



China's Involvement in Ukraine's Economy Vis-à-vis Russia

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China has increased its involvement in Ukraine, using development assistance through its Belt and Road Initiative (BRI) as a convenient pretext. China's main goal is economic benefits for itself, and the Russian aggression against Ukraine makes that easier, since China can exploit their worsening relations. At the same time, China is strengthening its position in Eastern Europe to gain an advantage in its relations with Russia, the EU and the U.S. China's priority partnership is with Russia, but its activity in Ukraine does not threaten Russian interests.

For China, Ukraine is mostly an important BRI partner, while for Ukraine, China is its main Asian economic partner. In 2011, the countries signed a strategic partnership. Their previous cooperation, mostly economic, carried on with some difficulties. Because of internal political disputes and Russian aggression against Ukraine, the country was unable to keep its commitment to China under a “loan-for grain” deal signed in 2013, with the case sent to arbitration in London. Both sides downgraded their relationship on the highest level after Russia's annexation of Crimea and the start of the war in the eastern Ukraine. Later, in January 2015, Ukrainian President Petro Poroshenko and Chinese leader Xi Jinping discussed increasing cooperation during the World Economic Forum in Davos, Switzerland. In September 2017, Ukraine's foreign minister, Pawło Klimkin, paid a visit to China, and then last December, Ma Kai, China's vice premier, visited Kyiv.

Chinese Presence in Ukraine. China's activity in Ukraine fit into BRI mostly because of Ukraine's transit-state position and its free-trade agreement with the European Union. One of the main elements of BRI is establishing new railway connections between China and Europe. In 2016, Ukraine launched a test of a new rail-ferry line transporting goods between the Black and Caspian seas, but using other connections that exclude Russian territory. It was supposed to be a way to include Ukraine into the existing China-Europe route through Kazakhstan, Georgia, and Turkey (the Baku-Tbilisi-Kars line). This connection would make it easier to send goods to China that, because of the sanctions on Russia (and its counter-sanctions), are forbidden to be transported through the Russian Federation. Tests of the route were unsuccessful, mainly because of a lack of Chinese interest in the connection.

Overall, China is Ukraine's third trade partner, after the EU and Russia. From January–November 2017, trade exchange between Ukraine and China totalled more than \$7 billion, which is 8% more than in all of 2016. Of the \$7 billion, \$5 billion is Chinese goods exported to Ukraine (11% of total imports). Ukraine's main exports to China are foodstuff, with Ukraine its biggest corn exporter, and military equipment—in 2016, China bought about \$90 million worth of equipment.

China invests in Ukraine but until now it has been on a limited scale (about 1% of FDI, mainly in aviation or information technology). During the December visit, the Chinese vice premier declared the implementation of projects worth \$7 billion. Chinese firms will build a section of the Odesa-Mikolajów highway (complementary to the Odessa-Gdansk route, with a possible extension to Kherson), a railway connection between the Boryspil airport and Kyiv, and an additional subway line and new bypass in the capital. The Chinese have already upgraded the harbour in Yuzhne, and are participating in a bid to dredge the port of Chornomorsk and build a port terminal there.

China has learnt lessons about excessive bureaucracy and administration chaos in Ukraine, with the example of a 2012 fiasco involving a long-term loan agreement from a Chinese state bank to Naftohaz worth \$3 billion. China now tries to increase its control of investment procedures in Ukraine. In 2016, China bought a majority of the shares of the Ukrainian Bank of Reconstruction and Development. China's investments mostly focus on acquisitions of Ukrainian companies and infrastructure, financed from loans from Chinese state banks. Despite the high level of state debt, these loans are eagerly accepted by Ukraine's authorities because of its financial needs and the lack of reform strings like those connected to IMF or EU loans.

China and Ukraine's economic cooperation is not matched by increased political dialogue. China underlines its partner's cooperation in BRI, but, for example, was restrained in its response to reports that the vice chairman of the Ukrainian parliament in 2016 expected the country to join the "16+1" cooperation initiative, which includes most countries in Central and Eastern Europe and China. The Chinese ambassador to Ukraine instead underlined that their cooperation is fundamentally about BRI. The Chinese authorities' perception of Ukraine is influenced by the idea that it is within the Russian sphere of interests. Political support for Ukraine would increase the likelihood of a dispute between Russia and China, which is not in China's interest.

Ukraine and China-Russia relations. The Chinese activity in Ukraine appears not to antagonise Russia, and it remains China's most important political partner. China's earlier economic involvement in Ukraine also did not threaten Russia's position. Russia is Ukraine's second-largest export destination, with trade exchange in 2016 almost double China-Ukraine trade. Russia also perceives Chinese capital in Ukraine as more welcome than the EU or U.S.

China splits the middle on policy towards Crimea's annexation and Russian involvement in the war in Donbas. Chinese experts point to negotiations between the EU/U.S. and Russia as the only way to stabilise the situation in Ukraine, which at the same time reduces Ukraine's role in the process. China, though, does not recognise the peninsula as Russian territory and calls on both parties to refrain from military operations. This balance act in Chinese policy also is seen in its limited support to the Ukrainian military, mostly in the form of humanitarian aid and minor equipment, making it the only non-NATO country to do so. This information was presented in 2016 by the Ukrainian Ministry of Defence, but without further detail.

Right after the outbreak of the conflict, Chinese companies temporarily held off further investment in Crimea, but some firms are still present, for example, helping with development of the port of Kerch at Russia's request, or investing in solar power plants. Sevastopol city governor stated that Chinese entities' participation in development projects in the city (apartments, schools, sports centres) were worth more than \$120 billion. Chinese firms may also be involved in Simferopol airport modernisation.

Perspectives. China's growing engagement in Ukraine is an attempt to return to its level of involvement before the Russian aggression, when relations were more advanced. China exploits the weak condition of the Ukrainian economy, as well as its hardships stemming from the war involving Russia. China wants to profit economically but also to strengthen its political position in Eastern Europe, which in turn will be used in its relations with Russia, EU and U.S.

As long as China's cooperation with Russia remains of key importance, its involvement in Ukraine will take Russian interests into consideration. Although Chinese experts underline their country's readiness to cooperate with the EU, for example, in the Eastern Partnership (EP), the lack of official declarations on that issue bears witness to China's reluctance to antagonise Russia. Ukraine EU-China projects outside the BRI and the railway connection that excludes Russia will be considered by China as against Russia and thus not in China's interest.

In addition, while Russia's military involvement in Ukraine and continued occupation of Crimea worsened its relations with the EU and U.S., it also forced Russia to pivot towards China. Russia has allowed Chinese investment in its energy sector and sold China modern military equipment.

At the same time, the ongoing conflict on eastern Ukraine continues to threaten the country with destabilisation, which threatens Chinese economic interests and growing involvement. The political aspect of the Chinese presence will then primarily focus on maintaining the status quo in Donbas and Crimea. In the long-term perspective, increased Chinese involvement could become an important form of competition to the EP, as well as U.S. economic presence in Ukraine.