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In This Issue:

In a Fortnight

OBAMA'S STATE OF THE UNION "A MIX OF LOVE AND HATE" TOWARD CHINA

By Nathan Beauchamp-Mustafaga

On January 20, U.S. President Barack Obama gave his second to last State of the Union address to the U.S. Congress, striking out a bold vision for his last two years in office. While the speech mainly focused on domestic issues, especially the economy and middle class, President Obama also touched on Asia, though he again failed to make the case for his "rebalance to Asia" to a domestic audience. The Chinese media saw a stronger Obama seeking a "breakthrough" in foreign policy, but did not link this to a tougher stance on China.

President Obama's tone on China was a "mix of love and hate," mentioning China directly three times and indirectly twice (Xinhua, January 21). First, Obama stated that the United States needs to increase exports, especially to Asia, but "China wants to write the rules for the world's fastest-growing region" (White House, January 20). This led Obama to ask "both parties to give me trade promotion authority [TPA] to protect American workers" by negotiating the Trans-Pacific Partnership (TPP) free-trade agreement, which excludes China. Second, Obama

D MESSAGING SURROUNDS LATEST SOUTH CHINA SEA MOVE

Chinese President Xi Jinping meets with Russian President Vladimir Putin in Shanghai in May 2014.

(Credit: Xinhua)

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hailed the return of manufacturing jobs to the United States from China. Third, Obama touted the "historic" November 2014 environmental agreement with China to limit pollution by 2030. President Obama also discussed U.S. alliances and maritime security in Asia, as well as protecting the United States from cyber attacks—which the Chinese media correctly interpreted as at least in part aimed at China.

Chinese experts on U.S.-China relations sought to explain this framing of a cooperative yet competitive relationship. Fudan University professor Jin Canrong said: "As today's only superpower, the United States is extremely worried about a new power emerging and rewriting global rules, and at the same time wishes to revive its domestic economy by promoting re-industrialization, and this precisely means a competitive relationship with China. On the other hand, for responding to climate change, counter-terrorism and other global problems, the United States cannot solely rely on its own power, and it needs China's cooperation" (*Global Times*, January 22). Tsinghua University professor Sun Zhe said that President Obama "emphasized the competitive relationship with China" by talking about "requiring China to follow the rules the United States made for international norms" and the global market (People's Daily Online, January 21).

The Chinese media mostly saw a reinvigorated Obama that "wanted to put his all into the fight," though some were skeptical of how much he could get done with a Republican-controlled Congress (*China Youth Daily*, January 21). Although the Chinese media widely called President Obama a "lame duck president" after the Republican victory in the November 2014 midterm elections, the *Global Times* said that the U.S. economic recovery has given Obama "new wings" (see *China Brief*, November 7, 2014; *Global Times*, January 22). A Xinhua article stated that Obama "desires a foreign policy breakthrough on Cuba and Iran" to give himself a "foreign policy legacy," since "Republican control of Congress and warring political parties [mean] Obama's only free space is foreign policy" (Xinhua, January 21). Yet, Obama ultimately "needs political cooperation to succeed." Calling Obama's last two years "garbage time," Professor Sun said that "Obama needs to focus on making the U.S. economic recovery successful, and after that, he might be able to make some major foreign policy moves" (People's Daily Online, January 21). Sun predicted that these may include "establishing relations with Cuba, talking with North Korea and a possible agreement," as well as "limited military action" and "airstrikes" on the Islamic State organization. Despite President Obama's explicit pledge to veto any new sanctions on Iran, Sun also believed Obama may increase sanctions to "gain popular support." Yet Xinhua said that an Iranian nuclear deal would lead to a "chain reaction" in the Middle East, giving new momentum to the fight against ISIS (Xinhua, January 21).

The Chinese media also cast President Obama's speech in the context of the upcoming 2016 presidential election. One article said Obama played the "economics card" and "hopes to use the economic recovery to sell his policies and pave the road for the Democrats, who lost last year's election" (China News, January 21). Professor Sun was skeptical that Obama's tax plans would win Republican support and foresaw Republican complaints about taxing the rich, immigration and health care policy. One article called the Republican response by Senator Joni Ernst (R-Iowa) "much softer" than previous responses and added that possible third time presidential candidate Mitt Romney later commented that Obama's speech was "more interested in politics than in leadership" (China News, January 21).

President Obama's address did not offer any new policies toward Asia, and the approach to U.S.-China relations coasted from his November 2014 summit with Chinese President Xi Jinping. Most notably, President Obama has set his sights on finalizing TPP before he leaves office, but that is not a foregone conclusion. The question remains if President Obama will be able to muster enough domestic support for the tough negotiations ahead and bring enough Asian countries back into the U.S. fold to make TPP a worthy endeavor. At the same time, Obama must make good on his bolder rhetoric to shed his "lame duck" status and engage with a Chinese leadership that may increasingly be willing to sacrifice U.S.-China relations for more influence in Asia while waiting for the next president in 2017.

Nathan Beauchamp-Mustafaga is the editor of China Brief.

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China's "Server Sinification" Campaign for Import Substitution: Strategy and Snowden (Part 2)

By Clark Edward Barrett

Since 2009, the Chinese government, in cooperation with state-run and private firms, has conducted an import substitution campaign in its computer server market, which is currently dominated by U.S. information technology (IT) companies IBM, Oracle and Hewlett-Packard (HP). China's policy objective has been to reduce its reliance on the United States in server equipment, which it believes constitutes a threat to Chinese information security and imposes excessive costs on its domestic industry.

This article details the impact of external events on China's import substitution program; most notably the effect of disclosures made by former National Security Agency (NSA) IT contractor, Edward Snowden, beginning in June 2013, which have proven useful to China in justifying import substitution on national security concerns. China also appears to be accelerating its activities in this area following diplomatic disputes with the United States, most notably in retaliation against the indictment of five alleged Chinese military officers on cyber espionage charges by the U.S. Department of Justice in May 2014.

Piling on Snowden

Beginning in June 2013, various world newspapers published leaked information from Snowden exposing extensive global monitoring systems operated by the United States in conjunction with several key allies, including the United Kingdom and Canada. Information from Snowden led to the public acknowledgement of the PRISM program, which allows the NSA and the Federal Bureau of Investigation (FBI) to monitor the private emails and conversation records of the U.S. public and foreign targets operating outside the United States. It is also claimed that the intelligence capabilities of the U.S. government have been enhanced with the support of a plethora of large U.S. IT companies, including Microsoft, Yahoo, Google, Facebook, PalTalk, AOL, Skype, YouTube and Apple. The *Beijing Morning Post* also reported claims that Cisco Systems had participated in the PRISM project directed against the Chinese government, customs service, postal service, finance, railroads, civil aviation, medical services, military and police (*Beijing Morning Post*, June 19, 2013). A recurring criticism appearing in Chinese media is that prior to Snowden, relatively few restrictions had been imposed on U.S. IT and telecommunications companies in China; yet the United States had regularly impeded the activities of Chinese firms, such as the Chinese telecommunications giants Huawei and ZTE, in the U.S. market on national security grounds (*Beijing Morning Post*, June 19, 2013).

