China’s spectacular economic growth over the past three decades has significantly altered its position in both regional and global oil markets. The International Energy Agency’s (IEA) June 2010 Oil Market Report states that “China’s urgent need for energy supply to sustain economic growth and raise the wellbeing of its people has become a global market issue.”1 In an interview reported in The Wall Street Journal, IEA chief economist Fatih Birol went further, contending that China’s economic ascent marks the beginning of “a new age in the history of energy.”2

This “new age” is marked partly by China’s soaring demand for oil and increasing dependence on foreign sources of supply. It is not surprising that these developments have raised concerns in China about “energy insecurity.” Nor is it surprising that China’s expanding oil consumption requirements and efforts to secure its future energy needs have raised concerns by others about China.3 Some contend that China’s quest for overseas oil supplies is likely to lead to rivalry and discord,4 while others believe that such risks can be mitigated.5

Patterns and trends in the global oil market

China’s efforts to meet its growing oil consumption requirements have taken place during a period of oil price volatility and in the context of longer term structural changes in worldwide oil supply and demand. Crude oil prices have risen and fallen dramatically for most of the 2000s. The price of crude oil doubled (to $60 per barrel) between 2003 and August 2005, skyrocketed to $145 in July 2008, and then plunged to $33 six months later. These wild price fluctuations have been attributed to a complex combination of financial and supply-and-demand factors: “price fixing” by the Organization of Petroleum Exporting Countries (OPEC), i.e. setting production quotas based on assessments of the market’s call on OPEC supply; the erosion of OPEC’s spare capacity; the shift by international oil companies’ (IOCs) to a “just-in-time” inventory management system; the increasing importance of the oil futures market in the pricing system; the poor quality of data; and the weakening of the US dollar.6

Meanwhile, the global oil market has been undergoing profound changes. On one side of the equation, OECD demand has leveled off and is forecast to decline, while non-OECD countries have emerged as the main demand growth centers.7 In fact, the primary sources of projected demand growth are in Asia, chiefly China, India, and Middle Eastern countries. There
have been major changes on the global supply side as well. Oil production in Organisation for Economic Co-operation and Development (OECD) countries is in decline. By 2030, production in the USA and other industrialized countries is expected to decrease from current production levels, while OPEC countries are expected to provide most of the increase in world oil output.8

This changing global supply-and-demand profile has been accompanied by a structural change in supply relationships. While the USA, which is still the world’s leading oil consumer by far, has been shifting away from its reliance on oil from the Middle East, China and other Asian countries have become the leading customers for oil from the region. This new pattern is perhaps best illustrated by the case of Saudi Arabia. In 2009, Saudi Arabia’s oil exports to the USA dropped below 1mbpd for the first time in two decades just as China’s purchases climbed above that level.9

What are the net effects of this pattern? For one thing, unstable and high oil prices might well be here to stay. Many experts are skeptical that future demand growth needs can be met. Slack investment due to the financial crisis threatens to constrain capacity growth, which could risk a supply shortfall when demand recovers. For another, the current supplier structure is fragmented; therefore, decisions by or conditions in just one of the many producing countries tend to have a rippling effect. In addition, there are multiple sources of potential dislocation, ranging from instability in the Niger Delta to uncertainty about Iraq’s ability to expand production. According to the IEA, this pattern “consolidates mutual dependence but also enhances the risk of supply interruptions, as much of the additional oil imports have to transit vulnerable maritime routes.”10

These trends and concerns have evoked several types of behavior worldwide, including resource nationalism and resource mercantilism.11 As will be shown, China has engaged in these, as well as in other forms of behavior.

**China’s energy fundamentals**

Though coal is by far China’s predominant energy source, oil nonetheless constitutes roughly 20% of the primary energy mix and is thus of critical importance to the economy.12 For more than a decade, China has experienced 1) a widening gap between domestic oil production and consumption requirements, 2) an increasing dependence on foreign sources of oil, and 3) continued heavy reliance on maritime transport of the bulk of imported supply.

As recently as the 1980s, China was a net oil exporter. Most of the country’s oil output at the time came from three enormous onshore fields in the northeastern part of the country: Daqing (Heilongjiang Province), Liaohe (Liaoning), and Shengli (Shandong). China became a net oil importer in 1993 due to slowly declining production and the failure to discover new fields of comparable size. Nevertheless, China is still the world’s fourth-largest oil producer after Saudi Arabia, Russia, and the USA.13 The bulk of output is obtained from onshore fields, though production from offshore fields has expanded rapidly in recent years.

