China and Russia’s Competition for East and Southeast Asia Resources

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Background Briefing: China and Russia’s Competition for East and Southeast Asia Resources

1. Introduction

The aim of this paper is to provide a brief review of the engagement of China and Russia in the energy and mineral resource sectors of East and Southeast Asia, and to assess the extent to which political or economic competition exists in respect of these resources. The paper is structured as follows:

- China and Russia’s relations in the region
- Contrasting energy and resource strategies
- Sino-Russian energy and resource relations
- Chinese and Russian resource activities in Southeast Asia
- China and Russia in DPRK
- Looking to the future: conflict or cooperation

2. China and Russia’s relations in the region

Russia and China are two global resource powers. They are global political and economic powers in their own right, and both play a major role in international energy and resource commodity markets. Russia is the world’s largest producer of oil and of gas, is a treasure house of mineral resources, and has ample supplies of water for hydro-electricity. The downside of this endowment is Russia’s continuing dependence on the energy and minerals industries for 10-15% of its GDP and on the energy industry for about two-thirds of its export earnings. In contrast, China has become a major importer of natural resource raw materials over the last ten years, despite its own considerable resource endowment. It is the world’s largest importer of oil; at times is the largest, or one of the largest, importers of a wide range of commodities such as coal, iron ore, copper and zinc; and is a rapidly growing importer of gas. These supplies of energy and mineral raw materials have provided vital support for China’s infrastructure-led economic boom over the last ten years or so.

China has been steadily increasing its political and economic engagement with countries across East and Southeast Asia since the end of its diplomatic isolation in 1978, and especially since the 1990s. This engagement has both strategic and economic dimensions. The strategic objectives include the security of the sea lanes in the East and South China Seas through which most of China’s large and
growing quantity of imports and exports flow, as well as the need to counterbalance the USA’s long-standing military and strategic commitments in the region. Central to this latter objective has been China’s long-standing support for North Korea (DPRK). China plays a critical role in the economy of East and Southeast Asia through trade in manufactured goods and, increasingly, energy and raw materials, and through outward and inward investment flows. In support of these strategies China’s government has steadily deepened its relations with the Association of Southeast Asian Nations (ASEAN) as well with individual Member States.

The Soviet Union and the Russian Federation have consistently paid much less attention to East and Southeast Asia than has China. With the exception of the Soviet Union’s support of the new communist government in China during the 1950s, the political and economic attention of the government in Moscow has been directed predominantly to the west and, to a lesser extent, the south (Central Asia). The main priorities for the Soviet Union in the east were to maintain the DPRK as a buffer against US encroachment and to use Vietnam as a naval base for the protection of sea lanes. The newly-formed Russian Federation also neglected the region and only slowly woke up to its economic and strategic importance after Putin took over from Yeltsin as President in 2000. Since then a combination of factors have encouraged the Russian government to expend effort on eastward-directed diplomatic and economic engagement: greater domestic political stability; a stronger economy and improved policy coherence; the need to promote economic growth in eastern Russia; the growth of demand for energy and other raw materials in East Asia; deteriorating political and economic relations with the European Union; and, more recently, the economic crisis in Europe. Two important priorities for Russia today are the search for markets for oil, gas, other commodities and manufactured goods in the Asia-Pacific, and, like China, to counterbalance US engagement in East Asia. A further priority is the rapid opening of the Arctic Ocean as a potential trade route. Russia’s deepening engagement with the DPRK is an important part of Russia’s regional strategy.

In addition to their separate bilateral relations with individual states in Southeast Asia, both China and Russia have formal diplomatic relations with the Association of Southeast Asian Nations (ASEAN), and are members of the Asia-Pacific Economic Cooperation (APEC), the East Asia Summit (EAS), the Asia-Europe Meeting (ASEM), and the ASEAN Regional Forum. In the context of Central Asia, both China and Russia are members of the Shanghai Cooperation Organisation (SCO) and both participated in the Six-Party Talks relating to the DPRK.