Particularly damaging to U.S. government and corporate prestige included reports that the NSA pays U.S. companies "hundreds of millions of dollars" to access their communication networks and that the NSA had been monitoring the private communications of world leaders, including those of Mexico, Brazil and Germany. Additionally, despite the United States long professing that it does not engage in economic or industrial espionage, leaked documents allege that beginning in 2009, U.S. intelligence services had been infiltrating the servers at the headquarters of Huawei, actions which the company severely condemned (Beijing News, March 24, 2014).

China was quick to capitalize on U.S. discomfort from Snowden's revelations. On June 25, 2013, *People's Daily* claimed that the NSA had, "for the last 15 years conducted organized attacks, invasions, robbery and supervisory activities against Chinese and Hong Kong Internet and communications systems…and yet has repeatedly denounced China internationally for hacking without evidence, slandering the Chinese government and military in order to tarnish China's international image" (*People's Daily*, June 25, 2013). A key element of China's interpretation of the Snowden affair is the claim that the NSA's activities were aided by the massive technological superiority of the United States in IT hardware, computer operating systems, key intellectual property and the support of U.S. industry: "being well-acquainted with software loopholes allowed it [the United States] to conduct cyber intrusion and theft of sensitive information secure in the knowledge that it would be difficult for other nations to amass evidence of its activities" (*People's Daily*, June 25, 2013).

Seizing on FBI Indictments

The spying dispute between the United States and China escalated further in May 2014, following the public indictment of five Chinese nationals by the FBI on charges of conducting cyber espionage against five U.S. companies between 2006 and 2014 (FBI, May 14, 2014). An official response was soon forthcoming. At a routine press conference on May 20, 2014, Chinese Foreign Ministry Spokesman Hong Lei, said that the indictments ran contrary to international norms and that the United States risks jeopardizing cooperation with China and demanded that the United States correct its mistake and retract the accusation. He added that China had terminated Internet cooperation with the United States (although no specifics were given) and that China would take further action according to how the situation develops (Ministry of Foreign Affairs, May 20, 2014).

On May 27, Bloomberg claimed that a server substitution review would be submitted to a working group on Internet security chaired by Chinese President Xi Jinping (Bloomberg, May 27, 2014). Furthermore, several Chinese newspapers reported that the Chinese government had demanded that Chinese state-owned enterprises (SOEs) sever ties with U.S. consulting companies, such as McKinsey and Boston Consulting Group, due to suspicions that the companies engage in espionage on behalf of the U.S. government (Phoenix, May 27, 2014). The same day, the *China Economic Times* claimed that the People's Bank of China and the Ministry of Finance were encouraging domestic banks to stop using IBM servers and adopt Chinese made high-end servers in response to an "escalating spying dispute" (*China Economic Times*, May 27, 2014).

Also on May 27, Inspur launched the IBM-2-Inspur plan (I2I plan), which the company's vice-chairman claimed has the capability to comprehensively replace IBM products in small server systems (*Beijing News*, May 30, 2014). Inspur also claimed that 80 IBM workers had defected to the company following news of the Chinese government's Internet security review and that it had begun swapping parts of IBM servers and related systems in Chinese domestic industries (*Beijing News*, May 30, 2014). Although no specific industrial sectors were mentioned, previous pronouncements would suggest that server substitution would not be limited to the banking sector but may include the petrochemical industry, agriculture and telecommunications (Xinhua, January 22, 2013; *People's Daily*, July 4, 2014).

On May 28, the *Beijing Morning Post* reported that the People's Bank of China and the Ministry of Finance were examining whether over-reliance on IBM servers in commercial banking threatens China's financial security. An "inside source" told the newspaper that due to these concerns, over the past few years systems at state-run banks had been brought under "red letters" (*hong tou wenjian*), namely controlled by the Chinese government, which interpreted in relation to the server sinification program probably refers to the transfer of Chinese banking systems from foreign servers to those manufactured and maintained by Chinese companies. The source also claimed that it is becoming increasingly difficult for IBM, HP and other foreign businesses to operate in the Chinese banking sector, which presents sales opportunities for domestic companies (*Beijing Morning Post*, May 28, 2014). Based on the remainder of the article which reports that the Postal and Reserve Bank of China had begun testing and adopting Inspur server products in March 2013 and are now considering their position in relation to the continued use of IBM servers, the most likely beneficiary of bringing the Chinese banking IT systems "under red letters" would probably be Inspur and Chinese SOEs allied with it.

Collateral Damage

In a move which could possibly be related to announcements made against IBM later in the month, on May 16 the Chinese National Central Government Procurement Centre proscribed the use of the Windows 8 operating system, which it maintained was part of an "energy efficiency policy" (Central Government Procurement Network, May 16, 2014). Linking this pronouncement against Microsoft to retaliation against the FBI indictments is complicated since the firm regularly faces anti-trust investigations in China (Xinhua, August 1, 2014). Although the measure enacted by the Procurement Centre may have been planned well before the latest flare-up of the U.S.-China espionage dispute, the timing of the announcement is suggestive of a relationship.

References to import substitution in the IT sector have not been limited to server products alone—it also extends to computer processors. On October 23, Xinhua reported that the Chinese supercomputer company Sugon had been successful in developing and manufacturing China's first server based on the Long Xin 3B eight-core processor, the intellectual property for which, including hardware and operating systems, is completely owned and manufactured by Chinese companies (Xinhua, October 24, 2014). Li Guojie, a scholar at the Chinese Academy of Engineering, claimed that Chinese ownership of the Long Xin 3B processor and server technologies employing the device would mean that in the future, communications in fields such as the military, industry, finance and energy would no longer be controlled by "foreign tycoons," thereby establishing a reliable and secure national Internet. Li further added that China's IT industry had been completely monopolized by foreigners due to a lack of independent Chinese intellectual property in central processing unit design technology and that the development of servers and processors utilizing entirely Chinese intellectual property would allow the country to independently control its IT systems (Xinhua, October 24, 2014).

