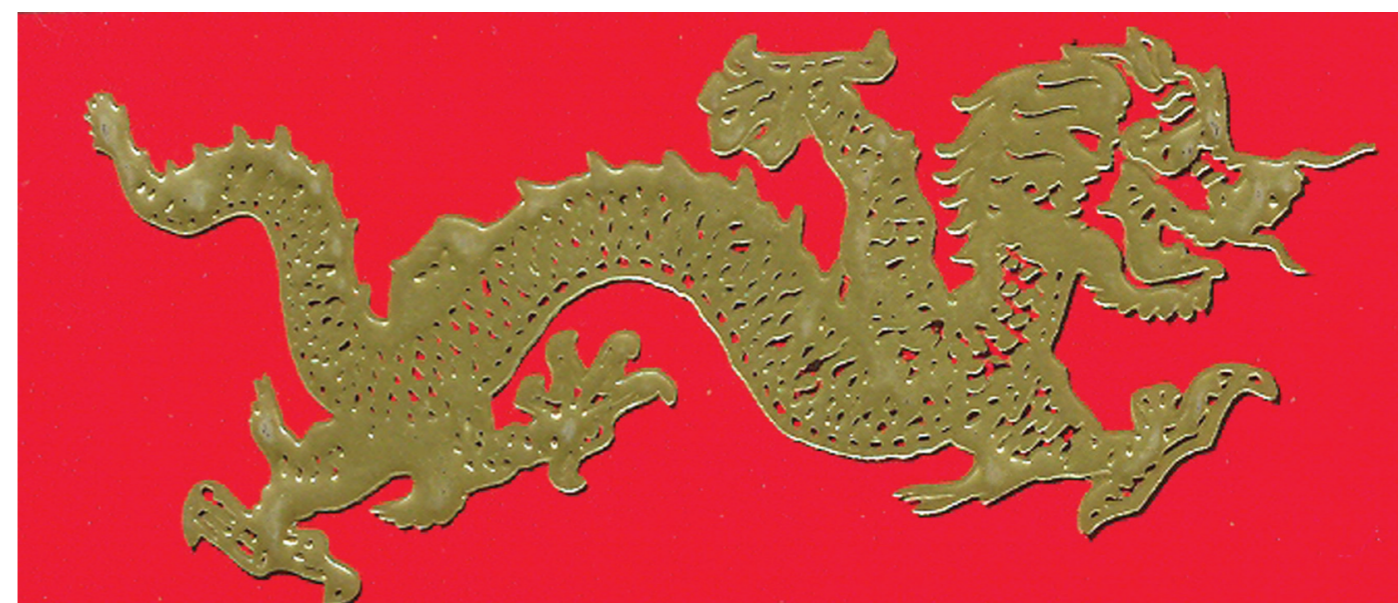


Ingolf Kiesow

China's Quest for Energy; Impact upon Foreign and Security Policy



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Ingolf Kiesow

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Abstract (not more than 200 words) <p>Contrary to Chinese intentions, the proportion of China's imports coming from potentially unstable countries is steadily increasing. As a response, China tries to diversify its sources of import and to own the oil when loaded in an export harbour. In spite of very high costs and political problems, China tries to import oil and gas from owned fields in Central Asia through pipelines. In the case of China, the competition is evident on the highest international level. Especially with Japan, this tends to make already previously sensitive relations deteriorate. China has territorial disputes with several neighbouring countries that are becoming more complicated by the fact that there is oil and gas on the bottom of the sea in the disputed area. Relations with Russia have been complicated. Since the 1990s they are on their way of being steadily improved, but they become strained, when Japan is given priority access to oilfields in Siberia. The sensitive relations with the U.S. tend to be impaired by China's ways of getting access to more secure supply of oil and gas. Chinese efforts to get a more attractive foreign policy profile is on the other hand alleviating but does not eliminate the potential of the energy issue to complicate China's foreign and security policy relations.</p> <p>The European Union seems to be on its way to introduce energy questions as a field of common policy. This is a reason for Sweden to study the development. It is a matter of special interest that China has proposed an "Energy Dialogue between Asia and Europe" about the resources on the Eurasian continent. The Chinese example illustrates the need for a Swedish energy security policy and plans for energy crisis preparedness.</p>		
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Sammanfattning (högst 200 ord) <p>Tvärt emot Kinas avsikter har beroendet av mindre stabila länder som leverantörer av olja och gas ökat kraftigt. I gengäld försöker Kina diversifiera sina importkällor och äga oljan redan vid utskieppningen från exporthamn. Trots mycket höga kostnader och politiska problem försöker Kina importera olja och gas från ägda fält i Centralasien via pipelines. Konkurrensen om olja tar sig för Kinas del uttryck på högsta mellanstatliga nivå. Särskilt med Japan tenderar detta att försämrade redan förut känsliga relationer. Med flera grannländer har Kina territorialgränsproblem, som förvärras av att det finns olja eller gas på havsbotten i området. Förbindelserna med Ryssland, som har varit komplicerade men också sedan 90-talet varit på väg att förbättras stadigt, ansträngs av att Japan får företräde till oljefält i Sibirien. Med USA. tenderar de känsliga förbindelserna att försämrade av Kinas sätt att skaffa sig säkrare tillgång till olja och gas. Kinas ansträngningar att få en mera tilltalande utrikespolitisk profil mildrar å andra sidan, men eliminerar inte, energifrågans potential att trassla till Kinas utrikespolitiska och säkerhetspolitiska relationer.</p> <p>EU ser ut att införa energifrågor som ett område för gemensam politik. Det gör att Sverige har anledning att studera utvecklingen. Av särskilt intresse är att Kina har föreslagit en "energdialog mellan Asien och Europa" om tillgängliga på den eurasiska kontinenten. Exemplet Kina visar på behovet av en svensk energisäkerhetspolitik och en planering för beredskap inför energikriser.</p>		
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Acronyms and Abbreviations

ARF	ASEAN Regional Forum
ASEAN	Association of South East Asian Nations
ASEM	Asia-Europe Meeting
CNPC	China National Petroleum Corporation
FOI	Swedish Defence Research Agency
IT	Information Technology
LNG	Liquefied Natural Gas
LPG	Liquefied Pressurised Gas
PLA	People's Liberation Army (China)
SCO	Shanghai Co-operation Organisation
SLOCS: s	Sea-Lanes of Communication
UNCLOS	United Nations Convention on the Law of the Sea
WTO	World Trade Organisation

Executive Summary

China is being blamed for high international oil prices. That seems to be true to a certain extent. Since the situation on the energy markets is tense, China's energy policy merits attention.

China's main sources of supply of oil and natural gas are located in potentially unstable countries in Africa and the Middle East. Efforts are made to diversify sources, but so far they have not been successful. It has also been deemed easier to simply lease or buy foreign oil fields, giving China exclusive extraction and import rights.

Another solution is to connect China with sources for oil and gas in Central Asia via pipelines. This is an open challenge to Russia's hitherto almost complete dominance over the outlets for the export of oil and gas from Central Asia.

A Chinese preliminary agreement with the Russian oil company Yukos proved to be of little value, when Yukos became involved in a web of domestic policy complications. Japan used this opportunity to snatch the access to the oil wells in Angarsk in Siberia from China. This was performed on high official level. A rising dispute about the right to extract gas from the bottom of the sea between Japan and China indicates that both countries see the problem in a geostrategic perspective.

China's desire to secure access to oil and gas on the bottom of the seas in China's neighbourhood have also caused disputes with the ASEAN countries over the location of maritime borders. In this case the recent introduction of a new style in Chinese foreign policy has helped reduce the tensions that have existed since 1992.

The issue of safe sea lanes of communication (SLOC: s) is becoming a matter of concern and is being made more serious by the element of competition about safe oil supply.

In competition with the U.S. about access to oil and gas, differences in perspectives appear as a matter of potential friction. The U.S. regards the Chinese policy of buying oil and gas fields abroad for export exclusively to China as a breach of the principle of free trade. Other geostrategic and military considerations like safety of sea lanes and the U.S. military presence in the Western Pacific make the competition about energy resources potentially dangerous.

Against all the negative and destabilising effects of China's suddenly increased quest for energy the new style in foreign policy has had some, if limited, success. It may not be enough to counter the destabilising trends, unless there is a common effort to

build mutual confidence on the ground of growing economic interdependence, in which oil plays an important role.

The experiences from China's efforts to cope with the suddenly appearing problem with rapidly growing demand and increasing difficulties to buy enough energy raw materials from abroad is of relevance for Sweden, which is a small country with a cold climate and high energy consumption. Sweden needs a policy for energy supply security and planning for energy crisis preparedness.

Introduction

The Project

The so called China Project is made in cooperation between the Swedish Ministry for Foreign Affairs and the Swedish Defence Research Agency (FOI).

Since several years China, with its more than one fifth of the world's population, has had the fastest growth rate that any large country can show. If this growth rate can continue unabated, China's Gross Domestic Product could become comparable to that of USA within a few decades. What would be the consequences? Will China wish to expand and if so in what direction? How will the European Union be affected?

When, toward the end of 2001, China was associated to the World Trade Organisation (WTO) it was seen by many as the final touch to the economic reforms initiated by Deng Xiaoping. The WTO-membership means that China will have to open up to the outside world, to a growing foreign trade and foreign investments, but also to an increasing exchange of people across national borders. On the other hand, increasing integration into the world community of nations also means that China and its future actions will affect the outside world more and more. Already today we see how China's increasing needs for raw materials push the prices upwards. It is one of the factors behind the world market price for oil being higher than it has been for many years and it can affect the economic development in Sweden. We can also see how China's importance as an agent in military and security policy matters is steadily growing.

The intention with the China Project is to collect internationally available information about trends that can be observed today and assess its importance for the attitudes of the Chinese leaders toward the rest of the world in the future.

The work with the civilian part of the project was started, when the Ministry for Foreign Affairs, as one of several international institutions, asked the British think-tank Oxford Analytica to compile a report about China in a five-year-perspective. Thereafter several complementary studies have been made at FOI.

Kristina Sandklef has studied imbalances in the regional development, environmental problems and the role of Information Technology (IT) in the Chinese society as well as *Energy in China: Coping with increasing demand*.¹

Ingolf Kiesow is project leader and has studied China's role in the interaction between the powers around Central Asia and the Middle East as well as compiled the present report.

Acknowledgement

Special appreciation has to be expressed to Professor Tom Hart at the Stockholm School of Economics, who is a well-known specialist on China with international reputation and who was kind enough to accept the task of examiner of this report and who has given much invaluable advice.

The Matter to be Treated

China is experiencing an energy supply problem of such dimensions that the government has found it necessary to slow down demand. It has introduced restrictions on investments in the manufacture of steel and aluminium and even taken a number of general measures to reduce demand.² Moreover, a couple of surveys have been carried out and resulted in a plan for the field of energy production for the next twenty years.³

There were several reasons for these measures. Most important was the several consecutive years of rapid GDP growth which so improved living conditions that a significant part of the population began to find it possible to buy cars, temperature-conditioned housing, refrigerators etcetera. An insufficient rate of investment in the coal industry, which produces two thirds of the total amount of the consumed electrical energy, seems to have been another factor.⁴ As a consequence, importation of oil increased by 44 per cent between 2002 and 2003 and imported oil now produces one third of the total. If this rate of growth were to continue very long, China would need to import an amount that could not possibly be purchased on the world market for oil.⁵

¹ Sandklef, Kristina (2005) *Energy in China: Coping with increasing demand*, Stockholm, Swedish Research Agency, FOI-R-1435-SE.

² *International Energy Agency – Monthly Oil Market Report*, 11 August 2004.p. 9

³ *China Daily*, 1 July 2004.

⁴ Sandklef, Kristina (2005) *Energy in China: Coping with increasing demand*, Stockholm, Swedish Research Agency, FOI-R-1435-SE, p. 27-28.

