



Russia

## Is the Russian Economy Finally Tilting East?

By VLADIMIR POPOV

**It may well be that in the next decades, with the benefit of hindsight, it will be only too obvious how Russia had sidestepped its Asian opportunities until 2014. Russia is lucky to border China – an emerging world economic leader – but it has not benefitted from this proximity as its primary policy goals have been Western-oriented, at least until the Ukraine conflict.**

“The Russian eagle has two heads. One is looking westward, the other is looking eastward.”

*-Former Russian President Boris Yeltsin*

In 2012, Russia exported 550,000 barrels of oil per day (bpd) to tiny Netherlands, but less than 500,000 bpd to China. According to the “gravity model” of trade, the volume of trade is proportional to the size of two countries’ GDPs and inversely related to the distance from each other, so Russian exports to China should greatly exceed exports to the Netherlands. China’s GDP is at least an order of magnitude larger than that of the Netherlands, while the distance from the main Russian oil fields in western Siberia is approximately the same to both states. Not only oil trade, but all Russian trade and investment flows are very much skewed westward.

The Ukraine conflict and the Western economic sanctions that followed have provided a major push for the geographic reorientation of Russia’s foreign economic trade and investment.

A Eurocentric pattern of foreign trade and investment is gradually being replaced by a more balanced one, in which Asia and especially China will play a more prominent role. It is likely that Europe and Asia will be evenly represented in Russia’s future economic relations. But if Russia’s confrontation with Europe continues, China (and all Asia) may well replace Europe as Russia’s center of economic gravity.

### Russia’s Energy Trade Imbalance

In 2014, over 50% of Russia’s overall oil exports went to Europe and the post-Soviet states, while only 24% went to East Asia (China, South Korea, Japan). Up until 2009, Russian natural gas was not at all exported to East Asia. Even now, all Russian non-liquefied gas goes to Europe, the post-Soviet states, and Turkey.

**Only 13% of Russian exports and 25% of imports went to or came from China, Japan, and South Korea, while over 50% of Russian trade was with Europe.**

Russia started to export liquefied natural gas (LNG) with the operation of the Sakhalin Energy LNG plant, which can export up to 22 million cubic meters of LNG per year. Unlike its traditional oil and gas exports, Russian LNG is totally Asia-oriented. Nearly all Russian LNG goes to Japan (76% in 2012) and South Korea (20%) under

long-term supply agreements the rest goes to China and Taiwan. However, revenue from LNG exports in 2014 totaled only \$5.2 billion, less than 10% of the revenue from natural gas (without LNG) exports of \$55.2 billion.

Russia has also finally begun to send more piped oil to Asia as well. In 2011, the Skovorodino-Daqing segment of the Eastern Siberia–Pacific Ocean (ESPO) oil pipeline, intended to export 15 million tons of oil every year over the next 20 years, was launched. Before, oil was exported to China only by railroad. In December 2012, the pipeline was extended to Kozmino, near Russia’s far eastern Nakhodka port. In December 2013, Russia signed an agreement with China to sell up to 31 million tons of oil.

An agreement on a new gas pipeline (the “Power of Siberia”) between Russia and China was also finalised in 2014, with construction scheduled for completion in 2018. This line is to provide annual deliveries of up to 38 billion cubic meters over 30 years. A second proposed pipeline, the Altai route, crossing the Russian – Chinese border between Kazakhstan and Mongolia, would deliver another 30 billion cubic meters of gas per year. Nonetheless, even with these new projects, gas and oil export from Russia to East Asia will still be less than to Europe today. Total Russian gas exports in 2014, including LNG, amounted to about 195 billion cubic meters with only 20.5 billion cubic meters of LNG going to East Asia.

### The Same Goes for All Russian Foreign Trade and Investment

In 2013, the geographic structure of all Russian trade was similar to its oil and gas trade. Only 13% of Russian exports and 25% of imports went to or came from China, Japan, and South Korea, while over 50% of Russian trade was with Europe (see Figure 1 on next page). In 2012, China’s trade with Brazil,

a country with a GDP (ppp) similar to Russia's, was nearly as large as its trade with Russia (\$83.3 and \$87.5 billion respectively), even though Brazil is thousands of kilometers away, whereas Russia is a close neighbour sharing a 4000 km border.

Foreign investment flows have a similar geographical structure. Over half of all foreign investment in Russia is from European states, whereas only 11% is from China and Japan. For foreign *direct* investment (FDI) in Russia, the share of Japan and China is only 1% each, whereas over two-thirds comes from European states. Of outward Russian FDI, Japan, China, and South Korea account for less than 1% each.