IBM's Response

The negative consequences for U.S. IT companies, especially in China, as a consequence of Snowden's revelations are reflected in the poor global second quarter sales reported by IBM, Microsoft and Cisco. Adjusted for currency conversions, IBM witnessed a drop of 20 percent in the first quarter of 2014 and an 11-percent decline in 2014 second quarter sales in China compared with the previous year (Bloomberg, August 23, 2014). Although it is difficult to establish definitively whether the poorer sales figures are attributable to the Snowden disclosures, many industry figures have indicated that it may well be a significant factor. In late 2013, Qualcomm's chief executive said that U.S. restrictions on Chinese companies and NSA surveillance were affecting the company's business in China. This sentiment was echoed by the chief executive of Cisco, John Chambers, who stated that reports of the NSA's surveillance activities had "an impact in China" on the company's earnings (*Wall Street Journal*, May 20, 2014).

Nevertheless, IBM's current strength in the Chinese market and its continued superiority in the most technologically advanced servers mean that the company will likely retain its premier position in China in the immediate future although its Chinese rivals, notably Inspur, are rapidly gaining market share. However, the firm's position in China has undoubtedly been substantially weakened, which may already be forcing the company to cooperate with its Chinese competitors. On August 23, it was reported that IBM had formed a partnership with Inspur, under which IBM's database and WebSphere software would be deployed on Inspur's servers and that Inspur would utilize IBM's Power8 chips in its own systems (Bloomberg, August 23, 2014). Later, Inspur confirmed that it will sell its K1 server system with IBM's database and web application software installed (Reuters, August 26, 2014). According to a press release from IBM, the company pledged to "support Inspur's development of OpenPOWER Foundation based system solutions. IBM will make available its new POWER8 processors, support chips, technical assistance and support services to help Inspur design its systems." Also announced was that IBM and Inspur will jointly develop a Center of Excellence. Commenting on the deal, Inspur Chairman and CEO, Sun Pishu, added that Inspur, "looks forward to teaming with IBM to drive business innovation for local clients using the latest IBM technologies, business expertise and superior client support…Inspur's growing partnership with IBM and our collaboration in the OpenPOWER Foundation demonstrates our joint commitment to fuel innovation in China" (IBM, August 25, 2014).

Conclusion

The timing of Chinese press releases detailing the acceleration of the server sinification program in the wake of the Snowden and the FBI May 2014 indictments would suggest that China is using every available opportunity to justify its long-term plans in the IT sector. As with any event, correlation does not necessarily imply causation, but the event chronology and suggestions in Chinese media reports that announcements against IBM in May formed part of an "escalating spying dispute," would appear to reinforce the connection (*China Economic Times*, May 27, 2014). Placed in the context of China's long-term technology development plans, announcements regarding "breaking a long-term import substitution" with the development of the Inspur Tiansuo K1 server and the establishment of the China Server System Industry Alliance in Beijing on September 27, 2013 under the direction of the Ministry of Industry and Information technology would suggest that the espionage disputes have accelerated rather than instigated an import substitution program (*People's Daily*, July 4, 2014; *Guangming Daily*, October 24, 2014).

Discriminatory trade practices enacted by the Chinese government to further industrial policy goals are not new. A well-known case is the March World Trade Organization (WTO) ruling against China in relation to its "technology for market access" policy in the rare earth metals sector. The WTO dispute panel judged that China's rare earth export restrictions were discriminatory and were intended to achieve Chinese industrial policy goals through controlling the international market in rare earth elements and securing preferential use of those materials by Chinese manufacturers (WTO, March 26, 2014). China's server sinification program probably meets the criteria for "innovation mercantilism" as defined by the U.S.-China Economic and Security Review Commission's 2012 Annual Report to Congress (U.S.-China Commission, August 13, 2012). In order to reduce the erosion of U.S. competitiveness with China in high technology products, the commission recommended that Congress ensure that the "Office of the U.S. Trade Representative and the Interagency Trade Enforcement Centre have sufficient resources so that the agencies can bring the necessary challenges against Chinese innovation mercantilism before the WTO." However, leaked information about the NSA's global surveillance program and national security concerns might constitute a robust defense for China, despite references to IT import substitution predating the Snowden affair by several years. Moreover, public acknowledgement of the PRISM Project, which began in 2007, further supports China's position such that it might be unwise for the United States to seek redress for these issues given the international opprobrium that has undoubtedly weakened its standing following the Snowden affair.

The larger issue arising out of China's server sinification program, which requires redress, is how can Western companies successfully compete long term against Chinese SOEs in their home market in sectors that the Chinese government considers strategically important? More fundamentally, how can the current system of global economic government as it is presently constituted respond to the challenge posed by a strong, populous, mercantile nation such as China? Based on this case study of servers, foreign companies appear dispensable to Beijing once they have served their purpose by supporting China's economic development and transferring their technological innovations to Chinese companies. This suggests foreign IT firms in particular face a challenging road ahead to continue their dominant position in the Chinese market and the Chinese government will use any pretext to justify pre-existing industrial policy goals.

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The Impact of SOE Reform On Chinese Overseas Investment

By Zhibo Qiu

Chinese President Xi Jinping's new round of state-owned enterprise (SOE) reform and his anti-corruption campaign will dramatically change the preferences and performance of SOEs' overseas economic expansion. The economic and political initiatives undertaken by Xi meet in the state sector, as the Chinese government is tightening its control over assets and overall strategy at the macro-level, while loosening control over corporate governance at the micro-level. The increasing role of private stakeholders in SOEs will improve their management skills at the executive level and improve the transparency of the decision-making process. However, the introduction of private capital will not reduce the state's control. In the short run, Chinese SOEs will be more prudential in acquiring foreign assets, with increasing awareness of risk control and profitability analysis. Vital to China's national interests, the energy sector is still at the top of Beijing's agenda for overseas investment and acquisition, together with an increasing appetite for the cultural, high-technology, healthcare and food industries. To create more investment opportunities for Chinese companies, the Chinese government will also accelerate its negotiations with major trading partners on bilateral or multilateral investment agreements.

When the Chinese government under then-President Jiang Zemin announced the "going-out" strategy to nurture national champions in the global market two decades ago, Chinese SOEs were the first and biggest movers to invest abroad. In 2013, SOEs represented 63.4 percent of China's overall non-financial overseas direct investment (21st Century Business, January 17). Beyond government initiatives, Chinese companies have diversified their investments into foreign markets in response to diminishing returns at home and to acquire human capital abroad—upgrading their supply chain, improving management capability and acquiring high-tech intellectual property rights (IPR)—as well as to gain access to more mature markets.

Inside China, the ongoing SOE reform and Xi's widening anti-corruption campaign will have a profound impact on the SOEs' corporate behavior and resource allocation, both domestically and internationally. **[1]** These reforms will ultimately improve the competency of SOEs and their overseas investments. Yet in the short-term, the anti-corruption campaign will likely limit SOE investment abroad and open the door for private Chinese companies.

