

CIIS Report

**Eurasian Economic Union  
and Sino-Russian Economic  
and Trade Cooperation**

No. 12  
August  
2017



中国国际问题研究院  
CHINA INSTITUTE OF INTERNATIONAL STUDIES

## **About CIIS**

China Institute of International Studies (CIIS) is the think tank of Chinese Foreign Ministry. Founded in 1956, CIIS is one of the oldest research institutions specialized in international studies in China. It conducts research and analysis focusing primarily on medium- and long-term policy issues of strategic importance to China, particularly those concerning international politics and world economy. It also makes comments and policy recommendations on major world events and hot international issues.

## **About *CIIS Report***

Contributed by researchers at CIIS and published aperiodically, *CIIS Report* brings forth a series of research papers on hot issues of international relations as well as on major aspects of China's diplomacy. Presented with clear-cut views based on detailed and substantive information and in-depth analysis, *CIIS Report* aims at offering a comprehensive picture of assessment of the situation, academic studies and policy evaluation in clear and precise language. *CIIS Report* is published both in Chinese and English and downloadable on the website of CIIS (<http://www.ciis.org.cn>). The views expressed in *CIIS Report* are those of the author(s) or their research group only and do not necessarily reflect the official position of CIIS.

# CIIS Report

## Eurasian Economic Union and Sino-Russian Economic and Trade Cooperation

Chen Yurong

Li Xin

Liu Huaqin

Han Lu

No. 12 - August 2017

中国国际问题研究院  
CHINA INSTITUTE OF INTERNATIONAL STUDIES

## CONTENTS

|  |     |
|--|-----|
| Summary  | iii |
| I. Development of the Eurasian Union: History and Future   | 1   |
| A. Domestic and Foreign Context in Which Putin Proposes the Eurasian Union   | 1   |
| B. Russia Advancing Eurasian Integration Processes   | 5   |
| C. Goals in Forging the Eurasian Union   | 7   |
| D. The Possibility of and Restraining Factors for Materializing the Eurasian Union   | 10  |
| 1. The post-Soviet region has what it takes to realize integration   | 10  |
| 2. The Eurasian Union was jointly initiated by leaders of Russia, Belarus, and Kazakhstan                                  | 10  |
| 3. Economic growth in the post-Soviet region entails integration   | 11  |
| 4. The CIS members come under huge external pressure from different aspects  | 12  |
| 5. Russia maintains its place as the market for CIS industrial and agricultural products as well as an enormous job market | 13  |
| II. EEU, SCO and China-Russia Economic Cooperation   | 15  |
| A. Prospects of Cooperation Among EEU and SCO Member States  | 15  |
| B. China-Russia Economic Cooperation: Status Quo and Future Development  | 20  |
| 1. Remarkable achievements in all-round Sino-Russian economic cooperation  | 21  |
| 2. New challenges to economic cooperation between China and Russia   | 27  |
| 3. Prospects for the development of Sino-Russian economic cooperation  | 29  |
| 4. Proposals to promote the development of bilateral economic cooperation  | 31  |
| 5. Reflections on several issues in Sino-Russian economic cooperation  | 33  |
| III. The Status Quo and Future of Russian Economy  | 37  |
| A. An Overview of Russian Economy in 2015  | 37  |
| B. Main Reasons for the trouble of Russian Economy in 2015   | 38  |
| 1. No sharp rebounding for oil price   | 38  |
| 2. Impacts of western economic sanctions   | 39  |
| 3. Not the right time yet for Ruble appreciation   | 40  |
| 4. Inadequate endogenous motivation  | 40  |
| C. Slim Possibilities for Russian Economic Collapses   | 41  |
| 1. Russian government's plans saving the economy   | 42  |
| 2. Abundant natural resources and national reserves  | 43  |
| 3. Russians uniting as one in overcoming difficulties  | 44  |
| D. Long-Term Challenges  | 45  |
| 1. Conflicts between economic and social goals   | 45  |
| 2. Hardships in achieving innovative economic growth   | 46  |

## Summary

This report is composed of three main parts. In the first part, namely the development course and the future of the Eurasian Union, it points out that great changes have taken place on the international situation since the 21st century. The United States has been bogged down on the wars in Iraq and Afghanistan and its economy suffers from the international financial crisis. Both hard and soft powers of the U. S. are frustrated obviously. At the same time, the European Union (EU), as the ally of the United States, is also bogged down in the debt crisis which leads to the slow-down of the economic growth and social instability in many countries. On the contrary, during the period when Putin and Medvedev are in power, Russia has experienced political stability, high growth of economy and restoration of social order. Since favorable changes have taken place on the domestic and external situations of Russia, its international strategic view has changed dramatically. From the perspective of Russia, the international system is entering a new stage of profound adjustment in which the Western World is losing the leadership of globalization and the multi-centered international order is further reinforced while unipolar world has passed out of existence. Especially in 2009, EU launched the Eastern Partnership and extended farther in former Soviet Union countries including Ukraine, Belarus, Moldova, Georgia, Armenia and Azerbaijan. Russia has to defend its sphere of influence. Under such circumstances, Russian President Vladimir Putin put forward a proposal of creating a Eurasian Union in 2011 and the fundamental objective of the Union is to enhance Russia's influence and economic existence in the former Soviet Union countries. In the process of promoting the Eurasian Economic Community, Russia takes a four-step strategy which means customs union, unified economic space, Eurasian Economic Union (EEU) and Eurasian Union in sequence. Finally, Russia wants to forge the Eurasian Union into one pole of the contemporary multi-polar world and make it an effective and solid link between Europe and the rapid developing Asia-Pacific region. The final target of the Eurasian Union is not just confined to an economic union. The economic weakness of Russia and the economic imbalance and industrial underdevelopment of the Commonwealth of Independent States also constrain the promotion of the Eurasian Union.

The second part of the report is the EEU, Shanghai Cooperation Organization (SCO) and Sino-Russia economic and trade cooperation. In this part, it illustrates that economic cooperation has been a motivation for further development of SCO. China and Russia affirmed the importance of the docking of EEU and the Silk Road Economic Belt and committed themselves to pursuing the joint points of the two mentioned plans. In 2014, despite of the influences of various adverse factors domestically and externally, China and Russia has worked together to deal with crises and achieved great progress in the fields of trade, investments, finance and local cooperation while at the same time, remarkable achievements have been made on the comprehensive economic and trade cooperation between the two sides. However, the challenges of slowdown of bilateral trade growth and the increasing risks of Russia's commerce still exist. Concerning the prospect of Sino-Russia economic and trade cooperation, from the short term perspective, due to the economic recession of Russia, the growth of bilateral economic and trade cooperation will experience a dramatic slowdown. In the medium and long run, accompanied by the two economies adapting to the "New Normal", all the cooperation agreements signed by the two countries will be implemented gradually and bilateral economic and trade will achieve stable growth. Besides, the report provides two principles and five recommendations to the bilateral economic and trade cooperation. The two principles are that the two countries need to balance the gain and loss in the cooperation comprehensively from the strategic level and to implement cooperation projects concretely and steadily. The recommendations are as follows. First of all, we should tap the potential deeply in order to expand bilateral trade scale. Secondly, the process of currency swap should be accelerated and RMB should be used as the bilateral trade settlement currency. Thirdly, we should participate in the infrastructure construction of Russia. Fourthly, we should take part in the building of Russia's Far East development zone actively with caution. Fifthly, we should implement the legal foundation and enhance the role of market mechanism playing in the bilateral economic and trade cooperation while at the same time, operational efficiency of the cooperation should be improved and various trade and investment promotion platforms should be set up in the future.

The third part of the report is the status quo and future trend of Russia's economy. Under the impact of Ukrainian Crisis, the Western economic sanctions, the falling of international oil price and other external factors, Russia's economy has been far from satisfactory since the second half of 2014 which consequently pared down all the economic indicator of the whole year. In 2015, the Russia's

economy will continue the negative developing momentum and the growth rate will keep declining while all economic indicators will be worse than 2014. Based on the prediction of Russia's governmental and non-governmental economic agencies, Word Bank and other international economic organizations that the international oil price will hit \$50 a barrel, in 2015, the GDP of Russia will decrease by 3%-7% while the fixed capital investment will have 10%-19% negative growth and inflation rate will be 15.8%-18%. The Per Capita wage will decline by 9.6%-11% and the real income of residence will reduce by 6.3%-10%. The financial deficit will increase four times which counts 3.8% of the whole GDP. The reasons why Russia is in such dilemma are slight possibility of rebound of international oil price, the subsequent effects of the Western sanction, more time for the ruble appreciation, insufficient internal impetus for economy ,etc. In spite of these difficulties, there is no problem for Russia to gain self-sufficiency because of its vast territory and abundant resources. Besides, the Russian government takes measures to control the economic situation in addition to good macro-financial condition, substantial reserves, low unemployment and unprecedented high social cohesion, which guarantees that the economy will not collapse. The economic difficulties confronting Russia are temporary. Once the external pressure is over, Russia's economy will break out of the dilemma. However, in the long term, since the supply-demand relation of international energy market is hard to forecast and there are still many difficulties in the economic transition, it will be a new normal for Russia's economy to face downward pressure.







# I. Development of the Eurasian Union: History and Future

On 3 October, 2011, the Russian newspaper *Izvestia* published Vladimir Putin's article entitled *A New Integration Project for Eurasia: The future in the Making*,<sup>1</sup> proposing the establishment of a "Eurasian Union" in the post-Soviet space to link Europe with the dynamic Asia Pacific region. Belarusian President Lukashenko and Kazakhstani President Nazarbayev echoed positively Putin's proposition by publishing on 17 and 25 October respectively their pieces in support of Putin in *Izvestia*. The Eurasian Union is no castle in the air, since Russia has been advancing the Eurasian economic integration all along, exemplified by the Commonwealth of the Independent States (CIS) Free Trade Zone (FTZ) and the Customs Union (CU) and the Common Economic Space (CES) of Russia, Belarus and Kazakhstan under the framework of the Eurasian Economic Community (EEC). Putin pointed out that, "Building a customs union and single economic space is to pave the way for the Eurasian Economic Union (EEU)."<sup>2</sup> The EEU initiated in 2015 will be integration at a higher level,<sup>3</sup> with an aim to emerge as one of the poles in the multi-polar world economy, thus fulfilling its historic mission of a Eurasian power.

## ***A. Domestic and Foreign Context in Which Putin Proposes the Eurasian Union***

It was during the worst financial crisis since 1930s that Putin came up with the proposal of Eurasian Union. The crisis unfolded rapidly from the virtual economy to the real economy. In the U.S., a lot of banks and real estate developers went bust, stock markets plummeted, liquidity was in severe shortage, imports and exports were slashed, and unemployment skyrocketed. Though major economies

---

1 <http://www.russianmission.eu/en/news/article-prime-minister-vladimir-putin-new-integration-project-eurasia-future-making-izvestia-3->

2 [http://www.gazeta.ru/business/2011/07/12/kz\\_3693185.shtml](http://www.gazeta.ru/business/2011/07/12/kz_3693185.shtml).

3 Putin said on 20 October, 2011, at the press conference of CIS heads of government commission, the EEC Interstate Council and the Customs Union Supreme Council that, "if we keep the current momentum of hard work, we will be able to bring the Eurasian Union to fruition around 2015." Please refer to the Customs Union website <http://www.tsouz.ru/news/Pages/21-10-2011.aspx>.

in the world responded quickly with massive bailout plans, advanced economies including the European ones and the U.S. went out of steam, troubled by scarce liquidity and deflation. A large amount of capital flooded into emerging markets with strong economic growth such as China, fueling inflation and bidding up their currency values, which dampened their exports. It was unlikely to coordinate macroeconomic policies between developed and developing countries. In the mean time, European sovereign debt crisis endangered the Euro zone, necessitating cuts in fiscal expenditure so that European countries could reduce deficits, which triggered social crisis in Europe, with the rise of extreme nationalism as well as waves of prolonged strikes in protest of unemployment and shrank welfare. Severe inflation and unemployment also led to political crisis in the Middle East and North African countries and even civil wars in Libya and Syria. Europe and the U.S. were dealt a heavy blow in this financial crisis, with weakening economic strength and diminished international status, worsened by the EU sovereign debt crisis and waning U.S. hegemony. With the liberalism growth model of the West coming under grave criticism, developed countries became less and less attractive to developing ones. In contrast, emerging markets spearheaded by China and Russia reemerged as vital forces and major players in the world economic landscape.

In the wake of USSR collapse, Russia embraced western countries with undivided attention in terms of foreign policy while shedding former Soviet republics as heavy “burdens”, only to find out the true colors of western countries when they squeezed or even fragmented Russia’s living space. It was not until the turn of the century that the CIS revealed its accentuated importance to Russia. *Concept of the Foreign Policy of the Russian Federation* released in 2000 and 2008 outlined unequivocally the CIS as a top priority in its regional agenda. “Russia in its foreign policy prioritizes multilateral and bilateral collaboration with CIS members.”<sup>4</sup> With a deep imprint of Russian culture and ideology on Central Asia, the post-Soviet space has always been seen as a sphere of influence and cornerstone by Russia on its way back to the status of a Eurasian power. The report on *Russia’s Economic Interests and Goals in the CIS* released in February 2010 by the Institute of Contemporary Development recommended tying current benefits resulting from economic collaboration with a stronger Russia for CIS member states to the long-term and strategic interests of Russia in the post-Soviet space, so as to advance integration with CIS states until the formation of a common economic space. It also outlined nine areas of fundamental interests to Russia in the post-Soviet region, with a focus on controlling energy and resources in the

---

4 Концепция внешней политики Российской Федерации. Независимая газета, 11 июля 2000 года; Российская газета, 12 июля 2008 года.

region to uplift its status and role in the international arena, enhancing cooperation in national defense, nuclear energy, aviation, rocket and aerospace industry areas, tapping markets, implementing joint cooperative projects in processing industries, making full use of CIS labor markets in attracting intellectual elites in the region, full exploring geostrategic potential of the CIS in the formation of a common economic space, so as to re-emerge as an Eurasian power.<sup>5</sup> It is Russia's fundamental goal to enhance its influence and economic presence in the post-Soviet space and reunite it in a joint attempt to resist infiltration of outsider powers while forcing former Soviet republics into its sphere of influence by pulling economic levers. With the post-Soviet space being Russia's geostrategic priority area, losing influence there is tantamount to a stoop of Russia's global status to a regional power, which is in no way acceptable to Russia for the sake of its national interests.

