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News Analysis: Chinese FDI Begins to Justify the Relationship

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It appears that China is steadily stepping up efforts to build and own assets in Russia, bringing the economic relationship beyond just bilateral trade.

If all goes well, this trend may boost Chinese investment here and dent the longtime conventional wisdom that business ties between the large neighbors do not measure up to their geopolitical camaraderie.

Last week, China made its biggest equity commitment so far as it hosted a visit by Prime Minister Vladimir Putin, agreeing to contribute $1 billion to a joint state fund that will inject most of the capital into Russia.

This is about equal to the value of all Chinese direct investment in its neighbor since the Soviet breakup.

Lou Jiwei, chief of China Investment Corporation, said the sovereign wealth fund joined forces with the Russian Direct Investment Fund because a state-owned institution as a partner provided more guarantees.

Lou said in May that Russia's investment climate was unfavorable compared with the global landscape, which was holding back some possible Chinese investors.

But some other recent developments — regardless of Russian government backing — also suggest a growing inclination for Chinese companies to hold assets here.

China Huadian Corporation is investing 10 billion rubles ($323 million) in the construction of a gas-fired power plant in Yaroslavl that began last month. Huadian holds 51 percent in the joint venture, with Russia's energy company TGK-2 to build and operate the plant.

It is the first project since the inception of the Russia-China Business Council in October 2004 in which a Chinese company will own an asset together with council member Sintez Group that controls TGK-2, council spokesman Vladimir Rostunov said.

Chinese investment in manufacturing in Russia would suit Moscow best, said Dmitry Abzalov, a foreign trade analyst at the Center for Current Politics, a think tank.

"Russia is interested in expanding its industrial base," he said.

Earlier this year, China signed on to another project that will hand it partial ownership of Russian assets: construction of multiple power stations in Siberia with Russia's private EuroSibEnergo. The effort to generate electricity for consumption both in Russia and China requires hundreds of millions of dollars to pull off.

China is also investing in assets that could boost its trade with Russia, expected to reach at least $70 billion this year. In a deal that has already come to fruition, state-owned China Chengtong Holdings Group became the proprietor of the sprawling business park Greenwood outside northwestern Moscow, the country's biggest investment in Russia to date. China's top legislator, Wu Bangguo, arrived in Russia last month to open the park after Chengtong spent $350 million since October last year to buy and complete the project that is a giant showroom of Chinese products.

This turnaround in China's course of business with Russia is especially vivid, given the dearth of attempts to gain a foothold on Russian soil over the long years after the friendship treaty of 2001 — and the subsequent border delineation completed in 2005 — promised to send relations to new highs.

Since then, the best known of these efforts have been China's purchase of a stake in midrange oil producer Udmurtneft, ongoing construction of the Baltic Pearl business and apartment compound in St. Petersburg and the plan to build a business center within Moscow city limits that stalled over a disagreement with the previous city authorities.

China's total post-Soviet direct investment in Russia, according to the State Statistics Service, stood at $1.1 billion at the end of March.

Global foreign direct investment in Russia is more than $100 billion, Prime Minister Vladimir

Putin said Monday. Kraft Foods, an American confectionery, food and beverage conglomerate, alone has invested $800 million since 1994.

Sergei Sanakoyev, chief of the Russian-Chinese Center for Trade and Economic Cooperation, attributed the slow growth of Chinese direct investment partially to the economic crisis that affected 2009 and the end of 2008.

Drawbacks have also come from perceptions in China that Russia was suspicious of its investment, he said.

"There are many myths that there are forbidden areas where the Chinese face an entry ban," Sanakoyev said. "The Chinese leadership also believes this, and it takes meetings on the highest level to debunk this."

Now that the countries have eliminated much of the misunderstanding through joint governmental commissions and ministerial agreements, and Russia has suggested numerous projects for cooperation, the conditions are ripe for more Chinese money to flow in, he said.

China, with its enviably overflowing investment capital, is willing to unload the money abroad in order to avoid overheating its own economy, seek new markets for its products and secure natural resources, Sanakoyev and Abzalov said.

Chinese pursuit of energy resources in Venezuela, Libya and Sudan has recently run into a worrisome stretch, Abzalov said, with ailing president Hugo Chavez in Venezuela, a new pro-Western provisional government in Libya and the division of Sudan. These hindrances could prompt an even closer look at Russia, he said.

Putin mentioned last week that China could explore for natural gas in Russia's Far East off Sakhalin Island and the mainland near Magadan. China has also expressed interest in mining coal in Siberia and the Far East.

Other Chinese investment that could materialize includes the deal, signed in July, to set up a joint venture to produce cars and light commercial vehicles in Ulyanovsk.

Most recently, Economic Development Minister Elvira Nabiullina said Friday that entrepreneurs from the two countries were thinking about joining forces in Russia to produce rabbit meat, whose imports from China have been growing.

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