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Editor-in-Chief

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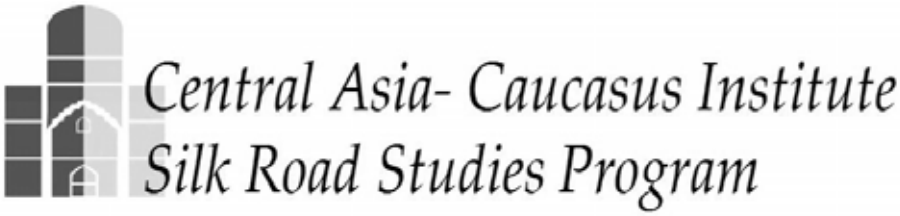
Johns Hopkins University & Uppsala University



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Editor's Note

Dear Colleagues and Friends,

This is the first issue of the CEF Quarterly under new directorship. The former editors, Matthew Oresman and Malia Du Mont have stepped down. We are very grateful for their work and will try our very best to continue the success of the China and Eurasia Forum. Besides ensuring the quality of the CEF, we would also like to explore new ways to reach out to our members and to make news and information on China-Eurasia more accessible. Since taking over, we have developed the homepage and introduced a weekly newsletter for our members. Readers are invited to visit our homepage and utilize the news archive.

Concerning the CEF Quarterly, we decided on a topical approach so that every issue would cover a particular topic in-depth, even if we still accept interesting off-topic articles. The China-Eurasia region is currently under-going a lot of change and the respective governments are faced with a numerous challenges. In this issue, we focus on the topic of Energy and Security. Energy security has become one of the most important issues in international relations today. Demand for energy is on the increase, especially in Asia, where rapid modernization has led to rising consumption. As a result, there has been growing competition between states to secure their energy supplies with access to oil and gas becoming increasingly a matter of national security. The recent U.S. reaction to the Chinese bid on Unocal underlines the impact of energy security on politics. Oil and gas markets have become strategic assets in a political and economic struggle over influence and domination, at least this is what many states and policy institutions perceive as the reality.

In no region is this more apparent than in China-Eurasia. With energy security a major consideration for the governments in this region, the energy sector has not been left to market forces alone. Governments retain strong control of the sector through regulation, ownership and state investment. With high and concerted levels of political engagement by the respective governments, energy security considerations naturally resonate through the foreign policies of these governments. The lack of cooperation in these issues in the region is very apparent and cooperation that is initiated is either bilateral or trilateral. Multilateral structures that has been initiated has either excluded a region, such as APEC Energy Working Group, that do not include Central Asia despite its importance for Northeast Asia in energy terms, or has stagnated due to political considerations. This point to that Eurasia is in a dire need of an effective organization that could coordinate energy cooperation and tie together

both economic considerations and affect the political landscape positively with strong regional integration.

Parts of the region have also been blessed with significant energy resources, energy resources that has not been fully developed by all actors and which in many cases has problems reaching it potential customers. Transit of oil and gas from Central Asia to customers in Europe or in Northeast Asia has been marked by problems, partly due to the lack of economic incentives and partly due to the lack of cooperation between consumers, providers and transit states. This has partly changed as the energy market has passed a level where profitability of pipelines and refineries can be reached, if the different actors begins to cooperate and jointly utilizes pipelines and refineries.

As this CEF Quarterly issue illustrates, energy security considerations could draw states closer together when energy interests converge, or become a source of friction when such interests collide. The Middle East factors considerably in Asia's strategy for energy security. Kent Calder discusses how Asia's dependence on Middle Eastern oil and gas could transform the Asia-Middle East relationship, Phar Kim Beng and Vic Li examines how China's dependence on the Middle East would affect Asian security, while J. Brandon Gentry zooms in the growing role of energy as a bond for strengthening Sino-Iranian relations.

China's growing energy consumption, increasing import requirements and acquisition activities has been a major factor in fuelling the uncertain political outlook of the region. Zha Daojoing provides us with an account of how China's growing energy demands from abroad has led to a more pro-active foreign policy. He notes how China's energy-driven diplomacy has caused much anxiety among many observers and suggests measures the Chinese government could adopt to alleviate the worries of the international community, especially through better governance of the energy sector. Also on the topic of governance, Gaye Christofferson offers a piece on Sino-Japanese competition for Russian oil resources, tracing the steps taken to manage this rivalry through the issuance of principles, norms and rules and how this would eventually form the basis of a regional regime. Maria Kielmas, on the other hand, tackles a fundamental economic question - whether China's present aggressive and high-cost energy asset acquisition strategy is sustainable in the long-term. Meanwhile, Vladimir I. Ivanov writes about new natural gas-based technologies in Northeast Asia while Arthur S. Ding focuses on China's exploration activities in the East China Sea and how this has affected Sino-Japanese relations.

While China and Japan have been actively working to secure its long term energy supply, Russia and the Central Asian states have, on the other hand, a significant proportion of oil and gas resources that they

would like to export. Niklas Swanström points to the need of cooperative structures and the possibility of an "Asian Oil and Gas Union" to succeed with this task. However, access to Russian and Central Asian oil and gas is fraught with political pitfalls and strategic maneuvering. As Stephen Blank's article will reveal, despite the growing relationship between China, Russia and Kazakhstan, and even though all three are members of the Shanghai Cooperation Organization, China continues to face numerous official obstacles in its attempt to penetrate the energy sectors of these two states. Finally, the last article of the journal by Christopher Len examines Japan's entry into Central Asia. The article examines the motivations, prospects and implications of Japan's role in the region.

For your information, hardcopies of the CEF Quarterly is now available free-of-charge. However, we only have limited stock so we may not be able to fulfill every request. In order for us to be able to print more copies and to continue our work, we would very much appreciate contributions to the China and Eurasia Forum. So if you believe in what we are doing and would like to help us grow, please get in touch with me.

For regular news updates regarding China and Eurasia, you can sign up to receive our weekly electronic newsletter by contacting the newsletter editor Nicklas Norling at <nnorling@silkroadstudies.org>. Alternatively, you can access our homepage at <www.chinaeurasia.org>.

Finally, on behalf of the CEF team, we hope you enjoy your read.

Niklas Swanström

Editor

China and Eurasia Forum Quarterly

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East Asia and the Middle East: A Fateful Energy Embrace

Kent Calder[*]

Two thousand years ago China's Han dynasty traded extensively with Persia and Mesopotamia. For fifteen centuries a vigorous trade in silk, spices, and a variety of manufactures continued. In the past decade Beijing, Dhahran, Abadan, Mumbai, and Yokohama have grown ever more connected once again. The catalyst this time is energy. Across the vast swath of Asia south of Sakhalin, east of Xinjiang, and north of Sumatra—home to over a quarter of humanity—there is only one major oil field—Manchuria's Daqing. And that is rapidly declining toward depletion. Japan, Korea, and Taiwan have virtually no on-shore domestic oil or gas reserves at all. Whatever prospective hydro-carbons they have appear to be off-shore, and often in disputed waters of the East and South China Seas. The substantial oil and gas that China does appear to have are concentrated in the West and North, while the country's explosive growth centers along the southern and eastern coast. Even though China is the fifth largest oil producer in the world, its energy-infrastructure problems and rapid growth make it a large and growing importer, responsible for more than a third of the entire world's expansion in oil demand over the past four years.

Overall, the Asian region holds only around 3 percent of world oil reserves, and roughly 8 percent of global gas. It holds a substantial 23 percent of global coal, centering on China, which still satisfies 70 percent of that massive and rapidly growing nation's total energy demand from coal. Yet coal cannot, amidst an automotive revolution, supply China's rising demand for hydrocarbons, and is, in most forms, intensely polluting. Coal is no long-term solution.

The ultimate long-term solution to East Asia's energy insecurities lies inevitably in the Middle East. Saudi Arabia, Iran, and Iraq together hold nearly 43 percent of the world's proven oil reserves, and 21 percent of global natural gas. The Persian Gulf as a whole holds nearly two thirds of the world's oil, and around 40 percent of its gas. At current rates of consumption, the Gulf could supply the entire world for more than 26

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years, or East Asia as a whole for nearly a century. Both East Asia and the Middle East, of course, have multiple potential partners in increasingly global and flexible energy markets. Russia is an especially important potential supplier, especially in natural gas. It holds over 30 percent of proven world gas reserves, with vast areas of tract-less Siberia remaining virtually unexplored.