Reform Background

Chinese SOEs are usually regarded as an extension of the Party's power into the marketplace, as all senior executives are appointed exclusively by the Party's Organization Department. **[2]** With government subsidies and preferential policies, SOEs dominate many strategic industries with monopoly advantages, including energy, telecommunications, transportation and infrastructure. This combination of political power and economic interests at the corporate level has created enormous rent-seeking opportunities and led to endemic and rampant corruption. The past paternalistic support from the central government also provided fewer incentives for SOEs to upgrade management style, improve the quality of their products and services, or build their innovative capacity.

When these uncompetitive SOEs have invested overseas in the past, it sometimes led to poor performance and huge losses. Their heavy reliance on the government for financial support and insurance, coupled with their historically domestic-focused business model and low penalties for poor performance, meant Chinese SOEs were less interested in risk analysis, particularly for political and social risks. Their lack of understanding of foreign social and legal environments was another obstacle for Chinese SOEs' efforts to overcome cultural differences of management styles and consumer preferences. One example of the challenges facing SOEs abroad is Chinese Investment Corporation (CIC), China's largest sovereign wealth fund. With $575 billion under management, 12 of its overseas investments from 2008 to 2013 were reported as losses, including high-profile cases in the energy sector in Canada and the United States, and this was widely blamed on CIC's inability to understand foreign markets and risks (21st Century Business, June 20). Other SOEs are learning from CIC and other earlier failures: The China Chamber of Commerce for Minerals, Metals and Chemicals Importers and Exporters, has recently released guidelines on labor rights, environmental protection and community relations, for Chinese companies to invest abroad (China Finance, October 30).

Xi's SOE Reforms and Corruption Crackdown: Less Is More

To sustain economic growth, the Party has launched a series of SOE reforms in order to turn uncompetitive SOEs into global competitors, the latest in a long line of intermittently successful reforms since Jiang Zemin. On July 15, the State-Owned Assets Supervision and Administration Commission (SASAC) announced the first round of pilot SOE reforms. **[3]** The SOE reforms are expected to separate government functions from enterprise management, which should ostensibly reduce the Party's influence over SOEs. The private sector will also have easier access to invest in state-controlled sectors. At the initial stage, the reforms focus on four major initiatives: promoting mixed ownership (state and private); restructuring national capital investment corporations; empowering the board—appointed by the SASAC—to select, evaluate and reward senior managers; as well as placing Central Commission for Discipline and Inspection (CCDI) inspectors on the board (Xinhua, July 16). **[4]** This pilot reform is expected to be gradually expanded to other SOEs.

In a parallel policy effort, President Xi's anti-corruption campaign has also targeted senior SOE executives for corruption. In 2014 alone, over 70 senior SOE executives have been investigated, covering the oil, iron, electricity, telecommunications, aviation and shipping industries (*Global Times*, December 18). Furthermore, the Party began urging officials to resign from their concurrent positions at the companies. Within two months, over 40,700 officials had resigned or been removed from their roles in SOEs, including 229 officials at the provincial and ministerial level (Xinhua, July 23). Previously, senior or retired officials held positions in the private sector, which created massive opportunities for briberies, rent-seeking and misconduct, as the official could take advantage of their contacts inside the government to generate economic benefits for company.

Reforms Impact SOEs at Home…

The injection of private capital into select SOEs will upgrade their decision-making capacity for evaluating overseas investments, especially in regards to risk control. With increased share (about 15 percent), private investors will have a bigger say in the composition of the SOE's executive board. This change will bring sophisticated management skills and risk control mechanisms to the decision-making process. The Party-appointed executives who currently run SOEs often follow the Party's policy directives instead of acting in the company's market interests, thereby sacrificing business opportunities. Furthermore, the companies' lack of understanding of foreign market rules and business environment overseas also hinder them from avoiding bad investments (*South China Morning Post*, March 31). The successful experiences of private sector managers in overseas investment will also help the SOEs to make better decisions. In August, President Xi also called for SOE executives' salary reform during a meeting of China's Central Leading Group for Overall Reform, naming a ceiling of 600,000 Renminbi ($97,532). The salary reform also includes encouraging hiring top executives from outside government, to reduce the Party's intervention into corporate governance (Bloomberg, August 25).

The current largest foreign investor in China's banking industry is Temasek, a Singaporean investment company. Temasek holds a total of $18 billion in stakes of China Construction Bank, the Commercial Bank of China and the Bank of China (*China Daily*, November 11, 2013). The Chinese government sees the Temasek model as a good example for separating the corporate operations from administrative functions. In the foreseeable future, more private and foreign investors will start to invest or increase their shares in SOEs. Temasek is a Singapore-based investment company, wholly owned by the Singaporean Ministry of Finance. The Singaporean government does not intervene into corporate governance, but appoints senior executives and approves the company's regular financial reports. The board of directors is majority private investors but also includes some government representatives. Under this split model, the private investors focus on improving the profitability and the officials are responsible for macroeconomic strategy and social justice (CBN, December 6, 2013).

In a mixed ownership structure after the reforms, private stakeholders will be a counterbalance to the Party's control over SOE decisions and improve the transparency of corporate governance. Although the government will still control the board and the majority of shares, the presence of private and foreign investors signals the Party's interest in learning from their experience and suggests the Party is willing to cede some control to improve performance. The purpose of introducing private and foreign investors is to maximize returns on assets and mitigate the risks of huge financial losses. Opening up ownership to private, or even foreign, investors will make SOEs more competitive at home and abroad, while retaining or even increasing state control.

In the Party's considerations, another approach to improve the competitiveness of SOEs is through massive consolidation, which is seen recently in the railway industry. For instance, after being separated for 14 years, Chinese Southern Railways (CSR) and Chinese Northern Railways (CNR) recently consolidated, as they had constant price wars when bidding for overseas deals, such as in Turkey and Argentina (*China Business News*, December 31; *Beijing News*, December 31). The cut-throat competition between Chinese companies jeopardizes China's national interests and results in severe resources wasted and lost. Similar to the railway industry, this consolidation trend is more likely to gain momentum in the nuclear, telecommunications and aviation industry.