Since the year 2000, Russia has been confronted with fiercer competition with third countries on the CIS markets. The Institute of Contemporary Development emphasized in *Russia's Economic Interests and Goals in the CIS* that Russia's major rivals on the CIS markets are EU, China, and the U.S., with India, Turkey and others entering the fray. Following the USSR's demise, the EU has gone to great length to incorporate former Soviet states into its orbit. In 2003-2004, the EU launched the European Neighborhood Policy (ENP) including a joint Action Plan (AP), aiming at 16 countries, including six former Soviet republics: Azerbaijan, Armenia, Georgia, Moldova, Ukraine and Belarus, with financial aid totaling €1 billion. In 2009, it rolled out the Eastern Partnership (EaP) initiative in an attempt to expand the scope of validity for European values and laws via the application of EU legal framework and norms by the above-mentioned six countries, while encouraging their maximum estrangement from Russia. EaP mainly takes the form of Association Agreements (AA), with an aim to achieve political coalition and economic integration between the EU and its partners. The major component of AA is to establish a "Deep and Comprehensive Free Trade Area" (DCFTA), requiring absolute harmonization of non-EU states with the EU in terms of legislation concerning foreign trade adjustment, investment, antitrust and other areas, so as to tilt former Soviet states totally towards its own side.

According to WTO statistics, in the year of 2010, exports of 27 EU member states to CIS states (excluding Russia) totaled \$65.18 billion, 6.3 times of that of 2000. The U.S. secured its dominance in the oil and gas sector of Azerbaijan and Kazakhstan, major energy exporting CIS countries. According to U.S. experts

---

5 Доклад Института современного развития: экономические интересы и задачи России в СНГ, февраль 2010 г. Please refer to the Institute of Contemporary Development website: [http://www.insor-russia.ru/files/Intrest\\_Books\\_02.pdf](http://www.insor-russia.ru/files/Intrest_Books_02.pdf).

before the crisis, U.S. investment in Azerbaijan would total \$47 billion in 2010. By mid-2009, accumulated U.S. direct investment in Kazakhstan's mining industry had accounted for 48%, with as much as 78% being portfolio investments in the sector. China has been on the rise in CIS foreign economic relations, with its role of a goods supplier reinforced in all CIS nations without exception, in particular in Central Asian countries.

In the first decade of the 21st century, Russia worked stunning miracles with its economy. In the eight years with Putin in power, residents' real income increased by 1.5 times, unemployment and poverty were halved, the economy maintained stable growth, with a 72% increase in GDP and an all time high post-Soviet GDP annual increase of 8.1% in 2007. Exports and imports of goods quadrupled, absorbed foreign investment grew six fold, net capital inflows in 2007 set a record of \$82.3 billion, and securities market capitalization increased 20 fold over that of 1999. Foreign debt decreased to 3% of GDP, which was the lowest in the world. By 1 July, 2008, foreign exchange reserve had reached \$568.3 billion and stability fund \$160 billion. In 2008, Russia's GDP registered \$2812 billion on a purchasing-power-parity basis, next only to the U.S., Japan and Germany among OECD countries, thus joining the ranks of high-income countries with a per capita GDP of nearly \$20,000.<sup>6</sup> The two years in the build-up to the financial crisis witnessed real investment and consumption booms in Russia, which remarkably stimulated global economic growth and significantly boosted Russia's economic strength and status.

With rapid improvement of economic strength, Russia accelerated political, military, economic, energy and cultural integration processes in the former Soviet region. On one hand, it strengthened the role of Collective Security Treaty Organization (CSTO) and its Rapid Reaction Force (RRF), implementing security and military integration; on the other hand, putting the Customs Union(CU) of Russia, Belarus and Kazakhstan at the core of economic integration, advancing the development of the CIS-FTZ and the EEC towards the Eurasian Union, pushing for a single economic space and common currency as well as a common energy market in order to realize free flow of goods, services, capital and labor, with the basic road map being FTZ—Customs Union (CU)—Common Economic Space (CES)—the Eurasian Economic Union (EEU)—the Eurasian Union.

---

6 Statistics in this paragraph are derived from Russian National Audit Office: Национальные счета России в 2003-2010 гг. . 2011: Стат.сб./Росстат. - М., 2011. ; Россия в цифрах . 2011: Стат.сб./Росстат. - М., 2011. ; Российский статистический ежегодник. 2010: Стат.сб./Росстат. - М., 2010.

## ***B. Russia Advancing Eurasian Integration Processes***

In as early as September, 1993, twelve CIS member states signed an *Agreement on the Economic Union* in Moscow in the hope of establishing a free trade zone, a customs union, a common market and a monetary union modeled after integration in Western Europe step by step. In 1994, consensus was reached on the Free Trade Zone Treaty, but it wasn't ratified by many countries including Russia. In mid 1990s, Russia began to realize the stake of former Soviet space in its national security before it shifted gear by narrowing down the integration processes to smaller areas.

In January, 1995, Russia, Belarus and Kazakhstan (Kyrgyzstan later joined) signed the *Customs Union Treaty*, with an aim to remove barriers to free trade of goods, prepare unified "rules of the game" for fair competition, and coordinate economic policies of member states including safeguarding their interests on the global market. In February, 1995, the above four countries and a new comer Tajikistan signed the *Treaty on Customs Union and Common Economic Space*. In October, 2000, the heads of five states (Russia, Belarus, Kazakhstan, Kyrgyzstan, Tajikistan) signed the *Agreement on the Creation of Eurasian Economic Community* (effective in May, 2001), with an aim to put in place a full-fledged free trade system, ensure free flow of capital, establish a common financial market, prepare unified rules regarding trade in goods and services as well as market access, shape an integral transport service market and system, set up a common energy market, labor market, education space and legal space, and so on. The establishment of the EEC represents a step forward for economic integration from the FTZ (tariff-free trade) to the CU (unified customs duties for non-member states) towards a common market (free movement of goods, capital, services, labor force, harmonized trade policy toward third countries, unified monetary policy). Ukraine, Moldova and Armenia acquired observer status in 2002 and 2003 respectively. The EEC member states enjoyed remarkable economic growth entering the 21st century, with nearly all states registering positive growth in all macroeconomic indicators, with relatively stable home currency against the dollar, slowing inflation rates and remarkably increasing average wages. On the initiative of their presidents, Russia and Kazakhstan signed an agreement on the establishment of the Eurasian Development Bank, which was later joined by Armenia and Tajikistan respectively in April and June, 2009, Belarus in June, 2010, and Kyrgyzstan in August, 2011, in the face of the global financial crisis. In a joint EEC effort to stave off the global financial crisis, the EEC Anti-Crisis Fund was founded in 2009. The EEC Court of

Justice has also been up and running since 2012.

There are four steps for advancing the EEC's development. First, speed up the development of the CU of Russia, Belarus, and Kazakhstan. The above three countries signed an upgraded version of the *Customs Union Treaty* in October, 2007, and two years later the *Customs Code of the Customs Union*, which marked the official establishment of the CU. The period from harmonizing tariff rates, tariff quotas, preferential systems as well as unified list of forbidden or restrained items toward third countries being effective in January, 2010, to the establishment of the CES in July, 2011, signaled a de facto functioning CU and the formation of a sub-regional economic organization with 170 million people, 90 billion barrels of oil in reserve and \$2 trillion in aggregate GDP. The CES led by Russia thus took initial shape, giving a strong impetus to the creation of a common market and monetary space in the post-Soviet region. With active Kyrgyzstani and Tajikistani consultations on accession, the CU is about to cover the entire EEC territories.

Second, build a Common Economic Space (CES). The agreement on the Customs Union (CU) within the framework of the EEC came into force in July, 2010. In December, the EEC Summit produced an agreement on the creation of the EEU based on the CES of Russia, Belarus and Kazakhstan. In October, 2011, the EEC decided to embrace Kyrgyzstan in the CU. In November, heads of Russia, Belarus and Kazakhstan signed *Declaration on Eurasian Economic Integration and Agreement on the Eurasian Economic Commission* to usher in a new stage of Eurasian economic integration, i.e. building the CES, which will not only enable free movement of goods, capital and people but also a supranational coordination body harmonizing macro- and microeconomic policies of member states, a central bank issuing unified currencies, and an integral energy market. Being the most pragmatic organization dedicated to economic integration in the post-Soviet space, it will bring sweeping changes to rules governing the movement of goods, capital and labor force among the three countries, thus uplifting the geopolitical standing of the troika. It is scheduled to turn the EEU into reality by 2015. In May, 2012, Russia, Belarus and Kazakhstan put in place a team in preparation for the formation of the Eurasian Union Parliament, but it made no inroads since Belarus and Kazakhstan were in no hurry to initiate political integration under the Eurasian Union. In December of the same year, C. Gnatyev, advisor to Russia President, remarked that negotiations on a single currency for the EEU had met its fair share of obstacles. In September and October, 2013, Armenian President Sargsyan and Deputy Syrian Prime Minister K·Zamil expressed their respective decisions to join

the CU.

Third, establish the Eurasian Economic Union (EEU). In 2011, heads of government meeting for the CU of Russia, Belarus, and Kazakhstan deliberated on and signed the *Resolution on Establishing the Eurasian Economic Union*, moving towards closer economic and monetary policy coordination based on the CU and CES, so as to create an economic union in real sense. Putin made resolute remarks that, “we have every confidence that we will take the third step in 2013.”<sup>7</sup> In May, 2014, leaders of Russia, Belarus, and Kazakhstan signed in the Kazakhstani capital Astana the *Agreement on Establishing the Eurasian Economic Union*, effective on 1 January, 2015. The next day marked Armenia’s official membership in the EEU. Kyrgyzstan also officially joined on 29 May, 2015. Tajikistan is also considering the possibility. The EEU has moved faster on the codification of the *Basic Law of the Common Economic Space and Customs Union*, which will constitute the foundation for the *Treaty on the Eurasian Economic Union* with its whole package of documents covering all cooperative areas from harmonizing macroeconomic and customs policies to coordinating migration and visa systems.

Fourth, move from the EEU towards the Eurasian Union. In December 2010, the EEC Moscow Summit generated consensus on materializing the Eurasian Union based on the CES of Russia, Belarus and Kazakhstan. At the Interstate Council of EEC and the CU High-level Meeting Press Conference, Putin was full of excitement when he said “We will not stop here. We have yet to fulfill a more ambitious mission of moving towards a higher level of integration, the Eurasian Union.” He predicted the fruition of this historical mission by 2015.<sup>8</sup>

### ***C. Goals in Forging the Eurasian Union***

In his article entitled *A New Integration Project for Eurasia: The future in the Making* published in *Izvestia* on 3 October, 2011, Putin proposed the creation of a Eurasian Union in the post-Soviet region, sending shock waves through home and abroad, with reproofs from the West as well as a mixture of fear, criticism, and approval among CIS members. At such a moment, Presidents of Belarus and Kazakhstan, the other two major players of the Eurasian Union, made clear their stances, which soothed public anxiety. *On the Destiny of Our Integration*<sup>9</sup> by

7 Please refer to Russian TV News Channel coverage: Путин: Евразийский союз заработает в 2013 го-ду, <http://www.vesti.ru/doc.html?id=50653>.

8 Please refer to Putin’s remarks on 20 October, 2011, at the Press Conference for the CIS heads of government commission, the EEC Interstate Council and the Customs Union Supreme Council High-level Meeting. The Customs Union website <http://www.tsouz.ru/news/Pages/21-10-2011.aspx>.

9 Лукашенко А., О судьбах нашей интеграции. Известия, 17 октября 2011 года.

Lukashenko was published on 17 October and *Eurasian Union: From the Idea to the History of the Future*<sup>10</sup> by Nazarbayev on 25 October in *Izvestia* in approval and praise of Putin's proposal from different perspectives. These three representative pieces concerning the Eurasian Union reveals goals in following areas for the union they envisaged.

First, the ultimate goal will not be limited to an economic union. In Putin's words, the EEU kicking started in 2013 will lead the way to "the Eurasian Union, an elevated version of integration, in 2015". That is to say, the Eurasian Union will be not only an economic but also political, military and other unions. In terms of political union, though it will not be "restoration of the Soviet Union" in a certain form by Putin's words, and Nazarbayev reassured that there will be no "reinvention" or "reincarnation" of the Soviet Union in any form. Putin also expressed the intention to forge a "strong super-national union". Lukashenko took a step further by saying "Upon maximum economic integration, we are bound to build solid sociopolitical superstructures to shape common values, judicial system, living standards and the way forward, where the gradual formation of some super-national mechanisms including political ones are necessitated." For instance, the CU Commission is mandated to handle all operational matters of the CU, with its decisions being super-sovereign and resolutions rising above domestic laws of member states. In October, 2011, a decision was made at the St. Petersburg heads of government meeting to further extend the Commission's mandate. Nazarbayev and Lukashenko both underscored the necessity of expanding cooperation of the Eurasian Union from economic to social, cultural, educational and other areas. Lukashenko pointed out that it is essential to expand from "economic to social and even partial political integration".<sup>11</sup> Ю. Shuvalov, deputy secretary of the United Russia Party Committee Presidium, said that the Party will promote a common land use system for Russia, the EEC and the CU, and work on land development policies and measures for different countries.<sup>12</sup> That is to say, the next step following the CU, the CES and common currency would be harmonizing land use rules among signatories. At that point, "national sovereignty" underlined by Lukashenko will find no place in the "cornerstone" of the Eurasian Union. Besides, military union is also seeing rapid progress, and the CSTO and its RRF will also be incorporated into the Eurasian Union framework over time.

Second, shape the Eurasian Union as one of the centers of the multi-polar world and lead global sustainable development together with the EU, the U.S. and

10 Назарбаев Н., Евразийский Союз: от идеи к истории будущего. Известия, 25 октября 2011 года.

11 Лукашенко А., О судьбах нашей интеграции. Известия, 17 октября 2011 года.

12 Please refer to RIA Novosti website:<http://www.ria.ru/economy/20111013/457439179.html>.



China. Putin emphasized that “The unity of forces will enable us a part not only in the global economic and trade system but also in pragmatic decision-making process as well as design of rules of the game and future architecture”. Nazarbayev mainly focused on major economic goals, i.e. integration should start with the economy, and “the CES should be the first building block for the Eurasian Union” which should be “a union with global competitiveness” from day one, become “part of the new global financial and monetary system, and introduce a common payment system and currency in due course”.