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Despite this growing engagement across the region, both China and, to a lesser extent Russia, continue to experience tensions in their relations with certain individual states that arise from a combination of unresolved historical issues and specific territorial disputes. In China these actual or potential disputes involve most of the littoral states of the East and South China Seas. Russia’s main dispute is with Japan.

3. **Contrasting energy and resource strategies**

Russia and China have contrasting energy and resource strategies on account of their quite different balances between supply and demand, though one priority unites them – the desire to retain state control over key assets and resource flows for both political and economic reasons.

**China**

As a growing net importer of energy and mineral raw materials, for China, the key priority is security of supply. Government strategies involve maximising domestic production of oil, gas, coal and mineral resources, building good relations with the governments of energy- and mineral-exporting countries, diversifying sources of imports, constructing import pipelines for oil and gas imports from neighbouring states, and placing increasing emphasis on energy and resource efficiency in the domestic economy. In addition, the government and its state-owned companies are constructing strategic stockpiles of oil and selected minerals, and greater attention is being paid to sea-lane security in the East and South China Seas and in the Indian Ocean.

Domestic oil production has almost reached a plateau due to the limited size of the remaining reserves, but natural gas production continues to rise rapidly and may be further enhanced by shale gas in due course. The production of coal is not limited by resource availability but by increasing costs for transportation, a desire to limit pollution, and by intensifying shortages of water in the coal-producing regions of North China. Although China has large resources and production of many mineral resources, it imports about half of its annual requirement of crude oil, iron ore, copper, lead and zinc, and is a significant importer of other minerals such as aluminium, cobalt and manganese, and a growing importer of coal and natural gas.

In addition to direct actions to enhance supply security, China’s government provides explicit political and economic support to state-owned energy and mineral companies that want to invest...
overseas. Nevertheless, the primary driver for this overseas investment comes from the companies themselves as they seek opportunities for assets, revenues and profits outside their own country. This is for the simple reason that the opportunities abroad are often more attractive than those at home and may be essential to the long-term success of the companies. Government support primarily takes the form of low-interest loans from state-owned policy banks. In some cases this is complemented by diplomatic support, which may involve aid, trade and other forms of investment. The government provides this support because this overseas investment is in line with the industrial policy to promote the internationalisation of large state-owned enterprises in selected sectors, because it provides employment and tax revenues, and because a belief exists that these investments enhance security of supply. At the same time, China’s government can use these investments to raise its diplomatic profile in the respective countries and regions.

In terms of investment and trade, Southeast Asia plays a relatively small role in China’s global energy and mineral resource strategies on account of the relative paucity of its endowment, but its significance arises from its proximity to China and its location astride key sea lanes. Of particular importance to China in recent years has been the rising (but still speculative) expectations of the existence of substantial oil and gas resources beneath the South China Sea.

Russia

One of President Putin’s top priorities during his first two terms as President (2000-2008) was to regain control for the state over the energy sector, especially the oil and gas industries. This objective has largely been met, and Rosneft, Transneft and Gazprom now dominate the domestic oil and gas sectors. A further priority was to use the gas resources of Eastern Siberia to support domestic economic development for this relatively backward region of the Russian Federation. Thus, the government gave Gazprom a monopoly over all gas exports and BP’s plans to develop the Kovytka field for the export of gas were foiled. A final priority for the energy sector has been to develop new markets and export routes in East Asia for its huge reserves of oil and gas. This has been easier to achieve for oil than for gas, for oil is a more fungible commodity than gas and the transportation infrastructure cheaper to build.

Russia has ready markets for oil in East Asia, notably, Japan, China and South Korea (ROK) which are all highly dependent on the Middle East for oil imports. Not only that, but they pay an ‘Asian premium’ for Middle East oil. As a consequence, Russia constructed the East Siberian-Pacific Ocean

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(EPSO) oil pipeline to the Pacific coast with a branch to northeast China. The branch to China has been operating since late 2010 and in 2012 delivered 15 million tonnes of oil to China. The main line to Kozmino on Russia’s Pacific coast was completed in December 2012 and brings the total export capacity of this pipeline to 80 million tonnes, though full use of this capacity will depend both on demand for the oil and on the rate at which production can be raised in East Siberian oil fields.

