



THE JAMES A. BAKER III  
INSTITUTE FOR PUBLIC POLICY  
OF  
RICE UNIVERSITY

*POST SEPTEMBER 11 UPDATE REPORT*

**POLITICAL, ECONOMIC, SOCIAL, CULTURAL, AND  
RELIGIOUS TRENDS IN THE MIDDLE EAST AND THE  
GULF AND THEIR IMPACT ON ENERGY SUPPLY,  
SECURITY, AND PRICING**

**CHINA'S OIL STRATEGY TOWARD THE MIDDLE EAST**

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PREPARED IN CONJUNCTION WITH AN ENERGY STUDY SPONSORED BY  
THE PETROLEUM ENERGY CENTER OF JAPAN  
AND  
THE JAMES A. BAKER III INSTITUTE FOR PUBLIC POLICY  
RICE UNIVERSITY – SEPTEMBER 2002

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## Introduction

China's growing quest for energy security and its closer links with strategic energy regions, especially oil producers in the Middle East, are becoming increasingly important subjects for all the countries involved. Some inter-governmental organizations, government agencies and several renowned institutions, such as the International Energy Agency, the U.S. Energy Intelligence Administration, the Rand Corporation, and James Baker III Institute for Public Policy at Rice University, have produced major studies on this topic<sup>1</sup>. Serious discussions and studies were conducted by relevant organizations (including the government agencies, national oil companies and some research institutes) within China over the last few years. This author's study on the cross investment with the Middle East<sup>2</sup> appeared in 2000 to high interest and positive response. Concerns have emerged from analysts in the OECD countries that Chinese growing dependency on the Middle East will stimulate competition with Japan and other major oil consumers in this aspect. This paper will explore further China's new focus on and strategic intentions toward the Middle East. The strategic balance will also be addressed.

## Escalating Dependency on the Middle East

The Middle East is the region comprising the countries of Southwest Asia and Northeast Africa. It is an unofficial and imprecise term that generally encompasses the lands around the southern and eastern shores of the Mediterranean Sea, notably Libya, Egypt, Jordan, Israel, Lebanon, and Syria, as well as Iran, Iraq, and the countries of the Arabian Peninsula<sup>3</sup>.

This is a well-known region of concern. Oil and gas in the region, accounting for about 30 percent of world total output and around 65 percent of world proven reserves, are the origins of both wealth and conflicts. Notably, about 60 percent of the region's oil, around 549

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<sup>1</sup> See References

<sup>2</sup> Xiaojie Xu, China and the Middle East: Cross Investment in the Energy Sector, *The Middle East Policy Journal*, Volume VII, Number 3, June 2000.

<sup>3</sup> See the Britannica Concise's definition online.

Million tones (mt), was exported to the Far East or Asia-Pacific markets in 2000. The oil dependency of the Asia-Pacific region, particularly Japan, on the Middle East is projected to grow in the longer term<sup>4</sup>. China is expected to be a big contributor to the increase.

China, as the third largest oil consumer in the world and the second largest in the Asia-Pacific region, has imported oil from the Middle East since 1985. It will continue to import a sizable amount of oil from the Middle East. The country's import volume from the region was around 20 mt in 1998, 30 mt in 1999, 41 mt in 2000, and close to 50 mt in 2001, accounting for over 60 percent, 65 percent, 58percent, and 82 percent of total Chinese imports.<sup>5</sup> Oman and Yemen were major sources prior to 1998 because of their low sulfur content crude. But in recent years, imports from Iran and Saudi Arabia have been growing. In 2001, Oman, Iran and Saudi Arabia were China's major suppliers from the Middle East. One reason Iranian and Saudi oil imports have been able to expand is that refining facilities in coastal China have been upgraded significantly to permit additional processing of high sulfur content (over 2%) crude oil from Iran and Saudi Arabia.

**Table 1 Chinese oil imports from the Middle East Million tones**

| Country      | 1995 | 1996 | 1997  | 1998 | 1999 | 2000 | 2001  |
|--------------|------|------|-------|------|------|------|-------|
| Oman         | 3.65 | 5.65 | 9.03  | 5.79 | 5.02 | 1.56 | 8.14  |
| Yemen        | 2.47 | 3.76 | 4.05  | 4.04 | 4.13 | 3.61 | 2.28  |
| Iran         | 0.93 | 2.31 | 2.75  | 3.62 | 3.95 | 7.00 | 10.84 |
| UAE          | 0.36 | n.a. | 0.048 | 0.51 | nil  | 0.04 | 0.65  |
| Saudi Arabia | 0.33 | 0.23 | 0.49  | 1.80 | 2.49 | 5.73 | 8.78  |

Source: China Custom Bureau, 2002.

