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**Pipeline Politics:
Comparative Bargaining Capacity in the
Sino-Japanese Competition for Siberian Oil**

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Abstract

This article analyzes the relative bargaining capabilities of China and Japan in their drawn-out quest for Siberian oil. We apply an institutional analysis that examines over-time and cross-country variations in government-business relations and elite bureaucratic interests in responding to domestic energy needs and international oil supply options. While one might have expected China's authoritarian policymaking process to convey an advantage in bilateral negotiations with Moscow, in fact Beijing became bogged down over the ten-year negotiation period with shifting corporate interests of national oil companies, bureaucratic preferences through administrative reform and succession politics, and elite redefinitions of energy security and ways to diversify the sources of imported crude oil. As a result, Beijing faltered in its commitment to Siberian oil. In contrast, the Japanese Prime Minister Junichiro Koizumi exercised executive autonomy to secure a pipeline deal with Russia before seeking a consensus among the divided domestic bureaucratic and corporate interests. Our surprising findings highlight political economic contingencies that shape China's and Japan's strategies in addressing fundamental energy needs, with implications for the contentious nature of energy and security cooperation in Northeast Asia.

Introduction

The People's Republic of China and Japan are increasingly vying for energy supplies in the East China Sea, Russia, Central Asia, Southeast Asia, and even Africa. This paper provides a preliminary analysis of their domestic institutional differences that mediate these two countries' objectives and strategies of their rivalries across these regions (Liao 2007). We focus on Chinese and Japanese competition over the Siberian oil pipeline, leading to the former Russian President Vladimir Putin's decision in 2006 to build the main pipeline to Nakhodka on the Sea of Japan (Gulick 2007). This outcome, which retracts an earlier Sino-Russian blueprint for an Angarsk-Daqing pipeline, is seen as a major disappointment by the Chinese (Feng 2004). While negotiation for a branch pipeline continues, China is forced to settle with Russian promises of increased delivery via railroad and an existing Kazakh pipeline (Atasu-Ala-Shankou). At the same time, the current situation represents an uncertain victory for Japan, which continues to be haunted by questions over the eventual capacity available for, investment sum of, and Russian commitment to the Pacific option.¹

In explaining this unsatisfying outcome for the competing parties, one would naturally give priority to considerations of Moscow's preferences and the dynamics of Russian domestic politics and government-business relations. As the pivot in the simultaneous negotiations with Japan and China since 2003, Russia enjoys the prerogative to revise continually its decision based on updated information on the motivations and financial offers of her Northeast Asian, oil-guzzling neighbors. Both the Japanese and Chinese offers fall within the "win-set" (Putnam 1988, p.427-460) of Vladimir Putin who seeks to reassert Russia's global status as a major natural resource producer, implement regional development in Siberia, and consolidate the central government's leverage over oil and gas oligarchs. The Russian side in pipeline politics has been well documented by Russian specialists (Rozman 2005; Gulick 2007), who tend to emphasize the economic rationality in Russia's favoring the Pacific option, taking into consideration uncertainties in the Siberian crude output and attractive possibilities in diversifying the consumer base for Russian oil. We accept this explanation, but suggest that it is not the complete story since it ignores *variations in the relative bargaining strength* of Japan and China over time, which has

¹ "Energy Minister: No Pacific Pipeline Until at Least 2015," *Oil and Gas Eurasia*, July 20, 2007, available at <http://oilandgaseurasia.wordpress.com/2007/07/20/energy-minister-no-pacific-pipeline-until-at-least-2015/>, accessed 14 May 2009; "Trutnev: Russian Crude will be Enough for the ESPO," September 3, 2007, available at <http://www.transneft.ru/press>, accessed 14 May 2009.

apparently led to vacillations in Moscow's strategic decisions. As Transneft spokesman Sergei Grigoriev stated starkly, "politics, not geography, will decide the oil's course" (Helmer 2005). What then are the fundamental domestic conditions that push China and Japan to raise their respective stakes in resource acquisitions abroad? How is energy security linked to other major economic and security interests? What role do corporate interests play? What is the relationship between conservative political priorities at home and daring commitments abroad?

We argue that the relative bargaining capacities of Japan and China and the negotiation outcomes can be better understood by considering domestic interactions among the executive, bureaucratic agencies, and corporate interests. While a static institutional analysis would suggest that China's authoritarian context should produce a single-minded pursuit of energy supply diversification, we argue that dynamic factors have offset some of these advantages. Over the ten-year negotiation period, Beijing's commitment to Siberian oil had faced significant changes from bureaucratic reform, corporate restructuring, and redefinition of energy security interests. In particular, tied to the national oil corporations through fiscal and shareholding interests, the Chinese government has paid increasing attention to addressing the commercial considerations of the national oil companies. In contrast, Japanese initiatives emerged strongly during the intense negotiation period of 2004-6 due to an unusual exercise of executive autonomy. We find the Japanese Prime Minister Junichiro Koizumi approaching the Russians without first securing support from broader corporate interests.

Section II lays out the domestic institutional advantages China enjoys over Japan in formulating and advancing a bargaining position in overseas energy supply negotiations. Section III examines the dynamic factors, arguing that succession politics and the rise of corporate interests in the form of national oil corporations that have caused China to waiver in the commitment to Siberian oil. Section IV lays out Japan's short-term bargaining strength, focusing on factors that enable the central policy entrepreneurs to seize the initiative from divided domestic industrial interests, at the same time offering tangible support for Putin's domestic coalition in order to derail the more entrenched Chinese deal. In conclusion, we elaborate on further applications of our analytical framework for understanding over-time dynamics of Japanese-Chinese standoffs over energy supplies and investment opportunities in Russia and elsewhere.

