-china-talks-silk-road-leads-to-eurasia/i8vo>).

47 “Toward the Great Ocean-3. Creating Central Eurasia: The Silk Road Economic Belt and the priorities of the Eurasian states’ joint development”, Valdai Discussion Club Analytical Report, Moscow, June 2015, pp.8, 15.

only a limited mutual (human) attraction. Ultimately it is a project of the political elite in Moscow – but not necessarily a bad one.

5 PROSPECTS

Dmitri Trenin expects a fairly smooth and beneficial evolution of the Russian-Chinese relationship: “In the coming years, those relations are likely to get appreciably closer, tending toward a quasi-alliance and quasi-integration, with Beijing as the more powerful member of the relationship.”⁴⁸ At first glance Robert Kagan’s doomsday scenario seems to come true who once warned “the coming battle will be between autocratic nations like Russia and China and the rest”.⁴⁹ A more sober look, however, reveals a more nuanced picture.

First of all, Russia has to come to terms with its powerful neighbor. The history of the Sino-Soviet rivalry testifies to serious risks of failing to do so – in spite of having subscribed to the same Marxist-Leninist faith. Secondly, even a close relationship needs to tackle obvious asymmetries. There are three interrelated Russian concerns: the prospect of being no more than the junior partner, the fear of ending up as a resource appendix of the dominant neighbor and the anxious expectation of an influx of Chinese people (and in some instances even of its capital). They have been a recurrent theme in the Russian debate about its Asia pivot. The first concern is countered by Russia’s nuclear deterrent, on par with the US and well ahead of China’s, the second by the argument that having been a resource appendix of the EU proved risky but not detrimental and the third by pointing to mutual benefits. In any case, these concerns are reminiscent of Russia’s grievances against the West and have been identified by many as a prime cause for its current distancing from the West. Conversely, and thirdly, the current Russian-Chinese rapprochement is clearly a function of Moscow’s demarcation from the West – and thus possibly conditional and temporary. Yet it certainly helps mitigate Sino-Russian rivalries.

More generally, Russia’s Asia pivot is also considered a natural byproduct of the global power shift at the expense of the traditional West and as a building block of a new – multipolar – international order. In this regard, however, Russia’s high-profile offensive carries serious risks. Acting as a battering ram not only reflects a fairly one-sided division of labor between Moscow and Beijing – with China gently marching through the gate pushed open by Russia. It also implies overstretch and a misallocation and waste of precious and ultimately scarce resources – with the fate of the Soviet Union looming on the horizon.

As of now China does not venture to upgrade its relationship with Russia to a level of exclusivity which would then target other countries or alliances. Beijing rather seems to rejuvenate the art of triangulation between Moscow and Washington, if not opting straight for a G2 with the US as the prime source of its economic progress. So far China and Russia seem content with assuring mutual respect and with at least simulating equality and equity – something Moscow keeps complaining to have missed in the West. Moreover, a careful management of diverging interests and lingering conflicts by Russia and China in Central Asia and expanding economic links up to a process of economic integration could amount to something the EU can learn – and benefit – from.

Sino-Russian economic relations only partly fit into this picture, because essentially they follow an energy-driven diversification strategy which Russia needs as badly as the EU pretends to. Cutting back on its overdependence from the West – the prime destiny of its energy exports and the prime

48 Dmitri Trenin, *From Greater Europe to Greater Asia? The Sino-Russian Entente*, 9 April 2015, in: <http://ceip.org/1auTpa4>.

49 Robert Kagan, *Forget the Islamic threat, the coming battle will be between autocratic nations like Russia and China and the rest*, in: timesonline.co.uk, 2 September 2007. See also his book: Robert Kagan, *The Return of History and the End of Dreams*, New York (Knopf) 2008. Not much different at around the same time Sergei Karaganov who observed “an unfolding struggle between two models of development – the liberal-democratic capitalism of the traditional West and authoritarian capitalism” which he attributed to Russia and China (Sergei Karaganov, *Nastupaet novaya epocha*, in: *Rossiyskaya Gazeta* 6 July 2007).

source of its value-added imports – has become even more urgent in light of the vulnerability Russia encountered by Western sanctions. However, the downside is that diversification expands the number of customers and suppliers, but preserves structures – Russia is not conquering the Chinese market with new products, but reverses the flow of its old commodities and takes ever more imports from China aboard. Preserving structures – political as well as economic – has always been fairly high on Putin’s conservative agenda, and it may turn out – once again – self-defeating.

In sum: Russia’s turn to the East is not predicated on a modernization or development strategy, but rather amounts to damage limitation. Yet damage limitation entails costs and as a rule does not follow an economic rationale. In this sense the push seems to dominate the pull. Substituting the Western direction by the Chinese rather than complementing it – as originally conceived – is not a promising proposition.

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