



CHINA'S DEPENDENCE UPON OIL SUPPLY

PART 2 of 3

SERIALIZED STUDY BY –

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Super-Power Oil Thirst Analogy

Who knows if China will be able to quench its immense thirst? What are the alternatives? In the last resort, there may be a forced military option.

Poolside Combatants

Arbitrarily, we are confronted with a vision of the three/four super powers: expanding China, expanding India, uncertain Russia, and the declining US, together with all the other lesser powers, sitting around an ever dwindling pool of crude oil, greedily sucking profusely through straws to expeditiously gather in the last remaining drops of crude oil.

This so-called pool may be construed as the “global” pool of total oil/gas resources available to hungry worldwide consumers. The Arabian Gulf littoral States are seen as the predominant and consistent faucets for replenishing the global pool of available oil/gas resources. The “chokepoint” Strait of Hormuz is the vital conduit for the passage of this oil/gas. Nonetheless, there are at least two other contributing *de facto* pools (1) the Caspian Sea and (2) the Nan Hai (South China Sea). The latter two will contribute substantial oil/gas supply in the future so as to partially mitigate China’s massive thirst. Other nations will assist in the depletion of these subsidiary-contributing pools. (As an exercise, it may be useful to calculate the contribution made by (1) and (2) above as a percentage of China’s total oil/gas supply in the next decade).

This colourful analogy is perhaps unfair, measuring the participants only in terms of their economic strength and consequent “driver” demand for the crude oil. Again, the global financial meltdown will slow down the thirst of the poolside participants until favourable economic boom conditions return.

Notwithstanding the rate of oil depletion at the poolside, it is still an urgent race against time. The world desperately needs alternative sources of energy³. Unfortunately, the world has been slow to develop alternative energy resources. The oil majors must divert more monies from their enormous profit margins for research into renewable energy. It is incumbent upon them to take this action as a responsibility for the welfare of our planet. For example, ExxonMobil, reputedly the largest oil company in the world, with an annual profit of around US\$400B has to date only diverted US\$0.1B into renewable energy research.²⁷ This is grossly inadequate.

The terminology, “declining US” as stated above, needs clarification. Recently Dr. Thomas Fingar, Deputy Director of National Intelligence, at a press briefing in Washington, stipulated that worldwide perceptions of US decline “relate to the absolute power of the US, and not to the relative power.” Dr. Fingar went on to say: “at one time the US had 50% of the global economy; yet today the US still has roughly 20% of the global economy with only 6% of the world’s population. The US is thinking of it as the rise of the rest, rather than the decline of the US.”²⁶ The US welcomes growth economies in the rest of the world.

As for “uncertain Russia”, this refers to the difficult political and economic aftermath resulting from the breakup of the FSU. The debacle in Afghanistan has damaged and called into question Russia’s military strength. The Red Army appears less formidable. Russia is struggling to reassert its position in the world order and is confronted by expansionist NATO and by consolidation amongst the European powers. Russia is rebuilding its economy. Notwithstanding, as the world’s second largest oil producer, Russia is more likely to replenish some of the oil in the pool and this is inconsistent with the analogy.

The analogy does not give full consideration to all the rising states – the so-called BRIC – Brazil, Russia, India and China. Brazil has been omitted, but is likely to become a significant oil consumer in the next decade. Japan is omitted although it is a major oil consumer.

An important question comes to mind. Is the pool of available oil large enough to accommodate all the poolside participants? Oil industry experts attest that the world has entered the 21st Century with proven reserves over one trillion barrels of oil.⁴⁵ Global output to maintain the size of the oil supply pool has in the past been overestimated. The era of “easy oil” is long surpassed.

Peak Oil Production

Dr. Fatih Birol, Chief Economist of the International Energy Agency (IEA) has predicted that “global production (oil) is likely to peak in about 10 years (i.e. in the year 2019) – at least a decade earlier than most governments expected”.⁹² The IEA concludes that production at most of the largest oilfields has already peaked and that “the rate of decline in oil production is now running at nearly twice the pace as calculated just two years ago”. IEA conducted a detailed assessment of 800 major oilfields accounting for more than 75 percent of the world’s proven oil reserves to reach the above conclusion.

Excluding those countries that have already reached or are about to reach peak oil production, only fifteen oil producing countries remain with enough potential to boost production to replenish the ever dwindling pool of available oil. The countries are: Algeria, Angola, Azerbaijan, Brazil, Iran, Iraq, Kazakhstan, Kuwait, Libya, Nigeria, Qatar, Russia, Saudi Arabia, the United Arab Emirates, and Venezuela.⁴⁹

Two important documents are worthy of note here. Firstly, the Hirsch report entitled *Peaking of World Oil Production: Impacts, Mitigation, and Risk Management* published in February 2005; and secondly the *Rimini Protocol (Uppsala Protocol)* proposed in 2003. The latter is a proposal to stabilise oil prices and minimize the effects of peak oil.⁹⁴

Need for Fresh Investment

Also derived from the above assessment, IEA concludes “beyond predictions for peak oil projections, on top of this is the problem of chronic under investment by oil producing countries, a feature that is set to result in an oil crunch within the next five years”.

IEA estimates the amount of fresh investment needed to ensure adequate supplies of petroleum in 2030 is no less than US\$5.4 trillion.⁴⁶ It is apparent that investors do not want to risk capital in the future development of “tough oil” reserves.

The amount of fresh investment postulated by the IEA cannot be directly equated to output expressed in barrels of oil.⁵⁹ A large proportion of this investment will be expended in new oil pipelines, new refineries, upgrades of existing refineries, terminal and transport facilities, and other oil infrastructure projects. However, as a convenient yardstick and as an arbitrary assumption, oil supply in 2030 will surely have to be maintained at (say) several trillion barrels to meet the needs of the latter half of the 21st Century and well beyond. (This assumes an average “spot” price for a barrel of oil at (say) between US\$50 and US\$100; together with increasing global oil consumption, over the next twenty years and is reflective of the effects of the world economic recession/depression.)

A sophisticated mathematical/statistical model, analysing all the variables, is needed to arrive at more refined estimations/projections for future world oil supply. This constitutes a huge task with international ramifications.

Some mathematical models have been used in the past to predict the timing of peak oil. It is notable that M. King Hubbert, who devised the peak theory, correctly predicted in 1956 that oil production would peak in the US between 1965 and 1970. Hubbert further predicted a worldwide peak at about “half a century” from 1956 at some 12 gigabarrels (GB) a year in magnitude. Later in 1976 he revised this estimate to 40 GB/yr in 1995.⁹³

The pool of available oil is not likely to be easily replenished in the future? The poolside participants want more, but less is available.

Export Land Model

On a technical note, at this juncture, mention should be made of the *Export-Land Model*. This relates to work done by Jeffrey Brown, a geologist in Dallas, and is discussed widely on The Oil Drum.⁹⁴ It models the decline in oil exports that result when an exporting nation experiences both a peak in oil production and an increase in domestic oil consumption. In such cases, exports decline at a far faster rate than the decline in oil production alone.

This model is important to petroleum importing countries because when the rate of global oil production peaks and begins to decline, the petroleum available on the world market will decline much more steeply than the decline in total production. Hypothetical and actual examples are detailed on The Oil Drum.⁹⁵ China needs to be assessed in the light of the *Export-Land Model*, and further research is outstanding in this area.

Political and Military Consequences at the World Oil Poolside

In a worst-case scenario, the poolside participants may leave ugly footprints, lay waste to the shoreline and pollute the local waters, desecrate the environment (as has happened at Baku and in the Arabian Gulf), fester social unrest, invoke political mistrust, and eventually pre-empt military confrontation. Military history has shown that this type of scenario is a very much a reality.

Once this ugly dissension arises amongst the poolside participants, in rush the rapid response military forces from nearby bases or from overseas. Pre-positioned caches containing armaments, munitions, sophisticated weaponry and other war materiel are already logistically in place to fuel any such conflict. Such are the sinews of war. It is possible the entire pool could quickly go up in flames.

It is not known how much oil was irrevocably lost (and/or production disrupted) during the Iraq-Iran War in 1980-88. Both sides sustained enormous damage to oil installations. At the outset of the war, Iraq was obsessed with Abadan (once the largest oil refinery in the world). For two years Iraqi artillery and aerial bombardment rained down on the oil town. Although shattered and virtually destroyed, Iraqi ground forces were unable to capture this prize. Iraq also attacked and destroyed the Kangan refinery as well as the Kharg Island terminal. Early in the war, the Iranian navy shelled Umm Qasr, the oil port on the Fao peninsula. This prevented Iraq from using the Arabian Gulf for its oil exports. Saudi Arabia and Kuwait eventually donated all oil production from the neutral zone: shared to the Iraqi war effort.

