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The Kremlin's China Problem

By Alexei Bayer

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China’s success has been very important for Russia. Of course, Russian leaders find it hard to admit that they envy the Chinese. After all, when Communists took power in Beijing in 1949, China was a younger Communist brother, learning Marxism-Leninism at the feet of their more experienced Soviet comrades. Then, after Josef Stalin died in 1953, there were three decades of tension and hostility. They even fought a seven-month battle along their long shared border during the height of the Chinese-Soviet split in 1969.

But to Russian nationalists, Communists and others nostalgic for the Soviet era, China provided a highly successful alternative to Western democracy espoused by Mikhail Gorbachev and Boris Yeltsin. In those circles, democracy and market capitalism in Russia are seen as a failure, resulting in corrupt privatization, winner-takes-all crony capitalism and the humiliating capitulation in the Cold War. Many in Russia believe that China made the right decision to leave the monopolist Communist Party apparatus in charge and curb political freedoms while implementing market reforms.

In the Kremlin, China is seen as a natural ally against the United States. Moscow eagerly chimes in with Beijing in criticizing the U.S.-dominated "unipolar" world, its huge debt and weakening dollar. Russia would like to join forces with China to find an alternative to the dollar as a reserve currency, but the Chinese are understandably reluctant to undermine the greenback since the bulk of China's $3.2 trillion worth of hard currency reserves is held in dollars.

The Kremlin also sees China as an alternative to the European market for oil and natural gas. Russia hopes that its oil pipeline from Eastern Siberia to the Pacific Ocean and China will not only boost its export revenues but give the Kremlin more leverage as it tries to exert political pressure on the West by turning its energy spigot on and off when necessary.

But all this may come crashing down. China is teetering on the brink of an economic crisis. Economists worry that the Chinese economy may be facing a hard landing. The Chinese real estate market, which is every bit as inflated as the U.S. bubble that burst in 2008, is starting to come off the boil. Prices are stagnant or declining in more than half of urban markets.

While China may not have a subprime mortgage problem that hit the U.S. banking system, Chinese banks sharply increased lending after 2008 on the instructions from the government to counteract the global economic slowdown. The amount of loans issued by Chinese banks, at nearly $8 trillion, dwarfs both Greece's $350 billion of debt and even Italy's $2.5 trillion. With the jobless rate rising, the debt burden may undermine China's notoriously opaque banking system.

True, nobody has made any money doubting China's resilience over the past three decades. But a crisis has to come sooner or later, especially since the Chinese economy is so dangerously unbalanced.

The Communists in Beijing have been living in mortal fear of an economic crisis, afraid that it would trigger political unrest. They never let the economy release any steam in a smaller downturn, which means that when a crisis does eventually occur, it is bound to be a major one. How the rigid, one-party political system will fare is anyone's guess.

In any case, China is likely to be preoccupied with its economic problems in coming years. As a result, Beijing may be drawn much closer to Washington, leaving Moscow on its own to combat the U.S.-dominated "unipolar" world.

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