Yet East Asia—much more than any other region in the world—is locked above all in a fateful energy embrace with the Middle East. In 2004 that volatile region supplied 70.8 percent of Asia's oil imports, as compared to only 23 percent of American overseas supplies. And the Middle East also provided 34.8 percent of Asia's gas. Asia's major nations vary marginally in their current energy dependence on the Middle East. Japan, for example, gets around 87 percent of its oil from the region, South Korea's dependence is 80 percent, and China's only 51 percent. Yet these are mere matters of degree. All face the long-run prospect of unavoidable Middle East reliance, given their rapid growth and lack of local energy supplies, combined with the formidable reserves that the Middle East, and especially the Persian Gulf, have at their disposal.

The inter-regional reliance that East Asia experiences with respect to the Middle East appears to be mutual: Asia is also the Middle East's largest energy customer, by far. In 2004 Asia took just short of two-thirds of Middle East oil exports: a full 64.5 percent. And it also took 52 percent of the Middle East's gas exports, with an ever-larger share in liquefied natural gas (LNG). Over the long-run, Asia's rising role in the global economy, combined with its energy insecurities, will make it an indispensable customer for much of the Middle East on economic grounds alone. And geopolitical considerations, including a desire by both regions for autonomy from the United States and Europe, could well deepen this cross-regional entente.

There is a parallel, if less urgent, logic for East Asian energy interdependence with Central Asia as well. Kazakhstan, with its massive Tengiz field, is rich in oil, while Turkmenistan and Uzbekistan, in particular, are rich in natural gas. Many have equated Central Asia's energy endowments with those of the North Sea. Central Asia has a particular attraction for India and China, due both to proximity and to the inescapable geopolitical reality that pipelines from Central Asia reduce their dependence on sea lanes from the Middle East currently dominated by the United States.

East Asian Strategies for Middle East Access

As befits a pattern of mutual interdependence that is both important and uncertain in its prospects, East Asia's approach to Middle Eastern energy

questions is a multi-faceted one, that emphasizes neutralizing the inherent risks. The approaches of all the key Asian nations—Japan, China, South Korea, and India—have parallel trade, investment, and national-security dimensions. All four countries—most interestingly China—are also actively striving to diversify their energy relationships away from the Middle East—even at economic cost—so as not to be caught up too deeply in its regional political complexities.

On the trade front, Asian nations have been active in soliciting long-term contracts, and in providing goods and services to the Middle East so as to defray the cost of rising energy imports. Japan, Korea, and China have all been active in Middle East construction, ever since the first Oil Shock of the 1970s. With the run-up in energy prices over the past two years, they have geared up their export strategies once again. China, for example, recently garnered contracts for the first two stages of the new Tehran metro system, and stands a good chance of landing the rest of the related construction business as well. Korean construction contracts in the Middle East surged 65 percent in the first half of 2005, to $6.2 billion.

The dynamic area now is that of long-term investment in energy development and distribution, which could transform the Asia-Middle East relationship, "from a courtship into a marriage", in the view of many observers. During October 2004, for example, China's Sinopec Group concluded a gas agreement to import more than 270 million tons of natural gas over the next 30 years from Iran's South Pars field in the Persian Gulf, the largest natural-gas reserve on earth, which Iran shares with its small neighbor Qatar. This project will bring Iran $70 billion in hard currency over the coming three decades. The deal also gives Sinopec a half-share in one of Iran's most important new discoveries, the Yadavaran field in southwest Iran, allowing Sinopec to explore for oil there over the next few decades. With the field's oil reserves estimated at around 17 billion barrels, China's operations there could be worth another $100 billion, in return for substantial investment.

Japan has also made recent commitments to invest heavily in the Middle East. After Japan's Arabian Oil Company in February, 2000 lost the Kafuji concession in Saudi Arabia that it had held since 1957, the Japanese government concluded a deal to develop the huge Azadegan oil field in Iran, only ten kilometers from the Iraqi border, in February, 2004. Japan's total investment is to be $2 billion, over a contract period of 12 and a half years, stretching to late 2016. The prospects for the deal are clouded by the Iranian nuclear problem and U.S. opposition, but Japan clearly faces strong competitive pressures from China if it does not go ahead with the Azadegan project—pressures that are painfully intensified by the short contract period.

India is undertaking two major new energy projects in the Middle East, also focusing on Iran. The first is a $4 billion gas pipeline, stretching 2775 kilometers from Iran's massive South Pars natural gas field on the Persian Gulf to the west coast of India, via Pakistan. The second is an ambitious $22 billion long-term project providing for Iran to supply India with 5 million tons of LNG annually, for 25 years from 2009.

With Middle East relationships taking on increased geostrategic importance for Asia, as the economic scale of those relationships increases, and as energy prices rise, Asian nations are taking a variety of steps in the national-security realm to safeguard their interests. It is by no means accidental that South Korea and Japan had, in the fall of 2005, two of the largest contingents of peace-keeping forces still remaining in Iraq, apart from the United States and Britain, or that Japan was one of the largest Official Development Assistance (ODA) donors to the Palestinian authority, as well as five of the seven Central Asian states, most of them major energy producers. China's deepening presence in Iran, as well as its reported stationing of 4,000 non-uniformed forces in the Sudan, both seem to be closely related to its oil interests.

Neutralizing Future Energy Insecurities

Clearly Asia will want to hedge its future bets on the volatile global energy future. While deepening ties with strategic Middle Eastern energy producers such as Saudi Arabia, Iran, and potentially Iraq, Asia will simultaneously want to diversify its conventional oil and gas supplies away from that turbulent region, to the extent that it realistically can. China, in anticipation, has been consorting with African oil producers such as Angola and Congo, while all three major Northeast Asian countries—Japan, China, and South Korea—have been courting Russia as well.

Given its energy efficiency and environmental friendliness, Russian gas is a rational alternative to oil, and especially to Middle Eastern oil, for Asia. With nearly a third of global reserves—and possibly more in the unexplored recesses of Siberia—Russia is a natural supplier, and especially to Asia. When the North Korean nuclear crisis is resolved, a more developed regional gas pipeline network could become a serious prospect, paralleling the emergence of extensive regional gas networks in Europe and North America in earlier years. Nuclear power will also be an inevitable element of Asia's hedge against Middle East volatility. Japan and South Korea are already among the most substantial producers of nuclear power on earth, together with France and Sweden. And China is projected to be the largest generator of nuclear power on earth by 2050.

Yet in the end, the inexorable arithmetic of global energy supply and demand will continually force the Middle East and Asia back into interdependence with one another. Hydro-carbon supply, to put it simply, is in the Middle East. And demand, fueled by remarkably relentless economic growth, is in Asia. Indians consume about one barrel of oil per person, China two, and the U.S. twenty-eight barrels per person annually. As developing Asia modernizes, the supply to meet its aspirations for a mobile, affluent life-style will have to be in the Middle East, that region's ceaseless troubles notwithstanding.

Quest for Oil and Geostrategic Thinking

Ingolf Kiesow[*]

The production levels of oil and gas in China, India and the United States are either in decline or have stagnated. Meanwhile, the level of energy usage has dramatically risen in these countries. This has created a deficit between local production and domestic usage which in turn, has to be covered through the import of oil and gas. However, the search of such overseas energy resources is increasingly taking on a competitive streak. Tension has been building, especially in Asia, as the race to secure oil and gas abroad heats up.

In a recent article in *Alexander's Oil & Gas Connections* titled "United States and China are after oil sands," we learn that both Chinese President Hu Jintao and U.S. Treasury Secretary John Snow used their visits to China to discuss the oil fields of Alberta, which is said to contain the world's largest reserves of oil sand. These fields are estimated to contain 180 billion barrels of oil, second only to Saudi Arabia's reserves of oil.[1] Chinese growing interest in Canadian oil sands is further illustrated by China Petrochemical Corporation's deal with Calgary based Synenco Energy to buy 40 percent of the Northern Lights oil sands project, and China National Offshore Oil Corporation's (CNOOC) purchase of a 16.69 percent stake in MEG Energy.

