

**Energy Security: The Russian Trans-Siberian Pipeline and the  
Sino-Japanese courtship**

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## **Introduction**

Nowadays, oil pipelines play a substantial role and the companies involved in the trans-siberian pipeline being built in Russia's Far East know this fact very well. The Russian, Chinese, and Japanese governments, as well as the Chinese National Petroleum Corporation (CNPC) and Transneft, all have interests in seeing oil flow across the continent by means of pipes, yet their interests differ greatly and are only somewhat related to business and economics. What should be a matter of cost feasibility is instead a political issue being exploited by competing interests in a rapidly changing region of the world. The impending construction of the Siberian Pacific Ocean Pipeline proves that insecurity and offsetting power balances exist with great relevance in East Asia. As in the case of the earlier Baku-Ceyhan oil pipeline project, geopolitical considerations far outweigh any commercial considerations.

There are two significant energy trends underlying the competition between China and Japan for Russia's far-east oil pipeline project. First, the need to seek additional energy supplies and secondly, the need for greater energy diversification. And for both China and Japan, Russian energy both offers a significant supply source and would contribute to greater import diversity. But these trends in energy interests are matched by an equally dynamic and intense geopolitical rivalry, defined by a complex and contradictory set of converging and diverging national interests.

Within this context, the competition between China and Japan, as well as the Russian role in exploiting this rivalry, is driven by the distinct energy interests of each country. China's position is largely defined by the demands inherent in its fairly recent rise to replace Japan as the world's second largest oil importer, with internal demands driven by rising consumption and serious energy inefficiency. Japan's position is also driven by the challenges imposed from its own energy insecurity, its worsening relations with China, and its still-weak relationship with Russia. As for Russia, in the short- to medium-term, its position is dominated by its significant role as the world's second largest oil producer, and magnified by its fiscal overdependence on energy revenue.

## **Background**

Early versions of the Siberian pipeline project were far less ambitious than they have ended up today. In 1994, China and Russia began cooperation on feasibility studies to examine the viability of an oil pipeline from the fields in Angarsk to China's Daqing province to feed industrial centers within China. The original actors charged with carrying out that work were Yukos, the now bankrupt Russian major petroleum company headed by the now imprisoned Mikhail Khodorkovsky, and CNPC- the Chinese National Petroleum Company- (Shue 2004). The feasibility study was a complex technical undertaking due to the remoteness of the region and the lack of existing resources from which to conduct the study.

Yukos and CNPC labored over the work for close to a decade. During this phase, progress was being made on the political front to facilitate details of the deal. In 1999, Prime Ministers Yevgenii Primakov and Zhu Rongyi signed a framework agreement to investigate the export of oil and gas from Russia's Far East (Rutland, 2004), signaling an improvement in bilateral relations, and a proposed commitment of the natural resource.

The climate, though, soon started to change. Undoubtedly due to the events on and surrounding September 11<sup>th</sup>, nations around the world began to seek means by which they could diversify their dependence on Middle East oil. In 2002, Japan began buying Russian oil as a strategy to meet this end. Having ample supply, Russia has been since then seen as a resource of strong significance for Japan's energy strategy.

Simultaneously, the relationship between the Kremlin and Yukos began to deteriorate and so did the Yukos-CNPC deal. On May 28, 2003 Russian President Vladimir Putin declined to attend a signing ceremony between Yukos and CNPC to consummate the development of the Angarsk to Daqing pipeline at which Yukos and CNPC signed agreements committing CNPC to purchase up to 5.13 billion barrels of Russian oil between 2005-2030 (Daly, 2003). The signal was clearly taken in Beijing: warm relations had suddenly turned cold.

Behind the scenes, the Japanese government had been aggressively lobbying the Russian government to consider a pipeline not from the proposed Angarsk to Daqing route, which would terminate deep within China, but rather from Angarsk to the Pacific port of Nakhodka, where it could theoretically serve the entire Pacific basin while remaining entirely within Russia's territorial realm (see map). As part of the enticement, the Japanese government offered to finance a large portion of the project in addition to allocating monies for exploration and social projects (Rutland, 2004).

The deal seemed to be sealed when Russian officials announced that the pipeline would run from Angarsk to Nakhodka (near the Sea of Japan) as laid out in the Japanese plan over New Year's Celebrations in 2004 (Blagov, 2006)- roughly double the price and, at a projected 3,700 kilometers, significantly longer than the Chinese alternative. Much to analysts' dismay, however, the plan took yet another turn when Russian officials and Transneft executives reported in January 2005 that the Nakhodka route would include a pipeline spur from Skovorodino (located about 30 miles from China), which could provide China with Russian oil.

According to Russia's state-owned pipeline monopoly Transneft (which has long backed the Taishet-Nakhodka project), the route would extend roughly 2,500 miles, from Taishet, through Kazachinskoye, Tynda, Skovorodino, Khabarovsk to the Perevoznaya

Bay terminal in the port of Nakhodka<sup>1</sup>, crossing Russia's Irkutsk, Chita, Amur, Buryat and Primorie regions (see map) and the pipeline will have a capacity of 1.6 million bbl/d. Although this option was significantly more expensive than the alternative route to Daqing, China, since it covers a greater distance and involves more investment, the Angarsk-Nakhodka route will open up a new Pacific port from which Russian oil exports could be shipped by tanker to other Asian markets and possibly even North America. But, Russian executives realize there is no need to rush exports to the United States. Transneft president Semyon Vainshtok reportedly said that the Marathon terminal in Louisiana could only accept approximately 110 million barrels of Urals or Siberian grade crude oil per year. Although the Daqing option has been abandoned, China will also obtain exports via the Nakhodka route. In a recent announcement at the 2006 G8 Summit Viktor Khristenko (the Minister of Industry and Energy of Russia) affirmed that a spur would be built off the Angarsk-Nakhodka pipeline, running into China and terminating in Beijing, making the proposed pipeline one of the largest and most expensive ever built.

