

PISM REPORT

CHINA'S ECONOMIC SUPPORT FOR RUSSIA SINCE THE FULL-SCALE INVASION OF UKRAINE



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THE POLISH INSTITUTE OF INTERNATIONAL AFFAIRS

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MAIN CONCLUSIONS

- Russian-Chinese political cooperation has been ongoing since the collapse of the USSR and intensified before the 2022 Russian invasion of Ukraine. From the point of view of the People's Republic of China, the actions of the Russian Federation are favourable as contributing to the erosion of the international order, perceived by both partners as pro-Western. The common desire to change it is a cornerstone of the China-Russia strategic relationship, which is also reflected in economic relations.
- Russia's full-scale invasion of Ukraine in 2022 and the economic response to it by the West (i.e., the EU, the U.S., and their allies) have clearly deepened the Russian turn towards China, which has become a key recipient of Russian energy resources and a supplier of industrial goods and technology. China's economic support for Russia is comprehensive and limits the effectiveness of Western sanctions and of the potential for countering aggressive Russian policies. China is the only country that does not participate in the sanctions effort and at the same time has an economy big and diverse enough to replace Russia's traditional partners. The Russian Federation's cooperation with China has allowed the Russian economy to avoid collapse and maintain relative fiscal stability. As such, it indirectly supports Russian aggression against Ukraine.
- China refuses to participate in economic pressure on Russia to force it to end the war in Ukraine. It refuses to join the Western sanctions and maintains relations with Russia. However, practice shows that it is possible and necessary to influence China's actions so as to limit its support for Russia, including by increasing the cost of it in relations with the EU and the U.S. It is important to continue to take action against specific companies, as well as to consider broader measures against the Chinese economy as a whole.
- The weakening of the Russian economy will be important in the context of Russia's ability to continue the war and position in future peace talks, regardless of their format. In economic relations with China, the West, including the EU and Poland, should therefore take into account not only economic interests but also security aspects, both in Europe and the Asia-Pacific. By engaging in cooperation with Russia, China is testing and gaining experience in countering Western responses to possible Chinese actions in the Asia-Pacific.
- From the EU's point of view, a more robust approach to Chinese involvement in support of Russia's war in Ukraine is advisable. Delays in sanctioning the Chinese actors involved and low efficiency of the sanctions enforcement by the Member States send a weak signal regarding the EU's decisiveness and ability to actively counter Chinese support for Russia.
- Initiatives to reduce China's support for Russia can be part of transatlantic cooperation. The problems of China's non-market and WTO-incompatible economic policies and Chinese support for Russia can be tackled together by increasing the pressure on China through access to the U.S. and EU markets. Close coordination between the EU and the U.S. is desirable for the maximum effectiveness of such measures.

STRATEGIC DIMENSIONS OF CHINA'S COOPERATION WITH RUSSIA

The Russian full-scale invasion of Ukraine in February 2022 was not the immediate reason for the intensification of Russia's political and economic cooperation with China, which was by then already ongoing.¹ However, it represented a clear breakthrough in China's approach to Russia, with the former viewing Russia's active military actions against Ukraine and its confrontational policy towards NATO, the U.S., and European states as an important probe of the West's commitment and possible reaction to Chinese policy in the Asia-Pacific, especially towards Taiwan. Above all, China sees these actions as significant support in competing with the U.S. and modifying the international order towards its preference. In the optics of the Chinese authorities, after Russia launched its full-scale war with Ukraine, the development of Sino-Russian relations became a key element of China's foreign policy.²

China's current multidimensional cooperation with Russia is thus a direct result of a strategic foreign policy goal: to change the current international order identified as "pro-Western". The basis for this cooperation is the perception, shared by the ruling elites of both countries, of the threat posed by U.S. policy (and as pursued within the "West"³, in cooperation with partners and within international organisations). In their view, it seeks to disempower elites and dominant political circles in both Russia and China. In the view of the Chinese Communist Party (CCP), this common threat perception aligns the interests of the Russian and Chinese elites and thus, despite the political differences and disparity of potentials—and potentially to some extent the negative impact of cooperation with Russia on China's economic interests with the U.S. or the EU—makes sustaining cooperation with Russia a primary objective.

Expressions of China's policy towards Russia are found in statements published after meetings between Chairman Xi Jinping and President Vladimir Putin in 2022⁴ (on the occasion of the opening of the Beijing Olympics), 2023⁵ (Xi's visit to Moscow), and 2024⁶ (Putin's visit to Beijing). Each contains parts in common describing fixed elements in the two countries' cooperation, as well as parts specific to that year but not included in the others. The 2022 document, signed just before the Russian full-scale aggression against Ukraine, was groundbreaking, indicating for the first time the two countries' common goals and cooperation in both Europe and the Asia-Pacific. Subsequent statements in 2023 and 2024 elaborated on these themes, confirming the multi-sectoral and multi-pronged cooperation between the two states. They clearly distinguished topics relevant to the interests of both countries, the analysis of the current international situation and plans to change it. Changes in the following statements also point

¹ M.Bogusz, J. Jakóbowski, W. Rodkiewicz, "Beijing-Moscow axis. Foundations of an asymmetric alliance," Centre for Eastern Studies, 15 November 2021, www.osw.waw.pl.

² M.Przychodniak, "China adapts policy in response to Russia's aggression against Ukraine," *PISM Strategic File*, No. 7 (128), 31 March 2023,

³ In China's view, the primary culprits (and inspirers of other states, precisely within the "West") in this context are the United States and its allies in the Asia-Pacific (Australia, Japan, New Zealand, South Korea), as well as the EU institutions and the Union as a whole (although not all of the Member States).

⁴ "Joint Statement of the People's Republic of China and the Russian Federation on International Relations and Global Sustainable Development in the New Era," PRC Ministry of Foreign Affairs, 4 February 2022, www.mfa.gov.cn.

⁵ "Joint Statement of the People's Republic of China and the Russian Federation on Deepening the Comprehensive Strategic Partnership of Coordination in the New Era," *Xinhua*, 22 March 2023, www.gov.cn.

⁶ "Joint Statement of the People's Republic of China and the Russian Federation on Deepening the Comprehensive Strategic Partnership of Coordination in the New Era on Occasion of the 75th Anniversary of the Establishment of Diplomatic Relations between the People's Republic of China and the Russian Federation," *Xinhua*, 16 May 2024, www.gov.cn.

to a deepening of Russia-China cooperation and its increasingly strategic dimension. The 2024 document explicitly indicates that Sino-Russian cooperation is not temporary, conjunctural, or driven by current benefits, but by the “fundamental interests of both countries and peoples”. It characterises bilateral relations in detail, including the development of border areas (taking the form of Chinese investment in the Russian Far East), and the intensification of political communication involving dozens of contacts between ministries, government agencies, political parties, and state institutions. The 2024 statement also included a section on China’s support for the legitimacy of Putin’s rule and criticism of actions that Russia says are aimed (allegedly by the West) to undermine it, such as the March 2024 terrorist attack in Moscow. This is further confirmation that for China, its cooperation with Russia is important from the perspective of long-term strategic interests, supported by the current Russian regime under the leadership of the current president.⁷

The strategic dimension of Sino-Russian cooperation is not only expressed in bilateral relations but also manifested in multilateral formats. Its basic form is the actions of both states to act as leaders in their cooperation with the Global South, as well as with other regional powers (i.e., Brazil, India, South Africa) interested in reducing the importance of the West (or more precisely, the U.S.) in the international arena and moving towards a multipolar order. This cooperation also extends to international organisations, including the UN, where the two states put forward joint proposals (e.g., on regulation of the internet⁸), promote (effectively) their own nomenclature concerning, for example, Chinese development and security initiatives,⁹ and mobilise support for their political ideas, such as conflict-resolution in the Middle East¹⁰ or the Sino-Brazilian proposal for talks on the war in Ukraine.¹¹ Russian-Chinese strategic cooperation vis-à-vis the Global South also includes dialogue forums, most notably BRICS+, where the selection of participants and the agendas of individual summits are derived from the relationship between the two countries.

⁷ M. Przychodniak, “China assesses the prospects of Putin’s contend leadership” *PISM Bulletin*, No. 144 (2263), 12 October 2023.

⁸ J. Sherman, K. Komaitis, “China’s new UN Internet Proposal could resonate with growing economies,” 12 June 2023, www.techpolicy.press.

⁹ C.J. Fung, Shing-hon Lam, “Mixed report card: China’s influence at the United Nations,” Lowy Institute, 18 December 2022, www.lowyinstitute.org; M-O. Baumann, S. Haug, S. Weinlich, “China’s expanding engagement with United Nations Development Pillar,” Friedrich Ebert Stiftung, November 2022, www.fes.de.

¹⁰ Since the Hamas attack on Israel on 7 October 2023 and the subsequent outbreak of war in Gaza, China has not condemned Palestinian terrorist organisations, it maintains its position on the need for Israel to halt hostilities and ultimately the creation of a Palestinian state. This has also led to a reduction in the frequency of political meetings between Israel and China.

¹¹ In May 2024, China and Brazil put forward a proposal for a solution to the war in Ukraine, including: de-escalation, an international peace conference acceptable to Russia and Ukraine, humanitarian support, prisoner exchange, no use of weapons of mass destruction, no attack on civilian nuclear installations, and stable international trade. It reflects the Chinese position against Russian aggression against Ukraine, but is promoted as a two-state proposal (also within BRICS+) to be joined by other states, the so-called “friends of peace”, mainly those of the Global South. It is also presented in opposition to other international conferences organised around the Ukrainian peace plan. The concept has been rejected by Ukraine as pro-Russian, but with acceptance of international talks involving Russia. It has been tentatively endorsed by Russia.