⁵ *China emerges as a major energy player*, *Alexander's gas & Oil Connections*, volume 9 issue #17, 2004, available

www.gasandoil.com/goc/frame_cns.company.htm

Recent increases have already caused some repercussions. The price of oil has exceeded 55 dollars a barrel during the autumn of 2004 and rapidly increasing demand from India and China as well as the U.S. has been one important reason. Concerns regarding the economic and political stability of oil producing countries like Nigeria, Venezuela, Saudi Arabia, Sudan and Iraq as well as the financial crisis within the Russian oil company Yukos have together formed another factor of equal importance. However, the sudden increase of China's oil importation was given more attention, to the consternation of the Chinese leadership,⁶ and there have been efforts in Chinese media to deny the connection between the country's growth rate and the increase in the price of oil.⁷

Among other things the long-range energy plan mentioned above talks about a more efficient and cleaner processing of coal, diversification of supply countries for oil, more extensive ownership of oil fields abroad as well as building up of a state-owned system for the storage of oil in order to eliminate peaks of demand and extreme downswings in supply.⁸ Coal is intended to remain the main energy source for the foreseeable future (China is in possession of reserves that can cover demand during some 250 years at the present rate of consumption) and yet a strong increase in demand for oil cannot be avoided, not even with the limited measures for demand reduction that may be possible to apply.⁹

It should be observed that in the U.S., an unexpectedly strong increase in demand for imported oil, caused by gas fields reaching maturity and the drying up of oil fields, it has not been considered possible to introduce any demand reducing measures. The U.S. and Japan have become the strongest competitors, when China is seeking to find new sources for its supply of energy raw materials, basically oil, but with India as a third and rapidly growing competitor.

The European Union does not have a common energy policy but one may be on its way. The goal of a common energy policy is included in the proposal for a new EU constitution adopted in June 2004 and due to be ratified by 2006. The new post of commissioner for energy affairs has already been introduced and filled. Various proposals have been made in the field of energy and are on their way to being

visited 21 September 2004

⁶ Reuters, Oil hits record on China, India demand, 19 August 2004.

⁷ China Daily Online, available

http://www.chinadaily.com.cn/english/doc/2004-06/22/content_341408.htm

accessed 7 July 2004.

⁸ China Daily 1 July 2004.

⁹ Sandklef, Kristina (2005) *Energy in China: Coping with increasing demand*, Stockholm, Swedish Research Agency, FOI-R—1435—SE,p.13-14.

accepted or have already been accepted.¹⁰ A great deal of curiosity from the Chinese side with respect to the emerging common EU policy in the field of energy was evident during a recent seminar in Shanghai. In time the Union will emerge as a fourth, very significant competitor on the world oil market — not necessarily in terms of increased consumption, since the sum of the consumption of the members of the Union will not be affected, but because a common EU policy will alter the structure of the market.

Other countries begin to be concerned about the way China tries to improve its security of oil supply by means of purchasing oil and gas fields for export exclusively to China.¹¹ This policy is inconsistent with the policy followed by the U.S. and the EU countries, which aims to add as much oil as possible to the open market. Some Japanese efforts to get more secure supply of oil by purchasing oil fields abroad through state-owned Japanese companies have also been criticised. When, in addition to that, such a large country with such a rapidly growing economy as China also begins to pursue this kind of a policy, international frictions are likely to appear sooner or later. If and when, for instance, the U.S., with its many huge private oil companies and its own rapidly increasing hunger for imported oil, decides to raise the issue, the European Union will have the need for a new policy in response to an entirely new situation on the energy market.

It should be added that the whole problem takes on a special dimension considering the fact that most of the world's oil and gas resources are found on the Eurasian continent, where also the U.S. will have to meet its own energy needs in pursuing policies similar to those of the Europeans, who on the other hand have a much shorter way to transport their purchased products.¹² As far as gas is concerned, the Europeans have the great advantage of being able to transport their import via pipelines, which is also true for China, at least in theory.

In this way, a number of state actors have recently made new inroads on the world market for oil and gas and the most significant case is China, since it is acting directly through state-owned companies or openly in intergovernmental oil and gas

¹⁰ See for instance the (not approved) *Green Paper - Towards a European strategy for the security of energy supply* (Com 2000) 769 and *Proposal for a Directive of the European Parliament and of the Council concerning measures to safeguard security of electricity supply and infrastructure investment* (COM 2003 (740) and *Proposal for a Directive of the European Parliament and of the Council on energy end-use efficiency and energy services*(COM 739) and *Proposal for a Regulation of the European Parliament and of the Council on conditions for access to the gas transmission networks* (COM (2003) 741 and *Proposal for a Decision of the European Parliament and of the Council laying down guidelines for trans-European energy networks and repealing Decisions* (COM (2003) 742 and *Communication from the Commission to the European Parliament and the Council - The internal market in energy: Coordinated measures on the security of energy supply* (COM (2002) 488).

¹¹ See for instance Chang,Felix,K. (2001) *Chinese Energy and Asian Security*. Foreign Policy Research Institute, Washington, Spring 2001, p. 233

¹² Kiesow, Ingolf,(2003) *Energy in Asia; An Outline of Some Strategic Energy Issues in Asia*. FOI-R-0793—SE, January 2003, p. 27.

negotiations, which is neither true for the U.S. nor for European countries. Japan, on the other hand, sometimes appears as a state actor and moreover, in its negotiations with Russia, in a kind of competition with China that is often described as hostile. Thus there is cause to take a closer look at how China is responding to its energy needs and how this is having an impact on its foreign and security policy.

Structure of the Report

In this report recent trends are discussed and tentative conclusions are made about how China has been affected by the increasing demand for oil and natural gas from abroad, how China's leaders try to find solutions to these problems and how these efforts sometimes come into conflict with other priorities in foreign and security policy.

The report has been structured to help provide answers to the following questions:

- Which are China's sources of supply of oil and gas and how secure are they?
- What efforts is China making to gain access to energy raw materials in its own neighbourhood in Central Asia?
- How are China's efforts to gain access to oil and gas in the vicinity affecting relations with its neighbours?
- Why, in the name of secure supply, is China not importing more oil and gas from its neighbour Russia?
- How does Chinese competition for oil affect relations with the U.S.?
- Is China's new style in foreign policy affecting its oil policy?

In a last chapter, observations and conclusions about the mechanism of conflicting interests and efforts to find a balance between them are made. Under the subtitle *conclusions* the observed trends are described, possible future scenarios are outlined and finally some recommendations of relevance for the EU policy toward China in the field of energy are made.

Litterature

The phenomenon of China's rapidly rising demand for imported oil has emerged very recently and literature on the subject is relatively scarce. Use has been made of web sources like *Platts Newsletters & Reports*, *International Energy Agency* and *Alexander's gas & Oil Connections*, where they have been available and the news media have been referred to for information as to events and public statements, if not for facts and figures. Official Chinese publications like the *China Daily*, *People's Daily* and the *Beijing Review* have on the other hand been used as sources of specific facts and figures regarding very recent developments.

Problems

As with many other countries, manageable foreign trade statistics are only available after more than a year. Current customs figures are only made available in disaggregated form and must be aggregated to be of much use. This has made comparisons between China and other countries during the most recent period impossible.

Another difficulty must be mentioned here, namely that it is not possible at all to establish what quantities are being shipped directly to China from the oil and gas fields that Chinese companies have bought and are operating. Such figures would tell us how much oil has been withdrawn from the open market by China's policy of purchasing oil and gas fields abroad, primarily for exclusive export to China. That information would of course be very interesting, but to establish the proportions it would probably be necessary to make study trips to all the countries where China possesses oil- and gas fields. To do so has not been an alternative within the limits of this project and may not even have been worth the effort, since many of these countries have regimes that are not likely to be helpful.

CHAPTER ONE

China's Main Sources of Supply

This Chapter will address the following questions:

- *Which are China's sources of supply of oil and gas?*
- *How secure are they?*

Findings:

- *Main sources are in potentially unstable regions of Africa and the Middle East*
- *China tries to diversify its supply sources and to secure ownership of the oil as soon as it is loaded for transport*
- *The same is true for natural gas*

Reasons for "Trying to Own the Oil when Loaded"

That China tries to establish long-term energy security by investments in oil and gas fields abroad is a natural consequence of the situation described in the introduction. As early as in 1997 such a policy for a stable and long-term supply of oil and gas was formulated by Premier Li Peng.¹³

This came about not only against the background of environmental problems, falling or at least static production levels in domestic energy raw materials and a drastically increasing demand for energy, but also against the background of a rapidly increasing dependence on oil from Africa and the Middle East with the ensuing problems of instability in those regions. The following table¹⁴ may serve as illustration to what was happening:

¹³ *China's Worldwide Quest for Energy Security (2001)*, International Energy Agency, available at <http://www.ica.org/dbtw-wpd/textbase/nppdf/free/2000/china2000.pdf>

Accessed 6 July 2004, p. 61

¹⁴ *Ibidem*, p. 50

China;	Per cent of total imports	
	1990	1997
Region		
Middle East	39.4	47.5
Asia-Pacific	60.6	26.2
Africa	0	16.7
Others	0	9.6

In 1990 China took most of its imports of crude oil from stable neighbouring countries, with which it had well established relations, but seven years later the proportions were reverse.

In 2001 China's dependence on suppliers in the Middle East had increased further, while Asia-Pacific countries had become a minor source of oil. Africa had become more important than the Asia-Pacific:¹⁵

Oil imports by region in per cent, 2001	
Middle East	56
Africa	23
Asia-Pacific	14
Others (Europe, Central Asia)	7

Africa and the Middle East

By 2001, China had invested in several Middle Eastern countries plus Argentina, Bangladesh, Canada, Colombia, Ecuador, Indonesia, Kazakhstan, Malaysia, Mexico, Mongolia, Nigeria, Pakistan, Papua New Guinea, Peru, Russia, Iran, Sudan, Thailand, Turkmenistan, Venezuela and the Gulf of Mexico. China National Petroleum Corporation (CNPC) had signed or had under negotiation contracts in at least 20 countries and had pledged more than 8 billion USD for oil concessions in Sudan, Venezuela and Iraq.¹⁶

Meanwhile, efforts to get contracts for supplies of oil from Middle East and African countries continue to be made on the highest level of state. During a trip to three African countries in February 2004, President Hu Jintao took up matters of oil and gas supply with his hosts in Egypt, Gabon and Algeria.¹⁸ China has also offered to

¹⁵ 2004 Report to Congress of the U.S.-China economic and Security Review Commission, available at <http://www.uscc.gov>

Accessed 26 June 2004, p. 156.

¹⁶ Ibidem.

¹⁸ *China Daliy*, 28 January and 3 February 2004.

negotiate a free trade agreement with the Gulf Cooperation Council and talks have been initiated.

In Africa, the Great Wall Drilling Company, a CNPC subsidiary, signed a contract in 1997 with Sudan to buy a 40 per cent stake in Sudan's Greater Nile Oil Project and renewed its drilling contract in 2000 for drilling rigs and new oil development wells. CNPC also began joint exploration of the Chad Basin in 1997 and bought two blocks in the Niger river delta in 1998. In Angola it signed a letter of intent for joint construction of a refinery.¹⁹

In the Middle East, China made several investments in Iraq in 1997, when CNPC bought a 50 per cent stake in the al-Ahdab oil field and negotiated for a contract to develop the Halfayah oil field as well. Several electricity plants were also constructed by Chinese companies, but after the U.S. invasion these investments have not been of much use for China.

In Saudi Arabia, Sinopec entered into a joint venture with Aramco in 2004 to conduct gas exploration, which is likely to become an important development for Saudi Arabia's energy supply – and possibly for China as well. A Sinopec subsidiary has been given several contracts for oil well repair services.²⁰

The Great Wall Drilling Company has been active in many Arab countries and is carrying on drilling activities in Sudan, Egypt, Qatar, Tunisia, and Oman and elsewhere.²¹

According to Iran's oil minister, Iran is China's oil supplier number one.²² A Petrochina subsidiary signed a series of contracts with Iran in 1998, and since then China has invested in the drilling, seismological and exploration sectors of Iran's oil industry and is becoming involved in offshore and onshore as well as upstream and downstream development projects. Iran now delivers around 10-12 mn tonnes of crude oil every year to China.²³ A Memorandum of Understanding was signed in

¹⁹ Chang, Felix, K. (2001) *Chinese Energy and Asian Security*, in *Orbis*, Spring 2001, Foreign Policy Research Institute, Philadelphia, p. 238.

