China's Global Oil Diplomacy: Benign or Hostile?

By Mamdouh G. Salameh*

Introduction

Deng Xiaoping was the inspirational architect of contemporary China, and is thus among the pole figures of the twentieth century.

Deng's advice after Tiananmen was that China should "observe developments soberly, maintain our position, meet challenges calmly, hide our capabilities and bide our time, remain free of ambition, never claim leadership. China should not attempt to be a hegemon, it should never practice power politics and it should never pose a threat to its neighbours or to world peace". These are mantras that Chinese officials continue to repeat. China's foreign policy is designed first and foremost to serve economic development, following Deng's injunction. Moreover, its rise is to be peaceful. **1** But China's peaceful rise could be marred by its huge thirst for oil and energy and having to compete with other major consumers around the world for the fast-depleting resources.

China's economy at $4.22 trillion in 2008 is the third largest in the world after the United States and Japan. **2** If current trends continue, it is set to become the second largest economy within a decade. **3** However, based on a purchasing power parity (PPP) used by the World Bank and the International Monetary Fund (IMF) as a measuring stick, China is now unambiguously the world's second-largest economy – worth $7.3 trillion compared with the U.S.'s $14.5 trillion and Japan's $5.18 trillion. **4**

In 2008, China's current account registered a $400 bn surplus, 9% of GDP. By the end of 2008 it had more than $2 trillion of foreign-exchange reserves. China is the world's second largest user of oil after the United States and also the third-largest importer of oil after the United States and Japan. Before 2010 it will be the world's largest exporter of goods. It is comfortably the world's second-largest military power.

However, China's robust economic growth and its aspiration to a superpower status would falter without oil, particularly from the Middle East. China's global oil diplomacy is, therefore, geared towards ensuring that this never happens.

China's Oil Fundamentals

China's spectacular economic growth has significantly altered its position in the global oil market. In 2008, China accounted for 9% of global oil consumption compared to 5% in 1996, whilst its share of global production only amounted to 4.6%. **5**

Against a background of dwindling proven oil reserves, China's domestic consumption has been rising at an annual rate of 9% between 1998 and 2008, while production has risen by 1.8% annually during the same period (see Table 1).

	1998	**2006**	**2007**	**2008**	**2010**	**2020**	**2030**	**1998-2030**
Production	3.21	3.68	3.74	3.80	3.14	2.88	2.44	- 24%
Consumption	4.23	7.45	7.74	8.00	9.49	13.18	16.60	+ 292%
Net imports	1.02	3.77	4.00	4.20	6.35	10.30	14.16	+1266%
Imports as % of demand	24	51	52	53	67	78	85	

Sources: BP Statistical Review of World Energy, June 2009 / International Energy Agency (IEA), World Energy Outlook, 2008 / Author's projections.

Table 1
China's Oil Production, Consumption & Net Imports, % change, (mbd) 1998-2030

The rise in consumption and in oil imports is the result of several factors, including rapid GDP growth of about 9%-10% a year over the past two decades, urbanization, improving standard of living and a sharp increase in the number of vehicles on the country's roads projected to rise from 20 million in 2004 to 60 million in 2010 and 130 million in 2020. **6** Another factor is the building of strategic oil reserves with the projected stockpiling of 35 days' imports or 153 million barrels (mb) by 2008, 50 days' imports or 445 mb by 2015 and 90 days' imports or 1017 mb by 2020. **7**

Chinese Energy Security: a Serious Concern

The growing dependence on oil imports has created an increasing sense of 'energy insecurity' among Chinese leaders. There is even concern that eventual supply shortages or sharp rises in crude oil prices could endanger economic expansion, job creation and social cohesion. Chinese leaders tend to believe that

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dependence on imported oil leads to great 'strategic vulnerability'. Moreover, the U.S. invasion of Iraq in 2003 has endangered Chinese investments in the oil sector in that country. The war on Iraq and growing U.S. hegemony in the Middle East, have made it even more urgent for China to reduce its dependence on the Arab Gulf. 8

Twenty million barrels of Gulf oil pass every day through the Strait of Hormuz between the Gulf of Oman and the Arabian Gulf).

The strait is twenty-one mile wide at its narrowest point, and the Iranian-occupied island of Abu Musa is near its entrance – manned by Iranian Revolutionary Guards reportedly equipped with Silkworm anti-ship missiles. 9 By 2020 Iran, or any committed terrorist group, would be in an even stronger position. The threat is live.

Chinese military leaders argue that China's energy problem needs to be taken 'seriously and dealt with strategically'. **10** That means less reliance on the Middle East, less transportation of oil via sea lanes policed by the U.S. navy, more capability for the Chinese navy to protect Chinese tankers and more oil brought overland by pipeline from central Asia. The American build-up of its naval base at Changi in Singapore, allowing it to patrol the Strait of Malacca between Malaysia and Indonesia, through which 80% of China's imported oil moves, is regarded with particular suspicion. The channel is 625 miles long, and less than two miles wide at its narrowest point. With India modrnizing its military facilities on the Andaman and Nicobar Islands at the northern end of the strait, China feels sandwiched in and strategically vulnerable. The president of China, Hu Jintao, has referred a number of times to what he describes as the 'Malacca dilemma'. 'Certain powers, 'he has declared, 'have all along encroached on and tried to control the navigation through the strait'. **11** There is no mistaking whom he means.