I. Comparing Chinese and Japanese Bargaining Capacity: An Institutional Perspective

Both generally seen as possessing a coherent developmental agenda and strong statist institutions, China and Japan exhibit marked differences in the historical and organizational dynamics of their central bureaucracies and government-business relations. These differences have constrained the national executives' ability to provide and update offers in international negotiations in three areas: 1) a supportive domestic coalition facilitating the executive's upward revision of offers; 2) the influence of vested bureaucratic interests in specific outcomes irrespective of economic or financial calculus; and 3) the organization of government-business relations. These domestic institutions in turn shape the executive's preferences in bringing bilateral and multilateral resources into the negotiation, and in considering alternative energy sources to the Siberian oil. We examine these effects below.

Given the entrenched dominance of a ruling party in both Japanese and Chinese politics, domestic constraints refer not to the prospect of veto by domestic constituents, but to the presence or absence of a coalition to rally behind the executive's decision and to help the negotiators lobby Russian firms, regions, and central politicians, etc. This coalition can offer pre-agreement support, as well as a post-agreement commitment to implementation. We focus on the commercial interests of domestic firms and representation of regional interests that are interested in and able to promote economic ties with local business interests and governments in Moscow and Siberia.

Mediating these domestic interests is the national executive branch – the Politburo and State Council nexus in China's party-state system, and the in Japanese Prime Minister's Office. We examine bureaucratic preferences as based first and foremost on whether or not the central executive involved in the negotiation has vested financial or career interests in the outcome of additional oil supplies. Second, we evaluate changing notions of energy security reflecting the economic development of these two countries over a ten year period.

National executives also face institutional constraints in external institutional or political forces that could be brought to bear on the negotiation. These include alliance structures, multilateral frameworks, international and regional organizations, and non-governmental groups. In particular, bilateral negotiations may be hierarchically "nested" (Aggarwal 1998) in or parallel to the alliance structures and international organizations centered on the US – generally speaking,

one would expect the former relationship to apply to Japan and the latter to China. Border disputes and other outstanding state-to-state issues may also be linked to the energy supply provisions under negotiation.

A basic consideration of static institutional constraints suggests that the Chinese should exhibit superior bargaining capacity, raising the question of why Beijing has failed to secure a favorable outcome to date. In the following sections we will examine how China's early entry into the negotiation process actually inhibited its ability to respond to new challenges over time such as Russia's changing international status and domestic politics, and Chinese oil companies' growth strategies. In contrast, since Koizumi's intervention in the Sino-Russian deal in 2003, Japan has been effective in sticking close to its goals and channeling considerable diplomatic and political energy into the process, including attempts to de-link border dispute issues with the pipeline. However, the government-led initiative has proceeded despite a clear lack of Japanese commercial interest in the project which will likely pose problems of business sector commitment and implementation in the coming years. Our comparative analysis highlights the importance of domestic asymmetries of preferences and actions that are often glossed over or ignored in conventional accounts of oil diplomacy of Japan and China. In contrast to the indifferent Japanese oil companies, the newly corporatized and publicly listed Chinese national oil companies actively bargained with the central government in addressing energy security needs and international oil supply opportunities. Yet in attempting to incorporate the commercial interests and overseas investment capabilities of domestic firms, economic planners in Beijing lost significant policy coherence and momentum in the face of an increasingly assertive Moscow.

II. China's Bargaining Capacity: The Impact of the Rise of Corporate Interests since the late-1990s

The pipeline deal originated with Moscow's initiation in 1994 of bilateral discussions with Beijing over the prospect for a Sino-Russian energy nexus, but initially the Chinese elite exhibited divided opinions over the relative attractiveness of an expensive Siberian pipeline given the alternative of importing relatively cheap crude.² In 1999, as the global price of crude started its ascent to the record-breaking height of the mid-2008, the two governments brought together the three key firms of Yukos, Transneft, and Sinopec in a Trilateral Agreement to build an oil

² Oil prices were below US\$20 per barrel at the time.

pipeline from Siberia to China. Premier Zhu Rongji visited Russia in September 2001 as both sides reached a basic agreement on the parameters of the (2300km, \$3bn, 4-year) Angarsk-Daqing pipeline project, which received further official confirmation in a joint declaration on December 2002 that constituted a guarantee in the eyes of the Chinese(Paik 2004). Under this agreement, both sides agreed to foot the bill for the segments within their respective territories. CNPC, however, would provide loans to Yukos given the length of the Russian segment which was about double that of the Chinese.

The Chinese were exclusively engaged with the Russians on the pipeline project's conception and design for nine years before January 2003 when Japan submitted a reported \$15 billion bid for a different pipeline and Putin seemingly succumbed to the temptation of unilaterally rescinding the pending deal with China(Glodstein & Kozyrev 2006, p.170; Buszynski 2006, p.294). China scrambled to salvage the pipeline deal for the long-run while proposing alternative measures of accessing Russian oil resources in the short-run. In May 2003, Hu Jintao, during his state visit to Russia, obtained a declaration from Putin that the Angarsk-Daqing pipeline would form the cornerstone of Sino-Russian bilateral energy cooperation. Yukos and CNPC signed an agreement for the former to supply 700mt of oil over a 25-year period at a price-tag of \$150bn. This long-term contract would be implemented through increased reliance on railroad transportation before the completion of the pipeline (ITAR-TASS 2005; RIA Novosti 2005). Rosneft and Lukoil, the biggest Russian state and private oil companies, respectively, have entered into agreement with Sinopec and CNPC to allow direct Chinese access to oil extraction in Russia. In return, the Russian firms could expect to obtain Chinese cash in raising capital and in joint venture gas stations in China (Interfax 2009; AFX UK Focus 2006a, 2006b; AP via Yahoo! Finance 2006; Dow Jones Energy Service 2006). Rosneft has further committed to increasing oil exports to China via the Atasu-Ala-Shankou section of the oil pipeline from Kazakhstan and China. Yet in 2007 both companies have shown no hesitation to cut back Chinese access in face of alternative bids – Rosneft inked a cooperative framework agreement with the Japanese on developing oil fields in eastern Siberia after dragging its feet with the Chinese Sinopec, and Lukoil said outright that it would not sell oil to China given the higher prices it could fetch in Europe (Interfax 2005). Lastly, Gazprom successfully lobbied the Russian energy ministry to prevent Exxon from selling natural gas from the Sakhalin-1 project to China (RIA Novosti. 2007). In short, China has not made significant inroads into securing resources directly at the source, and remains dependent on the fickle Russian rail transport of oil. As a