²⁰ Chang, Felix, K. (2001) *Chinese Energy and Asian Security*, in *Orbis*, Spring 2001, Foreign Policy Research Institute, Philadelphia, p. 236.

²¹ *Middle East Policy Council Journal*, Volume VII, June 200, number 3, available <http://www.google.com/search?hl=sv&ie=UTF-8&q=Middle+East+Policy+Council+web+site&btnG=Google-s%C3%B6kning&lr=> accessed 22 September 2004

²² *Al Jazeera News Agency*, available <http://english-aljazeera.net/HomePage> Accessed 1 November 2004.

²³ *China emerges as a major energy player*, Alexander's gas & Oil Connections, volume 9 issue #17, 2004, available www.gasandoil.com/goc/frame_cns.company.htm visited 21 September 2004.

Beijing in October 2004 in the presence of the oil minister of Iran, according to which SINOPEC will buy 250 million tonnes of LNG (Liquefied Natural Gas) over 30 years and develop the giant Yadavaran field, from which China will also export 150,000 barrels per day of crude oil to China at market prices after commissioning of the field. If and when this MOU will be made into a real contract and implemented, it is estimated to have a value of 70 billion USD.²⁴

Latin America is Becoming Involved as well

In 1997 CNPC bought the Caracoles block and the Intercampo Norte block in Venezuela for a high price, raising eyebrows in professional oil circles. CNPC also acquired 25 million USD worth of oil and natural gas properties in the Peruvian Talara block.²⁵

China's Sinopec has signed a partnership agreement with Brazil's Petrobras for oil exploration in China, and Chinese companies are to invest 5 billion U.S. dollars in Brazil's energy sector.²⁶ In 2004 cooperation with Petrobras was extended to cover petroleum sales, exploration, production and several other activities. Exploration is intended to start in the South China Sea as well as in waters off the Brazil coastline in early 2005 and will later be carried out near Africa, Venezuela, Colombia and in the Mexican Gulf.²⁷

Even North America is being Targetted

According to media reports, the Chinese government was considering acquiring the Calgary-based oil and gas giant Husky Energy Inc. from Hong Kong billionaire Li Ka-shing in November 2004. A similar deal had been under negotiation via the state-controlled PetroChina Co.Ltd. in 2002, but did not lead to a contract. Mr Li controls about 71 per cent of the shares through personal holdings and the family-controlled Hutchinson Whampoa Ltd.

²⁴ *China Daily Online*, available

<http://www.chinadaily.com.cn/english>

Accessed 1 November 2004.

²⁵ Chang, Felix, K. (2001) *Chinese Energy and Asian Security*, in *Orbis*, Spring 2001, Foreign Policy Research Institute, Philadelphia, p. 238.

²⁶ *China emerges as a major energy player*, Alexander's gas & Oil Connections, volume 9 issue #17, 2004, available

www.gasandoil.com/goc/frame_cns.company.htm

visited 21 September 2004.

²⁷ Xinhua, English, 18 August 2004, available

<http://www.xinhuanet.com/english>

accessed 22 September 2004.

Husky Energy Inc. is the owner of the White Rose oil project off the coast of Newfoundland, which is believed to contain 165 million barrels of oil and where at least 20 million barrels of oil have recently been proven to exist. The value of the company on the stock market is over 14 billion U.S. dollars.²⁸

The deal would also give China the ownership of Alberta oil sands resources, which would mean that China would be embarking on a new phase of extraction techniques. Oil sands are available in many places and only rarely extracted as yet because of the high costs involved. With higher oil prices, this may represent another, albeit still costly, way for China to assure access to a more secure supply of oil.

Conclusion

It appears that China is becoming more and more dependent on supplies of oil from Africa and the Middle East, in spite of its efforts to reduce this dependency. Regarding gas, China has signed a contract for the supply of LNG (Liquefied Natural Gas) from Australia during a ten year period and has entered into a similar agreement with Indonesian companies. However, a recent Memorandum of Understanding with Iran and exploration efforts in Saudi Arabia makes it likely that also LNG will mainly come from the Gulf countries.

²⁸ *Globe and Mail*, 26 November 2004.

CHAPTER TWO

Pipelines from Central Asia

This Chapter will address the following question:

- *What efforts does China make to gain access to energy raw material in its own neighbourhood in Central Asia?*

Findings:

- *An oil pipeline is to be built from Kazakhstan to Xianjiang in China.*
- *A parallel pipeline for gas would make sense but will depend on negotiations with other countries in Central Asia.*
- *China must compete with India for access to natural gas in Central Asia*
- *Russia's near monopoly on the export of oil and gas is being challenged by these plans.*

The Central Asian Oil and Gas Context

China has some serious problems with ethnic strife and separatism.²⁹ The northern part of its Xinjiang autonomous region, which borders on Russia, Kazakhstan and Kyrgyzstan is mainly populated by the Uighur people, who are mostly Muslims. They have constituted a security problem for the Chinese government in this oil-rich province since a long time, with a separatist movement that often has been using bombings and small-scale armed resistance. To Russia and the new states in Central Asia, it became a problem in their relations with China because of the connection to fundamentalist Islamic circles and the drug trade. In the mid-1990s contacts between these countries became intensive and China took the initiative, together with Russia, in launching a formalised, high-level multilateral consultation structure. Bilateral talks had been going on for several years between these countries about other security matters, like border delimitation, troop reductions and confidence building in border areas.

The emergence of independent oil-rich states in the Caucasus and Central Asia had intensified the historical rivalry for geopolitical dominance and has attracted players

²⁹ Justin Rudelson and William Jankowiak, "Acculturation and Resistance", *Xinjiang: China's Muslim Borderland*, Starr, Frederick, S. ed. (New York: Central Asia-Caucasus Institute, 2004), p. 316.

both within and from outside the region. Each player, be it an oil company or a state, has its own agenda with regard to the oil and gas resources of the Caspian basin and its transportation to the West. The system of pipelines built in the Soviet era was made to pass through Russia. Turkmenistan cannot send oil and gas to the West without passing through Uzbekistan, Kazakhstan and Russia, Azerbaijan offers an alternative route, but this would only be of use to Kazakhstan (and possibly Uzbekistan), and each transit country is taking high fees etcetera.

This goes a long way to illustrate the many-sided and often incomprehensible relationship between Russia, China and the Central Asian states, a relationship that is today becoming even more complicated by the military presence of the U.S. and the economic presence of companies from the EU member states, both as buyers and sellers.

At its launching, the so-called “Shanghai Five” was basically an instrument for the two great powers to eliminate problems emanating from Central Asia and their own mutual competition for influence in the area, which was causing problems for them both.

Meetings were held in Shanghai and Moscow in 1996 between the presidents of China, Russia, Kazakhstan, Kyrgyzstan and Tajikistan and agreements calling for increased mutual trust and the reduction of military forces in border regions were signed. The institutionalised summit meetings were called “The Shanghai Five”.

Uzbekistan, hitherto following a policy of avoiding to be drawn into any kind of co-operation dominated by Russia, was eventually persuaded to accept an invitation to participate as a member. The formalisation went further and resulted in a new treaty in 2002, whereby “The Shanghai Six” transformed themselves into the “Shanghai Co-operation Organisation”(SCO) and the purposes were defined in much broader terms of co-operation.³⁰

Investments in Kazakhstan

The two most ambitious investment projects in the energy sector outside China have been for a gas pipeline parallel with one for oil from Kazakhstan to the province of Xinjiang, where both oil and gas fields are located. Both projects – which can be made much cheaper by being built at the same time, using common infrastructure as much as possible – depend to a large extent on the productivity of the Xinjiang fields. If they prove sufficiently productive, it will make economic sense to construct pipelines from Xinjiang to the east coast of China, where the large consumption

³⁰ Shanghai Cooperation Organisation, *Chinese Ministry of Foreign Affairs*, available http://www.chinadaily.com.cn/english/doc/2204-06/15/content_339648.htm (15 June 2004).

centres including Shanghai, are situated, as well as to extend them farther southwards to the industrial centres of Guangdong province. While construction work on the gas pipeline project to Shanghai has already been initiated³¹, there has been disappointing news about the actual size of the oil resources in the Tarim basin,³² casting doubts over the whole pipeline idea.

For some time it looked like China's pledges about pipeline investments would not be lived up to. Some amount of Kazakh oil was being transported by rail to China and a swap deal was made by which oil produced by CNPC would move across the Caspian Sea and on to a refinery near Teheran, with China receiving an equivalent amount of Iranian oil exported from Iran's Gulf Coast.

However, construction of the first part of the oil pipeline from Kazakhstan, connecting the Chinese-owned fields along the Caspian coast with refineries and Chinese-owned fields in the inner parts of Kazakhstan, the so called Kenkiyak fields, (a stretch of some 450 kilometres) was started and completed in March 2004.³³ Also, in 2003, a series of purchases in shares of oil fields altered the picture. In March 2003 a Chinese company made a vain attempt to acquire eight percent of the Kashagan oil field in Kazakhstan and in October CNPC acquired 35 percent of the Buzachi oilfield and later took full control by buying the remaining shares from a Saudi oil company. In December another Chinese oil company bought 50 per cent of three large blocks in the Tengiz field, also in Kazakhstan.³⁴

At the same time it became increasingly apparent that China's oil needs were rising beyond expectations. It was reported that during the first six months of 2004 crude oil imports rose by 32.8 per cent over the same period last year.³⁵

³¹ *China Daily*, 5 July 2002.

³² *China's Worldwide Quest for Energy Security (2001)*, International Energy Agency, available at <http://www.iea.org/dbtw-wpd/textbase/nppdf/free/2000/china2000.pdf>
Accessed 6 July 2004, p. 62.

³³ *China Daily*, 30 July, 2004 and Kurtenbach, Elaine(2004) *China, Kazakhstan oil Giants agree to build 1,000 kilometers oil pipeline*, available at <http://www.Canada.com>
Accessed 19 May 2004.

³⁴ *China steps up presence in Kazakhstan oilfield (2004)* available at <http://www.eurasianet.org/departments/business/articles/eav012104.shtml>
Accessed 22 January 2004.

³⁵ *China Daily*, 22 July 2004.

Connecting with Central Asia

Thus it was not so surprising that rumours began to circulate about extending the pipeline ending in the Kenkiyak fields in Kazakhstan to the Chinese border. In connection with a state visit by President Hu Jintao on the occasion of a summit meeting with the Shanghai Cooperation Organisation, the two presidents signed a general agreement on the construction of an oil pipeline from western Kazakhstan to China and another agreement on increasing China's investment in oil and gas in Kazakhstan.³⁶

The most extensive natural gas resources in the Caspian region are found in Turkmenistan. China has made some investments there and discussed purchasing Turkmen natural gas, but between Turkmenistan and China lies Uzbekistan, which does not allow gas from Turkmenistan to pass through its territory without taking high fees for the transit rights — as is the case with some amounts that transit Uzbekistan on the way to Russia.³⁷ It is therefore interesting that in 2004 CNPC signed a contract dealing with surveying and drilling for oil and gas with Uzbekneftegas, once again in connection with a visit to Tashkent by President Hu Jintao.³⁸

China's ambitions in the region are complicated by competition from India, however. With the support of the Asia Development Bank and several western oil companies, India and Turkmenistan have been negotiating for years on building a natural gas pipeline from Turkmenistan via Afghanistan and Pakistan to India. The U.S.-led military intervention in Afghanistan and the ensuing political and social unrest and strained relations between India and Pakistan put an end to these contacts during 2003. In the autumn of 2004, however, relations between India and Pakistan had again improved to the extent that the energy ministers of the two countries were expected to meet and agree about a pipeline project for gas, either from Iran or from Turkmenistan.³⁹

If there is serious bargaining for access to Turkmen gas, China is likely to find it difficult to meet the challenge of offering competitive financial conditions. Moreover, Turkmenistan does not have enough gas to supply two pipelines in different directions. Another complication is that the state-owned Russian oil and gas company Gazprom is the owner of a part of the shares in the Turkmen company

³⁶ *China Daily*, 4 July 2004.

³⁷ Kiesow, Ingolf (2003) *Energy in Asia*, User Report FOI-RO793-se, January 2003, available at <http://www.asia.foi.se>

p. 32

³⁸ *People's Daily Online*, available at http://english.com.cn/200406/16eng20040616_146515html

Accessed 16 June 2004.