Meanwhile, however, China’s oil consumption requirements have risen dramatically. Since 2004, China has been the world’s second-leading consumer of oil, behind the USA. China recorded its largest oil demand in June 2010 at 8.98mbpd, 10% higher than a year before, and 0.7% higher than May 2010, the previous record.14 There are several reasons for China’s surging demand for oil: urbanization, the increasing number of registered vehicles, and the use of fuel oil and diesel to generate electricity in order to overcome power shortages.

The growing gap between domestic production and consumption requirements has translated into increasing dependence on imported oil. While the largest share of Chinese oil imports
comes from the Middle East, in recent years China has sought to manage risk by diversifying its foreign sources of supply. As a result, Africa’s share of the oil imported by China, for example, rose from 24% in 2003 to 30% in 2008. Yet, even while having succeeded in thus diversifying its sources of supply, China remains heavily dependent on Middle Eastern oil and its overall oil import requirements have continued to grow.

China is highly dependent not only on foreign sources of oil but also on the maritime transport of its oil supplies from abroad. Approximately 80% of China’s imported oil is delivered by sea. As will be shown, China has completed (with Kazakhstan) and is pursuing several ambitious and expensive overland pipeline projects (with Russia, Burma, and Pakistan) in order to reduce its reliance on maritime transport of oil. However, it is not clear whether or when these efforts to achieve higher overland oil deliveries will bear fruit, much less whether they will greatly enhance China’s oil supply security. Indeed, some analysts believe that the country’s seaborne oil imports are likely to increase.

Yet another aspect of China’s foreign dependence is the fact that Western oil companies (such as, British Petroleum, Chevron, ConocoPhillips, Exxon-Mobil, Royal Dutch Shell, and Total) control most of the world’s high-quality oil reserves as well as substantial shares of the oil technical services market, international oil trade and investment in oil projects, and advanced technology in the oil and petrochemicals sectors.

Most analysts believe that China’s oil consumption and net import needs will continue to increase. According to the IEA’s 2009 Reference Scenario, China’s oil consumption would more than double in the medium term, from 7.7mbpd in 2008 to 16.3mbpd in 2030. The IEA also projects that China’s domestic production would drop from 3.8mbpd in 2008 to 3.2mbpd in 2030. As a result, the country’s net import needs would rise from 3.9mbpd in 2008 to 13.1mbpd, making China the world’s largest net importer of crude oil by 2030, slightly ahead of the USA (13.5mbpd in 2008, 12.7mbpd in 2030). Under this scenario, China’s net import dependence ratio would jump from 51% in 2008 to 80% in 2030. Issues related to this projected long-term dependency on foreign oil are at the core of Chinese perspectives on energy security.

**Chinese perspectives on energy security**

Over the past decade, Chinese perspectives on energy security have tended to reflect concerns about the extent of the country’s dependence on foreign sources of oil and transport of oil supplies over maritime routes they do not control, and about the uses of American power. As a number of observers have noted, Chinese leaders and analysts do not consider energy as a purely economic issue. Nor do they regard oil as a common commodity. Some Chinese officials and experts have argued that the country’s growing dependence on foreign oil supplies poses a strategic threat, while others have maintained that this reliance should be treated as a natural byproduct of its growing interdependence with the rest of the world.

The 2003 Iraq War seemed to have bolstered the conviction of some in China at the time that the USA was pursuing hegemony in the Middle East and that if conflict were to erupt over Taiwan, Washington would do everything in its power to reduce China’s access to imported oil. The setbacks suffered by Chinese oil companies following the launching of the war appeared to have reinforced this view. In May 2003, for example, Royal Dutch Shell and five other companies used their shareholders preferential purchasing rights to block the joint offer of China National Offshore Oil Corporation (CNOOC) and Sinopec Corporation to acquire shares of an oilfield in the Caspian Sea owned by Kazakhstan. In 2005 CNOOC’s bid to buy the American oil company Unocal ran up against strong US resistance. At the time, these
setbacks were interpreted by some Chinese scholars (perhaps also by some officials) as part of a scheme by the West to contain China.\(^\text{22}\)