result, it could only agree to conduct a feasibility study of a branch pipeline from Skovorodino to the Sino-Russian border (Al Madani 2005). By mid-2007, China has advanced Russia a “first tranche” of financing for the design work on the 700-km, 30-million-tonne annual capacity pipeline, with construction to start in 2008 (AFP Moscow 2007). As of the end of 2007, Putin had yet to sign the formal agreement on the China-bound branch pipeline – despite Chinese Premier Wen Jiabao’s highly publicized visit in November – yet Transneft spokespersons continued to issue reassurances that the commitment to build it is firm (RIA Novosti 2007; Reuters 2007).

We argue that domestic and international institutional factors strongly support China’s initial bid for Russian oil. Governing an authoritarian party-state that holds significant assets in big oil companies, Chinese leaders clearly show a vested interest in the successful outcome of the negotiation. Beijing faces no overt resistance from the industry and consumers, and controls the information channels throughout the negotiation process. However, the absence of a societal veto power in energy issues does not mean that interest groups do not figure into the elite’s consideration. In particular, over time, China’s choice set was considerably constrained by concerns for the viability of newly restructured national oil companies, regional developmental policies, and succession politics of the Chinese Communist Party. Concurrently, Chinese policymakers pursued diplomacy in multilateral organizations, in particular the Shanghai Cooperative Organization (SCO), designed to enable China to secure Central Asian resources. Hence, the consensus on the desirability of the Siberian oil for China’s energy security and commercial interests had become less well defined over the ten year negotiation period, leading to a lackluster response to the Japanese offer in 2006.

Changing Preferences and Numbers of Domestic Players

Three sets of social interests figure into the State Council’s decision-making regarding the Siberian pipeline: the national oil companies, provinces targeted for rapid development and energy consumers. The first two are active players in the policymaking process. Several studies suggest that since their restructuring in the late 1990s the national oil companies have gained increasing autonomy from the Chinese party (Downs 2004; Lin 2006). As the firms evolve out of their previous role as instruments of the Chinese government’s bilateral policies, they have begun to act upon more complex corporate purposes. Three exogenous trends in firm motivations have

affected the pipeline negotiation: 1. overseas expansion driven by organizational needs to grow out of a restrictive competitive environment at home and incentives offered by Beijing's "Going Out" policy of promoting outward direct investment by Chinese multinationals(Wong and Chan, 2003); 2. increasing importance of financial returns in deciding major projects such as pipelines; 3. more wide-ranging consideration for various forms of equity control, strategic alliances, and market access privileges that could be achieved in firm-to-firm negotiations alongside governmental negotiations. Since their restructuring into shareholding concerns in 1998-9, Chinese national oil corporations – supported by the state's proactive diplomacy toward resource-rich African, Latin American, Middle Eastern, and Southeast Asian countries – have made significant progress in acquiring oil assets and improving access to global oil supplies(Zweig & Bi 2005). Chinese access to crude oil through equity arrangements rose quickly from 970,000 tons in 1997 to 3.5 Mt in 1999, 5.05 Mt in 2000, 12 Mt in 2002, 50 Mt in 2003, and 60 Mt in 2005(Zhongguo Shiyoushuhua 1999, 2000; Zhongguo Qiyebao 2001; Zhongguo Guotuziyuanbao 2003; *Zhongguo Shibua* 2005; *Guoji Shangwu* 2005) . However, the proportions of equity oil in China's oil imports and total oil consumption in 2004 were only 14 percent and 6 percent respectively (Kong 2005). In 2006, the amount of equity oil flowing into China is only about 320,000 bpd, out of total imports of 3.6 million bpd and total Chinese consumption of 7.4 million bpd.³ Thus it cannot be argued, except in the marginal sense, that equity oil has moderated China's import thirst. Nonetheless, China's regional diversification strategies have also affected the relative value of the Siberian oil supply – for example, since 1999, crude oil imported from Africa has accounted for over 20% of China's total oil imports, and in 2005, this percentage increased to over 30% and remained at this level to date (Energy Information Administration 2006; Zhao 2007; Xinhua News Agency 2009).⁴ Even in the context of rapidly growing import dependency, China's success in oil import diversification would suggest diminishing reliance on any single source.

While the more profit-oriented corporate interests do not necessarily impose constraints on or support the Siberian pipeline, they tend to introduce more variables into the government's consideration of the impact on domestic firms in this project. For example, in the Sino-Kazakh

³ "China's overseas investments in oil and gas production", report prepared for the US-China Economic and Security Review Commission, (Eurasia Group 2006), p.3, available at http://www.uscc.gov/researchpapers/2006/oil_gas.pdf, accessed 14 May 2009.

⁴ "China's crude production rising slower than demand". (2007) *The Oil and Gas Journal*, 105,19.

oil pipeline project, both CNPC and the Kazakh government arrived at a shared realization of the lack of commercial viability of the project by 1999, thus halting the project for several years (Sheives 2005, p.16). In response to and in light of the failing Russian deal, the Chinese government had to offer greater financial inducements and step up political pressures to complete the pipeline which has come online in 2006(Lee 2009). The Chinese oil companies' success in overseas asset acquisitions has also increased their appetite for direct ownership of oilfields in Russia and Central Asia, thus diverting attention away from the pipeline negotiation.