With technological improvements, the sulfur (over 1.4%) oil processing capacity in China is close to 28.50 mt in 2000 and will be over 36 mt in 2005.<sup>6</sup> As a result, Chinese oil imports from the Middle East could grow by 60-70 percent. This means not only will Chinese dependence on the Middle East rise, but also that millions of Chinese petro-dollars will flow to the Middle Eastern exporters.

<sup>4</sup> Fesharaki's projection at FACTS Inc.

<sup>5</sup> China Custom Statistics 2002

<sup>6</sup> The data is from Chinese industrial unpublished sources and the projection is based on a reasonable price differential between low sulfur crude and crude with sulfur over 1.4 percent.

In addition, liquefied petroleum gas (LPG) imports from the Middle East grew over the past few years. Saudi Arabia and UAE dominate Chinese LPG imports (0.95 mt and 0.68 mt in 2001, respectively). Meanwhile, Iran and Qatar are actively trying to increase exports of LNG to China and have expressed their great interest in penetrating the gas market in southern China. As planned, China's first LNG receiving terminal is to be constructed in Guangdong province in southern China in 2000-2005. This construction plan is projected to cost US\$600 million, including a receiving terminal with capacity of 3 mt and a 204-km high-pressure transmission pipeline to Fushan and other surrounding cities. The second and third LNG receiving terminals have also been planned for Fujian and Shanghai, respectively. These projects and technological innovations present growing pressure for oil sources from the outside.

### **New Focus**

#### *Oil Services*

China has realized that its dependence on the Middle East for oil and the flow of petro-dollars to the Middle East make the country's external energy links quite insecure. A counter flow of the petro-dollars by industrial cooperation in China is being explored. It is the hope of major Middle East oil and condensate exporters to secure access to petrochemical market in the Far East or Asia Pacific region, especially the important Chinese market. At the same time, Chinese companies have recognized that the Middle East is not only a dominant source of oil but a big oil field service market as well. More importantly, oil producers in the Middle East are in a better position to pay for such services in hard currencies than some other poor producers in the Central Asia or Africa. Considering surplus labor and some technical resources at home, Beijing has started to encourage Chinese energy service companies to go abroad and seek cooperation with their counterparts in oil producing countries as a new strategy beginning in 2000.

The presence of Chinese oil services companies in the Middle East started with their technical

labor services in the early 1980s. China Petroleum Engineering and Construction Corporation (CPECC), the CNPC overseas construction arm, moved into the Pakistani, Kuwaiti and Iraqi markets in 1983. CPECC's entry strategy was to compete for subcontracts and small turnkey projects. Its business expansion continued in 1995 when CPECC won an oil storage re-construction project valued at US\$400 million in Kuwait and five highway construction projects in Pakistan. This success was soon expanded to Sudan and Egypt. The Chinese Great Wall Drilling Company (GWDC, a branch of CNPC) captured growing drilling business opportunities in Sudan, Egypt, Iran, Qatar, Tunisia, Oman and other parts of the Middle East. It is scheduled to expand its activities into Libya soon. The value of CNPC overseas oil service contracts in 2001 reached US\$1.48 billion. This compares to the increase in 1992-97 from US\$60 million to US\$553 million. The operating profit of GWDC in 2001 was US\$100 million.

Libya, Iran, Iraq and Kuwait are considered major markets for Chinese service firms because of their ambitious plans to increase their oil production capacities. Oil facilities in these countries are outdated and require significant investments. It has been widely reported that Libya plans to raise its domestic production capacity from its current level of 70 mt to 120 mt. Large field facilities and pipelines need rehabilitation. Iran would like to expand its spare capacity in the future. Iraq has an ambitious plan to increase its output to 6 million barrels per day once sanctions are lifted. To make this happen, Iraq plans to offer foreign oil companies service contracts to apply technology to 8 fields already in production. This will likely include new reservoir developments at the North and South Rumaila, Zubair, Luhais, Subba, Abu Ghirab, Buzurgan, and Fuqa fields. Iraq also will provide incentives to promote exploration in the remote Western Desert. Located near the Saudi and Jordanian borders, there are at least 110 prospects identified from previous seismic work in this area.