…And Abroad

The SOE reforms and anti-corruption campaign are likely to change the overseas investments of Chinese conglomerates in the following ways:

First, SOEs will be more prudent and cautious on high-profile overseas investments. Although the reforms are still in the pilot stage, they will have a spillover effect on other SOEs, given the strong political initiatives behind the reforms. The anti-corruption campaign and audits will also intimidate SOEs from signing large deals without clear official approval. Several pending overseas investment deals have been suspended or canceled as a result of personnel changes and resource reallocation. For instance, CNPC's overseas subsidiary, PetroChina International (Canada) signed a contract with Canadian oil company Athabasca in 2009 to exploit the oil sand reserve in Mackay River and Dover, with a total value of 3.9 billion Canadian dollars ($3.4 billion). This deal was regarded as a "gamble," as no substantial research and prospecting were conducted and no proven reserves were found (Caixin, June 9). The deal was about to be completed in June, but the President of PetroChina International (Canada) was removed during the CNPC's corruption investigation in July (Phoenix News, July 17). It is highly likely this deal will be postponed.

By contrast, private Chinese multi-national corporations (MNCs) will likely be more active in overseas investment in short term. The Chinese government also recently amended regulations on investing in foreign markets, which streamlined the approval process for mergers and acquisitions (Xinhua, September 9). This increased private investment abroad is already evident in the Wanda Group's recent investment in a landmark building in Chicago and Lenovo-affiliated Hony Capital's purchase of PizzaExpress (21st Century Business News, October 17). SOE investment abroad will likely rebound after the anti-corruption effort either loses momentum or becomes more institutionalized and predictable.

Second, Chinese SOEs will be less willing to bet on speculative investments, such as purchasing overseas property, and more likely to focus on the strategic sectors of China's domestic economic growth. Energy will remain the primary sector for SOE overseas investment, along with high-speed trains, telecommunications and aviation. Attention is also increasing on the cultural, clean energy, healthcare and food industries. With improved risk management, SOEs will attempt to avoid high-risk large-scale investment, in particular, on property and in the financial industry. SOEs will target high-quality foreign assets, with high profitability and moderate risk, which could help them upgrade their global supply chain and offer a fast track to catch up with international conglomerates (*South Morning Post*, March 31).

Third, the Chinese government will provide more support to create a better investment environment for SOEs, mainly through bilateral and multilateral negotiations on investment treaties. The government realized that foreign policy support is essential to level the playing ground for Chinese MNCs to enter into and compete with international conglomerates in foreign markets. The bilateral investment agreement (BIT) was one of the rare moments of progress in the most recent U.S.-China Strategic and Economic Dialogue (Xinhua News, July 9). In the past few years, a series of high-profile investment deals by both Chinese state and private companies in "sensitive" sectors were blocked by the U.S. government on national security grounds. Based on the proposed BIT, the United States will be obliged to increase the transparency of its security review measures and give Chinese companies fair treatment and equal investment opportunities. Following the U.S.-China model, Beijing will pursue more BIT initiatives with its other major trading partners, such as the European Union.

Future Reform Path Uncertain

The pilot round of SOE reforms failed to meet analysts' expectations by excluding large SOEs in strategic industries. Changing the bureaucratic structure and corporate culture of SOEs will be a challenge for the current leadership's anti-graft agenda, which requires a sustained effort over time. One thing is for sure—SOEs will still take a leading role in China's economy, likely with tightened state control over SOE assets but less intervention in corporate governance and business operations. The government has sent a clear signal that the purpose of the reform is to strengthen SOEs, not to weaken them, by introducing private sector experience and enhancing the role of market. Ultimately, the Party will still set the grand strategy for investment priorities, but it appears willing to allow greater freedom of action for individual SOEs to pursue profitability within those bounds.

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Notes

1. When SOEs invest overseas, they need to build or rent offices, factories and compounds, as well as dispatch staff abroad. As the SOE reforms and domestic politics change the investment destinations and priorities, SOEs are expected to reallocate their resources (capital and personnel) accordingly.

2. Richard McGregor, *The Party: The Secret World of China's Communist Rulers*, 2012.

3. SASAC, affiliated with the State Council, is the leading government body to supervise and manage the state-owned assets of the enterprises under the supervision of the Central Government (excluding financial enterprises). Its responsibilities range from appointing top executives, approving mergers or sales of state assets, as well as drafting laws related to SOEs. Currently, 113 central government SOEs are under the supervision of SASAC.

4. Six SOEs were selected, including State Development and Investment Corporation (SDIC), China National Cereals, Oils and Foodstuffs Corporation (COFCO), Sinopharm, China National Building Materials Group (CNBM), Xinxing Cathay International and China Energy Conservation and Environmental Protection Group (CECEP).

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"Ruling the Internet According to Law": Chinese Internet Governance in 2014 and Beyond

By Yaqiu Wang

The Chinese government is known for its heavy-handed censorship of the country's Internet, now with a user base of about 665 million. After the blockage or shut down of a series of social media accounts, commercial websites, text messaging applications, online libraries and cloud computing services, 2014 ended with the total blockage of Gmail, inaccessible without recourse to a Virtual Private Network (VPN). **[1]**

In February 2014 three months after creating and presiding over a powerful National Security Commission, which is responsible for cyber security issues, Chinese President Xi Jinping moved to head up a new government body, the Central Internet Security and Informatization Leading Group (CISILG). During the first meeting of the group, Xi called for "the proper management of public opinions on the Internet" (Xinhua, February 27, 2014). Making sure the Internet is under its control is now one of the most pressing strategic concerns for the Chinese Communist Party (CCP).

In October, the CCP held its Fourth Plenum of the 18th Party Congress. The decision document that emerged from the conference outlined an array of reforms under the theme of "ruling the country according to law" (*yifa zhiguo*), including "regulating Internet activities according to law" (see *China Brief*, November 20, 2014; Xinhua, October 28, 2014). The phrase "ruling the Internet according to law" (*yifa zhiwang*) has since been popularized. "The Party's Fourth Plenum spirit of law should be vigorously applied to the Internet to ensure regulators and online users behave within the limits of law," said Lu Wei. Lu, dubbed "China's Internet Czar" by Western media, is the director of the State Internet Information Office (SIIO), China's leading Internet regulatory body (Xinhua, October 27, 2014).

While the phrase "ruling the Internet according to law" may sound new, the practice of employing law as a tool to contain the Internet is certainly not. In the past decade, laws and regulations have been issued one after another to tighten the Party's grip over the Internet. Below is a discussion of important rulings issued in 2014 that pertain to Internet governance and how they have been or could be used to undermine China's Internet freedom. This is followed by an analysis of the implications of the government's Internet governance plans for 2015 from the perspective of Internet freedom.

Intensified Crackdown on Online Opinion Leaders

China topped the country list of journalists jailed in 2014 with 44 journalists now behind bars, up from 32 the previous year, according to the Committee to Protect Journalists (Committee to Protect Journalists, December 17, 2014). This may not be a complete list since the Chinese government does not publish relevant statistics and often times trials are carried out secretively. Besides those who have been formally sentenced, there are numerous people who ran afoul of the authorities in various ways for speaking out online. Several new regulations issued in 2014 provide policy and regulatory grounds to facilitate the intensified crackdown on online commentators.

