

The Energy Factor in Russia's "Asia Pivot"

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For a variety of economic and geostrategic reasons, Russia is again attempting to increase its efforts to develop the economy of its Eastern territories and integrate more deeply into the rapidly developing Asian regional economies. As the Obama administration announced its "Asia Pivot" in 2011, Russia's own "Asia Pivot" was marked by its hosting of the APEC Summit in Vladivostok in September 2012. Historically, Russia was a primarily European focused power, until the Cold War confrontation with the United States. Engaging in Asian affairs does not come naturally to Russia's elite, but Vladimir Putin is keenly aware of the shifting global economic balance of power to Asia, and he understands that Russia's integration there is essential for its successful long-term development. It is true that during the latter Soviet period Moscow was more focused on Asia because of the emergence of China as a perceived strategic threat, but this engagement with the region was almost entirely on military-strategic terms. Now, however, the currency of power has shifted to a certain degree from military to economic prowess. And just as energy, mainly oil and gas, has been Russia's principal economic comparative advantage to its West, Russian economic integration in Asia leads with its energy resources.

The Geopolitical Importance of Development: Necessity and Controversy

It remains critical that Russia develop the hydrocarbon resources of Eastern Siberia and the Far East for three primary reasons: 1) the decline of production from oil and gas deposits in Western Siberia; 2) the necessity of developing the economically backwards Far East; and 3) Russia's deep concerns over Chinese encroachment in the Far East. The most pressing is the decline of the large oil and gas deposits concentrated in Western Siberia that have historically served as the backbone of the Russian oil and gas sectors. These deposits largely fell into decline in 2007; since that time, Russia has barely overcome that shortfall through the development of new assets. Such deposits accounted for 77 percent of oil production in 2009, even as they have been depleted by

¹ This memo is based on research for a co-authored study by the author with Shoichi Itoh.

approximately 60 percent (similarly, the major exploited gas deposits in Western Siberia have already been depleted by 65-75 percent). With these large deposits “at the phase of actively declining production,” the focus of the oil and gas sectors is set to shift toward medium- to small-scale deposits and “hard-to-recover” reserves, all of which will require immense private sector, public sector, and foreign investment. The Russian development plan for the Eastern regions is predicated on the idea that these fields can quickly be brought on line to make up for these production shortfalls and create a stable oil and gas sector that is once again capable of expansion.

Absent the contribution of new fields in Eastern Siberia and the Far East, the decline of Western Siberian oil and gas would have a dramatic negative effect on both Russia’s geopolitical position and its public finances. Oil alone provides over half of Russia’s export revenue, and oil and gas profits account for over 40 percent of the federal budget. Unlike many of the other major global oil and gas exporters, Russia also suffers from a dearth of spare capacity, meaning that without significant modernization and the development of the Eastern regions it will be unable to maintain current levels of oil and gas exports.² In fact, the Russian energy strategy calls for the expansion of oil and gas exports overall. This is in part driven by a desire to diversify Russia’s export portfolio away from traditional export markets in Europe, where energy demand is expected to decline over the coming years, toward the growing markets of Northeast Asia. Russia also views this diversification as a way to increase its leverage vis-à-vis its consumers in Europe who have recently sought to reduce their dependence on Russia.

Russia’s push to develop the hydrocarbon resources in its Eastern regions is also deeply tied to its concerns about the relative economic backwardness of its eastern flank. Russia has deep concerns regarding the balance of its relationship with China that, in recent decades, has been characterized by a widening gap both economically and in terms of population. This divide is on stark display along the Sino-Russian border, where the population of China’s northeastern territories is roughly ten times that of Eastern Russia, despite those territories accounting for approximately 60 percent of Russia’s overall territory. The gap in economic dynamism is even more glaring, with the Eastern regions of Russia contributing only 5.6 percent of the country’s total GDP.³ Energy, an industry dominated by state-directed enterprises and an area in which the Far East boasts numerous natural advantages, has been the obvious choice to drive the development of the Far Eastern economy and its attendant infrastructure, so as to, in part, assuage fears about domination of the Eastern regions by its massive neighbor. However, the expansion of Sino-Russian energy relations has demanded the expansion of Chinese foreign investment in these regions. Paradoxically, this investment has stoked fears about economic domination and “silent expansion” by the Chinese in the Russian Far East, even as it has contributed to the end goal of economic development.

² Thane Gustafson, “Russian Oil Industry at a Crossroads as Infrastructure Ages,” *The New York Times*, December 4, 2012, http://www.nytimes.com/2012/12/05/business/global/russian-oil-industry-at-a-crossroads-as-infrastructure-ages.html?_r=0.

³ Rens Lee, “The Far East Between Russia, China, And America – Analysis,” *Eurasia Review*, July 31, 2012, <http://www.eurasiareview.com/31072012-the-far-east-between-russia-china-and-america-analysis/>.