The Chinese oil companies also believe that opportunities exist in the Gulf and other Middle Eastern countries in the years ahead. Libya, Iran, Iraq and some smaller oil producing countries are Chinese targets.

*E & P Activities*

Considering its low R/P ratio, its high cost oil and its growing demand at home, China has to expand its direct investments for oil equity in some strategic oil regions. CNPC has already signed 24 contracts covering exploration, development, marketing and refining in 10 countries. In 1995-2000, CNPC produced 23.79 mt of oil and 3 billion cubic meters of natural gas abroad. In 2001 alone, CNPC's overseas oil production was 16.23 mt and overseas gas output was close to 1 billion cubic meters. Equity equivalent oil stood at 8.88 mt. China National Petrochemical Corporation (Sinopec) and China National Offshore Oil Corporation (CNOOC) also have onshore and offshore projects in Iran and Indonesia, respectively. China has made a good entry into the upstream sector of the Middle East, South America and Southeast Asia. CNPC's E&P projects in the following countries are widely well known.

Sudan is a very small oil producer in the North Africa. The country's domestic oil consumption (around 26,340 barrels per day in 1996) was mainly satisfied by imports. Chinese involvement in Sudan started in 1995. In March 1997, CNPC signed integrated contracts with the Sudanese government. According to the production sharing agreement (PSA), oil production capacity from Blocks 1, 2, and 4 reached 7-10 mt/yr (140,000 – 200,000 b/d). With a 40 percent equity interest, CNPC held 2.40 mt/yr (48,000 b/d) of oil output in 2000. At the same time, a refinery with a capacity of 2.50 mt/yr (50,200 b/d) was built in the capital, Khartoum, 50 percent of which is owned by CNPC. Based on its dominant position in these major projects, CNPC has greatly contributed to the expansion of Sudan's oil industry. This activity has also given CNPC/China an operational base for oil activities in the Middle East and Africa. CNPC proposes to expand its business into other key countries, including Libya, Egypt, Iran, Iraq and others. Currently, some Chinese energy companies are working with their counterparts in hope of receiving some big development projects and related service contracts in some countries subject to U.S. economic sanctions.

Iran is the second largest oil producer after Saudi Arabia in the Middle East. A harsh political environment since 1979 has hampered the Iranian economy. Although the Post-war Reconstruction Era in 1989-1992 led to some economic recovery, the U.S. dual containment

policy and the unilateral implementation of the Iran-Libya Sanctions Act led to a slowdown in foreign investment in the country. However, the sanctions, despite their extreme nature, have ultimately failed to achieve their primary objective of halting international involvement in the country's oil industry, which is now in a state of restructuring and development. Iran's international projects represent attractive business opportunities, for which American firms have not been allowed to compete.

In January 2000, Sinopec signed an agreement with the National Iranian Oil Company (NIOC), worth over US\$ 13 million, to explore for oil in Zavareh and Kashan, in Iran. It should be completed in 3 years, with a possible one-year extension. Sinopec and NIOC also inked another contract for upgrading the Tehran and Tabriz refineries and to build oil terminal port in the Caspian Sea.

Iraq is potentially the most promising market for China. In May 1997, an Iraqi oil official stated that 3 million barrels per day of production capacity could be resumed within one year, 3.5 million barrels per day within 3-5 years, and more than 6 million barrels per day could be reached in less than a decade after the lifting of the U.N. sanctions. This would be accomplished by a 3-phase development effort including: 1) re-working and upgrading existing upstream and downstream facilities; 2) attracting foreign investment for new field developments and production; and 3) actively conducting exploration and development activities in prospective areas such as the Western Desert.

Field development work under the three phases would be extensive, with 33 fields containing 50 billion barrels of reserves and a potential production capacity of 4.65 million barrels per day slated for eventual development. Of these 33 fields, 25 fields have been appraised, but never developed. Of the 25 appraised fields, eleven are located in southern Iraq and have an output potential of 3 million barrels per day. Smaller, undeveloped fields are located in northern and central Iraq and have estimated output capacities of 450,000 b/d and 300,000 b/d, respectively. The remaining eight of the 33 fields are already in production, but will require more work to tap additional reservoirs and to bring another 900,000 b/d of production online.



