

# China-Russia: the progressive building of a major trading block

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In the broader context of deepening Russia-China political relations throughout the 1990s, mostly since the start of a “strategic partnership” in 1996, the economic linkages between the two countries have been largely considered “the weakest link” until very recently.<sup>1</sup> Due to the widespread skepticism in Russia about the possibility that intensifying economic exchanges with China would lead to a dependence on what was then, already in the second half of the 1990s, expected to become a more successful economy in a short period of time, the Russian leaders refrained from deepening economic relations with China beyond the limited cooperation and exchanges that were planned by Moscow and Beijing after the establishment of the Russian Federation in 1992. This is why, throughout the 1990s, bold mutual ambitions to reach high levels of bilateral trade between the two countries went largely and invariably unmet, so that the value of total bilateral trade in 1999 was less than in 1992.<sup>2</sup>

During the three decades that have almost passed since the collapse of the Soviet Union, Russia and China significantly intensified their economic and trade relations, progressing from a “strategic partnership” to a treaty of “friendship and cooperation” signed in 2001. This was the result of both domestic and international factors. On the domestic side, Russia developed the need to build stronger sources of growth than energy exports to the West, who proved to be unreliable as an economic partner following the after-Ukraine sanctions. This led to major changes in the policy priorities of the Russian government, who had until then resisted the Chinese willingness to improve economic cooperation on the concern that this would head to an unbalanced relation to the benefit of China. Within the broader context of changing geopolitical conditions, Moscow progressively shifted its strategic focus from West to East: over less than a decade, the two countries managed to revitalize their once weak and troublesome economic partnership to such an extent that they are now the key players in a recently formed trading block covering most of the landmass across the Eurasian continent.

After analysing the bilateral trade relations and structure through the 1990s, the chapter will focus on how the difficulties encountered by the two countries in building stronger economic relations came to an end through the following decade, increasingly since the mid 2000s, when bilateral economic ties started to

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<sup>1</sup> Jeanne Wilson, ‘The Weakest Link’, in Jeanne Wilson, *Strategic Partners: Russian-Chinese Relations in the Post-Soviet Era*, Routledge, 2015, pp. 61-92.

<sup>2</sup> Wilson, 2015, p. 61.

grow stronger, following institutional arrangements and agreements that have fostered a progressive improvement of economic cooperation and regional integration. Today China and Russia are major economic partners, linked together by increasing trade and investment linkages: in 2017, China-Russia trade rose 20.8 percent to more than 84 billion U.S. dollars, and by that time China had remained the largest trade partner of Russia for the eighth consecutive year.<sup>3</sup> According to Chinese Customs data, in the first eight months of 2018, bilateral trade increased 25.7 percent year on year, well above China's overall foreign trade growth of 9.1 percent.<sup>4</sup>

The ability to overcome the unfavourable framework in which bilateral economic relations were set at the times of the former USSR was the result of strong mutual commitment to advance bilateral economic cooperation. Besides bilateral relations, major regional cooperation arrangements have been signed that include both countries, most notably the Eurasian Economic Union (EAEU), which includes Russia, Belarus, Armenia, Kazakhstan, and Kyrgyzstan, makes up all the landmass between China and the EU, it has a population of 183 million people with a gross domestic product of more than US\$4 trillion, and has been growing at trade volume rates of 30 percent per annum. Moreover, the Shanghai Cooperation Organization (SCO) has recently included economic cooperation besides the more traditional aim of security cooperation. More recently, a number of Free Trade Agreements (FTA) were signed between the EAEU and a number of countries across Europe and Asia, including China are building a major trading area that extends from East Asia to the Eastern borders of Europe, from the Arctic to India.

The chapter will then turn to review the mounting speculations inspired by the progressive remaking of a Eurasian economic and trade block about the implications for the EU, in terms of EU relations with Russia, EU relations with China, EU relations with their partner countries and also for the EU overall economic security strategy. The widespread view, at least until the global financial crisis, that the world was organizing into three major trading regions – the Americas, Europe with Northern Africa, the Middle East and Russia, and Asia – has proven largely divergent from the actual development of international trade relations. Since sanctions were imposed on Russia back in 2014, the country has been increasingly and deeply intertwining with China, not just through trade, but also investment, energy, transport, and now holds much deeper relations with China than with Europe, once Russia's major historical economic partner. As trade usually brings cooperation and peace (as witnessed by the history of the EU), whereas difficult trade relations often lead to larger frictions in international affairs (as the world is now and again faced with as a result of the current US administration's policy stance), some concluding remarks will

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<sup>3</sup> [http://www.xinhuanet.com/english/2018-09/11/c\\_137460976.htm](http://www.xinhuanet.com/english/2018-09/11/c_137460976.htm) .

<sup>4</sup> [http://www.xinhuanet.com/english/2018-09/11/c\\_137460976.htm](http://www.xinhuanet.com/english/2018-09/11/c_137460976.htm) .

elaborate upon the need for securing positive trade relations with the new Eurasian trading region as a major policy priority for the EU.

### **Difficult Russia-China trade relations in the 1990s**

The trade relations between the two biggest former command economies have always been rather cumbersome, since the establishment of the Russian Federation. The main reason for this is to be attributed to the fact that “trade between the Soviet Union and China consisted largely of a protocol trade consisting of bilateral contracts concluded between governmental structures”<sup>5</sup>, largely regulated on barter terms, and little room was given to the high complementarities in the two countries’ economic structures, which would naturally suggest a series of areas of mutually beneficial trade integration, namely technology, agricultural and energy cooperation.