Sandwiched between these two setbacks was the accession to power of the “Fourth Generation” Chinese leadership led by President Hu Jintao. The political transition occurred in the midst of electrical power shortages throughout China, which raised awareness of energy security as a basis for economic development and led to a call for government action. It was at this very time that the Development Research Center of the State Council assembled leading energy research institutes in China to analyze the energy situation and to recommend a comprehensive energy strategy. The team produced a summary report and 11 sub-reports, which were published in 2004 as the China National Energy and Strategy Policy (NESP). According to the NESP, oil security entails guaranteeing that the country’s demand for oil is met satisfactorily in terms of quantity, quality, and price. Oil insecurity, on the other hand, refers to potential damage to the country’s economy due to supply cut-offs, shortages, or price shocks.\(^\text{23}\)

**Chinese responses to energy insecurity**

The NESP brought to light the energy-related challenges facing China and proposed a number of policy recommendations to address them, including:

- Using the world oil market, including the futures market, in order to obtain oil and oil products.
- Diversifying sources of oil imports and oil business activities, including exploration, development, refineries and pipelines.
- Investing more in upstream development, both domestically and internationally.
- Deepening the reform of Chinese national oil companies while continuing to transform them into powerful international companies.
- Seeking a “proper mix” of competition and alliances with regard to countries and companies.
- Establishing a strategic petroleum reserve.\(^\text{24}\)

The actions that China has taken since the issuance of the NESP to deal with China’s dependence on imported oil are consistent with many of these recommendations: pursuit of diversified import sources; investment in foreign production facilities, as well as in oil (and gas) pipelines in producing countries or from them to China; creation of a strategic oil reserve; and more receptive policies toward foreign investment in Chinese energy.

Traditionally, most of China’s oil imports had been obtained by long-term supply contracts or bought on the spot market rather than derived from equity investments. The early 1990s were the exploratory phase of China’s international acquisitions policy. The successful bid by China National Petroleum Corporation (CNPC) for an oilfield in Peru in March 1993 marked the entry of China’s petroleum industry into the international market. This success was followed shortly thereafter by acquisitions in Canada, Thailand, Indonesia, and Sudan.

Since the early 2000s, these international acquisitions efforts have gained momentum. Outward investment by China’s three main state-owned oil companies (CNPC, China National Offshore Oil Corporation (CNOOC) and the China Petroleum and Chemical Corporation (Sinopec)\(^\text{25}\)) has surged. This investment has taken several different forms, including: 1) both the acquisition of specific resource concessions or shares in resource concessions (projects) and of overseas companies (or shareholdings in companies) that hold a range of assets, and 2) a “finance-for-assured supply” model involving long-term loans from Chinese banks to support overseas oil and gas companies’ efforts to develop new resources and pipelines.\(^\text{26}\)
As reported by the IEA in its June 2010 *Oil Market Report*, between January 2009 and April 2010 alone, CNPC, Sinopec, and CNOOC spent about $29bn worldwide on acquiring oil and gas assets.\(^27\) In the same period, Sinopec and CNPC negotiated 11 finance-for-assured supply deals with eight countries worth $77bn, and entered contracts committing them to invest at least $18bn in future exploration and development, mainly in Iraq and Iran.\(^28\) Here, one should mention that it is not necessary to own oilfield concessions in order to import oil. In fact, most countries have neither oilfields nor oil companies. As it happens, Chinese oil companies do not operate any oilfields in Saudi Arabia, though the latter is their top supplier. Nor is all of the oil that is produced by Chinese companies overseas consumed in China. Furthermore, all three of Chinese major companies still produce most of their output within China, a fact that tends to be underreported in the Western press.

Regardless of how China acquires foreign oil contractually, there is still the issue of transporting it. In order to reduce its reliance on maritime transport of oil supplies through the Malacca Strait, China has identified several alternative strategic access routes, through Kazakhstan, Myanmar (Burma), and Russia. The Kazakhstan-China pipeline has been operational since 2006.\(^29\) In June 2010, construction began on the China section of the Sino-Myanmar oil pipeline, which is expected to be finished in 2013.\(^30\) September 2010 marked the completion of an oil pipeline from Russia to China.

**China’s impact on oil markets**

What have been and could be the effects of China’s growing oil demand and import dependence and expanding overseas involvement in oil markets? Let us first consider China’s impact on the *global* oil market and then discuss its impact on *regional* markets.