Third, make the Eurasia Union an effective “bond” and “strong link” between Europe and the fast growing Asia-Pacific region. In Putin’s opinion, the Eurasia Union is “an indispensable part of Greater Europe united by freedom, democracy and laws of the market”, and he hoped that a FTZ could be created in conjunction with the EU so that “harmonious” free trade and open market principles would prevail on the whole Eurasian continent from the Atlantic to the Pacific. This harmonious economic community spanning from Lisbon to Vladivostok is aiming at “changing the geopolitical and geo-economic landscape in the whole continent”. Nazarbayev pointed out that the Eurasian Union should be “a bridge linking the EU with emerging economies of East and Southeast Asia”. Along the road transport corridor connecting Western Europe and Western China plus a completed Eurasian High Speed Rail, there will emerge a modern logistics transport system. Lukashenko made it clear that “our integration should be not limited to the West. Close integration with countries in the East and the EEC should be given priority.”

Fourth, uphold principles of equality, sovereignty and voluntariness over the Eurasian Union membership. Seeing eye to eye with Putin on the principles of respect for sovereignty and equality, Lukashenko held that “it is equality that lays the foundation for the new Union”, and “our national sovereignty constitutes the cornerstone” of the Eurasian Union. Nazarbayev highlighted further the principle of voluntariness, insisting on a path of natural evolution and rejecting any intentional urging or whipping of certain countries; the Eurasian Union should be a union of countries based on the principles of equality, non-intervention in each other’s internal affairs, respect for sovereignty and non-intrusion into other’s territories; the super-national body of the Eurasian Union should be based on consensus while taking every member’s interests into consideration; the establishment of the Eurasian Union should be based on broad-based public support.

## ***D. The Possibility of and Restraining Factors for Materializing the Eurasian Union***

### **1. The post-Soviet region has what it takes to realize integration**

“With a shared history, we have inherited plenty of USSR legacies, for example, shared infrastructure for transport, energy, communications, among others, specialization of production, a common language, science and technology and cultural space. We used to have a unified national economic complex with the Soviet Union,” said Putin.<sup>13</sup> All these make integration processes much easier and faster in the post-Soviet space than in Europe. There are mainly two motives driving integration in the post-Soviet region. First, many former Soviet countries are less competitive in terms of goods when compared with foreign countries. If tariff barriers were to be removed, a lot of processing industries such as textile, food and wood processing would go bankrupt under the pressure of cheap and quality imported goods. Therefore, what’s all CIS states are concerned about is putting in place a system temporarily shielding the collective economy of their own enterprises from foreign competition. Second, there is a high level of technology interdependence. Integration is aimed at restoring and maintaining the economic links severed upon USSR demise in the 1990s among former Soviet republics. According to experts, without coordination of other CIS countries, even the most self-sufficient Russia among all former Soviet republics could only produce 65% of needed products; Kazakhstan could produce only 10% of industrial products without Russia’s coordination, and Kyrgyzstan and Tajikistan less than 5%. In Putin’s words, “Our life would be unimaginable without those links.”<sup>14</sup>

### **2. The Eurasian Union was jointly initiated by leaders of Russia, Belarus, and Kazakhstan**

In December, 2010, the EEC Moscow Summit generated consensus on building the Eurasian Union on the basis of the CES of Russia, Belarus, and Kazakhstan. When Putin’s article about the Eurasia Union was published on 3 October, 2011, Belarusian President Lukashenko and Kazakhstani President Nazarbayev responded

---

13 Please refer to Putin’s remarks on 20 October, 2011, at the Press Conference for the CIS heads of government commission, the EEC Interstate Council and the Customs Union Supreme Council High-level Meeting, available at the Customs Union website <http://www.tsouz.ru/news/Pages/21-10-2011.aspx>, and Putin’s article in *Izvestia* Путин В., Новый интеграционный проект для Евразии – будущее рождается сегодня. Известия, 3 октября 2011 года.

14 Путин В., Новый интеграционный проект для Евразии – будущее рождается сегодня. Известия, 3 октября 2011 года.

quickly in support of Putin's idea by publishing articles in *Izvestia*. Lukashenko said that he deemed the USSR's disintegration the harshest and most agonizing lesson and behind Putin's article was the correct strategy. It is a right step forward in favor of world stability. "For Belarus, the only way forward was, is and will be profound and fruitful integration with its closest neighbor." Belarusians prefer concrete and rapid progress in integration rather than let it stay in paper. If the CES was to be realized, steps would be taken towards the Eurasian Union, where Belarus would take an active part. "As the Belarusian President, I will implement the correct strategies for deepening integration in close collaboration with the Russian and Kazakhstani leaders." As early as March, 1994, Nazarbayev proposed the formation of a brand new integrated union named "Eurasian Union of States". "This is our common strategic goal." He regretted that "the CIS didn't make itself the decisive mechanism for integration in the post-Soviet space due to some objective and subjective reasons" and emphasized the necessity of the Eurasian Union as well as principles and goals to be upheld.

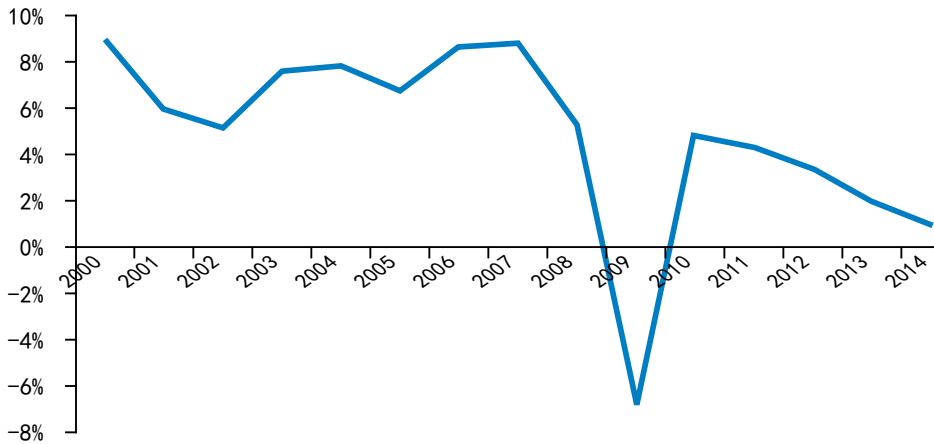
### **3. Economic growth in the post-Soviet region entails integration**

With remarkable economic growth, the post-Soviet region has become one of the fastest growing regions in the world since the 21st century (See Fig. 1). In 2008 when the global financial crisis took place, the EEC's size of economy increased by 68% compared with that of 2000, with an average annual growth rate of nearly 7% and investment increasing at a rate of 13.7%.<sup>15</sup> CIS countries saw rapid growth in foreign trade which exceeded \$500 billion in 2005, \$1 trillion in 2011, and \$1145.3 billion in 2014. However, with ceaseless efforts in tapping new international markets, CIS countries showed increasing diversification in trade and less interdependence. In 2014, two-way trade between CIS states stood at \$213.67 billion, only accounting for 18.7% of total foreign trade. Certain countries, however, were still quite dependent on the CIS, for instance, Ukraine 29.7%, Armenia 28.8%, Kyrgyzstan 48.2%, Tajikistan 45.5% and Belarus as high as 59.3%.<sup>16</sup>

---

15 Евразийское экономическое сообщество. 2000-2009. Справочник. Please refer to <http://www.evrases.com/i/data/item7264-2.pdf>.

16 The Interstate Statistical Committee of the Commonwealth of Independent States website: <http://www.cisstat.com>.

Fig. 1 Average GDP Growth Rate (%) of the CIS<sup>17</sup>

#### 4. The CIS members come under huge external pressure from different aspects

First, the unexpected global financial crisis dealt a heavy blow to all CIS member states. According to World Bank, six among the ten countries with the biggest drop in GDP in 2009 were CIS countries.<sup>18</sup> Second, the CU has exerted enormous pressure on and demonstrated appeal to non-member countries in the post-Soviet region. In 2014, the CU member states registered nearly \$1 trillion in foreign trade. The two-way trade between the CU members rose from \$47.14 billion in 2010 to \$63.1 billion in 2011, up by 33.9%, and increased further to \$68.58 billion in 2012.<sup>19</sup> As mentioned earlier, Armenia, Kirgizstan and Tajikistan rely heavily on the CIS, in particular, Russia. When the CU raised tariff rates, the above three countries bore the brunt, since Kirgizstan and Tajikistan imports 50% of their total goods from the CU and about 1/3 of their citizens work in Russia whose remittances constitute an important source of the country's revenue. These countries counting mainly on exports of raw agricultural and mineral materials as

17 Compiled by the Interstate Statistical Committee of the CIS: Основныесоциально-экономическиепоказателигосударств-участниковСНГза 1992 (1994) — 2010годы.; Data released by the CIS Interstate Statistical Committee website: <http://www.cisstat.com>.

18 Quoted from: Доклад Института современного развития: экономические интересы и задачи России и в СНГ, февраль 2010 г. Please refer to the Institute of Contemporary Development website: [http://www.insor-russia.ru/files/Intrest\\_Books\\_02.pdf](http://www.insor-russia.ru/files/Intrest_Books_02.pdf).

19 Statistics released by the CU website: [http://www.tsouz.ru/db/stat/Pages/international\\_stat.aspx](http://www.tsouz.ru/db/stat/Pages/international_stat.aspx).

well as remittances were hit hard by the global financial crisis. Third, upheavals and political crisis in Arab countries and Ukraine also caused apprehension about political stability among CIS members. Possible terrorism overflow following the U.S. troop withdrawal from Afghanistan also left Central Asian countries worrying about national security. Once infected by an Arab-style “revolution” or terrorism, these countries could only turn to Russia for restoring their domestic stability. For example, Uzbekistan initiated procedures in 2006 (interrupted in 2008) to join the EEC and return to the CSTO after the Andijan Riot in 2005. In the wake of unrest in Kyrgyzstan in 2010, the CSTO beefed up its efforts in addressing domestic crisis. Under such circumstances, Russia had no choice but to value the importance of regional stability for its own national security. Fourth, the global financial crisis enfeebled Western countries to a great extent in terms of economic strength and standing and called into question the liberalism growth model, which rendered the West much less attractive.

## **5. Russia maintains its place as the market for CIS industrial and agricultural products as well as an enormous job market**

Nose-diving prices for raw industrial materials and semi-finished goods on the international markets due to the financial crisis further reinforced the awareness among elites in the post-Soviet space that the Russian market was key to maintaining balanced economic development in the CIS. Russia accounts for 72% of the GDP of the post-Soviet region, 76-77% of its oil and gas exploitation, and 67-68% of its total goods and services exports. The Russian economy represents 90% of the EEC and the CU.

While giving due credit to Russia’s important role in the region, we should also note that Russia is not longer the only strategic partner for cooperation with former Soviet republics, since Russia doesn’t have enough resources at its disposal and the necessary economic appeal to tie the former republics’ foreign economic interests to its own. First, Russia’s privilege to sway the post-Soviet space is not recognized by the international community. Similar export mix has intensified the tension between Russia and some CIS states over competition of certain products on the international markets. The political tension between Russia and certain CIS states also fuels the centrifugal trend, harms mutual investment cooperation and adds to trade barriers. Second, with regional energy price approaching or reaching international levels and enhanced diversification in energy supply, energy as a lever and one of the major economic tools for Russia to hold sway in the region will

play an increasingly diminishing role. Already weighing much less than energy, trade and migration in Russia's relations with former republics, capital as a lever might be further undermined during and after the crisis, since during the crisis the region witnessed enhanced presence of multilateral and ultra-CIS international financial organizations which brought in plenty of financial aids. Besides, due to political differences and divergence of interests among members, it is impossible to push for the creation of a common economic space among CIS states by political means alone. Third, enabling economic conditions in favor of a higher level of integration in the post-Soviet space are not ready yet. Without highly sophisticated and diversified processing industries, CIS countries lack advanced intra-regional cooperation relations which constitute the foundation for integration. In terms of export mix, Russia and other countries in the region rely heavily on raw fuel materials which are in large part subject to global market fluctuations, thus unable to forge close economic ties with each other. Fourth, there are huge economic gaps among former Soviet republics as a result of different economic potentials, unbalanced socioeconomic development, structural differences in sectors, varied degrees of market reform, sufficiency of natural resources and dependence on external links and other factors. CIS members find it hard to have harmonized economic policies and legislation that are necessary to integration.

The Ukraine Crisis revealed that Russia has lost Ukraine. Without Ukraine, the Eurasian Union is deprived of its strategic sense. More countries, nevertheless, have shown strong interest in the Eurasian Union. Armenia and Kyrgyzstan joined the CU of Russia, Belarus and Kazakhstan in 2014 and the EEU in 2015. Countries outside the region such as Vietnam, India, Syria, Turkey, New Zealand expressed willingness one after another to sign FTAs with the EEU or even join the CU and the EEU.



## II. EEU, SCO and China-Russia Economic Cooperation

### *A. Prospects of Cooperation Among EEU and SCO Member States*

The SCO currently has six member states, namely China and five former Soviet Union members: Russia, Kazakhstan, Uzbekistan, Kyrgyzstan and Tajikistan. Russia, Kazakhstan and Kyrgyzstan are already EEU members; Uzbekistan signed a free trade agreement with the Customs Union of Russia, Belarus and Kazakhstan in 2011; Tajikistan, already a member of the EEC, is going to join the EEU. The five countries of the former Soviet Union are basically member states of the Eurasian economic integration process, so in a sense, the SCO is in fact the “EEU + China”.

Cooperation between the member states of the SCO has continuously deepened during the 15 years of its development, and remarkable achievements have been made in comprehensive security, economic and cultural cooperation. Regional economic cooperation has gradually emerged as an important component of cooperation with the developing situation, and has become the driving force for the further development of the SCO.

The mechanisms for economic cooperation have gradually come to maturity. The SCO clearly set its fundamental objectives of economic cooperation when it was established, and later on, it mapped out its priority areas, main tasks and long-term strategic objectives for economic cooperation. The establishment of the Business Council and the Interbank Consortium has played a positive role in deepening multilateral economic cooperation. A series of mechanisms and modes of operation have been developed to promote economic cooperation among the member states, such as summit meetings, prime ministers’ meetings, meetings of economic and trade ministers or high-level officials, and specialized working groups.

The trade volume among member countries has increased significantly. According to official statistics, the foreign trade volume of the six SCO member

states amounted to \$5,135.73 billion in 2013, with an increase of nearly 4 times from 2001. The trade volume between China and the other five SCO member states has risen from \$12.22 billion in 2001 to \$129.454 billion in 2013, an average annual increase of 68.5%. In particular, China's trade with Russia was only \$5.596 billion in 2001, but it reached \$89.213 billion in 2013, accounting for 10.3% of total Russian imports and exports. China has become the largest trading partner of Russia and Kazakhstan and the most important export market for other SCO member countries.