Russian interest in exporting natural gas eastwards dates back to the mid-1990s when intergovernmental agreements addressed the issue of exporting gas and electricity from Russia to China, and production sharing contracts were signed with foreign oil companies to exploit the gas fields off the shores of Sakhalin. While gas from the latter fields could be and has been exported as liquefied natural gas (LNG) and sold on international markets, gas sold to China would depend on that country’s ability and willingness to pay an acceptable price, as well as on Russia’s ability to develop sufficient gas reserves and construct the necessary pipelines. In particular, Russia has wanted China to pay a price equivalent to that paid by its European customers. As of April 2013, no agreement on price has been reached.

Like China, the Russian government supports overseas investment by its state-owned energy and resource companies, but the scale of activity is much smaller on account of the abundance of domestic resources remaining to be exploited and a shortage of funds. With respect to nuclear energy, Russia’s priority appears to be to export the technology as part of its wider drive to diversify its economy and exports away from dependence on natural resources.

4. Sino-Russian energy and resource relations

Despite the ‘strategic partnership’ proclaimed by Presidents Jiang and Yeltsin in 1996 and the Treaty of Friendship signed in 2001 by Presidents Jiang and Putin, economic engagement in the form of trade and investment has grown only slowly, despite the obvious complementarity in respect of energy supply. The total value of trade in 2012 was US$88 billion, with most of Russia’s exports taking the form of energy (mainly oil) and other raw materials. China’s potential economic importance to Russia is greater than vice-versa. Deep distrust of China persists in Russia, including an often irrational fear of a mass migration of Chinese to Russia’s empty spaces in the east. Cross-investment in energy infrastructure has been further constrained by regulatory and pricing issues.

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Building on the momentum created by the diplomatic rapprochement, an agreement was signed in September 2001 for Yukos and CNPC to collaborate to construct an oil export pipeline from Angarsk in Eastern Siberia to Daqing in northeast China. This project was first suspended and eventually abandoned in 2005 after the nationalisation of Yukos assets. Although oil exports from Russia continued by rail, in its determination to put in place an overland import pipeline, China’s government switched its attention to Kazakhstan and constructed a pipeline which was commissioned in 2005. Only in 2008 was agreement to construct an oil export pipeline from Russia finally reached (the EPSO pipeline, see above), with China providing a US$25 billion loan to the Russian oil companies, to be repaid in oil. During President Xi Jinping’s visit to Moscow in March 2013, Rosneft agreed to triple the annual quantity of oil piped to China. This will require further loans from China.

The slowness of the Russians to conclude a deal also drove China to look east for an overland import pipeline for gas. An MOU was signed in 1994 to draw up plans for a gas pipeline between the two countries. In 2003 BP, CNPC and the Korean Gas Corporation published a feasibility study for a pipeline to bring gas from the Kovytka field through China and under the Yellow Sea to the Republic of Korea (ROK). The proposal was undermined by the Russian government’s new energy strategies and BP was later forced to relinquish its interest in the Kovytka field. As a consequence of this delay, China turned to the vast gas resources of Turkmenistan. An agreement was signed in 2007 and by the end of 2009 gas was flowing from Turkmenistan to Shanghai. Russia’s slowness to conclude a gas supply deal with China has its roots in changes to domestic energy priorities and in Russia’s quest for a ‘European’ price from China. At the meeting in March 2013, Russia committed to supplying China with gas from Eastern Siberian gas fields, but the exact route and price have yet to be agreed. The parties’ claim that the deal will be finalised by the end of 2013 will probably be dependent not just on agreement being reached on price but also on the provision by China of a US$ 25 billion loan to Gazprom.

Other interactions between China and Russia in the energy field include the supply of hydro-electricity and coal from Russia to China and a limited extent of cross-investment in different energy fields such as oil and gas exploration, oil refining and nuclear power.