(Iraq was also able to pump northwards to the Mediterranean via Turkey through its one useable pipeline).

There have been three conflicts in the late 20th Century and the early 21st Century called the Persian Gulf War; two are occasionally referred to as the Second Gulf War.⁵⁸ In one of these wars, during Operation Desert Storm at the beginning of 1991, over 700 oil wells were ignited, pipelines ruptured, and a massive oil slick formed in the northern waters of the Arabian Gulf. Carbon emissions from burning oil wells left the planet and permeated well into outer space.

To digress, it is difficult to resist quoting the words of Chinese author Xinran (Jin Zhi: not her real name): “Since the year 2000, oil has been both a cause of war and a weapon in the struggle for world domination. Less than a hundred years after the first oil was poured into the first barrel, it has leaked into the skies, seas, and earth of humanity, into our clothes, food, homes, and transport; it has become a part of the structure of our lives that is impossible to ignore.”⁶³

The amount of “shrinkage” in world oil supply has never been estimated. Notwithstanding oil losses incurred during wars in the past, oil has been lost at wellheads, at refineries, in pipelines, from holding/storage tanks, from oil tankers at sea, from road tankers, from rail tankers, and from evaporation and wastage. Refinery processes, such as by utilising gas/oil separator plants (GOSPs), NGL fractionating columns, catalytic units, stabiliser columns, and de-ethanisers, sometimes lead to unavoidable losses some of which are accidental. In many instances seepage has contaminated groundwater, waterways, and oceans (i.e. Unocal Well (off the coast at Santa Barbara), Deepwater Horizon, Exxon Valdez, Ixtoc1, Burmah Agate, Barge Bouchard 155, Amoco Cadiz, Prudhoe Bay, Montara Wellhead, and other oil spill incidents). World weather patterns have also caused losses, for example cyclones in the Mexican Gulf, and storms in the North Sea. Natural disasters such as earthquakes and volcanic activity lead to further losses. These oil losses will never be recovered.

In the hitherto mentioned conflicts, billions of dollars worth of precious oil have been lost, perhaps more oil than was used in WWII? The sums are incalculable.

On the battlefields, irrespective of oil infrastructure damage/losses, the US military in WWII consumed one gallon of petroleum per soldier per day, during the first Gulf War of 1990-91, the rate rose to four gallons per soldier per day, and in the Bush administration’s war in Iraq, it leapt to sixteen gallons per soldier per day.⁶⁰

As a means to defuse the situation for any future worst-case scenarios, a newly contrived, perhaps reorganised and greatly strengthened United Nations “strategic deployment policing force” (assuming it is immediately available), could instantly be sent to the area of potential military conflict. Such action may yet save the day and prevent a future world catastrophe?

If direct military conflict, possibly sparked by a single unforeseen incident, occurs at the poolside, the fracas could expand outwards. It might migrate back to the distant homelands of the thirsty oil consumers. Here then are the ingredients and recipe for WWIII.

A fourth war in the Gulf would be calamitous. Seen as the frontline, it is very dangerous to be resident at the poolside.

China's true intents in the Arabian Gulf are yet to become clear and transparent. It is highly likely China will take a stronger seat at the poolside.

Strategic maps and Sea Lines of Communication (SLOCs)

Upon exit from the Strait of Hormuz, the oil supply route traverses through the Arabian Sea, rounds Dondra Head (Sri Lanka), crosses the Indian Ocean, enters the Strait of Malacca, bypasses Singapore, enters the Nan Hai (South China Sea), enters disputed waters claimed by China as part of its "Sacred Territory"; threads its way past the Spratly Islands, Johnson Reef, Macclesfield Bank, and Paracel Islands, to Zhanjiang (opposite Hainan Dao), to Zhuhai and Guangzhou; to Xiamen (Amoy) and continues on through the Taiwan Haixia (Taiwan Straits) to the Dong Hai (East China Sea), calling at Hangzhou and Shanghai; then northwards to the Huang Hai (Yellow Sea), to ultimately deliver the crude oil to Qingdao, Dalian, and Tianjin (Nanjiang).⁷³

Entry ports and oil infrastructure facilities can be further defined by access to www.portguide.com - Lloyd's Register Fairplay Ltd have published a *Tanker Berth Guide* available to subscribers.

It is anticipated the PRC may lead an increase in demand for oil tankers as its energy needs rise in the next five years. Assuming the increased oil tonnages are sourced from the Arabian Gulf, it could create demand for an additional eighty VLCCs to meet Chinese oil consumption by 2015.¹¹⁷

By 2020, it is projected that 95% of Asia's oil will come from the Middle East and most of this oil will be consumed by China.

In following the sea-lanes described above, oil tankers carrying Middle Eastern oil are vulnerable to hijackings, piracy, and military action as they pass through maritime "chokepoints" such as the Strait of Malacca, Sunda, Lombok, and Makassar. Many tankers approach the Strait of Malacca by sailing between India's Andaman and Great Nicobar islands. Over 80% of the PRC's crude oil imports transit the Strait of Malacca.²¹ China also uses ships for imports of liquid natural gas (LNG) over sea lines of communication (SLOC's) from Indonesia, Australia, the Middle East and elsewhere.

China is examining the feasibility of constructing a US\$20B canal across the Kra Isthmus in Thailand. This new canal would allow tankers and other commercial vessels to bypass the "chokepoint" Strait of Malacca. The canal project, if implemented, will give China port facilities, warehouses, military installations, and other infrastructure in Thailand aimed at enhancing Chinese influence in the Andaman Sea and the Gulf of Thailand.

It is interesting to note that Malaysian, Indonesian and Saudi companies signed a contract in 2007 to build a US\$7B oil pipeline across the north of Malaysia and southern border of Thailand to reduce 20% of tanker traffic through the Strait of Malacca. It is estimated over 50,000 vessels transit the Strait of Malacca each year.

Chinese military specialists have the view that "the US has the military capability to cut off Chinese oil imports and could severely cripple China by blocking its energy supplies." Chinese President Hu Jintao recently stated that China faces a "Malacca dilemma" – the vulnerability of its oil supply lines from the Middle East and Africa to disruption. (Reported in the *Washington Times*, January 2005).

The Cuban naval blockade in October 1962 almost preempted a thermonuclear war between the US and Russia.³⁴ It is notable that the US blockade did allow an oil tanker free passage to Havana, as quoted below:

“All day, crowds had been gathering on the waterfront in old Havana to cheer the first Soviet ship to pass through the American blockade. The skipper of the *Vinnitsa* entertained them with stories of the armada of US warships, helicopters, and planes that had failed to stop his little ship. Clutching a Cuban flag and a portrait of Castro, Captain “Pedro” Romanov described how he had braved gale-force winds and the imperialists to deliver oil to “freedom-loving Cuba.”³⁴

Some twenty-one years earlier, in July 1941, the US previously blockaded oil supply to Japan (following the Japanese occupation of French Indochina.) President Roosevelt prohibited US oil and gas exports to Japan. This was one of the main reasons why Japan entered WWII.

A naval blockage contrived by Western powers to obstruct oil supply to China is unthinkable in the 21st Century. Will the perpetrators of the blockade allow oil tankers to reach Chinese ports?

Chinese retaliation would be swift. Chinese military strategists are well aware that their own naval blockades have the potential to deny, disrupt, degrade, or otherwise complicate the arrival of US forces and supplies in the region via sea.³⁵ Chinese doctrinal writings reveal the potential these types of operations are believed to have for achieving both political and military objectives. Chinese writings on blockades often overlap with writings on attacks on sea lines of communication (SLOC’s) and ports because such actions are often conducted simultaneously.³⁵ Chinese doctrinal writings follow aphorisms taken from Sun Tzu – the venerated military strategist in the Middle Empire in 512 B.C.⁶⁸

As a political safeguard, China maintains good relations with the maritime powers of South East Asia to help mitigate its “Malacca dilemma.”²³

Beyond this, what then are the wider military implications?