³⁹ *Dawn*, 28 October 2004.

owning the fields from which the gas will be extracted. It may appear that it is the national interest of Russia to rather see its strategic ally India get access to the Turkmen gas than sending it to China – but it may also be that Russia would prefer to see Iran get the contract in order to preserve the existing order, whereby all export of natural gas from Turkmenistan flows through a small pipeline through Uzbekistan and Russia.

Limited Amounts

All these purchases and projects are performed in Central Asia, which (according to the International Energy Agency) has about 1, 5 per cent of the world's known and proven oil reserves and about six per cent of its gas reserves. In China there seems to be a general impression that these reserves constitute a much higher share of total gas reserves — as much as 16 per cent, according to some sources.⁴⁰ Whether this is wishful thinking or is based on data not available in other countries is unclear.

Conclusion

In any case it is not only the putative size of the reserves that motivates the Chinese to make great efforts to gain access to them; perhaps more important is the factor of geographic proximity and the greater energy security nearby sources could offer.

⁴⁰ Kiesow, Ingolf (2003) *Energy in Asia*, User Report FOI-RO793-se, January 2003, available at <http://www.asia.foi.se>
P. 34.

CHAPTER THREE

Competition with Neighbours

This Chapter address the following question:

- *How are China's efforts to gain access to oil and gas in the vicinity affecting relations with its neighbours?*

Findings:

- *There is fierce competition with Japan, including territorial disputes.*
- *Japan has an advantage in being able to offer financing.*
- *China can no longer easily afford to support North Korea with oil.*
- *Territorial disputes with ASEAN countries are being toned down.*
- *Secure Sea Lanes of Communication (SLOC:s) are a problem.*
- *Pipelines across Burma and Thailand are seen as potential solutions to the SLOC problem.*

Competition and Disputes with Japan

Japanese interests offered to cover the cost of a more expensive and longer pipeline from Angarsk to the Russian port of Nachodka on the Sea of Japan. Building two pipelines was regarded as too expensive, in as much as Russia may not have the oil export capacity to serve both.

China meets hard competition from Japan on the island of Sakhalin as well. There are large deposits of oil and gas on Sakhalin and in nearby waters and the Royal Dutch/Shell Company is trying to make the gas resources available for Chinese consumption. Talks have been initiated about the conditions for long-term contracts.⁴¹

However, the Japanese Mitsui and Mitsubishi companies have dominated the production of oil and gas on Sakhalin during the entire first phase, the Sakhalin-1-project, which is still going on in cooperation with with American Exxon, India's oil and gas corporation and Russian Rosneft. The Sakhalin 2 project is being planned between Shell, Mitsui and Mitsubishi, but the Japanese companies have already

⁴¹Reuters, 26 August 2004, available <http://www.reuters.com/news.jhtml> accessed 27 August 2004.

signed an agreement on the supply of LNG to Japan, and it remains to be seen if there can be any additional contract about deliveries to China.⁴²

There is another twist to the competition between China and Japan. A Chinese gas exploration project in the East China Sea, near Japan, has caused the Japanese government to lodge an official protest against what is characterised as a violation of the boundaries of the Japanese economic zone. Japan argues that it has a right to claim its share of resources of oil and/or gas which are found straddling the intermediate line between the economic zones of the two countries. In a response action to Chinese exploration activities, Japan will start exploring for gas resources in its exclusive economic zone, according to the Japanese industry minister Shoichi Nakagawa.⁴³ A geological survey was started in the disputed section of the East China Sea.

This move was strongly criticised by the Chinese vice foreign minister Wang Yi, who summoned the Japanese ambassador to China, saying that China would not tolerate the move and “firmly opposes the dangerous, provocative act”.⁴⁴ The dispute has gone so far as to cause the Japanese Self Defense Agency to include a reference to it in its annual report on national defence. Beijing’s new focus on modernising its military and its research activities in waters near Japan were included in the areas of concern.⁴⁵

The confrontation is made serious by the fact that the activities are carried out near the disputed islands called the Senkakus in Japanese and Diaoyutai in Chinese. They have been in dispute since World War II, with a great deal of symbolism and hard feelings involved on both sides.

After talks between the foreign ministers of China and Japan, negotiations were held in Beijing in October 2004. They only led to clarifications of the differing standpoints. Japan holds that the exclusive economic zone should be delimited along the median line between the two countries, while China maintains the principle of a continental shelf, which gives it a lion’s share of the East China Sea. The talks are supposed to continue.⁴⁶

Voices of moderation are heard on both sides. The executive director of the Shanghai Institute for International Studies has for instance made a statement for the media,

⁴² *Oil and gas projects in far East most promising for Russia and Japan*, , Alexander’s Gas & Oil Connections, volume 9 issue #17, 2004, available www.gasandoil.com/goc/frame_cns.company.htm visited 21 September 2004..

⁴³ *Japan Times*, 30 June 2004.

⁴⁴ *South China Morning Post*, 9 July 2004.

⁴⁵ *South China Morning Post*, 7 July 2004.

⁴⁶ *China Daily*, 27 October, 2004.

urging cooperation, not competition. He stressed the importance of not letting competition for energy raw materials go so far as to lead to open confrontation.⁴⁷

Korea: Influence, Pollution and Competition

China has taken upon itself to supply energy to North Korea to some extent. Since the 1950s, China had been providing North Korea with oil and initially expected to receive North Korean goods in return, in barter trade arrangements. North Korea, however, was rarely able to fulfil its part of the agreement. In this way oil deliveries became practically free of charge. The Soviet Union used to accept similar arrangements because of its desire to compete with China for influence over Pyongyang, but it stopped doing so around 1980 and began to demand cash payments, which China also began to do. This occurred at a time when the supply of electricity in North Korea had obviously become insufficient to meet demands, for other reasons, and emergency measures had to be introduced. In addition, North Korea's hydroelectric plants, which had been built during the Japanese colonial period, began to need replacement. Imported machinery and other equipment in factories built with Soviet and Chinese aid during the 1960s also needed spare parts and replacement.

These developments hit North Korea severely. The country had become increasingly dependent on thermoelectric power and when oil deliveries threatened to dry up, the transportation system suffered. This was the beginning of the economic problems which have caused near famine conditions on North Korea during the last decade, and energy is a key factor. China has tried to keep up some deliveries, but now, when it needs to import a third of its own oil from abroad, this kind of generosity becomes rather peculiar and is being substantially reduced – to the detriment of North Korea's economy.⁴⁸

With South Korea China has a very different problem. A recent study shows that up to 49 percent of South Korea's pollutants come from across the Yellow Sea, directly from China. It is mainly China's coal-fired plants that cause the pollution. Nothing is known about diplomatic efforts from South Korea's side to make China change its habits, but if they have not happened as yet, it seems reasonable that they may appear soon.⁴⁹

South Korean companies are also buying oil and gas from Russia, produced on the Sakhalin peninsula, in direct competition with Chinese companies.⁵⁰

⁴⁷ *South China Morning Post* 2 July 2004.

⁴⁸ Kiesow, Ingolf (2004) *Perspectives on North Korea's nuclear and missile programs*. Stockholm, Swedish Defence Research Agency, FOI-R-0226—SE, p. 19.

⁴⁹ *Far Eastern Economic Review*, 8 July 2004, p. 29.

⁵⁰ *South China Morning Post*, 27 September 2004.

Competition with the Members of the Association of South East Asian Nations (ASEAN)

An old and thorny issue that tends to re-arise whenever China's efforts to secure oil supplies from within its own neighbourhood are discussed is that of the South China Sea. As with oil in Central Asia, China tends to estimate the size of the reserves near its own borders as being larger than do other nations – up to 17 percent of the world's remaining recoverable crude oil is believed in China to be deposited under the South China Sea. This is several times greater than international surveys tend to conclude.⁵¹

The history of maritime boundary disputes in this area goes back to the 1960s. A UN seismic study in Asian waters in 1968 had revealed possible oil deposits. This was followed up by national studies by most of the Southeast Asian nations. Oil was discovered in 1976 at Reed Bank in the Spratlys, and the Philippines began production there, followed by Indonesia and Malaysia in other parts of the South China Sea.⁵² Today, up to 65 islets, reefs and rocks in the South China Sea are occupied by military troops flying various national flags.⁵³

What made China take a serious interest in the South China Sea were developments in the field of international law. The new principles of economic zones and the way they were defined gave China a new opportunity to lay claim to vast areas of the South China Sea. The urge to do so was reinforced by the fact that China's energy needs began to outgrow what could possibly be produced on the Chinese mainland. Activities by other nations in areas where China's presence had previously been expressed in terms of vague historical claims suddenly took on increased importance and were perceived by other as a threat.

⁵¹ *From Taiwan to Taliban; Two Danger Zones in Asia*, 2002, Editor Ingolf Kiesow, Stockholm, Swedish Defence Research Agency, FOI-R—0393—SE.

⁵² *Ibidem*.

⁵³ Tien, Hung-mao and Cheng, Tun-jen (2000) *The Security Environment in the Asia-Pacific*, New York, M.E. Sharpe, p.268.

China Starts "Retaking Lost Territory"

As mentioned, by 1992 almost all Southeast Asian nations were involved in offshore oil exploration, and Vietnam and Malaysia had announced their interest in the joint development of oil fields wherever their claims overlapped. A Chinese declaration of the Law on the Territorial Sea, Chinese occupation of reefs, and skirmishes with Vietnamese naval units all reflected China's heightened sensitivity to what it regarded as other nations' "resource invasion" in the South China Sea.

In February 1992 China promulgated its "Law on the Territorial Sea and the Contiguous Zone".⁵⁴ According to this law, what China defined as its territorial waters were extended from 37,000 square kilometres to 2.8 million square kilometres, including the Paracel and Spratly Islands. The Chinese territory from which the 12-mile limit was to be measured includes offshore islands that are under dispute with the Philippines, Japan, Malaysia and Vietnam.⁵⁵ These regulations not only cast doubts upon the freedom of navigation in the South China Sea but also revived regional antagonisms over maritime sovereignty.⁵⁶

The Philippines, Malaysia and China each made statements in the process of ratifying UNCLOS (The United Nations Convention on the Law of the Sea) in 1996 that were incompatible with each other, thus manifesting their conflicting claims.⁵⁷

In its UNCLOS ratification-declaration China reiterated all its previous claims in the South China Sea. It also stated that it would feel free to request "a foreign state to obtain advance approval from or to give prior notification to... (China) ...for the passage of warships through the territorial sea".⁵⁸ Currently, China has two military zones in force, namely a Military Security Zone in the northern Yellow Sea, which vessels may enter only with permission of the Chinese authorities concerned, and a Military Operational Zone in the waters north of Taiwan and south of 29 degrees north latitude, in which vessels are advised not to fish.⁵⁹ In the United States, Japan and other nations surrounding the South China Sea, these regulations are seen as a harbinger of possible future threats to free navigation in the region.

⁵⁴ Ibidem.

⁵⁵ Kim, Duk-ki (2000) *Naval Strategy in Northeast Asia*, London, Frank Cass Publisher, p. 48.

⁵⁶ Studeman, Michael (1998) *Calculating China's Advances in the South China Sea Identifying the triggers of "Expansionism"* U.S. Naval War College, www.nwc.navy.mil/press/Review/1998/spring/art.sp8.htm, accessed 21 August 2001.

⁵⁷ *The United Nations Convention on the Law of the Sea*, www.un.org/, accessed 21 August 2001.

⁵⁸ *The United Nations Convention on the Law of the Sea*, www.un.org/, accessed 21 August 2001.

⁵⁹ Kim, Duk-ki (2000) *Naval Strategy in Northeast Asia*, London, Frank Cass Publisher, p. 48.



ASEANs Efforts to Deal with China's Expansion

Since disputes in the South China Sea are either disputes between members of the ASEAN or, more often, disputes between a member of ASEAN and China, this issue would seem to rate as a natural agenda item at ASEAN meetings. However, the

extremely cautious and consensus-gearred approach of the ASEAN has made it a comparatively rare item for formal statements from meetings of that group. In 1992 an ASEAN Post Ministerial Conference held in Manila announced its first declaration on the issue of regional security. It called on all competing claimants to settle their disputes peacefully and called for regional cooperation in furthering the safety of navigation and communication, pollution prevention, search and rescue, and in combatting piracy and drug smuggling in the South China Sea.