Regional development took on renewed interest in the transition from Party Secretary Jiang Zemin to Hu Jintao. Tired oilfields in Northeastern China, previously exploited for resource and tax revenue by both central and provincial governments, were placed in a developmental context of “reviving” the Northeast starting in 2002. As a part of this re-orientation in Beijing’s regional policy, firms in Northeast China received policy support for infrastructure, investment in upgrading the rust belt, and the experimental establishment of a social safety net for laid-off workers (Chuang Lai & Joo, 2007). Notably, China’s biggest producing and most efficient oilfield, Daqing in Heilongjiang province, faces certain decline and its refining capacity will increasingly outstrip its crude production. Of all the oilfields in China, Daqing has historically been the largest, most prolific, and most efficient by far (CNPC 1993, Chapter 3). Given its contribution to central and regional coffers and to the profitability of the China National Petroleum Corporation (CNPC), policymakers and corporate headquarters have an intense interest in directing Russian oil to rejuvenate the aging oilfield and affiliated refineries (CNPC 1994, p.153; Shue 2000).⁵

Changing Bureaucratic Preferences through Succession Politics

With a decision as important as the Siberian pipeline, members of the Standing Committee of the Politburo form a consensus which will then be implemented by agencies of the State Council including the Ministry of Foreign Affairs, Ministry of Trade and Economic Cooperation (MOFTEC, restructured into the Ministry of Commerce in 2003), and the relevant bureaus under the State Development Planning Commission (renamed the National Reform and Development Committee in 2003). Energy security issues will additionally involve the national oil companies, which enjoy ministerial status in politico-administrative terms, and the Ministry of

⁵ Interviews with one of the authors, Daqing, Heilongjiang, July 2001.

Land and Natural Resources and Ministry of Communications (renamed Ministry of Transport in 2009), etc.⁶ While MOFTEC/MOC conducted the actual negotiations with Russia, the fate of a project of this stature was mainly decided at the State Council level through a consultative process involving the premier or vice-premiers, representatives of the national oil corporations, and officials of the NDRC(Lin 2007).

The bureaucratic changes and political attention underscore the high priority of energy issues. The elite priority is anchored in the fiscal and developmental bases of the Chinese state. As the central government holds the vast majority of assets in big national oil companies and relies on tax contributions from oilfields and refineries as the second largest industrial cash cow after the tobacco producers, Beijing has ownership interests in the viability of domestic firms. In particular, the newly restructured national oil corporations, CNPC and Sinopec, face declining outputs from their largest oilfields and thus are eager to find new supplies of crude oil to meet the growing domestic demand. As mentioned in the earlier section, while these two firms had alternative notions of tapping the Russian resources, they were quickly brought in line by their political patrons and at this point are more accurately characterized as non-competing players in a coordinated effort to diversify China's sources for imported crude (Downs 2004).

In addition to concerns for the viability of newly restructured national oil companies, Beijing's perception of the usefulness of the Siberian pipeline is influenced by shifting political attitudes and personal agenda of preeminent leaders involved in the critical succession politics of the Chinese Communist Party. The succession of relevance to the pipeline negotiation is the retirement of the "third-generation" of leaders under Jiang Zemin's leadership in order to usher in the "fourth-generation" duo of Hu Jintao and Wen Jiabao. Studies have discerned a marked difference in the two leadership generations' mindset on China's energy security and measures needed to achieve it. Jiang Zemin and his economic czar Zhu Rongji favored a "market" approach of addressing domestic shortages through stimulating exploitation of domestic oil deposits, regulating domestic demand, improving energy efficiency of factories, and purchasing on the global oil market. In contrast, Hu Jintao and Wen Jiabao have taken a more administrative approach that has emphasized conservation of domestic resources, development of alternative energy sources, a strategic oil reserve, proactive bilateral oil diplomacy, and a neo-mercantilist strategy of gaining direct equity control over or locking-up foreign oil supplies through long-term contracts(Chen 2008; Goldstein & Kozyrev 2006, p.166). The more centralized governing

⁶ Interview of an MOC official with one of the authors, Singapore, September 2007.

approach of the current leadership is evidenced by the creation of an “Energy Leading Group” in 2005, after over a decade of absence of a central agency exclusively dedicated to conceptualizing energy security and reform policies. Led by Premier Wen Jiabao and includes heads of thirteen relevant ministries within the State Council, this group potentially exercises a broad scope of authority but its preferences remains unclear on the issue of the Siberian pipeline (Embassy of the People’s Republic of China in India 2005).

Finally, effective leadership depends on the central executive’s possession of timely and accurate data on the negotiating party. The Chinese seem to fall short in this respect as compared to the Japanese. Chinese policymakers often were caught off guard and remain confounded by the decisions of their Russian counterparts, such as when they misjudged the relative fortunes of key corporate interests in Russia in picking a champion for Chinese interests. Zha Daojiang (2005 p.165) has identified Russian interests that preferred to “monetize the oil and natural gas reserves without much coordination or benefits for local industries and local community needs, and without considering overall developmental needs,” and “groups that prioritize regional development, social advancement and national energy security, as well as access to multiple markets in Northeast Asia.” China sided with the former, in the form of the private oil company Yukos, which was politically targeted for dismemberment thus leaving China at a loss on Russian corporate sponsorship. In fact, as early as 2003 Yukos was criticized by Transneft for its Angarsk-Daqing proposal (Alexander’s Gas & Oil Connections 2005; Kazinform 2003). Semyon Vainshtok, the head of Transneft, went on to propose the Pacific Ocean alternative. Japan, in contrast, identified the winning contender by trying to develop cooperative relations with Russia’s state-owned oil pipeline monopoly, Transneft, although the latter’s periodic doubts about the feasibility of the Nakhodka route did leave Tokyo in a quandary (Helmer, 2005).