THE POLITICS OF ECONOMIC RELATIONS BETWEEN CHINA AND RUSSIA

An important element of Sino-Russian relations is economic cooperation. The PRC's official position, supported by sympathetic experts, is dominated by the view that Russia is a normal state with which China has normal, standard relations, including in the economic sphere, and that China does not accept sanctions and that its trade with Russia does not imply support for the war effort. As recently as the early February 2022 statement, China's narrative on economic cooperation with Russia focused mainly on trade and investment issues, including primarily the energy dimension. One of China's objectives has been and remains to take advantage of Russia's deteriorating situation in the face of Western sanctions and more difficult cooperation with the West since 2014 to obtain more favourable prices for natural resources, among other objectives. China is also interested in better market access in Russia (e.g., in telecommunications, 5G) and in replacing Western manufacturers in supply chains (automotive, digital industries). Over time, the Chinese concepts of economic cooperation with Russia are becoming more advanced, covering more and more areas as Chinese exports increase. The Sino-Russian statement of 2023 already featured declarations to use local currencies rather than the U.S. dollar in bilateral settlements, a solution also promoted by both countries in multilateral formats, such as BRICS+.¹² According to a statement following the May 2024 meeting between Xi and Putin, cooperation is also to include customs issues, increasing the competitiveness of economies, and better protection of intellectual property rights, as well as improving cooperation channels (and dispute-resolution methods) between Chinese and Russian companies. There is also an additional passage on financial cooperation, in practice oriented towards reducing the effectiveness of possible secondary sanctions on Chinese companies. Trade is to be increasingly based on the yuan (RMB; consistent with Chinese declarations).

For China, engagement in economic cooperation with Russia has two dimensions: a more important, strategic one, as a condition for the successful realisation of political objectives, and an internal one, secondary to the first, calculated to support exports as the main engine of economic development and GDP growth, and the acquisition of energy resources at bargain prices. The first is realised in sustaining the possibility of rebuilding Russian military capabilities mainly through the supply of dual-use items and the interaction of the Chinese and Russian militaries in the Asia-Pacific or the Arctic. It is not only about enhancing Russian capabilities but also about reducing those of the adversary (in China's perception, the United States), such as China's exploitation of its position in production and supply chains and, for example, limiting (by blocking the purchase of batteries produced by Chinese companies) the production capacity of U.S. drones sold for military purposes to Ukraine.¹³ The second dimension—finding a buyer for China's production surpluses—is primarily realised by increasing exports of specific goods from China to Russia and their role in the supply chains of Russian entities as an alternative to Western solutions.

In China's official messaging, economic cooperation with Russia is not presented in terms of assistance to the war effort but as a natural dimension of relations between neighbouring countries and partners. The Chinese often refer to similar cooperation between Russia and its other partners, such as India, but also EU countries. In the Chinese narrative, this cooperation does not contradict China's concept for ending the war in Ukraine and its rhetoric

¹² P. Dzierżanowski, "Alternatives to the U.S. Dollar as a Global Currency Face Brick Walls" *PISM Bulletin*, No. 64 (2372), 18 April 2024.

¹³ D. Sevastopulo, K. Hille, R. McMorrow, "China sanctions hit US drone maker supplying Ukraine," *Financial Times*, 31 October 2024, www.ft.com.

of not supporting either side of the conflict. The sanctions imposed by the West are seen as illegitimate and China does not intend to comply with them. In practice, however, the approach to economic cooperation with Russia is constrained by political interests, meaning it does not go beyond what is necessary for Chinese needs, both political (as a distraction from Chinese policy in Asia) and economic. Examples of this include the limited progress in deepening cooperation in gas trade and the lack of a breakthrough in the construction of the Power of Siberia 2 pipeline¹⁴ despite many Russian attempts to accelerate this project from 2022 onwards. The issues of energy cooperation with Russia are treated as secondary by China and indicated by the content of the statements. In 2022, this topic did not appear at all, while in 2023 it was only mentioned as an example of cooperation and in 2024 in reference to civil nuclear power as a dimension of this exchange.

Economic cooperation with Russia is subject to the traditional, political character of foreign interactions for China in which the political message of the leader signals the directions of development and relations in specific sectors under the “umbrella” of a given initiative, such as the Belt and Road Initiative (BRI). The existing sanctions on Russia and possible burdens on the Chinese economy from the U.S. and the EU further complicate the situation and make the actions of Chinese companies more dependent on the approval and decisions of the authorities in Beijing. The strategic dimension of China’s cooperation with Russia makes it particularly highly supervised and controlled by the state authorities, with a very low level of autonomy for action by Chinese companies. State-owned companies, such as energy companies and export banks, remain under the programmatic supervision of the State Council (i.e., the government) and the personnel under the supervision of the Organisation Department of the CCP Central Committee. Others whose operation depends on party regulations, subsidies, the support of CCP members, or the approval of management decisions by party cells, also constitute an effective instrument for the implementation of foreign policy. To a large extent, involvement in Russia is also profitable for some of them, hence they are keen to pursue PRC policy objectives.

¹⁴ “As Power of Siberia 2 pipeline stagnates, so do Russia’s hopes for pivoting gas exports eastward,” *Moscow Times*, 20 June 2024

IMPACTS OF THE 2014 AND 2022 ESCALATIONS ON RUSSIA'S EXTERNAL ECONOMIC RELATIONS

Since the collapse of the USSR in the early 1990s, the key economic partner for the Russian Federation has been the West, primarily the European Union and the United States. Due to their dominance in the global economy, there was no real alternative for Russia. China's GDP in 1990 was comparable to the Netherlands', in 2000 to Italy's, and in 2008 to the Netherlands' and Germany's combined. Although there were plans to develop Russian-Chinese economic ties, both countries were primarily focused on contacts with the West. The relationship context has changed due to the rapid economic growth of China, which around 2010 became the third-largest economy in the world (after the U.S. and the EU), and the severe consequences of the 2008 global financial crisis for the Russian Federation, which demonstrated the dangers of economic dependence on the West.¹⁵

A turning point in Russia's political relations with the West was the 2014 aggression against Ukraine, the internationally illegal annexation of Crimea, and Russian support for the creation of the separatist so-called People's Republics of Donetsk and Lugansk. These acts resulted in sanctions of varying degrees of severity being imposed on the Russian Federation by the EU, the U.S., and their allies, including Norway, Switzerland, Canada, Australia, and Japan. The sanctions primarily targeted the financial, energy, and defence sectors. They also included travel bans on many Russian politicians, officials and businesspeople. In response, Russia introduced import bans on agricultural products (meat, dairy, fruit and vegetables) from the EU, the U.S., Norway, Canada, and Australia. The sanctions have triggered an economic slowdown and a decline in consumption in Russia, but assessing their impact accurately is difficult due to the concurrent long-term decline in oil prices, which began in the second half of 2014. However, the political tensions did not cause a break in Russia's economic ties with the West, so while the decline in the value of EU imports from Russia was mainly due to the fall in energy commodity prices, the structure of trade did not change.¹⁶ As recently as 2021, Russia was the largest supplier of oil and gas to the EU market, with a share of 24.8% in EU oil imports in Q4 of that year.¹⁷ In the same year, the EU was the largest buyer of goods from Russia, with a 38.2% share of Russian exports (compared to 53.7% in 2013, before the aggression). The EU was also the largest exporter to Russia (32% of Russian imports; down from 42.2% in 2013).¹⁸

While the West, especially the EU, remained Russia's most important economic partner after 2014, China's role was already growing. It did not join the Western sanctions, but the strengthening of economic relations with Russia during this period was rather a result of structural factors and the parties' interests – although influenced in part by Western sanctions – than a shared anti-Western political vision. Against a backdrop of deteriorating relations with the West, this led to a relative increase in China's importance in Russia's economy. This was evident in, among other things, the field of energy, a key area of Russia's economy. In May 2014, just two months after the annexation of Crimea, Gazprom signed a 30-year contract worth \$400 billion to supply gas to China Power of Siberia pipeline. At the beginning of 2018, the second line of the ESPO oil pipeline became operational, reinforcing Russia's position as one of the two key oil suppliers to the Chinese market alongside Saudi Arabia. The growing

¹⁵ C.G. Gaddy, B.W. Ickes, "Russia after the Global Financial Crisis," *Eurasian geography and economics* 51.3 (2010): 281-311. web.

¹⁶ Archive: Russia-EU - international trade in goods statistics - Statistics Explained (europa.eu), Eurostat

¹⁷ EU imports of energy products - latest developments Statistics Explained, Eurostat

¹⁸ Bank of Russia Annual Report 2021, Bank of Russia Annual Report 2013, Central Bank the Russian Federation

importance of China for Russia is clearly visible in trade statistics. In 2013, China received 6.8% of Russian exports and accounted for 16.7% of Russian imports, and in 2021 it was 14.0% and 24.8%, respectively.¹⁹

A much more profound economic effect was caused by the subsequent Russian full-scale invasion of Ukraine in 2022 and the sharper economic response of the West. As early as February 2022, the EU began imposing sanctions on Russia. Exports of certain goods to Russia are now banned, including high-tech products (e.g., quantum computers, advanced semiconductors, certain computer software), products and technologies necessary for oil extraction and refining, parts and technologies necessary for the aerospace industry, and all types of weapons. The EU has restricted imports of energy raw materials (oil, gas, coal) and metals and banned the provision of certain services to Russian customers, including IT, cryptocurrencies, and accounting.²⁰ So far, sanctions in the areas of energy and dual-use goods had the biggest practical significance²¹. Similar sanctions have been introduced by other Western countries, most notably the U.S. They include the disconnection of some Russian and Belarusian banks from the SWIFT system and the introduction of a price-cap mechanism on Russian seaborne crude oil and petroleum products and by G7. Some Western companies voluntarily withdrew from the Russian market, while others reduced or suspended operations.²² The result was a rapid and mutually economic decoupling between the West and the Russian Federation (although not total, as the EU still imports Russian gas and about 1,700 Western companies are active on the Russian market),²³ necessitating Russia to find new partners to replace the traditionally key EU and U.S.

¹⁹ *Ibidem*.

²⁰ EU sanctions against Russia explained - Consilium

²¹ E. Kaca, "Two Years after Russia's Invasion of Ukraine, Lessons Learnt Can Strengthen EU Sanctions Policy," *PISM Policy Paper*, No. 1 (214), 28 March 2024, www.pism.pl.