**The global market**

With respect to China’s impact on the global oil market, several areas deserve attention: 1) oil prices, 2) market supply, 3) commercial competition, and 4) investment. Expert opinion on the impact that China has had or might have on both the price of oil and access of oil is decidedly mixed. Here, it is useful to distinguish between the impact of Chinese demand growth and the effects of Chinese overseas activities in the oil sector.

*Oil Prices:* According to BP’s *Statistical Review of World Energy*, Chinese oil consumption in 2009 rose by 6.7% from the previous year (to 8.6mbpd), in spite of the economic downturn.\(^31\) The IEA reports that, “China is currently seen generating 40% of 2010 incremental demand and nearly 45% of 2010–15 growth.”\(^32\) Clearly, China’s buoyant oil demand has helped sustain oil prices during the global economic recession. For suppliers, therefore, China has been a bright spot in the market. This is especially true in the case of the Gulf Co-operation Council (GCC) countries, for whom oil accounts for a substantial portion of their revenues and export earnings. These earnings are a vital source of financing for the economic programs and projects they have undertaken, and influence consumer and investment confidence.

But one must be careful about extrapolating from this experience. The fact that the Chinese have been buying oil does not necessarily mean that they have been consuming it. The Chinese oil industry is not transparent. The volume of crude oil (and refined products) that has been put in storage is unclear. It is possible that government encouragement and expectations of higher prices has spurred a storage boom. Thus the boost to the recovery of GCC economies provided by robust Chinese oil demand might be only temporary, and if so, will not necessarily recur. In addition, one must consider the possibility that China’s foreign acquisitions may be primarily
focused on the long-term goal of controlling oil at its source in order to influence prices as a
global producer, not just as a strategic consumer.

Finally, tight spare capacity, whether due to “peak oil” or, as the IEA argues, because of
underinvestment in oilfield development, is a real possibility. Tight capacity would drive oil
prices higher. Under such circumstances, prices would rise even if China’s consumption growth
were flat; they would rise even more were China’s rate of consumption to increase.

Market Supply: Some assert that China’s practice of “locking up” oil supplies takes oil off the
market. Others contend that Chinese oil companies are investing in the few remaining under-
developed oil regions of the world. The latter argue that China’s NOCs contribute to a better-
supplied world oil market by extracting oil from countries that are off-limits to Western firms.
If, for example, China seeks oil supplies from Sudan, it buys less elsewhere, thereby making
more oil available to all other consumers.33

Commercial Competition: Chinese oil companies have become increasingly sophisticated and
successful players in the international commercial arena. As such, they have become both
respected competitors and valued partners of their Western counterparts.

Chinese firms are a significant force in global mergers and acquisitions (M&A) activities in a
wide band of business sectors. In the oil sector, Chinese state companies have been active in
acquiring entire companies, as well as stakes in smaller (and non-US) companies with overseas
(oil and gas) assets. The IEA estimates that Chinese firms accounted for 13% of total acquisitions
in 2009 and that they are operating in 31 countries and producing equity barrels in 20.34

CNPC, Sinopec, CNOOC and Sinochem are involved variously as operator, non-operator
shareholder, and joint venture partner with many foreign companies. CNPC’s overseas
exploration and production relationships are primarily with host-country state oil companies,
with CNPC serving as project operator. Sinopec, CNOOC, and Sinochem also have links
through their overseas operations with Western oil companies. For example, Sinopec collaborates with Total in Yemen and Canada. CNOOC is a shareholder in the BP-operated Tangguh liquefied natural gas project and off-shore oil and gas fields in West Java, BHP Billiton-operated assets in Australia, and Total-operated assets in Nigeria. Sinochem is partnered with Sweden’s Lundin in Tunisia and with Repsol in Ecuador. PetroChina teamed up with Royal Dutch Shell for a joint bid for Arrow Energy, the Australian gas company. CNOOC and Total are seeking to work with each other to develop Tullow Oil’s assets in Uganda. In July 2010, CNPC and BP took over operation and management of Rumaila, Iraq’s largest oilfield.35

The circumstances of each deal are different. In Iraq, for example, where the projects
are technically straightforward but have political and security risks, having a Chinese partner
provides important benefits to foreign counterparts. Samuel Ciszuk, Middle East Energy Analyst
for IHS Global Insight, argues that CNPC brings political clout because it is state owned; a
skilled, cheap workforce; and a willingness to invest in a low-margin project.36 Overall, these
arrangements facilitate high-level business relationships across functions and engender habits of
cooperation. Furthermore, as discussed below, Western companies hope to build on their
respective relationships to secure greater access to the Chinese oil market.