Investment has gradually become more and more important in the cooperation among the member states. With the deepening of economic cooperation, the investment environment of those countries has improved significantly and hence the rapid expansion of mutual investment. China has invested cumulatively nearly \$30 billion in the other SCO member states, becoming the largest investment partner of Uzbekistan. With the expansion of the scale of investment, the fields of mutual investment for the member states have also gradually expanded from the development of mineral resources, and infrastructure construction to other fields such as the processing and manufacturing industry, agriculture, services, and culture. Non-resource areas will become a new source of growth for mutual investment in the future.

Financial cooperation has become an important area of cooperation. Since the breakout of the international financial crisis in 2008, China has pledged to provide loans up to \$60 billion to SCO member states on bilateral and multilateral occasions, and has succeeded in currency swaps with those countries. In November 2010, China proposed to deepen financial cooperation, establish the SCO Development Bank, explore new ways of joint venture for common benefit, expand cooperation in the use of national currencies for trade settlement, and promote regional economic exchanges. In December 2014, Chinese Premier Li Keqiang expressed his hope in Astana that SCO members will “bring the role of the Silk Road Fund into better play, and steadily progress in establishing the SCO Development Bank so as to offer a long-term and stable financing platform for the region.”<sup>20</sup> In November 2013, Premier Li Keqiang said in Tashkent that China was willing to establish a China-Eurasia Economic Cooperation Fund (CEECE) which would “welcome the participation of Asian and European countries, including SCO member countries, observer countries and dialogue partners.”<sup>21</sup> One year later,

---

20 “Li Keqiang Attends the 13th Meeting of the Council of Heads of Government of the Shanghai Cooperation Organization Member States”, Dec 16, 2014, [http://www.fmprc.gov.cn/mfa\\_eng/zxxx\\_662805/t1220076.shtml](http://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1220076.shtml).

21 “Chinese premier makes 6-point proposal on SCO cooperation”, Nov 30, 2013, [http://news.xinhuanet.com/english/china/2013-11/30/c\\_132929822.htm](http://news.xinhuanet.com/english/china/2013-11/30/c_132929822.htm).



Premier Li reiterated that China would officially initiate the selection of the first projects for the CEECF and was willing to establish bilateral sub-fund with all relevant parties to support the implementation of economic projects in the region.

Compared to its security cooperation, economic cooperation of the SCO still lags behind. In 2013 the trade volume between China and other SCO member countries accounted for only 3.1% of China's total imports and exports, which is incompatible with China's position as the world's first trade power. Moreover, the commodities of imports and exports between them are still mainly consumer goods exported from China to the other SCO members and raw materials imported the other way round, and the proportion of high value-added products and high-tech products is extremely low. China's investment in those countries is significantly lower, and there is a serious lack of investment especially in their urgently needed manufacturing and processing industries. The current difficulties faced by emerging economies also hampered economic cooperation among SCO members.

As regional trade agreements (RTAs) lead to a greater scale of market and enable enterprises in the member states to allocate resources in a wider range of markets, enjoy benefits of the scale economy, restructure the industries, exploit comparative advantages better, and thereby increase efficiency brought about by deepening division of labor, regional trade will thus increase. On the other hand, common external tariffs will discourage imports of goods from non-member countries to a certain extent, and the trade diversion effect will help the member states expand the scale of trade among them. Therefore, with the expansion of the EEU, the SCO members will also increase, with the possibility of India, Pakistan, Iran, and Mongolia becoming SCO member states. The accession of those countries will certainly provide new impetus to economic cooperation.

The Sino-Russian joint statement signed in May 2014 reaffirmed the role of the EEU, and Russia also emphasized the importance of China's Silk Road Economic Belt, removing the concerns of Russia politically about the Silk Road Economic Belt, so the two sides could work together to find the common ground of the Silk Road Economic Belt and the EEU. China should actively participate in the anti-crisis fund of the Eurasian Development Bank and the EEC, encourage SCO member states to participate in the Asia Infrastructure Development Bank (AIDB), adapt to their urgent need for investment by increasing Chinese investment in those countries, and actively implement the "going out" strategy so as to shift advantageous domestic production capacity, help to develop local processing and manufacturing industries, increase local employment, and help them achieve

industrialization and re-industrialization. SCO member states should be encouraged to use their national currencies for mutual trade settlement. An SCO energy club should be promoted so that China and India, as the two largest energy consumers, could forge a close alliance with such major energy suppliers as Russia, Central Asian countries and Iran. The use of national currencies for energy pricing and trade settlement should be achieved to create an independent energy trade system, and ultimately put an end to the US-led world energy trade pattern and system. China should actively push forward with the establishment of an SCO Development Bank as soon as possible to provide financing convenience for the construction of the Silk Road Economic Belt.

Based on past achievements, the objectives for SCO economic cooperation in 2020 should be as follows: working together with the emerging EEU to realize the free movement of goods, capital and services step by step based on the principles of free trade when it was established; further improving mechanisms for economic cooperation, adhering to the basic principles of the WTO, enhancing the transparency of trade and investment policies, and promoting trade and investment facilitation; expanding areas of economic cooperation, enhancing trade structure and quality and innovating models of economic cooperation to improve the level of regional economic development based on the principles of market economy in the spirit of mutual benefit and common prosperity and development; encouraging extensive participation of SCO observer states and dialogue partners in regional economic cooperation; properly handling cooperation and competition between the SCO and the Russia-Belarus-Kazakhstan Customs Union and the recently-launched EEU.

The SCO should carry out cooperation in the following areas to achieve the above goals. *First*, it should further push forward with mechanism-building for economic cooperation. *Second*, it should promote the development of mutual trade, improve trade structure and quality, and gradually increase the percentage of high value-added products such as electromechanical products, high-tech products and products of their own brands in the trade of various countries. While keeping its focus on merchandise trade, it should increase the proportion of trade in services gradually. Innovative models of trade should be encouraged while maintaining the traditional ones. Vigorous efforts should be made to develop the investment-driven processing trade in order to increase trade volume and improve trade quality. While maintaining mainstream inter-industry trade, intra-industry trade should also be greatly promoted. *Third*, investment cooperation should be strengthened to

improve the effectiveness of investment. Cooperation in regional economic projects should be intensified by adopting common standards and simplifying procedures to facilitate investment cooperation. Investment should be expanded from direct investment to various forms such as technology investment, BOT, etc. Direct investment should be encouraged to achieve transnational production, and more investment should be put in the development of new technologies and industries. Indirect investment should be promoted to provide convenience for corporate loans, the issuance of bonds and the fulfillment of IPO goals of enterprises in member countries. The areas for investment should be gradually expanded from the development of mineral resources to infrastructure construction, the construction industry, the processing and manufacturing industries, agriculture, and services. Increased efforts should be made to implement projects involving people's livelihood and expand the scale of investment in order to create more employment opportunities and alleviate social problems associated with industrialization and urbanization. *Fourth*, financial cooperation should be strengthened to achieve financing facilitation, expand interbank credit cooperation among member countries, and allow banks in member states to provide local currency loans, export buyer's credit, and issue local currency bonds. More financial support should be given to venture projects. The interbank cooperation mechanism on local currency settlement should be established to promote the development of bilateral local currency settlement. It should actively promote exchanges and cooperation between central banks and financial institutions in the region to prevent regional financial risks. Friendly cooperative relations should be established between the financial regulatory authorities in the member states, and effective financial regulatory mechanisms should be actively explored in accordance with the Basel principles for cross-border banking supervision. The special account for SCO economic cooperation should be converted into the SCO Development Fund, and an SCO investment cooperation fund and a venture fund should be established to provide financing services for multilateral cooperation projects. It should promote the establishment of regional cooperative banks and guarantee companies, encourage regional financial innovation, and increase loans for small and medium-sized enterprises to lay a solid foundation for the development of investment and trade within the region. An SCO Monetary Fund should be created to promote monetary cooperation among member states, strengthen currency swaps between central banks and mutual local currency trade settlement, explore the possibility of a super-sovereign currency, and promote the diversification of reserve currencies in all member states. It should promote the formation of offshore money markets and

bond markets, develop offshore financial markets, and support the international use of national currencies within the region. Mutual financial opening up should speed up to promote the free flow of financial elements in the region, optimize resource allocation, strengthen cooperation in capital, technology and talent, and promote investment and trade facilitation. It should accelerate the pace of business cooperation and mutual establishment of institutions and diversify the scope of business, including international settlement, credit, agency and investment. *Fifth*, it should deepen multilateral cooperation in science and technology, facilitate the industrialization of scientific and technological achievements in clean energy, new material, and new technology, push ahead with economic modernization in a comprehensive manner, and increase productivity through technological innovation so as to enhance the ability to withstand the international economic fluctuations. *Sixth*, cooperation in infrastructure construction should be strengthened to promote the development of land transportation infrastructure and the construction of intercontinental transportation routes, and gradually form a strategic transportation networks in Eurasia, including a highway network, a railway and high-speed rail network, and an information network. An efficient and safe system of supporting services and a legal support system should be established. *Seventh*, cooperation in environmental protection and water resources should be strengthened to jointly cope with climate change. *Eighth*, efforts should be made to promote the economic integration of the SCO to realize free movement of goods, capital and services based on free trade principles.

## ***B. China-Russia Economic Cooperation: Status Quo and Future Development***

In May 2014, China and Russia signed the China-Russia Joint Statement on a New Stage of Comprehensive Strategic Partnership of Cooperation and decided to upgrade Sino-Russian relations to a new stage of comprehensive strategic partnership of Cooperation. Although Russia's economy is mired in recession due to the economic sanctions imposed by the United States and European countries and triggered by the Ukraine crisis while China economic and trade growth has slowed and entered a new stage of development called the "new normal", Sino-Russian economic cooperation has still achieved a major breakthrough. China and Russia signed the Memorandum on China-Russia East Route Gas Project Cooperation and the energy companies from the two countries signed the China and Russia Purchase and Sales Contract on East Route Gas Project, a 30-year gas supply

agreement that worth \$400 billion. Such a breakthrough marks a new strategic stage of Sino-Russian economic cooperation and has laid a solid foundation for the comprehensive strategic partnership of Cooperation.

## 1. Remarkable achievements in all-round Sino-Russian economic cooperation

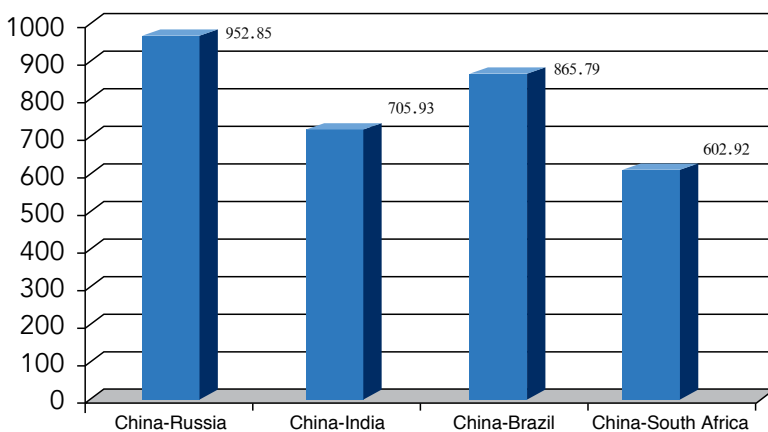
In 2014, Russia stepped up cooperation with Asia-Pacific countries in order to cope with the adverse influence triggered by the Ukraine crisis. As a result, China and Russia have achieved a breakthrough in their economic relations.

### *(1) Frequent highlights in Sino-Russian trade*

First, bilateral trade developed smoothly. Given the slowdown of China's foreign trade growth and the decline of Russia's foreign trade, Sino-Russian trade became a major highlight in the foreign trade development of the two countries. According to statistics from China Customs, China's total volume of foreign trade in goods with Russia reached \$95.285 billion in 2014, a year-on-year increase of 6.8%, higher than the national average increase of 3.4% over the same period; specifically, China's exports to Russia amounted to \$53.678 billion, a year-on-year increase of 8.2%, higher than the national average increase of 6.1% in exports; and China's imports from Russia was \$41.607 billion, a year-on-year increase of 4.9%, higher than the national average increase of 0.4% in imports. Russia was still among China's top 10 largest trading partners, and also the largest one among BRICS countries.

Figure 2. Bilateral trade between China and the other BRICS countries<sup>22</sup>

(Unit: billion USD)



<sup>22</sup> Website of the Ministry of Economic Development of the Russian Federation, [www.ved.gov.ru/monitoring/foreign\\_trade\\_statistics/](http://www.ved.gov.ru/monitoring/foreign_trade_statistics/).

According to statistics from the Russian Ministry of Economic Development, Russia's foreign trade in goods with China reached \$81.1 billion during the period from January to November in 2014, up by 1.4% on a year-on-year basis, while the total volume of Russia's foreign trade in goods fell by 5.4% over the same period; Russia's exports to China witnessed an increase of 7.5%, much higher than the -2.7% increase in Russia's exports over the same period. Although Russia's imports from China fell by 2.7%, but still better than its 8.3% decline in imports of domestic goods over the same period. Russia-China trade became Russia's source of foreign trade growth.

At the same time, the percentage of Russia-China trade in Russia's total foreign trade over the same period rose to 11.2% in 2014 from 10.5% in 2013. China was still Russia's largest trading partner and largest source of imports, while for the first time becoming Russia's second largest export market.

Second, energy products became a new source of growth in bilateral trade. In recent years, bilateral trade between the two countries became increasingly complementary with the industrial restructuring and changes in domestic demand in both countries. In 2014, energy products became a new source of growth in bilateral trade. China imported 33.1 million tons of crude oil that worth \$29.74 billion from Russia, accounting for about 70% of China's total imports of goods from Russia and 9.4% of China's total imports of crude oil. Russia became China's third largest source of crude oil imports, which fully shows that China and Russia are complementary in their energy industry.

Figure 3. A comparison of Russia's foreign trade growth and Russia-China trade growth from January to November in 2014 (%)<sup>23</sup>



Following the signing of the east route natural gas supply agreement between China and Russia in May 2014, China National Petroleum Corporation and Gazprom signed the China-Russia West Route Natural Gas Supply Framework Agreement in Beijing during the APEC summit on November 9 in the same year. Under the agreement, Russia will supply 30 billion cubic meters of natural gas from the West Siberian gas fields via the new Altai pipeline to China annually. With the official implementation of the two natural gas supply agreements, China will replace Germany to become Russia's biggest natural gas customer.