A number of other reasons were raised that were deemed responsible for the difficulties encountered by the two countries in building stronger economic relations, including the weakness of the Russian economy<sup>6</sup>, the lack of complementarity between the structure of the two economies, the widespread transportation bottlenecks and lack of connectivity between the two countries, the misalignment of policy priorities in the two countries and also some hostility in the Russian perception of the initial low quality of Chinese production and of an increasing Chinese influence to the possible detriment of domestic economic independence.<sup>7</sup>

For all of the reasons above, bilateral trade between Russia and China remained at very low levels throughout the 1990s and until the early 2000s (Figure 1). During those years, Russia’s total trade with China was less than 2% of Russia’s total trade. Europe was a much bigger partner by far, with over \$44 billion exports in 1995 and over \$72 billion in 2000, compared to \$3.5 billion to China in 1995 and \$5.2 billion in 2000, according to data from Unctadstat<sup>8</sup>. Moreover, despite severe flaws in official trade data do not allow precise calculations, Russia run a trade surplus with China until 2004. During the 1990s, the commodity composition of Russian exports to China was similar to what it had been in the previous decades, with fertilisers, polymers of ethylene and telecommunication equipment being the largest exported items (Figure 2). Natural resources, namely oil and gas, were not yet the most important item in the bilateral trade structure, as they are today.

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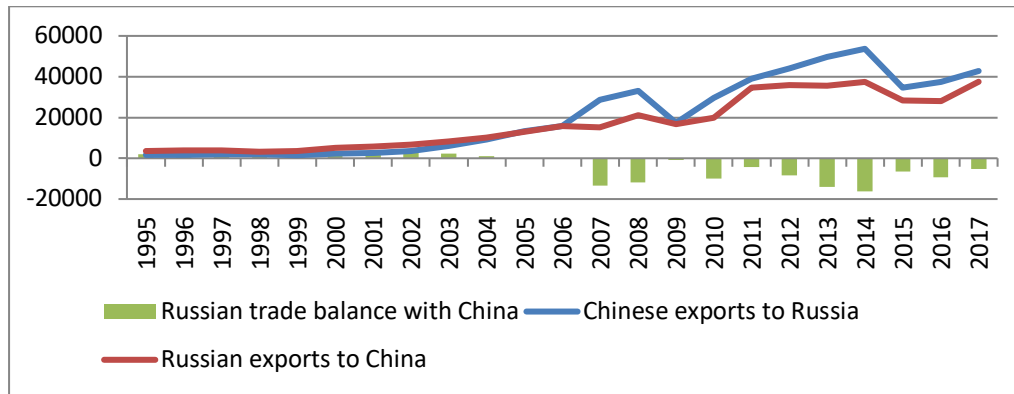
<sup>5</sup> Wilson, 2015, p. 72.

<sup>6</sup> Wilson 2015, p. 61.

<sup>7</sup> For a detailed history of bilateral economic relations until the early 2000s, see Wilson, 2015.

<sup>8</sup> <https://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx> .

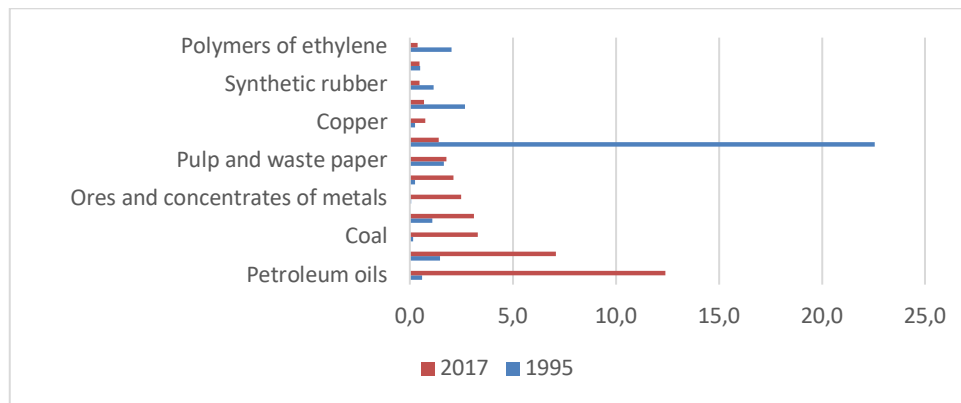
Figure 1. Russia-China trade since 1995 (mln USD)



Source: author's elaboration on data from UNCTADStat

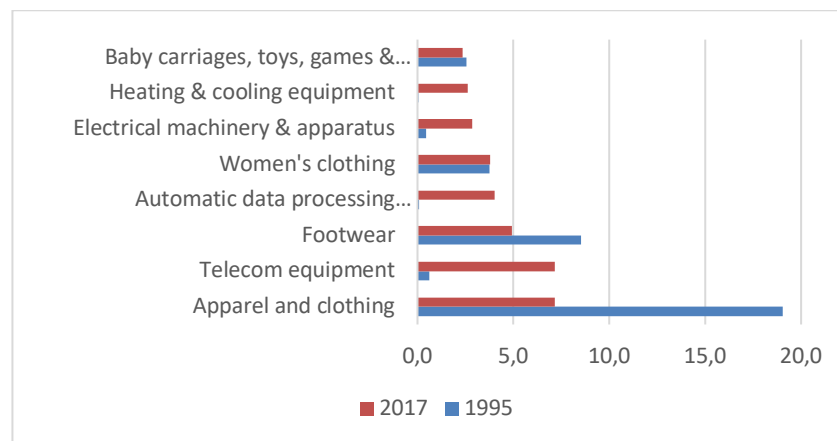
The early 2000s marked an increase in the trade intensity between the two countries, and China became a major trade partner for Russia. In 2002 bilateral trade already exceeded that of Russia with Italy (once its largest trading partner) and the mid-2000s marked a significant shift in the bilateral trade balance as well as in the commodity composition of bilateral trade flows. Although the EU altogether remained the largest trading partner for Russia (with 45% of Russian exports going to the EU, around \$160 billion compared to 11% to China, and 36% of imports coming from the EU, compared to 21% from China, according to data from Unctadstat), bilateral trade with China started to get a faster pace in both directions, following increasing cooperation and connectivity between the two countries, as well as a number of institutional arrangements to foster trade linkages (see below). The structure of Russian exports to China progressively changed in favour of energy exports already since the early 2000s, when Russia's dependence on natural resource exports intensified. This is especially true in the case of Russia's exports to China, which increasingly shifted to energy trade, as a result of a growing need by China to secure oil supplies, agricultural goods and semi-finished goods on the one hand, and on the other hand to benefit from a large neighbouring market for light manufactures such as clothing and apparel, footwear, telecom equipment, data processing machines and electrical appliances (Figure 3).