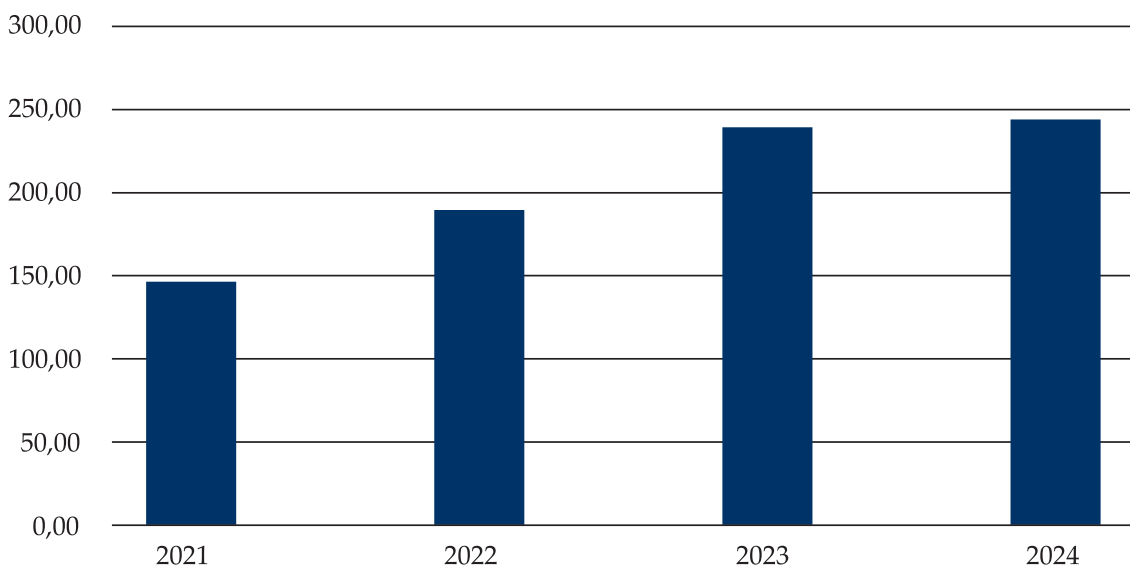
²² S. Kolarz, "Hundreds of Western Companies Still Operating in Russia," *PISM Bulletin*, No. 144 (2452), 03 October 2024

²³ P. Dzierżanowski, "Reviewing the Russian Economy a Year After the Invasion of Ukraine" *PISM Bulletin*, No. 31 (2150), 22 March 2023; P. Dzierżanowski, Z. Nowak, "Business and Consumer Protection Must Evolve after Europe's Energy Crisis" *PISM Bulletin*, No. 69 (2188), 06 June 2023.

CHINA'S REPLACEMENT OF THE WEST AS RUSSIA'S MOST IMPORTANT ECONOMIC PARTNER

According to Chinese customs administration data, the value of trade between China and Russia increased by more than 60% between 2021 and 2023 (see Figure 1). Chinese imports and exports from Russia grew evenly, by just over 60% for each flow. The structure of Russian exports to China has not changed and are still dominated (around 70%) by energy raw materials. There is a clear increase in the importance of vehicles in Russian imports from China (from \$0.39 billion in December 2021 to \$2.04 billion in December 2023). The value of machinery imports has also increased. Although the Russian administration no longer publishes trade data divided by country, the decline in the volume of Russian trade with the EU suggests that China is now Russia's most important trading partner in terms of exchange value.

FIG. 1. TOTAL VALUE OF TRADE BETWEEN CHINA AND RUSSIA (USD BILLIONS)



Source: Own compilation based on data from the Chinese customs administration.

China's Role as a Buyer of Energy Resources from the Russian Federation is Growing.

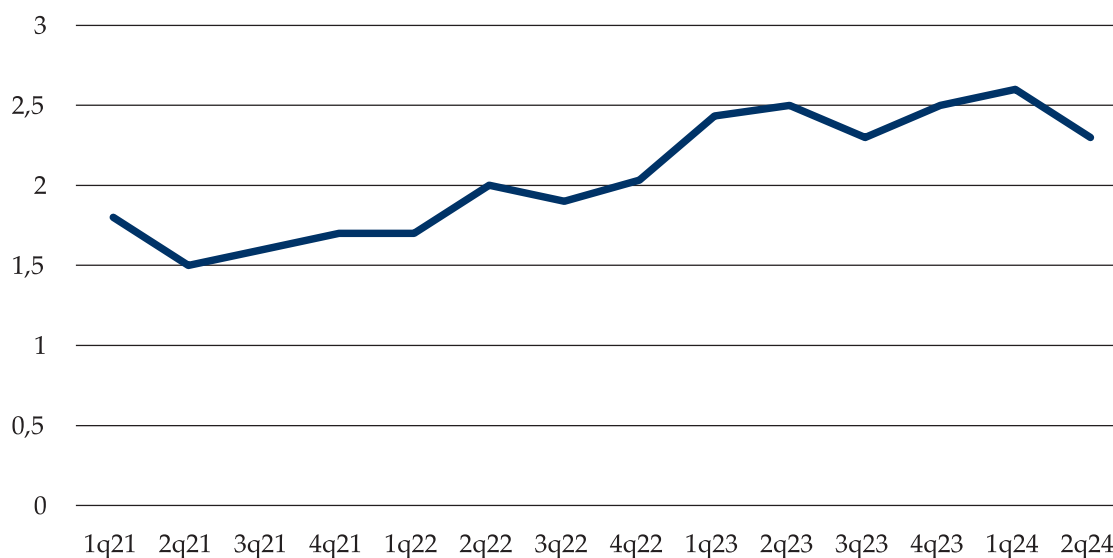
The most important economic challenge for Russia after the invasion was to find alternative markets for energy resources (following EU sanctions and unilateral supply restrictions by Russian entities). The stability of the Russian budget and economy depend on energy exports. According to data from the International Energy Agency, Russian oil supplies to China increased by more than 50% after the invasion of Ukraine²⁴ (e.g., between Q2 2021 and Q2 2023, see Fig. 2). However, due to Russia's difficult situation, they were delivered at a discount to world prices: a few months after the invasion, a barrel of Urals crude oil even cost about \$30 less than Brent oil (around \$50 and \$80, respectively). Also, transport costs to Asian markets are higher, further reducing profits for the Russian upstream sector and the Russian budget. Currently, the discount on Russian oil is smaller (around \$8 per barrel in January 2025²⁵), with

²⁴ "IAE Oil Market Report," International Energy Agency, January 2024; the several-fold increase in supplies to India and the several-fold increase in supplies to Turkey were also significant.

²⁵ V. Soldatkin, "Russia faces higher costs on sea-borne oil exports due to new US sanctions," *Reuters*, 13 January 2025, www.reuters.com.

China, India, and Turkey the main customers. This is due to the ineffectiveness of the price cap mechanism caused by, among other things, Russia's use of a non-compliant "shadow fleet"²⁶ and the export of oil to China via the ESPO pipeline, which is not covered by it (the cap covers seaborne trade). This situation supports the Russian budget and war effort in Ukraine.

FIG. 2. RUSSIAN OIL EXPORTS TO CHINA (MB/D, AVERAGE)



Source: Own calculations based on International Energy Agency data.

Far more difficult for Russia was the change in the structure of its natural gas trading partners. Between 2021 and 2023, the volume of Russian gas exports by land greatly declined, as it was impossible to quickly replace the European market due to infrastructure constraints.²⁷ The slight increase in exports of LNG by sea did not make up for the decline in supplies to the EU market. Although supplies to China have not and will not in the short to medium term reach volumes comparable to trade with the EU before 2022, they are steadily increasing: in 2023, China became the largest customer of Russian pipeline gas. The Power of Siberia pipeline is supposed to operate at full capacity and deliver 38 bcm in 2025—a substantial increase on 2022 when deliveries reached 15.4 bcm. Chinese imports of Russian LNG also grew slightly in 2024²⁸. Russian natural gas supplies to China are being delivered much below the prices that Western European countries were paying. Now, China is likely to demand even greater discounts, as media reports quote price demands at the level of subsidised Russian domestic prices, resulting in, among other things, the failure to start construction of the Power of Siberia 2 pipeline despite Russia's stated intention to sign contracts in 2023 and start work in 2024.

Increased Imports of Industrial Goods from China by Russia. Russia's economic relations with the West also included imports, primarily of industrial products, such as machinery, medicines, cars and car parts, aircraft, precision equipment, and chemical industry products. Russia imported consumer goods and inputs for production in civilian enterprises (semi-finished products and

