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Russia's Gas Pact With China Not About Ukraine

By Morena Skalamera

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Picture is of Chayandinskoye oil field, which will supply some of the gas to China.

After a decade of delays, on May 21 Russia and China clinched a $400 billion 30-year deal on the delivery of 38 billion cubic meters of gas per year starting in 2018. In Shanghai, President Vladimir Putin called the deal an "epic event."

Although at the eve of the summit a cohort of skeptics argued that another impasse was likely, the deal was inevitable. While the crisis in Ukraine may have spurred the deal's signing, China's attractive terms and Europe's long-planned pivot away from restrictive Russian gas contracts, in addition to long-term geopolitical concerns, made the deal a foregone conclusion.

In the past, observers had largely focused on the pricing impasse, which indeed proved to be the main stumbling block. Gazprom was hoping for a price of $10 to $11 per mmBtu from China, which is higher than what China is believed to pay for gas from Turkmenistan.

Price has not been the only impediment, however. Russia's resistance to China's equity investments, disagreements over the preferred route, the meager presence of natural gas in the Chinese energy mix and enduring mistrust on both sides have all contributed to the deal's delay.

It is the resolution of these other domestic conditions and energy realities on both sides — rather than the price per se — that determined the deal's breakthrough.

China offered a loan of about $50 billion to finance both the pipeline and Russia's eastern gas fields as part of the Chinese "investment package" in eastern Siberia and the Far East. Like in other parts of the world, the Chinese "going abroad" strategy includes not only energy infrastructure, but also investment in roads, bridges and other projects in exchange for a long-term stable commitment on part of the receiving country.

In Moscow observers also emphatically point out Russia has gained much by the agreement, with the final price set at about $350 per thousand cubic meters, or roughly comparable to the price Gazprom charges its European customers.

Gazprom also forged ahead with the deal due to the fact that it has been on shaky grounds in Europe, its most lucrative export market. In the midst of greater liquidity on European Union gas hubs and of the European Commission's push for greater liberalization of the EU's gas markets, European buyers have challenged Gazprom's traditional pricing mechanisms, thereby forcing it to turn decidedly eastwards.

These tensions with Europe originated well before the Ukraine crisis but have now reached a tipping point, giving China leverage over Russia.

In 2013, Russia conceded on building a gas pipeline through eastern Siberia to China and on May 21 was pushed to compromise on price in exchange for China's acquisition of equity in Russian exploration and production. Recently, a potential acquisition by China National Petroleum Corporation of 25 percent of the Chayanda Gas Field was mentioned for the first time.

Taking into account the Ukraine crisis, what could have Russia realistically hoped to achieve? Just before the crisis, Putin was in trouble on the home front. Russia has slipped into economic recession even as the price of oil, its most lucrative export revenue, continued to average $110 per barrel. Instead of enacting unpopular reforms that would threaten his "power vertical," Putin needed another market that pays: China.

The timing has been perfect for the Chinese as well. With pollution becoming an urgent political priority, the country's imports of natural gas are set to boom. In the next 10 years, however, China's shale gas production may not seriously take off because off a series of "above ground" obstacles. This, of course, works in favor of a deepening Chinese-Russian gas relationship. Moreover, from a security perspective, Russia also offers greater independence from sea lanes dominated by the U.S. Navy.

Economically for Beijing, the deal makes sense to restrain the liquefied natural gas price premium in the Asian market that will otherwise continue to rise if Japan and South Korea find themselves competing with China for LNG supply. With a partially eased Chinese

demand, supply in the Asia-Pacific region will outstrip demand and the market will become a battleground for gas exporters, pushing the price down to the consumers' benefit.

On both sides, powerful drivers have been in motion to bridge the price gap and concretize the deal on May 21.

Finally, many have speculated whether this deal goes beyond commercial terms and encompasses broader political arrangements that could be detrimental to U.S. interests in the Asia-Pacific region.

As cooperation in gas moves forward, the Chinese-Russian axis is gaining greater geostrategic weight in world affairs. Yet, even as potential for Chinese-Russian gas cooperation grows, rivalry remains conspicuous, and it is no surprise that Russia is often disinclined to defer to China on matters involving East Asia.

Russia worries about Chinese naval intentions in the northern Pacific and Arctic region. Even as Moscow and Beijing have been growing closer, Russia has also been improving ties with Japan. Russia does not support China's extensive maritime claims and has recently backed Vietnam, a major Russian arms client, in its dispute with Beijing over Chinese claims in the South China Sea. Russia also announced it would allow state-owned PetroVietnam to explore for oil in the Pechora Sea, located in the Arctic off Russia's northwest coast.

Additionaly, there is still a conspicuous rivalry between the two in Central Asia, which has of late been exploring closer ties with China. While Putin remains distracted in Ukraine, China will certainly use this moment to cement influence in this region. Finally, with Moscow increasingly balancing China’s presence in East Asia, there is neither the commitment nor the ability to act in concert against Western interests.

If you look at the future in regional terms, energy could be driving new patters in Chinese-Russian affairs. Nevertheless, the very driver of such cooperation is economic benefit more than a parallel, albeit much less pronounced, interest to counterbalance global influence.

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