Figure 2 Commodity composition of Russian exports to China, 1995 and 2017 (% on total)



Source: author's elaboration on data from UNCTADStat

Figure 3 Commodity composition of Russian imports from China, 1995 and 2017 (% on total)



Source: author's elaboration on data from UNCTADStat

The shift in the Russian structure of trade with China was also the result of an increasing amount of Chinese investment in the form of funding of energy projects with Chinese funding and acquisitions of stakes in major energy corporations in Russia by Chinese stakeholders. Therefore, Chinese acquisitions in the Russian energy sector (over \$26.5 billion since 2006, more than half of total Chinese direct investment to Russia over the same years, according to data from China Global Investment Tracker database by the American Enterprise Institute<sup>9</sup>) were a chief vehicle in the process of building a convergence of interests between Moscow and Beijing on energy cooperation. Such cooperation had long been searched for by China, but became a reality only when the Russian government found itself in the urgent need for a reliable export market with large availability of funding. This has been chiefly expressed as follows: “As Russian resistance to Chinese upstream investments has declined in the

<sup>9</sup> <http://www.aei.org/china-global-investment-tracker/>.

aftermath of the post-Ukraine sanctions, Chinese officials have become more interested in opportunities in Russia. Xi explained, ‘...we need to help neighbors in times of crisis... .In response, we hope that neighboring countries will be well inclined towards us, and we hope that our appeal and our influence will grow’ (Xi 2013a: 327<sup>10</sup>)”.<sup>11</sup> Since 2013, China has invested several billion USD to acquire stakes in Russian energy companies, with the highest level reached in 2017, when more than \$5.7 billion were invested in Russian oil and gas activities.<sup>12</sup>

As a result of the major energy infrastructure projects that have allowed the transportation of gas and electricity towards East Asia, Russia is today’s China’s largest source of both crude oil and electricity imports and its fifth largest source of coal imports. Energy trade is gaining even more importance, as the China-Russia east-route natural gas pipeline is expected to send up to 38 billion cubic meters of gas to China each year upon completion planned for 2020. Energy cooperation between the two countries gained impressive speed since 2013, and even more in 2014. Due to the sanctions imposed on Russia after its invasion of Crimea in 2014, Russia’s energy export industry has been forced to redefine a long-term strategy, as Europe has starting diversifying its gas suppliers (e.g. in favour of Qatar and the United States) to limit the dependence on Russian suppliers. In face of Western economic sanctions to Russia, with the support of Chinese funding, Russia launched a landmark Arctic gas project, the Yamal liquefied natural gas (LNG) project in Russia’s Yamal Peninsula in the Arctic, controlled by Russia’s Novatek.<sup>13</sup> Yamal was a first attempt at tapping the huge hydrocarbon deposits in the Arctic and at the same time testing the viability of the northern sea route to China.<sup>14</sup> Yamal LNG opened its first production line in December 2017, with both China National Petroleum Corporation and China’s Silk Road Fund owning stakes in the project. Yamal LNG will allow shipping gas to China (54% of contracted output, according to the Financial Times, in about 15 days, compared to almost twice that time when shipping gas to China through Europe and the Suez canal. At least 4 million tonnes of LNG will be shipped to China every year after the completion of more production lines.

Besides gas, oil has also become a major sector of energy cooperation. Chinese investment in Russian oil sector have grown rapidly, including a contract, between Russia’s state-owned Gazprom and the China National Petroleum Corporation for the construction of a 2,500-mile gas pipeline to China’s Heilongjiang province. A further agreement would secure an additional 30 bcm of gas to China’s Xingjiang Province

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<sup>10</sup> Xi, J. (2013a) ‘Diplomacy with neighboring countries characterized by friendship, sincerity, reciprocity, inclusiveness’, 23 in Xi Jinping The Governance of China, Beijing: Foreign Language Press, pp. 3259.

<sup>11</sup> Wishnick, 2017, p. 11.

<sup>12</sup> <https://www.cnbc.com/2018/09/11/russia-china-consider-investments-worth-more-than-100-billion.html>

<sup>13</sup> Jiang, W. (2015) ‘Energy Security, Geopolitics and the China-Russia Gas Deals’, China Brief 15(2)

<sup>14</sup> <https://www.ft.com/content/515d451c-dc11-11e7-a039-c64b1c09b482> .

from western Siberia for 30 years. The combined supplies of those pipelines would make China the largest customer for Russia, larger than Germany, its current largest customer.