In March, the Implementing Regulations of the Law on Protection of State Secrets came into force (2014). This law, along with the amended Law on Protection of State Secrets (2010), is part of the CCP's ongoing efforts to address the rapid growth of the Internet, expanding the scope of state secrets to include all channels of information. The wording of the law makes it such that nearly anything could be construed as a state secret, and anyone who publishes information without prior government authorization might be subject to prosecution.

Prosecuting individuals for national security violations is the most common method used by the Chinese government to silence dissent (Congressional-Executive Commission on China, May 7, 2003). Thousands of people have been detained or jailed in the name of such violations (Duihua Foundation, February 10, 2014). In November, the journalist Gao Yu was put on trial for "divulging state secrets" (Xinhua, May 8, 2014). The alleged secret is a Communist Party document, known as "Document No. 9," which ordered government officials to eradicate seven subversive influences on society, including Western constitutional democracy and human rights. Months before Gao sent the document to foreign news sites, however, the main content of the document was already widely circulated, including in local Party mouthpiece newspapers. This highlights the looseness with which the law on state secrets applies and can be used selectively by authorities.

In October, the Supreme People's Court (SPC) issued a new judicial interpretation addressing the illegal disclosure of personal information and damages caused by defamatory statements on the Internet (Xinhua, October 14, 2014). The ruling makes not only those who create but also those who share "harmful" information potentially liable for any impact. The ruling also stipulates that the degree of liability should correspond to the violators' "nature and scope of influence." Yao Hui, a judge at the SPC further explained in an interview, "If you have a very large number of followers, you should know that the information you repost will influence many people. Legally, you will have a higher responsibility" (Xinhua, October 17, 2014).

This ruling is a part of the CCP's ongoing efforts to muzzle influential social and political online commentators (see *China Brief*, February 7, 2014). In 2013, the SPC and Supreme People's Procuratorate issued an interpretation that stipulates social media users who post defamatory information viewed more than 5,000 times or shared more than 500 times will be held criminally liable and can be punished for up to three years in prison, and dissemination of false information on social media that causes a public uproar can be charged with "picking quarrels and provoking troubles" (*xunxin zishi*), which is punishable with up to five years in jail (2013). Hundreds of social media users have since been detained on charges of concocting and spreading false claims, often critical of the Chinese government. In May, prominent human rights lawyer Pu Zhiqiang was detained on suspicion of "picking quarrels and provoking troubles." According to Pu's lawyer, it was due to the over 30 messages he posted on Weibo that criticized certain CCP figures, including Mao Zedong's grandson (Radio Free Asia, December 19, 2014).

Tightening Control on Online Service Providers

Besides escalating the persecution of outspoken Internet users, the Chinese government has also been busy managing social media and other online services providers. After several years of aggressive censorship on Weibo, which ultimately led to the fast decline of this once dominant social media platform, in 2014 the government began to lay its hands on newcomer WeChat, now China's most popular social media tool.

The hammer first came down on WeChat in March 2014 when several dozen politically liberal high-profile public accounts were deleted with no apparent forewarning. A more deadly blow was dealt to WeChat in August with the promulgation of a new regulation stipulating that only the public accounts of news agencies and news websites can publish news and opinion pieces regarding current events. And the public accounts of non-news agencies and news websites can only repost news and opinion pieces (2014). In China, to qualify as a news agency or website an entity must obtain the necessary certifications, and only those that are directly managed by government agencies and are approved by the State Council can be news agencies or news websites. Therefore, the hobbling effect that the new regulation has is not that it requires the content of most public accounts to be pre-approved before publishing, it is that it denies their right to publish news and opinions on current events altogether. This regulation, just like many other regulations on the Internet, however, is not strictly enforced, as some grassroots public accounts of civil rights groups, independent writers and others continue to operate. But the purpose of this unreasonable and ultimately unenforceable rule is to create a climate of fear to force people into self-censorship, as they know that at any time, their accounts can be shut down and they can be prosecuted.

Not only is non-state controlled content regarding current events on the Internet viewed as a threat, Western entertainment is being cast as a menace too. In September, SAPPRFT announced that it would require "broadcasting licenses" for all foreign television programs and movies before they can be posted on video-streaming websites and the websites must take down unapproved content by March 2015 (2014). According to Sun Wenguang, a retired professor at Shandong University, "the values of freedom, equality and human rights [reflected in foreign entertainment shows] are in contradiction with the values the Chinese government promotes. That's why the government is hostile to foreign cultural products." Independent writer Zan Aizong doubts whether the regulation will have real effect, "Unless you cut off Internet entirely, users will always be able to find their ways to watch the shows" (Radio Free Asia, September 5, 2014).

Internet Freedom in 2015

Under the banner of carrying out "the spirit of the Fourth Plenum," the Chinese government held various conferences throughout the end of 2014 on a variety of topics relating to Internet governance. The conferences set the agenda for "ruling the country according to law" in 2015, with some of the policies discussed raising alarm bells for the future of Internet freedom in China.

During a conference for media executives held in November, Liu Binjie, former director of the now-defunct General Administration of Press and Publication and a member of the Standing Committee of the National People's Congress (NPC), said that the NPC is planning to introduce China's first press law and this law will enable traditional state-controlled media to operate more freely in the social media realm. Liu also revealed that the government plans to establish a platform where all original news information will be required to first be uploaded. Any online news portal that wants to repost the information will be required to pay (China Daily Online, December 1, 2014). Liu said the purpose of the platform is to better protect intellectual property rights so that online media cannot free ride for reproduction, but Wen Yunchao, a New York-based Internet activist, disagrees: "What the authorities really want to do is to block out the dissemination of original news information that is not pre-approved by the government" (Author's interview, January 5, 2015).

Perhaps the most foreboding news regarding the Internet in 2014 came from Internet Czar Lu Wei. Lu revealed during an October CISILG conference that China will establish an Internet users credibility history system that records and evaluates users' online activities to "reward those who behave well and punish those who do not." While Lu did not get into details, he said such a system will make "abiding by the law all Internet users' voluntary pursuit and behavior" (People's Daily Online, October 25, 2014). This is yet another attempt by the Chinese government to implement an Orwellian-style online surveillance system, after it failed to meet its goal of establishing a nationwide real-name registration online system by mid-2014 (Xinhua, March 28, 2013). Back in 2009, the government's plan of requiring the installation of specific filtering software "Green Dam" for all computers sold in the country was also later suspended after overwhelming pressure from Internet users (Xinhua, June 30, 2009).