Although development costs in Iraq are as low as \$1-\$2 per barrel, there is no doubt that any post-sanctions oil program will require massive amounts of foreign investment. A former Iraqi senior official estimated that Iraq would need at least \$5 billion of foreign investment during the first 2-3 post-sanction years in order to bring the country's oil output back to pre-Gulf War levels. He also projected that \$30-\$50 billion of foreign investment would be required to bring production capacity up to 6 million barrels per day.<sup>7</sup>

As of March 1998, there reportedly were dozens of foreign oil companies from a wide variety of countries, including the United States, in discussions with the Iraqi government. Iraq plans to offer new fields to foreign oil companies through PSAs, buybacks, service contracts and joint ventures. Initially, Iraq plans to offer up to 25 new fields to foreign companies. Ten of these fields, with a production potential of 2.7 million barrels per day, are slated for development under PSAs with foreign companies. Four of these fields are located in southern Iraq and, with a combined production potential of 2.1 million barrels per day, represent the cornerstone of Iraq's post-sanctions development plans. These four "giant" southern fields are Majnoon, West Qurna, Nahr Umar, and Halfaya.

As of October 1998, Iraq had signed production-sharing agreements (PSAs) with Russia, China and others for a handful of post-sanctions field developments. One deal with the CNPC and the Chinese state-owned firm Norinco is for development of the al-Ahdab field. Al-Ahdab is located about 40 miles south of al-Kut in central Iraq. The field contains an estimated 1.31 billion barrels of oil and has a production potential of roughly 100,000 b/d. CNPC and Norinco signed a contract with Iraq on June 4, 1997 and formed a new company, al-Waha, to undertake the development of the field. Development and operating costs are expected to be around \$1.3 billion. Due to U.N. sanctions, CNPC's activities, to date, have been limited mainly to surveying work on al-Ahdab. In 1998, CNPC and its Iraqi counterpart were negotiating another contract to develop the Halfayah field. This could be the biggest

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<sup>7</sup> Speech by Issam al-Chalabi, CWC conference, London, April 1999.

field of any of CNPC's overseas development projects, if a final contract is inked, with possible output of 360,000 b/d. But neither project can be undertaken unless the U.N. sanctions are lifted.

**Table 2 CNPC Investments in Iraq**

| <u>Oil fields</u> | <u>Acreage km<sup>2</sup></u> | <u>Proven Reserves Mt</u> | <u>Possible annual output</u> |
|-------------------|-------------------------------|---------------------------|-------------------------------|
| Al-Ahdab          | 250                           | 180                       | 5                             |
| Halfayah          | 350                           | 750                       | 18                            |

Source: Xu

## Overcoming Obstacles

### *Legislative Hurdles*

To penetrate the upstream sector in the Middle East, China is facing some legislative obstacles and contractual hardships in such countries as Saudi Arabia and Kuwait, where foreign investment in the oil upstream sector is forbidden. Iran has adopted Buyback arrangements instead of PSAs as the legal means to conclude contracts with international investors. International companies have found the contractual terms to be rigid, with low returns that are not in line with international practices and rates of profit. Under the buyback arrangement, contractors are required to take full commitments of investment and receive capital interests and rewards of services after cost recovery upon production. The operating rights will thereafter be transferred to NIOC by the contract. Under these arrangements, the contractors are forced to sacrifice any long-term returns that might be available from their projects. While any additional costs are responsibility of the contractor, NIOC will fill in the loss as a result of a decline in world oil prices.

Contract terms for Iran and Iraq are lower than that in Libya and Egypt while their cost recovery period is longer no matter the type of contract, as shown below.