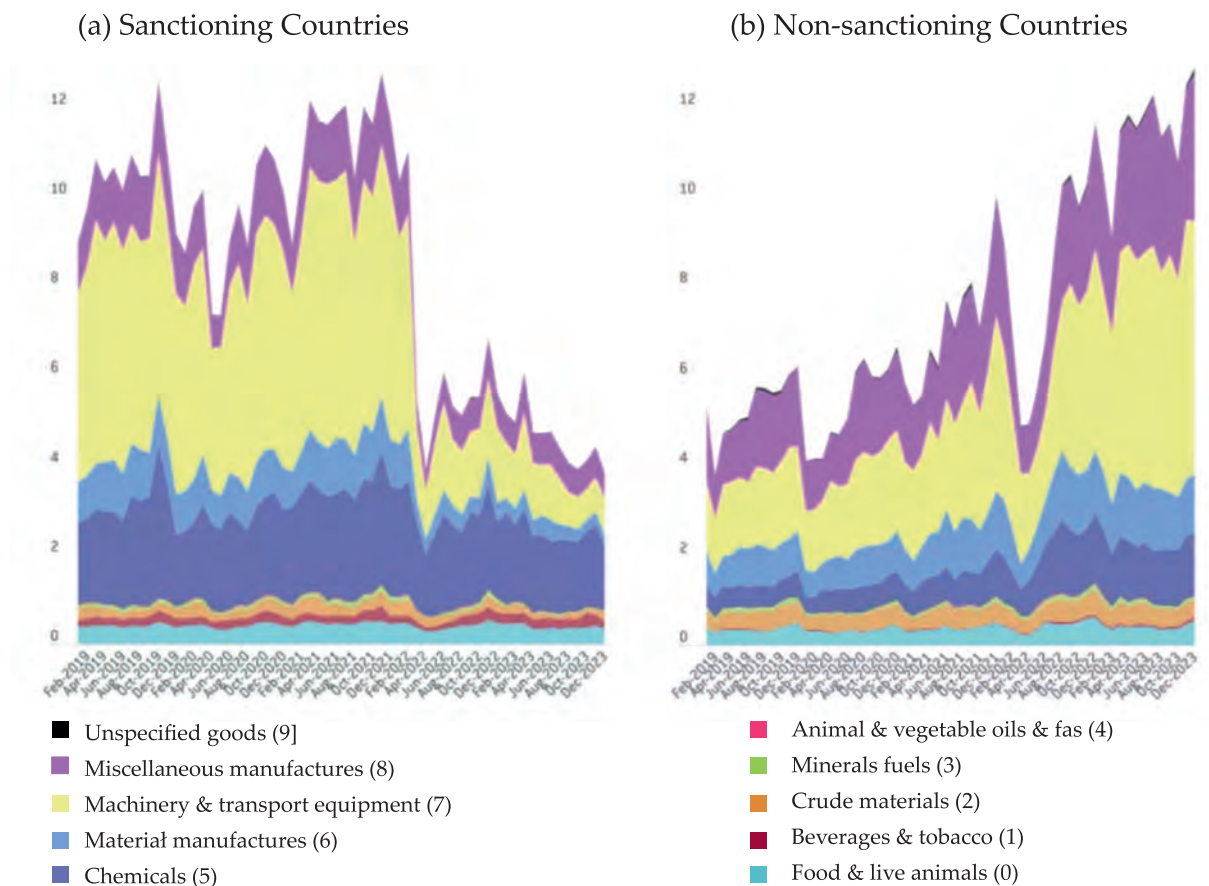
²⁶ T. Pastucha, "Russia's 'Shadow Fleet' on Course to Circumvent Western Sanctions" *PISM Bulletin*, No. 49 (2357), 29 March 2024.

²⁷ F. Rudnik, "Gazprom in 2023: exports to Europe stabilise, China's importance grows," Centre for Eastern Studies, 2 February 2024.

²⁸ According to Chinese customs data, the deliveries reached ca. 8.3 million tonnes, a 3% year-on-year growth. Due to lower prices, the value of trade decreased slightly from around \$5.2 billion in 2023 to around \$5 billion in 2024.

machinery) and the military industry. The disruptions of Russian supply chains by Western sanctions caused a collapse in many sectors of the economy, for example, automotive, in which production was down by 68% year on year in December 2022, air transport where out-of-service aircraft had to be used as a source of spare parts, electronics, and pharmaceuticals. EU exports to Russia fell from around 4% of extra-Community exports in 2021 to just over 1% in Q2 2024²⁹ and total exports from countries that imposed sanctions—the EU members, Japan, Norway, South Korea, Switzerland, the UK, and the U.S.—fell from around \$10 billion per month to less than \$5 billion.³⁰ This was partially offset by an increase in Chinese exports to the Russian Federation, which in 2023 were 67% higher than in 2021 and accounted for 38% of total Russian imports.

FIG. 3. THE COMPOSITION OF EXPORTS TO RUSSIA FROM SANCTIONING AND NON-SANCTIONING COUNTRIES, \$ BILLIONS, JANUARY 2019 - DECEMBER 2023



Source: Z. Darvis, L.L. Moffat, C. McCaffrey, "Emerging countries have replaced most of Russia's lost trade with advanced economies," Bruegel, 21 March 2024, bruegel.org.

China's role in Russian foreign trade is not limited to a quantitative stabilisation, as Chinese imports allow the Russian Federation to at least partially mitigate the consequences of its lack of access to specific Western products and technologies. After a short-lived slump of about six months after the full-scale invasion of Ukraine, Russian imports from China began to grow rapidly in categories such as data-processing machinery, telecommunications equipment, electrical machinery (including semiconductors), and precision instruments, and remain

²⁹ EU trade with Russia - latest developments - Statistics Explained, Eurostat

³⁰ Z. Darvas, L.L. Moffat, C. McCaffrey, "Emerging countries have replaced most of Russia's lost trade with advanced economies," Bruegel, 21 March 2024; Russian foreign trade tracker, Bruegel

today at levels 50-100% higher than before the war began. A general substitution of imports from countries that introduced sanctions by imports from countries that did not (notably China, India, Turkey, Brazil, and Kazakhstan) is also evident, with Russian trade with China accounting for 75-80% of the total value. Russian imports of industrial machinery transport equipment from these countries have grown dynamically. These are categories where the decline in imports from the sanctioned countries analysed is particularly visible (see Fig. 3).³¹ The surge in Chinese exports of industrial machinery to Russia is confirmed by statistics specifically for that country.³² The substitution of imports from the G7 countries by Chinese imports is also confirmed by the structure of growing Chinese exports to Russia, which in 2023 was dominated by machinery, transport equipment, clothing, raw materials, chemicals, plastics, and rubber.

About half of Russia's imports of Chinese products are consumer goods. Russian consumers are buying significantly more Chinese cars, imports of which increased by 900% between 2019 and 2023³³ and now account for around half of the vehicles sold in Russia. Due to the withdrawal of Western companies from the Russian market, the share of Chinese brands in white goods or consumer electronics has generally increased. Imports of consumer products and the semi-finished products and machinery necessary for their manufacture helped limit the impact of sanctions. It caused a slowdown in the primitivisation of production, as Chinese products and production technologies are more advanced than Russian ones, so even if they are not on par with previously imported Western solutions in certain areas, the difference is smaller than between Russian and Western products. As a result of low prices and virtually zero inflation in China, trade in consumer goods has helped to curb the Russian acute inflation, which reached almost 18% in the first months after the invasion and is currently at almost 10%, despite the effect of a high base and interest rates at around 20%. Slowing down price growth is beneficial for the Russian government as it reduces the risk of social unrest for economic reasons and, as a result, allows it to allocate fewer resources to domestic needs and further increase funding for the invasion of Ukraine and internal security in order to strengthen the position of the current regime. This is reflected in the structure of the Russian budget for 2025, in which defence and internal security spending has generally risen to record levels (the military budget will be 6.2% of GDP, the highest since the collapse of the USSR), while spending on social policy, education, and health is increasing minimal or even being reduced.³⁴

China's Technological Support for the Russian Defence Sector. Increased imports of industrial machinery, raw materials, and plastics indicate that Chinese imports are also used extensively by Russian manufacturing companies. Given the growing role of the arms industry in the Russian economy, it is extremely unlikely that it is not fuelled by Chinese imports. Of great importance for the situation on the frontline are the supplies of semiconductors, which have at least doubled since the beginning of the war and are used in Russian arms production. According to the Ukrainian side, electronic components from China have been appearing in Russian weapons (missiles, tanks, drones) since at least 2023. According to a study by the Kyiv School of Economics, China also brokers the sale of Western sanctioned electronic components to Russia.³⁵ Russian imports of trucks with a gross weight over

³¹ *Ibidem*.

³² Chinese Machine Tools Serve as Russia's Safety Net - The Jamestown Foundation,

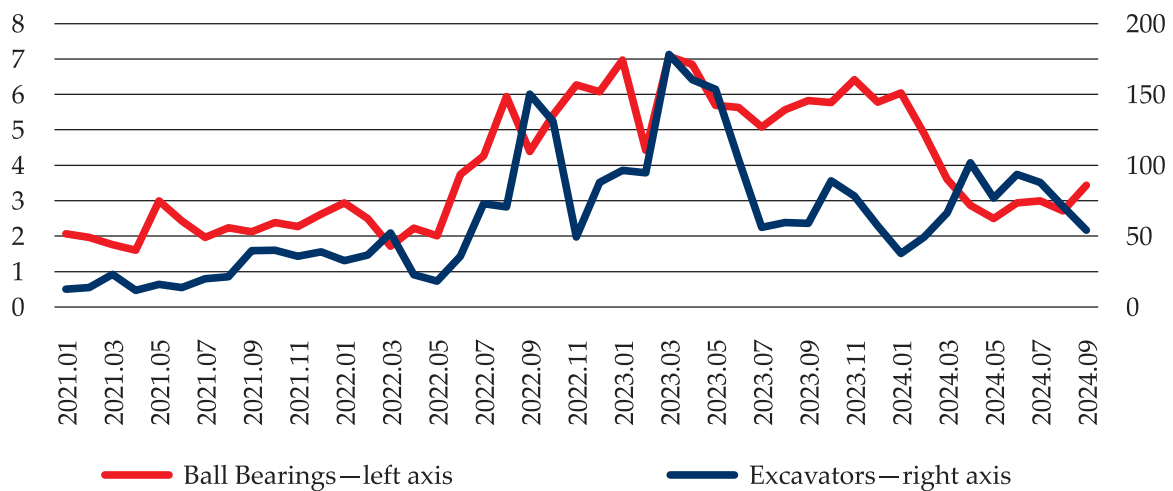
³³ N. Graham, "Chinese exports have replaced the EU as the lifeline of Russia's economy," Atlantic Council, 22 February 2024.

³⁴ "Russia's 2025-2027 Budget: Record Military Spending and Tax Reforms", Odessa Journal.

³⁵ O. Bilousova, O. Gribanovskiy, B. Hilgenstock, et al, "Russia's Military Capacity and the Role of Imported Components," Kyiv School of Economics Institute, 19 June 2023.

