

The Sino-Russian gas deal

Written by Gal Luft
Tuesday, 27 May 2014 00:00

Vladimir Putin got exactly what he wished for in his visit to Shanghai last week: a marriage agreement between his country, the world's largest energy exporter, and China, the world's largest energy importer, in the form of a pipeline that would run \$400 billion worth of Russian gas from Siberia to northeastern China over 30 years. After more than a decade of negotiations over price, the two neighbors finally came to a point in which they were equally ready for compromise. Diplomatically embattled, Russia needs a new market for its gas to replace the increasingly shaky European market. Facing the potential for social unrest due to a slowing economy and an escalating environmental crisis China needs a new economic booster and a scalable alternative to its current dependence on coal. The Sino-Russian gas deal seems like a seminal event in global energy geopolitics and an impressive debut to Putin's pivot to Asia strategy. It is therefore easy to see why its timing and content would make policymakers on both sides of the Atlantic cringe, especially since it comes just days before the G-7 leaders meet in Brussels to discuss how to isolate Russia. But while there are many reasons for the West to dislike the Sino-Russian gas deal, it may not as bad as it seems. In fact, it may offer some unforeseen benefits – even for the United States.

First, the deal can boost China's economy at a time of apparent slowdown which could have a chilling effect on the global economy. This is especially true for the specific destination of Russia's gas - China's northeastern provinces of Heilongjiang, Liaoning, Jilin and Inner Mongolia, together the home of more than 130 million Chinese. In much of this area per capita GDP is half that of the industrialized coastal provinces. One reason for the development gap is energy. In this part of China winter temperatures can drop to -40 °F, and the heating season lasts roughly six months, making the region's economy extremely energy intensive. Electricity in those provinces is generated almost exclusively from coal but this comes at high environmental cost. In recent years China's northeast has encountered some of the worst bouts of haze pollution with massive economic losses and rapid degradation in public health. Last year, Harbin, the capital of Heilongjiang province, a city of 10 million people, was literally shut down for several days due to pollution levels forty times higher than the World Health Organization's standard. Efforts to diversify the region's energy mix have been unsuccessful. With the exception of Liaoning all of the northeastern provinces are landlocked and therefore are not able to construct receiving terminals for liquefied natural gas (LNG). The annual supply of 38 billion cubic meters of Russian gas can transform the region's economy, opening the door to new industrial uses of natural gas, including petrochemicals, plastics, transportation fuels and fertilizers. The potential shot in the arm to the region and hence to the entire Chinese economy should be viewed as a positive development for the U.S. whose economy is intertwined with China's.

Second, the new source of supply of gas to East Asia would ease overall demand for LNG in the region and this can dampen future LNG prices for U.S allies like Japan and South Korea. Provided that Sino-Russian pipeline construction goes as planned, Russia's gas will reach the Chinese market by 2018, about the same time U.S. LNG terminals are scheduled to be ready to dispatch U.S. shale gas to the international market. The Russian-Chinese deal might make North American LNG less competitive in East Asia, but it would make it more likely to end up in geographically closer Europe, hence reducing Europe's dependence on the Kremlin.

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Third, the deal may not turn out to be a bonding experience for the China and Russia as commonly believed. Russia has always had uneasy relations with its clients, and its relations with China have been historically marred with distrust and mutual antipathy. This is not likely to change. The fact that the newly signed gas deal is shrouded in secrecy makes it even less likely that a happy marriage awaits the couple. The reason for the secrecy: Russia does not want its European clients to know that it provided China with a lower rate than what China pays for gas piped from Turkmenistan as this would expose it to pressure to provide similar discounts to others. But in the era of WikiLeaks and Snowdens such secrets are hard to keep, and when they leak Moscow will hold Beijing responsible for its weaker hand in future negotiations with Europe and well as with other potential clients like Japan and South Korea.

What happened in Shanghai is far from being the modern version of the “loss of China.” Putin’s Russia is more interested in clients than allies. It sure found one in China. But this is as far as it goes for the deal Putin described as “epochal.” To build robust and lasting relations the two countries will need much more than steel pipes in the ground. China may never be a client for U.S. energy as it is for Russia but with strong U.S. engagement and smart diplomacy, Washington’s relations with Beijing can be cozier than those forged with gas.

Gal Luft is co-director of the Institute for the Analysis of Global Security ([IAGS](#)) and Senior Adviser to the United States Energy Security Council ([USESC](#))