The Party does not always get what it wants, however, as many Chinese Internet users continue to passionately write and share information critical of the government, defying censorship laws. Some go further to demand the abolition of the laws, claiming that they are in violation of the right to free speech and thus unconstitutional.

Conclusion

2014 was the 20th anniversary of the Internet's arrival in China. Over the past 20 years, as an increasingly integrated part of China's "socialist market economy," the Chinese Internet market has grown remarkably. What comes along inevitably is the spread of diverse ideas and people's demand for deepening reforms and further liberalization of the economic and political system. The Party, unwilling to lose its grip on Chinese society, is equally unwilling to see the diminishment of economic activities as a result of excessive control over the Internet. This conundrum is embodied by Lu Wei's recent visit to Silicon Valley. On the one hand, the economic growth that companies like Facebook attain is immensely attractive to Chinese leaders, enough to warrant symbolic high-level exchanges between the two sides. Yet these opportunities are weighed against what Chinese leaders acknowledge and what relevant Chinese laws point to are risks to China's stability presented by social media platforms like Facebook that are not tethered to Chinese authorities the way indigenous platforms are. The key to striking a balance appears to lie in a sophisticated Internet censorship system. Besides improving the technological aspects of the system, employing laws more effectively to deter and punish those who dare to cross the line is also essential to achieving such a goal. That is what "ruling the Internet according to law" is really about.

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Notes

1. According to Freedom House's 2014 report on Internet Freedom, China ranked third to last of the 65 countries assessed, faring only better than Syria and Iran, and scored worse than it did in 2013 (Freedom House, November 2014).

Energy Security, Geopolitics and the China-Russia Gas Deals

By Wenran Jiang

During the November 2014 Asia-Pacific Economic Cooperation (APEC) summit, Beijing was not only an impressive host, but also a generous financial supporter of a number of China-centered initiatives. The largest economic package during the APEC summit went to the second China-Russia mega deal of the year: Moscow and Beijing reached a non-binding memorandum that will see top Russian gas producer Gazprom ship 30 billion cubic meters (bcm) of gas annually to China over 30 years. This is just slightly less than the $400 billion accord the two countries signed in May 2014 for Russia to supply China with 38 bcm a year by 2018. The two gas deals, sealed only six months apart, have profound implications on China's quest for energy security, the volatile global energy market, China-Russia relations and broader geopolitical movements worldwide.

China's Quest for Energy Security

While the world media and expert opinions have focused mainly on the significance of these deals for Russian President Vladimir Putin and his confrontation with the West over the Ukrainian crisis in recent months, Beijing sees them primarily as a part of its long-term search for energy security and diversification of supply sources. The timing simply gave China the final breakthrough.

When China became a net importer of oil in the early 1990s, it already had begun to talk to Moscow about large-scale imports of Russian oil and gas, including gas pipelines from both eastern and western Siberia (Reuters, November 10, 2014). Over the past two decades, China's dependence on imported oil has grown to 60 percent, with suppliers mostly from the Middle East and Africa.

One of China's key objectives for supply security in recent years has been to develop closer ties with Russia and Central Asian energy producing countries, such as Kazakhstan and Turkmenistan. Chinese national oil companies (NOCs) have invested heavily in Central Asian energy producing states, and built multiple oil and gas pipelines to the western part of China. Chinese policy makers consider these land-based supply routes less vulnerable than the sea routes through which 80 percent of its energy imports travel and where the Chinese navy does not yet have a major presence. The first China-Russia gas deal last May secured the supply pipeline from eastern Siberia while the second one in November focused on opening the western Siberian route. **[1]**

China has also been trying to diversify its primary energy sources from its heavy dependence on coal. Close to 70 percent of Chinese energy comes from coal, which has caused severe domestic air pollution over the past three decades of rapid economic growth. Coal use is also responsible for over 80 percent of China's CO2 emissions, whereas natural gas represents only 6 percent of China's energy mix, one-fifth of the global average (U.S. Energy Information Administration (EIA), 2014). Reducing coal use and increasing the shares of oil, natural gas and non-fossil fuels in China's energy mix have become a priority for both energy and environmental concerns. The two gas agreements with Russia, if finalized and delivered, will make up 17 percent of China's total natural gas supply by 2020 (*Wall Street Journal*, November 10, 2014). Yet the total Russian gas supply volume of the two deals will represent only 1.7 percent of China's overall energy demand.

With the right government policy drivers in place, the increased use of gas and other energy sources to replace coal can potentially lead to significant reductions in the country's CO2 emissions. One of the unintended consequences of the Chinese-Russian gas deals could be their positive contribution to the global climate change agenda. This is also good news for the U.S.-China Joint Announcement on Climate Change that President Barack Obama and President Xi Jinping signed during the APEC summit (White House, November 11, 2014).

The World Energy Market

In a rapidly changing and volatile global energy market, the two gas deals are significant for the energy industry and policy makers. The large volume movement of gas from Russia to China in the near future will have a number of impacts on global energy markets.

The first is an emerging, more integrated Euro-Asian gas distribution infrastructure. While the global transportation of crude oil is well developed via land and sea, natural gas is still constrained by the lack of delivery choices. China's gas pipelines have increased by nearly 20 percent annually in the past decade, but its per capita length remains at one percent of the United States (*Gas.in-en.com*, November 24, 2014). As a byproduct of the first China-Russia agreement, a 4,000-kilometer gas pipeline from eastern Siberia to China commenced construction in September 2014, with 2018 as the completion deadline. If the two countries move ahead with planned pipelines on both eastern and western fronts, plus China's push for the fourth gas pipeline from Central Asia, a Euro-Asian continental gas transportation infrastructure will shape future worldwide gas shipping as well as pricing.

The second related trend is the emerging shifts in regional distribution of natural gas trade. Since the Ukrainian crisis began, both European Union countries and Russia have been seeking alternatives to reduce their vulnerabilities as a gas buyer or a supplier. If the China-Russia gas deals materialize, China will overtake Germany as the largest single-country market for Russian gas exports. Russia's western Siberian export pipeline to China draws from the same gas fields that serve Europe (*Oilprice.com*, November 11, 2014). **[2]** Gazprom, even indicated that it might shelve its Vladivostok liquefied natural gas project, designed to supply Japan, in order to focus on supplying more gas to China by pipeline (*Financial Times*, October 10, 2014). Thus Beijing may continue to have the upper hand in its ongoing competition with Tokyo for Russian gas supply.