20 tonnes from China have increased significantly, from 500-800 per month before the invasion to more than 6,000 at peak times (e.g., April 2023)³⁶ Although theoretically civilian, these vehicles can be used for military logistics. Chinese earthmoving equipment (excavators and front-shovel loaders) were probably used for the construction of Russian fortifications in Ukraine as part of the so-called Surovikin line. This is indicated by a surge in excavator imports, almost eightfold between the minimum in May 2022 and the maximum in September of that year, and an approximately threefold increase in front shovel loader imports between autumn 2022 and late spring 2023, that is, also in winter when construction activity is relatively low. Russian imports of ball bearings from China, including those made by third countries, have also increased several times. These are used in, among other things, the production of tanks and have therefore been subject to Western sanctions³⁷ (see Fig. 4). The increasing imports from China therefore leads to a reduction in the effectiveness of the sanctions and an increase in the production capacity of Russian armaments plants. Publicly available U.S. intelligence information also confirms that aircraft parts, navigation equipment, and radar components with possible military applications were supplied from China to Russia. There is also information about the use of Chinese civilian drones by the Russian armed forces. The actual scale of Chinese aid to Russia in terms of dual-use goods is difficult to estimate, as some of it is shipped via third countries, including Central Asian countries, the South Caucasus, or Turkey, but even according to the Chinese customs administration it has increased by several dozen percent.³⁸ The problem of Chinese support for the Russian military seems to be getting worse: recently, the EU declared that it has evidence of armed drone deliveries by Chinese companies to the Russian Federation.³⁹ If these reports are confirmed, this would represent a change in China's policy of not supplying Russia with "lethal weapons" and should be considered a direct threat to European security and an escalation on the part of China.

FIG 4. EXPORTS OF EXCAVATORS AND BALL BEARINGS FROM CHINA TO RUSSIA (USD MILLIONS)



Source: Own compilation based on data from the Chinese customs administration.

³⁶ M. Garlauskas, J. Webster, E. C. Verges, "China's support for Russia has been hindering Ukraine's counteroffensive," Atlantic Council, 15 November 2023.

³⁷ *Ibidem*.

³⁸ N. Sher, "Behind the Scenes: China's Increasing Role in Russia's Defense Industry," Carnegie Russia Eurasia Center, Carnegie Endowment for International Peace, 06 May 2024.

³⁹ F. Bermingham, "EU has 'conclusive' proof of armed drones for Russia being made in China: sources," South China Morning Post, 15 November 2024.

China's Technology Support for the Russian Extractive Sector. Chinese technological support also goes to sanctioned companies in the Russian extractive sector, which was heavily dependent on leading Western solutions prior to the invasion of Ukraine. Due to sanctions on the export of technology for LNG production to Russia, it was necessary to find a partner to replace Western suppliers from the U.S., France, Germany, and others, in the Arctic LNG 2 project. Although the project was already partially completed and much of the equipment had been purchased, it was necessary to acquire, among other things, gas turbines to power the plant, which were eventually supplied by China's Harbin Guanghan Gas Turbine Company. The power-generating modules were also supplied by Chinese companies (Wison New Energies and its subsidiary, Zhoushan Wison Offshore & Marine Limited), which attempted to conceal their involvement.⁴⁰ This assistance enabled the project to be completed. With the increasing importance of LNG in the Russian gas trade, this type of support may contribute to the health of the Russian budget and, in effect, the financing of the aggression against Ukraine.

The Role of the Yuan in the Russian Economy. A problem for Russia in the aftermath of the sanctions has also been the impediment to transactions in the U.S. dollar, especially those related to the circumvention of sanctions. Prior to the invasion, Russian foreign trade was based primarily on the dollar, in which commodity prices are set on world markets and which remains the only global currency.⁴¹ With the reorientation of the Russian economy, especially foreign trade, towards relations with China, and the increasing difficulty of using the dollar, the role of the Chinese yuan has fundamentally increased. As recently as July 2022, the value of trading in the USD/RUB, EUR/RUB and USD/EUR currency pairs on the Moscow Exchange reached almost RUB 400 billion on some days, while trading in the RUB/CNY pair⁴² remained below the RUB 100 billion level (see Fig. 5). On the OTC market, trade in the RUB/CNY pair was almost absent until January 2022, while the USD/RUB, EUR/RUB, and EUR/USD pairs accounted for more than 95% of the value of transactions (according to Bank of Russia data⁴³). This reflected the situation in Russia's international trade in which the currencies of countries qualified as "unfriendly" and the Russian rouble in January 2022 accounted for almost 100% of settlements⁴⁴ (see Figs. 6 and 7). This situation has changed fundamentally. Following the sanctions imposed on the Moscow Exchange by the U.S. authorities in June 2024, the yuan became the main currency in exchange trading, being a party to almost 100% of transactions and overtaking the dollar in this respect⁴⁵ as early as 2023 (see Fig. 8). In OTC trading, as of June 2024, the RUB/CNY pair accounted for more than 30% of the value, although this is still less than the RUB/USD pair (around 40%)⁴⁶ (see Fig. 9). The yuan has also become a key currency in Russian international trade—by the end of 2023, its share in the structure of Russian imports and exports exceeded 35%⁴⁷ (see Fig. 7). According to the Russian side, more

⁴⁰ "Arctic LNG 2: The litmus test for sanctions against Russian LNG", Oxford Institute for Energy Studies.

⁴¹ P. Dzierzanowski, "U.S. Dollar to Maintain Position as the Leading Global Currency" *PISM Bulletin*, No. 23 (2331) 14 February 2024.

⁴² USD–U.S. dollar, RUB–Russian rouble, EUR–euro, CNY–Chinese yuan.

⁴³ orfr_2023-05.pdf; Май 2023 ОБЗОР РИСКОВ ФИНАНСОВЫХ РЫНКОВ, Central Bank of the Russian Federation

⁴⁴ ORFR_2024-06.pdf, Июнь 2024 ОБЗОР РИСКОВ ФИНАНСОВЫХ РЫНКОВ, Central Bank of the Russian Federation

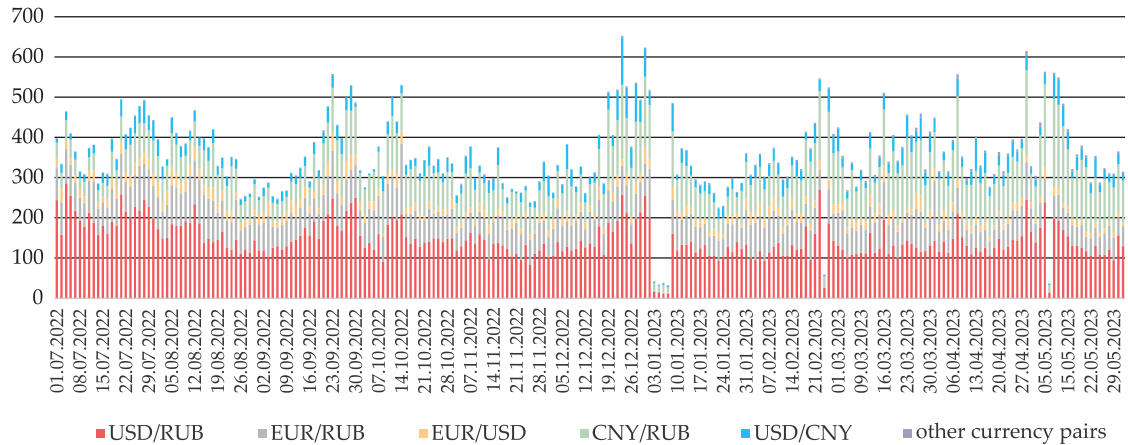
⁴⁵ Kommersant, Год по юаньскому календарю, 15.01.2024

⁴⁶ ORFR_2024-06.pdf, Июнь 2024 ОБЗОР РИСКОВ ФИНАНСОВЫХ РЫНКОВ, Central Bank of the Russian Federation

⁴⁷ orfr_2024-01.pdf, Январь 2024 ОБЗОР РИСКОВ ФИНАНСОВЫХ РЫНКОВ, Central Bank of the Russian Federation

than 90% of trade between China and the Russian Federation is now settled in their national currencies, bypassing the dollar.⁴⁸

FIG 5. TRADING VOLUME OF SELECTED PAIRED CURRENCIES (JANUARY 2022 – MAY 2023, RUB BILLIONS)



Source: О"бзор рисков финансовых рынков," no. 5 (74), May 2023, Центральный банк Российской Федерации, www.cbr.ru.

FIG. 6. RUSSIA'S TOTAL EXPORTS BY VALUE AND THE SHARE OF YUAN IN ITS STRUCTURE

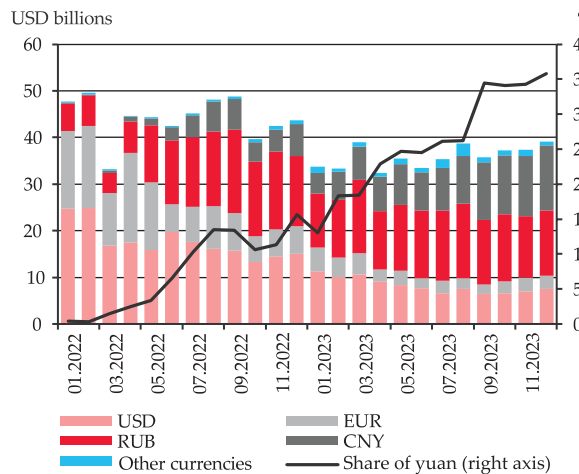
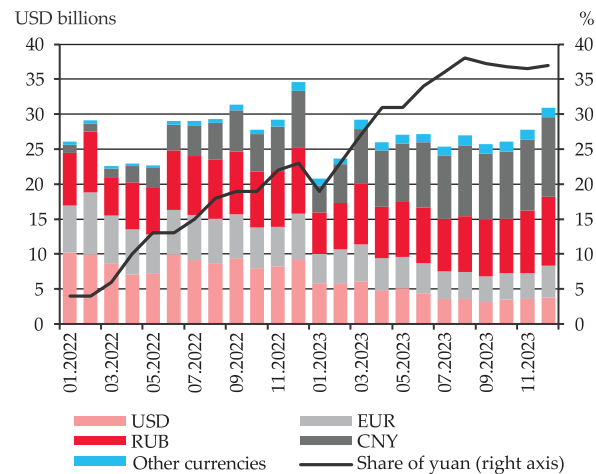