It is important to note that Russian concern over economic domination of the Far Eastern regions by the Chinese has significantly hampered the development of the region's hydrocarbon resources. It is widely accepted that Russia does not possess the investment capital to unilaterally develop these regions. However, fear about foreign investment, especially from China (Russia's most natural partner in this regard), along with an economic environment that is largely hostile to such investment has kept foreign investment in onshore development to a slow trickle. Many figures in the Russian government fear that with too much investment from China the Far East will become a "resource appendage" of China rather than an economically dynamic region of Russia. Some analysts have proposed that Russia pursue a foreign investment strategy based on a consortium of foreign partners, including states in Northeast Asia and the United States. Such a strategy would diversify the immense risk involved in hydrocarbon development in Russia among the investing countries while assuaging Russian concern over the economic sovereignty of Eastern Siberia and the Far East. However, the fact remains that the *Energy Strategy to 2030* calls for foreign investment well below the levels that would be necessary to sustain a major foreign investment consortium, making it unlikely that such a strategy will be pursued in the short term.

Concerns over the development trajectory of these regions have caused the government to pursue a somewhat centralized development strategy. However, considerable controversy has developed over how exactly the economic development of these regions should be managed. Two distinct approaches to this management structure have been proposed. The first consists of the development of a state corporation to direct the development of the Far East. This strategy was first presented to Putin by Sergei Shoigu, then minister of emergency situations (now minister of defense), in January 2012. He argued that a state-run corporation could best establish the type of economic environment that would allow for the sustainable and rapid development of these regions. A version of the bill to create this corporation leaked in April 2012. According to reports, the corporation would be allowed to bypass regional and local governments to give permits for mining natural resources. The corporation would be directly accountable to the president, while other state agencies would not be able to interfere with its decisions. To facilitate the ventures, the body would get 500 billion rubles (\$17 billion) worth of stakes in energy, resource, and infrastructure companies. The corporation would also receive unprecedented oversight in the decisions of major state monopolies like Gazprom and Transneft.

Controversy quickly developed over the issue of a state corporation in the Far East. Former minister of finance Alexei Kudrin was quick to criticize the proposal, stating that it would increase graft, enable the state to grant special preferences to certain investors, and consequently crowd out and deter other private investors.⁴ Additionally Minister of Finance Anton Siluanov, Kudrin's successor, publicly opposed the plan,

⁴ "Kudrin Slams Russia's Far East Mega Plan," RIA Novosti, April 24, 2012, <http://en.rian.ru/business/20120424/173012144.html>.

arguing that a state corporation was unnecessary and that it would hinder the development efforts of the regional governments.⁵

Subsequently, a separate proposal for the development of a ministry for the development of the Russian Far East was proposed and, ultimately, adopted. President Putin created this ministry in May 2012, appointing Viktor Ishaev, formerly the long-time governor of Khabarovsk, as its head. Its mandate was broadly defined to include the implementation of all state programs and federal targeted programs for the Russian East, including long-term projects such as those included within the *Energy Strategy to 2030*. Many officials within the regions have opposed the operations of this ministry, as they believe it impedes the development projects underway on the regional level while not significantly adding to the economic development of the Far East. Last spring, President Putin himself accused the ministry of not fulfilling its purpose and failing to effectively direct the economic development of the region. He was especially critical of the fact that the ministry had not fully developed a fully-fledged policy program and that it has exhibited considerable fiscal waste. Importantly, Putin's dissatisfaction with the ministry has led his government to reconsider the development of a state corporation for the development of these regions. At present, it remains to be seen what type of structure the Russian government will employ to guide the development of the Far Eastern regions or how efficiently it will be able to utilize the massive, and essential, hydrocarbon resources of Eastern Siberia and the Far East.

Diversification of Partners to Hedge China as Strategic Principle?

Despite the continuous public and official pronouncements of the historically unprecedented harmony in Sino-Russian relations (which may be true given that for centuries this has been a highly conflictual relationship), perhaps Vladimir Putin's greatest foreign policy challenge in the years ahead will be managing relations with his rapidly rising neighbor to the East. And just as Russia is wary of Chinese encroachment on its most valuable sovereign domain, hydrocarbon supplies, it is acutely concerned about becoming overleveraged to China more broadly in Asian regional relations if not global inter-relations. Consequently we are seeing increasing signs now of efforts by Moscow to diversify its portfolio of Asian partners, so to speak, especially with Japan, South Korea, and, most recently, Vietnam.

In June 2012, Minister of Foreign Affairs Sergey Lavrov stated that Russian and Chinese relations had reached unprecedented high levels.⁶ This was shortly before the Shanghai Cooperation Organization (SCO) summit in Beijing at which China and Russia signed ten important agreements on security, economics, and energy.⁷ Russia and China have formed a close political partnership in recent years that reflects shared understandings vis-à-vis the United States and the West (opposition to perceived Western "domination" in local affairs) and alignments on contentious issues such as Iran

⁵ "Минфин жестко раскритиковал идею создания корпорации развития Сибири и ДВ," Взгляд, May 2, 2012, <http://vz.ru/news/2012/5/2/576988.html>.

⁶ http://news.xinhuanet.com/english/china/2012-06/03/c_131628116.htm.

