

# **Russia's Energy Diplomacy toward the Asia-Pacific: Is Moscow's Ambition Dashed?**

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## **INTRODUCTION**

Russia's role as a large energy supplier has once again hogged the limelight of the global community against the background of growing concerns about energy security and the rising trend in energy prices. Not only is Russia the largest producer of natural gas but it also regained the top slot in crude oil production by outpacing Saudi Arabia in 2004.

Putin's Russia has greatly benefited from the contemporary energy markets. It has achieved 6.8% real GDP growth per annum in 2000–2006. Boosted by the massive inflow of petrodollars and the rapid accumulation of international reserves, exceeding \$300 billion by the end of 2006, Russia finished paying off its \$22.5 billion Soviet-era debt to the Paris Club in August of that year. The Russians have obviously become more self-confident of their independence from the rest of the world. Given that the revival of Russia's economic strength and status as a "great power" has been the main agenda of the Putin regime, Putin seems to have kept his promises to the nation, even though the Russian economy's potential weakness due to excessive reliance on the energy sector, which is vulnerable to the fluctuation of oil prices and the potential danger of the "Dutch disease," has remained unsolved.

On the one hand, Russia's opportunity to increase its energy sales in the global markets has been expanding. However, Moscow's heavy-handed stance in its energy diplomacy has increasingly created tensions with EU nations, the United States, Japan, and even China.

The very first paragraph of the Russian Energy Strategy toward 2020 (hereafter referred to as the *2020 Energy Strategy*), published by the Russian government in August 2003, is as follows:

Russia has a considerable amount of energy resources and fuel-energy complex's capability, which is a basis for economic development and implementation of domestic and foreign policies. The country's role in the global energy markets determines its geopolitical influence (underlined by the author).

Russia suspended oil supplies to Latvia (January 2003) and Lithuania (July 2006) and natural gas supplies to Ukraine and Georgia (January 2006) and Poland (October 2006). Moscow is now threatening an energy embargo on Estonia as well. While Russia has claimed various reasons of self-justification, including unpaid debts and unreasonable prices, the implication of Moscow's use of energy as a diplomatic "weapon" has been serious enough to aggravate concerns about increased reliance on this energy giant.

The former German Chancellor Gerhard Schroeder suggested in the 2007 St. Petersburg International Economic Forum (*The Moscow Times*, June 13, 2007) that Russia is still "a reliable hydrocarbons supplier."

The degree to which Russia can enjoy the status of a big power by making the best of its mineral resources will depend not only on windfall oil prices but also on its capacity as a stable and reliable energy supplier. Indeed, Russia has recorded steady growth of crude oil and natural gas production in recent years. In 2000–2006, crude oil production increased from 323.4 million tons to 480.0 million tons (9.6 million bbl per day), and natural gas, from 584 billion cubic meters (BCM) to 656BCM (*Rossiiskii statisticheskii ezhegodnik 2005*).

However, the controversy regarding the stability of the supply from Russia continues. The International Energy Agency (IEA) has suggested that Russia's possible production shortfall of natural gas may be caused by the lack of sufficient and timely investments in upstream development, the declining rate of state-owned natural gas monopoly Gazprom's major fields, the rising domestic demand, irrational domestic usage of natural gas, heavy reliance of the imports from Central Asia to fulfill international agreements, etc. (IEA, 2006a, pp. 26–43).<sup>1</sup>

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1 For a detailed analysis on the prospects of Russia's gas supply, see Stern (2005).

In addition, doubts have been raised on the future of crude oil production. For example, an American geographer, Leslie Dienes, presented a pessimistic view that Russia's present oil boom would not be sustainable due to geological and geographical constraints, the imbalanced reserve pyramid inheriting the Soviet legacy of reserve classification, unfavorable business and institutional environments leading to oil companies' shortsighted investment activities, and the difficulty of exploring the greenfield areas of East Siberia and the Far East (Dienes, 2004).<sup>2</sup>

At any rate, according to the *2020 Energy Strategy*, it was forecasted that crude oil and natural gas production in West Siberia would gradually level off and start to decline around 2010, even if this part of the country takes a commanding lead as the major producer of hydrocarbon resources.<sup>3</sup>

Meanwhile, the Russian government is starting to devote more effort to develop the previously untapped resource potential of Eastern Russia (i.e., East Siberia and the Far East). By an optimistic scenario of the *2020 Energy Strategy*, Eastern Russia is projected to produce 38 million tons in 2010 and 106 million tons in 2020, which will account for 7.8% and 20%, respectively, of the total crude oil production in the country. Similarly, natural gas production in this region is forecasted to increase from 52BCM (7.8%) to 106BCM (14.5%) during the same period.

Experts predict that the gradual decline in production volumes in West Siberia will be compensated for by the growth in production in Eastern Russia. In other words, the future supplying capacity of hydrocarbon resources in Russia will be largely affected by the tempo and the scale of the materializing energy potential of this "long-neglected" eastern half of the country.

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2 For discussions on his hypothesis, see Gaddy (2004) and Bradshaw & Bond (2004). Graces (2005, p. 210) notes, "Estimates that occasionally appear in the Russian and Western press about the possibility of Russia producing 12 million b/d or more by 2010 or 2012 are usually the result of mechanical multiplication and addition of theoretical productive capacities without attention paid to the timing of projects or the probability of their occurrence."

3 More than 70% of crude oil and more than 80% of natural gas production have hitherto taken place in Western Siberia.

In this context, Moscow wants to participate in the rapidly growing Asia-Pacific economies by exercising its capacity to supply energy products, attract foreign investment, and increase trade. Russia is more complicated than merely exploiting the available mineral resources. It requires a huge scale of capital and labor just for the building of the necessary infrastructure in the extremely severe geographical and geological conditions.