Relations between China and America frayed again when China National Petroleum Corporation's (CNPC) attempt to purchase Unocal, America's ninth largest oil company, earlier this year was rebuffed with American Congressmen voicing strong opposition towards this Chinese bid. Former CIA director James Woolsey even went as far as to describe the Chinese attempt as "a threat to U.S. national security."[2] The angry reaction in the U.S. Congress came at a time when U.S.-Venezuela relationship was going through a difficult patch. Venezuela is the fourth largest supplier of oil to the U.S., catering to about 11 percent of America's oil needs. However, President Hugo Chavez of Venezuela

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[1] *Alexander's Oil & Gas Connections* 10, 19, October 11 2005, <http://www.gasandoil.com/goc/news/nts54124.htm> (November 1 2005).

[2] *Alexander's Oil & Gas Connections* 10, 18, September 28 2005, <http://www.gasandoil.com/goc/news/ntn53958.htm> (November 1 2005).

who is anti-American has been threatening to cut the U.S. off Venezuelan oil. Such a move, if carried out would most certainly cause serious damage to U.S. energy security. Chavez' rationale is mainly political—to show that he could stand up to U.S. power in South America. He has gone as far as expressing interest in cooperating with Argentina, Brazil and possibly Iran to develop nuclear energy. As part of his bid to counter U.S. influence in Latin America, he invited China to replace the U.S. as recipient of Venezuela's oil.[3] China's cautious but nevertheless positive response further annoyed the U.S. Congress and such emotions became apparent during the debates on the Chinese's bid for Unocal.

Quest for Oil Initiating State Competition

U.S. oil reserve additions have only managed to replace 58 percent of crude oil production in 2003, a trend observed since the early 1990s.[4] Furthermore, with declining crude oil production and the inability to meet rising domestic demand, the U.S. has grown increasingly dependent on energy imports. Such reliance has been forecasted to grow by 2.5 percent annually until 2025.[5] From an American point of view, the rising energy demand has not been a problem in the past. However, competition in the energy market has risen significantly due to the greater international demand for oil.

The problem is a global one, with much of its roots in Asia. According to the International Energy Agency,[6] primary energy demand in the world will increase by 66 percent from the year 2002 to 2030. Asia's share will increase from 28 percent to 35 percent. The share increase will be especially significant with regards to oil demand. The Asian developing countries will take the largest share, 38 percent in 2030, with China taking 16 percent and India 8 percent.[7]

China is at present experiencing an energy supply crunch; one that is so severe that the government has ordered the slow down of investment in oil-intensive industries. China's energy shortages are very much linked to

[3] *Alexander's Oil & Gas Connections* 10, 3, February 10 2005, <http://www.gasandoil.com/goc/news/ntn50617.htm> (November 1 2005).
[4] US Energy Information Administration, US Dept. of Energy, Energy Statistics, U.S. Crude Oil, Natural Gas, And Natural Gas Liquids Reserves (Annual Report 2003), 21.
[5] US Energy Information Administration, US Dept. of Energy, Energy Statistics, Data.
[6] IEA-India Workshop on Emergency Oil Stock Issues, *Opening Remarks by Ambassador William Ramsey, Deputy Executive Director of the IEA*, <http://www.iea.org/> (February 9 2005).
[7] IEA-India Workshop on Emergency Oil Stock Issues, *Opening Remarks by Ambassador William Ramsey, Deputy Executive Director of the IEA*, <http://www.iea.org/> (February 9 2005).

its modernization process. Two major factors are said to be the cause of China's energy shortages. First, and most important, is the growing affluence of the Chinese population. With rapid GDP growth, living conditions have improved and an increasingly significant portion of the population can now afford to purchase cars, and electrical appliances such as air-conditioners, refrigerators and heaters. The second cause is the lack of investment in the coal sector. Coal has traditionally catered to two-thirds of the electrical energy consumed but of late, has increasingly been unable to keep up with the rising demand for electricity. As a result of growing energy demand and the inability of the traditional coal sector to keep up with supply, the importation of oil has been increasing rapidly. Between 2002 and 2003, the rate of imported oil increased by 44 percent. If China's demand for oil imports continues to grow at this rate, the oil market will have difficulty meeting its requirements.[8]

In 1990 China took most of its crude oil imports from nearby friendly-countries. However, a decade later, China's increasingly urgent quest for energy supplies has forced it to look further beyond. In 2001, China's international investments included several Middle Eastern countries, Argentina, Bangladesh, Canada, Colombia, Ecuador, Indonesia, Kazakhstan, Malaysia, Mexico, Mongolia, Nigeria, Pakistan, Papua New Guinea, Peru, Russia, Iran, Sudan, Thailand, Turkmenistan, Venezuela and the Gulf of Mexico. Altogether, the China National Petroleum Corporation (CNPC) had signed or was in the process of negotiating, contracts in at least 20 countries. It also pledged more than $8 billion in exchange for oil concessions in Sudan, Venezuela and Iraq.[9] During the last four years, China has also invested in large projects in Brazil and Canada.

Compared to China, India is a late-comer in the race for oil fields abroad. It is basically facing the same problem as China where the pace of modernization processes is outstripping energy demand. India's energy import statistics is very telling. Oil imports increased by 6.3 times between the 1970-2002 period while domestic production only increased by 4.5 times. This makes India's import dependency as high as 73.3 percent in 2002. As dependence on overseas supply grow, state-owned Indian oil companies have also become active in the quest for energy security.

Under the pressure to improve oil import security, the state-owned Oil and National Gas Corporation (ONGC) has acquired exploration blocks abroad in Myanmar, Sudan, Iraq, Russia, Vietnam, Venezuela and Libya. It has also begun a deep-water drilling program in the Bay of

[8] *Alexander's Oil & Gas Connections* 9, 17, 2004, <www.gasandoil.com/goc/frame_cns.company.htm> (September 21 2004).
[9] *Ibid.*

Bengal. The private sector company Reliance Industries Ltd is pursuing a plan for equity and acquisition of oil fields in Sudan, Iraq, Madagascar and Libya and has a stake in an exploration block in Yemen.[10]

Chinese and Indian Energy Diplomacy Worries the U.S.

It seems that the U.S. is genuinely concerned about the long-term consequences of competition with the two Asian giants. America's growing unease towards the two Asian powers was reflected in the report titled "Mapping the Global Future" published this year by the U.S. National Intelligence Council, a government think-thank which advises the Central Intelligence Agency and senior U.S. policy-makers. The report states that "the likely emergence of China and India as new major global players...will transform the geopolitical landscape". It adds that "in the same way that commentators refer to the 1900s as the 'American Century,' the early 21st century may be seen as the time when some in the developing world, led by India and China, come into their own.....(and) will have substantial impacts on geopolitical relations."[11]

It was reported that Deputy Secretary of State Robert Zoellick in a visit to Beijing, told his Chinese hosts that "China will be increasingly in conflict with the United States if it continues to pursue relations and energy deals with countries the U.S. believes to be "problematic."[12] Henry Kissinger even warned that "the global battle for control of energy resources could become the modern equivalent of the 19th century 'Great Game' between Great Britain and Tsarist Russia for supremacy in Central Asia."[13]

China's quest for energy has also created problems in its near abroad. The Sino-Japanese dispute over oil and gas discovered offshore in the East China Sea, their rivalry over the pipeline route from Angarsk in Russia, and competition for the oil riches of the Sakhalin peninsula are all potentially destabilizing elements for the two countries' relationship.[14] China's influence in the Central Asian states and particularly Kazakhstan are also growing in significance as plans are underway to link

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[10] Reliance, Exploration & Production (Oil & Gas), <http://www.ril.com/business/petroleum/ep/business_petroleum_ephome.html> (September 20 2005).

[11] *Alexander's Oil & Gas Connections* 10, 15, August 17 2005, <http://www.gasandoil.com/goc/news/ntn53306.htm> (November 1 2005).

[12] *Alexander's Oil & Gas Connections* 10, 18, September 28 2005, <http://www.gasandoil.com/goc/news/nts53990.htm> (November 1 2005).