The construction of the East Siberia-Pacific Ocean oil pipeline started in April 2006. Since then, more than 100 kilometers (62 miles) have been laid and 330 kilometers (205 miles) have been prepared for pipe installation. The first stage of the project will connect Taishet, in the Irkutsk region, to Skovorodino, in the Amur region in the Far East, and will be completed in the second half of 2008.

Despite the fact that the construction has already begun, some hurdles exist to the Nakhodka plan. First, financing the project is challenging. The Siberia-Pacific oil pipeline project could become the most expensive pipeline in history, as it would need a larger investment than the Alaska oil pipeline, which cost \$9 billion (Blagov 2005). Early estimates of the cost of an oil pipeline from Eastern Siberia to Nakhodka could reach \$11-12 billion (Russia has only obtained Japanese promises of \$7 billion for the project). Also, the initial pipeline route was too close to the waters of Lake Baikal (the world's largest body of fresh water), a UNESCO-protected site. The plan had been at the center of controversy and protests by environmental groups, who argued that Lake Baikal could suffer irreparable damage in the event of an accident on the pipeline. In this instance, President Putin ordered in April 2006 the pipeline re-routed from its original path, which would have seen it run within 800 meters of Baikal. And in May 2006, Transneft head Semyon Vainshtok said the new route would be 10 times farther away than Putin had suggested should be the absolute minimum.

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<sup>1</sup> In late July 2005, Transneft announced that it would build an oil terminal in Kozmino Bay, instead of Perevoznaya Bay. Opponents of the plan to build the terminal at Perevoznaya based their objections on logistical, safety and environmental arguments. Perevoznaya would have required oil tankers to maneuver in shallow waters, through a channel dotted with tiny islands, in frequently windy and foggy weather. Moreover, the bay is full of chunks of ice about four months of the year. Under these circumstances no one would know how to respond to an oil spill. (Wachter, 2006)

## Map of Russian Far East pipeline routes



### Key

- Existing crude oil pipeline
- Crude oil pipeline proposed by Transneft
- - - Potential natural gas pipeline routes
- - - Potential crude oil pipeline routes

Source: [www.chathamhouse.org.uk/pdf/research/sdp/Roilgas.pdf](http://www.chathamhouse.org.uk/pdf/research/sdp/Roilgas.pdf)

## The Strategic Imperatives of the Pipeline Courtship

The core determinant of the Chinese-Japanese pipeline courtship of the Russian Far East is only one element in a deeper geopolitical contest driven by the differing strategic imperatives of each country. Therefore, in order to present a more complete assessment, it is necessary to examine the essential nature of Chinese, Japanese and Russian interests.

## **China's thirst for oil and gas (domestic, economic and geopolitical parameters)**

Energy security became an issue for China as a by-product of economic expansion. Over the past three decades China's access to offshore sources of energy has never been threatened for political reasons. The nexus of interdependence between China and United States and its Asian allies on the one hand, and oil-supplying countries on the other, provide the single most powerful assurance against future disruptions to Chinese oil imports.

China's energy policies are actually rooted more in a position of weakness and concern than one of overt aggression and ambition. This weakness is demonstrated by a serious imbalance between the location of China's energy resources and its main centers of energy demand, and reflected in the overwhelming vulnerability of the country's access to external energy supplies. This inherent weakness defines the core of Chinese energy strategy and, most important, results in two distinct needs: for greater energy imports and for a modern infrastructure able to cover great distances.

Moreover, Chinese energy strategy is still mainly defensive, rooted in the strategic fear that the United States will seek to block or contain China's pursuit of energy resources in an attempt to weaken or destabilize the regime. A potential conflict between China and the US for position in global energy will not be a direct confrontation, however, but one marked by a competition for secondary markets and suppliers. Such an indirect confrontation will most likely center on areas of US absence or neglect, fostering a new arena for Sino-US rivalry and jockeying<sup>2</sup>. The course toward energy-driven confrontation with the United States is offset by a convergence of interests. These shared interests are intertwined, including certain regional security issues, such as the North Korean case, and even energy interests, as with the common need to maintain the security of sea lanes. China sees regional maritime security as a pressing priority, compounded by its vulnerability in the Strait of Malacca, which accounts for the passage of four-fifths of all Chinese oil imports. Thus, although China's energy strategy is increasingly active and assertive, it remains offset by an inherently defensive approach.

There is also a corollary political aspect which is often underappreciated: Beijing's access to foreign resources is necessary for the survival of the Chinese Communist Party (CCP)<sup>3</sup>, because growth is the cornerstone of China's social stability. In this way, any threat to the delicate relationship between secure energy supplies and sustained economic growth is a threat to the internal security of the Chinese state. Thus, China's energy policy is one of political legitimacy as much as economic growth. And it is through this prism that one can best understand the Chinese view of energy as a strategic imperative.

Another political component is seen in China's relations with Russia and other Eurasian states. The Chinese-Russian relations, including energy ties, are on a path of converging interests, partnering in response to the US military presence along their borders and reacting to recent US policies which emphasize democracy promotion and regime change. In fact, this is the underlying motivation for the close Chinese and

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<sup>2</sup> Central Asia can also be viewed as one of the more prominent of these new arenas.