Chinese Military Expansion

“China’s increasingly mercantilist strategy to assert control of oil and natural gas supplies and transport routes risks fueling tensions and conflict in a region where lack of regional institutions to manage conflict is already a major problem and a region which is facing a sensitive transition to accommodate China’s rising power over the next two decades. Energy competition is beginning to seriously aggravate existing and, in some cases, deepening rivalries between China and her neighbors.”²⁴

In 2004/5, defense contractor Booz Allen Hamilton prepared an internal report entitled *Energy Futures in Asia* for Defense Secretary Donald H. Rumsfeld.⁵ Some of the salient contents of this report were reported in *The Washington Times* in January 2005. They are relevant to this research paper. These contents are briefly discussed below.

In order to protect its oil shipments and to project its power overseas, China is building up military forces, installing electronic eavesdropping posts, and setting up naval bases along sea-lanes from the Middle East to the Nan Hai (South China Sea). These measures not only suggest defensive and offensive positioning to protect China’s energy interests; but also underline broad security objectives.

The report states that China is adopting a “string of pearls” strategy of military bases and diplomatic ties stretching from the Middle East to southern China.⁵

For example, at Gwadar, a mere 200 nautical miles from the mouth of the Arabian Gulf (Persian Gulf), Beijing is helping Pakistan to construct a deepwater port and naval base. (At the time the Soviet Red Army occupied Afghanistan, the FSU had similar intentions - as outlined in the presentation given to the Royal United Services Institute (RUSI) in Melbourne in 1981. Refer to Author’s Notes and Personal Experiences). China has provided 80% of Gwadar port’s US\$248M initial development cost. Some internecine rivalry between Gwadar and the main Pakistani ports of Port Qasim and Karachi Port has delayed progress as reported recently in *The News*.⁶ Gwadar lies at the confluence of not just local offshore drilling pipelines, but also the sea and land routes that will move oil to India, China and Japan in the 21st Century. In addition to the port and naval facilities, China has financed an airport (envisaged as Pakistan’s largest) and an oil refinery destined to produce 60,000 barrels a day from offshore drilling.

The infrastructure development at Gwadar totaling approximately US\$12 billion marks China’s new strategic presence on the Indian Ocean. Military analysts in the US are wondering about an eventual Chinese naval base in the Arabian Gulf. The most likely site is Bandar Abbas (Iran), directly opposite the Musandam Peninsula, at the very throat of the Strait of Hormuz (roughly 50 km wide at its narrowest point). Chinese electronic eavesdropping, monitoring ship traffic (around 300 shipping movements per day) through the Strait of Hormuz and the Arabian Sea, is already fully operational.

Again, in Sri Lanka, Chinese aid and commercial investments have increased markedly whilst the regime controlled by President Mahinda Rajapakse has been in power.¹¹⁹ The US\$1 billion Chinese funded Hambantota Port Development Project near Dondra Head in the southern part of Sri Lanka will set up a naval military base to rival that of UK’s Diego Garcia military base currently leased to the US Navy in the Chagos Islands. Hambantota is a strategically vital gateway for securing access to SLOCs in the Indian Ocean. When completed in thirteen years from now, Hambantota will be more than three

times the size of Colombo harbour. The port will be able to accommodate a new generation of mega-ships and is to include four terminals (12 berths), bunkering and refueling facilities, a LNG refinery, aviation fuel storage facilities, and dry docks. The port will be able to handle VLCCs essentially as a halfway respite stop on their way to China. Other Chinese funded projects in Sri Lanka include new port infrastructure at Galle; the new international airport, the Norochcholai Coal Power Plant Project (US\$855M); the Colombo-Katunayake Expressway (US\$248M); and the National Performing Arts Theatre (US\$21M). In recent years, Chinese aid to Sri Lanka has grown fivefold.

Likewise, in Bangladesh, a container terminal is under construction with Chinese help at Chittagong. The Chinese are actively seeking more extensive naval and commercial access in Bangladesh.

In Myanmar (Burma), China is building naval bases. Beijing has supplied Myanmar with “billions of dollars in military assistance, including fighter aircraft, helicopters, tanks, naval patrol vessels, artillery and ammunition, to support a de facto military alliance.”⁵ And again, in Myanmar, electronic listening posts have been installed on islands in the Bay of Bengal to enable the Chinese to monitor the activities of the Indian and US navies in the areas around the Strait of Malacca.

“For the PRC, a close alignment with Myanmar offers a number of benefits. First, access to the Indian Ocean through Myanmar would be instrumental in the development of China’s landlocked southwestern provinces. Secondly, Beijing is keen to exploit Myanmar’s rich natural resources, particularly crude oil and natural gas. Finally, and most importantly, Myanmar is able to offer the Chinese Navy access to its ports. This will enable the Chinese Navy to project power into the Indian Ocean and Strait of Malacca.”²³ The vital sea artery for oil supply to China is thus covered militarily.

China signed a military agreement with Cambodia in November 2003 to provide training and equipment. Cambodia is helping Beijing build a railway line from southern China to the sea.

China is also building up its military forces in the Nan Hai (South China Sea) region to be able to “project air and sea power”. These forces extend from the Chinese mainland and from Hainan Island deeply into the region. At Sanya on the southern coast of Hainan Island, the People’s Liberation Army Navy (PLAN) is building up to twenty nuclear submarine pens and massive underground facilities to accommodate surface combatants.⁹⁶ In terms of sea power, Beijing has systematically bolstered the capabilities of its PLAN. The current Chinese navy dispositions are detailed elsewhere in this paper. New military airstrips, for example on Woody Island and elsewhere, together with increased missile deployments have considerably enhanced PRC air power.

To summarize, the West is losing the race to militarily protect the supply routes originating from the Arabian Gulf to supply crude oil to India, China and Japan and also ultimately to Europe and the US. Chinese funded infrastructure developments at Gwadar, Hambantota, Chittagong, at Sittwe in Myanmar, in Cambodia, and at Sanya on Hainan Island, collectively amounting to an estimated US\$25 billion, will facilitate military domination of the sea lines of communication well into the 21st Century and beyond. The net is closing - too quickly for the West.

ADM Robert F Willard, USPACCOM, has stated: “China’s rapid and comprehensive transformation of its armed forces is affecting regional military balances and hold implications beyond the Asia-Pacific region”.¹²¹

In fact, the PRC has engendered a new naval arms race in the Nan Hai. Neighbourhood countries have swiftly reacted: Japan has introduced several new classes of warships, including the *Osumi* amphibious assault ship and is building its first aircraft carrier, Malaysia has sought to develop the largest and most potent navy in SE Asia, Thailand has already acquired the region's first aircraft carrier, namely the *Chakri Naruebet*, and has purchased patrol boats from Australia, Indonesia has bought forty eight ships from the Netherlands, Germany and the US; Singapore likewise has purchased and is rapidly building corvettes and patrol vessels, the Philippines has acquired additional patrol boats (ex-Hong Kong naval base), Brunei Darussalam has ordered corvettes from the UK, and Vietnam has ordered six Russian KILO-class submarines.

More mention should be made about Japan. This country is worried about increasing militarism in China and the unpredictability of North Korea. Japan wants to protect its oil imports and is very much dependent upon Middle East crude. Largely a "pacifist" country in accordance with Article 9 of its rewritten post-WWII Constitution, Japan maintains a Self-Defence Force (SDF). However, for the first time ever, Japanese forces were deployed overseas to Iraq in 2003. Further changes to Japan's Constitution are likely to enable the SDF to adopt a more militaristic stance.

The US is cognisant of the naval build up in the Nan Hai. The US Seventh Fleet, based at Yokosuka in Japan has undertaken regular naval exercises in the Nan Hai area. In 1999, in an interview aboard the aircraft carrier USS KITTY HAWK, the then commander of the US Seventh Fleet, RADM Timothy J. Keating remarked: "The sea routes are very important to us. A lot of Japanese oil comes through the Straits of Malacca, turns left, and heads through the South China Sea to Japan. So it's the uninterrupted flow of commerce through these waters that is of critical importance to the US." China might well echo the similar words.

Looking beyond the Booz Allen Hamilton report, today in 2008, it is now determined that China has the most active ballistic missile programme in the world. The PRC is developing and testing offensive missiles, forming additional missile units, qualitatively upgrading certain missile systems, and developing methods to counter ballistic missile defenses.