Despite these frustrations in the field of energy transactions, they do not seem to have undermined the otherwise strong overall diplomatic relations between the two countries. In many respects the two governments have similar attitudes to international institutions for governing energy and
natural resources. While they see certain advantages to be gained by joining or cooperating with organisations such as the World Trade Organization (membership) and the International Energy Agency (cooperation), both Chinese and Russian governments seek to limit outside interference in the governance of their domestic energy sectors. An institution such as the Energy Charter Treaty, with its emphasis on transnational investment and transit, is unlikely to attract full membership of either party until their domestic energy industries and policies are substantially reformed. They are both founder members of the Shanghai Cooperation Organisation, but energy does not feature prominently on the agenda of this security-focused group.

5. Chinese and Russian energy and resource investments in Southeast Asia

There is no comparison between China and Russia in the scale of investment in energy and mineral resources in Southeast Asia (see chart). With the exception of Vietnam and Cambodia, China’s investments in this region are one or two orders of magnitude greater than those of Russia in terms of funds deployed or committed and are much more diverse. In addition, most of the agreements for investments by Russian companies have been made in just the last two years, with a few dating back to 2008 or before. In contrast, many Chinese investments date back ten years or more, with a few (oil and gas) originating in the mid-1990s.

Chinese energy and mineral companies are investing in every country in Southeast Asia, with the apparent exception of Timor Leste (but Chinese companies are active in other sectors there). They are active in the extractive industries of oil and gas exploration and production, mineral production and, to a much lesser extent, coal mining. Investment in these extractive industries is greatest in Indonesia and Myanmar; Indonesia on account of the scale of its resource endowment and Myanmar on account of its proximity to, and diplomatic relationship, with China. China imports growing amounts of gas and coal, and declining quantities of crude oil from Southeast Asia.

Its own domestic energy sector has given Chinese companies great experience in the construction and operation of hydro-electric dams, both large and small. These companies are deploying their skills and funds in nine countries across the region, most notably in Vietnam, Myanmar and Laos, where hydro-electricity is seen to hold the key to economic development. However, this dam building, along with the constriction of large dams in southwestern China, is causing significant controversy in the region on account of the disruption to the livelihoods of those living near and
downstream of the dams, and because some of the electricity is to be sent to China. China’s nuclear power companies appear not to be investing overseas, but rather are focusing their attention on building new capacity at home.

The activities of Russian companies are very modest in comparison to the tens of billions of dollars invested or committed by Chinese companies, and appear to be limited to just four countries: Vietnam, Cambodia, Myanmar and Indonesia. Vietnam remains the key regional partner with two Russian 1 GW nuclear power plants contracted to start construction over the next two years and two others under discussion. In the oil and gas sector, Lukoil, Gazprom and TNK-BP (now Rosneft) hold offshore exploration and production licenses. A Russian company is constructing a 1 GW hydro-electric dam in Cambodia.

Myanmar has significant resources of uranium, some of which are exploited as a by-product of gold mining. In 2007 Russia agreed to build a nuclear research centre in Myanmar. This project was soon suspended due to civil unrest in the country, but the training of Myanmar nuclear engineers in Russia has taken place. Russia appears to be trying to rebuild this relationship. In Indonesia, discussions are reported to be in progress relating to nuclear power and to oil and gas exploration, but no firm contracts appear to have been signed.

6. China and Russia in DPRK

China and Russia have been key strategic and economic allies of North Korea since its creation in 1945, not least during the Korean War from 1950 to 1953. Until 1990 the Soviet Union played the greater role in providing economic support to the DPRK, but after the collapse of the Soviet Union China has taken the lead in this respect. In 2011 China accounted for 74% of the DPRK’s total international trade (exports and imports totalling about US$ 6 billion), while Russia accounted for just 1.5% (US$ 130 million).