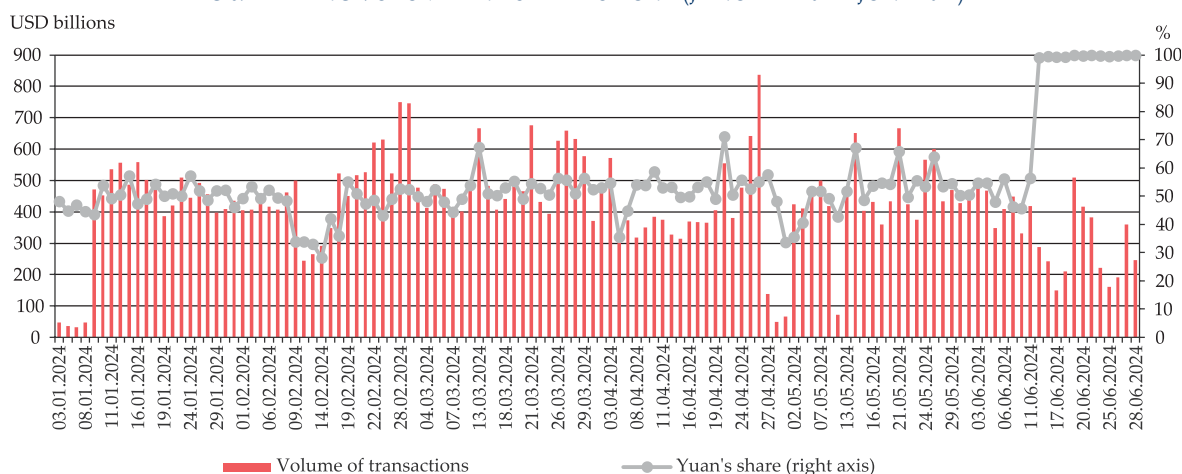
FIG. 7. RUSSIA'S TOTAL IMPORTS BY VALUE AND THE SHARE OF YUAN IN ITS STRUCTURE



Źródło: Обзор рисков финансовых рынков, nr 1 (82), styczeń 2024, Центральный банк Российской Федерации, www.cbr.ru.

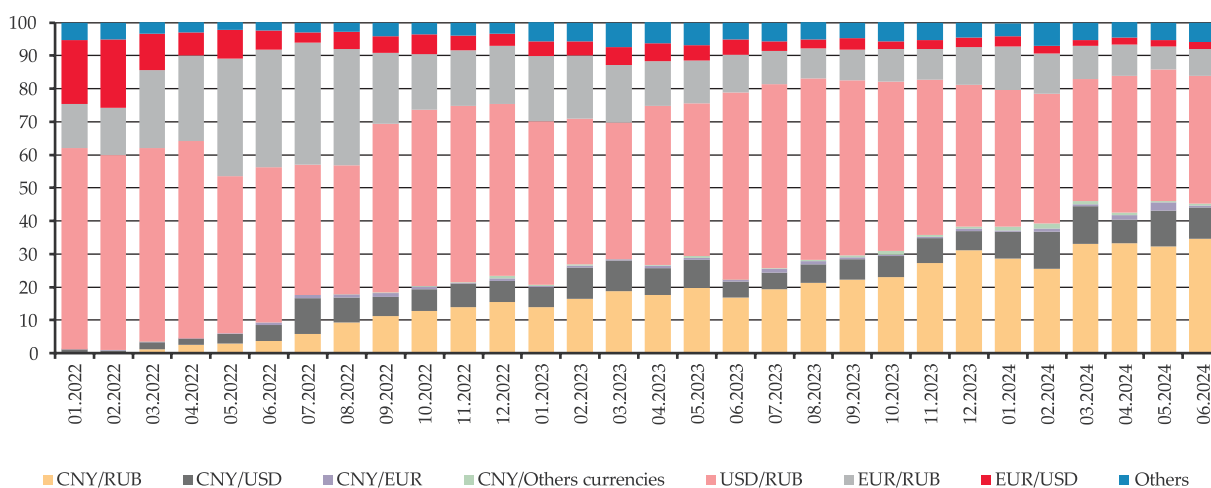
⁴⁸ TASS, "Dollar almost completely gone from Russia-China trade relations - Lavrov," 22 April 2024.

FIG 8. TRADING VOLUME AND SHARE OF CNY (JANUARY 2024 – JUNE 2024)



Źródło: "Обзор рисков финансовых рынков," no. 6 (87), June 2024, Центральный банк Российской Федерации, www.cbr.ru

FIG 9. SHARE OF CURRENCY PAIRS IN THE TRADING VOLUME OF THE OTC MARKET (JANUARY 2022 – JUNE 2024).



Source: "Обзор рисков финансовых рынков", no. 6 (87), June 2024, Центральный банк Российской Федерации, www.cbr.ru.

Although the Russian Federation uses the yuan in trade with China, it will not solve Russia's problems in trade with third countries. Due to political and economic conditions (e.g., weak property protections in China, the large role of the authoritarian state in the economy and financial markets, political control of the exchange rate, control of capital and investment flows, low domestic consumption, lack of willingness to accept trade surpluses of partners), the yuan has no prospects of becoming a real global currency and replacing the U.S. dollar. Any increase in its share of international trade will therefore be derived from political decisions and not economically optimal. There is currently no indication of extensive use of the yuan by the Russian Federation in trade with partners other than China. For a brief period in 2023, the Russian authorities tried to force payments for oil supplied to India in the Chinese currency, but this was met with a negative response from the Indian government, which controls many of the refineries in India, resulting in a return to settlements in Indian rupees (INR).

The Role of BRICS+. Although BRICS+ is not a coherent group with the potential to form a single economic bloc,⁴⁹ it remains an important foreign policy instrument for China and Russia. The recent increase in the number of participants and plans for further expansion indicate a move towards a change in the group's concept of cooperation. Ambitious joint actions are highly unlikely to be undertaken due to the divergent political interests and economic characteristics of the participants. With further expansions, the format will eventually lose its capacity for decisive action, but will increase its usefulness as a forum for discussion where "coalitions of the willing" can be formed and agreements worked out in smaller groups, probably with the participation of China, which dominates the format and will remain a crucial partner for any BRICS+ participant.⁵⁰

The presence of countries long subject to sanctions (such as Iran) in BRICS+ or the participation in the recent summit of representatives of such countries (most notably Venezuela) indicates that it could be used to coordinate the cooperation of countries unfriendly to the West, including Russia. Plans to create its own currency or payment system would be expected to lead to a reduction in the use of the dollar by the U.S. as a political instrument. Particularly relevant in this context is China's technological involvement in the development of the mBridge system, designed to allow direct settlements between the central banks of the countries using it (and thus allow commercial banks to bypass the so-called correspondent banks system in the U.S.). The Bank for International Settlements has recently withdrawn from the project.⁵¹ The Russian Federation's bilateral relations with other members of the format also have important security (e.g., drone deliveries from Iran) or economic (oil trade with India) dimensions. As such, China's continued push for BRICS+ expansion will help to at least partially break Russia's international isolation and, in turn, reduce the effectiveness of Western economic pressure.

⁴⁹ P. Dzierżanowski, "BRICS+ Grows but Economic Cooperation Remains Limited," *PISM Bulletin*, No. 90 (2398), 24 June 2024.

⁵⁰ J. Szczudlik, "BRICS Members Should Heed Lessons From China's '16+1' Platform," *The Diplomat*, 31 October 2024.

⁵¹ "Putin's plan to dethrone the dollar," *The Economist*, 20 October 2024.

RESPONSES: THE WEST'S AND CHINA'S

The growing awareness of China's role in supporting the Russian economy and war effort has resulted in increased economic pressure on China by states opposing the Russian aggression. The Chinese economy remains strongly linked to the West, providing certain leverage. According to Chinese data, even though trade with Russia has grown dynamically to around RMB 1.7 trillion in 2023, relations with countries opposing Russian aggression are much more important, with trade with the U.S., EU, Canada, and UK alone exceeding RMB 10 trillion. Despite the growth of the Chinese economy, it does not yet have the potential for self-sufficiency (although it is trying to achieve it), and large companies cannot afford to be cut off from Western economies, which act as markets and suppliers of technology (albeit increasingly less so) and financial services. So-called secondary sanctions, those imposed on entities that help circumvent primary sanctions, for example, by supplying specific products to the Russian Federation or cooperating with sanctioned companies, have become an important instrument of the West in its relations with China. So far, the U.S. actions were most significant in this area, but the EU's restrictions having important qualities of secondary sanctions can also play a role in discouraging Chinese entities from cooperation with Russia.⁵²

Action Against China's Financial Sector. The financial sector is particularly vulnerable to secondary sanctions. Financial institutions from third countries, including China, that handle dollar transactions do so in practice primarily through accounts with U.S. banks, acting in this case as so-called correspondent banks. Due to the organisation of the international payment system, there is currently no effective alternative, although there are reports of new solutions being developed.⁵³ The imposition of sanctions on a foreign financial institution, such as blocking it from using U.S. banks, effectively prevents it from clearing in U.S. dollars and makes it much less useful for business customers interested in international transactions.

In December 2023, the U.S. administration created a framework for the imposition of sanctions on foreign financial institutions operating outside U.S. jurisdiction and supporting the Russian military-industrial complex, primarily in the technology, defence industry, construction, aviation, and industrial sectors.⁵⁴ Sanctions may be imposed by the Secretary of the Treasury (after consultation with other Cabinet members identified in the Executive Order) on entities transacting with sanctioned Russian entities, such as the banks VTB or Sberbank. The executive order introducing this solution does not require that the financial institution be aware of the prohibited transaction. The U.S. Treasury Department has also issued compliance recommendations related to the identification of potential sanctions violations and appropriate controls. These measures significantly increase the risk in the performance of relationships with Russian entities by financial institutions from other countries, for example, China, but also Turkey or the United Arab Emirates, and require more thorough due diligence of transactions, increasing the labour intensity of the process.