The Chinese South and East Sea Fleets, largely based at Zhan Jiang in the Nan Hai (South China Sea), adjacent to Hainan Island, and at Dinghai in the Dong Hai (East China Sea) presently comprise one nuclear attack submarine, thirty-two diesel attack submarines, seventeen destroyers, thirty-six frigates, forty-seven amphibious ships, and thirty-five missile patrol craft.²¹

The PRC is acquiring large numbers of highly accurate cruise missiles, such as the domestically produced ground-launched DH-10 land attack cruise missile (LACM), the Russian SS-N-22/SUNBURN supersonic anti-ship cruise missile (ASCM) outfitted on China's two SOVREMENNYI and two SOVREMENNYI II-class guided missile destroyers (DDG), also acquired from Russia, and, the SS-N-27B/SIZZLER supersonic ASCM, outfitted on the last eight of twelve total Russian-built KILO-class diesel electric submarines China has acquired.²¹

China is developing an anti-ship ballistic missile (ASBM) based on a variant of the CSS-5 medium-range ballistic missile (MRBM) as a component of its anti-access strategy. The missile has a range in excess of 1,500 km and when incorporated into a sophisticated command and control system, is a key component of the PRC's anti-access strategy to provide China with the capability to attack ships at sea, including aircraft carriers, from great distance.²¹

Additionally, the PRC is modernizing its longer-range ballistic missile force by adding more survivable systems. Most notably, the DF-31 and longer range DF-31A are now being deployed to units within the 2nd Artillery Corps.²¹

China is also working on a new submarine launched ballistic missile, the JL-2, for deployment aboard new JIN-class (Type 094) nuclear-powered ballistic missile submarines (SSBN). The JL-2 is expected to reach initial operational capability (IOC) between 2009-2010.²¹

Deng Xiaoping, referred to as the father of China's modernisation, once gave his colleagues a profound piece of advice: "Hide your strength, bide your time, and do what you can." China is very cleverly attempting to disguise its increasing militarism under the guise of "peaceful development".⁹⁷

Nonetheless, ASEAN countries together with Australia, Japan and the US are somewhat alarmed that the PRC has developed a new ballistic missile designed to strike ships at sea. The Dongfeng 21 (DF-21) anti-ship ballistic missile (ASBM) constitutes a technological leap that the PLC has not achieved before. The initial phase seeks to have a rudimentary 1,500 to 2,000km range ASBM capability available to PLAN by the end of the 11th Five Year Plan in 2010. The implications are horrendous. The US Seventh Fleet could be rendered obsolete. It will need to invoke urgent counter measures? (The US second-generation Aegis BMD capability may negate Chinese intentions)? The DF-21 is believed to have a speed of Mach 10. It can carry a warhead large enough to destroy US aircraft carriers and significant surface combatants.⁹⁸ Randy Schriver has asserted: "The Chinese would have the ability to hold our carriers at a great distance (from China) – it almost makes the US aircraft carriers obsolete".⁹⁹

In the longer term, once operational, these defensive/offensive measures will partially enable China to provide full "umbrella" strategic coverage to protect its oil supply routes from the initial Middle East and African sources, through to the Indian Ocean, transiting the Malacca Strait, through to the Nan Hai and Dong Hai. Chinese military strategists will no longer be so fearful of the vulnerability of the PRC's global oil supply routes to military interdiction.

Looking further ahead to the future, China's leaders will possibly remove all the vulnerabilities by developing extended-range power projection, including aircraft carrier development, expeditionary warfare, undersea warfare, anti-air warfare, long-range precision strike; maritime C4ISR for geo-location and tracking of targets; expeditionary logistics and forward basing; training and exercises, especially in open water, and a more activist military presence abroad.²¹

Nevertheless, it is to be stressed that, today, the PRC is neither capable of using military power to secure its foreign energy investments nor of defending critical sea-lanes against disruption.²¹

China's multi-dimensional programme to limit or prevent the use of space-based assets by its potential adversaries during times of crisis or conflict is considered beyond the scope of this research paper. It is noted the majority of the technology used in China's manned space programme is derived from Russian equipment, and the PRC receives significant help from Russia with specific satellite payloads and applications. China's leaders remain silent about the military applications of the PRC's space programmes and counterspace activities.

It is beyond the scope of this research paper to analyze the full extent of the PRC's forward planned militarisation programme in all its multiple complexities.

It is sad to note, as often in the past, the West has failed to give credence to the stated intentions of enemies and potential enemies of the US and its Western Allies. For example, Senior Colonel Professor Liu Mingfu has recently stated: “China should build the world’s strongest military and move swiftly to topple the United States as the global “champion”.”¹²²

Chinese Territorial Claims in the Nan Hai (South China Sea)

Preemptively, China claims an extensive area of the Nan Hai (South China Sea) in contravention of international law. The territorial claims include more than 170 small islands, rocks and reefs. Six governments claim sovereignty over these features; China, Taiwan, and Vietnam claim sovereignty over the entire group, while the Philippines, Malaysia and Brunei Darussalam claim parts of the group. The claimants have sought to consolidate these claims by occupying geographical features, building facilities for military personnel atop them and strengthening *effectivities* (acts of administration demonstrating effective exercise of authority over the islands, such as establishing lighthouses, regular postal and telephone services, and air and sea transportation links.²³)

In 1974 Chinese troops seized the Paracel Islands from Vietnam and the PRC continues to maintain sovereignty over the islands. Troops from China, Malaysia, Taiwan and the Philippines have occupied some of the other islands. Between 1988-99 there have been at least thirteen military clashes. The PRC was directly involved in nine of these military actions. In 1995, tensions were heightened when China occupied Mischief Reef, an islet claimed by the Philippines and well within that country’s EEZ.²³ China also claims the Pratas Islands and the Nansha (Spratly) Islands. The Chinese named Nansha Islands claim is based on continuous Chinese administration of the archipelago since the Tang dynasty (618-907). A significant segment of the archipelago is also claimed by the Philippines, which lies just to the east of the main Spratly formation. Manila calls its cluster of reefs and islands Kalayaan (“Freedomland”) and has positioned small military detachments on some of these geographical features.⁶⁵ There has been and there continues to be strong political and military opposition to these Chinese claims from Taiwan, the Philippines, Brunei Darussalam, Malaysia, and Vietnam.

China’s claims to the Nan Hai are based on the 200 mile Exclusive Economic Zone (EEZ) and continental shelf principle, that is the UN Convention of the Law of the Sea (UNCLOS), as well as historical records of the Han (110 AD) and Ming (1403-1433 AD) Dynasties.⁷

Legal ownership of the islands would confer the right to exploit the extensive natural resources under the surrounding seabed. China signed a contract with the US company Crestone in 1992 and sank its first exploratory drill west of the Spratly Islands in the same year. China still extracts oil from the area despite protests from Vietnam. In 2002, Beijing pervaded the region with oil drilling platforms and ocean survey ships. China signed the ASEAN *Treaty of Amity* helping to reconcile differences in the region.

It is suggested China, as a signatory to the Treaty, could be doing so as a cynical ploy. At the same time as making diplomatic moves, China has established a strong military presence on the two island groups in the Nan Hai (South China Sea). Chinese activities in the region are less about territorial claims than “protecting or denying the transit of oil tankers through the South China Sea”.⁸

Since 2005, China via the CNOOC, the Philippines via The Philippine National Oil Company and Vietnam via PetroVietnam have worked together to conduct seismic surveys in a 55,000 square mile

area including the Spratly Islands. In April 2007, CNPC, and CNOOC announced plans to begin drilling additional exploratory wells in the waters surrounding the Spratlys in early 2008.

Disputed Boundaries in the Dong Hai (East China Sea)

In early 2005, CNOOC began drilling in the Chunxiao gas field from a position just a mile or so from median line claimed by Japan. Military confrontation was almost immediate. By early September 2005, reconnaissance planes of Japan's Maritime Self-Defense Force (JMSDF, Japan's navy) had commenced regular flights over Chinese drilling rigs along the disputed median line. Soon afterwards, a Chinese naval squadron of five missile-armed destroyers and frigates was deployed to the same area, reported in the *New York Times*, September 11, 2005. Both sides were guilty of gunboat diplomacy.

Fortunately no incidents took place.

The nearby Senkaku Islands, although administered by Japan, are claimed by China and Taiwan. This adds another dimension to the complexity of the boundary problem.

Beijing and Tokyo have since conducted new rounds of negotiation over the disputed boundary. The discussions have been held on an irregular basis. At the time of writing, it is not known if the protagonists have reached an agreement. China and Japan continue to build up their respective naval forces in the disputed areas.

In the future, as China's quest for oil and gas accelerates, the boundary dispute in the Dong Hai could become another flashpoint for military conflict, similar to that of the Taiwan Strait (discussed later in this paper).

International Perceptions of Chinese Military Expansion

International agencies are unanimous in saying that China is not only putting together a blue-water navy to control the sea-lanes, but also to develop undersea mines and missile capabilities to deter the potential disruption of its energy supplies from potential threats, including the US Navy, especially in the case of a conflict with Taiwan.

