

China's Energy Strategy and Primary Role of the Middle East in This Strategy

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Abstract: In face of challenges to its energy security, China has been making adjustments in its energy policy and energy development strategy since mid-1990s, and implementing a strategy for overseas energy development. Compared with Central Asia, Latin America, Southeast Asia and West Africa, the Middle East is still the major source for China's overseas energy cooperation and development.

To avoid over-dependence on the energy resources in the Middle East, China seeks more overseas energy sources and transportation channels other than those in or connected to the Middle East. However, the primary role of the Middle East in China's overall strategy for overseas energy development is still irreplaceable by that of any other region, at least for the near future. This situation will surely produce an increasingly important impact on China's Middle East policy, moving China to take a more active posture in the political and economic arena of the region. It can even be expected that China to maintain its stable and friendly relations with Middle East countries, will, more likely than ever, act as a diplomatic mediator in trying to resolve certain longstanding conflicts in the region.

Key Words: China's Energy Strategy; Primary Role; the Middle East

Breakthroughs in developing domestic oil resources freed China from its dependence on foreign oil in the mid-1960s, and ushered in an arena of oil self-sufficiency that China took great pride in. Indeed, its oil production grew so rapidly that China later on exported oil, reaching a peak of 6.21 million tons in 1985. However, all this was changed in the early 1990s when China became a net importer of petroleum in 1993. Following this development, China has been adjusting its energy policy and energy development strategy since the mid -1990s, and implementing a strategy for overseas energy development in which the Middle East plays a more and more important role.

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I. Challenges to China's Energy Security

The change from an oil exporter to a net oil importer occurred mainly because of China's fast growing consumption. From 1978 to 2000, total energy consumption in China more than doubled, increasing from 57,144 tce (tons of coal equivalent) to 128,000 tce.² China's oil consumption has mostly assumed a proportion of around 20% of its total energy consumption and also jumped correspondingly. The turning point came in 1993, when China imported a net total of 9.91 million tons of crude oil and refined oil products. The imports in 1994 and 1995 dropped somewhat respectively to 3.30 and 8.75 million tons.³ After 1995, oil imports increased very fast. By 2000, China's imported petroleum amounted to 70 million tons, nearly 1/3 of its total oil consumption of 220 million tons. By 2003, its imported petroleum had amounted to 90 million tons. In 2007, China imported 163 million tons of crude oil, more than 40% of its total oil consumption, making another historical record.⁴ China has now surpassed Japan as the second largest energy consuming country, next only to the United States. It is expected that by 2010, China may import 180 to 200 million tons of crude oil, over half of its total consumption.⁵

With the country's growing dependence on oil imports, high oil prices have harmed China's economic development and have even had a negative impact on social life in China. First, high oil prices have reduced China's export revenues, diminished its economic growth rate, accelerated the inflation rate, and increased China's foreign-currency payment. Second, as an indirect result, production costs have risen, hampering China's export-oriented light industry, which in the long run could inflict considerable harm on China's competitiveness.⁶ Third, the economic decline in other parts of the world has reduced demands for China's products. Fourth, high oil prices have led to the inflation of prices for a number of related products, producing a serious impact on the daily life of the Chinese people. For example, the rise in transportation costs has pushed up the jump in the prices of public and private transportation, aviation, tourism, catering, construction and real estate as well as daily necessities. The burden of expenditures on the Chinese households has definitely become significantly heavier.

² *Yearbook of the People's Republic of China 2001*(Beijing: China Yearbook Publishing House), p.229.

³ *Oil and Petrochemical Industries in China: Market and Development Report 2000-2001* (Beijing: China Science and Technology Publishing House, 2001), p.30.

⁴ Website of the General Administration of Customs of the PRC: <http://www.customs.gov.cn>.

⁵ *Oriental Morning Post*, Shanghai, Feb. 16, 2005.

⁶ *The Daily Telegraph* (UK), July 7, 2008.

Meanwhile, with the steady rise in energy consumption, environmental pollution as well as energy waste is going up, presenting a host of serious challenges to the government and the society. As a result of the growing consumption of coal and oil, China has witnessed the increase of its greenhouse gas (GHG) emission. Most reports say that China is currently number two in terms of GHG emission, next only to the United States, and some recent reports even say that China already has overtaken the US and has become number one in such emissions.⁷ Such developments, while affecting the quality of life of the Chinese people, will give rise to increasing international pressure as well. In 2005, China's energy consumption for each GDP dollar was three times that of the world average, and the economic loss as a result of low energy utilization rate was as high as \$120 billion a year.⁸ Now China's energy consumption for each GDP dollar is going up to three times that of the US average, five times that of Japan's average and eight times that of the UK's average.⁹