Third, there was much room for the development of trade in services. China and Russia not only proposed goals for the development of trade in goods, but also stressed the need to enhance the quality of trade, promote diversification of the trade structure, increase the proportion of electromechanical and agricultural products, further open their markets, and oppose trade protectionism. At the same time, the two sides stressed the development of areas of trade in services such as tourism, transit transportation, education, financial services, healthcare, sports, media, communications, and exhibitions. The two countries decided to continue activities such as China and Russia cultural festivals, film festivals, etc., and strengthen all-round, multi-form cooperation. Direct links are encouraged to be established between individual sports associations and local sports organizations in the two countries. The two sides will continue to strengthen communication and coordination in international sports affairs, and will continue to launch promising tourist cooperative projects (youth tour, sports tour, family tour, water tour, and wellness tour), and develop tourist routes featuring red tourism and commemoration of the seventieth anniversary of World War II victory.

### *(2) Significant enhancement of cooperation in mutual investment*

First, a legal foundation was laid for the expansion of bilateral investment. In October 2014, during the 19th regular meeting between Chinese and Russian prime ministers, the two countries signed documents such as the Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income together with the Protocol and the Memorandum of Understanding on Antitrust Cooperation, which laid an important legal foundation for the enterprises to expand mutual investment. The Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion protects the legitimate economic interests of the enterprises in both countries and reduced their operational costs. The antitrust cooperation and trade cooperation would maintain order in

market competition and encourage more enterprises to participate in bilateral economic cooperation. The two countries decided to expand cooperation in the field of intellectual property protection and jointly fight against intellectual property rights infringements, which will provide important legal protection for bilateral cooperation in the field of high technology to foster new growth in economic cooperation.

Second, the mechanisms for bilateral economic cooperation have improved. The China-Russia Joint Statement on A New Stage of Comprehensive Strategic Partnership of Cooperation pointed out that both countries supported the improvement of the regular meeting mechanism for Chinese and Russian Prime Ministers, and decided to establish a vice-premier level China-Russia investment cooperation committee, high-level oversight working groups for strategic projects in economic cooperation between China and Russia, and specialized working groups in energy, in order to strengthen coordination in large projects between the two countries. Meanwhile, the two sides also decided to establish an effective cooperation mechanism in customs between China and the EEU, step up cooperation in information exchange and promote trade and investment facilitation. The establishment of new mechanisms will provide essential organizational support for promoting large projects between the two countries quickly and efficiently.

Third, the areas of mutual investment have expanded. In 2014, the cooperation agreements signed between the two countries expanded bilateral investment from the energy sector to agriculture, processing and manufacturing, infrastructure construction, high technology, etc.

Investment in energy sector will be expanded. In the energy sector, the two sides will further deepen a package of bilateral cooperation in oil, implement agreements on supplying Russian natural gas to China, expand cooperation in the coal fields, including the development of Russian coal mines and the construction of corresponding infrastructure, and upgrade cooperation in power, energy efficiency, energy conservation and renewable energy. The power companies in China and Russia are exploring plans to build thermal power plants in the Russian Far East and export electricity to China. If the project is finally carried out, part of the electricity will be transported to China via 2000 kilometers of 800KV UHV DC transmission line, and its initial investment costs are estimated to reach \$15 billion. At the same time, the two sides will further expand a package of cooperation in the peaceful uses of nuclear energy.



Cooperation in agriculture will be expanded. The two countries will jointly promote pragmatic cooperation in the field of agriculture, expand the scope of cooperation and ease policy restrictions on farming, marketing of agricultural products, customs clearance for large farm machinery, food buyback, trade cooperation in agricultural products, exchange of agricultural technology, etc., to create a relaxed environment. The two countries will discuss cooperation in the production of green farm produce and promote agricultural trade between the two countries and exports to a third country. Relevant Russian state and district governments and the Heilongjiang provincial government have reached an agreement of intent to further strengthen cooperation in the field of agriculture. The two countries will also explore long-term mutually beneficial cooperation in the fisheries.

High-tech cooperation will be strengthened. In the field of civil aviation, key projects will be promoted to expand cooperation in aviation engines, science and technology, craft and materials, etc. In the field of communications, cooperation will be strengthened in wireless communications equipment, network equipment, high-end servers, in-vehicle information services, etc. Cooperation will be carried out in integrated circuit design, research and development of telecommunications equipment and accessories, and construction of land fiber optic communications networks. Exchanges will be conducted regarding wireless broadband access, optical fiber networks, universal service, government regulation and policies, etc. Joint efforts will be made to reduce international roaming charges between China and Russia. In addition, the two sides will also promote exchanges and cooperation in medicine, medical devices, chemistry, electronics, the aluminum industry, oil and gas production equipment, ship building, machine tools and manufacture of transportation machinery, etc.

Cooperation in infrastructure construction will be pushed further. China and Russia are currently planning the construction of a Eurasian high-speed transportation corridor from China (Beijing) to Russia (Moscow). Comprehensive cooperation will be carried out on the priority high-speed rail project from Moscow to Kazan.

*(3) The financial cooperation between the two countries scored a major breakthrough*

On October 13, 2014, the People's Bank of China and the Central Bank of the Russian Federation signed a bilateral currency swap agreement of 150 billion yuan

(815 billion rubles) to facilitate bilateral trade and direct investment and to promote bilateral economic development. The agreement is valid for three years and may be extended by mutual consent. China and Russia also began to carry out cooperation in the payment system. Currently in Russia there are about 100,000 businesses accepting China's UnionPay payment system, at least 30,000 ATMs with Chinese cash available, and 30 Russian banks adopting the UnionPay payment system. In 2014, China UnionPay issued over 10,000 cards in Russia and will issue 2 million cards in the next three years. By the end of 2013, the City of Suifenhe has been officially approved by the Chinese State Council as China's first pilot city to use the ruble, also known as China's foreign currency special zone. This is the first time China allows a foreign currency to be officially used alongside its sovereign currency the yuan (RMB) in a particular area of China since the founding of the People's Republic. Enhanced financial cooperation between the two countries has created an important prerequisite for the expansion of bilateral economic cooperation. Given that Russia suffered economic sanctions by the United States and European countries and Russian enterprises are particularly severely constrained in financing, it is more urgent for China and Russia to strengthen bilateral financial cooperation.

*(4) The rapid advance of regional cooperation between the two countries*

In September 2009, China and Russia signed the Program of Cooperation between the Northeastern of the People's Republic of China and the Far East and Eastern Siberia of the Russian Federation (2009-2018), which outlined bilateral cooperation in infrastructure construction, transportation, investment, science and technology, tourism, culture, etc., and brought neighboring development projects in the two countries into cooperation.

In 2014, the two sides launched an economic cooperation mechanism for cooperation between regions in the middle and upper reaches of the Yangtze River and the federal districts along the Volga River and signed the Protocol on Cooperation between the Regions in the Middle and Upper Reaches of the Yangtze River and the Federal Districts along the Volga River. This cooperation involved six regions along China's Yangtze River including Chongqing, Anhui, Jiangxi, Hubei, Hunan, and Sichuan; the federal districts involved in the cooperation along the Volga River include 14 regions/republics: Orenburg Oblast, Penza Oblast, Kirov Oblast, Nizhni Novgorod, Samara Oblast, Saratov Oblast, Ulyanovsk Oblast, Perm Krai, Moldova, Tatarstan, Udmurtia, Chuvashia, Mari El, and Bashkortostan. The first meeting of the working group for the bilateral cooperation was held in

Chongqing on February 25, 2014. Relevant authorities said that the two sides would negotiate a plan for cooperation later on, and would work out a list of bilateral investment project a roadmap for cultural cooperation to promote win-win cooperation between the two sides. The two sides will carry out extensive cooperation in the following areas in the future:

*First*, the high-end manufacturing industry, including aircraft manufacturing, especially the development of heavy-lift helicopters and business jets, as well as automobile manufacturing; *Second*, the exploitation of mineral resources; cooperation will be strengthened in the comprehensive development of mineral resources and deep processing of metals, etc.; Large Chinese enterprises are encouraged to participate in the exploration and exploitation of mineral resources in the federal districts; *Third*, economic exchanges and cooperation; trade fairs will be held, wholesale markets will be constructed, and marketing networks will be improved to jointly expand the share of market; *Fourth*, cooperation in tourism development; efforts will be made to strengthen cooperation in tourism promotion, route planning, mutual tourist delivery, etc. to promote the development of tourism between the two sides; *Fifth*, cooperation in ecological protection; exchanges and cooperation will be strengthened in river basin ecological protection, environmental management and so on.

## **2. New challenges to economic cooperation between China and Russia**

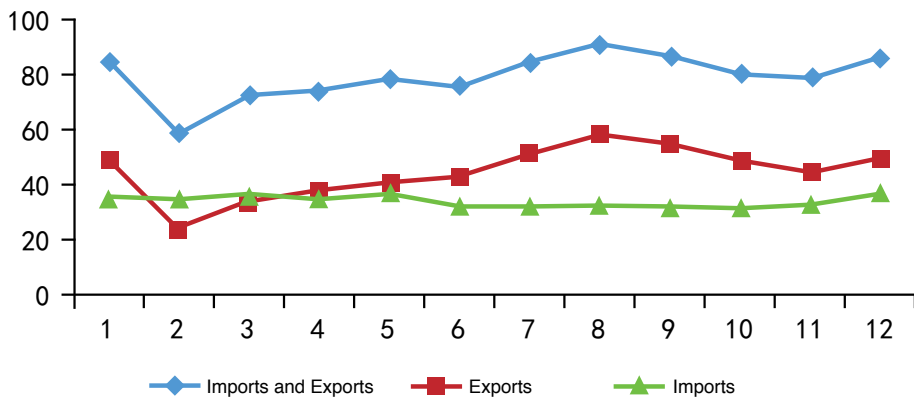
Although China and Russia made remarkable achievements in economic cooperation and reached a number of cooperation agreements of strategic significance in 2014, the recent economic slowdown in both countries, especially Russia's economic recession, had some adverse influence on the expansion of bilateral economic cooperation and will also constrain the cooperation process in the future.

### *(1) The downward trend of bilateral trade growth*

As China's economy entered a new stage of "new normal", its demand for raw materials has fallen due to the transformation of economic development pattern, economic restructuring, and the reduction of excess capacity of production. Therefore, the growth of imports from Russia, such as paper pulp, fertilizer, ferrous and non-ferrous metals, has slowed down. According to statistics from China customs, China's imports from Russia amounted to \$3.738 billion in May 2014, the highest in whole year. The figure kept dropping each month later on

and in November it was only \$3.332 billion, down by 11%. Along with Russia's deteriorating economic situation, decline of investment scale and shrinking purchasing power of residents, China's imports and exports to Russia declined each month since August. In November, China-Russia trade reached \$7.87 billion, down by 13.55 from August; China's exports to Russia amounted to \$4.538 billion, down by 22% from August.

Figure 4. 2014 January-December China-Russia trade development situation chart<sup>24</sup>  
(Unit: billion USD)



On January 31, 2015, the Ministry of Economic Development of Russia released the latest economic forecast. According to the forecast, if the oil price remained at \$50 per barrel, Russia's GDP would decline by 3%, investment in fixed assets would fall by 13%, the disposable income of residents would drop by 6%, and retail business would decrease by 8%. Under the influence of the combined effects of those factors, Russia's foreign trade in goods will drop by about 30% in 2015. As China is Russia's largest trading partner, Russia's shrinking foreign trade will inevitably affect the development of bilateral trade so that cooperation between the two countries will be faced with greater challenges

## (2) Significantly increased business risks in Russia

Russia's economic downturn led to its deteriorating business environment, which is manifested in growing trade risks above all. Difficulties in corporate financing led to the fall of the ability to pay, the rise of default rate, the suspension

<sup>24</sup> Yang Jun & Huang Xin, "Zhong e maoyi: Wujin qianli" (China-Russia Trade: Infinite Potential), *Zhong-guo Haiguan* (China Customs), Issue 12, 2014.

of payment by letters of credit, and the spread of payment delays. Chinese enterprises are facing dramatically rising risks of foreign exchange in exports, and business risks have significantly increased for traders.

Investment risks in Russia have also risen. The plunge of the ruble exchange rate caused inflation to pick up rapidly, while declining disposable income of the residents resulted in insufficient purchasing power, shrinking market demand, and declining sales for enterprises. Normal trade settlement is affected by fluctuations in exchange rate, and investment risks increased significantly. The Chinese automobile manufacturing enterprises currently investing in Russia have been impacted considerably. Under the combined influence of the devaluation of the ruble and the continued decline of new car sales, Geely Automobile's net profit fell by about 50% in 2014. European and American multinational automobile companies, such as Volkswagen, Mercedes-Benz, General Motors, Ford, etc., have also lowered their production and sales targets in the Russian market recently and even cut their investment plans.

On January 6, 2015, Standard & Poor's downgraded Russia's credit rating to BBB-. As crude oil price fell to around \$55 a barrel, and the Russian Central Bank took drastic measures to push up the ruble exchange rate, the international financial market regarded Russia's sovereign credit rating as near-junk grade B. On February 3, Moody's issued a report pointing out that the Russian banking sector would sustain a net loss of 1 trillion rubles, and the predicament of the banks would greatly increase the risks faced by enterprises. While it cannot be ruled out that Western rating agencies might deliberately play down Russia's economy and exaggerate its risks, it is an unquestionable fact that business risks in Russia have increased.

### **3. Prospects for the development of Sino-Russian economic cooperation**

China and Russia will be both in the "new normal" stage of transformation and restructuring in the next 2-3 years, marked by an obvious slowdown in economic growth as compared to the last decade. China's annual GDP growth rate will remain at 7-7.5%. Russia's economic situation will worsen significantly under the impact of Western economic sanctions and the sharp fall of international oil prices. According to the forecast of Russia's Ministry of Economic Development, Russia's economy will experience negative growth in 2015-2016 and then will resume growth. Even if the Western countries lift the economic sanctions against Russia, it will take time for Russia to restore the previous links with the international

economy. Under the combined effects of various factors the Russian economy will grow at 2.5-3.0% in the long term. Such factors will adversely affect future bilateral economic cooperation between China and Russia.

*(1) Significant slowdown of growth in bilateral economic cooperation in the short term*

Although China and Russia signed many cooperation agreements in 2014, most of the agreements involve long-term cooperation projects. The natural gas supply will start in 2018, and the implementation of other infrastructure projects also takes some time, so it is difficult for them to provide a new impetus to boost bilateral trade growth. Therefore, slow growth of bilateral trade in the near future may be more realistic. Meanwhile, under the impact of the significant decline in Russia's foreign trade, the probability of negative growth will further increase in Sino-Russian trade in the short term.