Investment: There are numerous reasons why Chinese oil companies have been able to
compete successfully for business in the oil market, including that they have no shareholders and
that they have generally been willing to accept higher political and security risks than
their counterparts.37 China’s strict adherence to a policy of non-interference in the domestic
affairs of other countries furnishes an additional advantage. Yet, perhaps the most
important factor has been Chinese oil companies’ ability to leverage their own sizable financial
resources and to supplement them with state support in the form of loans and development
assistance.38
China is not only a major source of investment in the oil sector, but also is an increasingly important destination for it. China needs several trillion dollars in energy investments. Western oil majors have become strategic investors in the internationally listed subsidiaries of China’s three leading oil companies, and, as previously shown, are extensively involved with these same companies in China and elsewhere, particularly in the refinery sector.39

Investment in China’s oil sector is also driven by the competition for market share among foreign suppliers of oil and refined products. According to Kuwait Petroleum Corporation (KPC) CEO Saad Al-Shuwaib, Kuwait is seeking to obtain the Chinese government’s approval to build a 300,000 barrels per day refinery and petrochemical complex in southern China.40

Regional markets

Chinese oil companies have established a global presence, and they are having a significant impact on regional oil markets: 1) establishing new footholds, 2) emerging as major players, 3) building complex interdependent relationships, and 4) creating new and dynamic nodes of energy-led economic growth.

Establishing New Footholds: In recent years, Chinese oil companies have successfully penetrated regional markets in which they previously had had little, if any involvement. They have done this both by signing long-term supply contracts and by acquiring strategic assets.

North America is a case in point. In December 2009, CNOOC acquired a small stake in four oilfields in the Gulf of Mexico from Statoil of Norway. The same month, PetroChina obtained the Canadian government’s backing to buy a stake in two Alberta oil-sands projects for about $1.9bn.41

In South America, CNOOC established a joint venture partnership with an Argentine firm, Bridas Energy, by acquiring a 50% share in the Bridas Corporation, one of the company’s subsidiaries.42

Chinese oil companies have been active in the Caribbean Basin as well. In 2009, Petro China assumed Saudi Aramco’s lease on the NuStar LP Statia fuel oil terminal on the Dutch Caribbean island of St Eustatius. Some observers believe that Petro China’s immediate goal is to establish itself as a major player in the ship fuel trading market.43 But the company could be positioning itself for the future, a decade or so from now, by which time it might have secured significant crude oil production (perhaps through involvement in the development of Venezuela’s Orinoco Belt) and a maritime crude oil corridor to the Pacific markets resulting from the widening of the Panama Canal.44

Over the past decade, Chinese firms also have been very active in Africa. They have established new footholds there, as illustrated by the $23bn deal between the China State Construction Engineering Corporation Limited (CSCEC) and the Nigerian National Petroleum Corporation (NNPC) to construct four new refineries in Nigeria. CSCEC described this venture as part of an effort to “expand its presence on the African continent and establish its footprint firmly in the Nigerian oil and gas landscape.”45

Emerging as a Major Player: China has rapidly become a major player in regional oil markets in three respects: 1) as an oil customer, 2) as an owner of strategic assets, and 3) as a source of investment.

China is the largest importer of oil from the Middle East, importing 1.94mbpd, or 14% more than the USA.46 Within the region, China is Iran’s number one oil importer, with about a 23% share.47 In the case of Latin America, Venezuela, which supplies China with 400,000 barrels of oil per day, aims to increase this to 1mb. barrels by 2013. This would put Venezuela’s oil exports to China roughly on a par with its exports to the USA.48
China has become a major player in Central Asia as well, particularly in Kazakhstan. CNPC has a 67% stake in PetroKazakhstan. In 2009, CNPC purchased a 50% stake in MangistaumunaiGaz, giving it joint ownership of the latter’s main producing assets at the Kalamkas and Zhetybay fields and of the company’s other upstream assets. It is estimated that Chinese companies already control nearly one-third of Kazakhstan’s oil output.49