China, as a so-called ASEAN dialogue partner, opposed this declaration.⁶⁰

An attempt to adopt a multilateral, cooperative approach on the issue was made in 1995, when Vietnam's entry into ASEAN and simultaneous Chinese pressure on the Philippines with regard to the Spratlys facilitated a coordinated approach toward China. The attempt did not meet with success. China did not wish to enter into a multilateral discussion about the matter, preferring bilateral "codes of conduct" with the Philippines and Vietnam.⁶¹ China also declined to accept discussions about the South China Sea in the ASEAN Regional Forum (ARF), which was established in 1994 as a forum for the discussion of security policy-related issues (which until then had been banned from the ASEAN-meetings).

China's New "Soft Line Foreign Policy" Applied in the South China Sea

During the last few years, China has tried taking a more diplomatic approach vis-à-vis the ASEAN countries. At a heads of state meeting in 2002 ASEAN signed two agreements with China, one on creating a free-trade zone, the other a non-binding declaration on Good Conduct in the South China Sea.⁶² The declaration obliges all parties to avoid any activity that could damage or complicate relationships between them. China followed up by proposing cooperation with the Philippines in the joint development of the Spratly Islands. CNOOC and the Philippines National Oil Co. agreed to set up a committee to identify areas in which exploration might be carried out.⁶³

Negotiations in 2004 led to a basic consensus on the proposed trade arrangement⁶⁴, but other factors continue to cause friction regarding the implementation of the Declaration on Good Conduct. In May 2004 The Chinese Academy of Sciences set up a research centre in Guangzhou for exploration and scientific development of natural

⁶⁰ Tien, Hung-mao and Cheng, Tun-jen (2000) *The Security Environment in the Asia-Pacific*, New York, M.E. Sharpe, p.287.

⁶¹ *The South China Sea Region (2001)* United States Energy Information Administration, www.eia.doe.gov, accessed 21 August 2001.

⁶² *South China Morning Post*, 5 November 2002.

⁶³ *The Japan Times*, 14 November 2003.

⁶⁴ *China Daily Business*, 21 May 2004.

gas hydrates in the South China Sea.⁶⁵ This is the first time that China has shown interest in developing this new form of energy raw material, but it can possibly presage China's infringing upon the claims of other countries vis-à-vis the same sea bed. Vietnam seems to have taken the challenge seriously; on the same day the Chinese research centre was set up, Vietnam announced plans to renovate its air base on Truong Sa Lon (Big Spratly) in the disputed Spratly Islands. This was said to be a consequence of a decision to open up the islands for tourism, and a group of 60 people made an eight-day trip to the islands.⁶⁶

Continuous and successful crisis management seems to be required to keep the problem within manageable limits. Claims continue to overlap with one another and they do not seem to be much ameliorated by the existence of a code of conduct. The latter only makes it somewhat easier to avoid worsening the problem.

Relations among the ASEAN countries in the field of energy are, however, characterised by more than disputes about maritime boundaries and economic zones. The Chinese company CNPC signed a production-sharing contract to develop the Sukothai field in Thailand, and CNOOC purchased a 32.6 per cent stake in an offshore field in Indonesia and acquired another 6.9 per cent in 1995.⁶⁷

Concerns about “Sea Lanes of Communication”

A plan to invest about 10 billion dollars in building up the capacity of China's tanker fleet in order to let domestic ships transport half of China's imports has been presented to the State Council. At present only about ten per cent of the oil is being transported by Chinese tankers.⁶⁸ Such a plan may seem quite innocuous, and the intentions behind it probably are.

It may lead to complications, however. Most of China's oil imports are for instance carried by sea via the straits of Malacca. Admiral Tom Fargo, Commander of the U.S. Pacific Command, has cautioned the nations around the Malacca Strait that the United States expects them to guard their territorial waters and cooperate with one another and with the U.S. to protect the shipping lane from the terrorist attacks that may be expected.⁶⁹ Piracy is already widespread there and fundamentalist Islamist movements like Jemaah Islamiyah pose another and more serious threat. The wreck of one very large tanker attacked and sunk in the strait could block it effectively for a long time. The matter is serious enough to cause the U.S. Secretary of Defense

⁶⁵ *South China Morning Post*, 14 May 2004.

⁶⁶ *Stratfor: Premium Global Intelligence Report – May 20, 2004*.

⁶⁷ Chang, Felix, K. (2001) *Chinese Energy and Asian Security*, in *Orbis*, Spring 2001, Foreign Policy Research Institute, Philadelphia, p. 233.

⁶⁸ *China Daily*, 7 January 2004.

⁶⁹ *Agence France Presse*, 23 June 2004.

Donald Rumsfeld to issue a similar warning at an IISS meeting in Singapore⁷⁰ and suggest that U.S. forces would be hunting terrorists in Southeast Asia “pretty soon”. Malaysia and Indonesia have rejected the idea of American patrols in the straits or rapid response units at the ready, explicitly for reasons of sovereignty.

Units of the Indian Navy have participated in joint manoeuvres in the South China Sea with South Korean and Vietnamese counterparts, and India’s naval policy includes force projection to protect Indian commercial shipping and other maritime interests there.⁷¹ The Indian Navy is looking toward expanding its activities to the Strait of Malacca and beyond.⁷² If the threat from terrorism grows stronger, naval units from India, the United States and other nations may begin to escort commercial ships and/or large tankers through the straits.

Suspicious about China’s Naval Intentions

China could decide to do the same, and that would mean that the Chinese navy would appear in the Indian Ocean, where India already regards Chinese cooperation with Myanmar and the Chinese naval expansion into the Indian Ocean as a threat and one of the reasons for India's decision to acquire nuclear weapons, according to former Defence Minister George Fernandez.⁷³ The Indian Navy has the means in the form of air fields on the Nicobar Islands and aircraft carriers in the Indian Ocean to reach the Strait with attack aircraft.⁷⁴ There is a belief among military analysts in the region and the West that China has an ambition to gain a dominating position by means of force projection 1) over its energy arteries, most notably the Sea Lanes of Communications (SLOCs) from the Persian Gulf, 2) over the petroleum reserves in the South and East China Seas and 3) over the entries to the Strait of Malacca and beyond.⁷⁵ If Taiwan then would be annexed by China, it could result in the South China Sea in practice becoming an Inland Sea.

Under the influence of such fears, the development of a Chinese tanker fleet capable of carrying half of China’s oil import needs can easily be construed as being likely to lead to a decision on the military level to give the PLA Navy the necessary resources to protect the sea lanes. A mandate of that kind could mean a risk for unfriendly competition with U.S. and Indian naval units with the same ambition to protect the free passage for their own ships.

⁷⁰ *The Economist*, 12 June 2004.

⁷¹ Sidhu, Waheguru Pal Singh and Yuan, Jing-dong (2003) *China and India; Cooperation or Conflict?* London, Lynne Rienner Publishers, Inc., p. 60.

⁷² Andrews-Speed, Philip, Liao, Xuanli and Dannreuther, Roland (2002) *The Strategic Implications of China’s Energy Needs*, Adelphi Paper 346, London, The International Institute for Strategic Studies, p. 79.

⁷³ *Ibidem*.

⁷⁴ *Ibidem*, p. 261.

⁷⁵ Andrews-Speed, Philip, Liao, Xuanli and Dannreuther, Roland (2002) *The Strategic Implications of China’s Energy Needs*, Adelphi Paper 346, London, The International Institute for Strategic Studies, p. 78.

Chinese Commitments to "Peaceful Means"

At present there does not seem to be any risk for such a development, which remains a rather improbable scenario so long as the U.S. Navy does not appear in the Strait. Contrary to talking about naval build-ups and the protection of sea lanes, China seems to be eager to clothe its anxiety over its energy needs in peaceful terms. In July 2004 a draft energy plan for the period up to the year 2020 was approved in principle by the State Council and made public. It deals only with domestic measures and makes no mention of steps that might be taken abroad to increase China's energy supply security.⁷⁶ Furthermore, China has used its role as host for an Asian Cooperation Dialogue foreign ministers' meeting to launch an energy cooperation initiative.⁷⁷ It seems that China's leaders are conscious of the fact that unrestricted competition in the quest for energy could bring the sorts of risks mentioned above in the context of terrorism in the Strait of Malacca into being — which they wish to avoid if at all possible.

These risks are nevertheless under consideration, and means are sought to avoid them without having to involve the U.S. Navy. This is demonstrated by the fact that Chinese academics are suggesting that an oil pipeline be constructed from Burma to China in order to reduce the country's dependence on oil imports shipped through the Strait of Malacca (at present about 60 per cent of China's total oil import). According to media reports Chinese Premier Wen Jiabao and the Burmese Prime Minister Khin Nyunt discussed plans for an oil pipeline when they met on 11 June 2004 in Beijing.

This idea has been criticised, however, for not taking into consideration the problems of further transporting the imported oil from the mountainous areas near the Burmese border to the centres of high consumption in China.⁷⁸

Another similar idea has been discussed as well, namely to unite with South Korean and Thai business groups to construct a pipeline across the Malay peninsula, so that oil can be pumped from the Andaman Sea to the Gulf of Thailand and then be taken by ship to China. As far as is known, that idea has not yet been discussed on the governmental level between the countries concerned.

⁷⁶ *China Daily Business*, 1 July 2004.

⁷⁷ *Beijing Review*, 1 July 2004, p. 14.

⁷⁸ *Interfax News*, available

<http://www.interfax.com/com?item=Chin>

accessed 20 September 2004

Conclusion

On the whole, and with the exception of Japan and North Korea, China is, of late, seen as having changed its attitudes toward its neighbours in the context of access to supply of oil and gas. China is now trying to show a more benevolent face, including giving up on its own national interests to a certain, albeit limited extent, and promoting good neighbourly relations.

CHAPTER FOUR

Russian Oil – Access Denied?

This Chapter will address the following question:

- *Why, if its goal is a secure supply of energy, is China not importing more oil and gas from its neighbour Russia?*

Findings:

- *Japan is outcompeting China in the case of the Angarsk fields and on Sakhalin, and the Chinese reaction is bitter.*
- *Persisting mutual suspicion between Russia and China is probably a large part of the explanation .*
- *Conditions negotiated with the Yukos company were rendered invalid by the Russian government, who seems to favour Japan.*

Complications in Relations with Russia

China makes efforts to import oil and gas on long-term contracts from Russia, which possesses a considerable share of the world's energy resources: about 5 percent of its oil and 30 percent of known gas resources.⁷⁹ The latest available information tells us that while only 2.9 per cent of China's oil imports came from Russia in 2001,⁸⁰ by 2004 Russia had moved up to become the fourth largest supplier of oil to China.⁸¹

Russia's relations with China are also complicated.⁸² During much of the Cold War, the two countries competed openly for leadership of the socialist camp, and in the

⁷⁹ Kiesow, Ingolf (2003) *Energy in Asia*, User Report FOI-RO793-se, January 2003, available at <http://www.asia.foi.se>
P. 61.

⁸⁰ 2004 Report to Congress of the U.S.-China economic and Security Review Commission, available at <http://www.uscc.gov>
Accessed 26 June 2004, p. 157.

⁸¹ *China emerges as a major energy player*, Alexander's gas & Oil Connections, volume 9 issue #17, 2004, available
www.gasandoil.com/goc/frame_cns.company.htm
visited 21 September 2004.

⁸² Elisabeth Wishnik, *Mending Fences: The Evolution of Moscow's China Policy from Brezhnev to Yeltsin* (Seattle: University of Washington Press, 2001), p. 187.

1980s their relations soured almost to the extent of making China into an ally of the United States against the USSR. One of Moscow's first foreign policy tasks after the dissolution of the Soviet Union was to re-establish good relations with China. It had to include solving old border disputes. An interim agreement was concluded in May 1991, though it was not until 2001 that Russia and China could come together and conclude a Treaty on Good-Neighbourly Relations, Friendship, and Cooperation, which was signed by the respective leaders, President Jiang Zhemín and President Putin⁸³.