A More Uncertain International Environment

When China started the pipeline negotiation with Russia, it benefitted from a relative position of strength. Russia feels less need to please China today – over time Moscow not only regained its control over the Siberian resources, but also acted with more confidence over its ability to shape energy supply deals that places itself at the center of balancing various interests in Northeast Asia and between Asia and Europe. More broadly speaking, starting with Gorbachev’s concessionary posture to China during rapprochement in the mid-1980s, and moving toward a more equal,

unified stance against US military actions in Kosovo in 2001 and the formation of SCO, Russia has increasingly pushed back on China's attempt to treat Russia as a junior partner or a compliant supplier of its resource needs. President Putin's reconsolidation of presidential authority and the power of the Russian state vis-à-vis business interests have bolstered Russia's relevance in regional politics and economic development. It does not appear that Beijing had adjusted to this changing relative power reality in its pipeline negotiation strategy.

In the post-Cold War era, China has shared with Russia an overarching objective of achieving multipolarity in the global power distribution to counter US hegemony. China's relationship with Russia and Central Asia has been revived following the post-Cold War conundrum (Tang 2000). Russia has found it profitable to outfit the PLA with its military hardware, and revived consultation with Beijing after Bush Sr.'s declaration of a New World Order in 1991 (Dittmer 2005). China moved to sign a border treaty with Russia on the eastern front in 1991 and a Friendship Treaty in 2001, which paved the way for the complete resolution of all border disputes by the summer of 2005. Diplomatic statements issued by both sides in 2005 emphasized the objective of facilitating economic development and resource trade along the borderline areas (Embassy of the People's Republic of China in India 2005).

As expected in realist theories, China lauded the Sino-Russian partnership as a model of its new strategic relationship with regional powers. The 1996 formation of the "Shanghai Five" consisting of China, Russia, and the Central Asian republics of Tajikistan, Kazakhstan, and Kyrgyzstan offered a confidence-building measure in which member states could cooperate on border delineation issues (Yom 2002). The association did not produce any significant norms or institutional dynamics, but established the platform for the Shanghai Cooperation Organization in 2001, which aimed to strengthen members' ties toward collective security and economic cooperation in Central Asia with a significant component of energy cooperation (Yom, 2002). To further consolidate the relationship between the SCO's co-leaders, Jiang Zemin and Vladimir Putin concluded a Twenty-Year Friendship Treaty (Dittmer 2005, p.14; 2006). The Chinese even offered support for Russia's bid for WTO accession in return for steady supplies of Russia oil at the quantities desired by China (*Associated Press* 2004).

In the aftermath of 9/11, Russia and China both bandwagoned with the US, yet were careful to maintain in SCO an anti-hegemonic agenda even as they enthusiastically took up the anti-terrorist commitment (Swaine 2004, p85; Hanson 2004, pp179-180). China invested SCO with dynamism in issuing statements of intentions and supporting the institutionalization of SCO

through a Charter, signed in June 2002, conferring formal legal status and submission of a proposal to achieve recognition by the United Nations (Cossa 2002, p.9). Iran, India, and Pakistan (at China's insistence) were admitted as observers in SCO in 2005, and became full members along with Mongolia a year later (Bhadrakumar 2006).

The SCO has had a direct impact on China's calculus regarding Siberian oil, by offering a new bargaining venue that enhances or circumvents China's bilateral negotiations with Russia. Beijing did not trust Putin's promises – typically cast as memoranda of understanding – on the pipeline and other issues, and sought to secure greater commitments through various deals ranging from economics to security under the SCO (Pan 2006). Russian official reassurances do not amount to any gentlemen's agreement and mask a far more uncertain reality (People's Daily 2006). On the ground Russian officials are often keen to keep Chinese influence in check in particular by introducing competing Japanese and Korean economic influences in the frontier regions (Rozman 2005). In fact, a persistent Chinese fear toward the Eastern Siberia-Pacific Ocean oil pipeline is that it would put China in a tough position of direct price competition with Japan and South Korea (Interfax 2005b; The Japan Times 2005). The vulnerability arises from Russia's monopoly of surplus oil resources in Northeast Asia and from direct competition with Japan. Cloaked in the expressed norms and goals of enhanced energy cooperation among all SCO members, China has pursued a mixed strategy of pushing Russia to prioritize oil supply to China rather than to other Northeast Asian consumers, on one hand, and pursuing new energy deals with Central Eastern countries and Iran on the other (Cohen 2006; Blank 2006). Backed by timely bilateral initiatives underpinning Beijing's "oil bridge" strategy toward Central Asia starting in the mid-1990s (Christoffersen 2005), Chinese national oil corporations have engaged in "cherry-picking available gas projects in Kazakhstan, Turkmenistan and Uzbekistan, with the eventual routing also likely to be designed with an eye of tying up otherwise stranded gas projects to east-west export pipeline routes (Olcott 2006; Kielmas 2005)."

In Northeast Asia, China is unable to gain traction vis-à-vis Russia with a regional consortium for energy consumers. Continuing its Cold War self-perception as a victim of American-based regional alliances in Asia, China has conducted the diplomacy of distrust toward Japan, Taiwan, and North and South Korea (Dittmer, 2005). At best, the Six Party Talks on the Korean Peninsula has brought together Russian and Chinese strategic interests, signaling China's move away from cynical avoidance to active engagement with a multilateral framework on

Northeast Asian security issues (Lin 2008). However, it is a far stretch to argue that the Six Party Talks have positive spillover effects on Sino-Russian energy trade and investment cooperation.

In sum, the protracted negotiation of over ten years on the pipeline project did not help China reduce uncertainties and clarify the importance of following through on this project for both sides at the governmental and firm levels. There is a fatigue factor that creeps in as the Chinese officials continue to press for an explicit commitment and Russians offer reassurances that fall just short of what the Chinese want, even as both are aware of the improved bargaining position of the Russians in light of their strengthened national executive capacities and Japan's attractive counteroffer.

