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Arctic Matters: Sino-Russian Dynamics

As the Arctic ice recedes, interest in resource extraction and promising trade routes increases. Two actors in particular will have a strong impact on the region: China and Russia. Both are bound by an intricate dynamic of cooperation and competition, particularly in the energy sphere. As their interests do not always overlap, tensions and asymmetries between them may increase.

By Maria Shagina and Benno Zogg

The Christophe de Margerie (R), an ice-class tanker fitted out to transport liquefied natural gas, is docked in the Arctic port of Sabetta, Yamalo-Nenets district, Russia, 30 March 2017. *Olesya Astakhova / Reuters.*

The last couple of years have seen unprecedented attention for the Arctic by media and think tanks, with reports of Arctic wildfires, oil spills, new energy projects, military exercises, or the ubiquitous image of polar bears on melting ice. July 2020 marked another record-low coverage of ice on the Arctic ocean, making resource deposits and trade routes more accessible. Arctic routes promise shortened shipping lanes between Asia and Europe, creating commercial opportunities. At the same time, climate change is increasingly threatening the fragile ecosystem and local populations, and geopolitical rhetoric is becoming ever more present in the Arctic.

Two actors are particularly central to recent events in the Arctic. Given its enormous landmass and Arctic coastline, Russia has been the most invested. This is underlined by the fact that a large part of Russian nuclear forces and its most promising natural resource reserves are in the Arctic. The region is thus key to its national security and its economy. China, meanwhile, has emerged as the most hotly debated actor in the Arctic. It frames itself as a "near-Arctic state" based on its stakes in polar research and commerce in the region. Its role is set to increase in a number of spheres.

These two actors are connected through a "strategic partnership" on the international stage (see CSS Analysis 250). Their main area of cooperation in the Arctic is energy exploration, which they have intensified since Western sanctions following the Crimean annexation. Chinese funds and technology are increasingly important for Russian extraction projects, for example in their flagship cooperation project on liquefied natural gas (LNG) on the Yamal peninsula. However, despite their warm rhetoric, China and Russia's interests do not always overlap. The effects of the coronavirus pandemic may exacerbate their underlying asymmetry, as Russia's dependence on China is likely to grow. Russia is especially keen on maintaining its dominant position in the region and aims at diversifying its partnerships. As a result, a complex pattern of cooperation and competition between China and Russia has emerged, which will have a strong impact on future Arctic matters and is indicative of their relationship overall.

Arctic States and Stakes

As it is most commonly defined, the Arctic region extends above the Arctic Circle and comprises five littoral states with an Arctic coastline: Canada, Denmark (through Greenland), Norway, Russia, and the US. Furthermore, being located above the Arctic Circle, Iceland, Finland, and Sweden are also commonly considered Arctic states. The population of the Arctic regions in these countries approximates 4 million people, most of whom live in Russia.

The Arctic region is considered of vital importance to many countries' national security and sovereignty. Arctic littoral states' exclusive economic zones extend 200 nautical miles (370 kilometers) into the sea. Most of the vast confirmed and assumed Arctic resource deposits lie on land or within these zones. Offshore reserves, meanwhile, are often difficult and costly to access. Apart from oil and gas deposits, the Arctic is rich in minerals.

Some of these resources lie in disputed territory. Based on extensions of their continental shelf, several Arctic states claim enlarged exclusive economic zones. Importantly, these demands are submitted within the UN Convention of the Law of the Seas (UNCLOS), and thus in line with international law. A fundamental disagreement exists as to whether certain Arctic sea lanes, namely the Northwest Passage north of Canada and the Northern Sea Route (NSR) north of Russia, should be considered these two countries' internal waters, or rather international sea lanes and thus free for navigation. Currently, only a few dozen international passages transit either of these lanes.

While UNCLOS is guiding the approach to the issues raised above, the Arctic Council is the region's most important intergovernmental forum. Switzerland assumed observer status in 2017. The Council deals with issues such as the environment, development, search and rescue, and research. Russia will assume its chairmanship in 2021 and will use the platform to bolster its Arctic strategy.

However, there is a lack of a suitable forum to discuss such hard security issues, particularly since the 2014 annexation of Crimea. At the same time, military activities, such as manoeuvres and deployments, have increased in the Arctic. Capabilities remain below Cold-War levels, though, and often serve both civilian and military purposes.

