

A View from the “Rodina”

By Robert Jutson, Managing Director, Griffin Capital Partners

Over the centuries, Russia has kept a weather eye to its west, south and most recently its east, employing international trade and multilateral diplomacy to balance countervailing forces, competing interests and strategic objectives. Spanning eleven time zones, a multitude of diverse ethnic and language groups and eighty-five administrative regions, the challenges of size and governance, language and administration underpin the ongoing debate about the nature of Russia's borders and her defense. Moreover, the conditions of Russian communities living in the “near abroad” continue to draw attention and merit consideration. These historic issues are nowhere more acute than in Russia's resource rich and thinly populated Far East and Pacific Maritime provinces. Multilateral trade groups like the Eurasian Economic Union offer a potentially durable forum to gather the states of the region around common interests, opportunities and perceived threats.



DAY TRIPPER

Igor's wife and her girlfriends have been day tripping to China for decades.

One bright summer day during the financial crisis of 1998¹, we cast off from the pier at her magnificent Georgian-style villa along the broad, meandering Amur River. China beckoned from the opposite bank. Her riverside home was once a redoubt for Chang Kai-shek after Mao's 1949 victory in China's Civil War. While traveling the Amur in 1890, an enraptured Anton Chekov declared he “lacked the skill to describe anything as beautiful as the banks of the Amur.”

That afternoon, we enjoyed a leisurely cruise upstream from the provincial capital of Khabarovsk to the Chinese frontier town of Fuyuan in Heilongjiang province (pop: 38 million, 2012). After our shopping spree, Igor's yacht returned us at dusk to the sandy beach of Khabarovsk's “Hotel Paris”².

The vast region of Khabarovsk-krai, Russia's fourth largest district, has a mere 1.3 million people (1.7 persons/sq km, 2010), eight of ten of whom live in the capital. Over a quarter of Russia's trade with China today passes through Khabarovsk-krai to Heilongjiang province. It is the entrepot for Chinese imports of Russian Sukhoi fighter jets manufactured further downstream at Komsomolsk-na-Amur.

On our way to the airport the next morning, we found the tree-lined avenues of the Khabarovsk crowded with right-hand drive cars and trucks imported from Japan. Our flight to Moscow would take about nine hours – a distance of over 6,000 km.

That day, there was little question the future of Russia's Far East lay across the Amur.

RUSSIA WELCOMES INVESTORS

When President Putin visited Khabarovsk in July 2000, he noted the stark choice facing Russia: “If we do not make real efforts to develop the Far East in the very near future, the Russia population will mainly be speaking Japanese, Chinese and Korean in a few decades.”

Russia possesses the Earth's greatest reserves of mineral resources. It is the world's leading producer of oil and gas, exporting via multiple pipelines to the nations of Europe and Asia. Resource nationalism comes as naturally to Russia as it does to Saudi Arabia or the Texas Railroad Commission. Prudential management of this enormous latent energy and economic power is essential to achieving Russia's prosperity, ensuring its geopolitical prominence and realizing its manifest destiny as “Rodina”, the Motherland.

President Putin recently pitched hundreds of executives at the Eastern Economic Forum in Vladivostok. They were seeking investments in Russia's vast and sparsely populated Far East and Siberian regions. In addition to investment from China, India, Japan and South Korea, Russia aims to deepen its ties with the Asia-Pacific region.

During the conference, Rosneft, Russia's national oil company, and China Petrochemical Corp. (Sinopec) signed a heads of agreement on cooperation for the joint development of two big Rosneft fields. Sinopec will gain a call option on a 49% stake in East Siberian Oil and Gas Co. (ESOGC) and Tyumenneftegaz, which hold the exploration licenses for the Russkoye and Yurubcheno-Tokhoms koye fields, respectively.

The two fields are located in one of the key regions of Rosneft operations. Joint development of tight oil reserves will allow Rosneft and Sinopec to mitigate the operational risks of the projects. The cooperation will also enhance the projects' capacity in financing, technology, and implementation³.