Energy trade between DPRK and China is substantial, given the small size of DPRK’s energy sector. Since the year 2000, China has supplied just over 500,000 tonnes per year of crude oil to the DPRK. This, together with small but unknown quantities of oil imported from Russia by rail, supplies nearly all of the DPRK’s crude oil demand, as its domestic crude oil production is very small.
Using this crude oil, the DPRK’s oil refining capacity provides about 70% of the country’s annual consumption of refined oil products. The balance is imported from several countries. China continues to be the largest supplier to the DPRK of refined oil products with 86,000 tonnes of diesel and gasoline in 2012; the importance of these supplies rose markedly after the cessation of the Six-Party Talks in 2009 reduced the total imports by more than 50%. Russia also supplies refined oil products to the DPRK. In February 2013, China provided no crude oil to the DPRK, although it is not known whether this was in reaction to DPRK’s nuclear test.

In return for the oil supplies, the DPRK exports significant quantities of coal to China. In 2010 this amounted to 4.6 million tonnes, or possibly about 20-25% of the DPRK’s annual production. The growth of coal exports to China has been facilitated by the arrival of Chinese coal mining companies. A minor amount of two-way trade in electricity from hydro-electric dams takes place across the border between China and the DPRK. The DPRK has significant non-energy mineral resources and recent years have seen Chinese mining companies investing in iron, copper and gold mines. China also provides the country with iron, steel, machinery, vehicles and other manufactured products.

In addition to oil and food, Russia provides the DPRK with wood, pulp, fertilizer and iron and steel but, as indicated above, the scale of Russia’s trade with the DPRK is but a fraction of China’s. In 2011, the Russian government started to display a growing interest in deepening economic engagement with the DPRK. This culminated in September 2012 when Russia wrote off 90% of the DPRK’s US$11 billion debt and declared that it would invest US$1 billion in energy, health care and educational projects. One of the energy projects was to be a pipeline to take gas from the Sakhalin gas field in the Russian Far East to the ROK, transiting across the DPRK. Similar proposals exist for railway lines. These recent steps by Russia have been part of its wider strategy for East Asia, but the timing can be traced to the recovery of the Russian economy after the 2008 financial crisis and to the change of regime in the DPRK.

In recent years, explicit cooperation between China and Russia in matters relating to the DPRK has been relatively limited. Both countries were founder members of the Tumen River Area Development Programme (TRADP), which was launched in 1993 and transformed into the wider Greater Tumen Initiative (GTI) in 2005. The TRADP involved Russia, China, DPRK, ROK and Mongolia, whereas the DPRK is not participating in the GTI. Like the TRADP, the GTI is focused on the economic development of the Northeast Asia region, with energy cooperation as one of the priorities. Both
Russia and China took part in the Six-Party Talks which ran from 2003 to 2009, along with the US, Japan, ROK and DPRK.

7. Looking to the future: conflict or cooperation

China and Russia share significant strategic interests, most notably the desire for stability on the Asian continent and a resentment of the US presence on their eastern flank. Both governments have enough challenges at home and with other neighbours, without the need to disrupt the relationship with their largest neighbour. The importance of this relationship was highlighted in March 2013 by President Xi Jinping choosing Moscow for his first overseas visit as President.

Compared with Russia, China has had much longer and deeper political and economic relations with almost all the nations of East and Southeast Asia, with the exception of the DPRK and Vietnam. Combined with the nature of its energy and resource strategies, this has allowed its companies to gain a relatively strong position across Southeast Asia. Nevertheless, in countries such as Indonesia and Malaysia, which have been open to foreign investment for decades, China is still a minor player. Only in those countries which have just recently opened their doors to foreign investment have Chinese companies managed to build a relatively strong competitive position.

In contrast, Russia and Russian companies are latecomers to energy and mineral resources in East and Southeast Asia, with the exception of Vietnam. The scale and quantity of investment is negligible, though this may grow quickly depending on the availability of funds. They, and companies from other countries, will certainly face competition from Chinese companies. In some cases the outcome of this corporate competition will be decided by the scale of the political and financial capital expended by the governments behind the state-owned companies. In other cases, it may be decided by the host governments in their quest to balance the external political and economic influence of foreign governments, most especially China, the USA and Russia.