<sup>3</sup> The China Institute for International Studies, a government think tank, holds numerous conferences bringing together academics and leaders in business, the military, and the government to devise strategies for the top rung of the Communist Party. Partly on these people's advice, Beijing has been encouraging representatives of state-controlled companies to secure exploration and supply agreements with states that produce oil, gas, and other resources. (Zweig and Jianhai, 2005).

Russian approach to the Shanghai Cooperation Organization (SCO), spurring and solidifying bilateral military ties, and for a greater coordinated response to the "revolutions of fruits and flowers" in Central Asia<sup>4</sup> and other former Soviet states. Beijing and Moscow's interpretation of the recent revolutions in Georgia, Ukraine and Kyrgyzstan is starkly different from Washington's. Moscow sees them not as democratic victories of people power, but as externally-financed assaults on its traditional spheres of influence. And Beijing sees these developments as part of a broader American strategy of encirclement, aimed at curtailing China's expanding economic, political and energy ties. Here, again, politics is the key.

### **Japan's transformation**

Japan contains almost no oil reserves of its own (59 million barrels of proven oil reserves), but it is the world's third largest oil consumer (after the United States and China). Japan consumed an estimated 5.35 million barrels per day (bbl/d) of oil in 2004, down from 5.50million bbl/d in 2003. Part of the decrease in oil consumption was attributable to the recovery of Japan's nuclear power industry from a series of plant shutdowns in 2003, which had caused utilities to maximize use of oil-fired generating capacity. Most (75%-80%) of the oil consumed in Japan comes from OPEC, particularly Persian Gulf countries like the United Arab Emirates, Saudi Arabia, Kuwait, Qatar, and Iran. Until 1996, when Japan's oil consumption peaked at nearly 5.9million bbl/d, Japanese oil consumption (and imports) had been growing steadily for years. From 1997 through 2002, Japan's oil consumption declined as its economic slump caused demand by industrial and other users to fall (see figure 5).

For Tokyo, the Angarsk-Nakhodka pipeline is significant for two strategic reasons. First, the pipeline could result in an estimated 10-15% reduction in Japan's reliance on Middle Eastern oil imports. This reduction alone would offer an important new element of import diversification and, within the new landscape of international security, perhaps even spark a move away from imports from the volatile Middle East.

A second strategic factor for Japan stems from the fact that if Tokyo is able to conclude a successful agreement with Russia, it would represent a strategic reengagement with Moscow. Such a reengagement would be an important correction to the marked decline in Japanese economic and political influence, and even presence, in Russia through much of the late 1980s and into the early- to mid-1990s. This decline in Japan's position with Russia has been especially damaging over the longer term, as China was able to rapidly assert and deepen its relationship with Russia at the expense of Japan. Therefore, such a reengagement would help to match or even offset the recent gains in China's geopolitical pursuit of greater proximity to Russia (and Central Asia).

As with China, there is also a deeper set of driving forces determining the Japanese energy strategy. After a series of prolonged economic difficulties and political paralysis, Japan is now undergoing a profound transformation. In some ways, the impetus for Japan's transformation has been a result of accumulating tension, insecurity and a mounting pressure for change. This has fostered a degree of readjustment, mainly through

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<sup>4</sup>For example the 2005 "Tulip Revolution" in Kyrgyzstan.

a traditionally Japanese approach of gradual, evolutionary change designed to limit any unsettling or destabilizing effects on the Japanese society and system.

These changes have followed a gradual course of reevaluation, but have included a serious reexamination and questioning of Japan's very identity and future. Within this course of reevaluation, there have been three specific changes that comprise Japan's overall transformation and exert influence over both the Japanese approach to its competition with China and its developing relationship with Russia. The first change has been a reexamination of Japan's international position and influence. This has been demonstrated by the Japanese deployment of peacekeeping troops to Iraq and its bid for a seat on the United Nations Security Council.

The second element of this Japanese transformation was its expanding regional role as a US proxy force and more active ally in the Asia-Pacific region. This expanded role can be seen in Japan's participation in the US plan for theater missile defense and is also evident in the steady modernization of the Japanese Self-Defense Forces. Furthermore, the expanded area of operations and extended deployment of Japanese forces in support of the US-led "war on terror" represents another important aspect of this enhanced regional role.

And finally, the Japanese recognition of its regional power and influence as both a necessary and positive objective marks the third element in the country's transformation. Such recognition has been bolstered by Japan's threat environment, with greater concern over the buildup of the Chinese military and from the perception of threat posed by North Korea. Thus, each of these aspects of Japan's transformation has contributed to its competition with China for Russian energy as part of a broader dynamic. And although the emergence of a vibrant and heated Chinese nationalism has exhibited strident anti-Japanese feeling, it has been reversely the continued dispute over natural gas reserves in the East China Sea that has most recently fueled this Japanese-Chinese rivalry.

### **Russia's energy strategy**

The Russian role as an arena for competition between China and Japan stems as much from Russian energy strategy as from the Chinese-Japanese geopolitical rivalry. Under Russian President Vladimir Putin, energy has emerged as a tool for strategic leverage, in effect replacing the traditional Russian reliance on the "hard power" of its military with a new exercise of Russia's "soft power".

This use of energy as leverage consists of three components. First, it has supplemented, and in some cases even projected, an effective reassertion of Russian power and influence within the so-called "near abroad" of former Soviet states. Most notably, this can be seen in the Russian dominance over the energy sectors of much of the South Caucasus and Central Asia. Second, it has also featured the use of energy as a tool for strengthening state power, empowering Russia's status as a regional and, in this case, as an Asian power. And thirdly, it has offered Moscow an attractive way to restore its international position and regain its geopolitical relevance.