If Russia can effectively bring these targets into reality, just as depicted in the national strategy, it is likely to enable Russia to play enhanced roles in the Asia-Pacific. If Russia accomplishes these tasks as it wishes, its role among the Asia-Pacific nations will be enhanced. Whether Moscow has the capacity to implement such grandiose energy development plans is to be seen. In addition, whether the expected results can be obtained in the given timeframe is questionable. The degree to which Russia can achieve its goals without foreign influence is also at stake. The question of Russia's capacity to operate independently will be studied in conjunction with its potential for development and desirability for foreign business communities. The manner in which Russia prioritizes its economic and business logistics relative to its geopolitical aspirations needs to be examined as well. These are the basic issues to be considered in the discussion of Russia's capacity to establish its long-term energy policy and play a larger role in the Asia-Pacific market.

In this study, we examine Moscow's success during the Putin period in energy diplomacy and eastward development. Close attention is given to Russia's relationships with China and Japan during the development of East Siberia. Furthermore, the implications of an expanded Russian role in the Asia-Pacific nations will be considered.

First, a brief survey of the prospects and disincentives of developing oilfields in Eastern Russia will be presented. Although the crude oil pipeline from East Siberia to the Pacific Ocean (hereafter referred to as the ESPO pipeline) has been constructed step by step since the spring of 2006 (see map on the last page), uncertainties over the economic feasibility of this project have remained to a considerable degree.<sup>4</sup>

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<sup>4</sup> For a detailed analysis on the ups and downs of the ESPO pipeline project, see Itoh (2007a, pp. 42–62). Some parts of this article were reproduced with appropriate revisions from an earlier draft.

The second and the third sections address the progress of energy cooperation with China and Japan, respectively. In this explanation, the Chinese and Japanese involvement in the ESPO pipeline is reviewed. While the limitations of a Sino-Russian strategic partnership in the energy sector, notwithstanding the high degree of its mutual complementarity, have been gradually revealed, initial expectations of Russo-Japanese cooperation over the ESPO pipeline project have been bogged down in many respects.

Finally, we examine Russia's move into the east from a broad view relative to the consumers in the Asia-Pacific countries.

### **THE BLACK GOLD RUSH IN EASTERN SIBERIA**

The 2020 Energy Strategy states that Russia will increase its crude oil exports to the Asia-Pacific region from 3% in the beginning of the 21st Century to 30% by 2020 (RMIE, 2006a). Russia is forming a plan for providing the Asia-Pacific nations with a maximum of 100 million tons of crude oil by 2020. The Minister of Industry and Energy, Viktor Khristenko, reaffirmed Russia's willingness to be proactive in entering the Asia-Pacific energy markets since they will have the highest growth rates in the world. The reaffirmation is based on the unique geographical conditions of Eastern Russia and the fact that European energy demand will peak at some point (*Rossiiskaia gazeta*, February 22, 2006).

The extent to which Russia can strengthen its presence as a big energy power in the Asia-Pacific will be directly affected by the future of the ESPO pipeline project and the associated development of East Siberia's oil production.

In the case of Russia's failure to continue increasing its production of crude oil and a comparable quantity of reserves, Moscow would lose not only the business profitability of the ESPO pipeline but also crucial leverage to expand its influence in the Asia-Pacific region.

According to the Russian government's official schedule, the first stage (approx. 2,800 km) of construction on the ESPO pipeline from Taishet of the Irkutsk region to Skovorodino of the Amur region, launched in April 2006, is supposed to be completed by the latter half of 2008. By the end of April 2007, the Russian oil pipeline monopoly Transneft com-

pleted 920 km of the pipeline (*Vostochnyi nefteprovod*, April 28, 2007).

Whether the ESPO pipeline will ensure commercially adequate amounts of crude oil reserves in the foreseeable future remains controversial. In theory, geologists have, for many decades, pointed out potentially enormous amounts of unproven hydrocarbon reserves under the vast permafrost territory. There are, however, limits to the capital available for investment in the exploitation of the greenfield areas. In addition, assessments of the amount and the ratio with regard to proven and unproven reserves vary significantly. Even though such problems may not be typical for Russia, transparency with regard to the geological conditions continues to worsen.<sup>5</sup>

The Russian government objectives are to ship 30 million tons of crude oil when the first stage of the ESPO pipeline is completed and another 80 million tons when the second stage is completed (from Skovorodino to the Pacific Ocean). President Semen Vainshtok of Transneft reported that the construction of the second stage would likely begin within 6 to 7 years after the first stage goes into operation (*Vostochnyi nefteprovod*, April 28, 2007).<sup>6</sup> Ultimately, however, the progress depends on when Russia can ensure a commercially reasonable level of exploration and production (*Vedomosti*, April 28, 2005; *The Moscow Times*, June 17, 2006).

According to estimates by the Institute of Oil and Gas Geology of the Siberian Branch of the Russian Academy of Sciences in Novosibirsk,

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5 The Russian government made the decision to make the quantity of the country's oil and natural gas reserves a state secret in April 2004. As a result of the St. Petersburg G8 summit hosted by Russia in July 2006, the Statement on Global Energy Security Principles was issued. "Transparency" in energy markets was one of the key words to build energy security, considering the mutual interests of consuming and supplying countries (St. Petersburg G8 summit Website). It has been reported to date that the Ministry of Natural Resources has a policy for recalculating and announcing reserves by 2009 on the basis of new criteria to define reserves that were introduced in 2005 in order to bring them closer to international standards (*RusEnergy*, 2006d).

6 Minister of Industry and Energy Viktor Khristenko noted that the second stage of the ESPO pipeline would be completed in time for Russia to host the 2012 APEC summit (*Neftegazovaia vertikal'*, February 7, 2007).

the volumes of production in East Siberia and the Sakha Republic, the development areas for the crude oil shipment for the ESPO pipeline, are projected to rise to 12.5 million tons in 2010, 42 million tons in 2015, and 60 million tons in 2020 (Korzhubaev, 2005, p. 51). In the Eastern Siberian and Sakha Republic Geological Survey Program (hereafter referred to as the *Eastern Siberian Survey Program*) adopted by the Ministry of Natural Resources in 2005, the quantity of crude oil production is forecasted to reach 30 million tons in 2012–13 and 80 million tons after 2020–2025 (*RusEnergy*, 2006c).