**Table 3 Comparison Between Fiscal Terms**

| Country /field | Starting year of cost recovery | Cost in NPV | Investor take in NPV | Government take in NPV | NPV/bbl prior to government take | NPV/bbl after government take |
|----------------|--------------------------------|-------------|----------------------|------------------------|----------------------------------|-------------------------------|
|                |                                |             |                      |                        |                                  |                               |

|                           |      |     |     |     |     |     |
|---------------------------|------|-----|-----|-----|-----|-----|
| Libya/<br>Elephant        | 3    | 2.8 | 1   | 6.1 | 1   | 7.3 |
| Egypt/<br>Rosetta         | 2    | 1.1 | 1.8 | 4.2 | 1.8 | 6   |
| Iran/<br>Doroud           | 4-11 | 1.3 | 0.1 | 7   | 0.1 | 7.1 |
| Iraq/<br>West<br>Qurna    | 5    | 1.4 | 0.2 | 5.2 | 0.2 | 5.9 |
| Kuwait/<br>North<br>Field | 5    | 1   | 0.1 | 9.9 | 0.1 | 10  |

Source: Mr. Graham Kellas of Wood Mackenzie Consultants presented to the 2<sup>nd</sup> Chinese Overseas Investment in Beijing in October 2001.

While some of the largest international oil companies have learned to live with buy back agreement structures, for some medium and small companies, it may not be affordable to take capital commitments and cost risks under the Buyback regime.

### *Sanctions*

Sanctions are a definite barrier for the sanctioned country to do business with foreign investors. U.N. sanctions affect all countries. They have to follow the U.N. resolutions involved when they deal with Iraq. Currently, Russia, China and others who have major projects in Iraq have to wait until the U.N. sanctions are lifted. China and Russia can push Iraq to comply with U.N. agreements while at the same time persuading the U.N. to consider relaxation of its sanctions.

By contrast, to U.N. sanctions, unilateral U.S. sanctions provide an opportunity for non-U.S. companies to penetrate the sanctioned states. U.S. economic sanctions on Iran and Libya have left a large amount of room for non-U.S. companies in the two markets. While European companies are working hard to negotiate with Iran, China is exploring business opportunities in Libya and keeping its eyes on Iraq.

### *Competition*

In every case, China is facing intensive competition in the Middle East when it bids for major projects. Chinese companies are at a disadvantage in competition for large projects like the North field in Kuwait, not to mention offshore projects which require superior technical expertise. The natural gas sector in the Middle East is open and free from the OPEC quota. Some international energy companies are invited to offer development plans. China is at a disadvantage vis-à-vis the international oil companies in the gas sector, although some niche markets may be good for Chinese companies.

Western companies are concentrating on major oil fields, offshore gas and some oil services in the Middle East. Some European companies are working on some projects with Iraq and Libya. U.S. policy makers might be concerned that U.S. companies will get cut out of the Middle East oil investment pie when Iraqi sanctions are lifted.

In addition, in some sanctioned countries, China is facing serious competition from Russia and other countries as well. In Iraq, Russian companies like Lukoil, Zarubezhneft and Machinoimport inked a big deal with Iraq on West Qurna under a PSA in March 1997 and have done some work there. In October 2000, a Russian oil company was awarded a gas rejection project in Rumaila for production enhancement. In December 2000, with U.N. approval, the Russian companies Tatneft and Zarubezhneft supplied drilling equipment for 78 wells to reduce water flooding in Saddem, Kirkut and Bai Hassan fields. In August 2001, Slavneft negotiated with Iraq to develop Suba-Luhais field by supply drilling services.

In May 2001, Indian ONGC Videsh Ltd. (OVL), Reliance and Algerian Sonatrach formed a consortium to develop Tuba field between Rumaila and Zubair with a total investment of US\$500-600 million. OVL signed another agreement with Iraqi Oil Exploration Company to explore block 8 of the Abu Khema field in southern Iraq in November 2001.

### **China's Strategy**

*Business Expansion*

China does not yet have a clear and integrated oil strategy toward the Middle East despite growing imports from the region. Some Chinese leaders have realized the importance of progressive and integrated strategy but efforts have not always been coordinated given competition of power sources in the Chinese energy sector and government. Based on this author's observation, generally speaking, China's oil strategy toward the Middle East is multi-pronged.

First of all, China could use its oil import leverage to make petro-dollars flow back into its home downstream sector. Oil exporters in the Middle East are welcome to make investments in the Chinese petrochemical industry to secure and expand their market shares and enhance energy linkages between China and the Middle East. Saudi Aramco has negotiated for years with China to build or upgrade Chinese refineries in Qingdao, a port city in Shandong province, or in Lianyungang, a port in Jiangsu province. Unfortunately, the results were negative. Since 2000, when Jiang Zeming visited Saudi Arabia, Saudi Aramco, Exxon and Sinopec have worked together to build a petrochemical plant in Fujian province, which may be a good starting point for future cooperation.