“It appears Putin is not seeking to rebuild the Soviet Union but to create economic union in Asia.”
– Ian Barnes, “Restless Empire: A Historical Atlas of Russia”, 2015

“We will provide the best conditions to investors to do business so the Far East of Russia can successfully compete in terms of efficiency and return on capital,” President Putin said at the conference which was modeled on the Russia's annual economic forum in St. Petersburg.⁴

Russia is always careful to hedge its bets and balance its exposure, as it was when Rosneft also announced the sale of a 15% stake in Vankorneft, the operator of its largest oil and gas field in Siberia. The buyer is India's ONGC Videsh, a unit of India's state run ONGC national oil company. The purchase price is reportedly \$1.25 billion. Beijing no doubt observed that Delhi can compete successfully as a bidder for Russian energy.⁵

Vankorneft was established in 2004 for development of the Vankor oil and gas condensate field – the largest field discovered and put into operation in Russia in the last 25 years. The Vankor field, producing since August 2009, yields over 400,000 barrels of oil per day. Vankor's initial recoverable reserves as of 1 January 2015 are estimated at 476 million tonnes of oil and condensate and 173 billion cubic meters of gas. The acreage of the field is 447 square km. Transport is via the 556-km long Vankor-Purpe pipeline where it connects at Purpe to the Transneft national trunk pipeline. The oil produced at the field is thus a primary feeder for the Eastern Siberia – Pacific Ocean pipeline serving Asian markets.

GATHERING GREATER RUSSIA: AN ONGOING PROJECT

As the world's largest continental power, Russia has always endeavored to balance the promotion of its national interests against harsh geopolitical realities, while carefully limiting the possibility of becoming either too exposed to, or too withdrawn from, the world. This vital preoccupation with balancing the openness and security of its society and frontiers has a long history and continues today, from Russia's Far East to Georgia, Ukraine and the Baltic Republics.

Russia's territorial gains under Catherine the Great included what we know as Western Ukraine, the Crimea, Belarus, Moldova and Lithuania. Representatives of Alexander II and the Qing Xianfeng emperor signed the Treaty of Aigun in 1858 in the midst of China's Taiping Rebellion. This formalized Russia's sovereignty over what is now the Russian Far East. In the ensuing 1860 Treaty of Beijing, China further ceded the region that would become Primorye-krai, Russia's leading Pacific Maritime Province and home to the Russian naval port city of Vladivostok.⁶

“Who is to quarrel with a people's interpretation of the past? It is its only means of facing the future, and what ‘really’ happened is often less important than what is thought to have happened.” – Henry Kissinger, “A World Restored”, 1957

In gathering Russia, Ukraine remains a particularly special case. Kievan Rus' was the cradle of Russian civilization long before the Kremlin cornerstone was laid in 15th CE. After Ukraine's Orange Revolution of 2004 brought two populist, anti-Russian candidates to power, the euphoria in its wake led many western investors to jump in, as did we when we became a founding shareholder of MTV Ukraine⁷. But the incessant bickering of Victor Yushenko and Yulia Tymoshenko enabled graft to remain endemic and democratic reforms to languish. This led to former President Yanukovich returning to power, only to flee to Moscow in 2014 on being once again removed from office. He was replaced by Petro Poroshenko who will have a full dance card at the annual meeting of the World Bank and IMF this October as Ukraine restructures its sovereign debt with international creditors – among who include Russia.

The Treaty of Georgievsk (1783) gave Russia control of Eastern Georgia. Russia also assumed the obligation to defend Georgia's territorial integrity and station a garrison in Tbilisi. Following the dissolution of the Soviet Union, newly independent, oil-rich and landlocked Caucasus and Caspian states were keen to access world markets. Georgia provided a transit route to global markets which states like Kazakhstan, Azerbaijan and Turkmenistan use to export their oil and gas via the Baku-Tbilisi-Ceyhan pipeline, thereby avoiding the tolls and exactions imposed by northern routes. Russia naturally opposed multiple pipelines, reflecting a strong desire to retain control over strategic resources, pipeline and infrastructure networks providing market access.⁸

The dynamic of forces throughout the Caucasus changed with the 2008 Georgia-Russia war over South Ossetia. The West's leadership finally awoke to how manifestly ambivalent Russia remains about the changed political, economic and military realities on its southern rim and the encroachment of NATO on its western flank.

With little fanfare, Rosneft entered Georgia's midstream and downstream oil markets in late 2014 by purchasing a 49 percent stake of Petrocas Energy Ltd., a Georgian oil transportation company operating in the South Caucasus. Petrocas's assets include an oil terminal in Poti with a capacity of 1.9 million tons per year and a network of 140 gas stations in Georgia operating under the Gulf brand. Rosneft quickly gained high-quality storage capacity in one of the major oil and refined products hubs in the region, broadened Russia's supply route options and enhanced its upstream and downstream operations in the Central Asia and South Caucasus energy markets.