Difficulties in making payments between China and Russia have been emerging since the beginning of 2024. Due to sanctions risks, some Chinese banks stopped processing payments from Russia. Difficulties intensified in June after the U.S. imposed sanctions on a further 300 entities, including the Moscow Stock Exchange and Chinese industrial companies, and the possibility of sanctioning foreign financial institutions was extended. The U.S. authorities explicitly indicated on this occasion that they would seek

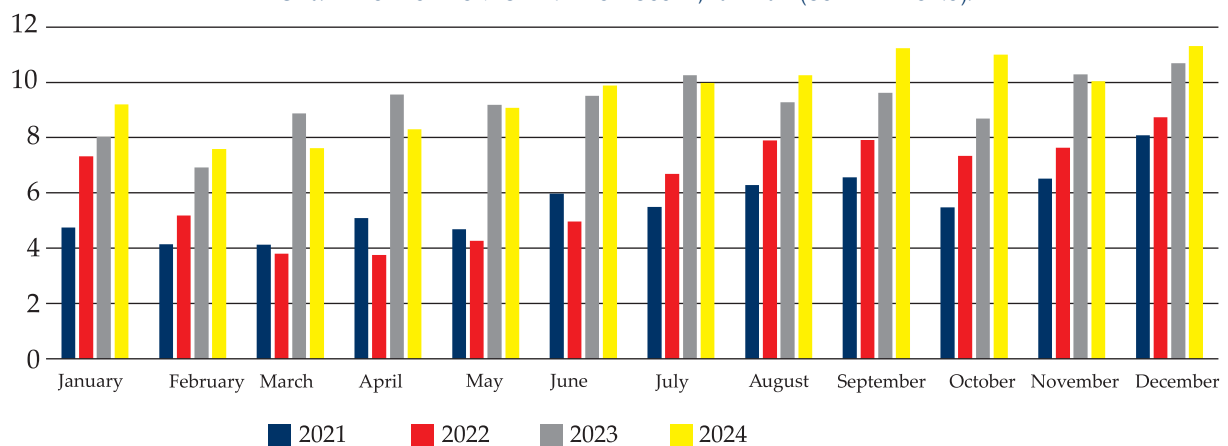
⁵² The EU officially does not use secondary sanctions, but in reality entities from the PRC and Hong Kong were targeted in the last sanctions packages linked to Russian aggression against Ukraine.

⁵³ A. Demarais, "Russia's Plans to Replace the Dollar Are Going Nowhere," *Foreign Policy*, 18 November 2024.

⁵⁴ Executive Order 14114 of December 22, 2023, <https://ofac.treasury.gov/media/932441/download?inline>.

to increase risks for foreign financial institutions transacting with the Russian Federation.⁵⁵ According to Russian media, after the introduction of this sanctions package, up to 80% of yuan payments were being returned to the sender, with payment delays reaching many weeks, causing trade uncertainty and exchange rate losses.⁵⁶ There is no indication that the reduction in Chinese banks' cooperation with Russia was a decision by the Chinese authorities, rather it is likely to be an individual bank reaction to the sanctions risk. Payment problems necessitate the use of intermediaries who, however, either withdraw from transactions with Russia or raise their fees due to the tightening of sanctions policy. This forces the Chinese side to create "burner banks" or use small banks isolated from the rest of the financial system to carry out transactions with Russia, as has already been noted by the G7.⁵⁷ The Russian authorities have acknowledged the effectiveness of Western sanctions in this regard and have allowed greater use of non-standard solutions, including cryptocurrencies, in foreign trade.⁵⁸ Media reports also mention consideration of the possibility of barter trade.⁵⁹ Difficulties in payments are likely to have contributed to a halt in the growth of Chinese exports to the Russian Federation in the first months of 2024, despite the strong year-on-year growth in 2022 (see Fig. 10).

FIG 10. EXPORTS FROM CHINA TO RUSSIA, 2022-2024 (USD BILLIONS).



Source: Own compilation based on data from the Chinese customs administration.

Energy Resources. Chinese companies also responded to Western pressure to stop support for Russian projects in the energy sector. The U.S. imposed sanctions on the Arctic LNG 2 project and related LNG vessels. A Chinese supplier (Wison New Energies) then took steps to conceal its involvement in the project by selling shares in a subsidiary and attempting to conceal the supply of equipment,⁶⁰ and has so far not been placed on sanctions lists. The U.S. authorities imposed a number of sanctions on companies linked to the project, including a Chinese-registered subsidiary of Russia's Novatek (the project's majority shareholder) to broker gas sales from Arctic LNG 2 to China. The pressure against the project was comprehensive and

⁵⁵ "As Russia Completes Transition to a Full War Economy, Treasury Takes Sweeping Aim at Foundational Financial Infrastructure and Access to Third Country Support," U.S. Department of the Treasury.

⁵⁶ Kommersant, Около 80% платежей в юанях возвращаются обратно в Россию, 29 July 2024.

⁵⁷ R. Standish, "G7 Takes Aim At Small Chinese Banks To Combat Russian War Economy," Radio Free Europe Radio Liberty, 12 June 2024.

⁵⁸ "Russian regulator encourages use of crypto to counter sanctions," Reuters, 3 July 2024.

⁵⁹ A. Lee, "China, Russia could skirt US sanctions with barter-trade deals that 'break with tradition'," South China Morning Post, 13 August 2024.

⁶⁰ M. Humpert, "Chinese Wison New Energies Ceases Work on Russia's Arctic LNG 2 Project," *High North News*, 24 June 2024; M. Humpert, "Inside the Elaborate Scheme to Transport a Chinese Power Plant to Russia's Arctic Undetected," *High North News*, 01 October 2024.

also included the vessels transporting gas from the facility and their owners.⁶¹ Despite the start of production and attempts to export gas eastwards, with China and India being key potential customers in Asia, the product from Arctic LNG 2 found no buyers, even at a reduced price. As a result, its operations were halted in October 2024.

Technology and Dual-Use Products. Secondary sanctions were also imposed on Chinese companies involved in the supply of sanctioned goods to Russia and cooperation with Russian companies. In August 2024, a number of companies from China and the Hong Kong Special Administrative Region involved in the supply of sanctioned goods to the Russian Federation were targeted by the U.S. authorities. These goods included industrial machinery supporting Russian industry, electronic components (used for, among others, the production of drones), inputs for Russian aerospace and naval manufacturing companies (including the Russian navy), and machinery for the production of automotive parts with potential military applications. Chinese and Hong Kong companies working with sanctioned Russian entities were also placed on U.S. sanctions lists in October 2024.⁶² Mainland Chinese companies supporting the Russian defence industrial complex through the supply of sanctioned goods were sanctioned by the EU for the first time under the 13th and 14th sanctions packages of February and June 2024, respectively.⁶³ The 14th package included Chang Guang Satellite Technology Co, Ltd. and the China HEAD Aerospace Technology Company, which provided the Russian side (Wagner Group) with satellite imagery of the combat zone in Ukraine. However, many of the Chinese and Hong Kong entities included on the U.S. sanctions lists were included in the European lists with long delays or not at all.

Sanctions on Chinese and Hong Kong industrial and commercial companies have not had the widespread freezing effect that they have had on companies in the financial sector. Of the companies included in the Yale University team's database tracking foreign businesses' withdrawal from Russia, the vast majority tried to buy time or dig in and do not take the war in Ukraine into account in the consequences, remaining present on the Russian market.⁶⁴ Recently, the Wanhua Chemical Group, the largest producer of isocyanates (necessary for the manufacture of foams, sealants, pipes or automotive parts, among other things) in China, withdrew from cooperation with Russian customers, causing problems for Russian companies.⁶⁵ While this will not markedly influence the outcome of the war, it shows that the withdrawal of specific companies from the Russian market can cause difficulties for the Russian economy.

Another problem in countering sanctions violations by Chinese and Hong-Kong companies is their characteristics. The majority of them are small companies, employing a few people and making deliveries totalling a few million dollars (most of the companies sanctioned by the U.S. authorities were placed on sanctions lists due to such small-scale violations). The possibility of using two jurisdictions (Chinese and Hong Kong), the low transparency of local corporate records and the need to analyse documentation in Mandarin and Cantonese make it easier to conceal transactions from the relevant services of Western countries. Moreover, when sanctions are imposed on a legal person, it is not difficult to set up a new company to

⁶¹ "New Measures to Degrade Russia's Wartime Economy," United States Department of State.

⁶² "New Measures Targeting Third-Country Enablers Supporting Russia's Military-Industrial Base," United States Department of State.

⁶³ *COUNCIL REGULATION (EU) 2024/1745 of 24 June 2024 amending Regulation (EU) No 833/2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine.*

⁶⁴ Yale CELI List of Companies.

⁶⁵ I. Trusevich, "Russia. Panic in the industry. China halted supply of one component," *Rzeczpospolita*, 26 August 2024.

continue operations. Thus, there is great potential for the circumvention of sanctions through small-scale dispersed activities, and it is very difficult to counter them through the imposition of secondary sanctions.

Concealment of Chinese involvement. There is a far-reaching disparity between the Chinese message of the standard and normal nature of cooperation with Russia and the real relationship between Russia's conduct of hostilities and Chinese aid. Hence (as well as, to some extent, out of fear of secondary sanctions from the U.S. and of EU restrictions having important qualities of secondary sanctions), China attempts to camouflage this cooperation, limiting the participation of state actors (e.g., banks) in favour of private companies, local actors or informal economy operators. In its economic cooperation with Russia, China thus exploits the subordination of private actors to the political decisions of state authorities and party institutions. Supervision and control is both statutory and formal (in the context of, for example, the transfer of information and data) but, above all, indirect, resulting from the functioning of the CCP's cell leadership bodies in companies that are superior to them. This allows China to skilfully camouflage its involvement in Russia's assistance, limiting its state dimension (e.g., in the context of Chinese banks providing financial assistance to projects), and intensifying the participation of private companies in the export of needed products to Russia and support for the war economy, purchases of Russian energy resources, and technological cooperation between actors from both countries.