But in the case of the Chinese-Japanese competition for the Russian Far East, it has also revealed Russia's fundamental weakness. Despite the tactical gains from the use of

energy as leverage, Russia's energy sector remains beset by four serious shortcomings: it has no unutilized capacity (meaning Russia lacks the ability to expand production as a "carrot" to states it might wish to influence); its oil is relatively expensive to produce; it has limited pipeline capacity; and it still is not a global energy player. Therefore, Russian energy strategy is predominantly driven by weakness and need.

On account of that weakness on December 30 2004, Russian officials promised to offer China National Petroleum Corporation (CNPC), as consolation, up to a 20% stake in a new state-owned entity that would control Yuganskneftegaz, the main asset of the collapsing Russian oil company Yukos. In yet another gesture towards Beijing, Russia has pledged to boost oil exports to China by rail. Russia's state-owned Russian Railways Co, or RZD, has promised to more than double rail crude oil exports to 130,200 b/d (6.46 million tons) in 2004, up from 60,000 b/d (3 million tons) in 2003. However, the planned oil exports to China could hardly serve as a substitute for the Angarsk-Daqing pipeline project. Rail freight is expensive, and while Yukos was keen to export oil to China by rail, other Russian oil firms are understood to be reluctant to replace Yukos as supplier to China due to high costs and low profit margins.

Besides, there is a broader strategic dimension in Russian energy strategy,. The Russian strategic perspective views energy as an integral part of an overall projection of Russia power and position. It is energy that most clearly marks a Russian shift toward Asia and away from Europe. And as an aspiring Asian power, Russia sees no real threat or challenge from Japan (other than the unresolved territorial dispute over the Kuriles). But it views China more as a rival power, and despite its rather reluctant partnership with Beijing, Moscow is consumed by a fear of Chinese expansion and penetration into the vulnerable Far East.

## **Politics vs. Economics: What is driving Russia's export strategies?**

### **Economics**

The East Asia oil market is extremely tempting. Economic growth in the region will cause the number of people living on \$2 a day to fall from more than a billion in 1990 to a projected 340 million by the year 2015 (*Seven Futures*, 2006). This increase in wealth will beget large increases in energy consumption especially in the transportation sector.

Currently, China is the world's second largest oil importer behind the United States (see figure 6), equating to 6.5 million bbl/d. A booming domestic economy, rapid urbanization, increased export processing, and the Chinese people's voracious appetite for cars are increasing the country's demand for oil and natural gas, industrial and construction materials, foreign capital and technology (see figures 1-5). Chinese demand is expected to skyrocket over the next two decades, which according to the U.S. Department of Energy's 2006 forecasts, is projected to be 14.2million bbl/d with net imports of 10.9million bbl/d by 2025.

For Yukos and CNPC, these forecasts proved reasonable enough to enter the game. The originally planned Angarsk-Daqing pipeline was estimated to cost \$2.8 billion adding considerable transportation costs to unproven reserves. Given this estimate of capital expenditures and the pipeline's proposed output of 0.6 bbl/d, Yukos and CNPC could expect to pay a \$1.01 per barrel premium under normal financing conditions. If, however, concessionary financing arrangements were arranged, that cost could be roughly lowered to \$69 per barrel depending on the arrangements of the loan. Such oil would have to compete directly with crude imported from the Persian Gulf.

As a region, Asia has the fastest growing oil demand in the world equating to annual increases of 3%-4%. Japan closely rivals China as the world's 3<sup>rd</sup> largest oil importer at 5.35million bbl/d (Japan- Oil 2005). An estimated 80%-81% of Japanese oil comes directly from the Persian Gulf – a condition that politicians in Tokyo would like to see undone (see figure 7).

The Russian government sees great potential in the Asian oil market. According to recent statements by the Russian Minister of Industry and Energy, the government expects the Asian portion of Russian oil exports to rise from today's levels of 3% to 30% by the year 2020 equating to an upper bound projection of 2 million bbl/d. The Angarsk-Nakhodka plan was designed to capitalize on this growing demand. Cost estimates for the Angarsk-Nakhodka pipeline are extremely murky. Originally, the cost was projected at roughly \$9 Billion of which the Japanese had pledged \$7 billion with upstream exploration and social development costs included, but more recent estimates project the cost to be between \$15 and \$18 Billion. Furthermore, the Russian government has committed to building a spur from Skovorodino that does not appear to be included.

The end capacity of the pipeline is expected to be 1.6 million bbl/d of which 0.6million bbl/d slated for China (EIA Country Analysis Briefs 2005). Roughly speaking, assuming capital expenditures of \$16.5 billion for 2,500 miles of pipeline and an additional 30 miles from Skovorodino to the Chinese boarder at \$198 million, net back expenditures could be \$6.29 per barrel for the entire output of 1.6 million bbl/d. Concessionary financing arrangements might lower this to around \$4.29 per barrel depending on the arrangements of the loan. These estimates do not account for varying expenditures based upon delivery location and output, which are both important factors in determining the final net back costs. One fact is clear: The Angarsk-Nakhodka pipeline with the Skovorodino spur will be the most expensive pipeline in history.

### **A Place for Politics**

The proposed Chinese route, running from Angarsk to China's energy-rich region of Daqing, would be considerably shorter, at 2,400 kilometers, and significantly cheaper but at the same time it follows a pattern in the region of increasing integration into what can be defined as a "greater Chinese economic space". This trend also fuels the Russian

fear<sup>5</sup> of Chinese penetration into the area, exacerbated by Russia's demographic vulnerability<sup>6</sup> and the substandard condition of the remote region's infrastructure.