The early 2000s marked the beginning of growing trade imbalances between the two countries, in the form of a rising Russian trade deficit vis-à-vis China, together with reinforcing trade patterns in which Russia mainly serves as a supplier of natural resources in exchange for manufactured goods. Oil and gas pipelines from Siberia to China has contributed significantly to the progressive pivoting of bilateral trade on energy and therefore to the growing interdependence between the two. This was exactly the form of trade dependence that former political leaders in Russia had resisted during the 1990s, concerned that such a trade pattern would make Russia grow increasingly dependent on natural resources (fuels and minerals account for 63% of Russian exports), to the detriment of industrial development. The small share of manufactures exported to China (22% of the total) is the result of cooperative agreements in the nuclear, aviation, and aerospace industries, according to which Russia has maintained a role of supplier of semi-finished machinery and parts of electrical equipment to China. A further area of energy cooperation between China and Russia is nuclear energy. The two countries will cooperate on nuclear power plant technology development: “both countries have signed nuclear deals with Iran, Egypt, Sudan and Turkey, and both have looked to dominate nuclear export markets”.<sup>15</sup>

Russia’s recent pivot to Asia<sup>16</sup>, and most notably to China, has been considered by some scholars as a ‘strategic necessity’ “to ameliorate the economic and demographic situation in the Russian Far East and Eastern Siberia”<sup>17</sup>, but also as a broader “opportunity for Russia to break out of the economic, security, and geographic traps she finds herself in within the Western-dominated international order”<sup>18</sup>. However, there are also opposite views that emphasise the detrimental effect that Russia-China deepening economic ties might have on the future of Russian industrial development. According to many scholars, the bilateral relationship between Russia and China seems an ever-deepening, but at the same time an increasingly imbalanced one. A relationship that would perpetuate an imbalance between Russia supplying raw materials to China and importing Chinese manufactures. This view suggests that “Russia

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<sup>15</sup> Sam Reynolds, Why the civil nuclear trap is part and parcel of the Belt and Road Strategy, *The Diplomat*, 2018, available at <https://thediplomat.com/2018/07/why-the-civil-nuclear-trap-is-part-and-parcel-of-the-belt-and-road-strategy/>

<sup>16</sup> Hill, F. and Lo, B. (2013) ‘Putin’s pivot: why Russia is looking East’, *Foreign Affairs*, July 31 <https://www.foreignaffairs.com/articles/russian-federation/2013-07-31/putins-pivot>. Kuchins, A. C. (2014) ‘Russia’s Asia pivot’, *Asian Survey* 54(1): 12937. Nye, J. S. (2015) ‘A new Sino-Russian alliance?’, *Project Syndicate*, 12 January available at <http://www.project-syndicate.org/commentary/russia-china-alliance-by-joseph-snye-2015-01>, 21 June 2016. Swantsroem, N. (2014) ‘Sino-Russian relations at the start of the new millennium and beyond’, *Journal of Contemporary China* 23(87): 48097.

<sup>17</sup> Maxim Bratersky, Russia’s Pivot to Asia: Situational Interest or Strategic Necessity?, *Asian Politics and Policy*, 2018, Volume 10, Issue 4, pp. 584-596.

<sup>18</sup> Bratersky, 2018.

should shift the focus of its export policy from negotiating politically driven large projects toward more intensive promotion of consumer goods exports.”<sup>19</sup>

However, an interesting alternative perspective on the growing interdependence between Russia and China has been recently offered on the claims that both countries suffer from resource vulnerabilities, therefore the widespread view that increasing economic interdependence might put Russia in a more worrying position vis-à-vis China than the other way around might be partly overstated.<sup>20</sup> According to this view, “Russia’s fears of becoming China’s resource appendage are more widely discussed than are Chinese insecurities about adequate and secure resource supplies”<sup>21</sup>, but in fact the two countries have developed mutual interdependence.<sup>22</sup> In particular, China has grown more and more dependent on Russia’s resources, namely oil and gas, but also water and timber.<sup>23</sup>

Oil and gas dependence and the relative dependence on import routes for energy supplies has been high on the policy agenda of Chinese leaders, who have stressed the need to diversify both suppliers and import routes. This has made energy cooperation with Russia a high priority for China since the times of Hu Jintao. Russia’s position as a major resource supplier to China would compensate the strong dependence of Moscow on Chinese demand. As Russia has possibly become the leading oil supplier to China in 2018, as well as the leading supplier of gas.

Water also represents another source of resource vulnerability for China, compared to the abundance of renewable water resources available in Russia, precisely at the eastern border with China. The so called ‘virtual water’, i.e. the water used in production processes, is also a potential source of dependence for China on Russia. China is currently the largest importer of Russian timber, and also agricultural cooperation has progressed to the extent that China is growing as a larger food net importer and some of the goods where tariffs have been levied during the current US-China trade war are agricultural products. These forms of resource vulnerability in China make the country equally dependent on her suppliers, as the latter are on China being their major export market.

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<sup>19</sup> Igor Makarov, Ilya Stepanov, Vasily Kashin, Transformation of China’s Development Model under Xi Jinping and its Implications for Russian Exports, 2018, Volume 10, Issue 4, pp. 633-654.

<sup>20</sup> Elizabeth Wishnick, In search of the ‘Other’ in Asia: Russia–China relations revisited, The Pacific Review, 2017, Volume 30, Issue 1, pp. 114-132.

<sup>21</sup> Wishnick, 2017, p. 11.

<sup>22</sup> Zhao, H. (2013) ‘Does China’s rise pose a threat to Russia?’, 26 April; China Institute of International Relations, [http://www.ciiis.org.cn/english/2013-04/26/content\\_5908664.htm](http://www.ciiis.org.cn/english/2013-04/26/content_5908664.htm).

<sup>23</sup> Economy, E. C. and Levi, M. (2014) *By All Means Necessary: How China’s Resource Quest is Changing the World*, New York, NY: Oxford University Press.



## **Improved connectivity and trade arrangements since the early 2000s**

The intensifying economic linkages between Russia and China since the early 2000s benefited from significant progress in alleviating transportation bottlenecks between the two countries, traditionally characterised by an important lack of infrastructure acting as a serious impediment to the development of trade relations. New border crossings were opened, air and shipping links were increased, new rail tracks were built and more communication facilities developed. However, the border between the two countries, although over 4100 km long, is characterised by relatively low accessibility; the western section runs for more than 4000 km, starting at the eastern China–Mongolia–Russia tripoint until the China–Russia–North Korea tripoint just a few km before the Pacific Ocean; the much shorter (less than 100 kilometres) western border section is between Russia's Altai Republic and China's Xinjiang and runs in the mostly snow-covered high elevation area of the Altai Mountains until its western end point is the China–Kazakhstan–Russia tripoint.