*(2) Steady growth to be achieved in bilateral economic cooperation in the medium and long term*

On November 19, 2014, speaking at a forum of the All-Russia Peoples' Front, Russian President Vladimir Putin pointed out that Russia's economic structure had been very one-sided during the many years since the disintegration of the Soviet Union, focusing mainly on the mining and processing of raw materials, oil and gas, chemicals, metals and so on for fast income, and one of the main tasks of Russia was to change that structure. But he also acknowledged that it would be a long process to change the economic structure, which required huge capital investment.<sup>25</sup> According to the forecast of Russia's Ministry of Economic Development, as Russia entered a period of economic restructuring, the development of the Russian economy would enter a new stage. Russia's economy was predicted to maintain low growth over the next five years and even longer, under the influence of international and domestic factors.

With China and Russia gradually adapting to the new stage of economic development, both sides will adopt market-oriented reforms to create a more stable and favorable environment for bilateral economic cooperation. Various cooperation agreements that have been reached will also be implemented step by step. Bilateral trade will be driven by investment and new growth will be fostered in bilateral economic cooperation, which would enable the two countries to enter a new stage of sustained and stable development. Based on the analysis of the status quo, it

---

25 "Pujing: Eluosi jingji fazhan ying jianshao dui nengyuan yilai" ("Putin: Russia Economic Development to Reduce Reliance on Energy"), Nov 19, 2014, [http://news.xinhuanet.com/world/2014-11/19/c\\_127228422.htm](http://news.xinhuanet.com/world/2014-11/19/c_127228422.htm).

remains considerably difficult for the two sides to achieve the \$200 billion target in bilateral trade by 2020 under the influence of various internal and external factors.

#### **4. Proposals to promote the development of bilateral economic cooperation**

In the face of temporary difficulties arising in Sino-Russia economic and trade cooperation, the two sides should take effective measures and promote the sustainable development of bilateral trade.

##### *(1) Short-term measures*

First, exploiting the full potential so as to expand the volume of bilateral trade. In order to alleviate the difficulties in bilateral trade, on the one hand, China should make the greatest possible expansion of imports of Russia goods, especially different kinds of electronic products, including dual-use goods and high-tech products. On the other hand, the two sides should actively explore flexible ways of expanding trade on credit so as to help Russian enterprises overcome their capital bottleneck and ease up Chinese exportation to Russia. These measures can inject fresh momentum into the development of bilateral trade.

Second, accelerating currency swaps and the use of RMB as trade settlement currency. At a time when considerable fluctuations occur in the exchange rate of the Russian ruble, China and Russia should expand the currency swap mechanism, and make greater use of RMB in bilateral trade settlement. This will be conducive to enhancing security and reliability of bilateral trade settlement. Currency swap agreements will increase the ability on the part of Russian corporations to pay imported commodities in RMB, and help reduce operational risks faced by China's exporters due to fluctuations in exchange rate.

Third, exploring new areas of cooperation. In early 2015, the Russian government initiated an anti-crisis program, which regarded infrastructure projects and industrial parks as an effective tool to boost its economy. The city of Moscow alone has worked out a plan for the coming three years which includes construction projects to build 240 kilometers of highway, 60 kilometers of underground railway, 100 kilometers of railway and 40 overpasses; the Russian government is also actively promoting the economic development in the Russian Far East and Eastern Siberia. In December 2014, it was pointed out on China's Central Economic Work Conference that the Chinese government will encourage enterprises to carry out projects for infrastructure interconnectivity and support outward investment efforts

by competitive industries. Companies on both sides can join their hands in the implementation of the strategic development plan and cooperative projects in the Far East, and large-scale infrastructure projects. Through these efforts, advantages in capital and technologies on the Chinese side and the large demand in the Russian market can be combined to bring about a win-win situation which will enhance economic growth in both countries and help Russia boost its economy.

*(2) Long-term measures*

First, improving the legal basis of bilateral economic and trade cooperation. After the two countries signed the “Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income” and the related protocol, specific implementation rules should be developed as soon as possible so that the agreement can be turned into operational policies which can help reduce investment costs and create a business environment with solid legal support. Meanwhile, relevant government departments in the two countries should deepen cooperation in standards, metrology, certification and inspection and supervision; efforts are also needed to push for Russia’s adoption or recognition of international technical standards and reduction of market access barriers. Programs can also be increased for exchange of experience in the reform of market economy and communication of economic policies. The two sides should draw on experiences in joining WTO and further open up their markets, while guarding against trade protectionism.

Second, strengthening the role of market mechanisms in bilateral economic and trade cooperation. The most outstanding feature of current Sino-Russian economic and trade cooperation is government-led, large projects-oriented investments. This cooperation paradigm is an appropriate option for large-scale projects of infrastructure construction, resource development and such strategic cooperation as energy and aerospace projects, and this is also a proper choice for the two emerging economies. But this mode of cooperation is not without limitations, especially when it comes to cooperation in processing industry, creativity industry and service industry in a market economy environment. In all other bilateral and multilateral economic and trade cooperation involving China and other countries, cooperation with enterprises as the main actors and market-based economy as the principle proves to enjoy the strongest vitality, the highest effectiveness and the best sustainability. As has been pointed out on the Third Plenary Session of the 18th Central Committee of the CPC, the future directions of reform are to let the



market play a decisive role in allocating resources, to streamline administration and to delegate power to the lower levels. This requirement means that the Sino-Russian economic and trade cooperation should be more widely promoted under the principles of market economy, and that market should be allowed a bigger role in regulating trade cooperation.

Third, improving the operational efficiency of mechanisms for bilateral economic and trade cooperation. The most comprehensive bilateral cooperation mechanisms ever established between China and Russia, including annual meetings between heads of state, regular meetings between premiers, ministerial conferences and several working group conferences, have played a positive role in promoting bilateral trade and economic cooperation. But it should also be pointed out that the efficiency of current cooperation mechanisms has yet to be improved. When the two sides seek to expand new areas of cooperation, they should give priority to the role of the existing bilateral cooperation mechanisms or assign a new function to a certain mechanism, so as to avoid efficiency reduction caused by redundant and mutually restraining organizations. The principles of streamlined and effective structure should be followed in enhancing the operational efficiency of mechanisms for bilateral trade and economic cooperation.

Fourth, building a variety of platforms for trade and investment promotion. Efforts are needed to give full play to entrepreneurs' committees, young businessmen's clubs, various regional cooperation mechanisms, different chambers of commerce, and associations. Better use should also be made of modern communication technology; the Internet should be relied on as a platform to facilitate communication and information exchange between enterprises, create new ways of trade and investment. Cross-border e-commerce, for example, can be further developed so that large, medium and small-sized businesses can all find modes of cooperation appropriate to their development, thus bringing into being a wide-ranging and multi-level cooperation pattern which will help the Sino-Russian trade and economic cooperation obtain continuing vitality and momentum of long-term development.

## **5. Reflections on several issues in Sino-Russian economic cooperation**

At present, Sino-Russian economic and trade cooperation is on a track of unprecedented sound development, but this does not mean that there is no difficulties. Bilateral economic ties are still encountering some problems, including such issues as differing levels of economic gains in bilateral cooperation, the

implication of the scale of bilateral trade and cooperation, and collaboration related to economic zones. A clearer understanding of these problems will greatly help promote future cooperation processes.

*(1) Understanding gains and losses in Sino-Russian economic and trade cooperation from a strategic perspective*

In the vagaries of the market environment, economic cooperation always involves certain risks; a predictable fact is that risks occur to different extents. Promoting Sino-Russian cooperation projects in the context of a harsh Russian economic situation will inevitably entail some risks, or even losses. But in the long run, deepening Sino-Russian economic and trade cooperation is in line with the fundamental interests of both countries. To this end, President Xi Jinping said that no matter how the international situation changes, we must view the development of Sino-Russian relations as a priority of our foreign policy, constantly enhance political and strategic mutual trust, and expand and deepen all-round cooperation.<sup>26</sup>

*(2) Respecting the objective laws of economic activities, and pushing forward cooperation projects in a solid and steady manner*

Cooperation projects between China and Russia are aimed at long-term interests and will have a significant impact on long-term economic development in both countries. Many of these projects involve huge investment funds and take a long time to materialize, so they are difficult to implement. At the same time, efforts for economic cooperation should follow the due course of economic development. Instead of taking hasty decisions and aiming to attain the goal quickly, the objective should be slow, steady and solid progress.

*(3) China's participation in construction of economic zones in Russia's Far East*

Special economic zones (SEZ) were an important part of China's endeavor to open up its economy to the outside world in its early days of reform and opening up. China followed the principles of mutual benefit and win-win cooperation through practices of "market for technology" and "market for managerial expertise". At first, a group of SEZs were established along the coast line. As the process of reform and opening up deepens, SEZs gradually increase in number and expand from coastal areas to inland provinces. Situated in coastal areas with convenient transportation, abundant and low-cost labor resources, solid industrial production basis and a welcoming investment environment, the early SEZs proved

---

26 "Xi Jinping huijian puding, zhong e qianshu duoxiang nengyuan xieyi" ("Xi Jinping Meets Putin, Witnessing the Signing of Multiple Energy Cooperation Agreements", Nov 9, 2014, <http://www.chinanews.com/gn/2014/11-09/6764324.shtml>).

a strong attraction for foreign investors, especially those interested in industrial processing and manufacturing. China's concept was, by offering profitable opportunities to foreign investment, to acquire advanced technology and managerial expertise, create more job opportunities, and increase exports, foreign reserve and national revenues. Foreign investments were attracted by China's huge market and indeed gained significant economic benefits. According to an analysis conducted in 2013 by Chinese Academy of Social Sciences, the average value of yield spreads of foreign investment in China amounted to 22 percent from 2005 to 2012, a lot higher than the profit growth rate of those same investors' investment in their home countries. At the same time, enterprises from other parts of China also moved into SEZs in large numbers, injecting great manpower, and material and financial resources. This is also an important reason that economic zones have undergone decades of rapid development.

Russia has been vigorously promoting the construction of economic zones, but these endeavors are sharply different from those in China in terms of concept and modes of operation. In early 2015, Russia officially launched 14 economic development zones, similar to China's special economic zones. These zones are situated in the Russian Far East, an economically underdeveloped region, with only six million people and a weak productivity basis. Moreover, the return on investment (ROI) is low. In April 2012, Pavel Alexandrovich Minakir, academician of the Russian Academy of Sciences and director of Institute of Far Eastern Economic Development told reporters that, according to his estimates, for the past four decades there has been a very low ROI in the Far East. The ROI for one ruble's investment is only 18 kopecks, but an investment becomes economically meaningful only when one ruble's investment gives an income of 1.5-2.5 rubles. As of present, investment in Russia's Far East is meaningless in economic terms. Russian entrepreneurs are reluctant to invest in the Far East. Foreign-funded enterprises are by no means willing to do so. In fact, low ROI is the primary factor restricting foreign investment in the Far East.

Participants of economic zone construction are primarily corporations whose investment projects and business operation aim to maximize their profit. When this goal cannot be met, it is difficult for investors to take serious interest.

#### *(4) A dialectical view on Sino-Russian trade volume*

Towards the development of Sino-Russian trade, the two sides have always held a positive and optimistic attitude. In the beginning of the new century, the two

countries had hoped that bilateral trade would increase to \$80 billion in 2010. But with the global financial crisis in 2008, the actual bilateral trade volume in 2010 was only \$55,449 billion. After that, a new goal of \$100 billion was set for the bilateral trade volume in 2015. In 2014, bilateral trade volume reached a record high of \$95.285 billion, the closest ever figure to the goal. Russian economic recession, however, led to a significant decline in its export growth, which made the attainment of the \$100 billion target in 2015 very difficult. The two sides have also proposed that in 2020 bilateral trade volume should reach \$200 billion. This short history of setting and trying to achieve trade goals showcases a fact that multiple factors are behind the expansion of bilateral trade scale, including China's own trade growth, the international trade environment and the economic development of the target country. Some factors cannot be controlled or reliably predicted. When it comes to whether or not a target of trade growth can be reached, there are always great uncertainties and difficulties.

According to Chinese customs statistics for 2014, Sino-German trade volume was \$177.7 billion, quite close to \$200 billion. IMF statistics shows that Germany, with a GDP of \$3.45 trillion, was the world's fourth largest economy in 2013. By way of contrast, Russia was the world's eighth largest economy, its GDP being \$2.2 trillion, or only 63.77% of that of Germany. According to Eurostat data, Germany's total import and export trade in goods in 2013 was \$2.64 trillion. In the same year, Russia, according to its Ministry of Economic Development statistics, made a total import and export trade in goods of only \$865.9 billion, or 32.8% of Germany's trade volume. In the foreseeable future, Russia is still unlikely to achieve the German level of economic development, and therefore to achieve the \$200 billion target will be an extremely arduous task for China and Russia.

After its economy enters a mode of the new normal, China is more concerned about the quality of economic development, rather than simply focusing on the pursuit of economic growth rate. Similar attitudes should be taken toward the development of bilateral trade. What should be gradually given up is the idea of one-sided pursuit of growth in bilateral trade. More attention should be paid to the impact of bilateral trade on national economic security, the socioeconomic development in both countries and the well-being of the peoples, which are much more important and are in fact the ultimate objective of our efforts to promote bilateral trade.



### **III. The Status Quo and Future of Russian Economy**

After 2008 international financial crisis, Russian economy is once again suffering from “economic winter”. Western economic sanctions and the drop in international oil price have driven Russian economy to the brink of recession. Though Russian government has already carried out a comprehensive anti-crisis plan, it does not touch the deep-rooted problems of Russian economy. To a large extent, it is more of political than of economic significance. Russian economic woes are rooted in its single-structured economy. Once external pressure disappears, Russia will walk out of the economic slump. However, in the long term, because of the unpredictable relationship between supply and demand in international energy market and difficulties in economic restructuring, downward performance will be a new normal status for Russian economy.

#### ***A. An Overview of Russian Economy in 2015***

Under the impacts of global economic downward, international oil prices dropping continually and economic sanctions by western countries, the Russian economy was subject to serious recession in 2015.

Firstly, the economic growth rate declined. According to Russian Federal Bureau of Statistics (Russtat), Russia’s GDP in 2015 was 80.41 trillion RUB (1.31 trillion USD), indicating a decline of 3.7% compared with that of 2014, lower than the expected 2.5%.