Russia and China's Ambitions

Russia has been part of the Arctic for centuries. Today, the Arctic is perceived as a source of Russia's pride and strength, notably through its resource potential, as well as its vulnerability, as the region is vast and sparsely populated. Climate change poses an opportunity, as it discloses trade routes and new resources, but also a threat, as it endangers the environment and existing infrastructure. Russia re-emphasized the importance of the Arctic, particularly the role of sea lanes and resource extraction for Russian economic growth, in its basic principles for 2035, adopted in March 2020. Currently, the gap between Russia's desire to exploit increasing economic potential in the Arctic and the needs for investments in infrastructure is widening.

Russia's threat perception in the Arctic has shifted from military confrontation that shaped the Cold War era to economic concerns and avoiding strategic vulnerabilities. Highly important for commercial purposes is the vast fleet of Russian nuclear-powered ice-breakers, which Russia aims to modernize to maintain its edge in that sphere. This push as well as increased deployment of coast guard and military assets should be read as part of Russia's aim of maintaining a dominant role in the Arctic and exploiting its economic potential. Its willingness to engage in multilateral cooperation is highlighted by a number of initiatives with Russian participation, such as its settlement of territorial issues with Norway in 2010, or the establishment of the Arctic Coast Guard Forum in 2015. At the same time, Russian rhetoric and strategic documents have stressed the importance of the Arctic for Russia's national security, the role of the military for its protection, and reinforced Russian claims on disputed land. Snap exercises have increased. Other Arctic actors increasingly view these moves with concern.

A complex pattern of cooperation and competition between China and Russia has emerged.

China, meanwhile, is an unlikely Arctic actor given its geographical distance from the Arctic. It bases its interest on long-standing scientific research in the region, and the implications of climate change in the Arctic on China itself. In 2018, Beijing unveiled its first White Paper on the Arctic, marking an "assertive turn" in China's diplomacy. For the first time, China sought to legitimize its interests in the region. The publication alone is indicative of China's growing Arctic ambitions.

China's interests revolve around energy exploitation, commercial interests, shipping routes, and regional governance in the Arctic Council in particular. Resource extraction, particularly of oil and gas, is a priority. As the Arctic oceans become more navigable in the coming decades, these shipping routes – particularly the NSR – promise China shorter and cheaper alternatives to the current navigation routes. They allow Beijing to avoid maritime chokepoints in the Straits of Hormuz and Malacca, which are vulnerable to piracy or interdiction by US naval forces or those of their allies. The NSR is even cited as part of China's maritime dimension of the Belt and Road Initiative – a move based on earlier Russian calls for such a "Polar Silk Road" in its hopes for investment in this remote region. Beijing is further concerned about being left behind in the changing governance of the resource-rich Arctic. Discussions about unresolved territorial and maritime disputes will have implications for China's commercial and shipping interests, after all. With its involvement in regional governance, Beijing seeks to secure its ability to influence the rules of navigation.

Driven by Energy Cooperation

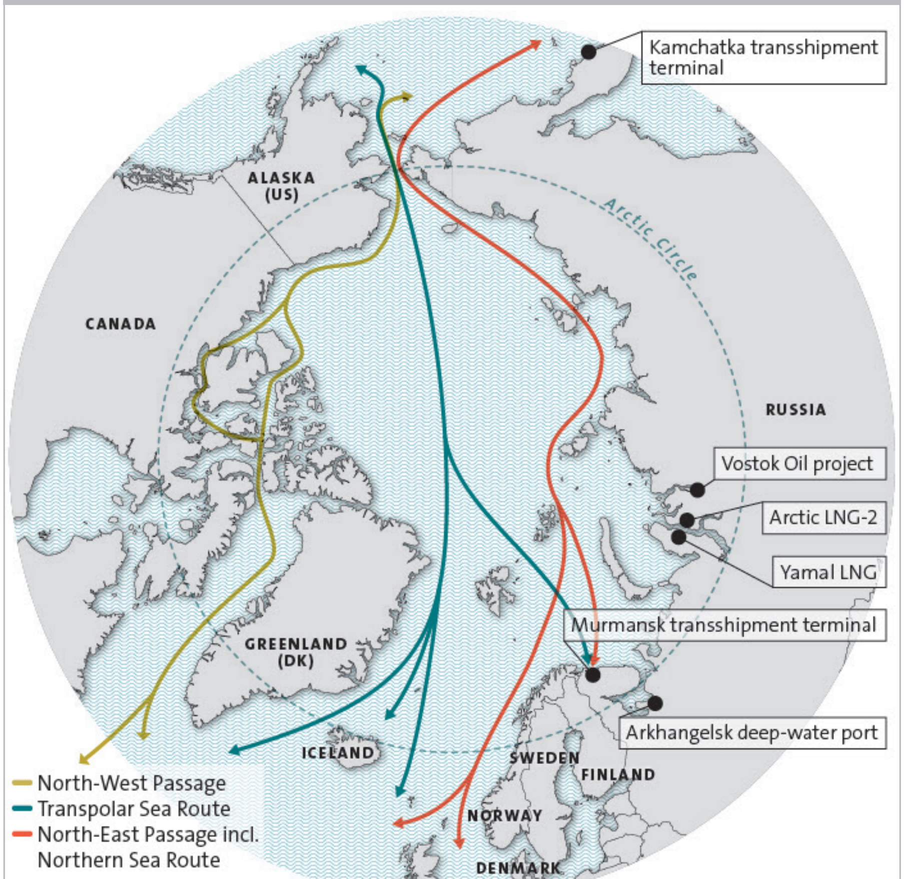
In the Arctic, Russia and China have their own ambitions, but their objectives currently overlap. Complementary economic interests are the main driver of their cooperation.