Rosneft need only move into upstream exploration and production to become Georgia's leading vertically integrated energy company, an outcome the Kremlin might find appealing.

THE NEW SILK ROAD AND CHINA

The rise of China presents a fundamental challenge to Russia as well as the US, Japan, Korea, the nations of South and Central Asia and elsewhere. Henry Kissinger recently observed: “A country that has had three thousand years of dominating its region can be said to have an inherent reality. The alternative[to Nixon's opening to China] would have been to keep China permanently subdued in collusion with the Soviet Union, and therefore making the Soviet Union—already an advanced nuclear country—the dominant country of Eurasia with American connivance. But China inherently presents a fundamental challenge to American strategy.”⁹

In the energy deals Putin recently struck with India and China, Russia manifestly views the ascendance of those states as an opportunity to counterbalance NATO advances while focusing on the real prize: long-term economic growth through trade and the promise of stability and prosperity for all Russians.

¹ During that financial crisis, Russia's industrial output in 1998 declined 5.2% year-on-year on ruble weakness and the near collapse of the banking system according to the State Statistics Committee. This came after 0.4% growth in 1997, the first recorded growth after ten years of economic decline. CBR reserves totaled \$12.2 billion on 1 Jan 1999 (of which \$8 billion was cash and \$4.2 billion precious metals). “There was a massive collapse in demand” said Roland Nash, then head of credit analysis at MFK Renaissance. “Incomes were suddenly squashed and companies literally couldn't process financial transfers.” (Russia Review, 20 January 1999 <http://www.griffincap.com/rfp/r200199.pdf>)

² Two officers of Griffin Capital served as directors of Dal Telecom International prior to its sale to Russia's Vimpelcom in 2004.

³ Oil and Gas Finance Journal, 4 September 2015

⁴ The Financial Times, (Russia courts Asian resource investors), 4 September 2015

⁵ The Financial Express (The Indian Express Online Media Pvt Ltd.), 4 September 2015

⁶ <https://www.foreignaffairs.com/articles/russian-federation/2015-07-05/russias-eastern-exposure>

⁷ “I Want My MTV Ukraine: Risk Management in Changing Markets”, 7 December 2007 <http://www.griffincap.com/rfp/MTV-Ukraine-Case-Study.pdf>

⁸ Russia Review, 20 October 1999 <http://www.griffincap.com/rfp/r201099.pdf>

⁹ The National Interest, 19 August 2015

After all, China has traditionally sought tribute and trade rather than territory¹⁰. The tributary system ended in 1842 after Great Britain defeated China in the First Anglo-Chinese War. Since then, China has carefully considered winning strategies to restore its position in the world. In support of this effort, Yen Fu, a leading Chinese scholar (1854-1921) first studied and translated the European works of Spencer, Huxley, Mill, Montesquieu and others into Chinese, largely to seek out the secret of Western power. He described the unity of Chinese culture and China's overriding goal from the late 19th century to resume its rightful place in the world by catching up with the West, or in Chinese parlance, by a search for wealth and power¹¹. China has been quietly implementing many of Yen Fu's findings for decades, supplementing traditional Chinese wisdom from the Warring States period.

Russia, independent Central Asian states and China share a common interest in access to global markets by land corridors free of interference by any single sovereign. Chinese President Xi Jinping enunciated the "New Silk Road Economic Belt" as an economic and security program during his tour of the Central Asian republics in October 2013. The phrase describes various initiatives to open land routes between China and Europe to supplement sea lanes which might be threatened or closed. These multiple interconnected roads, rail, pipeline and fiber optic networks span the Eurasian continent from China's Bohai Bay to Georgia's Black Sea ports and terminals.

These corridors may fundamentally reconfigure global trade and commerce, shifting the focus of trade and geopolitical strategy to the Eurasian landmass from the waters surrounding it. The resulting trade liberalization and economic cooperation among connected nations will lead – in the bland words of President Xi Jinping – to “a sense of common destiny” among China's neighbors and “answer the call of our time for regional and global co-operation”. Today, one may well ask: “Why pursue military dominance if it is more cost effective – and durable – to expand influence through trade and investment?” Indeed, if natural resources are readily available over multiple land routes from Russia, the Caspian region or the Persian Gulf, there is little need to protect every maritime trade route or project force by maintaining a blue-water navy.