A potential problem for Russia is control over the Siberian border areas, with a population of around seven million, and where some 100,000 Chinese are believed to live. This region used to belong to China. According to some sources the 2002 census showed that the Chinese population in Russia had grown to 3.2 million, of whom many are believed to have settled in eastern Siberia. The Russian population is declining and many are leaving eastern Siberia because of the difficult economic conditions in that region, which still do not show much sign of improving.⁸⁴ The border security problem is potential and not presenting itself as such today, but it adds to the old apprehensions in some circles in Russia over the future of Chinese-Russian relations.⁸⁵

There are also trade frictions. During a visit to Moscow by National People's Congress Chairman Wu Bangguo, President Putin tried to persuade China to abandon its resistance to Russia's accession to the World Trade Organisation (WTO). However, during the Tashkent meeting of the SCO in 2004, Chinese president Hu Jintao refused to give up China's demands that Russia abandon its policy of subsidizing steel exports and give access by Chinese workers to Russia. China later repeated that these demands are to be regarded as preconditions for its agreeing to let Russia join the WTO.⁸⁶ It was not until a visit by Premier Wen Jiabao to Moscow in September 2004 that an agreement was reached allowing Wen to announce China's support for Russia's WTO application.⁸⁷

Promising Negotiations about the Supply of Oil to China

⁸³ Irina Komissina, and Azhdar Kurtov, *Russia-China-Central Asia: Striving for a new Quality in International Relations, Central Asia and the Caucasus* (Stockholm: Center for Social and Political Studies, Sweden, No 2(26), 2004), p. 151.

⁸⁴ Sergei Khaikin, "A Chinese invasion", *Gateway to Russia*, available http://www.gateway2russia.com/st/art_144395.php (15 July 2004).

⁸⁵ Elisabeth Wishnik, *Mending Fences: The Evolution of Moscow's China Policy from Brezhnev to Yeltsin* (Seattle: University of Washington Press, 2001), p. 191.

⁸⁶ *South China Morning Post*, 18 June 2004.

⁸⁷ *China Daily*, 27 September 2004.

In 2003 the *Far Eastern Economic Review* reported that while China's president Hu Jintao was visiting Russia, heads of the CNPC and the Russian oil company Yukos signed a 25-year general agreement in Moscow for the supply of 150 billion dollars worth of crude oil to China from eastern Siberia.⁸⁸ This represents another of China's giant efforts to solve the problem of secure energy supply by constructing pipelines to neighbouring countries possessing oil and gas resources. In this case, the oil fields are located near Angarsk, north of Irkutsk, and the pipeline would be 2026 kilometres long and go to the Chinese oil fields at Daqing in the north-eastern part of the country, from where other pipelines would connect to consumption centres in Beijing and Shanghai. Here again, using a common infrastructure for a parallel gas pipeline would make the project more profitable, but no further details were leaked about the idea.

Japanese Competition

As soon as negotiations between Chinese and Russian companies began, problems arose for China in the form of competing offers from Japan. They were made in line with a several year old Japanese Government policy aimed at raising the proportion of oil imported from fields owned by Japan or Japanese companies to at least thirty percent of the whole. (A special agency was set up for this purpose, but it has so far failed to attain this level of success).⁸⁹

In June 2003 Foreign Minister Yoriko Kawaguchi of Japan visited Russia's Far East and reiterated Japan's readiness to finance the whole project in meetings with Russian officials.⁹⁰

In September 2003 China sent a high-ranking delegation headed by Ma Kai, director of the National Development and Reform Commission, to Moscow to lobby the Russian government for the endorsement of the pipeline to Daqing.⁹¹

In December 2003 Russian Prime Minister Michail Kasyanov called for Japanese cooperation in developing oil in eastern Siberia during a meeting with Foreign Minister Kawaguchi.⁹² Then, in January 2004 rumours began to circulate that Japan had offered to pay for a feasibility study as well as to furnish Russia with 5 billion dollars in concessionary loans for building the pipeline to Nachodka, as well as 2

⁸⁸ *The Far Eastern Economic Review*, 24 July 2003, p.14.

⁸⁹ *The Nikkei Weekly*, 6 November 2000.

⁹⁰ *The Japan Times*, 30 June 2003.

⁹¹ *China Daily*, 12 September 2003.

⁹² *Japan Times*, 16 December 2003.

billion dollars in grants to develop the oil fields at Angarsk, while China did not make any firm financial offers.⁹³

The Attack on the Yukos Company by the Russian Government

The Russian authorities had to put the decision on hold, when Mikhail Khodorovsky, president of Yukos, who had signed the original agreement with the Chinese company on the pipeline to Daqing, was arrested for tax evasion. In February 2004 the Russian Energy Minister announced that Russia is now studying the pipeline to Nachodka.⁹⁴ In April 2004 the director of the Chinese company who had signed the agreement with Yukos, declared that

The plan is not happening now. The Japanese are more practical and business-oriented. That's why they can use more money to grab gas and oil... It's hard for China to jump up and say we're going to pay such an enormous sum of money.⁹⁵

The possibility still existed to have a pipeline branch off to Daqing, and a decision about that would be taken at the end of 2004, according to Russian Prime Minister Alexander Zhukov.⁹⁶

The story became even more complicated when, on 20 September 2004, the Yukos company declared that it was going to interrupt its long-standing contractual deliveries of oil by railway to China because it could no longer pay the railway fees. Yukos was bound by contract to deliver 6.5 million metric tonnes of crude oil to China in 2004, of which some one million tonnes were now left to be undelivered. A spokesman for the Chinese Ministry for Foreign Affairs declared that China expected Yukos to honour its commitments.⁹⁷

It is widely believed that the Yukos decision was a political one, aimed at demonstrating to the Russian authorities that the problems caused by their accusing Yukos of tax evasion and the ensuing process would have consequences that will become unbearable for the Russian state economy. It also came days before a Russian–Chinese summit meeting.⁹⁸

⁹³ *Stratfor.com*, 9 January 2004.

⁹⁴ *2004 Report to Congress of the U.S.-China economic and Security Review Commission*, available at <http://www.uscc.gov>

Accessed 26 June 2004, p. 157.

⁹⁵ Goodman, Peter S. (2004) in *Washington Post Foreign Service*, available at <http://www.washingtonpost.com>

accessed 5 April 2004.

⁹⁶ *China Daily*, 2 May 2004.

⁹⁷ *China Daily*, 22 September 2004.

⁹⁸ *Platts Newsletters & Reports*, available at <http://www.platts.com>

Angarsk Oil Becomes a Matter for the Highest Level

Ahead of that meeting, the Chinese Premier Wen Jiabao made the following statement:

As for larger cooperation in this sphere, especially the construction of an oil pipeline from Russia to China, I must stress that two chiefs of state have expressed their unanimous opinion several times and related work has begun. We understand difficulties and problems of Russia in choosing the pipeline route. However, we are confident that, no matter how the pipeline project develops, the Russian government and plants will give the priority to a pipeline to China, which is the most sustainable market for Russian oil and gas. I think that bilateral oil and gas cooperation meets the crucial interests of China and Russia. Before the pipeline is built, we would like to enlarge Russian oil deliveries to China by railroad. We would like the railroad delivery to reach 15 million tons by 2006. Chinese enterprises are also ready for various forms of appraisal and development of oil fields together with Russian colleagues.⁹⁹

In Moscow, Premier Wen's Russian counterpart solemnly reassured him that deliveries of oil by train from Russia would not be interrupted, but nothing was agreed upon regarding pipelines.¹⁰⁰

President Putin then visited Beijing in October 2004, and expectations were high in China that he would at least bring with him a promise to allow China to connect to the projected Angarsk-Nahodka pipeline. However, before his departure, he was reported to have declared that "Russia would be driven only by self-interest in deciding to supply oil to rivals China and Japan through a future Far Eastern oil pipeline."

In Beijing Putin signed several agreements, one of which finalized a demarcation of borders, resolving 40 years of acrimonious disputes. He did, however, not even accept the idea that China should invest in the energy sector in Siberia but offered his hosts the general advice that other sectors of the economy should be chosen for Chinese investments.¹⁰¹

One of the many documents that were signed during the visit was a "vague pact" between Alexei Miller, head of the state-owned Russian company *Gazprom*, and

accessed 20 September 2004.

⁹⁹ *Interfax::China*, available

<http://www.interfax.com/com?item=Chin&pg=0&id=5756870&req=>

accessed 22 September 2004.

¹⁰⁰ *China Daily*, 10 October 2004.

¹⁰¹ *BBC NEWS/Asia- Pacific*, 21 October, available

<http://news.bbc.co.uk/>

Accessed 28 October 2004.

China National Petroleum, concerning cooperation in the field of production of natural gas. In the Russian media this has been interpreted as a possible compromise; China will be given access the natural gas that is also found in the Angarsk fields.¹⁰² That, however, would be a comparatively costly way for China to get access to the gas. If a gas pipeline can not be constructed side by side with a pipeline for oil, utilising the benefits of shared infrastructure costs, the unit cost per cubic metre is likely to be disproportionately high.

Conclusions

China and Japan have demonstrated equally geostrategic tendencies in looking at the problem of competition for secure access to foreign energy resources. Japan has been able to out-compete China by offering a better deal.

The reactions in China have been understandably bitter. The Chinese were negotiating with the private company Yukos, but the rules about “a level field for competition” were not applied. The Japanese, who had been negotiating through the state-owned company Gazprom, seem to be given the contract.

The conditions negotiated with Yukos were rendered invalid in connection with the attack on Yukos by the Russian government, who seems to favour Japan.

¹⁰² *The Moscow News*, 21 October 2004.

CHAPTER SIX

Competition with the United States, Sometimes Regarded as Strategic

This Chapter will address the following question:

- *How does competition for oil affect relations with the U.S.?*

Findings:

- *Competition is sharpening existing differences.*
- *The U.S. and China approach the world oil market in incompatible ways, and employ very different methods of doing business.*

The author of a leading article in the official and government-owned journal Beijing Review criticized the American presence in Central Asia, saying that “the American pipe-line programs pose a potential threat to China”.¹⁰³ The situation created by the competition between Japan and China over the Angarsk oil revealed a Chinese attitude to the problem of its own energy supply which is basically strategic and not commercial. It sometimes happens that the quest for oil initiates other strategic concerns.

U.S. Strategic Concerns

It should be recalled that on 1 April 2001, an American surveillance plane collided with a Chinese fighter plane over the South China Sea, inside the economic zone claimed by China, but according to the U.S. interpretation, over international waters. International experts on China believed that the incident was used by the PLA to boost its political clout by forcing the face-off with the U.S. over its security role in East Asia.¹⁰⁴ The official news agency Xinhua carried an article claiming China's right to regulate the conditions for passage through China's economic zone.¹⁰⁵

The United States has not promised to stop the reconnaissance flights over international waters but inside China's exclusive economic zone and has actually continued these flight missions without being challenged any more.¹⁰⁶ It remains

¹⁰³ *Beijing Review*, 8 August 2002.

¹⁰⁴ *South China Morning Post*, 10 April, 2001.

¹⁰⁵ *Beijing Review*, 19 April, 2001 and 26 April, 2001 and *China Daily* 17 April, 2001.

¹⁰⁶ *Japan Times*, 31 March 2001, *South China Morning Post*, 30 July 2001.

unclear, however, if China is claiming a right to regulate passage in peacetime of military ships and aeroplanes through its economic zone and/or whether the whole of the South China Sea is also claimed as "territorial waters". To claim the South China Sea as territorial waters would mean a serious challenge to the military role of the United States in the Western Pacific. So far, one logic interpretation is that China may indeed be preparing to maintain its "right" to do so, an interpretation of the UNCLOS that is questionable and rests on contested claims.¹⁰⁷

Opposing Views of the Nature of the Oil Market

The responsibility for a development without international complications and/or confrontation is not China's alone. Much will depend on the response from the outside world. A quotation from the previously cited *2004 Report to Congress of the U.S. China Economic and Security Review Commission* may serve to illustrate the nature of the issue:

There is a clear distinction between U.S. and PRC approaches to securing oil supplies. Whereas the United States has shifted from an oil import strategy that was based upon controlling the oil at its source to one that is based on global market supply and pricing, the Chinese strategy is still focused on owning the import at the production point..... Geopolitically, this could soon bring the United States and Chinese energy interests into conflict. Both countries will be in the Persian Gulf for oil. While China's direct investment into energy production could increase global energy supplies, its strategy of securing its own stake in an energy-exporting state, particularly in states of concern, does not appear on balance to contribute to the larger energy security picture for other energy-importing nations.¹⁰⁸

It will be important for the international energy market how these two consumer giants manage their relations in the competition for energy resources. Russia and the countries of the Middle East have better historical relations with China than the U.S., but will that be of any importance? Will the outcome of the race for energy affect relations between Europe, the Middle East, Russia, the U.S. and China?