II. The Adjustment of China's Energy Policy and Its Strategy for Overseas Energy Development

In face of challenges to its energy security, China has been making adjustments in its energy policy and energy development strategy since mid-1990s, and implementing a strategy for overseas energy development. The adjustments are reflected in the following five areas:

a). Energy production in the western part is encouraged while that in the eastern part stabilizes. To ensure adequate domestic production, those old oil and gas fields in eastern China, some of them already peaking out, now give way to the emerging fields in the west, with the latter becoming a new focus of energy development. Meanwhile, energy output like gas produced in the west is transported to the eastern part of the country as a correspondent measure. Energy development thus becomes a key component of China's national strategy for "developing the west".

b). Energy consumption structure is remodeled. In China's energy mix, the proportion of coal is to decrease from its current level of 65-69%, while those of oil, gas, hydropower and nuclear power will increase from their current levels of respectively 20-25%, 3%, 6% and 1%. It is expected that by 2020, coal will take up 54%, with oil expanding to 27%, gas to 9.8%, and hydro and nuclear power to 9.1%.

⁷ *New York Times*, June 14, 2008.

⁸ *Business Week*, April 11, 2005.

⁹ *The Daily Telegraph* (UK), July 7, 2008.



Of course, new sources of energy will be developed as well, just as clean coal technology will be promoted.

c). A national energy reserve system is constructed. The strategic energy stockpiling will not only control the national economic loss caused by any sudden break in its energy supply, but also help to stabilize the market when energy prices go up suddenly. China has, since the turn of the century, initiated the process of constructing its strategic energy reserve system.

d). Energy saving becomes one of the top priorities. The Chinese government is taking various measures to change the situation, such as promulgating "Renewable Energy Act", revising "Coal Act", enforcing energy-conservation criteria for buildings, turning petrol engines in vehicles into diesel engines, popularizing coal-based gas hybridization technology, working out energy-saving criteria for newly manufactured vehicles, closing down excessive energy consuming facilities, etc. Meanwhile, it is important to restrict strictly the GHG emission, close down serious polluters whenever possible, popularize the use of clean and low-carbon energy sources, and practice the sequestration of carbon.

e). Emphasis is laid on active energy development overseas. While sticking to the principle of mainly relying on domestic energy resources, China has embarked on the road of developing oil and gas overseas, expecting to diversify its energy import channels. This is of great importance to China.

A key objective of China's overseas energy development strategy is to ensure the diversification of oil and gas imports and their transportation routes. To achieve this objective, it is necessary to go beyond the mere purchase of energy products by directly engaging in the international markets of energy development and transportation. Starting from the 1990s, Chinese enterprises began to make their presence in the international market of energy investment and development. China National Petroleum Corporation (CNPC), China National Offshore Oil Corporation (CNOOC) as well as China National Petrochemical Corporation (SINOPEC), as leading Chinese companies operating in the world energy market, have invested in dozens of major energy projects around the world. On the whole, the overseas operations of Chinese companies are oriented towards five directions: Middle East, Central Asia-Siberia, Indonesia-Australia, Africa, and Latin America. Especially, remarkable achievements have been made in projects in Kazakhstan, Sudan, Venezuela, Indonesia, Australia, and Iran.

China's first and most active player in its overseas oil enterprise is the CNPC. As the first step, to the surprise of its foreign counterparts, CNPC had, in a matter of a few years, invested RMB 15.6 billion by the end of 2000 in the Middle East and North Africa, Central Asia and Russia, and South America as well. From its concessions in Kazakhstan, Azerbaijan, Sudan, Iraq, Iran, Venezuela, and Peru, it

obtained its share oil of 5.05 million tons in 2000, besides getting its gas share of 480 million cubic meters.¹⁰ At the initial stage, some of the notable CNPC international oil projects included: purchasing 60 percent of the Kazakh Aktyubinsk munaigaz Production Association that controls three oilfields with estimated recoverable reserves of 1 billion barrels; purchasing 51 percent of the Kazakh Uzen field with estimated recoverable reserves of 1.5 billion barrels; signing a 22-year production-sharing contract to develop the Iraqi al-ahdab field with estimated recoverable reserves of 1.4 billion barrels; purchasing 40 percent of the Sudanese Greater Nile Petroleum Operating Company to develop the Heglig and Unity fields with estimated recoverable reserves of 8.5-12.5 barrels; an acquisition of six Indonesian oil and gas assets with yearly output forecast at over 6.24 million barrels.¹¹ In Latin America, CNPC firstly invested \$30 million in Peru. Following that, in 1997, CNPC invested \$1.1 billion in Venezuela after winning the bids of two large oil projects. Since the turning of the century, CNPC has invested more and more in all parts of the world. Take Kazakhstan as a case, after years of operations in this country, CNPC now possesses capabilities of producing over five million tons of oil annually, aside from accumulating experience in cooperation with Kazakhstan partners. In October 2005, CNPC successfully acquired Petro Kazakhstan (PK), a Kazakh oil company headquartered in Canada, making further advance in investing in the Central Asian energy market.