However, assessments on the current state of development are not as optimistic as indicated by those prospects. It has become increasingly clear that even the high-ranking officials cannot help but admit their concerns about the slow pace of the geological survey and the inadequate amount of explored reserves. Prime Minister Mikhail Fradkov, during his visit to the Sakha Republic in March 2007, warned that oil companies had carried out only 5% of their obligations of geological surveys, threatening the profitability of the ESPO pipeline project (Sakha Republic (Yakutia) Government Website 2007). He noted that, while \$102 billion of investments were needed to ensure 50 million tons of crude oil production in East Siberia toward 2025, only 30% of the original plan had been invested by the oil companies as late as 2006 (*Kommersant*’, March 14, 2007; *Vedomosti*, April 11, 2007).

In March 2007, Aleksei Varlamov, Deputy Minister of Natural Resources, reported that the oil reserves in the adjacent areas of the ESPO pipeline route amounted to 1.1 billion tons (about 500 million tons is classified as category C1 and the others as C2) (*ProvoTek*, March 13, 2007). However, according to the Chairman of the Federation Council’s Committee on Natural Resources and Environment Protection, Viktor Orlov, if a coefficient of 0.66 is applied to the Russian evaluation of reserves of A+B+C1, they are more or less equivalent to the proven reserves by the Western standards (*RusEnergy*, 2004).

In September 2006, Sergei Fedorov, Director of the Department for Government Policy and Regulation on the Use of Energy Resources at the Ministry of Natural Resources, asserted that even realizing the production of 3,000 tons annually in East Siberia before the first phase of the ESPO pipeline goes online in 2008 was impossible (*RusEnergy*,

2006c). He further noted that, while the reserves secured in East Siberia by the beginning of 2006 totaled just 5.8 million tons, which was no more than 6.4% of the 90.7 million tons planned in the *East Siberia Survey Program*, in light of all the conditions, the only hope was for oil to be transported from West Siberia in the long term, including the second phase of the ESPO project, under special preferences for the transport tariffs with the government's political backing (*RusEnergy*, 2006b). It is possible that more than 30 million tons to the ESPO pipeline will have to be shipped from West Siberia until 2030 (Glazov, 2006, p. 21).

Calculations by the Ministry of Natural Resources as late as spring 2007 suggest that the potentially stable amount of crude oil production in East Siberia is 25–50 million tons. It is crucial to expand the volumes of reserves to achieve more than 25 million tons of annual production (RMNR, April 10, 2007).

It seems that the ESPO pipeline's greater reliance on West Siberian crude oil than previously expected has increasingly become a *sine qua non* for the project. West Siberia has had better performance in crude oil production than envisaged in the *2020 Energy Strategy*.<sup>7</sup> However, it by no means implies that profitability of the ESPO pipeline project will be secured without increasing volumes of production in East Siberia.

Despite the fact that exploration and development of Eastern Russia's hydrocarbon resources require enormous amounts of capital and new technologies, it remains questionable to what extent Moscow will welcome foreign investors. As reported above, East Siberia, notwithstanding its importance as the new resource base for Russia's future, has been seriously undercapitalized.

In light of Moscow's recent decisions to reduce foreign participation in its own energy sector, however, the degree to which Russia will use international cooperation as a means to accelerate its underdevelopment of energy reserves in the immediate future remains to be seen. The fate of revising the Law on the Subsoil (originally enacted in 1992), which has been one of the hottest issues in the energy debate among various interest groups in the Russian Duma to date, may largely affect the scale and possible forms of foreign investor participation.

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<sup>7</sup> For details on this background, see Sagers (2006).



In May 2006, when President Putin held a meeting with the Minister of Natural Resources Yuri Trutnev, he instructed the minister to reconsider the “strategic deposit” criteria (*Vedomosti*, June 6, 2006). In June of the same year, the minister revealed a new bill, in which the deposit reserves targeted by restrictions on entry by foreign investors were set at 70 million tons or more in the case of oilfields and at least 50BCM in the case of natural gas fields. If this new definition came into force, around 30 oilfields and 40 natural gas fields across Russia would fall into the “strategic deposit” category. An appropriate framework with a focus on the entry of foreign capital into East Siberian “strategic deposits” that will be supplied to the ESPO pipeline is still being developed (*Interfax*, June 19, 2006).

Some are of the opinion that the introduction of the definition of “strategic deposits” will work to the advantage of large state-owned companies, such as Rosneft and Gazprom, when aiming to introduce foreign capital (*Vedomosti*, July 6, 2006). On the other hand, the Federal Security Service (FSB), which fears the loss of Russia’s national security and interests the most, has apparently expressed the opinion that the conditions for foreign investors regarding which companies can participate in “strategic deposits” should be made even stricter (*Vedomosti*, October 24, 2006).

### **SINO-RUSSIAN ENERGY PARTNERSHIP IN DISGUISE<sup>8</sup>**

Apparently, one of the achievements in Russian diplomacy in the Putin period is the consolidation of the Sino-Russian strategic partnership. However, it has been noted that the level of economic relations between the two is lagging behind that of political relations, and, thus, further strengthening of this strategic partnership needs to be bolstered by the economic aspect of interdependence (Zhao, 2005). While Beijing and Moscow agreed to increase the bilateral trade volume to \$60–80 billion by 2010 at the July 2005 Summit, it reached \$33.4 billion, according to Chinese official statistics, as of 2006. It increased in excess of 4 times

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<sup>8</sup> For a detailed analysis of the Sino-Russian turbulence over energy cooperation, see Itoh (2007b).

the 2000 level, but it still accounted for less than 2.0% of China's total trade volume.