Secondly, Chinese energy companies are encouraged to participate in the upstream sector for larger oil equity. In this context, Libya, Iran, Iraq and some other oil producers should be targeted. Based on its success in Sudan, China should expand its business into Libya as its next major step in the near future. At the same time, China will continue to hold its contracts in Iraq. Diplomatic activities will be emphasized and will eventually play an important role in the near future.

At this moment, Saudi and Kuwaiti legal regimes block China from getting involved in the upstream sectors there. Still, it might be wise for China to expand its oil and non-oil related trade and economic cooperation with these two oil producers as some senior diplomats have suggested.

*Oil Diplomacy*

Oil diplomacy has been touted widely in Beijing at high-level internal seminars in late 2001 and early 2002. Oil diplomacy will be a critical component of dealing with oil producing countries, particularly those in the Middle East. Some experts have suggested that Chinese embassies in major oil producing countries should be staffed with energy counselors. The government should set up inter-departmental offices to coordinate energy issues between the Middle East, Northeast Asia and other regions. These would be subject to reorganization of the government and might not be possible until upcoming administration is there.

In the past, Chinese diplomats worked closely with the Chinese energy companies to secure energy interests in oil producing countries. Chinese successes in Venezuela, Kazakhstan and Sudan are results of cooperation between energy firms and diplomats.

Some key elements of Chinese oil diplomacy concerning energy issues might focus on three groups of countries: (1) Saudi Arabia and Kuwait; (2) Iran and Iraq; and (3) Libya and Egypt.

Surely, China will continue to increase its oil and LPG imports from Saudi Arabia, Kuwait and Iran and throw light on its oil business penetration in Libya, Iran and Egypt. Oil diplomacy is reflected in official and unofficial exchanges of views and high-level visits. In recent years, China has made high level visits to some key oil producing countries such as Iran, Iraq, Libya and other countries. Most importantly, Mr. Jiang Zemin, the President of the country, made state visits to Libya and Iran in April 2002. A series of agreements and memorandums were signed, including energy deals, during Jiang's visits. Jiang even invited Qadaffi to visit China when convenient. During his trip to Iran, the Chinese leader spelled out China's views regarding the U.N. sanctions against Iraq. The President's energy diplomatic activities in the Middle East were followed by frequent business contacts.

Through exchanges with Arabic countries, China has begun to work more closely with Arab countries on regional and international issues. In addition, it is the Chinese experience that Arab culture and history should be strongly respected when dealing with many sensitive and

critical issues in the region of concerns.

### **Coping with Strategic Concerns**

There are several more concerns and security dilemmas related to Chinese involvement in Middle Eastern energy issues. China's growing dependence on oil imports from the Middle East has been the subject of many in-depth studies. The Paris-based International Energy Agency has projected that China will import 8 million barrels per day, notably from the Middle East, by 2020<sup>8</sup>. This means that 60 percent or more of China's domestic needs will be satisfied by the outside sources in 2020 according to the author's calculation. As a result, this number has raised great concerns about economic and military security. There are, however, a number of reasons that this level of imports will not develop. One reason is that economic growth will level off to 5-6 percent in 2010-2020, resulting in major energy saving. Also, to avoid its dependence on the Middle East, China will diversify its importing sources. The main alternative sources will be available from the Russian Far East, Central Asia and even Africa. Russia would be a key center of supply to China and other countries in Northeast Asia, given China plans to build trunk lines linking cross border energy transportation routes around 2010. In addition, China is considering building-up its strategic oil reserves that will be an important leverage in adjusting its domestic demand.

A high Chinese oil import requirement scenario would be dangerous and would jeopardize and even reshape the framework of world energy security, both economically and geo-politically. Under that scenario, Chinese oil demand would seriously squeeze major competitors (including Japan and the U.S.A.) quests for additional sources from the Middle East. Any mismanagement of demand would hurt the stability of oil markets in Asia-Pacific region. Meanwhile major oil exporters would have to increase their daily production, spare capacities and investments to meet China's growing market. This would totally alter the structure of supply within the OPEC and beyond.

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<sup>8</sup> China's Worldwide Quest for Energy Security, page 7, International Energy Agency, 2000.