Due to the difficult geographical features of their common border, Central Asia remains a very important region on which China–Russia trade linkages depend, but that region is itself an area with the most severe lack of connectivity infrastructure in the world. According to World Bank data, transportation costs for many central Asian countries are still extremely high, which makes the price of imported goods for those countries much higher than it could be if adequate connectivity was in place. For example, Tajikistan currently faces the highest cost in the world to import with over \$10,000 per container compared to a global average of \$1,877.<sup>24</sup> Imports are particularly costly also for Uzbekistan, one of the two double-landlocked countries in the world, i.e. whose neighbouring countries do not have a direct access to the sea.

The combination of the rich resource endowments of Central Asian countries, their growth potential, their geographical position as a potential bridge from the eastern part of China to the western part of Russia and also from China to Europe (two major trade partners vis-à-vis one another) made Central Asia a policy priority in the eyes of Beijing since well before the recent launch of the Belt and Road Initiative in 2013. After 2001, a further geo-political motivation added to the above, i.e. the proximity of the region to Afghanistan, Iran, Pakistan and Iraq, a potential “arc of instability”.<sup>25</sup>

Besides transport connectivity, Russian–Chinese relations benefited from effective bilateral mechanisms and agreements with China, and their subsequent institutional development. This major shift in the tenor

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<sup>24</sup> <https://eurasianet.org/the-belt-and-road-through-urasia-who-wins-and-how> .

<sup>25</sup> Johannes Linn, *Central Asia: A New Hub of Global Integration*, 2007, available at <https://www.brookings.edu/articles/central-asia-a-new-hub-of-global-integration/>

of Russian-Chinese economic relations was marked by the arrival of Vladimir Putin on the Russian political scene, with a more attentive approach to domestic economic interests compared to those of Gorbachev in the 1980s. The Putin administration was in favour of the establishment of large-scale high-technology collaborative projects as a major means to increase trade ties between Russia and China, as noted in the 2002 joint communiqué between the heads of government, stating that “work should be done to lay a foundation for long-term stability of trade cooperation by increasing the share of high-technology, mechanical- electrical and other high value added products so as to improve the product mix and develop economic ties of advanced forms”<sup>26</sup>. However, it is precisely during those years that the structure of bilateral trade between the two countries started to become rather biased towards Russian energy exports in exchange for Chinese manufactures, and cemented Russia’s dependence on energy exports. Export concentration increased and along with it also trade disparity, a condition that had been long resisted by the previous administration. The economic imbalance with China has deepened, China is now Russia’s largest trading partner (although the EU altogether is a much bigger partner than China), and the bilateral relation has now become a strategic partnership aimed to counterbalance the United States’ global influence.<sup>27</sup>

The development of Russia-China trade relations extends well beyond the bilateral linkages to the broader range of institutional arrangements at the regional level. Initially, Russia and China have been chief actors in a series of cooperation and trade agreements, as both countries had ambitions to govern the trade integration process around each of them, competing with each other to expand their respective areas of influence among neighbouring countries.

First and foremost, the **Eurasian Economic Union (EAEU)**, between Russia, Belarus, Kazakhstan, Armenia, and Kyrgyzstan, was formed on 1<sup>st</sup> January 2015. The economic union has a population of 183 million people and a gross domestic product of more than US\$4 trillion, and has been growing at trade volume rates of 30 percent per annum. As the EAEU comes right up to the EU border via Belarus, and its borders with Latvia, Lithuania and most significantly, Poland, it has the potential to shake up and alter European trade flows between the EU and China and possibly to India and ASEAN as well.

The EAEU may appear at first glance to be a recreation of the old Soviet bloc, as member countries show a high degree of complementarity and intra-EAEU trade was up 38% in 2016. However, the region is also very much open vis-à-vis external trade flows, unlike in the history of the Soviet bloc. The Eurasian Economic Union’s share in world exports is 3.7 per cent, and its share in imports is 2.3 per cent. If it were a country, in GDP terms it would be the world’s fourth largest economy, just behind Japan but

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<sup>26</sup> Wilson, 2014, p. 69.

<sup>27</sup> Alexander Lukin, *China and Russia: The New Rapprochement*, 2018, Polity.

ahead of Germany. It is for these reasons that numerous countries have applied for Free Trade Agreements with the EAEU. Among them are India, Singapore, Iran, and Turkey as part of 40 countries currently involved in FTA negotiations. As we will discuss below, the Union has recently signed an FTA with China, since the early 2019. Vietnam is currently the only other Asian nation to possess an FTA with the EAEU, in a deal that has seen Russian investment into the country rise from close to zero to US\$10 billion in just two years.

Mainly considered as Russia's answer to the EU, at times when the latter started to become a more difficult partner due to the beginning of the economic sanctions in 2014, the EAEU should also be considered a Russian reaction to the increasingly pushy attitude by China in trying to expand the scope of the **Shanghai Cooperation Organization (SCO)**, or Shanghai Pact. SCO is a Eurasian political, economic and security alliance, the creation of which was announced on 15 June 2001 in Shanghai, China by the leaders of China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan, and Uzbekistan; the SCO Charter, formally establishing the organisation, was signed in June 2002 and entered into force on 19 September 2003. The original five nations, with the exclusion of Uzbekistan, were previously members of the Shanghai Five group, founded on 26 April 1996. Since then, the organisation has expanded its membership to eight countries when India and Pakistan joined SCO as full members on 9 June 2017 at a summit in Astana, Kazakhstan. SCO includes some of the most promising countries in terms of growth potential in the near future, among the next generation of emerging economies, such as Pakistan, Uzbekistan and Kazakhstan. Moreover, Belarus, Armenia, Vietnam, Iran and Israel are considering accession. Today SCO accounts for 21% of global GDP, compared to 22% in the EU.