It has been expected that energy will share an increasing ratio of Sino-Russian economic cooperation, at least on the official level, against the background of the high degree of mutual complementarity in energy trades. At the same time, the energy sector would be virtually the biggest locomotive for the two countries to reinforce economic reciprocity and, thereby, to underpin political trust between Beijing and Moscow.<sup>9</sup>

According to *World Energy Outlook 2006*, it is predicted that China's oil and gas demands will increase by 3.4% and 5.1% per annum, respectively, in the Reference Scenario from 2004 to 2030. With regard to China's rapid increase in oil demand, it is projected to account for 20% of the world total in 2030 (IEA, 2006b, p. 69, 516). The National Development and Reform Commission (NDRC) of China forecasts that the nation's net import of crude oil will double by 2020 (*ERINA Report*, 2005, 65, p. 44). The Institute of Energy Economics, Japan (September 2006) estimates that China and India will likely account for about 40% of the global increase in oil consumption by 2030.

When it comes to the question of whether the current trend in growing oil trade volumes is likely to consolidate their strategic partnership, however, the progress in Sino-Russian energy projects has gone through a number of twists and turns, suggesting that energy issues may ironically become a major source of mutual distrust in the years to come. The development of oil and gas pipeline projects has demonstrated the complications and the depth of mutual distrust.

### ***Crude Oil Pipeline***

Russian officials, including President Putin himself, have repeatedly underlined that it will keep the "official promise" with China to construct a branch pipeline from Skovorodino toward the Sino-Russian national border, from which the China National Petroleum Corporation (CNPC)

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<sup>9</sup> However, President Putin disclosed his concern that the increasing reliance on raw materials was a negative trend in the structure of Sino-Russian trade in his speech to the Sino-Russian Economic Forum held in Beijing during his visit in 2006 (President of Russia Website 2006).

plans to build a pipeline to Daqing in Heilongjiang Province (*Vostochnyi Nefteprovod*, February 2, 2007). However, Moscow has made the precise timing and terms of achieving the China route ambiguous until today despite the fact that it was reported that both sides supported the project of constructing an oil pipeline from Russia to China in the Action Program for Implementing the Sino-Russian Treaty of Friendship for 2005–2008 (hereafter referred to as *Sino-Russian Action Program*) (President of Russia Website 2004).

Beijing's expectation about the realization of a direct pipeline route from Russia has been betrayed. The earlier plan of building a pipeline from Angarsk to Daqing, over which CNPC and Yukos had negotiated, was completely buried. The *2020 Energy Strategy* articulated the compromised idea of building a trunk pipeline to the Pacific coast with a branch pipeline to Daqing, whereas no reference to the latter has been made to date in the Russian official documents, including the Government Decree no. 1737-r, which formally approved the promotion of the Pacific pipeline route plan, and the Directive no. 91 of the Ministry of Industry and Energy, which split the whole project into two phases concerning the pipeline between East Siberia and the Pacific Ocean.<sup>10</sup>

During his visit to Beijing in March 2006, Putin clearly stated that he had no doubt about the realization of a branch pipeline to China against the backdrop of signing a memorandum of starting a feasibility study between CNPC and Transneft.<sup>11</sup> While these two state companies have proactively promoted the branch pipeline route plan (*Vostochnyi Nefteprovod*, March 30, 2007), a considerable degree of uncertainty regarding its future has remained.

Deputy Minister of Foreign Affairs Aleksandr Losyukov remarked that the details about the branch route from the ESPO pipeline were not

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10 RMIE (2005). Alexander Lukin succinctly notes, "The abandonment of the Angarsk-Daqing project, which was approved at the very top level in both countries...would cause deep incomprehension in China and would demonstrate that Russia's policy in the sphere of foreign economic cooperation lacks consistency." (Lukin, 2007, p. 157).

11 "Vystuplenie na rossiisko-kitaiskom ekonomicheskom forume," 22 marta 2006.

discussed during President Hu Jintao's visit to Moscow in March 2007, adding that, notwithstanding the interest of trading with China, Russia would diversify its supplies to any consumers, considering all practical possibilities (*Moskovskie novosti*, March 30, 2007). This may sound reasonable *prima facie*, if an attempt is made to avoid a scenario of a buyer's monopoly market. It deserves questioning if Moscow's energy strategy toward China has been genuinely based on economic calculations or business risks. As a counterfactual analysis, if they reached an agreement on oil prices and/or more than sufficient amount of crude oil were produced in East Siberia, the question of whether Moscow would have been ready to export as much fossil products as possible to China in accordance with market principles would need to be posed. Furthermore, it would need to be asked whether Russia could accept as much Chinese investment as possible without non-economic barriers, and, if Moscow's stance toward Beijing could be explained by business logics, whether the former was really seeking positive-sum instead of zero-sum gains.

### ***Natural Gas Pipeline***

The Kovykta project has been a symbol of Sino-Russian energy cooperation from the 1990s. However, it has been virtually "shelved" in terms of reinforcing the partnership in the near future. The license of RUSIA Petroleum, the project's operator, was subjected to the possibility of revocation by the Russian government after all. The official reason of the license violation given to TNK-BP, holding 62.89 percent of RUSIA Petroleum, was its failure to fulfill production quotas by the designated deadline. Despite the fact that Gazprom's leadership had publicly denied its interest in the Kovykta project until not so long ago, TNK-BP was plunged into a situation without an alternative but to sell its stake in RUSIA Petroleum to Gazprom in June 2007 (*The Moscow Times*, May 24, 2007; June 22, 2007). It remains to be seen whether the entire situation can be clearly explained by the license issue alone. Moscow's intent to abide by the Sino-Russian Action Program, in which each authority was directed to assess the government reviews on a trilateral international feasibility study with regard to the Kovykta project, needs to be revisited.