[13] *Alexander's Oil & Gas Connections* 10, 12, June 22 2005, <http://www.gasandoil.com/goc/news/ntn52546.htm > (November 1 2005).

[14] Ingolf Kiesow, *China's Quest for Energy; Impact upon Foreign and Security Policy*, (Report at the Swedish Defence Research Agency, FOI-R--1371—SE, 2004) <www.asia.foi.se> (November 1 2005), 41.

the two countries via an oil pipeline. However, the pipeline also represent a breach of Russia's monopoly-like control of oil and gas exports from Central Asia, something Russia is not to be too happy about.

Just like China, India's energy diplomacy has also encountered problems with the United States. Together with neighboring Pakistan, plans are now underway to build a $7 billion gas pipeline from Iran. This did not go down well with the U.S. who pressured New Delhi to abandon the plan. In fact, U.S. pressure did not stop India from making another deal with Iran, this time, to import 5mm tons per annum of liquefied natural gas (LNG). The deal is valued at close to $22 billion and is the largest commercial deal ever entered into by India in the hydrocarbon sector. As a follow-up, a special envoy was sent by Iran to propose a comprehensive economic and political cooperation agreement. The idea of energy security cooperation between India and Iran is obviously a matter of significant concern for Washington as President Bush took up this issue with Prime Minister Manmohan Singh during talks on the sidelines at the opening of the UN General Assembly session in New York in September 2005.[15]

Energy Efficiency and Lessons to Learn from History

In an article by two prominent oil experts in the *Far Eastern Economic Review* an interesting observation is made. It states that the ruling party in China is, "...running the financial system primarily for the benefit of its own constituency of companies...With its economy requiring more oil per unit of output, China's emergence as a global economic powerhouse has caused the world economy to become more oil intensive...Whether the recent relinking of growth to rising oil intensity is the beginning of a new trend led by China or represents just a temporary phenomenon is one of the key uncertainties for the global energy markets going forward."[16] The article argues that "Improving energy efficiency is becoming a key driver of energy policy, and greater diversification of foreign suppliers as well as the energy mix looks set to gather momentum." This is the approach of the economists and engineers to the rapidly emerging problem of high oil prices due to declining production rates in combination with rapidly rising demand in some of the main consumer countries. This certainly represents a necessary insight in the "need to do something", but it can also become a dangerous decision trap. The problem is not only one of system engineering. The more dangerous side of the problem is the tendency towards geostrategic thinking that has

[15] *Alexander's Oil & Gas Connections* 10, 18, September 28 2005, <http://www.gasandoil.com/goc/news/nts53977.htm> (November 1 2005).
[16] Peter Cornelius and Jonathan Story, China revolutionizes Energy Markets, *Far Eastern Economic Review* 168, 9 (October 2005): 21.

appeared so conspicuously in the U.S., China and to a certain extent also in Japan, India and Europe.

We have some examples in history to remind us of the dangers that is hidden in that kind of reasoning. Adolf Hitler's original plan for the attack on the Soviet Union in the summer of 1941 had as one of the two most important parts a push through southern Ukraine in order to get secure access to the oil fields in Baku. To secure the supply of oil for the German forces and to cut off the Soviet supply seems to have been an important reason for his opening of a second front.[17] In September 1941 Japan's leaders decided to go to war with the United States if an agreement regarding oil was not reached by early October. Since an American oil embargo against Japan, which had been introduced in July, was still not lifted in October, plans for war were made and on December 7 the Japanese fleet attacked Pearl Harbour.[18] In July 1990 I happened to become an eye-witness to the failure of the last negotiation in Basra between Iraq and Kuwait about border issues, among them the oil fields on the border between the two countries, and about the OPEC price level for oil that were the two main factors behind Saddam Hussein's decision to invade Kuwait two months later, on August 1.[19]

It is not geostrategic thinking itself that is a decision trap. Oil is becoming a more scarce resource, compared to demand, and it is time to start not only one but both available lines of action, to improve energy efficiency and to secure supply of oil. Since the world is still a set of nation states, any government who neglects the geostrategic aspect is likely to be criticized by its citizens—and rightly so. It is the solution to the geostrategic problem that represents the danger. It is wrong if every nation starts to grab as much oil as possible without regard for the needs of other nations. The goal must be to create an efficient world-wide structure for oil production and a network of distribution that can give all nations as much oil as long as possible at the same time as energy efficiency is increased and to do so in a way that energy is produced by other means than by the burning of more oil. That requires international cooperation on a grand scale, not mercantile theory reflexes.

The academic world now has a task to alert politicians and public opinion to the growing energy problem. Since there is an obvious need for geostrategic thinking, whether we like it or not, the alert should also

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[17] Hermann Rausching, *Gespräche mit Hitler,*Zweite Auflage (New York: Europa Verlag, 1940), 120-127; Werner Maser, *Adolf Hitler; Legende-Mythos-Wirklichkeit* (Muenchen: Wilhelm Heine Verlag, 1975), 499-503.

[18] John K. Fairbank, Edwin O Reischauer and Albert M Craig, *East Asia; Tradition and Transformation* (London: William Clowes & Sons, 1975), 717-720.

[19] Ingolf Kiesow, *Svensk Kuwait* (Stockholm: Probus förlag, 1992), 28-30, 46 and 48.

highlight the inherent danger of the wrong approach to such thinking. The latter task is probably the most important one—and the most difficult and unrewarding one.

China's Energy Dependence on the Middle East: Boon or Bane for Asian Security?

Phar Kim Beng and Vic Y. W. Li[*]

Going strictly by its current energy usage and profile, China's coming over-dependence on oil from the Middle East is not necessarily a given.[1] According to sources culled from the International Energy Agency (IEA), China will import 5.9 to 6.9 million barrels per day (b/d) in 2020, constituting 63 to 70 percent of total oil consumption. In contrast, the Chinese observers put such imports at a lower figure between 3.6 to 5.0 million b/d in 2020, which translates into 46 to 54 percent of oil consumption.[2] In any case, with oil share in the energy mix projected to increase slightly from 25 percent in 2000 to just 27 percent in 2030 it can only remain as China's second most important fuel over the next two decades. Nevertheless, one of China's present acute pre-occupation is the stability and security of its energy supply, especially from the Middle Eastern region which currently supplies up to 57 percent of China's overall oil usage/imports.

China and Middle East in Future

China is now increasingly sensitive to events in the Middle East. While the region does not have a monopoly over world oil production, it has the world's largest oil reserves. The world's actual oil supply comes from a wide variety of sources, with the Middle East producing 29 percent of the total to date, followed by North America (accounting for 20 percent) and the remaining 51 percent fairly evenly distributed throughout the world. However, the fact remains that energy intensive countries, such as China, cannot be freed from the reliance on the Middle East in the foreseeable future.[3]

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[1] See for instance, the analysis by Peter S. Goodman, "Big Shift in China's Oil Policy: With Iraq Deal Dissolved by War, Beijing Looks Elsewhere," *Washington Post*, July 13 2005, D01.

[2] Erica S. Downs, "The Chinese Energy Security Debate," *China Quarterly* 177 (March 2004): 23.

[3] International Energy Agency, *China's Worldwide Quest to Energy Security* (Paris: OECD/IEA, 2000): 50; for the geographic overview of worldwide oil production, see

This is because the Middle East wields great influence over the oil market since it is home to some of the largest members of Organization of Petroleum Exporting Countries (OPEC). OPEC accounts for almost 42 percent of world production. Member countries include: Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, the United Arab Emirates, and Venezuela. Not counting Indonesia, these members' net oil exports average 50 percent of total oil production in 2004.[4] Some of the other major non-OPEC producers of oil have seen a decline in their production. The U.S. for instance has seen production fall from 10.6 million barrels/year in 1985 to the present rate of 7 to 8 million.[5]

According to OPEC's 2004 estimates, 75 to 80 percent of proven world crude oil reserves are located in OPEC member countries—a far higher concentration than current oil production.[6] A rough distribution of some of the largest oil reserves worldwide is as follows (Table 1):

Table 1. Oil Reserves Worldwide (As of 2004 in billion barrels)

North & South America	USA: 21.8	Mexico: 14.8	Venezuela: 79.7
Western Europe	Norway: 9.6	UK: 4.5	
Eastern Europe	Russia: 90.1		
Middle East	Iraq: 115	Saudi Arabia: 264	United Arab Emirates: 97.8
Africa	Libya: 37	Nigeria: 35.9	
Asia	China: 17.1		

Source: OPEC Annual Statistical Bulletin[7]

As the U.S.'s Energy Information Administration warns, "because non-OPEC countries' smaller reserves are being depleted more rapidly than OPEC reserves, their overall reserves-to-production ratio—an indicator of how long proven reserves would last at current production rates—is much lower standing at about 15 years for non-OPEC states and 80 years for OPEC members. This implies that OPEC countries are expected to

Energy Information Administration, U.S. Department of Energy, "non-OPEC oil Fact Sheet," <http://www.eia.doe.gov/emeu/cabs/nonopec.html> (October 25 2005).