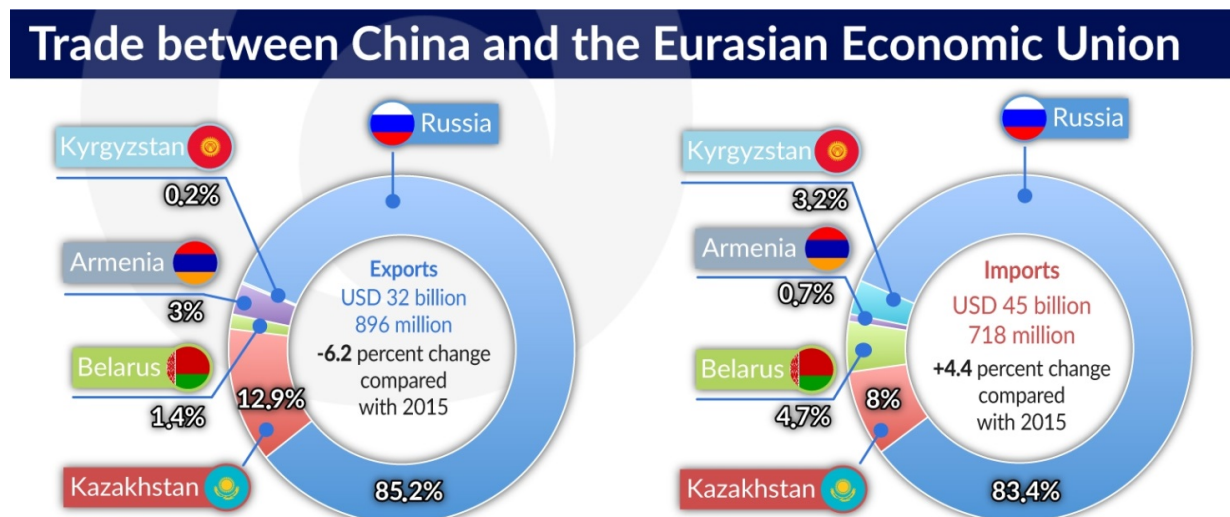
A major impetus to China-Russia bilateral ties has been recently given by the series of meetings of the Eastern Economic Forum, established by Putin in 2015, held each year in Vladivostok in just four years, the EEF has become the biggest international platform for discussing the strategy for developing political, economic and cultural ties between Russia and Asia Pacific. Among the major developments the recent **EAEU-China FTA** has the potential of becoming a real game changer not just in regional economic relations but also on a global scale, to the extent that, firstly, the FTA includes a number of countries that make up a vast majority of the landmass between Asia and Europe, and secondly, overcomes the competition between China and Russia to build their own separate sphere of economic and political influence in Central Asia.<sup>28</sup>

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<sup>28</sup> Kim, Y. and Blank, S. (2013b) 'Same Bed Different Dreams: China's 'peaceful rise' and Sino- Russian Rivalry in Central Asia', *Journal of Contemporary China* 22(83): 773390. Sophia Lian 2018, China and Russia: Collaborators or Competitors?, <https://www.cfr.org/blog/china-and-russia-collaborators-or-competitors> . <https://www.cnbc.com/2018/09/14/china-russia-ties--more-rivalry-than-allaince.html>,<https://carnegieendowment.org/2018/02/28/cooperation-and-competition-russia-and-china-in-central-asia-russian-far-east-and-arctic-pub-75673>

The agreement which is the first major systematic arrangement ever reached between the two sides, covers 13 aspects, including customs cooperation, trade facilitation, intellectual property rights, sectoral cooperation and government procurement, as well as e-commerce and competition. The goal is to reduce non-tariff trade barriers and promote the in-depth development of China's economic and trade relations with the Union and its member states. Russia's own trade with China is set to hit US\$100 billion, and the FTA will dramatically enhance this. The Russia-China trade space is growing at a faster rate than China's trade with the EU. Russia is a front runner in trade with China within the Union, accounting for more than 85 per cent of exports to China (worth almost USD33bn) and for more than 83 per cent of all imports from China to the EAEU (almost USD45bn). Other EAEU member states also run positive relations with China (Figure 4), but especially on the investment rather than trade side.

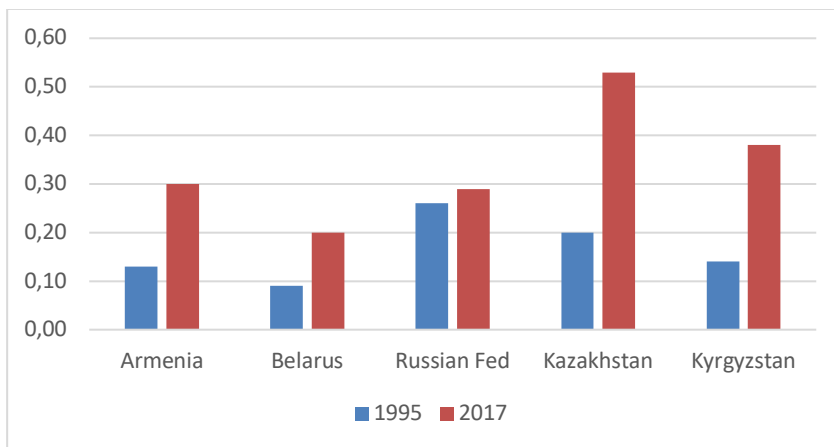
Figure 4



Source: Official website of the Eurasian Economic Union, <http://www.eaeunion.org/>

Commodity turnover between the EAEU countries and China amounted to more than 100 bln US dollars already in 2017. Besides, exports from the EAEU to the PRC raised by 40% in the same year. This shows that a significant degree of economic integration already exists between China and the members of the EAEU, which suggests that the newly signed FTA will likely be successful in expanding trade between member states. However, the current trade structure between EAEU members and China is very similar to the one between Russia and China, i.e. it is largely based on primary goods exports from the EAEU to China in exchange for manufactures. Increasing trade links with China over the past decade further amplified the export concentration of EAEU members, most notably for Kazakhstan, Kyrgyzstan and Armenia (Figure 5). This is why the Union countries find exports diversification to be of fundamental importance as a goal inspiring the sign of the FTA with China.