Putin also recognizes the significance of the two Russia-China gas deals for Russia's energy infrastructure development and resource diversification drive: "This will help us make yet another important step—to connect the western and eastern gas pipeline systems and have a possibility to redirect resources from East to West and from West to East when it is advantageous from the viewpoint of the world market situation" (*TASS*, December 18, 2014).

The third is the downturn pressure for global gas and liquid natural gas (LNG) prices due to increased competition in the Chinese and Asian markets. In recent years, China's natural gas and LNG imports have grown rapidly. With the forecast that China will consume as much gas as EU countries combined by 2035, there is a worldwide race to export gas and LNG to China. **[3]** Multiple projects in North America, Australia and the Middle East have been launched, all targeting the Asian market, where the price of natural gas has been much higher than other parts of the world in recent years. Compare the recent Asian market price of $14–16 per thousand cubic feet mcf for LNG to the North American price of $3–4 per mcf (EIA, September 27, 2013).

During the decade-long China-Russia gas price negotiations, Russians wanted a price range from China as close to its export price to the EU market as possible, whereas the Chinese wanted a reference price point around its import price from Turkmenistan. With President Putin needing a signature on the deal during his China trip last May to counter Western sanctions over Ukraine, the price of the bilateral gas deal was widely believed to have been settled more in Beijing's favor. Chinese sources have indicated that both sides agreed on a final price between $10–$11 per mcf. **[4]**

The delivery of gas from Russia to China is primarily via pipelines, but both sides have also been working on a series of LNG deals. China National Petroleum (CNPC) and China National Offshore Oil (CNOOC) have established partnerships with Novatek, Russia's second largest gas producer, to jointly produce LNG for the Chinese market as a part of the ongoing gas trade negotiations (*Moscow Times*, May 20, 2014; Reuters, July 10, 2014).

The mere prospect of large volumes of Russian gas coming to China in the near future has created a more competitive environment for LNG producers from North America, Australia and the Middle East. Together with the sharp drop in global oil prices in recent months, which negatively impacted gas prices, the LNG price in Asia has already dropped to around $10 per mcf (Reuters, December 11, 2014). The latest volatility in energy prices indicates that the Russians did not obtain that bad a deal after all, assuming the Chinese side keeps its side of the bargain in the next round of negotiations.

Global Geopolitics

The two China-Russia gas agreements have geopolitical implications. Such mega deals always go beyond simple market interactions between buyers and sellers. For Russia, a country with oil and gas exports accounting for 68 percent of the country's total export revenue in 2013, these export contracts are huge (US Energy Information Administration, *Today in Energy*, July 23, 2014). President Putin noted that, "This is the biggest contract in the history of the gas sector of the former USSR." Under sanctions by Western countries over the Ukrainian crisis, Putin signed the energy deals, showing defiance to the West and demonstrating that Russia cannot be isolated economically and politically.

China is willing to express its open support for Putin's ongoing fight with the West. Diplomatically, Beijing remains neutral in the Russian-Ukrainian confrontation, calling for a peaceful settlement of the conflict. But it is an open secret that the Chinese policy elites are sympathetic to Russia, partly due to their conceptualization that the United States, the North Atlantic Treaty Organization (NATO) and other Western countries are primarily responsible for destabilizing Ukraine in the first place. **[5]**

President Xi and the new leadership core came to power amid the U.S. "Pivot to Asia." They are alarmed by what they view as a worsening international security environment. In particular, they see Japan in the East China Sea, and the Philippines and Vietnam in the South China Sea, as "challenging" China's territorial claims with the backing of the United States (China News, January 2, 2013). Such strategic concerns prompted President's Xi to seek closer Russian ties as a balance against Washington. Russia, as the case with his predecessors, was Xi's first foreign visit as head of state in 2013, and called the two countries the "most important strategic partners" (BBC, March 22, 2013). Putin was visibly Beijing's most favored guest at the Beijing APEC summit.

Facing continuous Western sanctions, the Russian ruble is rapidly declining, which raises serious questions about the Russian economy and Putin's ability to confront Western pressure. Chinese Foreign Minister Wang Yi offered Chinese assistance to Russia to overcome its financial and economic difficulties (Xinhua, December 23, 2014). Clearly, Beijing does not want a collapsed ruble, nor a weakened Russia in its struggle with the U.S.-led Western allies over the crisis of Ukraine. Yet the gas deals with China will not fundamentally solve Russia's weakened economy under continued Western sanctions.

It is premature to conclude that China and Russia share the same dreams in their geopolitical games against the West. Beijing does not want to return to the 1950s-style military alliance with Russia, and Moscow does not want to become too dependent on China, which is already its largest trading partner. This may explain why Putin has not yet accepted China's offer to help even though the ruble has lost 50 percent of its value.

Furthermore, a comprehensive regional oil and gas pipeline infrastructure and stable supply of oil and gas from Russia to China in the next several decades will lessen Beijing's energy supply concerns. For those who view Chinese behavior in East and South China Seas partly as an expression of the country's energy insecurity, the China-Russian gas deals may provide some level of comfort and hope that Beijing will be inclined to moderate its positions for more talks of joint resource development with its neighbors while shelving or delaying sovereignty issues for future generations.

The two China-Russia gas deals are large in volume, significant for Beijing's quest for supply security and Moscow's quest for demand security, and they have a major impact on the global energy market and geopolitics. But like many international agreements, the devil is in the details. With the recent decline in oil prices and its impact on gas prices, the first China-Russia gas deal may now be reduced by more than 25 percent. The low oil price, if sustained for a prolonged period, may add complications to the second China-Russia gas deal negotiations as it was only signed as an accord of intent without an agreed price nor binding terms. As the first China-Russia gas deal revealed, the most difficult stumbling block to finalize the second gas deal between the two parties will be the price, and the volatile global oil and gas prices are the most to difficult to predict at the moment.

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Notes

1. Officially, the costs for building the pipelines are shared between China and Russia: Russia will build the section inside its boarder while China will build the portion inside China. For the Russian section, however, China is providing Russia loans to expertise to build the pipeline, since Russia lacks the necessary capital. While China's need to provide infrastructure support to Russia is a hindrance, CNPC can successfully do this.

2. Further development of the East Siberia gas field will primarily depend on capital and a long-term buyer, which the Chinese have promised, meaning Russia does not need the West to develop the field. This extends to technical expertise, as the Russians, together with the Chinese, are quite good at handling gas exploration and development.

3. Author's interviews, Beijing, October 21–31, 2014.

4. International Energy Agency, *World Energy Outlook 2012*.

5. Jin Canrong and Wang Hao, "Wukelan Weijizhong De Gefangboyi He Zhongguo Lichang," *Xushu Qianyan*, April 8, 2014. Also, author's interviews, Beijing, September–December, 2014.

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