China has also become a vital source of investment for some of its partners. CNPC is the largest stakeholder (with a 40% share) in the Greater Nile Petroleum Operating Company, Sudan’s biggest energy consortium. In addition, CNPC is the largest equity partner in all but one of Sudan’s operational oilfields. China is now the biggest single investor in Iraq’s post-war oil (and gas) sector as well, giving it control of about one-fifth of the reserves that have been auctioned since 2009. In June 2009, CNPC secured the 17-billion-barrel Rumaila field, as an almost equal partner with BP. Six months later, CNPC took a 50% share as the operator of the Halfaya field (partnered with Malaysia’s Petronas and France’s Total). CNPC also has a stake the Al-Ahdab field, which was revived in March 2009 by China’s Al-Waha Petroleum (in a joint venture with the Zhenhua Oil Company).50 Most recently, a Chinese consortium led by CNOOC and Sinochem Corporation signed an initial agreement with Baghdad to develop the Missan oilfield complex.51

China has leveraged its financial power in its dealings with Russia as well. After years of negotiation and maneuvering, the two countries reached agreement in February 2009 on a $25 billion loan-for-oil deal. The pipeline carrying oil from Russia to China was completed in September 2010,52 thereby helping to forge a major long-term supply relationship.

Building Complex Interdependence: China’s long-term oil supply ties with its partners form the backbone of increasingly extensive, multifaceted economic relationships. They have laid the basis for reciprocal investment in the energy sector and the development of non-oil trade.

Over the past decade, China’s non-oil trade with the Middle East especially with the Gulf Co-operation Council (GCC) countries and Iran, has climbed rapidly.53 Three years ago, McKinsey and Company estimated that total trade flows between China and the Middle East could climb to between $350bn and $500bn by 2020.54 In 2009 China passed the USA as the biggest exporter to the region. Today, China not only buys more oil but sells more products in the Middle East than does any other country.

Creating Growth Nodes: China’s energy plans and activities could foster the development of new nodes of energy-led economic growth. It is not far-fetched, for example, to imagine the Chinese province of Xinjiang a decade or two from now having become part of a dynamic economic region binding together western China and Central Asia. After all, Xinjiang borders eight countries, including Russia, Kazakhstan, India, and Pakistan. It has an operational oil pipeline originating in Kazakhstan (and another pipeline that carries gas from Turkmenistan). The Chinese government plans to embark on a 10-year development program to elevate Xinjiang into a leading “energy center,” that is, a center of oil-and-gas production, refining, petrochemical and other chemical manufacturing, oil storage, and engineering, and technology services.

The area encompassing Myanmar and Yunnan Province in southwestern China constitutes a second promising economic region-in-the-making. In June 2010, CNPC held a groundbreaking ceremony to mark the start of construction of the Sino-Myanmar oil (and gas) pipeline, which will transport crude oil sourced from the Middle East and Africa from the port of Kyaukryu on the Bay of Bengal to Runming, the capital of China’s Yunnan Province.55 The pipeline project also includes railway, road, and waterway construction, as well the upgrading of the Kyaukryu port facilities.

It is important to view these efforts within the broader framework of China’s modernization plans for Yunnan. In fact, the project as a whole is subsumed in China’s Western
Development Strategy. In preparation for receiving oil accessed through Myanmar, China is building three oil product pipelines in Yunnan. The energy pipeline feed from Myanmar is part of a broader commercial corridor that would also include an outlet for Yunnan’s industrial sector to ports that would carry its products westward to South Asia, the Middle East, and Europe.

A third such economic region could take shape in the border area between the Russian Far East (RFE) and Heilongjiang Province in northeastern China. Over the past decade, cross-border trade has been robust. There are other sinews of economic interdependence as well. Heilongjiang Province operates feed mills in Russia and has leased land across the border to grow crops. Since 2004, the province also has been purchasing electricity from Russian hydroelectric plants. While energy cooperation does not constitute the main strand of this web of interdependence, it is nonetheless an important element of the Northeast China Revitalization Plan, which aims to invigorate the province’s industrial base. A key part of this effort has been the construction of a spur of the East Siberia-Pacific Ocean (ESPO) oil pipeline, which is expected to become fully operational in 2011, that will extend from Skovorodino in the Amur region of Russia to the city of Daqing.

**Changing oil markets or changing China?**

How might China’s involvement in oil markets change the behavior of others? And how might China’s behavior, including the possible consequences of its own actions, alter Chinese perspectives on and activities in oil markets?

**Playing by whose rules?**

The growing involvement of Chinese companies in global and regional oil markets has prompted closer scrutiny of their business practices. Some of these practices, including the use of financing as a competitive tool (one which the Organisation for Economic Cooperation and Development (OECD) long ago agreed not to employ) have given the impression that China is determined to play by its own rules, come what may. Chinese firms also have been accused of igniting “bidding wars” to secure overseas oil contracts that could fuel geopolitical tensions.