Chinese weapons for sea-lane control include new warships equipped with long-range missiles, new submarines, and undersea mines. China is also buying aircraft and long-range target acquisition systems, including optical satellites and maritime unmanned aerial vehicles. The focus on the naval build up constitutes a new direction from China's past focus on ground forces.

US Military strategists are fearful as to China's long-term development. Defence analysts at CSIS, CNA, ODNI and the Pentagon believe China's military build up is accelerating faster than earlier estimates. The strategists believe that China will use its power to project force and to undermine US interests and regional security in SE Asia.

US Central Command (USCENTCOM) and US Pacific Command (USPACCOM), as unified commands, share responsibility for security in the areas through which China transports its oil supply.

In the late 1990s USCENTCOM produced a classified report similar to the Booz Allen Hamilton report. This report warned that China was seeking to use commercial port facilities around the world to

dominate and control strategic “chokepoints”. (For instance, a Chinese company with close ties to Beijing holds long-term leases on port facilities at either end of the Panama Canal.)

Among energy protection requirements, China must contend with a Japanese navy capable of controlling SLOC’s around the Senkaku (Diaoyu) Islands, and the Balin and Bashi Straits. China must also contend with an Indian navy in the Indian Ocean and beyond. The USCENTCOM report said China, by militarily controlling oil-shipping sea-lanes, could threaten ships, “thereby creating a climate of uncertainty about the safety of all ships on the high seas.”

In a speech to the Returned Services League (RSL) in September 2008, former Prime Minister Kevin Rudd of Australia foreshadowed a dramatic expansion of the Royal Australian Navy to counter a military build-up bankrolled by Asia’s growing prosperity.¹⁰ Mr. Rudd warned of a “substantial arms build-up over time”. He did not name any country as posing a specific military threat, but both Australia and the US have publicly expressed concern about China’s military expansion.

The Chinese diplomatic response was rapid. At the Australian Strategic Policy Institute luncheon in Canberra on Thursday 30 October 2008, Mr. Zhang Junsai, Chinese ambassador to Australia, directly challenged former Prime Minister Kevin Rudd.¹⁰ The ambassador defended China’s military build-up and warned that Australia’s political stance smacks of a return to a “Cold War” mentality. (This challenge is misleading considering the recent Russian public statements alleging a return to the Cold War. Could it be that the Sino-Soviet block are secretly posturing a renewed Cold War situation?)

Mr. Zhang went on to say “I don’t think this region currently is involved in a rabid arms race, because to suggest an arms race is a Cold War mentality.” He added, “No one is in favour of this – not China and not other countries.”¹⁰

As a means to cool down the debate, VADM Russell Crane AO, CSM, RAN, Chief of the Australian Navy, has rejected former Prime Minister Kevin Rudd’s characterisation of the region as being in the grip of an arms race. He has suggested China and India are involved in “a normal modernisation” of their weapons arsenals. Admiral Crane has further asserted: “The rise of China, the rise of India and perhaps Russia in terms of access to technology, are having an effect but this is part of a normal modernisation of the region’s defence forces.” Reported in *The Australian Financial Review* 10 November 2008.

In spite of the Chinese political ripostes, the Australian Government remains much alerted to the Chinese military build-up. Similarly, Japan, Taiwan, the ten-member ASEAN countries²⁵, India, New Zealand, the UK and the US are equally alarmed. The balance of power has been compromised.

Western Abandonment of Military Bases in the Nan Hai

In looking at the Nan Hai, Western forces have reduced their military presence in recent years. In 1991, the US abandoned its huge military bases, Clark Air Base and Subic Bay Naval Station in the Philippines, following the Mount Pinatubo volcanic eruption. For the US Navy, Subic Bay was its best and largest ship repair facility outside the US mainland. The deepwater harbour had been held since CDRE George Dewey vanquished the Spanish fleet in Manila Bay in 1898. These bases were the US’s largest military installations in Southeast Asia. By way of some compensation, the US Navy has now transferred some of Subic’s ship repair work to Singapore and Japan.

Likewise, the UK handed back control of Hong Kong to China in 1997. (This is somewhat analogous to the UK pulling out its military presence east of Suez in the Middle East in 1967). The British had ruled Hong Kong for 150 years (since 1842), apart from the five years of Japanese occupation during WWII. Despite a tradition of allowing US naval vessels to make port calls in Hong Kong, in November 2007, Beijing at the last minute denied entry into Hong Kong of the USS PATRIOT and USS GUARDIAN, two small minesweepers seeking refueling and weather avoidance – a decision that is inconsistent with international custom regarding safe harbour. A day later, Beijing denied the USS KITTY HAWK carrier strike group entry to Hong Kong harbour on the day it was scheduled to arrive for the Thanksgiving holiday. The PRC's subsequent reversal of this decision following US demarches came too late to be accepted by the ships of the strike group.²¹

Today, apart from US military assets located further north in mainland Japan and South Korea, only Diego Garcia, Okinawa, and Guam remain as dedicated Western military bases nearest to China's oil supply route from the Middle East, through the Indian Ocean, the Malacca strait, the Nan Hai (South China Sea), Dong Hai (East China Sea) and from other oil import sources in Africa and South America.

Okinawa Island is nearest to VLCC transiting through the Dong Hai on route to Mainland China. There are some 25,000 US troops on Okinawa, comprising the US Marine Corps III Marine Expeditionary largely clustered near Okinawa City. Kadena Airbase and White Beach Naval Facility are nearby. US-Japan diplomatic negotiations are continuing as to the future of US bases in Japan.

The British owned atoll of Diego Garcia in the Chagos Islands is a pre-positioning airfreight and maritime support base lying approximately 1,900 km south of Dondra Head (Sri Lanka). The airfield runway has been extended to cope with air-tankers and air-freighters. The harbour is currently leased to the US Navy. An estimated 1,700 US military personnel, 1,500 civilian contractors, and about 50 British personnel populate the strategic island.¹²⁰ The base played a key role in the 1991 military operation against Iraq.

Guam, comprising Anderson Air Force Base and a Naval Base, is a large US base in the Mariana Islands located some 2,600 km east of Taiwan. Diego Garcia and Guam are at a long distance from China's oil supply routes.

Major US Air and Naval facilities in the Western Pacific are confined to Osan and Kunsan Air Bases in South Korea; and to Misawa, Yokota, Iwakuni (Marine Corps Air Station), and Kadena Air Bases in Japan. Naval Air Facilities and Naval Fleet Activities are at Atsugi and Sasebo respectively, also located in Japan.

Thus, thousands of nautical miles from the Strait of Hormuz, through to the eastern seaboard of China, are scantily covered by Western military assets. China is well aware of this predicament faced by the Western allies.

By way of some compensation for Western abandonment of the bases in Hong Kong and Subic Bay, Australian, Indian, Indonesian, Japanese, Malaysian, UK and US warships do have reciprocal visiting rights to ports nearer to China's oil supply route(s), particularly in the Gulf of Oman, adjacent to the "chokepoint" Strait of Hormuz, and to the Malacca Strait "chokepoint". These pro-Western ports include Sib, Muscat, Masirah, and Salalah (Oman); Kadamba, Mumbai, and Vishakhapatnam (India); Trincomalee (Sri Lanka), Singapore, and Chi-lung/Tai-pei (Taiwan). India, threatened by Chinese

funded naval infrastructure developments, athwart the SLOC's on the Indian Ocean littorals, is planning new naval bases in the Agalega, Lakshadweep and Maldives Islands, Rambilli Maridai, Madagascar, expansion in Port Blair (Andaman and Nicobar Islands) and possibly elsewhere.

Pro-Western Singapore is without question the most important strategic port nearest to the Nan Hai as it sits so close to the busy Malacca Strait and to the southern end of the Nan Hai. There are four large container terminals at the port and commercial shipping throughput traffic is enormous. It is one of the busiest ports in the world. Singapore has become a close security partner of the US since the end of the Cold War. The US Navy (together with other pro-Western navies) often visits and uses ship repair facilities at the Changi Naval Base. The base would be most important strategically if any military confrontation occurred in the Nan Hai.

Chinese military strategists were infuriated when the US Government successfully lobbied in the 1990s for the US Navy to build a military pier at the Changi Naval Base. When the pier was completed in 2001, it was large enough to accommodate a Nimitz-Class supercarrier. Thus Singapore has become the *de facto* US Navy's hub in SE Asia.