Figure 5 Index of export concentration, EAEU members



Source: author's elaboration on data from UNCTADStat

Only in the years 2008-2014 the cumulative Chinese investments in the countries of the Eurasian Economic Union more than doubled – from USD11bn to USD27.1bn. Russia is not the main recipient of foreign direct investment (FDI) from the People's Republic of China, it is Kazakhstan that has the highest level of investment cooperation with China – almost 90 per cent of the cumulative FDIs in the EAEU according to data from Chinese Investment Tracker. In recent years, however, the value of Chinese investments in Russia has also increased. In the run up towards the negotiations to sign an FTA between the EAEU and China, Chinese direct investment in Russia soared 72 percent to reach 2.22 billion dollars in 2017. Chinese contractors signed new projects worth 7.75 billion dollars in Russia in the same year, up 191.4 percent, faster growth than that for most countries participating in the Belt and Road Initiative. As a result, China is now the largest trade partner and source of foreign investment for the Russian Far East. FDIs are generally implemented in the form of long-term loans and invested in the mineral and raw materials complex (up to 98 per cent of all investments). However, in recent times, Beijing has also been interested in agriculture and has attempted to locate its companies from this sector in the countries of the EAEU.

The China-EAEU FTA is the outcome of a convergence of interests between Russia and China in Central Asia and potentially also in Southeast Asia. This convergence represents a major shift in Russian foreign policy, to the extent that Moscow's traditional concerns about the growing Chinese economic and commercial activities and interests in Central Asia had been further magnified by the launch of the Silk Road Economic Belt (SREB, the land part of the Belt and Road Initiative) in Nursultan (former Astana, Kazakhstan) back in 2013. Such a convergence has led to the concept and building of the Greater Eurasian Partnership, a great economic space across Europe and Asia, which is the ultimate geopolitical ambition of China's Belt and Road Initiative, aiming at uniting Eastern Europe to the Eastern and Southern areas of Asia by connecting a number of existing agreements such as the EAEU and the SCO,

as well as a number of corridors, such as the Lapis-Lazuli Transit, Trade & Transport Route, the so called Lapis Lazuli Corridor, which connects the Caucasus to Central Asia, and Turkey's Middle Corridor Project (East-West Trans-Caspian Trade and Transport Corridor). The former begins from Afghanistan close to the Afghani border where rail connections already exist with Turkmenistan. From there, the routes continue west to the Caspian Sea Port of Turkmenbashi, in Turkmenistan. After transiting the Caspian, the route continues on to Baku, capital of Azerbaijan, and then connects onward to Tblisi, capital of Georgia, as well as the Georgian ports of Poti and Batumi; finally, the corridor will connect to the cities of Kars and Istanbul in Turkey, at the gates of Europe. The current dialogues between the EAEU and Iran, India, Indonesia and Singapore witness the ambition to extend the Greater Eurasian Partnership until the whole ASEAN, which has already started through the productive FTA the EAEU has with Vietnam.

Besides connecting the major lands of Asia from North to South, from East to West, China has ambitions to connect to Europe in a much varied and diversified way compared to the current sea lanes going from the Southern ports of China to the South of the Mediterranean. A major geostrategic goal of the BRI includes the Chinese plan to ship to Europe via the Northern Passage and the Arctic Ocean, within the Russian territory.<sup>29</sup> Moreover, Kazakhstan, Russia and Belarus have primary routing for rail freight services to Europe, and new projects of motorway construction and railroad infrastructure are ongoing, especially in Kazakhstan which is expected to receive 5 bln US dollars from transit through its territory, thereby allowing distributing Chinese goods across the European Rail network as far away as Madrid and London. Overall, the China-EAEU FTA accomplishes the Chinese goal to cross the entire Eurasian land mass duty free, until the EU's borders.

Although the progressive convergence of interests between Russia and China on building a greater Eurasian space has included as a chief objective the linking between the Eurasian economic integration<sup>30</sup> and China's strategic Silk Road Economic Belt project, it is worth noticing that the BRI itself has the potential to become a source of major friction in Russian-Chinese relations. Although the BRI includes a series of trade routes to achieve its goal to ship Chinese exports to Europe, some experts believe that, ultimately, the BRI will have to settle on a single route to be economically viable. This suggests that Russia is actually competing with other member countries of the EAEU to get the most benefits from its participation in the BRI. This is one of the reasons why, despite recent signs of cooperation and deepening ties between Russia and China, a 'serious geopolitical competition'<sup>31</sup> remains, according to experts including Robert Kaplan of the Centre for a New American Security and Dimitri Trenin, director

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<sup>29</sup> <https://www.cnn.com/2018/02/14/china-we-are-a-near-arctic-state-and-we-want-a-polar-silk-road.html>

<sup>30</sup> <https://www.brookings.edu/articles/central-asia-a-new-hub-of-global-integration/>

<sup>31</sup> <https://www.cnn.com/2018/09/14/china-russia-ties--more-rivalry-than-alliance.html> .