On a number of occasions over the past decade, Chinese companies have outbid their Indian counterparts. In 2005, for example, Sinopec outbid ONGC for PetroKazakhstan and did so again one month later in buying the assets of EnCana Corporation in Ecuador. Later that same year, however, CNPC and India’s Oil and Gas Corporation (ONG) placed a successful joint bid for a 37% stake in the al-Furat oil and gas fields in Syria, demonstrating both that there is scope for Sino-Indian energy cooperation and that there is at least some interest in pursuing it. Mani Shankar Aiyar, then India’s petroleum minister, hailed the venture as a model. However, few other such initiatives have followed.

Meanwhile, the practices used by Chinese companies to secure overseas oil assets have been adopted by some of their competitors, including by Indian firms. As far back as 2005, ONGC had agreed to spend as much as $6bn on roads, ports, railways, and power plants in Nigeria in exchange for oil supplies. Since then, the government of India has authorized an increase in the amount that ONGC and some other state-owned companies may spend in order to acquire overseas assets and establish joint ventures, and the creation of a sovereign wealth fund to support overseas energy investments.

In East Asia, however, the situation looks less benign, in spite of China’s participation in an array of consultative arrangements. China is a member of the energy working group of the
Asia-Pacific Cooperation (APEC), the ASEAN plus China, Japan and the Republic of Korea (ASEAN +3) Energy Cooperation, the International Energy Forum, the World Energy Conference, and Asia-Pacific Partnership for Clean Development and Climate. Yet, China and its neighbors (ASEAN and Japan) remain locked in dispute over Beijing’s claim to the entire South China Sea.63

**Rigid or adaptive?**

Chinese attitudes regarding energy security are not immutable. To the contrary, “… ideas about energy security are evolving from a vision of tight government control and self-reliance to a more liberal outlook that accepts market forces and diversified energy types and sources”.64 Nor are China’s leaders completely indifferent to the concerns that Chinese overseas oil activities have engendered. They have emphasized the importance of international energy co-operation.65

The 2007 White Paper on China’s Energy Conditions and Policies states that, “To ensure world energy security, it is imperative to strengthen dialogue and co-operation between energy exporting countries and energy consuming countries, as well as between energy consuming countries”.66

There are also signs that Chinese oil companies might not be stuck in a “proprietary” mindset. The participation of Chinese oil companies in Iraq’s oil tenders, for example, signaled a possible shift away from the proprietary control of reserves toward a market-based approach and offered evidence that Chinese oil companies have become more skilled and more confident of their ability to compete and collaborate with global majors.

**Unfettered or lashed to The Market?**

In an effort to reduce the risks associated with its foreign oil dependence, China might well have created some problems both for itself and for others. CNOOC and its fellow energy companies have been willing to enter areas of political uncertainty, buying assets in countries that face major problems such as internal conflict, endemic corruption, huge crime rates, or ineffective governments. One possible consequence of this surge of investment is that Chinese companies might incur big financial losses. Another is that it could spur more rapid investment into countries that might once have been considered unsuitable, and by any objective standard still are. Thus due diligence will have been sacrificed in the race for assets and, as a result, Chinese companies and their rivals could end up paying premium prices for inferior assets.

In addition, whether some of China’s energy partners will be able to follow through on complex oil deals is open to question. Venezuela is a case in point. Refineries have yet to be built. Agreements are non-binding. Venezuela’s offshore reserves are deep beneath the surface and covered by rock and salt deposits, requiring sophisticated technology that will be very costly to mobilize. Venezuela’s President Hugo Chávez has announced many deals in the past (for example, with Uruguay and Iran), but few of them have materialized.

**Conclusion**

The nature and extent of China’s future impact on global and regional markets will depend on numerous factors. Of these, perhaps the most important is whether China’s appetite for oil will continue to grow at rates similar to those experienced in recent years. This, in turn, will depend on which path the Chinese leadership will choose; a low energy future modeled on that of Japan or a high energy future resembling that of the USA? While most analysts project strong demand

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growth, those who take seriously Beijing’s determination and ability to curb China’s appetite for oil are more skeptical.67

A second important factor is whether China’s large national oil companies (NOCs) will continue to dominate the policy process and whether corporate interests or national interests will control the energy sector and guide industry practices.