⁷ http://zeenews.india.com/news/world/china-and-russia-sign-10-crucial-agreements_780126.html.

sanctions, Syria, and NATO expansion. They have dramatically expanded cooperation in trade (China is now Russia's largest partner⁸) and have pledged to increase trade from \$83 billion in 2011 to \$200 billion in 2020. In addition, the Russian Far East has fewer than 6.5 million people today. By comparison, China's northeast and Inner Mongolia have seen steady human population growth and had 139.9 million people as of 2008. Sergei Karaganov, of the Council on Foreign and Defense Policy in Moscow, expresses fears that Russia's "semi-dependency" on China could add "a great deal of international weight" to the PRC, which should concern other countries of the Asia-Pacific community." What Russians call the "China threat" simply reflects Russia's own paranoia against a backdrop of economic backwardness and depopulation of its eastern regions.⁹ In Beijing politics, Russia is now being talked about as "China's strategic rear."¹⁰ The commitment to secure China's "strategic rear" is motivated by obvious national security considerations, but also by pragmatic recognition that this allows China to concentrate on economic modernization.

Moreover, over the last five or six years, China has had an increasing footprint in Russia's historic sphere of influence, Central Asia. In 2009, the presidents of China, Kazakhstan, Uzbekistan, and Turkmenistan celebrated the inauguration of the Central Asian-China pipeline, which runs approximately 2000 kilometers through the four countries and has a planned total capacity of 40 billion cubic meters. This marked the first major diversion (Turkmenistan began exporting gas to Iran in 1998) of former Soviet republic gas resources outside of the Soviet legacy Gazprom pipeline network.

Conclusion

The APEC summit in September in Vladivostok was the global stage for Russia's assertive turn to the Far East, and its ambitious development in Russia itself. In an interview, Vladimir Putin stated that "two-thirds of Russian territory is located in Asia, and yet the bulk of our foreign trade—more than 50 percent—comes from Europe, whereas Asia only accounts for 24 percent,"¹¹ and predicted huge growth. According to Minister of Far East Development Victor Ishayev, \$1.1 trillion rubles (\$35 billion) was invested in the Russian Far East in 2010, an unprecedented amount.¹² However, President Putin was very critical of Ishayev, called for more concrete results and even proposed incentives for businesses such as a zero-rate federal profit tax for the first 10 years for start-ups for investments of 500 million rubles (\$16.5 million) or more. During the APEC summit, Russia did not make any political or financial demands of its Asian partners. Moscow raised technical questions and APEC countries raised questions such as the movement of cargoes across Russian territory for Asian countries to enjoy

⁸ <http://www.eurasiareview.com/31072012-the-far-east-between-russia-china-and-america-analysis/>

⁹ Shoichi Itoh, *Russia Looks East: Energy Markets and Geopolitics in Northeast Asia*, Center for Strategic and International Studies, July 2011, p. 40.

¹⁰ <http://valdaiclub.com/asia/52300.html>.

¹¹ <http://www.nytimes.com/2012/09/07/world/europe/at-asia-pacific-meeting-putin-focuses-on-the-far-east.html>.

¹² http://rbth.ru/articles/2012/12/04/putin_unsatisfied_with_the_ministry_of_far_east_development_20803.html.

promised benefits, including the unification of transport code, automation of logistical systems, and so on. Russia promised to cut the time taken to clear foreign containers from 12 days to four to five days by 2018.

Russia is primarily interested in its restoration as a great power. Although Moscow has not abandoned its fixation on the United States as its principal global foe with its encroachment on areas of Russian “privileged interests,” the rapid rise of China and its dramatically increasing economic influence and power in Central Asia and elsewhere among Russia’s neighbors has been the impetus for some recalibration of Russian foreign policy, serving as a stimulus for improved ties with Washington, for example. Also significantly, Russia is starting to look at Asia for its own importance and possible contributions to Russian development rather than as a thinly credible threat to the West that if Russian interests are not more respected it will align with China, a refrain heard often during the Yeltsin and earlier Putin presidencies.

Instead, Russia is shifting its strategy towards a complex policy of global accommodation. In line with its goal of modernization, Russia has pushed for regional economic integration with an eye toward joint investment projects. Specifically, it has highlighted energy, agriculture, infrastructure, and advanced technology as areas in which joint investment and technical cooperation should take place. The successful realization of Russia’s new Asia Strategy requires Russia to maintain a close relationship with China; this is more accurately described as an “axis of necessity” rather than an “axis of convenience,” as Bobo Lo termed it. The two powers share common multi-polar visions for the security architecture in the Asia-Pacific, predicated on the principles of non-interference, equality, respect for international law, cooperation in development, and opposition to Cold War-era policies. Together they have championed multilateralism as the legal foundation for this architecture and advocated for a system that would prioritize collective leadership.

But Russia is well aware of the need to extend and improve ties with a wide variety of Asian neighbors, including the United States, as it continues to deepen its ties with China. The most logical development from this in the Asian energy sphere would thus be a more accepting Russian posture to increasing Chinese investment and equity stakes in the development of its East Asian resources while at the same time increasing the involvement of other major Asian partners.

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