East Asia's economic potential surpasses that of Europe. According to IMF data for 2015, China's GDP (in purchasing power parity) amounted to \$19 trillion; Japan's, nearly 5 trillion; and South Korea's, nearly 2 trillion. Combined, their GDP exceeds that of the European Union at \$19 trillion by a good margin. Adding the GDP of Taiwan, Southeast Asia, Mongolia, and North Korea to the mix further boosts Asia's relative weight (Figure 2 on next page).

Asian economies are also growing faster than those of Europe. The annual (incremental) increase in GDP in East Asia is higher than that in Europe by an order of magnitude. Moreover, the geographical diversification of trade is a universal guiding principle for every country, regardless of its political orientation. No country wants to put all its eggs in one basket. An economic focus on a single region is undesirable even if that region contains friendly partners. Why then, is Russia so Eurocentric in its trade and investment patterns?

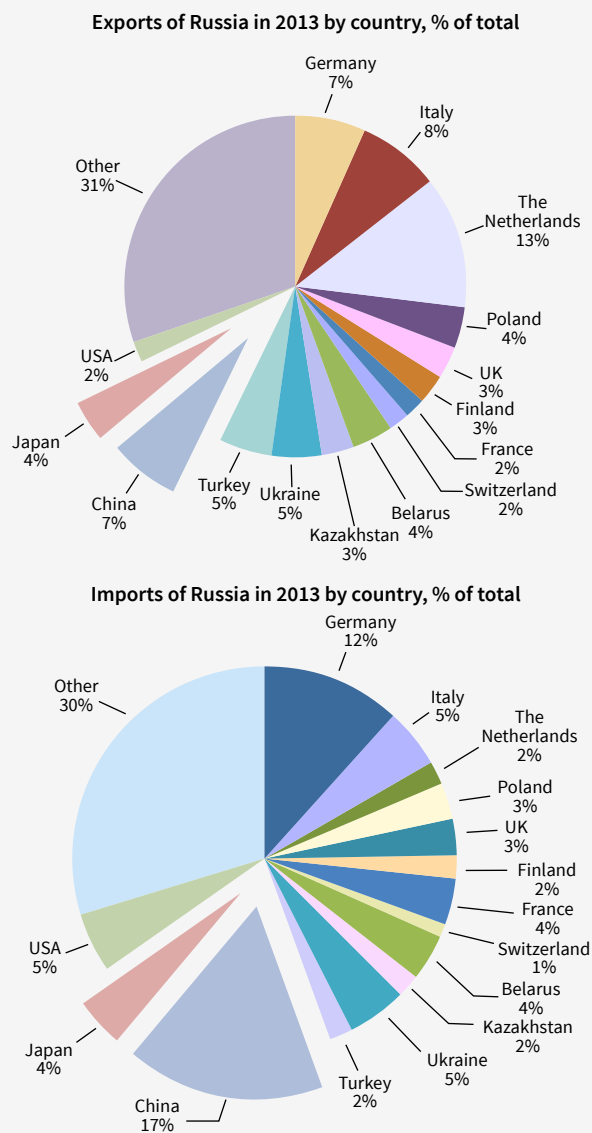
### East-West Stereotypes and Economic Orientation

"The Russian eagle has two heads," former Russian president Boris Yeltsin used to say, when questioned about Russia's international orientation. "One is looking westward, the other is looking eastward." Maybe so, but how much does the eastward-looking head actually see?

Whatever are the reasons for the Eurocentric geographical pattern of Russian trade and investment, they are mostly non-economic. Until the deterioration of relations with the West and the Ukraine conflict, Russia looked down upon China, not giving it the same attention China gave to Russia. For centuries, Russians have been unwilling to "become" Asians. They have identified themselves with and talked about European civilisation—European education, values, services, consumer goods, and so on. Toward Asia, Russians have had a different set of idioms, such as Asian craftiness, cunning, even cruelty. The nicest cliché phrase used has probably been "Asian exotics".