[4] OPEC, *Annual Statistical Bulletin* (Vienna, Austria: OPEC, 2005): 94.

[5] Energy Information Administration, U.S. Department of Energy, "United States Country Analysis Brief," <http://www.eia.doe.gov/emeu/cabs/usa.html> (October 25 2005).

[6] OPEC, *Annual Statistical Bulletin* (Vienna, Austria: OPEC, 2005): 43.

[7] *Ibid*., pp. 42-3.

take up a higher proportion of world petroleum production over the long term."[8] China therefore, like the U.S. or other Western countries, would remain largely dependent on oil production in the Middle East. Put differently, the future portends that the Middle East will strengthen its domination of the world oil market.

In particular, China will find its reliance most acute, given its voracious demand for oil as it races towards more economic growth. As Erica Downs astutely noted, such dependence on energy has been characterized as a debate that revolves around China's future behavior. More precisely, how will China try to break "out" from this Middle Eastern trap?[9] Is China on course for some destabilizing policies or will Chinese's reliance on foreign oil facilitate its deeper integration into the international system and mark the rise of a benign, status quo power instead?

The first scenario presents a realist perspective whereas the second, which adduces a more pacific outcome, is informed by liberalism. Analysts with realist persuasions foresee the emergence of China as a revisionist, if not a belligerent state. They speculate that China's oil needs could prompt it to pursue destabilizing policies such as naval arms build up and oil for arms exchanges. While these scenarios have not happened, China's embrace of rogue regimes such as Sudan and Iran, in exchange for obtaining almost exclusive rights for "overseas infrastructural investment" has clearly been regarded as alarming; and to the realists, reflects a "preliminary" form of behavior that is within the ambit of what they are predicting.[10]

Liberals on the other hand anticipate more Chinese cooperation with neighboring states to bring remote resources to consumers. In this regard, China has also begun forging ties with Russia and Kazakhstan to pipe natural gas and oil into China; though in the case of the former China's bid to win over Russia is being actively rivaled by Japan in every step of the way.[11] In response to the realist position, it is necessary to point out the nuances of China's relations with Sudan and Iran. While China has supported the two countries in the United Nations Security Council, it

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[8] Energy Information Administration, U.S. Department of Energy, "Non-OPEC Fact Sheet," <http://www.eia.doe.gov/emeu/cabs/nonopec.html> (October 25 2005).

[9] Erica S. Downs, "The Chinese Energy Security Debate," *China Quarterly* 177 (March 2004).

[10] For an early explication of the "China threat theory," see for example Denny Roy, "Hegemon on the Horizon? China's Threat to East Asian Security," *International Security* 19, 1 (Summer 1994): 149-68. See also Herbert Yee and Ian Storey (ed.), *The China threat: Perceptions, Myths and Reality* (London: Routledge Curzon, 2002).

[11] Sergei Blagov, "Russia tangles with Japan and China," *Asia Times Online*, September 1 2004, <http://www.atimes.com/atimes/Central_Asia/FI01Ag01.html> (October 30 2005). See also James Brooke, "Japan and China Battle for Russia's Oil and Gas," *New York Times*, January 3 2004.

has not aligned itself completely with these regimes as a full-fledged patron in other areas. For instance, China, having acceded to the Missile Proliferation Control Regime and due to U.S. pressures, has agreed, at least in theory, to stop selling its nuclear and missile technology to Iran,[12] unlike in the 1980s when China sold arms to both parties of the Iran-Iraq War.[13]

Therefore, contrary to what the realist may believe, China has been adopting a liberal economic approach and this has presented it with more policy options for addressing its energy needs. Indeed, contemporary economic diplomacy offers a richer mix of policy options that does not necessarily require the flexing of military muscle. China's state owned oil companies for instance now recognize the benefits of equity share in overseas companies, including American ones and have thus set about an acquisition policy as part of its strategy for energy security. And under the "equity oil" arrangements whereby the Chinese oil companies split the production output with the host government, China is entitled to buy the oil at a relatively cheaper price and such a setup involves lesser risk than buying oil on the international oil market.[14] As of 2001, the "equity oil," constituted 15 percent of oil import yearly; and it is predicted that the import level can go up to 30 percent in a long run under such equity arrangements.[15]

Equity position acquisition, above all, is an alluring option for China to secure oil supply without exposing itself to competitions largely dominated by major Western international oil companies in order to gain exploration rights.[16] Furthermore, the equity option also reduces, if not eliminates, market price risk because it enables the investor to predict exactly how much oil it will receive and at what cost over the life of the field. In a long run, the price is generally lower from that in the international market because the buyer, as an equity owner, usually produces and transports its oil below the market clearing price. It also enhances safe and stable supply as the equity ownership eliminates the need for middlemen, such as other oil companies, between the oil in the ground and the consumer, which could cut off supply.[17]

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[12] Alastair Iain Johnston, "Is China a status-quo power?" *International Security* 27, 4 (Spring 2003): 5-56.
[13] Sharif Shuja, "Warming Sino-Iranian Relations: Will China trade Nuclear Technology for Oil?," *China Brief (The Jamestown Foundation)* 5, 12 (2005): 8-10.
[14] Erica S. Downs, "The Chinese Energy Security Debate," *China Quarterly* 177 (March 2004): 35.
[15] *Ibid.*
[16] Amy Myers Jaffe and Steven W. Lewis, "Beijing's Oil Diplomacy," *Survival* 44, 1 (Spring 2002): 126.
[17] Erica S. Downs, "The Chinese Energy Security Debate," *China Quarterly* 177 (March 2004): 35-6.

Thus far, Chinese oil companies, in particular the China National Petroleum Corporation (CNPC) have been involved in the acquisition of equity position and are participating in various geological prospecting and explorations projects in oil fields and potential sites in more than 20 countries, mostly in Middle East and North Africa.[18] The most recent high profile case was the attempt by China National Offshore Oil Corporation (CNOOC) to buy Unocal in the United States, a venture which was eventually foiled by the U.S. Congress' opposition in August 2005.

"Perception Is Reality" in Energy Security

In spite of equity ownership as a measure for energy security, the possibility of major supply disruption continues to exist in the minds of Chinese leaders. So, despite the validity of the liberal argument, realism continues to dog the Chinese leaders' thinking. This is because of the transport routes used for delivery of imports. The seaborne oil import, largely through the strategic chokepoints of the Straits of Malacca and the South China Sea, are beyond Chinese reach, while the land based pipelines through Kazakhstan can easily be held hostage to adversarial elements and antagonistic policies of other countries.[19]

Similarly, equity ownership, as attractive as this option may seem to be, is also not a fool-proof strategy. This is because there is always the realist's fear that stable energy supply could still be disrupted by pressures from countries who oppose China. There are in fact historical reasons why realism continues to affect Chinese thinking, particularly with regards to the energy issue. There have been precedents of energy blockade, sanctions and intercession in Asia to which China became an indirect victim.[20] For example, the Japanese invasion of China in 1937 was intensified by Tokyo in order to replenish its energy supply back home. Later on, the manner with which the United States shut down Japan's economy in June 1941, led to the latter's fateful attack of Pearl Harbor six months later, and also renewed conquest of China. Thus, the historical precedent continues to hold certain salience in the "policy lesson/universe" of the Chinese leaders and strategic analysts. Furthermore, the U.S.' tendency to attack the electric and energy grids of

[18] An official list of the projects can be found on CNPC, "Overseas Oil and Gas Operation," <http://www.cnpc.com.cn/english/inter/OverseasOil.htm> (October 25 2005).