A declining Russian population means less inhabitants in an already sparsely populated region that is rich in natural resources held up by little infrastructure and economic opportunity. In historical perspective, the Cossacks began entering the Far East as late as the 16<sup>th</sup> century (which qualifies as recent history under the long chronicles of the region). Three centuries later, the trans-Siberian Railroad brought the first consolidation of Russian authority and with it access to the region's natural riches. Today, the Russian government sees a trans-Siberian pipeline as a means to build additional infrastructure, create job growth, and promote economic development (Khristenko, 2006).

The Chinese are only seemingly content within their geopolitical boundaries, but it is provocative to suggest that China could become enticed into an energy-rich region depleted of Russians and rapidly filling with ethnic Chinese if the opportunity presented itself peaceful or otherwise. Most likely, however, China will seek to improve its position relative to sourcing diversification while creating sufficient economic incentives for Russia to be involved. At what point those incentives prove to be too costly, remains to be seen. Under the recently proposed plan, China would contribute to an \$18 billion project that was originally \$2.8 billion. Financing arrangements, therefore, are largely unresolved as the Japanese have pledged less than half the cost of the main branch with nothing at all slated for the Skovorodino spur.

Regarding the security and reliability of oil imports, China has been looking for new supply sources (in an attempt to diversify the risk inherent in over-dependence on the Middle East) and is trying to gain greater control over imports and transport routes. To find these new supply sources, China has sought closer ties with countries that had little or no importance as suppliers in the 1990s (Goodman 2005), through trade agreements or by acquiring stakes in foreign companies. The fact that China is fostering good relations with many oil producers, besides from Russia, including Kazakhstan<sup>7</sup>, Nigeria<sup>8</sup>, Iran<sup>9</sup> and

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<sup>5</sup>This fear was also a significant factor in Russian President Putin's determination to restore central authority and control over the far eastern governors in an attempt to reverse their relative autonomy garnered during the Yeltsin years.

<sup>6</sup>The Japanese National Institute for Research Advancement approximates the number of permanent residents in Russia's Far East to be 7.2 million people and predicts a decrease to 6.8 million people by the year 2015.

<sup>7</sup>China's first major land-based oil import route, the Sino-Kazakh oil pipeline, begun construction in summer 2004 and was inaugurated in 15 December 2005. The 1,000-kilometer pipeline links Atasu in central Kazakhstan to Alashanku on the Chinese border. It was built, at a reported cost of \$700 million, in a joint venture between the state-run energy companies KazMunaiGaz and China National Petroleum Corporation. In 2005 China also purchased Kazakhstan's previously Canadian-owned oil producer PetroKazakhstan, whose energy assets are all in Kazakhstan. The first supplies of Kazakh crude oil through the new pipeline arrived in China in 12 July, 2006.

<sup>8</sup>To secure oil supply from Africa, China often agrees to provide economic aid alongside energy contracts. On the other hand, Chinese leaders have increased their diplomatic visits to Africa, in part because of oil.

<sup>9</sup>According to the US Department of Energy, Iran supplied 14% of China's oil imports in 2003, and is expected to provide an even larger share in the future. China is also expected to rely on Iran for a large share of its liquid natural gas (LNG) imports. In October 2004, Iran signed a \$100 billion, 25-year contract with Sinopec, a major Chinese energy firm, for joint development of one of its major gas fields and the subsequent delivery of LNG to China. Furthermore, at the June 15 2006 SCO (Shanghai Cooperation Organisation) meeting, Iran has been invited to become a full member. The admission of Iran into SCO has major implications for global energy security. By virtue of SCO membership, Iran can now take part in SCO projects, which in turn means access to badly-needed technology, investment, trade, infrastructure development. Iran sits on the world's second largest natural gas reserves, and Russia has the largest. Russia is the world's second largest oil producer after Saudi Arabia. These are no small moves.

Venezuela, as well as the recent developments in Cuba<sup>10</sup> indicate that they are willing to go elsewhere if Russo-Sino relations become too complicated and indeed they might. The Kremlin's decision to approve the East Siberia-Pacific oil pipeline and pump its Siberian crude toward Japan has come as a blow to China's hopes of securing its own slice of Russia's hydrocarbon riches. And Moscow's energy overtures toward Beijing as a consolation prize are not much by which to set store.

Japan is concerned with sourcing diversification as is China, but even so constructing the largest most expensive pipeline in history seems like a heavy premium to achieve such ends. More likely, the threat of increased cooperation between Russia and China – Japan's largest trade partner – and an unresolved territorial dispute over the Kurile Islands are also factoring into the cost-benefit analysis.

The most fundamental obstacle to the Japanese route was one of neither economics nor energy. As seen in the nature of the pipeline competition itself, the main concern for Japan is geopolitical. Specifically, the main challenge for Japan stems from its territorial dispute with Russia over the Kurile Islands which remains an impediment to the course of Japanese relations with an important regional power. Despite that fact, the Japanese financing concessions enabled the Russians to build a favorable infrastructure project, restrict the Chinese from accessing Russian oil unfettered, and coax the normalization of Russo-Japanese relations.

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<sup>10</sup> In May 2006, Cuba invited oil companies from China and India to drill oil off the Florida coast. US firms had also been invited, but were prevented from participating by the longstanding American embargo on trade with Cuba (CNN Money, 9 May 2006).

## Conclusion

This paper expounded the various elements of the Sino-Japanese courtship over the Russian Far East pipeline project as well as the core determinants of each involved country's geostrategic choices (Russia, China and Japan). Thus, there are some key assessments that can be derived.