This outlook is changing, but slowly. Russian liberals fear a pro-Eastern orientation the most. They do not like China because of its authoritarian, communist regime. Any

FIGURE 1. Geographical structure of Russian trade in 2013, % of the total



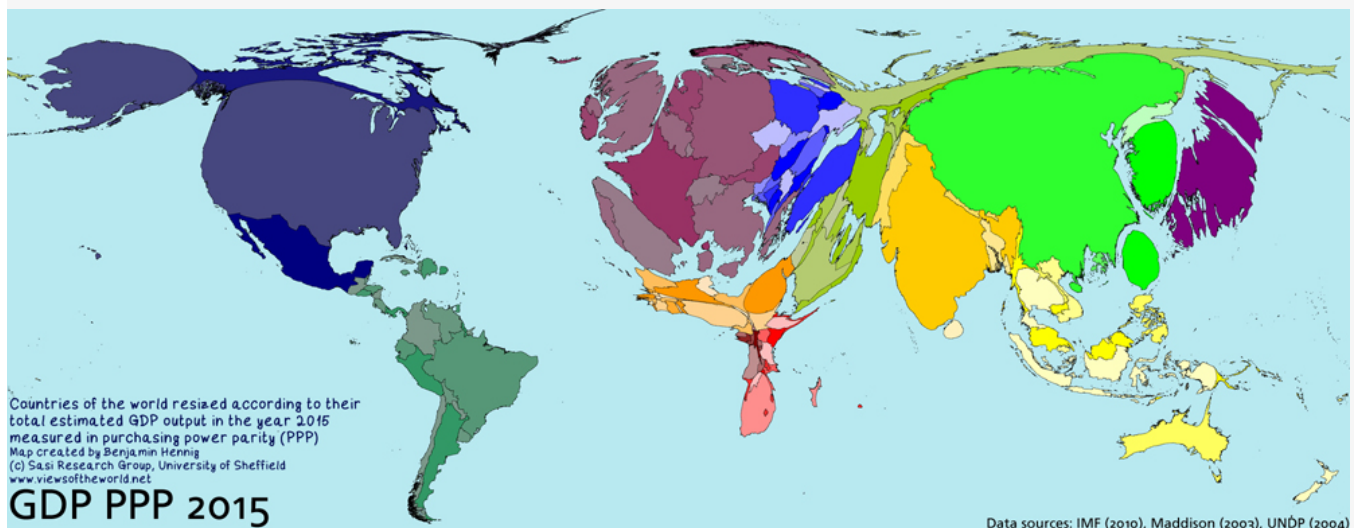
Source: Federal Statistical Service of RF, <http://www.gks.ru/>

contacts with China, or any study of its experience, they consider shameful. In China, Russian liberals are known as opponents of Russia-China cooperation. From the other side of the political spectrum too, it is not uncommon to hear talk about a "yellow peril" and the creeping expansion of Chinese migrants into Siberia and into major Russian cities. As a result, government policies, at least until recently, were far more favourable to developing ties with Europe than with Asia, in particular China.

The Russian elite still feel very much European and they are willing to develop pro-European orientation of Russia, if

# Outlook

FIGURE 2. Map showing states of the world resized according to their estimated GDP (PPP) in 2015



Source: Views of the World. <http://www.viewsoftheworld.net/?p=870>

only Europe would like to integrate with Russia. On its part, however, Europe was never eager to accept Russia into the European structures and recent conflict in Ukraine lowered European interest even more.

It may well be that in the future Europe will be forced to change its position versus Russia because of the need to compete with the rising China pushing ahead “one belt, one road” initiative: it is better to have Russia on the EU side in the global competition with China rather than to see Russia drifting in the direction of China-led East Asian alliance.


However, there are options for the future Chinese geopolitical orientation as well – it could go East or West. Western, Eurasian, orientation means an alliance with Russia and Europe to compete with the US and other Americas, whereas Eastern orientation is the alliance across the Pacific with the Americas to compete with Eurasia.

Chinese elite seems to be more inclined to go East rather than West, Chinese trade and investment across the Pacific are relatively more important than trade with Eurasia. True, TPP today is regarded as the US project of Pacific integration without China, but eventually current tensions between China and the US may prove to be a family quarrel and powerful Pacific gravity forces between two largest economies of the world will prevail, so it would be too late for Russia and for Europe to bet on Eurasian integration.

## Conclusions

Russian prejudices against closer relations with China are wrong and harmful. In ten years, maybe sooner, China will

be more developed than Russia economically and no less democratic. Then it will be possible to carry out an objective evaluation and to compare the costs and benefits of the two countries’ transformations – by how much living standards increased and how many lives were lost during the transition to market economy and democracy.

It may well be that in the next decades, with the benefit of hindsight, it will be only too obvious how Russia had side-stepped its Asian opportunities until 2014. Russia is lucky to border China – an emerging world economic leader – but it has not benefitted from this proximity as its primary policy goals have been Western-oriented, at least until the Ukraine conflict. Now the attitude of the Russian elite is changing, and there is no sign that Europe is willing to consider the inclusion of Russia into European structures. As a result, it is likely that the Russian economy will continue to reorient itself toward the East at least for the time being. 

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