

Russian Oil Sales to China May Impact Iran

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Jan 28, 2013

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Brief Analysis

A Russian state oil company is sharply increasing its exports to China, with potential negative consequences for Tehran.

On January 14, the top managers of Russian oil firm Rosneft met with representatives of the China National Petroleum Corporation in what was billed as a routine continuation of longstanding bilateral consultations on energy cooperation. The talks proved far from routine, however -- Russian media reported that the two sides reached a preliminary agreement to increase Rosneft shipments to China from 300,000 barrels per day (b/d) to 500,000. In addition to its implications for Moscow's relations with Beijing, the announcement could have considerable consequences for Iran.

CHINESE-IRANIAN RELATIONS AND OIL

Prior to 2012, Iranian authorities considered China a guaranteed market. At the time, Tehran was providing 10-16 percent of all Chinese oil imports, and the U.S. sanctions implemented from 2006 to 2011 did not significantly limit this flow. Beijing's periodic attempts to find alternative suppliers caused occasional shortfalls in volume, but these decreases did not last long.

Beijing's consumer loyalty was partly due to political factors: China's leaders were concerned about energy security as the country asserted itself on the global scene in ways that contradicted the interests of other international players. They apparently considered it dangerous to rely solely on hydrocarbon imports from Persian Gulf countries that had tight contacts with Washington.

The flow of oil to China had a political dimension for Tehran as well. Over the years, growing confrontation with the West and the periodic threat of military attack had spurred Iran's leaders to look for reliable allies. In particular, they sought a partner capable of counterbalancing international moves that hurt Iran's economy and preventing adversaries from abrupt, bold measures. After gradually becoming disappointed in Russia's qualifications for this role, Tehran turned its attention to China. Given the absence of a common ideological ground, Iranian leaders were

compelled to buy Chinese loyalty through economic means -- namely, oil.

BEIJING'S SHIFT TO MOSCOW

Beginning last year, however, energy cooperation with Iran became quite challenging for China. Expanded U.S. and EU sanctions had sensitive implications for Chinese companies and financial institutions that do business with the West. Oil purchases from Tehran also became tricky. Limits on banking transactions, tanker insurance, and sea transportation made it difficult to obtain and pay for Iranian shipments.

In addition, Beijing seemed concerned about Iran's political reliability. Statements by Iranian politicians on the necessity of improving relations with Washington and rumors of secret U.S.-Iranian meetings likely led the Chinese elite to question the future of Tehran's foreign policy priorities. Under these conditions, Moscow became a more appealing partner.

For one thing, Russia is not an OPEC member and therefore enjoys more freedom in determining its economic policy. Second, with Vladimir Putin's return to the presidency, Russian foreign policy again became more Asia-oriented. Third, growing economic cooperation between the two countries in different fields (including military) had already showed Beijing that Moscow could be a reliable element of Chinese energy security.

CHINESE OIL IMPORTS FROM IRAN AND RUSSIA

Although Russia and China have talked about energy cooperation for years, the results have been slow in coming. In 2009, Moscow completed construction of ESPO-1, the first phase of the East Siberia-Pacific Ocean pipeline. The line's current capacity is 600,000 b/d, and this figure could rise to 1,600,000 b/d by 2025. Then, in September 2010, Moscow completed the Skovorodino-Daqing pipeline linking ESPO-1 with northern China; the connector has a capacity of 300,000 b/d and could increase to 600,000 b/d by 2025. Finally, in December 2012, the second phase of ESPO came online with an existing capacity of 300,000 b/d and the potential to reach 1 million b/d by 2025. In addition to establishing an overland spur to China, the complete pipeline gives Russia new options for bringing Siberian oil to Pacific shipping lanes. All of these steps were necessary preconditions for a major increase in oil exports to China.

Last year, as new Western sanctions on Tehran took hold, Beijing scaled back its purchases of Iranian oil and simultaneously increased its imports from Russia. Specifically, Chinese imports of Iranian hydrocarbons dropped from 555,000 b/d in late 2011 to 433,000 b/d in fall 2012. By year's end, Beijing's purchases from Tehran had decreased by a total of 22 percent. This was quite unexpected for Iran's leaders, who had considered China less susceptible to the influence of sanctions.

Over the same period, Beijing increased its purchases of Russian oil from 395,000 to 500,000 b/d, nearly matching the 112,000 b/d drop in imports from Iran. And Moscow has the capacity to increase its exports much more.

China was not the only country to seek Russian assistance in replacing Tehran as an energy supplier. In December, Ankara asked Russian firm Gazprom to increase natural gas exports to Turkey by 3 billion cubic meters per year, the equivalent of 55,000 b/d of oil. Although neither side mentioned Iran during the negotiations, Turkish authorities were likely influenced by the ongoing sanctions on Tehran and the periodic disruptions in Iranian gas supplies.

RUSSIA DRIVEN BY ECONOMICS, NOT POLITICS

Moscow's drive to sell more oil to China is not related to the political situation surrounding Iran; it is a purely economic decision. Once Beijing attempted to diversify its suppliers, it opened a sales opportunity that the practical Russian government did not want to lose. Moreover, Putin recently tasked the country's oil industry with reaching a production goal of 10 million b/d within the next decade. This target will be impossible to reach without increased foreign investment. Cooperation with China is therefore extremely important -- when Beijing buys oil

from a country, it typically invests in upstream and downstream projects there in order to ensure an uninterrupted supply.

Under these conditions, Moscow views Iran's potential economic and political losses as unavoidable collateral damage. To be sure, China is highly unlikely to halt its oil imports from Tehran altogether -- the country's steadily growing domestic energy consumption leaves enough room in its market for all oil producers. Yet the recent talks with Rosneft should send Iran a serious signal that its oil is not essential to Beijing. Going forward, Tehran has to worry that it may need China as an oil market more than China needs it as a supplier.

Nikolay Kozhanov is an expert at the Moscow-based Institute of the Middle East and author of the Washington Institute study [Russia's Relations with Iran: Dialogue without Commitments](http://www.washingtoninstitute.org/policy-analysis/view/russian-relations-with-iran-dialogue-without-commitments)

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