The Taishet-Nakhodka route can be seen as a strategic economic asset for Russia, allowing it to funnel crude not only to Japan but to Korea, Indonesia, Australia and the US west coast as well.

Putin opted for Nakhodka not only because of economic reasons but also because of his consideration of the strategic objectives. Russia has two conflicting strategic choices: a strategy to counterbalance against China, on one hand, and a strategy to bandwagon with China, on the other. In this regard, Putin is trying hard to strike a balance between these two strategies. Considering a 4,300-kilometer-long border the countries share, constructing a solid relationship with China undoubtedly serves Russia's strategic interests. However, a complete reliance on China will limit Russia's sphere of actions in the Asia-Pacific region. Thus, Putin seems to be seeking a "strategic diversity in Asia, specifically reducing its dependence on China to promote its interests in the region" (Lo 2004).

In need of energy, China will eager to secure energy cooperation with Russia. It depends more on Russia whether both countries will be able to reinforce their energy cooperation. Maximizing its economic interests as well as seeking a "strategic diversity", Russia opted in favor of Nakhodka at the sacrifice of its credibility to China. Yet, China is the most promising energy market. Meeting the Chinese demand for energy, undoubtedly, serves Russia's interests. Naturally, Russia can not continue to turn its back on China. To offset its lost credibility and to buttress its economic relations with China, Russia appears to be ready to advance the energy cooperation with China.

Finally, converging energy interests of Japan and China can be greatly enhanced and bolstered by the precedent of region-based cooperation. The recent example of the six-party talks as a region-based, coordinated effort to address the North Korea issue offers an important confirmation of the need for multilateral security in the Asia-Pacific region. With such a demonstrated foundation of shared interests, the security outlook for the Asia-Pacific reflects more promise than peril. But the outstanding questions are whether this region-based approach will last, or if the Asia-Pacific will revert to the division and competition of these powers' unilateral impulses and energy imperatives

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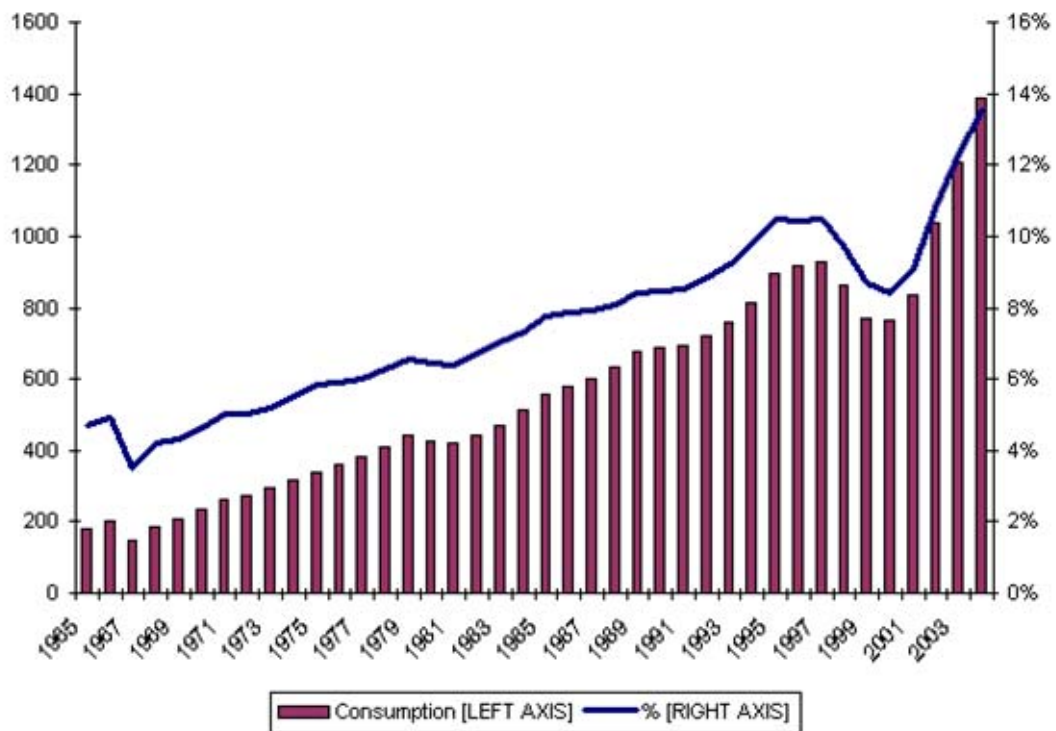
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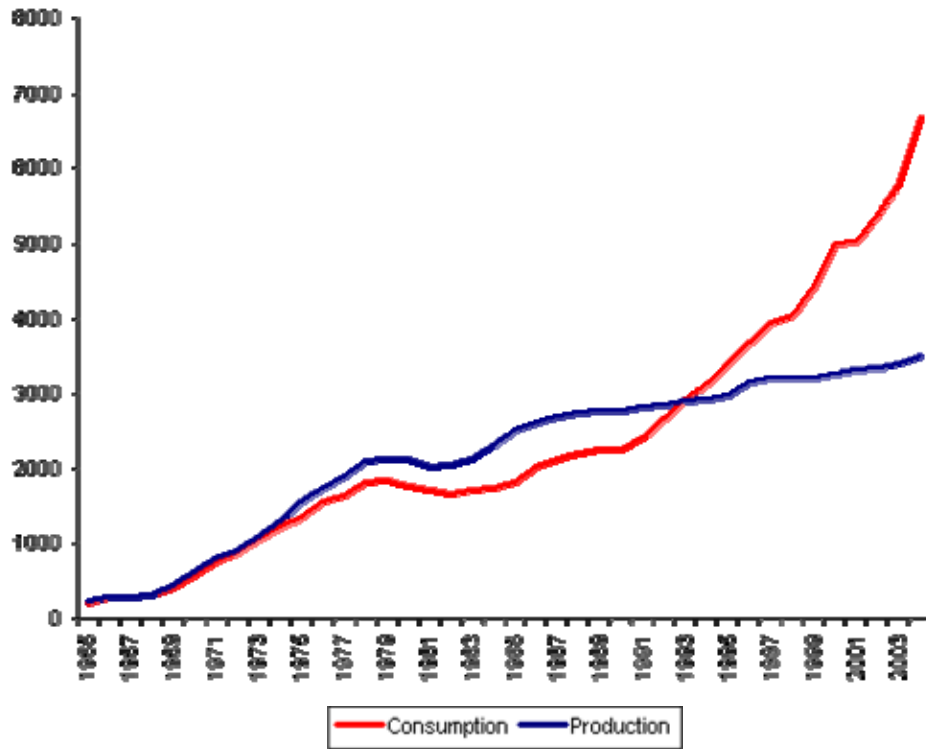
## APPENDIX

