

Russia's oil, China's demand prove hard to sync up

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Nelson Ching : Bloomberg CLIMBING DEMAND: A worker escorts journalists at Sinopec's Yanshan refinery in Beijing. As China's energy consumption increases, it must depend on other countries, such as Russia. Photo: Nelson Ching / 2011 Bloomberg Finance L.P.

MOSCOW - At exactly 48 minutes past midnight on Jan. 1 last year, Russia did something it had never done before: It began pumping oil to China across a 2,600-mile border that once bristled with tanks, troops and nerve-shredding tension.

The oil flowed from eastern Siberia through a newly completed pipeline, the first such link between the world's largest petroleum producer and its biggest energy consumer - and a symbol of what the two giant neighbors hail as a perfect symmetry of interests.

"We and the Chinese need each other," said Nikolai Tokarev, the head of Transneft, a state company responsible for the Russian portion of the pipeline. "They need oil, and we need a market," added the Russian, a longtime associate of Prime Minister Vladimir Putin.

When it came time to settle accounts for the first deliveries, however, Tokarev got an unpleasant surprise: China, Transneft says, underpaid by more than \$100 million.

"Naturally, this did not cause delight," Tokarev said. "We were surprised because there is a contract, and this contract has signatures. It should be respected."

The difficulties

The dispute hasn't shut down the pipeline, but it has put a spotlight on a curious malaise at the heart of a would-be energy axis between Moscow and Beijing. While the law of supply and demand - as well as a common desire to curb the United States - pushes the two countries together, a long history of mutual distrust, similarly hard-nosed business styles and gnawing fear of dependency keeps them apart.

"They look like the perfect partners, but this is a marriage made in hell," said a Western energy executive who has worked with both. Russia and China, he added, are "so afraid of being outdone" by each other that negotiations tend toward all-or-nothing combat.

The economic imperatives for greater cooperation remain powerful and, a report issued in November by the International Energy Agency predicted, should ultimately prevail, with China's share of Russia's total earnings from fossil fuel exports forecast to rise from 2 percent now to 20 percent in 2035. But economic logic has rarely run in a straight line between Beijing and Moscow.

China desperately needs what Russia has in abundance - oil, natural gas, coal, mighty rivers for hydropower, and nuclear know-how. And Russia, seeking to position itself as an "energy superpower," has increasingly looked to China to help boost its economic and political clout.

Demand soars

Between 2000 and 2010, China nearly doubled its oil consumption and is on track to overtake the U.S. as the biggest petroleum importer by the end of the decade. To feed this demand, and their own bottom line, state-owned energy behemoths such as China National Petroleum Corp., or CNPC, have scrambled for supplies across the Middle East and Africa and closer to home in the disputed waters of the South China Sea.

But perhaps no other country has offered quite as much promise - and frustration - as Russia, which produces more oil than even Saudi Arabia, sits just next door to China and, because of the retreat from democracy under Putin, is often on the same wavelength as Beijing's own authoritarian leaders.

Russia's proven oil reserves are five times as big as those of China, which in 2010 consumed three times as much petroleum as its northern neighbor. Russia also has the world's biggest supplies of natural gas, a resource that until recently China largely neglected but that is now at the center of its energy policy. It plans to double gas use over the next five years.

"China looks very seductive," said Vladimir Milov, a former deputy energy minister who took part in early oil and gas talks with Beijing. But, he added, energy cooperation doesn't depend on "just looking at the map. ... There is a deep lack of trust behind the facade."

Bigger suppliers

In the first 10 months of 2011, faraway Saudi Arabia sent 2½ times as much oil to China as Russia did, while Angola, even farther away, and Iran also supplied much more than Russia, according to Chinese trade statistics. Because of the new Siberian pipeline, Russia has nudged ahead of Oman for fourth place but still accounts for just 7 percent of its voracious neighbor's total oil imports.

Meanwhile, Russia's Gazprom, the world's biggest gas company, has spent a decade haggling with CNPC over a proposed gas pipeline and a mammoth supply deal worth up to \$1 trillion. Not only has construction not begun, but the two sides can't even agree within a thousand miles on where the pipeline would go.

Yang Cheng, a former Chinese diplomat in Moscow who is a scholar at Shanghai's East China Normal University, said Russia and China keep talking past each other. When Moscow first pushed for greater energy cooperation at the start of the 1990s, China "still thought it could supply itself," and when it later turned to Russia and sought to gain stakes in oil fields, Western companies already had the inside track. Yang said that he remains optimistic in the long run but that each side has to stop "talking about its own stand and neglecting the other."

Entanglements

The energy sectors in Russia and China are dominated by giant state-owned corporations that pursue profit but are also entangled with security and other government agencies. The former head of CNPC, petroleum engineer Zhou Yongkang, sits on the Communist Party's Politburo, combining a keen interest in energy with overall responsibility for China's security agencies.

Russia's energy companies are studded with former KGB men. Tokarev, the head of Transneft, used to work at the KGB with Putin, according to Milov and Russian energy experts. Tokarev declined to comment on that assertion.

Tokarev believes that the firm grip of state companies on Russo-Chinese energy deals "makes things much easier" because private companies "have different criteria and different approaches to business."

Khodorkovsky's arrest

But it was a private Russian oil company, Yukos, that pioneered oil deliveries to China - by rail - and led an early push for a pipeline.

Yukos' China efforts fizzled after the 2003 arrest of its boss, Mikhail Khodorkovsky, who - convicted of corruption and tax evasion - has since been in jail.

In a written reply to questions, Khodorkovsky described the Chinese as "very tough negotiators but scrupulous partners." In contrast, he said, Russian "state functionaries have demonstrated to China that internal ambitions and bickering are more important to the Russian bureaucracy than reliability in partnership."