III. Japan's Bargaining Capacity: A Balance Sheet

Divided Societal Interests

The lack of domestic energy resources and the subsequent reliance on foreign, mainly Middle Eastern, supplies is a well-documented feature of Japan's political economy. Since the first Oil Shock in 1973, Japan has succeeded in restricting the rate of growth in the demand for oil and decreasing its share in total energy use from 75% to just below 50% (Herberg 2004, p.354). It has been able to do this by enhancing fuel efficiency in the transport sector, virtually eliminating oil as a source of electricity generation and diversifying energy sources (Herberg 2004, p.354). A decade-long economic recession, post-war Japan's worst, from which it was only slowly beginning to emerge before the impact of the recent global financial crisis, also, inadvertently, served to dampen domestic demand for oil. The Ministry of Economy, Trade and Industry (METI) aims to further decrease oil's share of total energy to 40% by 2030. This does not mean that economic restructuring and low growth will significantly diminish Japan's status as a major oil importer; Japan remains a lucrative consumer market, ranked third in the world behind the US and China, and oil is expected to continue to constitute the foundation of its energy supply over the short- to medium-term (Toichi 2005).

Significant structural changes have taken place in the Japanese oil industry over the last decade. The liberalization and deregulation of energy markets have unleashed pressures that have led to a reorganization of both upstream and downstream sectors. For instance, the state-owned Japan National Oil Company (JNOC), established in 1967, and charged with the task of

providing public financing to oil exploration companies to secure access to new supplies, was dismantled in 2004 and reorganized into smaller units to enhance competition. In a move designed to create a more competitive “national policy corporation”, METI orchestrated a merger between Inpex Corp, one of the few successful former JNOC-funded upstream firms, and Teikoku Oil to form Inpex Holdings. The Japanese government has secured a nearly 30% stake in the new venture (Inpex Corporation 2008). In the downstream sector, domestic oil refiners and primary oil distributors have undertaken a ‘large-scale and rapid market reorganization’ that has seen the petroleum industry adopt a four-group corporate structure: Nippon Oil & Cosmo Oil Group, ExxonMobil Group, Japan Energy & Showa Shell Group and Idemitsu Kosan. A concomitant restructuring of refineries, oil storage terminals and service stations has resulted in declines in both Japan’s total refining capacity and refinery workforce (Petroleum Association of Japan 2006).

The corollary of these changes is that oil, electricity and gas companies in Japan are now even more preoccupied with economic considerations, chief amongst which is obviously profitability (Toichi 2005). According to one assessment of the actual cost basis for the Nakhodka route, the unit technical cost of the pipeline (capital and operational expenditures) for 30 years is approximately US\$1 per barrel to transport 2 million barrels per day and US\$2 per barrel for 1 million barrels per day. These figures are sufficiently competitive with the US\$2 per barrel tariff currently charged to pipe oil to the European market (Kanekiyo 2003). Nevertheless, while these are attractive figures, the enormous, and rising, costs of the project have made Japanese oil companies uneasy, which can largely explain why “there are not many positive voices actively promoting [the pipeline]” within the industry.⁷

This does not mean, however, that there are not elements within the Japanese oil industry that have expressed some commercial interest in the Siberian oil pipeline project. There are reports that trading houses, Inpex Corp and the Japan Oil, Gas and Metals National Corporation (JOGMEC), which has assumed the major functions of JNOC, are considering contributing capital for the project, with JOGMEC leaning towards shouldering half of the entire development cost. Even this level of public support is not enough to encourage more autonomous and active involvement from the private sector, which is also concerned about the lack of a guarantee that Russia will build the pipeline to the Pacific. Oil firms are currently

⁷ Personal correspondence between one of the authors and an official from the Petroleum Association of Japan (*Sekiyu Renmei*), 12 January 2007.

engaged in talks with METI aimed at encouraging JOGMEC to increase its share of the combined Japanese investment from 50-70% (The Japan Times 2006). Thus far, restructuring and streamlining of the Japanese oil industry have not resulted in a consolidated position regarding the pipeline among domestic firms, unlike China, which have largely overcome collective action problems.

Beyond the oil industry, a concerted push from within Japan for the Nakhodka route has come from subnational governments located on the Sea of Japan seaboard, which have been marginalized economically as a result of the post-war concentration of industrial and economic development within the metropolitan regions on the nation's Pacific belt. Motivated largely by the desire to emerge from economic stagnation and based on the notion of a perceived complementarity, these subnational governments have sought to promote trade and investment linkages with their counterparts in Northeast China, Korea and the Russian Far East "within the framework of such microregionalist initiatives as the Japan Sea Rim Zone and Pan Yellow Sea Economic Zone" (William 2006, p.265). These marginalized communities hope to benefit from the potential spill-over effects generated by an extension of the Siberian oil pipeline to the Pacific. Niigata, in particular, is positioning itself as a redistribution centre for Russian oil delivered to its port.⁸

While the Japan Sea port cities are competing for this role, they are also sufficiently cognizant of the benefits of collective action and have used bilateral fora such as the Japan-Russia Coastal Mayors' Association to discuss strategies with their Russian counterparts to lobby both central governments to this end (Niigata-shi). In a sign of cooperation among industry, academia and government (*san gaku kan*), The Economic Research Institute of Northeast Asia (ERINA) – a Niigata-based think tank, established in 1993, that conducts and disseminates research on a broad range of subregional economic issues – has been instrumental in providing a forum for interested parties in Russia and Japan to discuss the feasibility of the Nakhodka route. Participants at the 2004 and 2005 Niigata-Japan-Russia Energy Forums addressed a series of issues relating to the Pacific pipeline project including natural gas development, economic benefits and costs, as well as political and environmental concerns (ERINA 2005). The Japanese central and subnational governments have worked closely with political and economic elites from the Far East who have their own vested interests in seeing the pipeline extended to the

⁸ Yoshida S. n.d. "Kokusai Kōryū no Genjō to Nihonkai Seireishi", available at http://www.city.niigata.jp/info/kikaku/seirei_shitei_toshi/sympo/pdf/02.pdf.