A foreign policy commentator in Beijing has made the following statement:

Western monopoly capital, with the support and assistance of their governments, has scrambled and seized the main oil and gas resource markets in all parts of the world. Almost all good resources markets have been occupied and possessed by them. There is intense

¹⁰⁷ According to Article 19 of the UNCLOS it is only in case of so-called innocent passage through territorial waters that the coastal state has the explicit right to demand that the ship or aeroplane does not commit "any act aimed at collecting information to the prejudice of the defence or security of the coastal state". There is no corresponding clause regarding the exclusive economic zone.

¹⁰⁸ *2004 Report to Congress of the U.S. China Economic and Security Review Commission* (2004) available at <http://www.uscc.gov>
Accessed 24 June 2004.

competition among different groups of monopoly capital. All of them will certainly try even harder to impede Chinese companies from obtaining these resources.¹⁰⁹

It should be observed that China had acquired oil fields in Iraq for several billions of dollars prior to the U.S. invasion in 2003 and it still remains to be seen whether the new Iraqi government will honour the deal made by Saddam Hussein's regime. So far the U.S. has not succeeded in appearing as helpful in the process, and in Kazakhstan, American oil interests have not been kind to Chinese competition.

Thinking in Terms of "Worst Case Scenarios"

One thing seems to be clear: the attitudes to access to supply of oil and gas are likely to have a great impact on the relations between these countries in other fields.

A taste of what the pessimists may be expecting from the future may be an article reprinted in the *Beijing Review* commenting on the *2004 Report to Congress of the U.S. China Economic and Security Review Commission*:

A dragon's breath of apprehension is blowing through the imperial complacency of Washington. What used to be "U.S. Trade Deficit Review Commission" of the Congress has morphed from a general question into a particular one: It is now "U.S.-China Economic and Security Review Commission", tasked with examining "the national security implications of the bilateral trade and economic relationship" between the two countries... In response, the Commission is almost calling for a trade war with China, with references to the World Trade Organization, examination of subsidies, trade practices, intellectual property rights and transparency of corporate governance.....The United States even sees China's growing dependence on international oil markets as threatening.

¹⁰⁹ Jaffe, Amy Myers and Lewis, Steven W.(2002) *Beijing's Oil Diplomacy, Survival*, Volume 44 Number 1.The International Institute for Strategic Studies, London.P.127.

Conclusion

The reprinting of such an article in a semi-official journal may be taken as a warning that China may react strongly against any move that will hurt its foreign trade and especially any move that would threaten the security of its energy supply. This is consistent with the national policy priorities as expressed in the 2002 White Paper on China's National Defense:

The fundamental basis for the formulation of China's national defense policy is China's national interests. It primarily includes: safeguarding state sovereignty, unity, territorial integrity and security; upholding economic development as the central task and unremittingly enhancing the overall national strength...¹¹⁰

¹¹⁰ Available at
www.china.org.cn/english
Accessed 8 July 2004.

CHAPTER SEVEN

China's New Soft Approach Policy: More than Image?

This Chapter addresses the following question:

- *How does China's new soft approach in foreign policy affect its oil policy?*

Findings:

- *The new soft approach policy is more than just image*
- *Still, China is not likely to give up essential interests in the name of good neighbourly relations.*
- *Growing Sino-U.S. mutual understanding may mitigate the consequences of oil rivalry.*

The impact of China's oil purchasing policy sometimes runs contrary to the general aims of Chinese foreign policy. These aim at creating friendly relations favourable to China's export efforts and at promoting stability in trade relations and in China's neighbourhood.

The Formula of "China Peacefully Rising"

As shown by the well-known Hong Kong journalist and China specialist Willy Lam,¹¹¹ the formula that during a part of 2004 was used for summarising China's foreign policy, namely "China Rising peacefully" is a compromise between Deng Xiaoping's formula "Keep a low profile and never take the lead" and the wishes of his successor Jiang Zemin to be able to exercise a great power policy. The formulation that was mostly used during the spring of 2004 by foreign minister Li Zhaoxing represents the balance act performed by the present leader Hu Jintao between the different camps of opinion in the communist party.¹¹²

There are certain limits for the will always to find a compromise, when China finds it proper to demand respect for its status as a Great Power and in these cases it is not always possible to make the policy fit with the image that China wishes to project of itself.

¹¹¹ Lam, Willy (2004) *Beijing's new "balanced" Foreign Policy: an assessment*, China Brief, 19 February 2004.

¹¹² http://chinadaily.com.cn/english/doc/2004-03/08/content_312650.htm, accessed 8 August 2004.

It should not be forgotten, however, that the new image is a reflection of a real wish for stability and improved relations with the neighbouring countries and the rest of the world. It is an expression for changed social and economic conditions after the accession to the World Trade Organisation (WTO) and China's opening up to the outside world, with liberalisation of the economy, globalisation and dependence on free trade. In this way it can be seen as an expression of its own interests and not merely as a propaganda stunt. Where cooperation and compromise can substitute for threats and pressure, it is nowadays intended to be practiced and there have been occasions when it has been obvious that this has been carried out in practice. As we have seen, this is for instance the case regarding claims on an economic zone in the South China Sea, which overlap claims by several ASEAN countries, according to the rules of the Convention about the Law of the Sea. In this case, China has at least formally accepted a solution that is not entirely in its own favour.

To Avoid China-bashing

Willy Lam tells us that "China Peacefully Rising" was a formula that was invented by Shanghai-based academics and party cadres in order to counter the talk about "The China threat".¹¹³ The latter expression has been used both in the U.S. in connection with military matters and trade relations. It even appears occasionally in European debates – and is perceived as unfair by the Chinese.

They demand that also the Chinese shall be entitled to be rightly understood and respected when carrying out a policy for advancing the economic and strategic interests of their nation. They feel that they have already made enough for being in a position to expect to be trusted as having honest intentions. China's rapid economic development has hitherto been less damaging for the industry of other nations than were the Japanese economic successes during the last century. Nobody should for instance be surprised that China is trying to secure safe supply of oil and other raw materials.

The new formula is intended to help the Chinese in being understood but also to help in avoiding misguided actions that can hurt the nation. This kind of thinking has appeared since long ago in internal debates. In anticipation of the then imminent accession to the WTO, articles were written in Chinese media as early as 1999 about the danger for isolation and one-sided stressing of particular national interests.¹¹⁴

¹¹³ Lam, Willy (2004) *Beijing's new "balanced" Foreign Policy: an assessment*, China Brief, 19 February 2004.

¹¹⁴ Sa, Benwang (1999) *Don't isolate ourselves*, in *The Global Times*, August 1999, Beijing, Chinese Institute of International Studies.

China Entitled to a Leading Role in the Region

A well-known Chinese researcher, Wenzhao Tao, has explained what the new Chinese foreign policy is intended to mean. China shall continue representing “third world views” with an emphasis on the interests of neighbouring countries and focusing on the world’s major powers and oppose “great nation chauvinism”. Focus shall be on promoting the development of a “well-off society”, which requires a peaceful and stable development in the vicinity. China shall take on a larger leadership role, which inter alia has been a reason to host the so-called six-nation talks in Beijing about North Korea’s Nuclear weapons program. Finally, and with an explicit reference to the mutual economic interdependence, a stable relationship between China and the U.S. shall be established.¹¹⁵

A Cautious Multilateralism

It is already possible to demonstrate that China has implemented these guidelines in practice, not least in abstaining from obstructing some aspects of American policy that are considered objectionable, like the U.S. occupation of Iraq.

Furthermore, Foreign Minister Li Zhaoxing declared in his speech at the opening ceremony of the United Nations General Assembly in the autumn of 2004 that China is championing multilateralism and strengthening the role of the United Nations. When applied to China’s neighbourhood, this is a substantial deviation from former practice in Chinese foreign policy, where Beijing constantly insisted on bilateral handling of all issues of importance (which meant a better way of putting pressure on the smaller neighbours). China still has to prove in practice that the multilateral preference is meant seriously.

Relations with the U.S. are the Real Test for the Soft Approach Policy

“It takes two to tango”, and China’s long walk toward multilateralism and globalisation has not been promoted much by the recent influence by neo-conservative thinkers in Washington. Energy is one field, where national egoistic attitudes tend to appear faster than in other fields.

In spite of the generally positive development, a strong suspiciousness remains among certain circles in the U.S. toward China’s long-term intentions – and there cannot be any certainty whether China in the future will continue to quietly accept an American military presence right on its own coastal borders. There is no lack of

¹¹⁵ Tao, Wenzhao (2004) *Changes and Drivers in Sino-U.S. Relations*, in *China Strategy*, Volume 3, 20 July 2004, Centre for Strategic and International Studies, Beijing.

warnings about a coming Chinese assertiveness in American professional literature.¹¹⁶ Corresponding messages are directed to the leadership in China by scholars and security policy analysers, who propagate outright nationalism.¹¹⁷ These circles are not representative of the official policy, but they do have a certain influence under certain circumstances.

As late as during the summer of 2004 rhetoric on both sides of the Taiwan Strait was intensified in connection with the debates in Taiwan after the presidential elections in which Chen Shui-bian was re-elected for a second mandatory period. The Chairman of the Chinese Military Commission, former President Jiang Zheming, vowed to recover Taiwan by 2020, marking the first time China has set a deadline for reunification and requested Taiwan to give up its resistance soon. Units of the Chinese and U.S. navies conducted separate military exercises and Taiwan's air force practiced emergency landings on highways. Jiang Zheming retired from his post in September 2004, but it is not clear whether this will mean much of a change in Beijing's attitude to the Taiwanese issue. When Chen Shui-bian in October 2004 tried to invite Beijing to a dialogue about the cross-strait relations, this move was not welcomed in Beijing and Chen was rebuked in mainland media for "not being serious".¹¹⁸

The U.S. is maintaining a "strategic ambiguity" and its government is bound by legislation to provide Taiwan with all the weapons it needs to defend itself. This remains an obvious and dangerous bone of contention in Sino-American relations, while the U.S. remains the most important partner in foreign policy and military matters. From an American point of view, the situation in the Western Pacific requires a continued presence with military means to help Taiwan preserve its independence, keep the sea-lanes open in the South China Sea, contain China from expanding its sphere of dominance and keep Japan as a client, who abstains from having independent means for military power projection abroad.

¹¹⁶ See for instance Tkacik, John J.Jr(2003) *Time for Washington to Take a Realistic Look at China Policy*, in *Backgrounder*, No. 1717 December 2003, Published by the Heritage Foundation, Washington D.C.

¹¹⁷ Zhang, Binsen (2003) *China Should Abandon the Foreign Policy of "taoguang Yanghui"* ("Bide or Time, Build our Capabilities") in *Chinese Political Science*, 17 May 2003, available <http://www.ccrs.org.cn/233/ReadNews.asp?NewsID=212>

Accessed 10 October 2004.

¹¹⁸ *China Daily HK Edition*, 13 October 2004.

Conclusion

The economic exchange between China and the U.S. has become eminently important for both parties and mutual restraint is being shown by both sides in controversial issues. Any serious conflict between China and the U.S. would have very serious consequences for the economies of both countries and be very damaging to the rest of the world as well. This works as a deterrent against any confrontational move by either side in this complicated relationship. Competition about oil, safety of Sea-lanes and influence over China's neighbours is being kept within sensible limits by economic considerations and are an argument for a more structured and co-operative order in Northeast Asia.