For Russia, the development of unconventional reserves is necessary to maintain its production levels of oil and gas after 2030. With old oil fields in Western Siberia depleting, the Arctic offshore became a key strategic resource, in total estimated to harbor 13 and 30 percent of the world's undiscovered oil and gas respectively. In the future, the Arctic may account for 20 percent of the Russian GDP. Yet, Russian companies lack advanced technology and sufficient capital to develop the Arctic.

For China, the diversification of energy sources, suppliers, and transportation routes is part of its national strategy. China has ambitious plans for an energy transition, which foresees the share of gas to grow and partially replace coal. By 2050, China's gas demand is forecast to rise, increasing the country's dependence on imports.

Both powers are thus in mutual need of each other: while Moscow is reliant on Chinese technology and capital to develop

Arctic States and Stakes



Sources: Economist, Norwegian Polar Institute

its Arctic reserves, Beijing is dependent on Russia as a great-power player to access the Arctic's economic potential.

After the annexation of Crimea, Russia's pivot to China in the Arctic intensified. Deprived of Western capital and state-of-the-art technology, it turned to China, a convenient candidate at that time, to offset the impact of Western sanctions. Sino-Russian cooperation in the Arctic stood its first test in the *Yamal* LNG project by *Novatek,* Russia's second-largest natural gas producer. Russia granted Chinese investors equity stakes in the traditionally closed-off energy sector. The state-owned Chinese National Petroleum Corporation acquired 20 percent and the Silk Road Fund purchased another 9.9 percent. Most of the equipment and technology came from Chinese engineering companies. Breaking Western monopoly, Chinese companies enhanced their technological prowess at the expense of Russian local producers, which was hardly mentioned in the Russian media. Sino-Russian cooperation also extended to shipping. Partnering with *Novatek* and state-owned shipping company *Sovcomflot,* China's COSCO Shipping participated in managing *Yamal* LNG's fleet of ice-breakers to transport fuel from the Yamal peninsula.

Despite cooperative rhetoric of both powers, Moscow's heightened expectations of China's unconditional help to mitigate sanctions were quickly toned down. Chinese private banks *de facto* complied with US sanctions, refusing to provide loans to sanctions-hit *Novatek.* The external financing for *Yamal* LNG was secured only when China's state-owned Silk Road Fund, China Development Bank, and Export-Import Bank of China – which are decoupled from the Western financial system – provided loans. However, their 12 billion USD assistance came at a higher interest rate. The Kremlin had clearly overestimated the Chinese government's willingness to pressure its private sector to step in and mitigate the impact of sanctions. Other failed or protracted deals, such as Chinese withdrawal from the Vankor oilfield in Northern Siberia and stalemate over Chinese funding for the Arkhangelsk's deep-water port, show the limitations of Beijing's readiness to bankroll Moscow's ambitious projects at any price.