Chinese-Singaporeans are hotly canvassed by either China's Ministry of State Security (MSS), or by Western counterparts. There is a distinct dichotomy at trade functions and symposia in Singapore between those pro- or anti-PRC. China continues to lobby for naval facilities at Singapore.

US companies have invested approximately US\$45B whilst Chinese investments in Singapore are estimated at less than US\$1B.³¹ China intends to step up its investments in Singapore and Malaysia. Singapore has well-established political and economic ties with both Washington and Beijing, and siding with one side or the other would cause irrevocable damage to one of the relationships.

It is postulated, in retaliation, the PRC may attempt at great expense to build a new naval base elsewhere. The most likely location would be at the northern end of the Malacca Strait. This is surmise only as there is very little evidence to support such an assertion. The Malacca Strait will be of increasing strategic importance to China in future decades. Malaysia has outlined similar concerns.⁸⁴

It would be opportune to establish a new Western-sympathetic dedicated naval base, more centrally positioned in the Nan Hai region, to replace the loss of the US Subic Bay Naval Station in the Philippines.

The Taiwan Issue

Perhaps to compensate for this loss of military power in the Nan Hai, the US, in the dying days of the Bush Administration, announced plans to sell US\$6B (A\$7.8B) in arms to Taiwan. It seems the US wants to turn Taiwan into a permanent offshore aircraft carrier so to speak? China is furious and the North Korean disarmament efforts may be abandoned. The proposed US arms package includes: Apache helicopters, Patriot III anti-missile missiles, Harpoon and Javelin missiles, upgrades for Taiwan's E-2T aircraft, and logistical support for Taiwan's Airforce. We have yet to experience China's full reaction to this proposed deal.

The deal became a reality in 2008 and China has never forgiven the US for supplying these arms to Taiwan. (The US sold F-16 fighter planes to Taiwan in 1992 under President George H. W. Bush. Future sales of these aircraft have been deferred by President Barack Obama's administration).

Taiwan's Defense Ministry publicised a declassified document of the Cross-Strait Crisis in 1996. The Defense Ministry has illustrated China's military threats by releasing satellite photos of China's missile deployment to the public domain.

The Pentagon estimates by 2007 China had deployed between 990 and 1,070 CSS-6 and CSS-7 short-range ballistic missiles (SRBM) near its southeast coast, facing Taiwan, and is accelerating the buildup by adding some 100 missiles per year, including variants of these missiles with improved ranges, accuracies, and payloads.²¹

China's conventional ballistic and cruise missile capability satisfies much of the need to punish without occupation. If Chinese occupation of Taiwan becomes a necessity, China can meet that need in large part with its acquisition of large quantities of long-range refuelable aircraft.

China has already boosted its air assets with Ilyushin aircraft: it ordered thirty IL-76TD transport aircraft and eight IL-78M air-to-air refueling aircraft from Russia in September 2005. The contract is estimated at between US\$850M to US\$1.5B.¹¹

The massive build up in China's military capability in the Nan Hai may have preempted President George Bush to sell Taiwan the extra arms to re-adjust the military balance in favour of Taiwan and the US.

Could this be the flash point between China, Taiwan, and the US? If the latest US arms deal goes ahead, what are the political implications for US President Barack Obama? It may be that US President Obama may veto the proposed arms deal?

Diplomatic initiatives recently undertaken jointly by Taiwan and China might yet save the day. On Monday 3 November 2008, Mr. Chen Yunlin, a senior Chinese official arrived in Taiwan for a five day courtesy visit. Mr. Chen is the highest-ranking Chinese official to visit Taiwan since the two sides split in 1949. Taiwanese President Ma Ying-jeou (elected in May 2008) is anxious to improve ties across the Taiwan Strait and end decades of political rivalry. At the inception of his visit, Mr. Chen stated "I am bringing goodwill wishes to Taiwan's 23 million compatriots from the mainland 1.3B people." He went on by saying "only through cooperation can we create a win win economic situation." Mr. Chiang Pin-kung, Taiwanese counterpart, called Mr. Chen's visit "a historic moment in cross Strait exchanges that we've waited for 60 years."¹²

To lend some realism to these early diplomatic overtures, in December 2008, both countries announced daily commercial flights would commence between Beijing and T'ai-Pei. This is a milestone development within itself. This was quickly followed up with the generous donation of two Panda bears to T'ai-Pei Zoo. What else can we expect as an extension of Chinese *waishi* policy into the realm of international relations? (See page 47 below for full explanation of *waishi* policy). Can we believe China's true intentions?

Taiwan does have strong economic ties with China. For example, Taiwanese business entrepreneurs in the IT industry do employ ten million Chinese workers on the mainland in assembly processes for electronics goods. Most of the world's personal computers are assembled in China under the control of Taiwanese businessmen. It has been said that within the Taiwanese economy, China is perceived as "the elephant in the room".

Assuming China and Taiwan are able to reconcile their own political differences, US President Obama may have a much easier task to defuse the confrontational military situation by adopting a less intrusive US foreign policy.

Will China take early advantage of US President Obama's perceived lack of international experience? In the longer term, a military confrontation may be inevitable.

But the relationship between China and the US has now suddenly changed. It has hardened considerably. At the end of January 2010, the Obama administration approved an arms sale to Taiwan worth more than US\$6B. This sale included 114 Patriot missiles worth US\$2.82B, sixty Black Hawk helicopters worth US\$3.1B, and communications equipment for Taiwan's existing F-16 aircraft deployment.¹¹⁵

This arms deal has enraged the PRC and the consequences are frightening. China has stated that Beijing is likely to renege on military-to-military co-operation with the US, and that President Hu Jintao might boycott President Obama's planned nuclear security summit meeting in April 2010.

China's Relationship with Other Countries

China's relationships with Australia, Brunei Darussalam, Cambodia, India, Indonesia, Japan, Kalimantan (Borneo), Malaysia, Myanmar, Pakistan, the Philippines, Singapore, South Korea, Thailand, Taiwan, Vietnam, and other countries lying astride, adjacent, or at some distance to/from the oil supply routes are indeed profound.

It is impossible to fully detail the nature of all these individual relationships in this research paper. Suffice to say a few of the more important relationships are now briefly discussed.

According to its public pronouncements, India does not rank high among China's strategic concerns. Relations between the two have been improving from their nadir following the 1998 Pokhran nuclear tests. Chinese Premier Zhu Rongji's visit to India in 2002 strengthened economic ties, resumption of direct flights, and memorandum of understanding for cooperation. A guiding element of China's "calculative" strategy; evolving since the 1980s; is stated as: "a general restraint in the use of force, whether toward the periphery or against more distant powers."³⁷

However, a number of unresolved issues still influence the Sino-Indian relationship: a disputed boundary, Tibet and India's provision of sanctuary to the Dalai Lama and the Karmapa, China's support to Sri Lanka and Pakistan, and most specifically Chinese technical support to Islamabad's nuclear weapons and missile programmes. Chinese MRBMs in western China can reach Indian targets. Suspicions linger on both sides.

Another imaginable source of trouble emanating from India might lie in India bidding against China with respect to oil exploration and development in Central Asia. China has greater economic clout than has India with foreign exchange reserves (forex) about four times those of India. China will win the race for oil exploration and infrastructure development in Central Asia.

Japan's National Institute for Defence Studies has warned "China's military modernization is tilting the Taiwan Strait arms balance towards enabling Beijing to achieve unification by force with Taiwan". Mixed messages are emanating from China. A diplomatic truce between Taiwan and China was signed

in October 2008. As reported in the *China Post* newspaper: “this truce ends years of chequebook diplomacy to win foreign allies and signals warming ties between the two countries.” The Taiwan issue has been separately treated in greater depth elsewhere in this paper.

Additional research is merited to amplify China’s relationship with Japan and South Korea.

In countering the Chinese military build up, smaller country-to-country piecemeal relationships between themselves, and with China, are no substitute for a unified political, economic and military command. ASEAN, founded in 1967, may yet prove to be a “toothless tiger”. The member countries do not want ASEAN to be mistaken for a military grouping among political allies – as some of its predecessors had been²⁵. This political stance constitutes dangerous appeasement.