Pacific. Officials from Primorsky Krai, where the pipeline would terminate (and which also seeks to be the site of a large refinery), in particular, have lobbied the Kremlin extensively for the Pacific route and maintain close contact with Japanese officials (Vladivostok Times 2009). From a geostrategic standpoint, pipeline-generated development in the troubled Far Eastern territories might encourage regional in-migration and consolidate Russia's position in East Asia. Therefore, there would appear to be a congruence of interests between central and subnational governments from both countries. Nevertheless, it is important not to overstate the bargaining strength of the Japan-Russian Far East "unified front" given the recentralization of power that has occurred in Russia under Putin's "dictatorship of the law". While proponents of the Pacific pipeline route in the Russian Far East might be able to put forward forceful claims based on geostrategic thinking congruent with broader conceptions of the national interest, they lack sufficient means to overturn possible, unfavorable Kremlin-designed policy.

Koizumi's Exercise of Bureaucratic Autonomy

Japanese political leaders have actively involved themselves in the campaign to extend the Russian oil pipeline to the Pacific coast. In a much publicized visit, Prime Minister Koizumi traveled to Russia in January 2003 for a three-day visit where he met with Russian President Putin and later held talks with regional elites during a stopover in Khabarovsk on his way back to Japan. This marked the first visit to the Russian Far East by a Japanese prime minister. One of the fruits of Koizumi's visit was the joint issuing of a Japan-Russia Action Plan.⁹ Under this plan, both sides evinced a shared recognition that developing energy resources in the Russian Far East and Siberia, and constructing a pipeline for the transportation of such resources would be mutually beneficial from an economic perspective, as well as contributing to the development of those regions, the improvement of the stability of the international energy market and the energy security of the Asia-Pacific region and beyond.¹⁰ A number of mutual visits by high ranking government officials, as well as regular gatherings under the auspices of the Japan-Russia Experts' Meeting, have subsequently been used to reconfirm the importance of the Pacific pipeline to both countries.

⁹ See <http://www.mofa.go.jp/region/europe/russia/pmv0301/plan.html>, accessed 14 May 2009.

¹⁰ Gaimushō n.d., "NichiRo Kōdō Keikaku," at <http://www.mofa.go.jp/region/europe/russia/pmv0301/plan.html>.

The Japanese government has demonstrated a clear desire to realize the Pacific pipeline project. Ostensibly, it might appear that Tokyo has a vested interest in the successful outcome of the negotiations analogous to the Chinese. Total petroleum-related taxes contribute approximately 5.9 trillion yen (7.5% of total national taxes in FY2006) annually to the national coffers, making oil Japan's largest industrial cash cow (Petroleum Association of Japan 2006, p55-6). The central government is also the largest shareholder in Japan's new national oil policy corporation, Inpex Holdings. However, the public and academic discourse in Japan concerning the Pacific oil pipeline is not dominated by expectations about the potential tax windfall for the Ministry of Finance but by the project's implications for Japan's oil diversification strategy and energy security. Thus the executive's bias towards extending the Russian oil pipeline to the Pacific is therefore conditioned primarily by geoeconomic rather than financial factors.

Examining the structure of information flows between the various players in the pipeline negotiations, the Japanese, as outlined above, have been sufficiently cognizant of influential domestic interests in Russia, identifying potential allies in the Far East with whom they could formulate a joint lobbying strategy and ascertaining that the state-owned oil pipeline giant, Transneft, would be the logical partner with which to establish cooperative relations, given its monopoly power in determining the ultimate pipeline route. However, it must be recognized that while these informational advantages might have enabled Japan to spoil China's bid, they only helped secure an uncertain victory for itself. Concerning the government-business nexus in Japan, as outlined above, the oil industry remain extremely cautious about becoming involved in this project. Government attempts to shoulder an increasing share of the investment burden and other attempts to encourage participation from industry representatives have largely fallen on deaf ears.¹¹

Russo-Japanese Dialogues under International Constraints

The politics-economic nexus has been a salient feature of Japan's diplomatic strategy aimed at recovering what it refers to as the Northern Territories from Russia. During the 1960s and 1970s, when it was enticed by the prospects of access to Siberia's vast resource wealth, the Japanese government adopted a strategy analogous to its foreign trade policy towards China by

¹¹ The director of the Petroleum and Natural Gas Division in the Agency of Natural Resources and Energy noted that attempts were made in the leadup to Koizumi's visit to Moscow in January 2003 to secure corporate involvement in the pipeline project. Interview with one of the authors, Tokyo, 20 June 2007.

maintaining a formal separation between politics and economics (*seikei bunri*). In other words, efforts were made so that unresolved bilateral political issues would not have a dampening effect on economic ties. The Japanese government continued with this policy until the mid-1980s when it saw an opportunity to use the increasing Soviet desire for economic cooperation as a lever to extract concessions on the territorial dispute (Carlile 1994, p. 421). Under the *seikei fukabun* policy, politics and economics became tightly linked, with economic cooperation contingent upon progress in the Northern Territories dispute (no islands, no substantial economic assistance). Since this time, these two elements have been loosened gradually, but have not been severed completely. This moderate decoupling strategy paved the way for Prime Minister Koizumi to offer US\$5 billion in assistance for the project during his January 2003 summit with President Putin. Japan sweetened the package in June, offering an additional US\$7.5 billion in low-interest government loans and insurance for private investment in pipeline construction and oil field development in eastern Siberia (Paik 2004, p.39). The Japanese government demonstrated further flexibility the following month when it agreed to Russia's position that the condition of government guarantees for the recovery of Japanese investment be removed (Paik 2004, p.39)— a significant concession given the number of failed business ventures since the collapse of communism. Congruent with Tokyo's "multilayered approach" of promoting bilateral contacts across a diverse range of fields, Koizumi emphasized a "parallel paths strategy" in which territorial negotiations would proceed concurrently with the pipeline issue (Buszynski 2006, p.293). Pressure from conservative forces in Japan for a convergence or tighter linking of both tracks, should the expansion of economic ties significantly outpace progress in the territorial dispute, however, remains a distinct possibility (Blagov 2005).