**Figure 1. Energy consumption in China, 1965-2004 (million tons of oil equivalent and percentage of world consumption)**

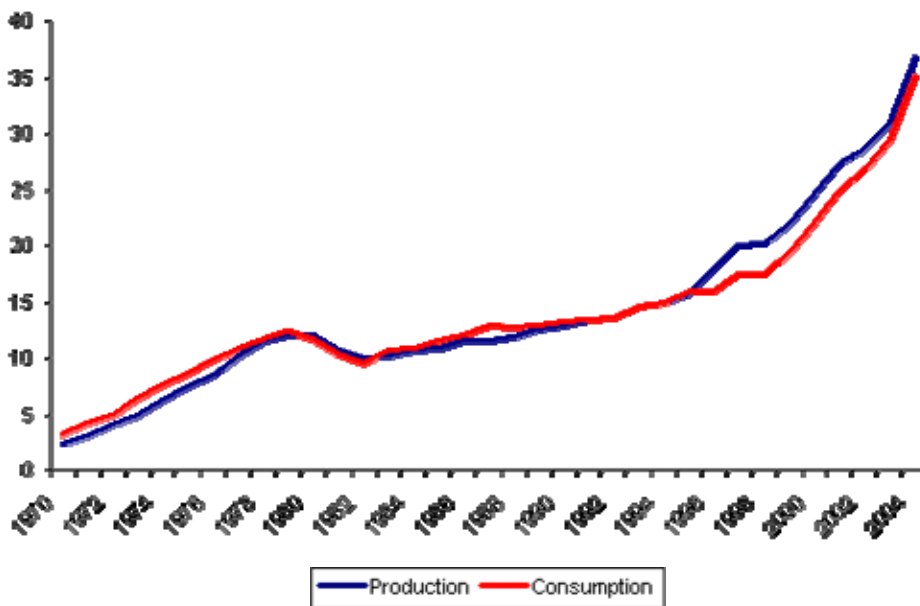


Source: BP (2005).

