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RESEARCH NOTE

After Ukraine, Russia looks to China for a lifeline; China treads a cautious path

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This map outlines major routes of crude oil transport through pipelines, sea-routes, rail links and sea-rail links, illustrating growing Sino-Russian attempts to secure stable export routes for Russian oil into China.

Source: As compiled by DRI

Executive Summary

Beijing can benefit from the growing feeling in Asia that the US is no longer in a position to be a security provider.

Ukraine gives China some much-needed breathing space.

Beijing will be cautious about increasing currency convertibility.

An energy-induced inflation wave in Europe and the US could spare China

China also has an opportunity to extend its economic influence over a weakened and isolated Russia.

The United States might try to use secondary sanctions to stop or slow down Chinese economic influence in Russia

Background and Analysis

China can benefit from the Ukraine war in different ways but they all require careful positioning. First, if Russia is able to extract painful concessions from Ukraine or if the war takes an even more destructive turn, **Beijing can benefit from the growing feeling in Asia that the US is no longer in a position to be a security provider.**

Second, **Ukraine gives China some much-needed breathing space.** The retired editor of the Chinese state-owned Global Times Hu Xijin recently gave a revelatory account of how Chinese officials see the war. He wrote in his Weibo account that the war moves Russia to the forefront of competition with the US, temporarily replacing China, "and giving us breathing space to regroup after Trump's brutal trade war. Two powers resisting US hegemony is better than one."

He added: “If the US can drive a wedge between Russia and China, Putin will face certain defeat, and China will be next.”

Third, **the heavy sanctions adopted by Western democracies against Russia can diminish the global role of the dollar**, especially as central banks become more cautious about holding its reserves as liabilities in the West. On the other hand, attracting hundreds of billions of dollars of reserves from the developing world would risk the sort of currency overvaluation Chinese authorities want to avoid. **Beijing will be cautious about increasing currency convertibility.**

Global energy markets could fracture. China will benefit from privileged access to Russian energy exports. Contrary to India, it has the infrastructure in place to access Russian natural gas, as Europe reduces its imports. **An energy-induced inflation wave in Europe and the US might spare China.** Cargos of Russian Urals crude oil have been offered to Chinese and Indian buyers at record discounts.

Such a policy will have to be carefully calibrated. China is not expected to join the sanctions adopted by Western democracies but it can be caught up in them and Beijing must be careful not to seem to be actively undermining them, lest economic relations with the West suffer a new shock after the Trump tariffs and economic sanctions against Chinese companies.

Over time, China also has an **opportunity to extend its economic influence over a weakened and isolated Russia.** This will be particularly the case if Russian goals in Ukraine continue to stall. Chinese Ambassador to Russia Zhang Hanhui told about a dozen business heads to waste no time and “fill the void” in the local market, the Russia Confucius Culture Promotion Association said on its official WeChat account. Zhang described the situation as an “opportunity.” The stock price of **Jinzhou Port**, which is located in Liaoning and handles East Chinese imports and exports to North-East Russia, jumped significantly since February 24, causing the company to issue a statement warning that the current traded valuation “has seriously deviated from the company’s fundamentals” and is “significantly higher” than the industry average.

Key issues

ENERGY

Russia and China are well suited to forge a robust energy partnership due to their geographic proximity and economic complementarity. Through long term agreements and joint infrastructure projects, Putin and Xi have made fairly permanent arrangements for an uninterrupted supply of Russian oil to China. Chinese state-owned energy giants are currently mulling increasing stakes in Russian energy and commodity giants. Chinese oil refiners are looking at alternative payment options, including payment in cash, for Russian crude oil imports, as transactions with Russia became more difficult due to Western sanctions.[1] Chinese independent refiners, mainly based in Shandong province, have already bought Russia’s ESPO crude even after the Russian invasion of Ukraine and reports suggest that many state-owned refiners have also returned to the Russian spot market attracted by the record discounts.[2] Although China does not regularly release the size of its crude reserves, reports suggest that Beijing recently expanded storage capability in Huangdao and Zhoushan, and built new facilities in Dushanzi, a border district in Xinjiang Region, Lanzhou, capital city of Gansu province, and in the northern port city of Tianjin.[3]