CHAPTER EIGHT

Observations and Conclusions

There is no doubt that China has an Achille's heel in its dependence on imported oil and gas and that this means a limit to the will for complacency and compromise expressed in the overall formula for China's foreign policy about "China rising peacefully". It may often mean a more hard-nosed profile when competition about energy is concerned than otherwise in relations with foreign countries (something which by the way is likely to be true about many other countries).

Different Roles of Energy in China's Foreign Relations

On the other hand, China's need to import oil from the Middle East and Africa has made much to engage China in closer relations with the countries of these two regions. It may have a special relevance in the Arabic countries, given the souring relations between these countries and the U.S. because of the way that the war against terrorism is being fought.

In the South China Sea, the development has been rather positive from a security point of view. China has accepted a code of conduct for the South China Sea valid for all ASEAN-countries and for China. It does not solve the problems of overlapping claims on the oil riches on the bottom of that sea, but it certainly has made effective crisis management easier, and it may be the beginning of a real cooperation in exploring the oil wells for common use, as proposed by some.

The Chinese proposal to create a common Asian energy policy seems to be somewhat connected to the problem of international control of the Malacca strait in order to prevent piracy and terrorism against shipping. It may also serve as a counter-move against what the Chinese perceive as American efforts to get military control over the straits.

In bilateral relations the energy needs have practical consequences and more so in relation to the neighbouring countries. China's efforts to secure supply from Central Asia of oil and gas have led to the construction of a pipeline from Kazakhstan, which can become the beginning of a breach of the hitherto almost monopoly-like Russian control of the export of oil and gas from Central Asia. It has also made China more important to the Central Asian countries, especially Kazakhstan.

Russia has not lived up to previous promises to let China use the oil from the first one of the large oil fields in Siberia to be opened for production, but instead it has sold the rights to Japan to construct a pipeline to the coast on the Pacific Ocean. This has caused a bitter reaction in China. The Chinese penetration of Central Asia, especially in the field of energy, is another element of potential friction between the two Eurasian Great Powers. The cooperation within the Shanghai Cooperation Organisation is not explicitly directed at energy cooperation but is serving as a forum for discussing differences of this kind in a more relaxed environment.

China's own needs for imported oil has made it impossible to continue the very expensive practice from previous decades to supply North Korea with oil almost free of charge, which has previously given China some leverage over the North Korean policy. That leverage is now being considerably reduced, which is obvious in connection with the so-called six-nations-talks about North Korea's nuclear weapons.

The competition about oil on the bottom of the East China Sea has recently become rather serious between China and Japan and is related to old conflicts with much symbolism involved. The Japanese success in getting the rights to the oil in the Angarsk fields in Siberia in competition with China has made matters worse, and competition about the oil riches on the Sakhalin peninsula may become another element in this process. The energy issue is a matter of friction between China and Japan that will need attention on both sides in order to limit its negative effects on the stability of the region.

Energy and the Principle of Free Trade

In the U.S., China is being accused of acting against the principles of free trade in the field of energy. This is obviously true in one sense, but its importance should not be exaggerated. The Chinese purchases of oil fields in Central Asia, the Middle East and Africa for exclusive exportation to China have so far been of a limited extent. Even several European countries have state-owned and/or partially state-owned companies owning and operating oil and gas fields abroad – albeit generally working along principles of free trade. When it comes to pipelines for gas, no large contract can be made without government involvement, since land rights for owners of land, where the pipelines are going to be made, have to be regulated. China is not acting very differently from other countries in that respect.

It is not possible to measure how much oil and gas is being withdrawn from the free world market for oil and gas by China's purchasing policy. The problem seems to be moderately serious so far, but it may of course become more serious by time, if the policy is becoming advanced by larger funds and more dedication in backing it up by state organs.

The problem is more what it means for the future. In the west, there is a tendency to listen to the explanations for the recent oil price rise from the oil companies. They tend to stress the political unrest in important oil supply countries as well as the rapid increase in demand from China and India.

In the Middle East, the stress in explanation lies more on the rapidly increasing demand for imported oil in America and in the insufficient investments in oil industry during the previous long period of low oil prices.¹¹⁹ There is a real anxiety about oil prices too high to bear and with consequences for the world economy during a period ahead of us and possibly permanently, due to this combination of factors.

¹¹⁹ *Al Jazeera News Agency*, 22 September 2004, available <http://english-aljazeera.net/HomePage>
Accessed 2 October 2004.

China, Oil and America

The most sensitive relation in the energy field is the same as in other respects, namely the one with America. Here the strategic competition in the Western Pacific, with such elements as Taiwan, the Korean question and the South China Sea make both parties see their respective energy needs in a geostrategic perspective and one of competition. This is one of several possible explanations why both sides sometimes describe each others' intentions in a manner that is amazingly sinister, when it comes to oil and gas. This is normally a field for peaceful competition in the globalised world of today and should not evoke memories of Pearl Harbour and Operation Barbarossa – which at times it does.

However, there is a perspective on the relationship, which is not only seemingly serious, and that is the beginning scarcity of oil and the increasing level of oil prices. It is widely believed in China that the American wish to have stability in the Middle East and the Gulf in order to secure oil supply to the world market was an important element in the decision-making process before going to war with Iraq. China has continuously opposed that action. On its side, the U.S. has made successful efforts to stop China from getting more oil and gas out of Central Asia. The actions of America's ally in the Pacific region, namely Japan, has also made China feel threatened in the energy field and China has bought oil from Iran, which is being subjected to American sanctions and China will buy huge amounts of natural gas from Iran, if a recent Memorandum of Understanding is formalised into a real contract.

In that perspective, the tendency toward more state intervention can become an element of political and strategic instability. There have been very few official comments about the U.S.-Chinese competition for oil, but Deputy Assistant Secretary of State Randall Schneider said recently in an interview with Voice of America, that it is still too early to say whether the need for oil will lead the United States and China into potentially harmful confrontation or bring the two countries together. It could also lead to cooperation in protection of sea-lanes, and promotion of stability in oil-producing regions.¹²⁰

¹²⁰ Ho, Stephanie,(2004)*Will China, US Have to Compete in Global Search for oil?* Article in *Voice of America*, 6 October 2004, available <http://www.voanews.com/contact.cfm>
Accessed 11 October 2004.

Conclusions

- It is easy to see that China's need for safe energy supply is difficult to accommodate with the "soft foreign policy profile" and close and friendly relations with all its partners, which China has decided to maintain in the interest of its rapidly globalising economy.

- The wish to get access to the oil riches on the bottom of the South China Sea tends to come in conflict with good relations with the ASEAN countries. The construction of a pipeline from Central Asia connecting to the national grid of oil pipelines is seen as a threat to Russia's hitherto almost complete control over the export of oil from that region. The need for oil from Siberia tends to create negative attitudes on both sides, when Japan is snatching the access to the Angarsk fields from China. The historically dangerous relationship with Japan is put at risk by disputes about drilling for oil and gas on what China regards as its own continental shelf in the East China Sea but which Japan regards as its own economic zone on its side of the median line between Japan and China.

- With America, the relations are even more complicated. Seen in a Chinese perspective, the ambition to have safe sea lanes for oil import is not readily compatible with the U.S. military presence in the Western Pacific. American plans for fighting terrorism in the Malacca strait are equally difficult to combine with perceived maximum safety for China's national interests in the South China Sea. Even worse is that China has North Korea as a traditional client and is bound by treaty to defend that country in case of any attack on its territory and North Korea keeps challenging the U.S. policy against proliferation of weapons of mass destruction. China has lost most of its leverage on North Korea's policy by no longer being in a position to provide nearly all the oil that is needed by that country.

- On the other side, the U.S. keeps saying that it may defend Taiwan and there is no guarantee that the Taiwanese leaders do not declare independence, in which case the strong nationalism in China may force the leaders to attack. Frictions over sea lanes and competition about access to oil in the Middle East and elsewhere may represent an extra element of risk that can mean that otherwise acceptable acts may have unintended consequences in a relationship with these elements. Worsening relations can appear in spite of increased mutual economic dependence.

- However, there are also opportunities to turn the energy dependence into confidence building if just the right measures can be invented. To do so remains an important task, not only for China and the U.S. but also for other countries, which can also be involved in common arrangements to increase the secure supply of oil to the market for common use. It may not be an easy task, but the opportunity ought to

be there. It does, however, require an amount of mutual confidence that has to be created. It will not come by itself, and China can not do it alone.

- China and Japan will have a heavy part of the responsibility for the further development, if there is to be a race for the oil from the Eurasian continent - and the U.S. even more so. The European Union will have to elaborate its emerging common energy policy with great care. There seems to be reasons for the European Union to have consultations with both its suppliers such as Russia (which is already made on a regular basis) and OPEC and with important competitors as buyers such as the U.S, Japan and China.

- That China is thinking of its relations with Europe in similar terms appears from a statement by Premier Wen Jiabao. According to him, China is willing to actively join international efforts to guarantee energy resources and explore new sources. Premier Wen Jiabao made the remarks at the Fifth Asia-Europe Meeting (ASEM), in October 2004.¹²¹ It seems that the EU will be well advised to take this invitation seriously.

¹²¹ *China Daily*, 10 October 2004.

Relevance for Sweden

This study and the study by Kristina Sandklef about *Energy in China: Coping with Increasing Demand*¹²² together illustrate how the government of one nation was forced to take drastic measures when facing a combination of a sudden increase in demand and a threatening crunch in supply. However, the Chinese example can hardly be a guide-line for Sweden to possible solutions for the following reasons:

- Sweden is a small country and increased government participation in competition with other states is not likely to yield much in the way of increased security in the supply of energy raw materials. Sweden is also a member of the European Union and cannot act alone.
- Sweden has cold winters and needs much energy for heating. Measures to reduce consumption are likely to be of little value.
- Sweden has a high living standard with high consumption of energy, its hydroelectric resources are already fully exploited and there are no exploitable energy raw materials available in the country. There is also a declared ambition to gradually phase out the use of nuclear energy. (The deposits of natural uranium that exist in Sweden are thus not economically exploitable under present conditions).

The value of the Chinese example is rather that it illustrates several international tendencies, of which increased competition between states for supply of oil and gas is the most obvious one.

There are several factors that have contributed to this tendency:

- Great consumer states like China, to a lesser but significant degree also Japan and, in the case of natural gas, India as well have all found it necessary to engage their governments in efforts to negotiate contracts for exclusive rights to extraction from oil and gas fields abroad and import exclusively to their own country. That limits the amounts available for the free trade in these commodities and is consequently acting as a pressure for higher prices on the remaining international markets for oil and gas.
- More frequent political unrest and more frequent domestic strife, including more frequent terrorist acts against production facilities in countries producing oil and gas have made investments more risky. The higher risks

¹²² Sandklef, Kristina (2005) *Energy in China: Coping with increasing demand*, Stockholm, Swedish Research Agency, FOI-R—1435—SE.

both increase the upward pressure on prices and can act to reduce the production in the future.

- A combination of these tendencies has stimulated debates about the time that is left until the worldwide resources of oil and gas are fully exploited and have to be replaced with alternative energy sources. These anxieties have in their turn contributed to the upward turn of the prices for oil and gas during 2004.

Recommendations

There seems to remain few ways out of the approaching dilemma for the Swedish government.

One possible way is to act within the European Union for making energy a new field of common policy and for making more secure supply of energy raw materials available for common use under conditions of free competition within the Union.

Another way is to promote actively the production of energy from gas and to promote construction of pipelines for the importation of natural gas as well as facilities for the importation of LNG and LPG. Production of energy from gas will add alternatives to the ways in which energy is produced in Sweden but it will not eliminate the dependence on other countries and fluctuations in the supply of energy.

Attention should also be given to studies of alternative energy raw materials such as methane gas and liquefied coal, but they are likely to result in substantially improved security in the supply of energy only in the long-term perspective and not in the near future.

Further studies are recommended regarding the situations and policies of other huge energy consuming countries, notably USA, Japan and India and last but not least the European Union.

Studies should also be made about how producers of energy raw materials tend to use their resources as an instrument for foreign policy. This is shown by the Chinese experiences in negotiations with Russia and it is especially important in the case of Russia, since the European Union is becoming increasingly dependent on the supply of gas from that country.

The government should give a high priority to the need for an energy security policy and the need to plan for energy crisis preparedness. This is a lesson that can also be learnt from the Chinese example.

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