In November 2003, as a result of the three-year feasibility study, RUSIA Petroleum, CNPC, and Kogas (Korea Gas Corporation) agreed

to construct a 4,900km pipeline from the Kovykta Gas field to South Korea via the Chinese territory and Yellow Sea to supply 20 BCM of natural gas to China after 2008. Only the Russian government's official approval was lacking. However, it is noteworthy that the Russian government designated Gazprom as the chief drafter of a comprehensive development and utilization program of natural gas to China after 2008 (hereafter referred to as *Eastern Program*) as early as July 2002.<sup>12</sup> In short, it appears that Moscow had little respect from the onset for the trilateral international feasibility study.

It has been pointed out that one of the main disagreements in Sino-Russian negotiations over the idea of building a natural gas pipeline from the Russian territory is a wide gap in expected gas prices (Japan Institute of International Affairs, 2004, p. 95). We then need to question the rationale for Russia knowingly proposing a series of gas pipeline routes to China, since essentially the same problem, namely, the disagreement regarding prices stemming from China's lack of sufficient demand for Russian natural gas in the immediate future, remains to be answered.

When President Putin visited Beijing in March 2006 with Gazprom's chairman of the management committee, Alexey Miller, they made no explicit reference to the Kovykta project while announcing their plan to supply as much as 80BCM, including 30–40BCM from West Siberia. Simultaneously, President Putin proposed the so-called "Altai Pipeline" project for building a pipeline from the Altai Krai to the Xinjiang Uighur Autonomous Region via the Sino-Russian western border without any prior scientific calculation of its economic benefits (*Neftegazovaia vertikal'*, April 14, 2006). Given that China has currently faced no problems satisfying its domestic natural gas demand, basically relying on its own production, it would be difficult to find a rationale from a business point of view that CNPC could make further concessions with regard to the price negotiation than they already had for the Kovykta project.

Meanwhile, it has been noted that Moscow's real intention to inflame the Altai project was, first, to raise the prices by implying the reduction of its supplies to Europe (*Neftegazovaia vertikal'*, March 22, 2006; *RusEnergy*, 2006a); and, second, to brandish the "China card"

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12 For a summary of the Eastern Program, see Itoh (2006a).

before the West, who has stiffened its attitudes toward Russian energy diplomacy. This means that Russia's primary motif was not to reinforce the energy link with China in this regard.

### **“China Phobia”**

Russia has been continuously and increasingly concerned about a possible geopolitical loss of its interests in the eastern part of the country. The so-called “China phobia” remains deeply rooted in Russia's geopolitical mindset<sup>13</sup> despite the fact that Moscow and Beijing had settled their border demarcation disputes by the beginning of the 21<sup>st</sup> Century and institutionalized interstate cooperation concerning illegal immigration.

There are suspicions regarding the possible danger of Russia becoming a resource “appendage (придаток)” of China if Russia continues to carelessly pump out its energy resources in that direction (*Nezavisimaia gazeta*, January 20, 2004; *Novaia Gazeta*, April 3, 2006). On the eve of the first anniversary of the Sino-Russian Treaty of Good-Neighborliness and Friendly Cooperation of July 2001, Alexandr Gol'bach, Commander-in-Chief of the Far Eastern Headquarters of the Russian Federal National Border Guard, publicly warned: “China has clearly continued its efforts to expand its political, economic, and demographic influence throughout the Russian Far East” (*Dal'nevostochnyi Pogranichnik*, 24, 2002). Likewise, Aman Tuleev, Governor of the Kemerovo region, once warned that the Russian territory could fall into the hands of foreigners if economic development were not accelerated, implying the expansion of the Chinese influence in Siberia (*Nezavisimaia gazeta*, May 20, 2003). According to a public opinion poll conducted by the All-Russia Public Opinion Research Center in August 2005, 81 percent and 71 percent of respondents in the Far Eastern and Siberian Federal Districts, respectively, were worried about Chinese participation in the development of Russian natural resources (RPORC, 2005). It has also been suggested that the Russian military is wary of exporting the Kovykta field's natural gas to China, since it contains high volumes of helium, which has been regarded as a strategic chemical component since the Soviet period and

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13 For various views regarding China today held by Russian elites, see Shlapentokh (2007).

could possibly be diverted into military operations (*The Moscow Times*, April 20, 2006).

***“Business” Wrapped in Politics***

An increasing number of Sino-Russian energy projects have been thrust into the world spotlight. These phenomena raise questions about the terms of the development of the energy business, whether they are mutually beneficial to the two countries, and the degree of political involvement driving the arrangements.

In July 2005, Rosneft signed a memorandum with the China Petroleum and Chemical Corporation (Sinopec) seeking to establish a joint venture in the exploration of the Venin mining field of Sakhalin III. Representatives of Rosneft and Sinopec also signed a memorandum of joint development of the mining fields in the Magadan region and the Sakha Republic in October 2005 after purchasing 96.6% of the Udmurtneft in West Siberia and implementing joint management in autumn 2006. Rosneft has likewise promoted cooperation with the CNPC, including the establishment of the joint-venture Vostok Energy in October 2006. Meanwhile, Gazprom concluded a strategic partnership with CNPC in October 2004.

However, other than the pipeline issues explained above, it is noteworthy that the Russians have allowed the Chinese to make investments only in fields of high business risk due to declining rates of production, unsuccessful previous drilling results, and uncertainties of reserves at hand. In other words, Russia has yet to welcome Chinese capital invested in economically lucrative projects (*RusEnergy*, 2007). The Sino-Russian energy cooperation appears to have been motivated politically rather than by any desire to share economic profits of developing Eastern Russia.