China's oil linkage with the Middle East requires safe navigation along the sea-lanes. Currently, China is not capable of providing security for its sea-lane imports given its limited air and offshore forces. Indeed, China, Japan and other countries benefit from the U.S.-led military safety system and the security commitments by the countries along the sea-lanes. In this context, China, the U.S., and others share strategic interests and have reasons to work together to secure the sea-lanes and tackle the many issues involved. Extensive military dialogues and cooperation are required between all the countries involved. In China, these may depend on Chinese economic strength in the first two decades to come and might eventually lead to a change of the Chinese military strategy and inward diplomatic stance designed by the late Mr. Deng Xiaoping. Against this backdrop, China would have to adjust its diplomacy toward brave new reality and geo-political relations with the countries in the Middle East, its neighbors and the Western countries.

Regional energy dialogues and cooperation are critical to enhance energy linkages between the strategic regions of supply and those of consumers in Eurasia. Japan, China and Republic of Korea are the major consumers in the Asia-Pacific region and are satisfied largely by oil imports from the Middle East. China has realized the importance of close work and dialogue with the oil producers in the Middle East and has joined several economic and energy dialogues Northeast Asia in the past. Shanghai Six Summit is the right avenue for China, Russia and four Central Asian countries to cooperate on many regional issues. Economic and trade ministerial meeting was held in Shanghai in May 2002. Energy sector is suggested to be included. China has responded to the Japanese suggestion to join the regional energy dialogues between East Asia and West Asia. Meanwhile, China, Japan and the Koreans are working with Russia on energy development in Eastern Siberia and the Russian Far East, in both the upstream and downstream sectors.

Among other related strategic concerns is energy development in the South China Sea. China is ready to discuss any potential issues with the littoral countries. China has its clear policy "pursuing joint development while putting aside disputes" and has not received positive responses, unfortunately. In this regard, the geo-strategic balance should be emphasized.



Any final solutions are subject to the effective management of the huge uncertainties facing China and the other littoral countries in years ahead.

## **Conclusions**

China's energy links with the Middle East are on the upswing. Oil imports and economic cooperation between China and the Middle East have been enhanced and encouraged. Oil trade and cross investment (especially energy related projects) will be stressed for security reasons. Libya, Iran, Yemen and other Middle Eastern countries have been targeted by the Chinese government as good prospects for trade and investment. Libya has been spearheaded in the near future because of the huge undeveloped and low-cost resources available for non-U.S. companies. Iraq is potentially an extremely important country where China and Russian both have major interests. Although some agreements are pending or suspended, China will continue to support efforts through diplomatic channels to lift the U.N. sanctions on Iraq within the U.N. framework.

The future of the sanctions on Iraq remains unclear, however. Chinese policy toward Iraq is well explained by its official statements at the U.N. and expressed by Mr. Jiang Zeming as mentioned above. Oil diplomacy should play an important role in this period, as suggested. There are some minor debates about a brave moment for business expansion in Iraq at some seminars. However, China's official position is widely accepted in government and private business circles.

It does not appear that the U.S. "smart sanctions" have been effective in pressuring Saddam Hussein. Any attempt to remove Saddam from his power seems in vain. Long standing member countries of the U.N. should work together to tackle and eventually solve the Iraqi problem. In theory, Iraqi oil resources should be open and accessible with fair competition. This seems to be a high priority of the U.S. administration. However, it is not expected that Iraq will offer a way for the U.S. to compete in the Iraqi oil sector. Iraq is not Libya in this regard.

So far, China has not developed any new ideas to solve the Iraqi dilemma. China is against regional hegemony by militarization. At the same time, China does not believe foreign interference is a justifiable route to international policy. China does not support political regime change as a legitimate policy because the internal politics of Iraq totally belongs in the domain of Iraq and its internal affairs. It might be time for the U.S. administration to reconsider its way ahead. China and other powers have to coordinate along an avenue to the peace and cooperation in the Middle East.

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## Acknowledgements

This paper was commissioned by James Baker III Institute for Public Policy at Rice University, USA. The author would like to extend his thanks to Ms. Amy Jaffe for her insightful guidance and comments and Erica Downs from Princeton University for her comments and editing assistance. The author received a valuable comment from Dr. Edward Morse of Hess Corporation with thanks as well.