[19] Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther, *The Strategic Implication of China's Energy's Needs*, Adelphi Paper 346 (London: Oxford University Press, 2002), chapter 2.

[20] Christian Constantin, *China's Conception of Energy Security: Sources and International Impacts*, Center of International Relations, The University of British Columbia, Working Paper no. 43 (March 2005).

its opponents first—as witnessed in Iraq during the first and second Gulf War—also underscored the importance of securing the integrity and independence of a reliable energy network. After the September 11th terrorist attack, the increasing control and influence of the U.S. over Saudi Arabia, Bahrain, Qatar, and Iraq, which together control 75 percent of the total oil production of OPEC, in addition to U.S.' presence in Central Asia, has made it difficult for China to ignore the strategic implications of being over-reliant on Middle Eastern oil; or alternatively being undermined by the United States.

Overall, in trying to overcome this Middle East conundrum, Beijing has resorted to a three-pronged strategy: engaging in diplomatic offensive to secure long-term energy supply arrangement, such as the conclusion of the "strategic oil partnership" with Saudi Arabia in 1999 and a similar declaration with Kazakhstan in 2005;[21] intervention of Chinese oil companies (most notably CNPC and its subsidiary Chinese National Oil Development Corporation) to gain rights to invest and develop oil fields in the region; and finally encouraging counter-/cross-investment by Gulf petroleum companies investing in Chinese refinery and marketing sectors to promote "closer links" with the Middle East countries and overcome the domestic capital bottleneck.[22]

Yet, such measures cannot ensure or guarantee a safe buffer between China and the Middle East because they are premised on working more closely with the Middle East, not less. This is also because the biggest energy basin at this stage is in the Middle East, not elsewhere. Thus, China's foreign policy geared towards the Middle East would only be enhanced if greater attention is spent on the Middle East. In this context, China has already established a China-Gulf Cooperation Council Forum to discuss its relations with the region.[23] To put things in perspective, however, it is unlikely that China's dependence on Middle Eastern oil would result in any balance-of-power implication predicted by realists. This is because China does not yet have the military muscle to challenge the U.S. and its regional allies in the Asian seas successfully. Thus a naval build-up is not a foregone conclusion.[24] As Ronald Soligo and Amy

[21] Virtual Information Center, "China's Hu Visits Russia, Kazakhstan, Attends SCO- A Special Press Summary," July 7 2005.

[22] Xiaojie Xu, "China and the Middle East: Cross Investment in the Energy Sector," *Middle East Policy* 7, 3 (June 2000): 122-36; Philip Andrews-Speed, Xuanli Liao and Roland Dannreuther, *The Strategic Implication of China's Energy's Needs*, Adelphi Paper 346 (London: Oxford University Press, 2002), 66-7.

[23] "China, GCC economic ties highlighted in Beijing," *People's Daily Online*, July 7 2004, <http://english.people.com.cn/200407/07/eng20040707_148737.html> (October 22 2005).

[24] Eric Heginbotham, "The Rise of The Fall and Rise of Navies in East Asia: Military Organizations, Domestic Politics, and Grand Strategy," *International Security* 27, 2 (September 2002): 86-105.

Jaffee of the Baker Institute write, "China lacks the military capability and the basing facilities to close Asian sea lanes for any extended period of time—should the U.S. Navy intervene to reopen them. At the moment, Chinese capabilities do include short-to-medium range ballistic and cruise missile systems that could threaten commercial energy shipments operating in Asian sea lanes. But even such capability would not be sufficient to defend its own incoming shipments of oil and other goods from retaliation by American or regional militaries in response to its own aggressive acts."[25] Indeed, even if China successfully increases its submarine fleets, a naval strategy Beijing is currently pursuing, their deployment would still face considerable difficulties. This is due to the peculiar maritime characteristics both in the Taiwan Straits and the Sea of Japan, both of which are too shallow to allow significant maneuverability.[26] In November 2004, for instance, Chinese submarines was spotted off the coast of Fukuoka, and tracked in open aerial view by a Japanese self defense force (SDF) for nearly two days.[27]

The above events do not suggest that China's status quo position would forever remain the same. China's intention has come under some scrutiny lately, due to its allegedly large defense budgets. In fact, there has been long suspicion since 1990s, in particular from the U.S. defense community, that the announced defense budget of the Chinese military is in fact much lower than the actual expenditure. The budget, according to Pentagon, is at least about three times the publicly known figure.[28] However, according to Singapore Mentor Minister Lee Kuan Yew's own observation it would take another 50 years for China to be able to develop a blue water navy fleet comparable to that of the U.S., Japan, and even India's.[29] Beyond this window, the future long-term balance in the region could only hold precipitously, unless future Chinese leaders are able to work with others, and in due course shed their vaunted nationalism too.

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[25] Ronald Soligo and Amy Jaffee**,** *China's Growing Energy Dependence: The Costs and Policy Implications of Supply Alternatives*, The Baker Institute Energy Forum, Rice University, <http://www.rice.edu/energy/publications/asianenergysecurity.htm> (October 15 2005).

[26] Michael O'Hanlon, Lyle Goldstein and William Murray, "Damn the Torpedoes: Debating Possible U. S. Navy Losses in a Taiwan Scenario," *International Security* 29, 2 (Fall 2004): 203-204. See also Phar Kim Beng, "The Chinese Dragon submerges," *Asia Times Online*, October 28 2004, <http://atimes.com/atimes/China/FJ28Ad04.html> (October 29 2005).

[27] Reiji Yoshida and Nao Shimoyachi, "Unidentified submarine intrudes near Okinawa," *Japan Times*, November 1 2004.

[28] Mark Mazzetti, "Pentagon Says China Seeks to Extend Military Reach," *Los Angeles Times*, July 20 2005.

[29] "Lee Kuan Yew: China to Overtake the US in 2050," *People's Daily Online*, May 24 2002, <http://english.people.com.cn/200205/24/eng20020524_96387.shtml> (October 28 2005).

Conclusion

To be sure, China will become more reliant to the oil produced in the Middle East. But this is not surprising because other countries will also be dependent on the Middle East. Since China does not have the means to protect its supply from the Middle East, it is almost inevitable that China's sensitivity to events in the region will increase proportionately. Hence, China is adopting market measures to secure the supply line in future. The latter, however, is bound to be a long term strategy because China cannot adopt a forceful or military profile without scaring other countries. Such an act would trigger an arms race which China wants to avoid in order to concentrate its economic resources on modernization. Hence, in the short to medium term, while it would make China more sensitive to the events in the region, China's reliance on the Middle East will not lead to the destabilization of Asia's security just yet. Also, China cannot be considered "vulnerable" in the way Joseph Nye and Robert Keohane has denoted in their book on complex interdependence.[30] Their concept of vulnerability suggests a scenario where a problem emerges when there are completely no policy alternatives. But China does have alternatives for its energy import strategy such as reaching out to other African, and Central Asian countries, or to Russia. Aside from market-centric measures, this diversification also includes using alternative energy, such as wind, nuclear, and solar power to secure its energy supply.

[30] Robert O. Keohane and Joseph S. Nye, *Power and Interdependence* (New York: Longman, 2001).

China's Foreign Energy Asset Acquisitions: From Shopping Spree to Fire Sale?

Maria Kielmas[*]

China's determination to acquire energy assets around the world has given rise to the assumption that its appetite for such resources may be limitless. The country's oil demand has been forecast by the Paris-based International Energy Agency (IEA) to rise from 6.5 million barrels per day (mb/d) to over 14 mb/d by 2025. It has been said that China's acquisition of energy assets in Central Asia and the growing influence of the Shanghai Cooperation Organization (SCO) is set to increase China's influence in the region. While most commentators have focused on how such a development is likely to be a source of growing tension between China and the United States, the hitherto ignored factor is whether these acquisitions are profitable and sustainable in the long term.