Secondly, overall decline was witnessed in exports, investment and consumption. In terms of exports, total trade summed up at 53.36 billion USD in 2015, with a decrease of 33.8% compared to that of last year. Exports amounted to 33.96 billion USD with a decrease of 31.8%. As the main exporting product, oil generated revenue of 8.9576 billion USD, with a significant year-on-year downfall of 41.8%. As for fixed capital, the investment continued to shrink rapidly. Although the dropping speed was lowered in the 4th quarter of the year, it could not turn around the tide. For the year round, fixed capital investment decreased by

8.4% to 14 trillion rubles on a year-on-year basis. The last aspect concerns a weak consuming market. According to Russtat, total retailing sales in 2015 were 27.58 trillion rubles, which showed a 10% decrease than that of the previous year, an obvious drop compared to the average level of 2013-14. Such a dramatic downward had never occurred since the past decade.

Thirdly, most sectors showed depressing production indicators while agriculture alone presented a different picture. In 2015, Russian industrial production gloomed, with main indicators largely dropping. Among them, the industrial production index decreased by 3.4% and the production index of processing industry even decreased by 5.4%. In the overall gloom, agricultural production increased by 3%, which held the equal level of the year of 2014, and year-round agricultural production reached 5 trillion rubles. Fourthly, with a higher inflation rate and a decrease of incomes, household living standard declined dramatically. According to Russtat, the Russian inflation rate peaked at 12.9% in 2015 after 2008. Market prices presented an overall ascent as food prices that were closely-related to household living increased significantly. In the meantime, disposable income and nominal monthly salary on average dropped, respectively, by 4% and sharply 9.5%.

## ***B. Main Reasons for the trouble of Russian Economy in 2015***

In 2015, the bleak status of Russian economy in 2014 went on, and its growth rate continued to drop and every economic indicator was expected to perform poorer than that of 2014.

Many complicated factors have contributed to the Russian economic plight. Simply put, domestic and overseas factors impacting 2014 economic development have not disappeared, but rather lasting continually, leading 2015 Russian economy running to the rock bottom.

### **1.No sharp rebounding for oil price**

In 2008, oil price peaked at \$147 per barrel, which stimulated gigantic petroleum production capacity. But now, slower growth among emerging economies, sluggish growth in the European Union and the fast development of the US shale oil and gas production have all contributed to the oversupply in international energy market and slump in international oil price in 2014 from \$107 to \$63 per barrel, decreasing 41% over half a year. OPEC countries adopt a laissez-faire attitude and maintain previous oil production level, which will not make any changes for current glut

of oil. In 2015, the international market of crude oil was shaken with the price struggling at the bottom and average price of the whole year resulted in 54.4 USD per barrel. Russian economy highly relies on energy exports, which took up 70% of Russian export revenues and 50% of its fiscal revenues. Falling prices of both oil and bulk commodities further slowed Russian economic growth, severely influenced Russian financial revenue and increased the risks of financial crisis.

## **2. Impacts of western economic sanctions**

Due to the Ukraine crisis, the US and EU have imposed many rounds of economic sanctions on Russia, forbidding five state-owned Russian banks including Vnesheconombank (Russian Development Bank), VTB Capital, Sberbank (Savings Bank of the Russian Federation) and GazpromBank to get loans for longer than three months from the US or European investors, postponing the provision of loans to Russia by EU Investment Bank and European Bank for Reconstruction, implementing arms embargo, launching a ban on dual-use export to Russia for military end-users, and restricting Russia to obtain sensitive technology from EU, especially that for oil industry.

The Russian government insisted on premature financial market liberalization policy and actively integrated domestic financial market into global network, believing that it was the right way to achieve economic growth momentum and effective market economy. This led to heavy loaning of huge enterprises and state-owned banks from western banks through risk mortgage not supervised by Russian Central Bank and other national organizations. Relatively cheap loans from international financial market have become the source of Russian economic growth and investment expansion, deepening Russia's economic dependence on the west. The US and EU sanctions on Russia's financial industry got the vital point, which caused four major problems. First, balance sheet issues can't be resolved, and Russian government has to pay to rectify those problematic banks. Second, foreign debts have to be repaid. In 2015, Russian government, corporations and banks owed \$130 billion of foreign debts, among which \$70 billion can't be paid off without external fund-raising. Repayment of debts will be the most realistic problem. Third, real economic development is in need. It is hard for Russia to get loans to promote the development of large state-owned enterprises (SOEs), and that's why domestic investment shrinkage problem ensues. To solve the problems mentioned above, Russia will either use up all of the national foreign reserves, or lower domestic consumption level, but neither stimulates the economy. What is

worse, there is no sign of improvement in the Ukraine situation. EU sanction on Russian economy prolongs to the present day which means Russian banks and companies would still be in the shadow of “no money” in both 2015 and 2016, with domestic demands shrinking to a larger extent with obviously insufficient economic vitality.

### **3. Not the right time yet for Ruble appreciation**

There are various reasons for Russian Ruble to decline sharply, and those reasons went on impacting the variation tendency of Ruble in 2015. Firstly, Ruble value has been linked up with international oil price. The drop in oil price led to ruble depreciation. Oil price was still downward in 2015 and Russian economic risks were aggregated, which increased the downward risks for Ruble against US dollar. Secondly, the US dollar rallied. The US economy was reviving from the financial crisis, but major economies such as the Europe, Asia and Australia fell into stagnation. The US dollar appreciated against most currencies in 2014 and it held the strongest currency in the world in 2015. The exit of quantitative easing policy of the US Federal Reserve raised expectations for higher interest rates of the U.S., which would push up the exchange rate and increase the risk for Ruble depreciation. Inflation stayed at a high level together with accelerated outflow of large amount of capital, and Russia’s economic energy would be weakened. Until December 31st, 2015, Russian Central Bank benchmark interest rate was still as high as 11%, showing that risks for Ruble depreciation still exist, and whether it will appreciate remains to be seen.

### **4. Inadequate endogenous motivation**

Russian economy relies on energy export, which depends on sound global economic environment, growing external demands and domestic demands derived from the external. In recent years, global economy was depressed with less demand for energy, and the development of US shale gas has readjusted global energy market, affecting Russian energy exports and lowering its export earnings. The volume of Russian foreign trade witnessed a 1.46% decrease in 2012 and a 2.6% decrease in 2013.<sup>27</sup> Reduction in external demands caused sluggish domestic demands. Since 2013, Russia’s consumption has been descending with the retail trade volume decreasing by 2.8% and fixed basic investment declining by 0.3%.<sup>28</sup>

---

27 Central Bank of the Russian Federation, see [http://www.cbr.ru/wps/statistics/print.aspx?file=macro/macro\\_13.htm&pdi=macro\\_sub&sid](http://www.cbr.ru/wps/statistics/print.aspx?file=macro/macro_13.htm&pdi=macro_sub&sid).

28 Russtat, see [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/rates/79a3cc004a41fc37bdd8bf78e6889fb6](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/rates/79a3cc004a41fc37bdd8bf78e6889fb6).



The consumption and investment slip had a direct impact on industry. Russian industrial production has shown a downward tendency since the second half of 2012, with less demand in electric power, energy, extraction, construction, etc., causing more production costs and obvious decline of corporate profits. From January to November in 2013, 28.6% of Russian companies were losing money.<sup>29</sup> Industrial production almost came to a standstill with only 0.3% of growth during the whole year.<sup>30</sup> Besides, capital outflow caused by factors like poor business environment, corruption and others had drawn the money and resources greatly needed by Russian economic growth to abroad, presenting difficulties while adding to economic risks for Russian economic growth and domestic industrial investment. The total amounts of capital outflow amounted as high as \$56 billion, \$70 billion and \$151.5 billion in 2012, 2013 and 2015 respectively. Although Russian government carried out some policies to boost economy, namely, supporting for small and medium enterprises (SMEs), expanding credit and loan supply, optimizing business investment environment, initiating infrastructure construction and providing special supports for areas relevant to keep promises while entering the WTO, but all those measures to stimulate economic growth failed, therefore, Russian economy continued its downward path. Russia's economic downturn started since the second half of 2012. In 2013, its GNP grew by only 1.3%. In 2014, even without external factors like the oil price or western sanctions, Russia still faced severe economic situation.

### ***C. Slim Possibilities for Russian Economic Collapses***

Economic collapse refers to a completely devastated economy stuck by serious economic crisis, chaos and paralysis. Russian economy does not yet conform to the above definition. Although facing many problems, Russia could still support itself with its vast territory and abundant resources. Moreover, measures have been taken by Russian government to control the economic situation. What's more, sound macro-financial situation, abundant capital reserves, low unemployment rate and unprecedentedly high social cohesion will make sure that Russian economic plight will be periodical and will never put on an old play like the economic turmoil in 1998.

---

29 "Erlingyisannian yiyue zhi shiyiyue e kuisun qiye bili da baifenzhi'ershibadianliu" (From January to November, 2013, 28.6% of Russian Companies Are Money-Losing Ones), *Eluosi Tashe* (Tass News Agency Moscow), January 29<sup>th</sup>, 2015, see [ru.mofcom.gov.cn/article/jmxw/20140110478529.shtml](http://ru.mofcom.gov.cn/article/jmxw/20140110478529.shtml).

30 Russtat, see <http://www.gks.ru/bgd/free/B04-03/lssWWW.exe/Stg/d03/8.htm>.

## 1. Russian government's plans saving the economy

Facing with increasingly severe economic situation, Russian government, after implementing policies like implementation of import substitution strategy, supporting non-raw material export, offering overseas capital amnesty and revision of federal financial budget, has restarted Anti-crisis Tracking Committee and issued the first systematic countermeasure file, *Scheme to Ensure Sustainable Development of Economy and Social Stability*, on January 28<sup>th</sup>, 2015. This scheme aims at keeping budget, inflation, foreign debts, foreign reserve and other economic indicators at “acceptable level”, maintaining macro-economic stability and social stability. The whole scheme is composed of 60 measures, with a budget of over 2.32 trillion rubles. The main contents include three aspects:

The first is the reduction of government expenses. Most of the federal budget items have been cut by 10% in 2015, and will decrease by 5% annually in 2016 and 2017. Salaries of the Kremlin politicians will be reduced by 10% and the average salary for an SOE manager should not exceed that of an SOE worker by eight fold.

The second is capital and policy support for specific economic fields, such as finance, infrastructure, industry, agriculture and innovation, among which the finance and banking system was prioritized. One trillion rubles have been appropriated to deposit insurance institutes to recapitalize banks, and 550 billion rubles allocated to banks--300 billion rubles going to Vnesheconombank, and the rest to other banks. Russia will consider creating a “bank with poor balance sheet” to buy back and compensate troubled shares, and the government will respectively allocate 50 billion, 20 billion, and 16 billion rubles to support agriculture, industry and health sectors. In the field of innovation, in order to support SMEs, Russian government decided to reduce redundant anti-monopoly regulatory policies, to lower the threshold for enterprises to get business licenses according to their tax contribution, and let more small businesses participate in national procurements. The central government of Russia also empowered local governments to reduce or exempt taxes of SMEs and simplify the administrative procedures with proper flexibilities.

The third is maintenance of social stability and civilian social welfare, which will be realized by monitoring prices of basic daily necessities and food and stabilizing the pricing of essential drugs, controlling and supervising imported medicines and improve the minimum wage standard of residents. Since 2015, Russian minimum wage standard has been increasing 411 rubles per month,

benefiting more than one million residents. Meanwhile, the pension also increased by 10% or so. Since February 1st, 2015, endowment insurance will be adjusted according to the increase of consumer price index (CPI). Every mother will get 20,000 rubles from the Mother Fund set for encouraging childbirth. The Anti-crisis Plan will provide assistance to mortgage lenders with financial troubles, providing more loans to economically affordable housing and related infrastructure construction. Within the Russian family housing framework, in some cases, Russian government will provide social mortgage loan to certain citizens. The plan will also increase 50 billion rubles to stabilize labor market and the Russian Communist Party even proposed a draft to Duma which fines the owners for dismissing workers without a reason.

Russian government demands that most of the measures should be implemented before the end of the first quarter of 2015. Russian Prime Minister Dmitry Medvedev stressed that the Anti-crisis Plan was not rigid, but rather adjustable according to different situations. While the authorities are stressing that the crisis is not just about fastening the belt, but about economic transformation, it could still be learnt from the policy contents that the essence is to stabilize finance, to stimulate domestic demands and to guarantee macro-economic stability. If the plan could be implemented, the crisis will be alleviated to a certain degree.

## **2. Abundant natural resources and national reserves**

Russia has absolute advantages in natural resources. The estimated value of Russian natural resources is \$24 trillion, while that of the U.S. is only \$4.6 trillion, and that of the UK, Germany or Japan is less than \$0.3 trillion.<sup>31</sup> Seen from the perspective of resources abundance, Russian economy is very stable and its industries have infinite potentiality, which makes its counterparts unable to catch up with and enables Russia to keep confidence under huge pressure. Therefore, though Russian economic downturn in the future is inevitable, it won't collapse thanks to its resource advantages. Besides, sufficient gold foreign reserves and general reserves have created a "safety cushion" for its economy. Until February 1<sup>st</sup>, 2015, the volume of Russian foreign reserves has reached \$376.2 billion,<sup>32</sup> enough for Russia to pay off all foreign debts in 2015. With long-term accumulation of "oil dollars", Russian social stability will be safeguarded by the Stabilization Fund set in 2003. Till January 1st, 2015, Russia had grown a reserve fund of \$76.1 billion

31 "Eluosi dui 'jingji chuntian' you xinxin" (Russia Is Confident about Economic Spring), *Huanqiu Wang* (*Global Times*), February 3<sup>rd</sup>, 2015, [http://world.huanqiu.com/hot/2015-02/5579711\\_2.html](http://world.huanqiu.com/hot/2015-02/5579711_2.html).

32 Central Bank of Russia, see [http://www.cbr.ru/statistics/print.aspx?file=credit\\_statistics/iip\\_ira\\_15.htm&pid=svs&sid=mipzRF](http://www.cbr.ru/statistics/print.aspx?file=credit_statistics/iip_ira_15.htm&pid=svs&sid=mipzRF).

and a National Welfare Fund of about \$67.5 billion. The former one will be used to fill fiscal spending gap and pay off national foreign debts and the latter one will be used to subsidize pensions and other social welfares.<sup>33</sup>

In addition, Russian macro-financial data has been showing sound momentum in recent years. Compared with EU member countries' sovereignty debt crisis, Russian finance has been unique with bright highlights. The percentage of Russian national debts in GDP is 10.5%, which is far below that of other western countries like Japan (200%), the U.S. (100%) and Germany (82%).<sup>34</sup> And the financial deficit of Russia is quite low, being 0.05% in 2012, 0.5% in 2013, and 0.6% in the most difficult year, 2014, which could even be negligible. Since financial balance of payments provided a strong guarantee for resolving economic problems, Russian unemployment rate has been kept at such a low level. In 2015, Russian unemployment rate was 5.6%, which was still not very high. Russian grain production reached 103.4 million tons, which not only enabled self-sufficing, but also made 30 million tons of grains available for export.