PAYMENTS

Russia and China share the goal of a more balanced global monetary system and as early as December 2021, Xi and Putin declared their intention to increase the number of deals they settled in their local currencies. The infrastructure to do so is in place with Bank of Russia and People's Bank of China having a multi-billion-dollar currency swap deal in place since 2014 and Beijing having provided an undisclosed amount of yuan to Russia in multiple deals since. Reportedly, the two banks are also working to integrate the Russian System for Transfer of Financial Messages and Chinese Cross-border Interbank Payment System to bypass Russia's exclusion from the Belgium-based financial messaging service SWIFT. Sberbank, Russia's largest bank in total assets and share of savings deposits, is reportedly assessing the possibility of issuing co-badged cards with the domestic Mir payments system and China's UnionPay after Visa and Mastercard suspended operations in Russia.[4] Recently, Russian Standard Bank made it possible for its clients to transfer money issued by foreign banks to UnionPay cards.[5] Shares of Chinese companies involved in developing payment infrastructure for the digital yuan, including Newland Digital Technology Co, Lakala Payment Co and Client Service International Inc have risen recently, despite weakness in the broader Chinese market.

MILITARY PARTNERS

China, once heavily dependent on Russian weapons to advance its military modernization, is increasingly shifting away from Russian exports as it builds its own manufacturing capabilities. A major importer of conventional weapons between 2005 and 2009, China expanded its military capabilities to become the fifth largest arms exporter in the world from 2016-2020. Recent Chinese imports from Russia show a shift in emphasis from weapons systems to component parts and smaller deals for advanced systems, including the S-400 and Su-35. Since 2014 and despite Russian concerns about Chinese reverse engineering, Russia has become heavily dependent on China, its second largest arms export client. Moscow has also turned to Beijing for the supply of weapons parts and technical expertise, as China outpaces Russia in military spending and military-technological developments. As a part of their expanding security cooperation, several joint production schemes involving high-tech weapons, notably in building heavy-lift helicopters, are also in place. Although Chinese officials have dismissed reports that Russia is seeking Chinese military assistance in Ukraine, the recent agreement providing a roadmap to expand military cooperation on strategic military exercises and joint patrols indicates a robust military partnership in the making which is unlikely to be deterred by the Ukraine crisis.

What's Next?

By invading Ukraine, Russia rendered impossible any attempt at a rapprochement between Moscow and Western democracies. **The strategic risk now is that the unavoidable wave of sanctions against Russian economic interests will weaken Russia to the point it becomes easy prey for Chinese economic might.** The Biden administration will try to solve the dilemma by threatening China with secondary sanctions if it moves too quickly or too boldly to take advantage of economic opportunities in Russia. **The goal is twofold: to ensure Russia does not bypass the sanctions and to stop China from becoming their main beneficiary.** White House officials are preparing measures that would also punish third parties in other countries for interacting with certain sectors of the Russian economy that have been sanctioned by the United States. China is the main target, but secondary sanctions are for the time being a deterrence tool more than a policy choice. Contacts in the State Council in Beijing tell us **China will move slowly and try to test America's limits in the most gradual manner.** Chinese government officials have been urging major energy companies not to make any rash moves scooping up Russian assets. For now, the priority is to avoid any entanglement in the Western-led sanctions against Russia. Sinopec recently suspended a project to market Russian gas in China after realizing that Sibur minority shareholder and board member Gennady Timchenko had been sanctioned by the West. During their meeting on March 30, the Chinese and Russian foreign ministers discussed the impact of the sanctions on bilateral ties and reinforced the message that **Moscow and Beijing are "more determined" to boost economic cooperation.**

1 https://gcaptain.com/china-russian-oil-tankers/ ; https://www.offshore-technology.com/news/china-seeks-alternative-import-payments-as-sanctions-around-russian-oil-tighten/ **2** https://www.qcintel.com/article/russian-urals-crude-tumbles-to-record-discount-after-litasco-offer-4923.html **3** https://www.scmp.com/economy/china-economy/article/3156952/how-big-are-chinas-crude-oil-reserves-and-how-do-they-compare **4** https://tass.com/economy/1417779?utm_source=google.com&utm_medium=organic&utm_campaign=google.com&utm_referrer=google.com **5** https://tass.com/press-releases/1378691