**EXPECTATIONS OUT OF ALIGNMENT IN RUSSO-JAPANESE  
ENERGY COOPERATION**

Hopes of soon settling disputes in the northern territories that arose during the Putin era have waned; however, energy cooperation between Tokyo and Moscow, *prima facie*, appears promising against a background

of instability in global energy markets and Moscow's interest in developing the economy of eastern Russia.

Given that Japan's energy self-sufficiency rate is extremely low at 4% (rising only to 16% with the inclusion of nuclear power) and, thus, is dependent on imports for virtually all of its crude oil supplies, it is clearly evident that Japan and Russia have a highly complementary relationship with regards to energy demand and supply. In this regard, Russia has cherished a stereotyped interpretation of a Japan desperate for oil with an almost exclusive import dependence on the unstable Middle East and hoped that Tokyo will cooperate on energy issues at the expense of political interests.<sup>14</sup>

Russo-Japanese energy cooperation has varied considerably over the years. Prime Minister Jun'ichiro Koizumi's visit to Moscow in January 2003 with the announcement of Japan's interest in the ESPO project, followed by the signing of the Japan-Russia Action Plan at the summit, was highlighted globally as a trigger for the Sino-Japanese scramble over Russian crude oil. In retrospect, however, neither this plan nor the Detailed Agreement Concerning Cooperation in Individual Energy Fields (November 2005) has developed in the direction originally hoped.

Japan's hesitance to invest in the ESPO project was not politically motivated directly nor was it linked to the disputes involving the northern territories; this is so regardless of Russia's typical criticism that Tokyo politicizes economic issues. Japanese investment in Russia has been increasing. As a clear example, the Toyota Motor Company broke ground for a new factory in St. Petersburg in June 2005. In 2006, Japan invested \$90 million in the Russian economy, and automobile production accounted for \$65 million (72%) of that amount (Japan Association for Trade with Russia and NIS, July 2007, p. 18). The Russo-Japanese trade volume marked a new record at \$13.7 billion in the same year.

However, there are four obstacles to the ESPO pipeline project becoming the major link in the Russo-Japanese relations (Itoh, 2007c). These are in addition to the fact that Russia cannot help but delay the development in the East, which was discussed earlier in this paper, and

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14 For an example of this oversimplified image, see *Nezavisimaia gazeta* (September 30, 2005).



the intensifying conflicts of interest among domestic stakeholders.<sup>15</sup> The obstacles are described below.

Firstly, the so-called “Middle East’s risk” is a delusion. It is not true that Japan desperately wants Russian oil. In fact, unlike Europe, Japan has fulfilled its energy demand without depending on energy supplies of Russia. It would be incorrect to believe that Japan would face a threat to its energy security due to a lack of oil supplies from Russia. It is true, however, that Japan’s excessive reliance on the Middle East as a source for crude oil is a concern and that diversification is a high priority. However, Russia recently claimed that resource nationalism was a valid policy. Gazprom’s forced participation in the Sakhalin II project is an example of this policy at work. Therefore, there is no assurance that any reduction in the dependence on the Middle East linked to an increased dependence on Russia would alleviate geopolitical problems. In fact, such arrangements might introduce more business risks into Japan’s energy security formula.

Moreover, the Japanese find it profitable to expand investment projects in the Middle East despite the chronic geopolitical risks inherent in the region. If the risks outweighed the potential for profits, they would not have increased their reliance on this region as a source of oil imports after the decline in the aftermath of the second oil crisis in the mid-1980s. In addition, given Japan’s excellent facilities suitable for refining cheap heavy oil from the Middle East, it is not certain that crude oil from Eastern Russia would be competitive in terms of price as a result of its low sulfur content, even when the cost of shipping it long distances in tankers is factored in.<sup>16</sup>

Secondly, it is highly probable that Russia’s expectation to sell its oil (crude oil and oil products) at higher prices in Asian markets than in European markets will be betrayed. While about 96% of Russia’s “Urals” crude oil was supplied to European markets as of 2006, Mos-

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15 The stakeholders include ministries, central and local authorities, oil companies, Transneft, and environment organizations. For details, see Itoh (2007a, pp. 42–52).

16 The author’s interview with Japanese energy experts, including the director of crude oil division in one of the major Japanese oil companies (anonymous).

cow claims that the price of the Russian product has been beaten down and that they are losing about \$6–7 billion annually, according to statistics from the Ministry of Economic Development and Trade (Glazov, 2006, p. 21).<sup>17</sup> However, one of the main reasons that Japan became interested in Russian crude oil was the potential for eliminating the so-called “Asian Premium” on crude oil imported from the Middle East, over and above the price paid by European countries. Japan hopes that competition between supply sources and markets will be realized with the construction of the ESPO pipeline. However, the Russian side is paradoxically aiming to make a profit in the form of “Asian Premium” by exporting to the east rather than the west.<sup>18</sup> Unless the “Asian Premium” is eliminated, it is likely that the attractiveness of Russian crude oil will diminish accordingly.

Furthermore, there exists another possible factor which may make the ESPO project’s products less competitive than otherwise for Japan. The Russian government has currently launched a policy of reducing the share of crude oil in the portfolio of oil exports. As a rule, oil companies are now encouraged to export more petroleum products than crude oil by tax incentives.<sup>19</sup> It has still remained unclear how much crude oil will be shipped to the Pacific coast by the ESPO pipeline, whereas Rosneft has already made an official announcement of building a petroleum product plant within the vicinity of the route’s end in Primorsk Krai in the foreseeable future. Basically, given that Japanese oil companies have

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17 The Minister of Energy and Industry, Viktor Khristenko, made the following remark during a meeting of the Government Committee on the Fuel and Energy Sector in October 2006 that, if the ESPO pipeline project was realized, 11.6–26% of the total volume transported by pipeline would be sent to the east (RMIE, 2006b).