### 3. Russians uniting as one in overcoming difficulties

Under the heavy pressures, the Russian people's patriotism has been aroused and the "hero complex" in their blood has been revived, greatly strengthening Russian courage and confidence in overcoming difficulties. Russian people are determined to make common efforts with the central government headed by President Putin to get through difficulties. Although ruble has been depreciating and inflation has been rising time and again over the year, opinion poll of Levada Center, a Russian independent opinion research institute, shows that Putin's approval rate reached 86% in March 2015 and that number was as high as in the most difficult period in September 2014. The logic behind is: "We are in an isolated island besieged by the west, and Putin is our protector". This allows President Putin to deal with domestic and overseas crisis more confidently and freely. Western sanctions draw Russian people's minds closer and many sectors joined this anti-sanction fight, real estate agencies lowering the housing mortgage loan rate to 9.5%, and retail traders offering anti-sanction discount price. The richest man in Russia, Alisher Usmanov, transferred his holdings in telecommunication and iron ore industry from abroad back to Russia, indicating that he would offer all his belongings to Russia

33 "Eluosi zhunbei dongyong chubei jijin yi wancheng 2015nian caizheng yusuan" (Russia Has Decided to Use Reserve Fund to Implement 2015 Budget), *Xinhua Wang (Xinhuanet)*, February 12th, 2015, [http://news.xinhuanet.com/world/2015-02/12/c\\_1114340614.htm](http://news.xinhuanet.com/world/2015-02/12/c_1114340614.htm).

34 Tian Chunsheng, "erlingyisannian eluosi jingji zhuyao tedian ji qianjing" (Major Features and Prospects of Russian Economy in 2013), *"Dongbeiyi Xuekan" (Journal of Northeast Asia Studies)*, March 2014, p.4.

if necessary, because he'd been a Russian citizen and took prides of that.<sup>35</sup> Russian people's calmness enables the government to deal with economic problems in an orderly way, preventing the whole nation from turbulences in front of calamities.

### ***D. Long-Term Challenges***

Current single-structured economy is the biggest obstacle to restrain Russian sustainable economic growth, and can only achieve economic transformation through economic modernization. In fact, Russian leaders have long realized this and the goal of achieving economic modernization has been a consensus reached by Russian elites. In Russia, to make a breakthrough in economic modernization, two factors, which are also two long-term challenges for Russian economy in the future, are the most crucial --The first is how to balance between economy and society, and the second is how to accelerate the process of transforming economic growth mode from an energy-export-oriented one to a high-tech-and-human-resource-innovative one.

#### **1. Conflicts between economic and social goals**

Firstly, there is a conflict between economic growth and social securities. Russian government has to maintain a certain economic growth rate and fulfill the promise of social welfare to its citizens at the same time. Running for the third term of presidency, President Putin promised to raise social insurance and welfare. After being successfully elected, his policies have still been focused to develop economy, solve social security problems and improve people's living standard. The problem is: Where does he get the money to keep his promise? Oil and gas revenues are definitely the best resources to fill the funding gap. Although it is generally believed that energy-oriented economy is the major obstacle for Russia to achieve sustainable development, it is undeniable that energy export is still the major driving force for Russian economic growth. If the Russian government significantly reduces the proportion of energy use in its economic structure, Russia may get into difficulty in both financial revenues and social operation, causing social contradictions, which is harmful to Putin's administration.

Secondly, there is a conflict between economic growth and modernization. President Putin wrote in the paper of "Our Economic Tasks" that Russian labor productivity was only 1/3 or 1/4 of that of the developed countries. The way to

---

35 "Eluosi shoufu xiangying puding haozhao dai ju'e zichan huiguo" (The Richest Russian People Responds to Putin's Call and Brings Huge Assets Home), [http://finance.ifeng.com/a/20141229/13391508\\_0.shtml](http://finance.ifeng.com/a/20141229/13391508_0.shtml).

improve labor productivity is to achieve economic modernization, and that's why the Russian government and economists propose that more capital should be used to adjust economic structure and achieve economic modernization. However, according to President Putin's economic outlook, the primary task is to maintain economic growth, and the best way will undoubtedly be oil and gas modernization and more military-industrial investments. That is to say, Russia will still use extra money to support energy and military industries. This measure will stimulate economic growth to a certain extent, but the spending in technology innovation will thus be reduced and it is adverse to the advancement of economic modernization. Russian government has to make a choice between economic growth and economic modernization.

In a word, the Russian government reiterates the need for economic growth mode transformation from a raw-material-export-oriented one to an innovation-oriented one, but at the same time is attracted by raw material industries like oil. How to properly settle the conflicts between these two modes will be the most urgent economic problem for Russia in the future.

## **2. Hardships in achieving innovative economic growth**

Innovation is a key factor for economic modernization. It was clearly pointed out in the *Development Strategy of Russia by the Year 2020* put forward on February 8th, 2008 by President Putin that innovative economic growth is the only choice for Russia. But until now, Russian economic transformation made little, even too slow progress, which could be understood from the following four perspectives.

First, there are flaws in innovation mechanism. Russia inherits an advantageous foundation of scientific research from the Soviet Union and invested more in research and development (R&D), but the general innovation performance of Russia is only on a medium level without much technological achievements or innovation stimulated economic growth. Currently, the core of Russian innovation system is still the state-owned R&D institutes, rather than private enterprises. The Top-down mode of R&D, driven by national provisions rather than demands, by making use of public research resources, hasn't made any changes. Such institutional arrangements will weaken the fluidity of knowledge system, causing the lack of exchanges between development and application of technology. That's why Russia can't manufacture advanced home appliances, but could have advanced space technology. In fact, enterprises operating in the market competition are the core of innovative activities, and public R&D could only play a subsidiary role.

Therefore, how to transform innovative system from the state-owned R&D to enterprises-oriented mode and effectively absorb international R&D capacity will be the major problems waiting to be solved for Russia to become truly innovative.

From the perspective of national policy, although Russian leaders have repeatedly stressed that industrial innovation should be strengthened, there is still a huge gap among its principal guidelines, economic policy-making and the goal of innovative economy, with unsatisfactory implementation of specific measures and ineffective incentive mechanisms to encourage innovative corporations to develop, which becomes a blocking factor for innovation.

Second, investments in technology innovation are lacked of. The key to Russian economy innovation is capital. The scale of Russian investments in scientific research and experiment design is 80% lower than that of the developed countries. In terms of per capita, Russia's annual spending on scientific research and experiment design is less than \$100, while that number in the developed countries is as high as \$500. Because of the high return rate of investments, most of Russia's limited capital flows into the energy sector, with 93.1% of innovation capital used to buy equipment and only 0.12% used to buy new technology. It is hard for non-energy related enterprises to get adequate financial supports, which leads to little enthusiasm for corporate innovation. To ignite such enthusiasm, subsidy from government is needed, but little capital of national budget is reserved to those innovative enterprises. This is a realistic problem for Russia in its transition to innovative economy.

Third, enterprises don't have enough innovation incentives. Over the last decade, the percentage of Russian innovative enterprises is kept at 9.7%, which number is 25%-30% in the East European countries and more than 40% in developed countries.<sup>36</sup> Russian innovative economy is mainly concentrated within some SOEs, distributed in point shape instead of in full bloom. Those large SOEs are obviously insufficient in innovative motivation, a situation that is "decided by Russian modern elites, who are the biggest beneficiaries of resource-oriented economy, so they are lack of enthusiasm in reformation. Meanwhile, some of those elites are high-level decision-makers with strong control over the overall situation".<sup>37</sup> As the backbone of innovative economy, SMEs' development is even harder, who have to tackle so many obstacles including high taxation, corrupted,

---

36 Xue Fuqi, "Eluosi fazhan chuangxinjingji quefa huanjing" (Russia Lacks Institutional Environment for Developing Innovative Economy), *Zhongguo Shehui Keixu Bao (China Social Sciences Weekly)*, August 13, 2009.

37 Guan Xueling, Liu Kejia, "Eluosi jingji xiandaihua: beijing, buju yu kunjing" (The Background, Layout and Plight of Russian Economic Modernization), *Eluosi Zhongya Dongou Yanjiu (Russian, East European & Central Asian Studies)*, Vol.1, 2011.

overstaffed and overlapped bureaucracy, over-regulation and difficult financing, etc., all of which have negative impacts on SMEs. Currently, in the U.S. and western developed countries, SMEs' contribution occupies 50% of GDP. The growth of US GDP over the past half century attributes to technological innovation, mainly developed by SMEs. In 2009, Russian SMEs' contribution to GDP is less than 15% with imbalanced sector distribution of small enterprises. Small enterprises majoring in industrial manufacturing or scientific research innovation accounted for slightly above 10% of the total and the percentage is decreasing year by year. Thus, it is foreseeable that Russian SMEs could only play very limited roles in the economic modernization process.

Fourth, human resources are losing momentum. Russian human resources have the following problems. First, low quality of engineering university graduates. Second, set-ups of college majors are not consistent with labor market demand, with only 60% of graduates' jobs being related to their majors. About 55% of science and engineering graduates work in business and trade area, not relevant to scientific research. Only 15% of those graduates are engaged in real scientific research. Third, weak scientific research ability in higher education is expanding gap between Russian universities and the world first-class ones. After two decades of higher education reformation, Russian universities only improved their quantity, and their quality even got worse. According to the newly released 2013-2014 World University Rankings by the British Times Higher Education, Russian universities encountered their waterloo that not a single university got in the top 200 best universities. Fourth, serious aging problem exist among technology talents. It is shown in the evidence of world scientific development that scientists have their highest productivity at the age of 27-40. However, the average age of Russian scientific researchers now is 49 and that of science associates and doctor of science (Sc.D.) are 53 and 61 respectively. Fifth, there is serious brain drain. Nowadays, there are about 500,000 Russian scientific researchers working abroad, and 60% of emigrant scientists are young talents under the age of 40, 12% of whom having doctors' degree.<sup>38</sup> From the perspective of human resources, both innovation capability and talents potentiality are main restrains in Russian economic transformation.

---

38 Li Fanghua, Saiyin Tuoya, "Eluosi Keyan Rencai Fazhan Zhuangkuang"(Developments of Scientific Research Talents in Russia), Eluosi Dongou Zhongya Shichang (*Russian, East European and Central Asian Market*), vol.9, 2009, <http://www.cast.org.cn/n35081/n35668/n35728/n36419/11105325.html>.





## **List of Published CIIS Reports**

---

- No.1 *Ruan Zongze et al.*: Toward a New Type of Major-Country Relationship Between China and the US: Challenges and Opportunities, 58 p., Beijing, December 2013.
- No.2 *Chen Xulong*: In Pursuit of the “World Dream”: The Progress and Prospects of China’s Promotion of a Harmonious World, 70 p., Beijing, December 2013.
- No.3 *Teng Jianqun / Xu Longdi*: Cyber War Preparedness, Cyberspace Arms Control and the United States, 56 p., Beijing, August 2014.
- No.4 *Cui Hongjian / Jin Ling / Wang Yi*: Changes of EU’s International Status and Influence, 70 p., Beijing, October 2014.
- No.5 *Shi Ze / Yang Chenxi*: China’s Diplomatic Efforts on Promoting Energy and Resources Cooperation Along the “One Belt and One Road”, 65 p., Beijing, April 2015.
- No.6 *Jia Xiudong et al.*: The Potential for a Win-win Cooperative Relationship Between China and the U.S. in Southeast Asia, the Middle East, Africa and Latin America, 55 p., Beijing, July 2015.
- No.7 *Lan Jianxue*: Sino-Indian Relations in the New Era: Current Status, Development Trend and Policy Recommendations, 42 p., Beijing, August 2015.
- No.8 *Jiang Yuechun / Zhang Mei / Li Xiaoyu*: New Progress of the TPP Negotiations and Strategic Considerations of the Parties Concerned, 50 p., Beijing, October 2015.
- No.9 *Ruan Zongze et al.*: China’s New Neighborhood Diplomacy: Seeking Stability Through Management and Planning, 61 p., Beijing, February 2016.
- No.10 *Liu Feitao et al.*: Managing Sino-U.S. Disagreements in Political, Economic and Security Fields, 69 p., Beijing, June 2016.
- No.11 *Jiang Yuechun et al.*: China’s FTA Strategy, 50 p., Beijing, October 2016.
- No.12 *Chen Yurong et al.*: Eurasian Economic Union and Sino-Russian Economic and Trade Cooperation, 48 p., Beijing, August 2017.

## **About the Authors**

**Chen Yurong** is Senior Research Fellow, Director of Department for Eurasian Studies and Director of Center for SCO Studies, CIIS.

**Li Xin** is Senior Research Fellow and Director of Center for Russian and Central Asian Studies, Department of World Economic Studies, Shanghai Institute for International Studies.

**Liu Huaqin** is Senior Research Fellow and Director of Department for European Studies, Chinese Academy of International Trade and Economic Cooperation, Ministry of Commerce.

**Han Lu** is Associate Research Fellow, Department for Eurasian Studies and Center for SCO Studies, CIIS.

# ABSTRACT

Ever since the Ukrainian Crisis broke out in November 2013, the geopolitical struggle between Russia and the West has become more and more intensive which is followed by a more isolated status of Russia. Influenced by the Western sanctions and declining of the international oil price, Russia's economy has experienced a severe down turn. On 1st January 2015, the Eurasian Economic Union (EEU) led by Russia was launched as schedule which is of great importance to Russia to integrate the Commonwealth of Independent States (CIS) and will be the strategic supports for Russia's re-rising. The economic effects of EEU will benefit the entire Eurasian area and the operation of it will influence the promotion of Sino-Russia economic and trade relations, Shanghai Cooperation Organization (SCO) and the Silk Road Economic Belt in different degrees. To a large extent, the future of EEU depends on the pushing function of Russia's economy as the engine of the Union. In the next two years, Russia's economy will proceed in hardship in the dilemma, which will bring about negative impacts on the further development of the EEU and Sino-Russia economic and trade cooperation. From this point of view, this report illustrates the EEU, Sino-Russia economic and trade relations and Russia's economic trends, and provides solutions and recommendations accordingly.

Edited by Office of Research Management, CIIS

Address: 3 Taijichang Toutiao, Dongcheng District, Beijing 100005, P. R. China

Tel: +86 10 8511 9556 Fax: +86 10 8511 9705

Email: wangqiang@ciis.org.cn Website: www.ciis.org.cn