China's Oil Deplomacy

For decades the doctrine of peaceful rise has meant that China has tried to secure energy and raw materials without confronting the United States and the West. China's long-standing willingness to deal with states that the West regards pariahs is in part a practical and ideological refusal to make judgments about other countries' domestic policy. It is also in part a recognition that dealing with Sudan, Angola, Iran or Uzbekistan allows China to avoid direct confrontation with Western interests. However, the larger China has become, the sheer scale of its energy needs has forced it more and more to intrude into areas that the United States regards as its own sphere of influence. The relationship with the United States and the West in general is, therefore, becoming steadily tenser.

Examples abound. Consider China's courtship of Canada. The Chinese oil company, Sinopec, has acquired a 40% stake in Synenco Energy's $4.5 bn Northerm Lights Oil Sands project, which is expected to yield 100,000 b/d by 2010, while CNOOC has acquired 16.9% stake in MEG Energy Corporation, which operates the Christina Lake project, near McMurray. Yet only six years earlier Dick Cheney, the former US vice-president, had declared that Canada's tar sands were part of the United States' energy security.

The Chinese oil companies have also followed an aggressive investment policy in the western hemisphere – especially Venezuela, where in 2005, they committed $450 million to the development of 15 oilfields and one gas project in exchange for 100,000 b/d of oil, 3 mn t/y of fuel oil and 1.8 mn t/y of orimulsion (an alternative boiler fuel). CNPC has also been given significant oil and gas development opportunities in the country including the fields at Zumano in eastern Venezuela, which hold an estimated 400 million barrels of oil. **12**

Saudi Arabia, holder of the world's largest proven oil reserves, supplies 16% of China's oil imports and is an object of assiduous Chinese courtship – again, a direct challenge to the United States' traditional sphere of influence. For the moment Saudi Arabia knows that its long-term security and its defence interests lie with the United States but it might one day make sense for the Saudis to align themselves with a rising power like China. This reality has already begun to mean that China has diplomatic opportunities to confront the United States which were not available even five years ago.

China is now Iran's number one oil and gas importer. China's state-owned corporation, Zhuhai Zhenrong, has an agreement to import 110 million tonnes of LNG over 25 years in a deal worth $20 bn, while Sinopec has agreed to a 25-year deal worth $100 bn for 250 million tonnes of LNG as well as a 50% stake in the massive Yadavaran oilfield from which China will get 150,000 b/d for 25 years. **13**

In Sudan, China is now Sudan's largest investor with total stakes estimated at $8 bn. The state-owned CNPC owns the largest share (40%) in Sudan's biggest oil venture, the Greater Nile Petroleum Operating Company. CNPC's equity oil from the project is around 150,000 b/d. With proven reserves of 1.61 billion barrels (bb), the project is among the largest China has undertaken overseas. CNPC has been a partner in a consortium developing oil production in Sudan since the mid-1990s, and has helped build the 930-mile pipeline to the Red Sea as well as building an oil refinery close to Khartoum. It is at present constructing a $215-million export tanker terminal at Port Sudan as well as a pipeline from the oilfields to the port. **14**

Chinese activity in Africa is increasing at an exponential rate. In 1999 the value of China's trade with Africa was $2 bn; by 2005 this has grown to $40 bn and is now projected by the Chinese Ministry of Commerce to top the $100 bn mark by the end of the decade. **15**

However, it is largely the issues surrounding China's oil quest – in Africa and elsewhere – that are provoking particular concern in Western capitals. The value of some of the more recent oil contracts signed between China and Africa amounts to $13 bn and give a flavour of the extent to which Chinese oil diplomacy is picking up speed in Africa.

Any analysis of China's oil diplomacy in Africa needs to be balanced and avoid the hyperbole that has characterized some accounts. In the short term, China's trade with and investment in Africa are of assistance to the development of the continent, if for no other reason than that little investment is forthcoming from other sources. China's investment in Africa's crumbling infrastructure is needed and is welcomed by most. Partly as a result of China's interest in Africa – particularly in African oil – the continent's growth rate has increased touching 4.5% in 2008. However, when one looks at the long-term trajectory, concerns mount.

If this is the state of affairs in 2008, tension with the United States and its allies is only going to rise.

Supply Chain Vulnerability

The Chinese government views the country's dependence on imported oil as a chink in its armour that must be defended, in particular against an increasingly unilateralist U.S. that has not shied away from using its military muscle to defend its oil interests.

It has sought to do so through two initiatives. One is its 'Strings of Pearls' (SOP) policy which aims to defend the shipping lanes that are vital to its oil lifeline, namely the Straits of Hormuz and Malacca. The other initiative is to reduce its oil import dependence on the Middle East and secure most of its oil needs overland by pipeline from central Asia.