18 Transneft Vice-President Sergey Grigoriev once revealed the company’s plan to introduce uniform charges for the transport of crude oil to markets in Europe and Asia, but, after the construction of the first phase of the ESPO pipeline, some individuals believe that oil companies can offset the cost of discounts in European markets by earning an “Asian Premium” (*RusEnergy*, 2006b).

19 Export tax on crude oil was set at \$237.6 per ton, whereas the tax on petroleum products was set at \$172.4 per ton as of October 2006 (*Neftegazovaia vertical’*, October 19, 2006).

maintained spare capacity to increase petroleum products and are even exporting their certain shares abroad, it may well be the case that petroleum products will be less competitive than crude oil in Japanese energy markets.

Thirdly, the investment climate with regard to investing in the ESPO project has remained ambiguous. Notwithstanding the interest in the project in principle, Japan has withheld large-scale investment because of the uncertainties regarding mutual gains that are clouded in secrecy and lack of access to information about reserves and concrete investment schemes with clear legal frameworks.

Fourthly, while the Japanese Ministry of Economy, Trade, and Industry officially forecasts that Japan's energy consumption will peak in 2014–2026, ironically, this will more or less coincide with the period when Russia will increasingly be trying to accelerate the development of hydrocarbon resources in eastern regions. Japan has learned lessons from the two oil crises in the 1970s and 1980s and has developed world-class energy conservation technologies. In addition to the continued efforts for the effective and environmentally friendly use of fossil fuels, the population has already begun to decline. Even if Japan experiences only a gradual decline in oil demand, it is not going to increase again. The share of Russian oil in Japan's energy markets will likely depend solely on its future competitiveness without regard to political maneuvers.

### **IMPLICATIONS FROM THE EMERGENCE OF COOPERATION AMONG THE CONSUMING COUNTRIES IN THE ASIA-PACIFIC<sup>20</sup>**

While Putin's diplomacy has demonstrated a clear ambition to re-inforce its position in the Asia-Pacific, where Moscow wishes to expand the share of its energy supplies within the country's total trade, it appeared that the aggravation of Sino-Japanese relations during the Koizumi period turned out "bonanza" to be exploited to maximize Russia's geopolitical and economic interests (*Krasnaia zvezda*, October 21, 2005; *Nezavisimaia gazeta*, October 31, 2005). Meanwhile, officials in Beijing

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<sup>20</sup> This section is partly based on Itoh (2007d).

and Tokyo have been perplexed by Moscow's opportunism, and their positioning for access to the ESPO project has turned out futile.<sup>21</sup>

Notwithstanding the huge potential of energy interdependence, mutual distrust in energy cooperation is worsening between China and Russia. China still must endure Russia's "paranoid" attitude emanating from the so-called "China threat" (*Zhongguo weixielun*), which is deeply rooted in the Russian mind-set (Cui, 2003, pp. 480–527). Securing a supply route from Russia is one of many alternatives, and access to other routes from Central Asia, North Africa, and South America is being seriously considered as well to maintain independence from Russia (Lu, 2005, pp. 25–26; Wu, 2003, pp. 267–268). It is noteworthy that the suspension of natural gas supplies to Ukraine in January 2006, regardless of Moscow's intentions, was serious enough to remind Beijing of the nightmare that they endured at the beginning of the Sino-Soviet conflict in 1960.<sup>22</sup> This incident ranked among the top ten major events associated with the oil economy in 2006 by one of the most widely read Chinese energy journals, *International Petroleum Economics* (*Guoji Shiyou Jingji*, 2007, 1, pp. 2–3).

Moscow's political maneuvering with Beijing and Tokyo with regard to the ESPO has not been successful. In fact, China and Japan are normalizing their relationship. In other words, Russia does not have any countermeasure against Sino-Japanese rapprochement. Furthermore, the temporary downturn in Sino-Japanese relations in the last few years of Jiang Zemin's term had more or less bottomed out by the end of the Koizumi administration. Overall, as Mike M. Mochizuki (2005, p. 135) reported, China and Japan "are more likely to establish a new equilibrium than to slide into a downward spiral" within the East Asian international system.

Contrary to internationally widespread rumors about his Asian policy, Koizumi's successor, Shinzo Abe, has taken a more or less concilia-

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21 Media reports on this very topic have been numerous. See *Huaiqiu Shibao* (March 12, 2003); *Sankei Shimbun* (January 28, 2003). For various interpretations of Sino-Japanese competition over the ESPO project, see Buszinski (2006); Goldstein and Kozyrev (2006); Liao (2007).

22 The author's interview with energy experts in Beijing in January 2006.

tory approach toward China in the energy field, despite the stalemate of the dispute over natural gas deposits in the East China Sea.<sup>23</sup> At the first Sino-Japanese summit to be held in more than five years immediately after Abe was elected Prime Minister, both leaders agreed to build a reciprocal strategic relationship in which energy and the environment were the priority areas for cooperation (JMOFA, November 18, 2006).

Their common interests include diversification of energy sources, reducing reliance on fossil fuels, ensuring stable access to energy supplies, and utilization of multinational frameworks. The Japanese Minister of Economy, Trade, and Industry, Akira Amari, reported that “*cooperation between the two countries is much preferable to competition that gives suppliers the upper hand and increases uncertainty* (International Herald Tribune, December 17, 2006).”

China and Japan have had no concrete form of policy adjustment toward supplying countries, including Russia, at the bilateral level until now. However, given the uncertainties and constraints concerning the development and production of hydrocarbon resources and Russia's xenophobic attitudes toward foreign capital, it is possible that Beijing and Tokyo may increasingly find that competition over the ESPO project makes no sense in view of the poor economic prospects for the immediate future.<sup>24</sup>

Furthermore, the gradual development of Sino-Japanese energy cooperation has also been reinforced by multilayered international frameworks beyond the domain of Northeast Asia, covering the Asia-Pacific. In December 2006, the energy ministers of five big energy-consuming

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23 The final solution of the Sino-Japanese dispute over the East China Sea is presently unforeseen, whereas ministerial level talks between the two governments have been implemented. The author is rather skeptical about the extent to which Sino-Japanese conflict on this issue can ultimately be analyzed in the context of the struggle over energy resources *per se*. It has more to do with matters of national boundary demarcation and protection of sea lanes for military ships, implying that the solution must be sought in the context of the Taiwan Strait issue between Beijing and Washington.