III. The Role of the Middle East in China's Energy Strategy:

Can Central Asia Replace the Middle East?

Compared with Central Asia, Latin America, Southeast Asia and West Africa, the Middle East is still the major source for China's overseas energy cooperation and development.

China currently imports oil from more than 30 countries in the world, with Saudi Arabia, Iran, Oman, Angola, Sudan, Yemen, Russia, Indonesia, Australia, Thailand, Malaysia, Congo and Kazakhstan high on the list. In terms of regions, the Middle East accounted for 59 percent of China's crude imports in 2003, to be followed by the Asian-Pacific region, Africa, and the rest. As shown in its Five-year Plan for 2001-2005, China's oil imports were substantially procured from the

¹⁰ *Yearbook of the People's Republic of China 2001* (Beijing: China Yearbook Publishing House), p.619.

¹¹ Erica Strecker Downs, *China's Quest for Energy Security*, pp.21-23, available at <http://www.rand.org/publications/MR/MR1244>.



Middle East.¹² In 2007, more than 50% of China's imported crude oil still came from the Middle East, including 26.332 million tons from Saudi Arabia, 20.537 million tons from Iran, 13.68 million tons from Oman and 10.306 million tons from Sudan.¹³ All relevant observers believe that such a proportion will be on the increase in the future.

The demand for speeding up to explore the Central Asia energy source is surging in China because the Middle East conflicts are aggravating, the insecure Persian Gulf and Malacca Strait, and, Central Asia is a source of energy supply that demands no protection from any ocean navy. As China is still unable in the near future to build up an ocean navy strong enough to protect its oil shipping lines, this nearby energy source coming by land is obviously of great strategic significance for China's energy security.¹⁴ However, Central Asia could not replace the Middle East as China's major strategic source for overseas energy development in a short period of time. The main reasons are as follows.

First, Chinese investors' confidence is still undermined by the threat to regional stability arising from terrorism and extremism. Especially, the Taliban and al-Qaeda have returned to Afghanistan and extremist forces like Hizb-ut-Tahrir are expanding rapidly and scoring high support in Central Asia, particularly in the poverty-stricken Ferghana valley. Meanwhile, people also worry about other existing or potential clash points in Central Asia and its neighboring areas: political tensions in Pakistan, the internal antagonism in Kyrgyzstan, and the Kashmir conflict.

Second, non-conventional security issues still abound in the region: drug-trafficking, weapons smuggling, illegal immigration, cross-border crimes, environmental pollution, water resource shortage, emergent public health incidents and others. All these factors undoubtedly exercise very negative impacts on attracting investments for energy development in Central Asia.

Third, the business environment in Central Asia is still far from being ideal. Such non-economic factors as red-tape, lack of law-based rule, a highly inadequate financial system, corruption and mafia groups pose great disturbances to normal economic and energy cooperation. For example, in contrast to the cost of only \$1-3 for each barrel of oil transported from Sudan to China by sea, the same by train from Central Asia to China can be as high as \$30-50 due to arbitrary, not law-based or rule-based rises in freight.

Fourth, funds available are still far from sufficiency, with neither full-scale

¹² The Planning Bureau of the State Economic and Trade Commission, *The Tenth Five-Year Plan for China's Petroleum Industry 2001-2005*, p.3 and p.5, available at <http://www.setc.gov.cn/trs.html>.

¹³ Website of the General Administration of Customs of the PRC: <http://www.customs.gov.cn>.

¹⁴ Guang Pan, "China and Energy Security in Central Asia," *Central Asia and the Caucasus*(Sweden, 2007, No.6), p.85.

international financial cooperation nor substantial loans granted. Energy projects in Central Asia are by nature massive projects like oil and gas pipelines, and such projects demand huge financial investment. Following increasingly keen competition for energy development in the region, it has become more and more difficult to enlist financial support for these massive projects from the international financial market.

Fifth, counterparts from America, Europe, Russia, and Japan have always posed serious competition. For example, the newly launched oil pipeline from Kazakhstan to China, despite its designed capacity to transport annually 20 million tons of oil for this stage and 50 million tons of oil at the final stage, is only handling 10 million tons at the moment. The chief reason for the underutilization of the capacity is that Kazakhstan needs to transport some of its oil to Russia, and to supply some to the Baku-Ceyhan pipeline supported by the US and Europe.