of the Carnegie Moscow Center. Currently, one of the main routes preferred by Moscow is the so called “northern” route relying heavily on Russia’s trans-Siberian railway system, but preliminary studies<sup>32</sup> show that a central route - an expanded and improved rail network from China’s western Xinjiang Province and the Central Asian states, bypassing Russia – has become considerably more time- and cost-effective than the trans-Siberian route. This is a source of concerns for Russian leadership, to the extent that they are linking the country more and more to Asia and even more to China, with a high degree of uncertainty about the net economic benefits for the domestic economy. Partly to compensate for the need to foster production diversification and industrial development, cooperation between China and Russia has recently gained a new momentum, including a joint venture set up in 2017 to build wide-body long-haul passenger jets, a research and development center on high-speed rail technology last year, the field investigation and design of the Moscow-Kazan high-speed railway, and further cooperation in such areas as nuclear power, aerospace, digital economy, and cross-border e-commerce.

## **Implications for the EU**

While discussions about a number of internal issues have dominated the debate in Europe, the economic and geopolitical implications of a deepening cooperation between Russia and China has been too long neglected, despite the potential huge impact of that on the future of the EU. European politicians have invariably underestimated the EAEU as an entity capable of exerting economic influence in the region, unlike many Asian countries who expressed an interest in starting negotiations to join or already joined the Union.

As a matter of fact, a joint initiative, the Eastern Partnership (EaP), was inaugurated by the European Union in Prague, Czech Republic, back in 2009 by the European External Action Service of the EU together with its Member States and six Eastern European Partners to govern its relationship with the post-Soviet states of Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine, with the ultimate aim of building a common area of shared democracy, prosperity, stability, and increased cooperation. The EaP has provided an avenue for discussions of trade, economic strategy, travel agreements, and other issues between the EU and its Eastern European neighbours.

Possibly even more important than the increasing competition around the EU borders, a major implication of a growing integration across Eurasia is a rising competition between the two major Unions – the EU and the EAEU – for new member countries. Recently, Moldova, Ukraine and Georgia have been offered by both the European Union and the Eurasian Economic Union to join their integration unions. All three countries opted for the European Union by signing association agreements on 21 March 2014. However, break-away regions of Moldova (Transnistria), Ukraine (Donetsk and Luhansk) and

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<sup>32</sup> <https://eurasianet.org/the-belt-and-road-through-eurasia-who-wins-and-how>

Georgia (South Ossetia and Abkhazia) have expressed a desire to join the Eurasian Customs Union and integrate into the Eurasian Economic Union.

Especially during the tensions between Russia and the European Union in 2014, pressures have increased by both unions to pressure post-Soviet states to join their integration unions. Both sides have accused each other of carving spheres of influence. Members of the union, especially Russia have tried to diversify their trade by signing economic agreements with China, Iran and Turkey. Trade with North and South Korea has also risen.

The recent FTA between the EAEU and the People's Republic of China (EAEU-China FTA) is a challenge to the economic position of the EU in the world, because each new economic agreement involves trans-border consequences. This is especially true when a free trade zone is created on a territory of nearly 30 million square km and with a population of more than 1.5 billion people, which is additionally located in the neighbourhood of the EU. The agreement is also an attempt to shift the economic centre of gravity in Europe, from the West to the East, and this could lead to the escalation of tensions between Brussels and Moscow. In the public, policy and scholarly debate alike, a lot of attention have been given disproportionately to the changing routes of international trade between China and Europe. Not just will Chinese goods cross the whole of Eurasia without any customs duties being paid, as Chinese goods can be sent to any location within the European Union through the main railway route for continental trade crossing Russia, Belarus and Kazakhstan. What's more, the longest border section separating the two blocks is the one between Belarus and Poland, and the main railway line connecting Berlin and Moscow, as well as the European E-30 route, are located here. As in the areas surrounding all the other border crossing points between the EU and the EAEU in Lithuania and Latvia one can expect a rapid development of Chinese infrastructure investments, EU producers, especially from SMEs, are likely to face increasing competition in the new reality of trade with the East.

One of the cases where competition between the EU and the EAEU was not effective is bringing about a beneficial solution for the third countries seeking to join either one or the other Union is Armenia. Included in the EaP, EU membership would probably enable faster social and economic development in the country, compared to the EAEU, where Armenia is not highly integrated and is actually piling up increasing economic dependence on China.

Among the main implication of the EAEU-China FTA is likely to be a change in the traditional axes of cooperation between Russia (and the EAEU) and the European Union. The implications of the growing cooperation in Eurasia may impact on the strategic agreements of Moscow and Berlin concerning the



energy sector, but also on the EU as a whole, who could be forced to accept the new economic status quo in the region of Eastern Europe and Asia.

Against the backdrop of the United Kingdom leaving the EU and its enlargement eastward coming to a standstill, the EU should consider deepening its neighbourhood policy through a Wider European Economic Area (WEEA).<sup>33</sup> Among other essential elements to increase linkages, free trade should be regarded as the first priority in his WEEA initiative, which embraces non-EU members such as Norway and Switzerland, the Balkans and those in East Europe which have association agreements with the EU. The WEEA could become a framework whereby the EU could develop coordination with the EAEU and China's BRI. This view has become particularly relevant given the rapid enlargement of an area of broader economic and political influence by China in Europe, including the recent joining the 16+1 initiative by Greece and the signing of a series of Memorandum of Understanding between the PRC and some EU member states beyond those in the Central and Eastern regions of the Union, such as Portugal, Italy and Luxembourg.

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<sup>33</sup> As suggested by Michael Emerson, of the Brussels think tank Centre for European Policy Studies, available at [https://www.ceps.eu/system/files/PI2018\\_05\\_ME\\_WEEA.pdf](https://www.ceps.eu/system/files/PI2018_05_ME_WEEA.pdf)