A third key factor will be how the rest of the world, particularly the USA, but also India and Japan, responds to China’s increasing presence in and influence on oil markets, and indeed to its emergence as a global power.

Notes

5 Henry Lee and Dan Shalman, ‘Searching for Oil: China’s Oil Initiatives in the Middle East’, Belfer Center for Science and International Affairs, John F. Kennedy School of Government, Harvard University (January 2007), pp. 31–32.
11 Resource nationalism refers to national governments making decisions about the production and marketing of the hydrocarbon reserves under their control not only on the basis of economic factors, but also on the basis of strategic and political calculations. Resource mercantilism refers to reliance of energy importing states on national energy companies to secure access to overseas oil and gas resources on more privileged bases than simple supply contracts. For a good discussion of these trends, see Flynt Leverett, ‘The Geopolitics of Oil and America’s International Standing’, Testimony Before the Committee on Energy and Natural Resources, United States Senate, 10 January 2007.
25 In 2002, another state-owned enterprise (SOE), Sinochem, previously a trading company, diversified into upstream oil and gas operations.
26 Along with this financial assistance, the foreign company engages in a long-term contract with a Chinese state oil company to supply a guaranteed annual volume of product at prevailing market prices. Deals of this kind have been agreed with Russia’s Transneft and Rosneft; another is in negotiation with Brazil’s Petrobras. Under the agreed Russia deal, China Development Bank will lend $25bn over 25 years to Rosneft and Transneft, who in turn guarantee the supply of 15m. tons of crude oil annually to CNPC at market prices.
27 International Energy Agency (IEA), Oil Market Report (June 2010).
28 Ibid.
29 In April 2009, Transneft and Rosneft signed an agreement for a $25bn loan from China Development Bank in exchange for delivering 300,000 barrels per day of oil to China for the next twenty years and also building a 64 km spur pipeline from Skovorodino to the Chinese border. The deal is currently on track.
30 The Sino–Myanmar oil and gas pipeline starts at Kyaukryu port on the west coast of Myanmar and enters China at Yunnan’s border city of Ruili. It saves about 1,200 km of shipping and reduces reliance on the Strait of Malacca. See ‘China Starts Building Sino-Burma Oil-Gas Pipeline’, BBC, 10 September 2010.
35 ‘Chinese Oil Giant and BP Start Operating Largest Iraqi Oilfield’, BBC Asia Pacific, 12 July 2010.
37 For example, Chinese companies proﬁted from the fact that American and other firms turned away from Canadian tar sands oil because of its heavy carbon footprint. The Pentagon also reduced its use of tar sands oil to meet a 2007 law requiring the US government to source fuels with lower greenhouse gas emissions. Major oil companies such as Shell came under shareholder pressure to pull out of the Canadian projects. See Suzanne Goldenberg, ‘Canada Looks to China to Exploit Tar Sands Rejected by US’, The Guardian, February 14, 2010.
38 China National Petroleum Corp., parent of the state-run oil and natural gas giant PetroChina, announced that it had received a low-interest $30bn loan from the China Development Bank to
41 There have been several other investments in the Canadian oil sector by Chinese companies in recent years, including CNOOC’s investment in the Northern Lights project in 2005 and CNPC’s purchase of oil sands leases that it has not yet developed. See Chris Kahn, ‘Syncrude Deal Part of China’s Shopping Spree’, AP, 13 April 2010.
43 It is also important to note that fuel oil—burned in power plants and ships—is China’s leading imported oil product. See Robert Campbell and Aizhu Chen, ‘China Eyes Caribbean Fuel Oil Market Now, Crude Later’, Reuters, 7 January 2010.
47 Ibid.
50 Middle East Economic Digest (MEED), 25 March 2009.
51 Middle East Economic Digest (MEED), 9 March 2010.
52 ‘China, Russia Mark Completion of Crude Oil Pipeline’, China Daily, 27 September 2010.
56 ‘China to Build Three Pipelines to Deliver Myanmar Oil’, Reuters, 26 August 2010.
59 The project was made possible by a $25 bn Chinese loan to Rosneft and Transneft. It is important to note that Moscow’s solicitation of Chinese investment represented a reversal of its policy of seeking to prevent Chinese economic penetration of the RFE and Central Asia. On this point, see Stephen Blank, ‘China Quietly Reshapes Asia’, Asia Times, 12 August 2009.