The first and westernmost pearl in the string is the deepwater port of Gwadar in Pakistan, which cost $248 mn to develop and was 80% financed by China. The port is of immense strategic location and importance being just 250 miles from the Strait of Hormuz. It also provides China with a trade route to the Central Asian republics. **16**

Besides Pakistan, China has established military security ties with Bangladesh, where it helped build a port facility at Chittagong. In Myanmar, China has helped build several ports, road and rail links from the Chinese province of Yunnan to the Bay of Bengal, and a listening post on Myanmar's Coco Islands to monitor sea traffic. Myanmar is well positioned for policing the chokepoint that concerns Beijing most: the Malacca Strait.

Another solution may lie in the Isthmus of Kra, a neck of land linking Thailand's north and south. Thai and Chinese authorities have discussed building a canal across the Isthmus, which would allow oil tankers from the Middle East to bypass the Malacca Strait. This "Asian Panama Canal" carries a price tag somewhere between $20 and $28 billion, and Washington is watching its development closely. **17**

Major Flashpoints with the U.S.

There are three primary flashpoints between the United States and China: oil, trade and currency. Looming over all of them is Taiwan and the possibility that one day China will test the commitment of the United States to defend Taiwan against a Chinese invasion.

A network of Chinese-financed pipelines that will take oil away from the United States towards its challenger is appearing or planned in Canada, Venezuela, Sudan and Iran. Four-fifths of China's oil is transported through the Strait of Malacca. At one end of the Strait is an American fleet at the Changi Naval Base in Singapore. At the other end, the United States' Indian Ocean fleet operates from Diego Garcia. From Beijing's perspective, the United States has its fingers on China's windpipe; President Hu Jintao makes frequent reference to the 'Malacca problem'. China wants more oil brought in by pipeline across Asia and by tanker across the Pacific. It wants a deep-sea fleet to protect its interests. Henry Kissinger has warned of a potential great-power conflict over oil: this is it.

In recent years Africa has emerged as the arena on which the U.S. and China intend to play out their rivalry over acquisition of energy resources. At present Africa supplies 15% of the U.S. oil import needs. Within the next decade Africa's share is projected to increase to one-quarter of U.S. total imports.

Oil from West Africa's Gulf of Guinea region provides an ideal source of supply for the U.S., given the high grade of the crude and the closer geographical proximity of the mainly offshore fields than Middle East oil.

However, the most pressing issue is over trade and currency. The anti-China sentiment that has surfaced in the past five years is obvious. Some of the twenty bills introduced in this period aimed at retaliation against China or its imports would have disastrous consequences if passed. One bill would impose a 27.5% tariff on Chinese imports if China does not immediately revalue its currency, the renminbi, significantly.

Seen from Beijing, the call to revalue the renminbi or transform the Chinese economic system is a de facto act of aggression that will destabilize the government. Seen from Washington, the refusal to become a good international economic citizen is a wilful neglect of duties as a responsible stakeholder in running the world system. It is an eyeball-to-eyeball confrontation, a great-power game to see who blinks first.

Recently, the Chinese government has begun a concerted campaign of economic threats against the United States, hinting that it may liquidate its vast holding of U.S. Treasury bonds if Washington imposes tariffs on Chinese imports to force a renminbi revaluation. Chinese officials have warned that Beijing may use its $2 trillion of foreign reserves as a political weapon to counter pressure from the US Congress. Described as China's "nuclear option" in the state media, such action could trigger a dollar crash and could further exacerbate a US economy already in deep recession. **18**

The scope for miscalculation by either the United States or China is, therefore, huge. But while the conditions exist for peace and cooperation, there are also many factors in the other direction. As China grows in strength, it grows in pride and nationalist feeling. Beijing's mandarin class is convinced that the United States wishes it ill. Flashpoints like human rights, Taiwan, energy or some unforeseen incident could spiral badly in an atmosphere of mistrust and with domestic constituencies – on both sides – eager to sound tough.

There is an accident waiting to happen unless we find an accommodation over values – the precondition for cooperative action. The Writing is on the Wall.

Conclusions

China's thirst for oil and its growing dependence on oil imports has transformed the global energy market and is already impacting on the price of oil and the global energy security and is also creating energy insecurity for China itself.

The recent growth in oil consumption, combined with forecasts of increased oil imports especially from the Middle East, have led to a deep concern among Chinese leaders regarding their country's energy security. They are responding in a number of ways. In particular they are determined to increase the security and reliability of oil imports by searching for new sources of supply and defending oil transport lanes, while boosting national production at any cost. China's global oil diplomacy could bring it into conflict with the United States unless both countries find a constructive accommodation that allows them to do business.

It is a truth universally acknowledged that a great power will never voluntarily surrender pride of place to a challenger. The United States is the pre-eminent great power. China is now its potential challenger. The great questions of our time are, first, whether China can translate that potential into reality without democracy, and without genuine capitalism. And, second, whether the United States will be wise enough to keep its markets and the wider world system open as this Chinese drama plays out, and by so doing accelerate the fundamental reform that must come to China. Our prosperity and even global peace depend on the answers.

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