The worldwide shopping spree by Chinese state-owned or state-controlled companies for assets, ranging from auto manufacturers to oil fields has provided the media, think tanks, policymakers and politicians much to talk about. China's demand for energy and basic commodities has been interpreted in these circles as the dominant factor in maintaining both high world oil prices and for reviving the economic fortunes of commodity exporting countries such as Argentina. China's export-oriented growth is also said to have played a significant and positive role in supplying the world with cheap consumer goods and contributed to keeping inflation low.

This state of affairs drummed along at a steady pace until June 2005 when the Hong Kong-based and state-controlled China National Offshore Oil Corporation (CNOOC) launched a $18.5 billion cash bid for U.S.-based Unocal Corporation. This bid exceeded a rival bid from U.S. bidder ChevronTexaco by over $1 billion and drove U.S. legislators, though significantly not the U.S. business community, into a fit of apoplexy. The U.S. House of Representatives voted by 398 to 15 against the proposed deal, calling it a risk to national security. In August, CNOOC decided to drop its bid and Unocal was taken over by ChevronTexaco.

However this move by the U.S. legislators has not bypassed criticism. James Dorn, from the CATO Institute, observes that "Politicians on

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both sides of the aisle in Congress see China as a major threat to U.S. jobs and view trade as a form of economic warfare rather than a mutually beneficial arrangement that increases the wealth of nations."[1] He believes that such a view is wrong. Instead, the United States can do more to spread the ethos of liberty by setting high standards at home. U.S. energy security, he concludes, as well as China's, will depend on sound free-market policies, not on destructive protectionism.

Worries in Kazakhstan

That may not be the way some opinion formers in Kazakhstan see matters. Just as the Unocal melodrama was beginning to settle down, The China National Petroleum Corporation (CNPC), the 70 percent owner and parent company of CNOOC, set its sights on Petrokazakhstan, a Canadian owned oil and gas producer formerly known as Hurricane Hydrocarbons. Petrokazakhstan produces about 12 percent of Kazakhstan's total 1.8 mb/d oil output. The Chinese offer was the culmination of a $9 billion agreement several years ago between the Chinese and Kazakh governments that also involved the construction, now underway, of an oil pipeline from east Kazakhstan to China.

But no sooner had CNPC's offer become public when the Kazakh parliament passed a law tightening the regulations on such deals. The new legislation grants the Kazakh parliament the final say on the full or partial transfer of oil and gas assets. According to Ermukhamet K. Ertysbayev, advisor to Kazakh president Nursultan Nazarbayev, Petrokazakhstan wanted to sell its energy assets in the country without informing the government and this is not acceptable as Kazakhstan's strategic interests are at stake. While Ertysbayev claimed that this would not affect the interests of foreign investors, it is clear that such new regulations has made foreign oil and gas investments in Kazakhstan a more complicated matter, not least on the issue of pre-emptive rights of foreign consortium or joint venture partners.

CNPC's bid of $4.18 billion to acquire Petrokazakhstan, warded off another competing bid by India's ONGC-Mittal Corporation and also a yet to be resolved challenge by Russia's Lukoil. The Russian company had requested a court in the Canadian province of Alberta to block CNPC's takeover of Petrokazakhstan by claiming that it had pre-emptive rights to buy Petrokazakhstan out of its 50 percent stake in a joint venture called Turgai Petroleum that holds nearly 29 percent of Petrokazakhstan's oil production. However, both the Canadian authorities and the Kazakh

[1] James A. Dorn, *US-China Relations in the Wake of CNOOC* (Cato Institute: Washington D.C. Policy Paper 553, November 2005).

government approved the deal in late October.[2] Following such setback, Lukoil has taken the case against CNPC to a court of arbitration in Stockholm. Meanwhile, CNPC launched its own counter-attack against Lukoil by claiming its own pre-emptive rights to 50 percent of the Buzachi oil field. This field is a joint venture between CNPC and Bermuda-based Nelson Resources, a company currently the object of a takeover bid by Lukoil.

China and Russia in Central Asia

Despite the dispute between the companies over the oil fields, Sino-Russo relations within Central Asia are actually improving, underlined by the ever-increasing profile of the SCO. Founded in 2001 and comprising China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan, the SCO started life aimed at halting the spread of Islamist and separatist movements in the Central Asian region. It has also been developing other areas of cooperation especially in the field of trade and development. While the SCO is meant to keep other powers, namely, the United States out of Central Asia, the extent of Russia and China's respective level of influence in Central Asia is also worth noting.

Russia's weaknesses in Central Asia and the Caspian region are apparent. It is set to lose influence in the energy markets as the Baku-Tbilisi-Ceyhan oil pipeline comes on stream, depriving Russian oil export pipelines of both revenue and market leverage. On the security front, it is bogged down by problems with militants in Chechnya and increasingly, in the North Caucasus.

However, whether China would be able to capitalize on Russian weaknesses and expand its influence in the region by buying up ever more assets in Central Asia is also open to question. CNOOC's bid for Unocal involved the provision of a soft loan from the Chinese government to the company. This is not like a commercial loan. The Chinese government protects its state companies at home and supports them financially overseas. But these companies are essentially expected to be an arm of national foreign policy in their foreign investment, rather than to create value. In common with many other state oil companies, China's two major refiners and distributors, PetroChina and Sinopec, are compelled at home to retail refined products at between 30 percent and 40 percent below cost in order to protect the domestic economy. Such a drain on companies' balance sheet should limit their capital investment capabilities anywhere and sets into motion a loss-making vicious circle.

[2] Under the new Kazakh law, CNPC was obliged to transfer one third of its new acquisition to the Kazakh government.

Chinese state companies' foreign investment has benefited from access to the country's $700 million in foreign currency reserves, but this does not mask the fact that oil investments are not really so spectacular. CNPC's upstream foreign investments compare with those of a private sector company but no more. Chinese state companies face the same difficulties with contractual insecurity in Latin America, Africa and most recently Central Asia, as do private sector companies. And while foreign investment by the Chinese state companies may be a good way to develop the country's foreign policy, such investment decisions are made by bureaucrats and are political, rather than aimed at providing an adequate return.

Conclusion

Ultimately, concern in Kazakhstan about Chinese energy asset acquisitions, just like the concern of U.S. legislators after CNOOC's takeover bid for Unocal, may be misplaced. Without institutional reform and privatization, China's bureaucratically restrained, state-owned oil companies may find it difficult, maybe impossible, to develop their new acquisitions in a way where growth would be sustainable in the long term. China's shopping spree could just as easily turn into a fire sale.

The New Natural Gas-Based Technologies in the Context of Northeast Asia[†]

Vladimir I. Ivanov[*]

All economies, including those in Europe and East Asia, are now facing the linked challenges of energy security, rising energy prices and climate change. These challenges all point in the same direction: the need for an increased emphasis on energy efficiency and on the de-carbonization of energy sources. Achieving these goals, in a way that enhances growth and competitiveness, will require (1) new investment and technological advancement, (2) the development and use of the most cost effective regulatory mechanisms, and (3) coordinated international efforts.

Improving energy efficiency in Russia should be seen as an opportunity to improve the productivity of the economy and of individual businesses. Innovation can create new markets and increase competitiveness through greater resource efficiency and new investment opportunities. The role of the government is to provide an effective policy framework and remove barriers so as to encourage the development and commercialization of new eco-efficient technologies and products.

In this context, the policy and investment decisions taken in Russia with regard not only to the future of its oil and gas industries, but also toward export-oriented natural gas projects, electric power generation and the massive application of technologies that improve energy efficiency, could have significant regional and even global implications. This is the approach shared by the United States and the European Union (EU) in their policy and energy dialogues with Russia. On both these fronts, Russia is engaged in intensive professional exchanges, as both the U.S. and the EU cultivate Russia as their strategic source of energy supply, especially with regard to natural gas, for decades to come.

For example, in the framework of energy dialogue with the EU, more than 100 experts from Russian and European companies and governments participate on a regular basis in the working-level discussions on investment, infrastructure development, trade and energy efficiency, preparing practical recommendations for Moscow and Brussels.

[†] This comment was presented at the 14th International Conference of the Honolulu-based Northeast Asia Economic Forum held in China, Shenyang, September 20-21, 2005.

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Moreover, on October 3 2005, the first meeting of the Standing Partnership Council on Energy took place in London. On the part of the U.S., a number of high-level professional meetings were organized to discuss prospects for natural gas and liquefied natural gas (LNG) technology in view of the anticipated demand in North America.