The political editor of the *Australian Financial Review* has not minced words in his criticism of the usefulness of ASEAN. He states: “For 32 years, ASEAN nations have boasted of a special spirit of harmony. It was “the ASEAN WAY” of doing things. In truth, “the ASEAN way” is an Orwellian cover for inaction and ineffectiveness, for tolerating bad policy and worse politics.”¹⁰⁴

The ASEAN states have made it clear that they do not wish to choose between China and the US. A conflict in the Taiwan Strait is the nightmare scenario - it may force them to change.²³

SEATO, founded in 1954, the defunct predecessor to ASEAN, was originally conceived as an organisation analogous to NATO. The underlying strength of NATO, founded in 1949, is its defence strategy in combating, then and now, the increasing militarism of the FSU at the height of the Cold War and that of present day Russia.

The Booz Allen Hamilton report⁵ underwrites Pentagon concerns as to the military threats now emerging from China. It fails to identify succinctly China’s most worrisome relationship with the resurgent Russia. In 1894, MAJGEN A.B. Tulloch, CB presented a paper entitled *Russia’s March Towards India* at a USI lecture in Melbourne. Perhaps nothing has really changed. Russia is still marching towards SE Asia through its pseudo ally China.

The *Washington Times* has claimed that China, Russia, and Iran have formed a new three-country “axis of evil”. The reason that China is listed as an evil state is that China provides Iran with weapons and China has become a serious threat to US security by remarkably updating its military capability. North Korea may soon join this threesome.

It may be said that the “spokes of malicious intent” deployed worldwide from the axis of evil may extend from the three-country hub to include Afghanistan (Taliban), Bangladesh, Burma, Cambodia, Iran, North Korea, Pakistan, Sudan, Vietnam and Venezuela. These listed countries are all under the direct/indirect influence of Chinese foreign policy. Where else overseas is China likely to spend some of its large defence budget?

Is the PRC playing dominoes with her neighbours? Political subjection and infiltration, energy resource acquisition, economic dominance, and military takeover by stealth may be the MO. Can we trust China? Outwardly, the PRC displays a warmer and friendlier image to the world.

In December 2008, China promulgated a major shift in foreign policy. China is now to enter into strategic economic alliances with Japan, South Korea and other S.E. Asian countries. Casting aside

political differences, and past distrust, China as a matter of economic self preservation and necessity, has encouraged these neighbours to band together with the PRC to fight against the global financial meltdown. A new “economic block” of countries will eventuate to dominate S.E. Asia.

China’s relationship with Australia has recently been under the spotlight. Mr. Zhang Junsai, Chinese ambassador to Australia, has issued a veiled warning, only last week, about any potential plan by the US to form an alliance of democracies involving Australia, India, and Japan.¹⁰ Mr. Zhang said the Asian region did not need any more military alliances. This was said in response to an earlier speech given by former Australian Prime Minister Kevin Rudd in September 2010. Australia does not want to damage its trade relationship with China at a time when China’s demand for resources may be cushioning it from the worst of the global financial crisis.

Chinese Military Expenditure and Economic Growth

Four years ago, Her Excellency Madam Fu Ying, Ambassador of the People’s Republic of China, gave an address to the Australian Capital Territory (ACT) constituent body of RUSI in Canberra. Madam Fu admitted there is “a bit of debate about China’s defence budget.” Madam Fu stated the Stockholm International Peace Research Institute (SIPRI) had estimated the 2004 China defence expenditure was US\$35.4B - about 4% of the world’s total. Madam Fu further said, that according to that figure, it is 7% of that of the US and only 3.5 times that of Australia.¹³

In the same address, Madam Fu indicated China, according to various international agencies, is likely to become the world’s number one economy by 2030.¹³ The exponential annual increases in oil and LPG consumption may bring forward this date faster than many of us realise?

By contrast for 2007, SIPRI calculates Chinese military expenditure, when converted into US dollars at the prevailing market exchange rate, is US\$66B. This figure corresponds to 11.5% of US military expenditure (including outlays from emergency supplementals). When converted at purchasing power parity (PPP), it corresponds to 25% of the US figure. However, the PPP-converted figure is not representative since it is based on price ratios for civilian goods rather than for military goods. The PPP’s for the PRC are susceptible to a wide margin of statistical error.²²

SIPRI’s estimate of China’s military expenditure is based on a detailed study of the Chinese official data. This includes an assessment of what the official data covers and what it does not cover. All items excluded from the official estimate, but which are included in the SIPRI definition of military expenditure, are added to the official defence budget in order to arrive to the SIPRI estimates. This procedure results in estimates in local currency substantially higher than the official Chinese defence figures.²²

In March 2008, China announced it would lift its military budget by 19.4% to US\$99B. Currently, the budget is about US\$93B (i.e. China’s defence White Paper: March 2011). Washington believes defence spending is as much as three times higher and may have outstripped Japan’s defence budget.¹⁰

The US Department of Defense’s annual report to Congress in 2008 on China’s military strength offered several estimates of actual 2007 Chinese military spending.²¹ In terms of the prevailing exchange rate, Pentagon estimates range between US\$97B and US\$139B – the second highest in the world after the US.

Some military analysts and journalists postulate China is today spending as much as US\$300B a year (i.e. three times as much as the DOD estimates) on its military expansion. This may be a grossly exaggerated figure. As there is no official source reference for the above figure, it is not possible to give any credence to this estimate.

Nonetheless, it is still not clear as to what is the most reliable estimate of China's defence budget. (To avoid further complexities and comparison difficulties, estimates for PRC military expenditure calculated by the RAND Corporation, CIA, DOD, and the Defense Intelligence Agency (DIA) have been excluded from this paper. The DIA is a super group comprising an intel network with some 1.4 million defense personnel in more than seven hundred bases and facilities in forty countries.)

Newly appointed Chinese ambassador to Australia, Mr. Zhang Junsai, in October 2008, claimed China's defence budget was only one-third of that of the US and two-thirds that of Japan. He indicated the budget was primarily structured to deal with domestic challenges such as natural disasters and earthquakes.¹⁰

If the larger estimate given above by military analysts and journalists is correct (contrary to the official PRC political statements and the qualified SIPRI estimates), the Chinese defence budget may equate to roughly 75% of the US defense budget. (This excludes the operational costs of the current military campaigns in Iraq and Afghanistan. These campaigns probably extend the US defense annual budget by some US\$0.2B or more.) However, when more accurately assessed, the comparison percentage to the US defense budget is likely to be a lot less, (say) to equate to between 12% and 45% (own calculations).

It is questionable whether the estimates provided by the military analysts or by the Pentagon are over inflated. The actual Chinese defence budget may never be known.

It is also difficult to ascertain how much of the Chinese defence budget is used for "oil for guns" deals (viz, foreign trade offsets), for the logistical supply of arms, munitions, heavy weapons, and for military infrastructure developments, to/for overseas countries; such as certain African countries, Bangladesh, Cambodia, Myanmar (Burma), Pakistan, Sudan, Tibet, and Venezuela. These somewhat "hidden" expenditures are facilitated through the Chinese Ministry of State Security (MSS) or through the People's Liberation Army (PLA) General Staff using legitimised/commercial "front" companies.

Russia may be supplying China with IT software for missile development and for missions into space, plus specialised hardware, CBRNE materials, and other military items not included in the official PRC defence budget.

Other difficulties pertain in arriving at assessments. For example, expenditure on the budget for the Chinese 2nd Artillery Corps is seen as "the budget of space development rockets" and missile development categories may not be included in the overall Chinese defence budget but in the "air science budget."²¹ These anomalies complicate the calculations.

Whatever the actual budgeted figure, China has rapidly increased its defence expenditure. This is the greater concern.

The stronger the Chinese economy grows, the more affordable it is for China to increase its military expenditure taken incrementally as a rising percentage of its GDP. Taken as a percentage of GDP, military expenditure in 2008 is estimated at 3.4%, with per capita expenditure of US\$90. At the current rate of progress, it will not take long for China to catch up with the US, NATO, and/or with Russia.

The World Bank, the International Monetary Fund, and the OECD have reached a consensus that “China’s growth will slow, but that it should be manageable.” Economic growth forecasts for next year range from 7.5 to 8.5%. (In the present downturn, some 20 million Chinese workers have already lost their jobs.) The growth forecasts are well below the 11.9% growth recorded in 2007, but they suggest a soft landing for the Chinese economy. The World Bank believes more than half of China’s GDP growth in 2009 (or four percentage points) will be due to “government-influenced expenditure.”²⁹

Glen Mumford, writing in Market Wrap for *The Australian Financial Review*, on Tuesday 24 March 2009, commented: “China now accounts for 11 percent of global GDP, compared with the US total of approximately 21 percent. It should easily bridge this gap over the next 20 years.”