The convergence of China and Russia's economic interests does not imply the presence of economic fundamentals, though. Resource extraction in the Russian Arctic is not profitable. Without generous tax breaks and lavish state subsidies, many projects in the Arctic would be economically unviable. Praised for being "on time, on budget", *Yamal* LNG was exempted from all associated taxes. The comparison with Russia's Far East points to the limitations of China's willingness to invest no matter the cost: despite the advanced special economic zones it established, Russia failed to attract Chinese investments in its eastern territories. In the Arctic, however, China is keen to invest regardless of Russia's adverse business climate and lack of economic fundamentals, as it suits Beijing's own geopolitical and geoeconomic objectives.

With its success at Yamal, Beijing transformed into a serious Arctic player, making Moscow wary of China's ambitions. To diminish its dependence on China's energy demand and financial support, Russia reached out to other Asian countries including Japan, South Korea, India, and Singapore. Having succeeded in gaining Japanese shareholders for Arctic LNG-2, *Novatek's* second LNG project, Russia was keen to attract more Japanese investment in *Rosneft's Vostok* Oil project and *Novatek's* transshipment terminal in Kamchatka. South Korean shipyards, meanwhile, played a crucial role in the construction of LNG vessels. Boosting its energy ties with Russia, India confirmed its participation in *Vostok* Oil. Lacking domestic expertise in offshore exploration, Russian companies have been particularly interested in acquiring technological know-how from Singapore, one of the world leaders in offshore drilling platforms.

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However, Russia's strategy of balancing China against other Asian countries has been limited so far. Ineffective regulatory regimes and administrative hurdles, compounded by sanctions risks, have deterred other Asian actors, leaving the potential for investments unfulfilled.

Less noticeably, this quest for diversification also applies to China. In the past decade, China has developed strong relationships via joint investments and polar research in a number of Arctic states. In Iceland and Greenland (Danish), China has been particularly vested in the development of infrastructure, geothermal energy, and the mining of rare earth elements – all of which are of a strategic value to Beijing. Even though Russia is crucial to China's commercial activities via the NSR, other resource-rich Arctic states also offer lucrative opportunities, including a better regulatory regime and adequate infrastructure.

Russia will face potential challenges for its vision of the region, which is in direct opposition to China's ambitions.

Outlook

For now, pragmatic considerations and the lack of alternative options on a par with China will push Moscow to continue cooperation with Beijing. As long as China does not seek an economically dominant position and is ready to pander to Russian sensitivities, cooperation will prevail. By mere geography and by way of foreign policy priorities, Russia will maintain a strong position in the Arctic. In the short term, the coronavirus will aggravate Russia's dependence on China, as the latter is one of few countries that shows signs of emerging from the pandemic and of economic rebound. The sharp drop in oil prices will worsen the economic prospects of Russian Arctic offshore projects. The competition for scarce public funds and foreign investments will get even fiercer. Tapping Chinese coffers will remain one of the few options for Russian energy majors.

In the long run, competition between Russia and China will likely intensify, weakening the current mode of cooperation. The strength of Sino-Russian ties in the Arctic will depend on their ability to coordinate the thorniest issues – Chinese equity stakes in Russian port infrastructure, joint development of ice-breakers, technology transfer of sanctioned equipment. These areas will be important to watch in the future, as cooperation on them will be indicative of a qualitative shift in the Sino-Russian relationship. Nevertheless, Russia will remain suspicious and fearful of China's increasing presence in the region, especially as China is reaching out to other Arctic states as well.

With China asserting its Arctic status, Russia will face potential challenges for its vision of the region, which is in direct opposition to China's ambitions. Russia's securitization of the Arctic does not bode well for China's aspirations of free navigation and commercial activities. Once the Arctic becomes largely ice-free during summers, perhaps as soon as 2050 as a result of climate change, shipping transit will be more viable. Territorial issues may also exacerbate differences. Depending on the verdict of the respective commission on countries' claims on extended exclusive economic zones and whether states can agree on a regime, Russia and China's diverging views may increase tensions. As China's expertise in constructing ice-breakers grows, its reliance on Russia will diminish, weakening Moscow's competitive advantage.

Furthermore, Beijing is increasingly utilizing civilian activities and scientific research for "dual purposes". Some observers warn that China's *BeiDou* navigation satellite system might be used for better shipping communication, but may also serve military purposes. Hence, Russia's concerns could spill over into the military sphere as well. Generally, as the Arctic is becoming more globalized and as the melting of polar ice is exposing new undefended territories, Russia's sense of vulnerability will grow.

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