24 For possible forms and merits of energy cooperation among the consuming nations, formulated by Chinese, Japanese, and South Korean energy experts, see the Institute of Energy Economics, Japan (March 2006).

countries in the region, namely the United States, China, Japan, South Korea, and India, which account for one half of the world's energy consumption, gathered for the first time in Beijing to talk on creating international energy cooperative measures for ensuring stable energy supply and energy conservation. They agreed to continue dialogue under this framework annually and published a joint statement affirming a shared view of the importance of establishing an energy price-mechanism based on market principles, constructing an oil stockpiling system, and the need for transparency of information with regard to consumption and stockpiling (*Nikkei Net*, December 17, 2006).

At the Second East Asian Summit in January 2007, the leaders of the United States, Japan, China, South Korea, India, Australia, and New Zealand issued the Cebu Declaration on East Asian Energy Security, setting forth cooperative goals, including the reduction of dependence on conventional fuels and the encouragement of open and competitive regional and international markets providing affordable energy (ASEAN Website).

While the U.S.-Russia relations have gradually soured, Washington's arguments on "containing China," which appeared in the 1990s, have increasingly diminished in recent years. Even the U.S. concern about China's "aggressive" advancement toward oil equities on the global scale has not discouraged the former from integrating the latter into various energy-related regional frameworks. Energy has increasingly become one of the main agendas in the U.S.-China strategic dialogue as well, whereas initial expectations about the U.S.-Russia energy dialogue against the background of the post-9-11 partnership have reached a stalemate on the whole.

The United States' increasingly proactive initiatives towards energy issues in the Asia-Pacific have helped not to simply multiply policy coordination channels but also to consolidate the Sino-Japanese energy dialogue, given that Washington and Tokyo share a common interest in engaging Beijing as a "responsible stakeholder" in the region, including energy issues. The Center for Strategic and International Studies published a report in February 2007, *The U.S.-Japan Alliance: Getting Asia through 2020*, written by Richard L. Armitage and Joseph S. Nye, which reads as follows:

The United States, Japan, and others will be further affected by China's surging demand for energy and raw materials. Some of the consequences will likely be negative: higher prices for foreign crude, increasing environmental degradation, and competition over disputed maritime boundaries. But there will also be new opportunities for cooperation on energy efficiency, "clean-coal technology," and nuclear power. It may also be the case that China's increasing reliance on the outside world will present the United States and its friends with foreign policy opportunities.<sup>25</sup>

Although there exists virtually no regional multilateral framework regarding energy security in which Russia could either play a leading role or alleviate tensions between consuming and supplying countries in the Asia-Pacific, it has become increasingly obvious that major powers of the region have found "common languages" for energy security without Moscow's participation.

## CONCLUSION

There is no doubt that Russia has enormous potential in theory to exploit and enhance its presence in the Asia-Pacific by way of increasing energy supplies from the eastern flank of the country, as its national energy strategy indicates. However, the translation of the potential into reality awaits the solution of a number of uncertainties in the foreseeable future.

Moscow's ambition to ensure a great power status has not necessarily entailed an economically logical set of policies to accelerate developments of hydrocarbon resources that will require a massive scale of investments and introduction of new technologies. Behind increasing "confidence" of its national power against the backdrop of high oil prices, Russia has ironically tried to drive out as much foreign influence as possible. It is unknown when Russia will be able to ship massive amounts of crude oil, followed by natural gas, from East Siberia to the Asia-Pacific markets. However, *timing* is everything in business. When

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25 For the author's brief view of the role of the U.S.-Japan alliance, see Itoh (2006b).

it comes to the question of East Siberian development, time is running out for Russia, but not for others. Russia itself has recognized that it has been lagging behind the originally expected pace of exploiting the hitherto untapped vast eastern terrain of the country, whereas Moscow cannot overcome its downward spiral of traditional geopolitical interpretation of its relations with other regional powers.

As reported in an earlier article (Itoh, Ivanov and Daojing, 2005, p. 139), “In reality, it is not China or Japan, but Russia that wants to bring large volumes of its oil and gas to the markets of the Asia-Pacific (North-east Asia in the original text) in the most economical way.”

To the extent that, in Stephen Blank’s (2003, p. 569) concise words, “Russia is weak on all measures in Asia, and, according to any index of power, unlikely to regain strength; it needs Asia’s help to become competitive,” Russia may be losing its own opportunity. Gilbert Rozman (2007, p. 350) reports:

On many occasions in the nineteenth and twentieth Centuries, Russia had a chance to strike a new balance among its objectives, but it was too confident of its own superiority and placed too little value on the benefits of regional integration. It still needs to reduce the emphasis on geopolitics. Given the fluidity of the current situations, however, Russia has a chance to act.

There is no need for Russia to bite off more than it can chew and to behave (or even pretend) as a great power if it deliberately wishes not only to make the best of its opportunity with natural resources but also to be welcomed as a “responsible stakeholder” of the Asia-Pacific’s energy security. For example, if Russia were a rational actor, it could have avoided the geopolitical tone of energy projects in any direction and shown its own initiative to “open” the energy development of East Siberia for a multinational commercial scheme by speeding up the improvement of the investment climate with regard to, for example, the promotion of information transparency about reserves and the establishment of clear and stable legal frameworks.

Yet, whether Russia will appreciate multinational cooperation in the east, seeking a positive-sum game, by denying the applicability of a zero-sum game for its own sake, remains to be seen.



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