RUSSIA AND THE EURASIAN ECONOMIC UNION

As dramatically illustrated by McKinsey¹², the world's economic center of gravity has moved toward Eurasia as Chinese and Indian populations grow and prosper¹³. Eurasian trade routes extend from Kashgar and Kazakhstan to Madrid, Georgia and ultimately to Pakistan's port of Gwadar on the Persian Gulf.

“The earth's economic center of gravity is shifting back to Asia at a pace never before witnessed.” – McKinsey Global Institute 2012

Russian initiatives such as the Eurasian Economic Union Treaty of 2014 provide one of many important venues for convergent interests across Central Asia. The rush by European countries and Japan to join the Asian Infrastructure Investment Bank is among the most powerful symbols to date of the eastward shift of global power. Neither of these initiatives implies that any one nation controls Eurasia's east-west land trade and transit. A consensual state of play benefits all who rely on open borders and international customs and trade conventions such as the WTO or the Eurasian Economic Union.

CONCLUSION

Within Russia, a durable world view about the nature of its borders and defenses has been forming for centuries and will likely continue to do so. Since Putin became president in 2000, he has consistently sought to maintain Russia's geopolitical position and the stability of its borders.

When addressing the conditions of Russian living in the “near abroad”, Russia is implementing its own version of the US Monroe Doctrine which proclaimed, in 1823, that European powers meddling in the Americas would face US intervention. At one extreme, Alexander Solzhenitsyn even proposed that the Russian-inhabited regions of Northern Kazakhstan should secede and become part of the Russian Federation. That is essentially what happened in Ukraine when a referendum in the Crimea resulted in its secession from Ukraine in 2014 which, according to *The Economist*, was “... the result of the neglect which Ukrainians displayed towards Crimea over the years, leaving it to its own devices and failing to integrate it deeper into Ukraine.”¹⁴

Russia is taking care not to neglect its Far East and President Putin visits often. The conundrum confronting Russia and many nations today remains security versus prosperity and growth. A policy alternative worthy of consideration on a limited basis might be to promote the temporary, free but orderly movement of skilled labor in the Russian Far East. Such an initiative might begin with student exchanges such as that represented by the School of Russian and Asian Studies.

Writing in *Foreign Affairs*, Salvatore Babones recently proposed Russia make Khabarovsk-krai and Primorye-krai special visa-free economic zones. “Such moves would, of course, flirt with ceding influence to China. But the alternative to institutional reform in the Far East may be complete depopulation.”¹⁵ Though no more than conjecture, if carefully managed, a trial, test or approximation of a solution could unleash the economy of Russia's Far East, where its energy resources “... meet the manufacturing power of China, the technology of Japan, the ingenuity of South Korea, and the wild card of North Korea”¹⁶. While the benefits of such initiatives are asymmetric, in this instance, considering such policy options is less risky than doing nothing.

Russia is more integrated into the world economy than ever before. Mindful of the long history that defines its self-understanding, its abundant natural resources and rich cultural endowments, Russia has a significant role as first among equals spanning the entirety of Eurasian markets. While some conflict is unavoidable given the region's enormous diversity, the behavior of most nations and peoples today suggest a strong preference for prosperity, economic integration and trade within and across existing borders.

Griffin Capital Partners is a specialist project finance advisor with decades of experience advising enterprises in Russia, Kazakhstan, Ukraine and Georgia as well as Europe, China, India and the Americas. Learn more at: www.griffincap.com or contact us at: partners@griffincap.ch

¹⁰ The Chinese tributary system dates from the Han dynasty (202 BCE –220 CE). It reflected the Chinese worldview that China was the center of the civilized world, and that all lands desiring relations with China must be tributary states.

¹¹ Benjamin I. Schwartz, *The World of Thought in Ancient China*, Belknap Press 1985

¹² http://www.mckinsey.com/insights/urbanization/urban_world

¹³ Most recently: “The Silk Roads: A New History of the World”, Peter Frankopan, Bloomsbury 2015

¹⁴ *The Economist*, (Ukraine's amputation), 17 March 2014

¹⁵ <https://www.foreignaffairs.com/articles/russian-federation/2015-07-05/russias-eastern-exposure>

¹⁶ *The School of Russian and Asian Studies*, www.sras.org/study_russian_far_east