Finally, there are a host of technical impediments as well. For example, there are disputes over the demarcation and division of the Caspian Sea and relevant resources; geological inspection and pipeline construction face various technological difficulties and problems in this geographically complex region; the ecological environment in the region is deteriorating as a result of human factors.

IV. China's Policy Principles for Middle East Energy Security and Energy Cooperation

China's approach to energy security and energy cooperation with the Middle East can find expression in her policy principles.

a). Insurance of regional security and stability is a precondition for energy development and energy cooperation in the Middle East. China would like to join the multilateral efforts to safeguard the security and stability in the region so that good conditions are prepared for the energy cooperation. China, as a permanent member of the UN Security Council, actively supports using peaceful means to resolve the various conflicts and disputes in the Middle East, as shown by the peace-brokering and negotiation-facilitating role that it is increasingly playing. As is appreciated internationally, China's special envoy for the Middle East affairs has acted constructively in trying to improve the Israeli-Palestinian relations; its special representative for the Darfur affairs has assisted in deescalating the crisis in Darfur; and China has also participated in the joint efforts made by six countries for addressing the Iranian nuclear issue. Having dispatched 1000-strong peace-keepers to Southern Lebanon, China is making its security and military role felt as never



before in the Middle East. Such developments are certainly conducive to promoting peace in the region and to protecting the Chinese national interests there.

b). Assistance is given to Chinese firms to encourage their participation in the energy development in the Middle East. The above-mentioned CNPC's success in Sudan is a significant symbol of the massive engagement of the Chinese firms in the energy development market of the Middle East. Meanwhile, in order to regulate the economic and trade activities of Chinese citizens and enterprises in the Middle East, China is working out its standards and rules on human rights, labor conditions, environmental protection, and intellectual property rights protection, by complying with related international conventions. These standards and rules will help to drive forward the steady and sustainable growth of the economic and trade cooperation between China and the Middle East.

c). Fair competition and international cooperation are both to be facilitated. China would like to conduct competition on an equal basis with all countries or groups involved in the energy development in the Middle East, and is also ready to undertake any form of cooperation with them in the spirit of reciprocity. On the other hand, China is opposed to the exclusion of any country (such as Iran and Sudan) from this sort of international cooperation, and is also opposed to any attempt by any country or group to dominate or monopolize the energy development market in the Middle East. As there are more and more cross investments and cross holdings of shares in each other's business operations, there is an increasing overlapping of interests among companies and states engaged in energy development in the region. As stakeholders in the Middle East energy market, all participants will have to follow the common rules of the game and act in a mutually responsible manner if they are to reap benefits from the business here. This means that any short-sighted act that hurts others' interests is likely to boomerang, and only reciprocity will ensure the sustainable development and prosperity for all involved.

d). Guaranteeing the security of sea and land routes for exporting oil and gas from the Middle East through the international cooperation, and especially through preventing the sabotage of the terrorist groups is critical. With regard to the alignment of the oil and gas pipelines, China holds that it should be sorted out by adhering to the principles of mutual understanding, mutual concession and mutual benefit. The interests of all the parties concerned should be taken into consideration. China opposes the addition of any political or ideological factor into the ultimate solution as evidenced by the choice of a certain pipeline alignment to reject or punish any certain country. Although pipelines of different directions lead to different destinations and seem apparently competitive, they are after all

connected in the Middle East, forming a network of energy supply that shortens considerably the energy transportation distance.

V. China's Participation in the Middle East Energy Development: Difficulties, Barriers and Prospects

China's participation in the energy development in the Middle East has mostly met with the following difficulties or barriers.

First, given the protracted Iraq War, the stalemate in the Iranian nuclear crisis, the highly complex Lebanese turmoil, the conflict in Darfur coupled with an ecological crisis, as well as the long-standing Israeli-Palestinian conflict, risks are increasing and upgrading substantially for China to invest, cooperate, or procure in the energy sector. For example, the 2003 Iraq War and the subsequent oil price increases had a considerable effect on China's economy. In the first four months of 2003, China's oil imports grew by 42.9%, but its payments rose by 110.6% per year, resulting in extra costs of about \$4 billion.¹⁵ Furthermore, the war caused severe damage to the more than 100 projects with Chinese participation that were underway in the Middle Eastern region at that time, also affecting tens of thousands of Chinese contract workers. Moreover, Iraq will not repay the loans China had granted the country in the past. Finally, CNPC will not be able to develop its three Iraqi oil concessions, at least in the near future.

