Economic Relations between Russia and China – Increasing Inter-Dependence?

Bruegel 21 June 2016
Heli Simola, Senior Economist, BOFIT
Economic Relations between Russia and China

- Russia and China seem to have huge potential for economic cooperation
  - Large neighboring markets
  - Complementary production structures

- Economic relations between countries have long time been even surprisingly narrow despite many years of high-level dialogue

"Year of China" in Russia in 2007
Trade has increased notably and its structure has changed

![Graph showing trade between Russia and China](image1)

Trade between Russia and China, bn USD (in value added terms)

![Bar chart showing structure of bilateral value added trade](image2)

Structure of bilateral value added trade, %

Source: Author’s calculations based on OECD-WTO TiVA data

Bilateral dependency still low

- Bilateral dependency has increased, but remains low
- Both more oriented towards other markets
- Rather one-sided dependency of Russia from China than inter-dependency

Source: Author’s calculations based on OECD-WTO TiVA data
High-level relations blooming after Russia’s relations with West cooling

- Russia’s statement of ”pivot to Asia”
  - Hope to receive additional income and financing under western sanctions

- Much attention for new steps in cooperation
  - Agreements on natural gas supplies from Russia to China
  - Contract on Russia selling missile defense system to China
  - Joint declaration on cooperation in coordinating development of Eurasian Economic Union and Silk Road Economic Belt

Sources: Kremlin, Xinhua.
Trade development more moderate and again one-sided

Change in Russian goods imports in 2013-15, %

Share of Russia and China in each other's goods trade in 2013 and 2015, %

Sources: Russian Customs, IMF DOTS
Investment flows have continued small and fallen

- Russia and China not among each others’ most important investment partners
  - FDI stock from Russia to China (incl. Hongkong) 1.5 bn USD
  - Estimates for Chinese FDI stock in Russia vary from 1.5 bn to 25 bn USD

- Chinese credit to Russian companies has not increased notably in general except some individual deals
  - Chinese banks take Western sanctions into account
  - Difficulties to agree on price

N.B. Figures from different sources are not comparable due to different methodologies.

Sources: MOFCOM, China Investment Tracker, CBR, author’s calculations
Oil trade volumes and inter-dependency have increased – reflecting earlier developments

Sources: CEIC, UN Comtrade

Russia's oil exports by area in 2015

China's oil imports by area in 2015
Natural gas agreements an important step forward, but much work remains to be done

Source: IEA

- **Power of Siberia** (→ 38 bcm)
- **Power of Siberia 2** (→ 30 bcm)
- **China – Central Asia pipeline** (55 → 85 bcm)
- **China - Myanmar pipeline** (12 bcm)
- **LNG facilities** (55 bcm → 88 bcm)
Arms trade an exception in economic relations

- Arms trade between countries has been declining during past decade
- In arms trade opposite situation than in other economic relations → SIPRI estimates that Russia still accounts 60-70% of Chinese arms imports

Source: SIPRI
Practical implications of regional cooperation unclear and challenges remain

The Belt and Road Initiative: Six Economic Corridors Spanning Asia, Europe and Africa

Source: HKTDC
Future perspectives for economic cooperation depend largely on political relations

- Best potential for further increasing and deepening cooperation in the fields of energy and raw materials, infrastructure
  - Politically the most sensitive areas
  - Especially in these areas both seem to be rather striving for reduced dependency on any country instead of increasing inter-dependency

- Russia wants financing but is not willing to give up on economic independency

- China aims at securing diverse raw material supply and finding new markets for domestic industrial production
  - Emphasis might be shifting to latter with China’s rebalancing of growth model and already vast and diversified supply secured
  - Often implies majority stakes and / or use of domestic materials, labour etc.

- Can a balanced approach acceptable to both be found or is it easier to find other partners?
Limited potential for increased cooperation in other sectors

- Traditional attractions of Chinese markets offer less possibilities for Russian companies
  - Poor competitiveness in most other products than energy and raw materials, especially consumer products
  - China is no more a market of cheap labor at least for Russian companies, as average wage in China appears to be already higher than in Russia

- Russia’s relatively large markets interest Chinese companies, but
  - Investment hampered by problems in business environment
  - Further increasing exports might be restricted by Russia’s protectionist policies (reducing import dependency, import substitution)
  - In sanctioned products China has less to offer and providing finance limited by risks
Conclusions

- Bilateral inter-dependency has increased, but remains low and is rather one-sided

- Recent warming of political relations has led to some important steps forward also in economic relations, but less results in practice

- In the near term, development of economic relations continues to rely largely on political considerations

Thank You for Your Attention