This recent interest shown by Russia in Southeast Asia is part of a growing realisation that the wider East Asia region is of strategic and economic importance to the country. This is reflected in Russia’s closer engagement with the DPRK and participation in regional organisations. This timing coincides with the USA’s ‘pivot to Asia’ as well as with China’s increased assertiveness in the East and South China Seas. In this respect, there certainly exists a degree of geopolitical competition in East Asia.
between these three powers, but energy and mineral resources are not the focus of the competition.

That being said, China has clearly been using its quest for energy and mineral resources as a diplomatic tool in parts of Southeast Asia, as well as elsewhere. To date it has encountered relatively little concerted opposition from outside powers, with the exception of the close attention paid by the USA to the South China Sea. Russia may have chosen to deploy energy as a diplomatic tool, but it lacks the financial resources and the import requirement to act as a serious competitor to China in this or most other regions of the world. Further, a lack of familiarity with the region, host governments and host companies means that Russian companies struggle to identify economic interests shared with Southeast Asia.

In the short-term, while resources may not become a source of competition in themselves, they could become a serious irritant to Sino-Russian relations if, for example, the activities of Russian oil and gas companies in offshore Vietnam expand into disputed waters.

In the longer-term, were Russia willing and able to press ahead with investments in the developing countries of Southeast Asia in which China has significant interests - such as Cambodia, Laos and Myanmar - diplomatic tension between these two powers could rise, especially if China saw Russia as forcing its way into China’s ‘backyard’. Similar opportunities for tension exist in North Korea in the absence of effective coordination between China and Russia.

Conversely, the likelihood that China and Russia would or could collude to create separate spheres of influence in the region’s resources appears low at present: firstly, because Russia is far behind China in its engagement, with the exception of Vietnam and possibly of the DPRK; secondly, the skills, interests and financial capacities of their energy and mineral companies differ to such a significant degree that the companies themselves are likely to seek different types of commercial opportunities; and thirdly, because most host governments in the region resent over-dependence on a single actor and seek to balance the external powers.

The main point of entry for the European Union in this arena would appear to relate to this last point. In its diplomatic engagement with the governments of Southeast Asia, the EU should encourage the efforts of these governments to balance the external powers and prevent over-
dependence on any one of them. The potential role of the EU on the Korean Peninsula would appear to be rather limited.

8. Implications for the European Union

The key economic interest of the European Union in East and Southeast Asia lie in trade which, in turn, relies on the sea lanes through the East and South China Seas. While the interests of the European Union do not appear to be threatened in the short-term by the resource activities of China and Russia in East and Southeast Asia, in the longer term, a number of concerns exist. For example:

- Energy and resources may provide triggers which escalate tensions between China and other nations around the East and South China Seas. Such escalation would draw in the United States and, possibly, Russia.
- The growing engagement of China and Russia in Southeast Asia could progressively reduce the influence of the European Union and United States in the region, despite the best efforts of ASEAN national leaders to maintain a balance.

Such events or trends have the potential to undermine the influence of the European Union in the region and to threaten the freedom of movement of investment and trade.

In response, the European Union should:

- Continue its efforts to draw China and Russia into closer engagement with institutions such as the International Energy Agency and the Energy Charter Treaty, but in the full realisation that this is a long-term objective.
- Deepen its engagement with ASEAN and with its member state governments in order to counterbalance the influence of China and Russia.
Chart: Simplified comparison of the scale of Chinese and Russian investments in different energy and mineral sectors of Southeast Asia. For each resource the scale of investment or commitment to each country was gauged loosely on a scale of 1 (small) to 3 (large).

Key to countries: Ph – Philippines; Vn – Vietnam; Cm – Cambodia; La – Laos; Th – Thailand; Mm – Myanmar; Ma – Malaysia; Id – Indonesia; Bn – Brunei; Pg – Papua new guinea; Tp – Timor Leste

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