**Figure 2. Oil consumption and production in China, 1965-2004 (thousand bbl/d)**

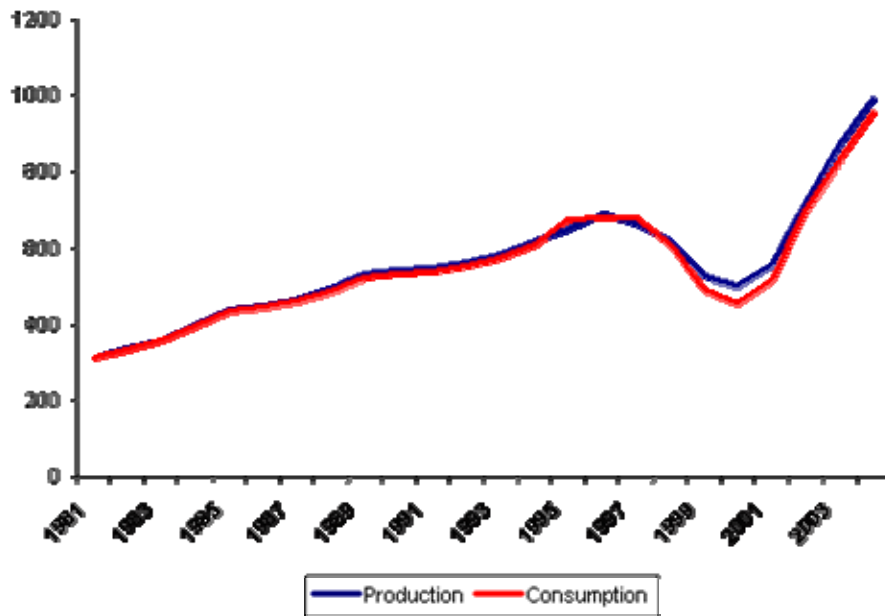


**Figure 3. Natural gas consumption and production in China, 1970-2004 (Mtoe)**



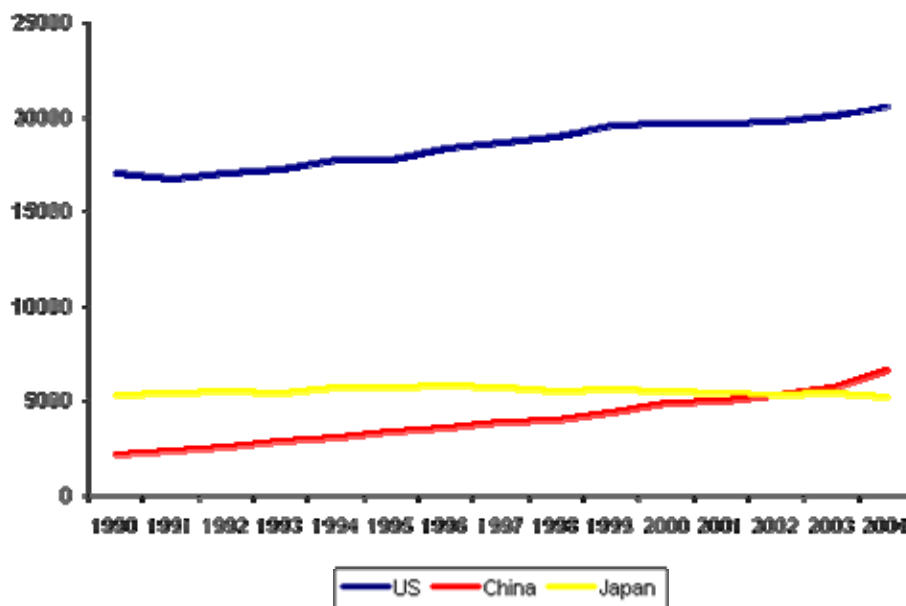
Source: BP (2005).

**Figure 4. Coal consumption and production in China, 1981-2004 (Mtoe)**



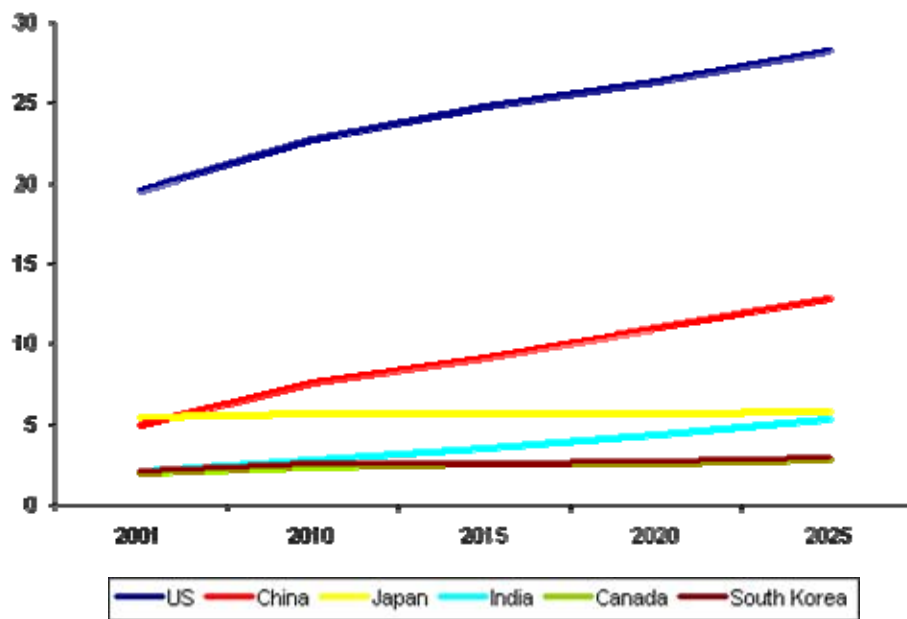
Source: BP (2005).

**Figure 5. Oil consumption in China, Japan and the US 1990-2004 (million bbl/d)**



Source: BP (2005).

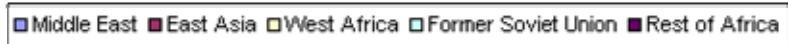
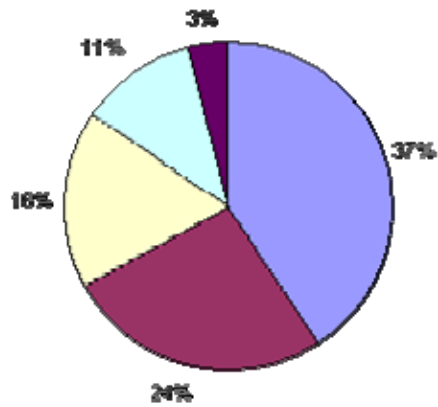
**Figure 6. Projected trends in oil consumption in several countries, 2005-25 (million bbl/d)**



Source: IEA (2005) and EIA (2005).

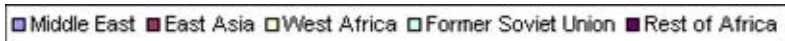
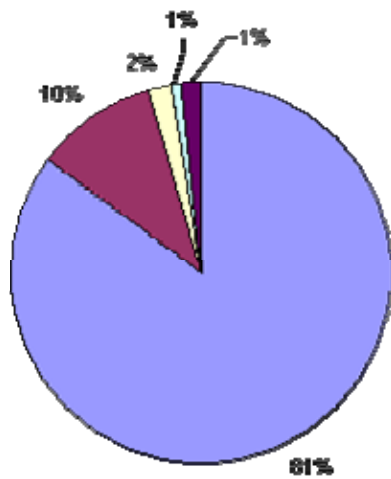
**Figure 7. Geographic distribution of Chinese and Japanese oil imports, 2004**

**CHINA: 3.4 million**



**bbl/d**

**JAPAN: 5.2 million bbl/d**



Source: BP (2005).