In addition to the unresolved territorial dispute, Japan's alliance with the US has also served to diminish the level of political capital it might be able to spend on Russia in oil pipeline negotiations (Gulick 2007, p.214). It is true that Japan's relations with its northern neighbor have progressed remarkably since the days of the Cold War when the Soviet Union expended considerable time and effort trying to wean Japan away from its superpower patron, often using a crude assortment of carrots and sticks. Beyond the territorial dispute, bilateral relations have grown in both qualitative and quantitative terms to include a broad assortment of state and non-state actors across a vast array of fields. Closer relations with Japan also function as a corrective mechanism when Russian elites periodically feel that balance-of-power posturing in East Asia tilts too steeply toward China. Nevertheless, despite reservations in some quarters and China and

Russia's initial bandwagoning with the US in the period shortly following the terrorist attacks of 9/11, Japan appears to be extremely comfortable with the notion of US hegemony – certainly far more than its neighbors – and has evinced an even greater preparedness in recent years to strengthen further alliance relations with Washington.

V. Conclusion: Implications for Future Games

In light of the sweeping narrative of “China rising, Japan stagnating,” this unexpected outcome suggests a gap between these two countries' bargaining influence over energy producers. How did Japan, a smaller state and energy consumption market with relative dependency on American foreign policy, manage to trump China, the political and economic leviathan's urgent attempt to obtain resources from its primary post-Cold War ally?

We considered several domestic and international institutional factors and find China to be in an overall position of strength. Pertaining to the corporate interests, over the course of a protracted pipeline negotiation with Russians, the Chinese national oil corporations resolved their initial disagreements and came to a consolidated position. In the case of Japan, the most significant commonality lies in Japanese oil companies' dissociated relationship with the former Koizumi cabinet and ministries and equivocal economic view of the pipeline project. China's post-socialist political economy also gave little direct leverage for consumers to resist price increases, and many means of subsidizing oil companies for investments in infrastructure. China's rapid growth and oil thirst also contribute to legitimating overseas supply acquisitions. Thus one might have predicted a greater leeway for China to pursue expensive capital projects.

One factor counts in Japan's favor: forced by historical and geopolitical circumstances, Japanese localities on the Sea of Japan seaboard have established an effective *modus operandi* in dealing with far eastern governments and communities, although one might question the efficacy of these sub-national links in a centralizing Russia. In contrast, the Chinese exclusively dealt at the state-to-state level, even as regional politics figure prominently in the recent political agenda to revive tired oilfields in Northeastern Chinese provinces as a key dimension of regional developmental policies since 2002. In addition, Japanese oil firms had the good fortune of picking the right strategic partner in Transneft for the pipeline project, despite some uncertainty from the Russian pipeline giant, whereas China stuck with the ill-fated Yukos that came under Russian president Vladimir Putin's attack.

International factors also gave China greater flexibility to approach Russia. Not only do these countries share an avowed vision of a multipolar world (i.e. balancing the American superpower), China has independently made significant attempts to deviate from US-centric international institutions through increasing bilateral agreements and leadership of regional groupings including the Shanghai Cooperative Organization. While it is important not to overestimate the potential of SCO based on a simple projection of its current activities, we have suggested that SCO has served as an effective “second pillar” in China’s foreign policy with the incorporation of energy cooperation into the agenda. The SCO could bring into its purview highly contentious issues such as Chinese and Japanese competition over Siberian oil and resource-driven territorial disputes in the East China Sea. However, this arrangement would compete with Japan’s proposal of an Asian Energy Community that treats energy security as an international public good within the framework of ASEAN+3(Christoffersen 2005, p.56). On the upside, Japan also exhibited pragmatism in not allowing itself to be unduly bound by security concerns in pursuing the pipeline; notably, it was able to loosen the link between the ongoing territorial dispute and the pipeline project. Japan’s energy diversification menu remains more stable and evolutionary in making adjustments to global price hikes and domestic needs.

We have argued that the Chinese advantages as an early claimant over Siberian oil and in its authoritarian policymaking structure and process seemed to have eroded over the long gestation period of the pipeline agreement. Fluctuations in domestic social and elite and regional bureaucratic interests and distractions from successful asset acquisitions around the world had led to a loss of focus on the pipeline negotiation. This loss is evident in China’s inadequate responses to changing Russian perceptions of its bargaining status vis-à-vis China, Russian economic interests, and the shifting fortunes of Yukos and Transneft. However, Japan’s bargaining capacity is also not without its limitations. While the Japanese were initially able to make a successful counteroffer, this involved a hidden cost. This offer was tabled in an environment characterized by attenuated government-business relations. This government-led proposal has failed to elicit sufficient support from the private sector, which has negative implications for Tokyo’s ability to maintain or deliver in terms of policy coherence.

The Chinese and Japanese governments marshaled considerable resources in a bid to secure access to stable supplies of Siberian oil. The time and energy both countries spent on lobbying the relevant parties in Russia and the Kremlin’s deliberate vacillations over the final route of the oil pipeline, the product of variations in the relative bargaining strength of China

and Japan, as well as Russia's attempts to highlight its own influence in global oil markets, has created some degree of tension in the relations between the three countries. In an era of fluctuating oil prices China and Japan may need to rethink how they practice resource diplomacy and introduce greater levels of cooperation to their efforts to secure access to energy supplies in other parts of the world.

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