Second, several Middle East countries have still been listed in the name list of terrorist countries by the United States: Iran, Sudan and Syria, while sanctions were imposed upon them, which impeded the normal operation of the energy cooperation projects.

Third, with the new surge of terrorism and extremism in the wake of 9/11 and the Iraq War, the terrorist cliques are threatening to attack the oil tanks and transportation channels, which caused more worries of security for the energy transportation lines.

Fourth, the obstruction of the non-economic factors, especially the corruption problem in some countries will be harmful to the investors' benefits.

Though many difficulties and obstacles need to be solved, there exist many cutting edges in the energy cooperation between China and the Middle East. First, China is a huge energy consumption market and her energy demand are always on

¹⁵ Shijia Chu, "The Impact of the Iraq war on China's economy and trade," in *The Iraq War and China's Economy*, ed. by Guangsheng Shi (Beijing, 2003), p.104.



the increase, while the Middle East is the richest source of crude oil and gas which is eager to expand its oil market. Such complementation provides a solid base for large-scale energy cooperation between China and the Middle East. Second, China now has more than \$1.7 trillion foreign exchange reserves, which is a necessary condition for importing oil and gas from the Middle East, and investing in the Middle East energy market. Third, with continuous expansion of its energy development and upgrading of its processing technology, China is competent to participate in energy development in the Middle East while China's good environment for foreign investment is attracting the investment from the petrochemical enterprises in the Middle East. Fourth, China has kept good political relations with all the Middle East countries including Israel and Iran, which has laid down a solid strategic basis for energy cooperation between China and the Middle East.

Viewing the cooperation as prospect as a whole, it is full of promise. In the Middle East, China's largest and most important partner for energy cooperation is still Saudi Arabia, which exported 26.332 million ton of crude oil to China in 2007, which accounts for 17% of China's total crude oil imports of that year.¹⁶ Following the recent earthquake in Sichuan, Saudi Arabia donated \$60 million, the biggest amount received by China from overseas. This testifies to the close relationship existing between China and Saudi Arabia.¹⁷ The crude oil export of Iran to China registered almost 80% of the Saudi export but there exists great potentials for energy cooperation between China and Iran. During recent successful meetings between Iranian and Chinese leaders, the two sides reached consensus in strengthening the cooperation in the energy field. Iran will not only play an increasing important role in her cooperation with China in the Middle East but also in the Central Asia, especially the Caspian Basin. Recently, Iran, Pakistan, and India have signed an agreement for constructing a gas pipeline from Iran to India via Pakistan. All three countries expect that China will take a part in the project. At the same time, since the sanctions posed upon Iraq have been lifted, China is now able to do more for energy cooperation in this country. It is beyond the expectation that China National Oil and Gas Exploration and Development Corp. (CNODC) has made a great success in her investment in the oil exploitation industry in Sudan, while China has made smooth energy progress cooperation with other Middle East countries, such as Oman, Yemen, Kuwait, Qatar, United Arab Emirates, and Libya,.

Finally, it is worth mentioning that the great development campaign in the

¹⁶ Website of the General Administration of Customs of the PRC: <http://www.customs.gov.cn>.

¹⁷ Website of Ministry of Foreign Affairs of the PRC: <http://www.mfa.gov.cn>.

western part of China will serve as a new motive force for China's energy cooperation with the Middle East. For instance, a 4000 km pipeline has opened recently and transports natural gas from Xinjiang to Shanghai, which may finally arrive in Japan and Korea in the east and connect with the Middle East in the west through China–Central Asia energy pipelines. With the reconstruction in Afghanistan, in the foreseeable future it will become possible to construct a pipeline through Afghanistan, which will shorten the distance in energy cooperation between the western China and the Middle East. It can be estimated, in the future, the energy source of the Middle East may be delivered to China not only through the traditional means of oceangoing tankers but also through newly built pipelines on land. This will open a new chapter in energy cooperation between China and the Middle East, and even between East Asia and Middle East.

VI. Conclusion

To avoid over-dependence on the energy resources in the Middle East, China will continue to seek and secure more overseas energy sources and transportation channels other than those in or connected to the Middle East. However, the primary role of the Middle East in China's overall strategy for overseas energy development is still irreplaceable by that of any other, at least for the near future. This situation will surely produce an increasingly important impact on China's Middle East policy, moving China to take a more active posture in the political and economic arena of the region. It can even be expected that China to maintain its stable and friendly relations with Middle East countries, will, more likely than ever, act as a diplomatic mediator in trying to resolve certain longstanding conflicts in the region.