As reported earlier in *The Australian* 11 November 2008, China unveiled an US\$586B financial package to revive its economy. This is an attempt by the PRC to maintain its strong economic growth rates by spending the equivalent of 7% of its GDP for each of the next two years on new roads, railways and ports. The financial package, equating to four trillion Yuan (US\$798B), represents about 16% of China’s economic output in 2007 and is roughly equivalent to all central and local government spending in 2006. The flow-on effects of this expenditure are expected to lift world economic activity crippled by the collapse of global credit and share markets. It remains to be seen whether this action by the PRC will help to revive the world’s economy?

There are signs that China’s stimulus plan is taking effect. Economists now expect the world’s third-biggest economy may expand 6.6 in the second quarter after slowing to 6.3 percent in the three months to end-March 2009.³⁹ Indicative figures released early in 2009 by the People’s Bank of China are optimistic. Actual figures are not yet available for the fourth quarter in 2009.

Chinese demand is seen to be picking up in the energy resources sector.⁸⁹

Beijing, on Thursday 23 October 2009, reported economic growth of 8.9 per cent year on year for the third quarter – an excellent achievement for the PRC’s stimulus package.

In December 2009, there was even more optimism. The State Council Development Research Centre, a leading government economic think tank in China, now predicts that the PRC’s economy is likely to grow by 9.5 per cent in 2010.¹⁰⁸ If this prediction holds true, it will top the anticipated performance for 2009, assuming real estate investment remains buoyant and inflation continues to be mild.

Within China, there are divergent views.

The optimism may yet flounder according to what economists and government researchers at the Chinese Academy of Social Sciences have stated in the official *Chinese Securities Journal* published in mid-January 2010. This was reported by Kevin Hamlin: “China’s economy may grow as much as 16 per cent this year (2010), with accelerating inflation, and risk of a property bubble unless the government reduces stimulus measures...” government researchers said yesterday in China.¹¹⁰

Perhaps the world may yet experience a “double-dip” global financial meltdown?

Earlier in 2009, in a speech at the Australian Strategic Policy Institute, Peter Varghese, Director General, Office of National Assessments (ONA), endorsed the controversial World Bank projections that China would surpass the US in relative economic size by 2020 and would be 50% larger by 2030. Mr Varghese also stated the financial crisis will have budgetary implications for the US including on its large military spending.¹⁴

Why so much Chinese Buying Aggression?

The PRCs aggressive policy to buy crude oil/gas supplies and to invest in oil infrastructure development on a worldwide basis is vested in the following reasons (not necessarily in order of priority)⁹⁰:

(1) China wishes to continue with massive consumer and manufactured goods production (vis-à-vis consumer products such as motor cars, white goods, electronic goods, luxury goods, and public transport for immediate internal consumption): to expediently meet and satisfy internal domestic demand and to raise general living standards to equal those of the West. China has the largest 1.3 billion, consumer market in the world. Economic expansion is paramount.

The “have-nots” in China desire to catch up and overtake the “haves” in the West. There is no greater incentive and human desire as far as the Chinese government is concerned.

A report released by management consultants, McKinsey & Company, in August 2009, titled *Unleashing the Chinese consumer*, outlines the challenges facing the Chinese government. The report argues China could again raise private consumption above 50 per cent of GDP. If successful, this would “enrich the global economy with US\$1.9 trillion a year in net new consumption”. China’s private domestic consumption in 2009 is estimated at 37 per cent of GDP.

China's economic expansion has placed it on a collision course with global competitors in the market for scarce resources including critical oil and gas supplies. The PRC accounted for nearly 40% of the increase in global oil consumption between 2004 and 2007. In a short period of time, China has evolved from a position as an oil exporter in 1992 to the world's second largest oil importer in May 2008.

(2) China wants to continue to export large volumes of consumer goods and services worldwide to retain its advantageous dominant position as the world’s leading exporter. Products exported include clothing and textiles, footwear, household furnishings, electronic goods, white goods, and a plethora of other goods. Every household in the West now possesses a significant number of Chinese manufactured goods. China has and will penetrate every market in the West including the emerging driver-economies of Brazil, India, and resurgent Russia (counterpart members of the BRIC consortium).

(3) The PRC is in a self-equilibrium economic mode and wishes to accelerate its growth. As such, China must reinforce its unique symbiotic relationship with the West, particularly with the US, one of its largest markets. The US accounted for about 90% of China’s US\$295B trade surplus in 2008. China

needs the West, and the West needs China. Global buyers will continue to enjoy acquiring perceived-quality Chinese goods at low cost.

Specifically, “Chimerica” – the symbiotic relationship between China and America – portrays capital flow from East to West, whilst China produces 33 percent of the world’s economic output to largely meet US consumer demand. China is dramatically seen as part Lion, Goat and Dragon.

The economic momentum could be self-perpetuating.

(4) China sees itself as the leader of a new world economic order, to eventually become the world’s leading economy by 2020/30 and to thereby acquire a dominant hegemonic position in world affairs and geopolitics. The country is deliberately posturing itself for future domination of the West.

(5) Being “cashed up” with some US\$2.13 trillion in forex reserves, China possibly will never again have such a golden opportunity to acquire crude oil/gas assets (and other worldwide energy resources) at such a low cost, while the global financial meltdown continues. Effectively, the People’s Bank of China is close to becoming the world’s *de facto* banker and has mounted a serious challenge to the IMF, to the Arab petrodollar and to overseas financial institutions. The artificially induced low value of the Yuan has permitted China to rapidly build up its forex reserves. “Thanks for your US dollar, here’s your change expressed in a foreign exchange certificate, as fifty Fen or otherwise.” This is a form of “hard currency larceny”. How could the West be so naive and allow itself to be financially ambushed in this manner? This has continued for more than a decade?

Note: It is theoretically possible the petrodollar could be eventually replaced by the “petroyuan”. That is if the Chinese authorities were to instigate the petroyuan? Notwithstanding, China is likely to keep the yuan unchanged against the dollar until late 2010.¹⁰³ China has held the Yuan at about 6.83 per US\$1 since July 2009, shielding its exporters from the slump in global demand.¹⁰⁶

There has been some discussion amongst economists that the international monetary system, currently dominated by the US dollar, the euro, and the yen, could admit the Chinese renminbi (RMB) to evolve as an additional world currency. However, Friedrich Wu, Rongfang Pan, and Di Wang have refuted this suggestion in a recent paper by stating that “the RMB is not in a position to challenge the preeminent role of the US dollar in the foreseeable future”.¹¹⁶

Abundant with cash, the People’s Republic of China (PRC) is wisely spending its US\$2.13 trillion forex reserves to buy energy assets made cheaper by oil’s 52.47% decline from a record US\$147.27 a barrel in July last year.

(6) China seeks to buy crude oil/gas (plus other energy resources) as it realizes these valuable commodities are finite and exhaustible. The rate of discovery of new and significant oil reserves is dramatically falling and most existing oil/gas fields have surpassed their peak. The age of easy oil is over, and what remaining oil there is will become increasingly technically difficult to extract.

(7) China intends to greatly increase its official strategic reserve of oil (and LNG/gas products). The first annual phase of the PRC’s strategic petroleum reserve is due to be completed in 2009. The reserve will hold 100 million barrels of oil (m/bo). The second annual phase is planned to hold 200 m/bo. If

this annual rate of stockpiling is successful, China will launch successive phases. This may eventually increase net storage capacity to beyond 500 m/bo sometime after 2013. Should this occur, the storage volume is likely to eventually eclipse the US and become the largest national strategic oil reserve the world has ever accumulated?

Having such a large strategic reserve, to the obvious disadvantage of other world powers, means that China can effectively mount a sustained conventional manpower-abundant military campaign (defensive/offensive) without the need for recourse to limited-theatre nuclear weapons and WMD. The West will be tactically impaired and might have to be the first to use nuclear weapons to impede any Chinese advances/gains.

While nuclear deterrence will possibly thwart any Chinese intentions to start a conventional military campaign, China's military philosophy based on "anti-access" strategies will invoke a more defensive than aggressive posture.

(8) Finally, it must not be forgotten the China has embarked upon a significant programme of military expansion. On a per annum per capita basis, the PRC's military expenditure of around US\$231 seems very modest and circumspect compared with others around the globe. But with a 1.3 billion population, any small per capita incremental increases will have tremendous implications in future years.

The military modernization programme comprises a component to upgrade PRC blue-water naval power to help stave off any aggression toward China's inbound sea borne oil/gas shipments. The Pentagon believes the programme to be defensive in nature but some pundits disagree with this analysis.