CONCLUSIONS AND OUTLOOK

Supporting the Russian economy is economically beneficial for China due to improved access to energy resources from the Russian Federation, as well as its market for manufactured goods. The Russian aggression against Ukraine distracts the world from the development of China's offensive capabilities and its actions in Asia (e.g., towards Taiwan, or in the South China Sea). At the same time, however, the West is a much more important economic partner for China than the Russian Federation. China's actions indicate that it is unlikely to support Russia in the near future to an extent that could seriously damage the Chinese relationship with the West. Consequently, the pressure exerted by the West on China is proving effective in many cases and should continue. However, in the event of a deterioration in the West's political and economic relations with China, greater support for Russia is possible, especially as China is constantly developing capabilities and potential to reduce its dependence on the West (e.g., in the field of modern industry, including technology with military applications), precisely because of its desire to change the international order and its global and regional rivalry with the U.S., carried out in cooperation with Russia.

The solutions politically and economically favoured by China would probably be total non-response or even open support for the Russian Federation. However, pursuing such a policy remains constrained by the costs it may impose on economic relations with partners more important to the future of the Chinese economy, primarily the U.S. and the EU. China's economic cooperation with Russia is mainly developing in areas where there is no stark conflict between political and economic interests, whether due to Western passivity or the possibility of concealing Chinese involvement. The great importance of economic issues was evident in the example of Chinese financial institutions refusing to handle trade with Russia throughout 2024. Also, some Chinese manufacturing companies, in the face of direct sanctions pressure, are choosing to limit their relationships with Russian customers, prioritising relationships with Western customers.

Dependent on exports, but also access to the global financial system and Western technology, the Chinese development model requires access to markets for manufactured goods, especially in the EU and the U.S., and hence, China's willingness to tactically signal a reduction in relations with Russia in certain dimensions sanctioned by the West. China's concerns about relations with the West may be growing with the second presidency of Donald Trump. Therefore, the Chinese authorities emphasise in their official messaging the lack of arms or ammunition supplies to Russia (without, however, commenting on similar assistance from their ally North Korea⁶⁶) as evidence of the stabilising nature of Chinese economic cooperation with the Russian Federation. At the same time, it is apparent that sanctions risks are being seriously considered by Chinese companies when working with Russian entities, such as the Wanhua Chemical Group, which decided to withdraw from the Russian market. It is important that sanctions remain carefully calibrated, which has delivered certain successes so far, to inhibit the development of sectors that in China's optics are expected to provide a competitive advantage vis-à-vis the West (e.g., robotics).

At the same time, however, since February 2022 China has helped Russia keep its economy functioning (including adaptation to the war effort) despite the sharp break in ties with the

⁶⁶ Questions about the involvement of North Korean soldiers in the war in Ukraine are regularly (almost daily) answered by the spokesperson for the Chinese Foreign Ministry with a reference to China's official position on the war in Ukraine, without a concrete answer.

West by accepting Russian energy resources exports and supplying it with industrial goods. Raw material exports to China have helped stabilise the Russian budget (and therefore support the Russian war effort) and the supply of industrial products has limited the impact of Western actions on Russian society and arms production. This has reduced the effectiveness of the West's response to aggression and enabled Russia to continue a war that threatens the security of Europe and will be important in negotiations to end it, leaving Russia with greater room for manoeuvre resulting from its improved economic and military situation. This means that, despite not being directly involved in the war, China is one of the key states for its resolution and is deeply involved on the side of the aggressor, which should be reflected in its perception by states respecting international law.

For China, cooperation with Russia is an important part of gathering experience in the context of possible future Western sanctions on China after a possible decision on its own military involvement in the Asia-Pacific. The solutions being worked out will be important in the financial field, especially if attempts to develop alternative payment systems, circumventing the need to use the dollar and correspondent banks in the U.S., are successful. The concept of hedging against the effects of dependence on cooperation with the West when tensions rise has been a dominant feature of China's economic policy in recent years, including in the context of technologies relating to energy transition, semiconductors, robotics, or other high-tech solutions. Supporting Russia in reducing the effects of Western sanctions is a valuable area for China to gather experience in this area, while gradually reducing its dependence on cooperation with the West.

China is not in a position to completely replace the West as a partner for the Russian Federation, and the degradation of the Russian economy will continue, but China's actions are slowing down this process and damaging the security of the EU and NATO's Eastern Flank, including Poland. China's support will be important to stabilise the Russian economy at a level that will allow the aggression to continue and avoid social unrest for a longer period. The continuation of the war and the deterioration of the security situation in Europe is therefore dependent on China's actions. It is advisable to approach relations with China in a holistic manner, which means taking into account both economic interests (including China's potential as a market for Polish and EU products and a target country for investment) and security issues. It is not advisable to be guided by short-term economic interests.

Although China is currently by far the dominant partner in relations with Russia, the balance of power may change in the long term. If China does not solve its internal economic problems⁶⁷ and Russia ends the war and reduces military spending, the disparity between the partners is likely to narrow. However, this will still not lead to a balanced relationship between the two. In the future, it will also be necessary to monitor the improvement of Sino-Russian methods of circumventing sanctions, such as work on a payment system to bypass the system of correspondent banks. Its operationalisation would cripple one of the West's most effective tools for influencing Sino-Russian economic relations and, as a result, might cause a spike of aggressive actions by the two countries, including in the security sphere.

Declarations by the EU and especially the U.S. (confirming advanced deliveries from China to Russia of not only dual-use items anymore, but also military material) regarding severe sanctions are taken seriously by China, but without much faith in their implementation, especially by the EU. The possible failure of the European Union to respond to reports of direct

⁶⁷ P. Dzierżanowski, D. Wnukowski, "China's Economic Problems Worsen: the Domestic and International Aspects" *PISM Bulletin*, No. 125 (2244), 08 September 2023.

assistance to Russia in the supply of military drones will exacerbate this. The fact that some of the goods with applications in the Russian war economy or used directly by the Russian armed forces are not covered by sanctions also remains a problem. It is advisable to respond more strongly to the supply of not only “lethal weapons” or typical dual-use items but also goods intended for civilian use that are in practice widely used by the military, such as earthmoving machinery or the largest trucks. A tool that also needs to be improved within the EU and its Member States is sanctions on entities from PRC and Hong Kong, having important qualities of secondary sanctions. More active use of such measures is advisable as so far many Chinese and Hong Kong entities included on U.S. sanctions lists have been included on European lists with considerable delays or not at all.

An unused tool so far is to put pressure on China not at the micro level (individual companies) but at the macro level (the whole economy). The Chinese economy is oriented towards the production of industrial goods for export. Chinese domestic policy deliberately creates imbalances in the economy. The control of the yuan exchange rate (when it is undervalued), the weak social security system, the inability of many workers to benefit from public services due to the *hukou* system,⁶⁸ which restricts internal migration and makes many Chinese *de facto* irregular migrants in their own country, or the weak position of workers vis-à-vis employers lead to a low share of wages in the Chinese economy and, as a result, unnaturally low consumption.⁶⁹ Together with direct and indirect subsidies in selected sectors,⁷⁰ this leads to an imbalance between industrial production and consumption, which amount to 31% and 13% of world production and consumption, respectively.⁷¹ As a result, China is dependent on exports to the rich markets of the EU and the U.S., without which it would be impossible to maintain industrial production (and thus pay workers' wages). This is a weakness for China in its competition with the West, which can be used to pressure the Chinese authorities to reduce their support for Russia in sectors where micro-level pressure proves insufficient

At the same time, the possible launch of a trade war by the U.S., with EU support, against China would result in at least a partial loss of this opportunity to stabilise China's actions. A failed or under-scaled attempt to cut China off from Western markets could negatively affect security issues, both in the Pacific and in Europe. It would be interpreted by China as a hostile act, that would nevertheless not paralyse its ability to respond and would be seen as a sign of weakness, raising the risk of strong retaliation. In the long term, it is also possible that the Chinese economy would improve with increasing domestic consumption and China becoming a leader in modern sectors (e.g., AI, pharmaceuticals, robotics, aerospace). This would reduce the possibility of Western pressure on China and open the way for further Chinese support for aggressive Russian actions in Europe. It is therefore advisable to exert strong economic pressure and to deal with the issue of Chinese support for the war together with the problem of overproduction and imbalances in Chinese economy. It is advisable to try to tackle both problems together, which this will enable a more coherent coalition to be built between the EU and the European part of NATO (for which the key problem is Russian aggression against

⁶⁸ The system is a registry of Chinese citizens according to place of birth and prevents free movement from villages to cities. Those without a *hukou* in a particular location cannot legally avail themselves of public benefits (primarily public health and education). The Chinese authorities have been trying to reduce restrictions in recent years by facilitating the legal settlement of labour migrants from the countryside in small and medium-sized cities.

⁶⁹ P. Dzierżanowski, “China Resists Correcting Unbalanced Economy, Risking the Future of International Trade” *PISM Bulletin*, No. 186 (2996), 12 December 2024.

⁷⁰ *Register of Commission Documents*, European Commission, 10 April 2024, www.ec.europa.eu.

⁷¹ M. Pettis, “What Will It Take for China's GDP to Grow at 4-5 Percent Over the Next Decade?” *Carnegie Endowment for International Peace*, 4 December 2023, www.carnegieendowment.org.

Ukraine) and the U.S., for which China's economic actions and offensive involvement in the Asia-Pacific are particularly important.

From the EU's point of view, a more robust approach to Chinese involvement in support of the war in Ukraine would be beneficial. Delays in sanctioning the actors involved send a negative signal as to the EU's decisiveness and ability to actively counter Chinese support for the Russian Federation. They will therefore limit the possibility of a freezing effect, that is, Chinese companies withdrawing on their own from activities supporting Russia. Such behaviour will also be negatively perceived by the EU's most important partner, the U.S., and will become an important argument for the new administration to demand a new distribution of the burden of supporting Ukraine.



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