Natural gas and its future in the context of energy supply in the subregion could represent one such area for innovation. While the LNG industry is about 40 years old, regional LNG consumption is still relatively new. At the same time, this is a very dynamic sector, expanding faster than any other sector of the international oil and gas industry. The economies of Northeast Asia, including Japan, the Republic of Korea and Taiwan were behind the development of this industry from its inception, serving as principal importers of LNG. In 2002, according to the Energy Information Administration, 12 nations shipped 113 million metric tons of LNG. Japan received two-thirds of global LNG imports in 1990 and 48 percent in 2002.

LNG projects are massive and expensive; such projects are traditionally financed based on long-term purchase contracts. While LNG is costly to produce, advances in technology are reducing the costs associated with the liquefaction and re-gasification. Over the last two decades, liquefaction costs declined by between 35 to 50 percent, while the cost of building an LNG tanker has fallen by about 45 percent. In addition, re-gasification costs have also dropped. According to projections, the world liquefaction capacity could reach 200 million tons (Mt) by 2007 and 300 Mt by 2012, with the number of suppliers and importers growing.

In addition to traditional LNG exporters such as Indonesia and Algeria, Russia, Norway and Egypt are in the process of constructing liquefaction plants. The number of importers is also increasing. The United Kingdom, India and China are currently building their first re-gasification facilities while the Dominican Republic and Portugal recently opened their terminals. About 40 new LNG projects have also been proposed in North America. LNG currently supplies about 2 percent of U.S. gas consumption, but could take a 25 to 30 percent share of the gas market by 2020. LNG's global energy profile is steadily gaining attention. In June 2003, Federal Reserve Chairman Alan Greenspan told the U.S. Congress that "... if North American natural gas markets are to function with the flexibility exhibited by oil, unlimited access to the vast world reserves of gas is required...Access to world natural gas supplies will require a major expansion of LNG terminal import capacity."

In Japan, the most recent METI publication "FY 2006 Economic and Industrial Policy: Key Points" refers to the set of issues called "Securing

stable energy supply by strengthening fuel strategy."[1] In this document, important measures were identified, including the following:

- Independent development of oil and natural gas in such strategic areas as Russia;
- Diversification of supply sources;
- Protection of Japanese mining rights in the East China Sea and other areas;
- Strengthening Japan's relationship with oil and gas supplier nations;
- Promotion of natural gas-related research and development.[2]

To fulfill these goals, a realistic transportation option must be found to promote natural gas imports from Sakhalin in Far Eastern Russia. Considering the fact that a natural gas pipeline project would be difficult to realize any time soon, as well as high cost and rising cost of LNG, an alternative for Japanese importers is the Compressed Natural Gas (CNG)[3] transportation option. Increasing prices for natural gas could allow CNG transportation technology[4] to become a viable alternative in delivering gas to markets with stable but limited demand such as Niigata. Projects offshore from Sakhalin, in particular offshore stranded and associated gas could serve as the long-term resource base for supplying CNG into the Niigata pipeline grid on to other locations in Japan.

The strength of a CNG system is the ability to start small and to add (or redeploy) capacity as market changes. The advantage of Niigata is the availability of the underground gas storage, as well as the backup gas systems represented by the local natural gas production and the LNG base. These alternative systems would offset the problem of reliability of CNG deliveries that may be caused by the stormy weather. The bulk of the capital and operating costs in a CNG system is the cost of ships or barges and the main challenges relate to the time taken for

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[1] METI, "FY 2006 Economic and Industrial Policy: Key Points,"<http://www.meti.go.jp/english/policy/FY2006keypoints.pdf> (November 1 2005).

[2] For development of the GTL and DME technologies, as well as other fuel sources: JPY 14 billion were allocated. On the other hand, the support measures for increased demand for natural gas accounted for another JPY 14 billion. These amounts are relatively modest, if compared with funding allocated for the effective management of oil reserves and the national petroleum stockpile (JPY 225 billion). In addition, METI intends to promote environment-friendly and efficient use of natural gas.

[3] Compressed natural gas (CNG): Natural gas which is comprised primarily of methane, compressed to a pressure at or above 2,400 pounds per square inch and stored in special high-pressure containers.

[4] Several papers presented at the Offshore Technology Conference in Houston, May 2-5, 2005 reviewed CNG as an economical alternative to LNG.

loading/unloading the CNG and the distance to be covered from the supply source to market. As for the latter, the advantage of Niigata is the geographic closeness from Sakhalin, where CNG can be loaded.

A new concept for CNG transportation and a new type of ship was recently proposed. It would have a containment system weighing 50 percent less compared to conventional pressure ship designs and would provide a larger storage volume.[5] In addition, CNG ships or barges could serve as both transportation and storage facilities and could directly discharge gas into a land-based grid of Niigata. The CNG carriers serve as transport and storage vehicles, discharging their cargo directly into the land based gas grid via offshore and onshore terminals thus avoiding costly liquefaction, re-gasification and storage. Only a few years ago, experts would comment on the prospects of CNG in somewhat skeptical terms: too much metal and too little gas to move. Technologies, however, have been improving rapidly.

The new type of ships (VOTRANS[6] and PNG[7] types) are much lighter in weight, making possible a large storage volume up to 34 million cubic meters of gas. For distances of 2,500 nautical miles or less, this technology should be very competitive vis-à-vis pipeline gas and LNG. This reduces investment in infrastructure and offers greater flexibility. The storage could be located both onshore (underground) and offshore. Moreover, stranded gas could be used for the project. Greater coordinated attention to these opportunities promises significant benefits and could help launch a new industry in a similar way the LNG business started 35-40 years ago.

[5] Introduced by Knutsen OAS Shipping AS, Haugesund, Norway with assistance from Europipe GMBH and Det Norske Veritas, it could be highly competitive compared to pipelines and LNG transport for distances less than 3,000 nautical miles.

[6] Volume Optimized Transport (VOTRANS) technology includes cooling natural gas in the range of conventional temperatures (minus 30 degrees Celsius) and the compression.

[7] Pressurized Natural Gas (PNG) technology does not require cooling, only compression.

China's Energy Security Demands and the East China Sea: A Growing Likelihood of Conflict in East Asia?

Arthur S. Ding[*]

On September 9, 2005, five Chinese warships were found patrolling in the water area close to China's Chunxiao gas field in the East China Sea. Among the five was a Russia imported Sovremenny class missile destroyer. This was the first time Chinese warships have been seen in the area. Several days later, a Japanese P-3C reconnaissance aircraft patrolling in the same area was reportedly locked by a Chinese warship's radar. Most recently in October, a Chinese electronics warfare aircraft was found flying over this area. The increased military activity in the East China Sea over disputed oil and gas fields has led to growing speculation about the possibility of conflict erupting in this area between Japan and China in the near future.

Since the 1990s, the three flash points considered most likely to cause conflict in East Asia were the cross-Taiwan Straits dispute between China and Taiwan; the Korean Peninsula over North Korea's clandestine nuclear program; and the South China Sea due to competing territorial claims over the area which is said to be rich in oil and gas reserves. Fortunately, these three flash points have to date, been mitigated. Instead, tension is increasingly shifting towards the East China Sea following China's offshore oil and gas exploration projects at Chunxiao, Pinghu, Tianwaitian, Duanqiao, Canxue, Baoyunting, Wuyunting, and Kongqueting. These eight sites are located so closely to the disputed "median line" demarcating maritime economic territory between China and Japan that the Japanese have become concerned about China's exploration activities and military presence in the area.

The East China Sea is a place of territorial disputes between China and Japan. Under the U.N. Convention on the Law of the Sea, a coastal country can claim an Exclusive Economic Zone (EEZ) extending 200 nautical miles from its shore. In this case, Chinese and Japanese offshore territorial claims overlap in the East China Sea. China claims the

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disputed ocean territory as its own EEZ since it is part of China's natural extension of its continental shelf. Japan on the other hand claims the disputed ocean territory as its own EEZ on the basis that it is within 200 nautical miles (370km) from Japan's coast. In the case of Chunxiao which is located about five kilometers away from the median line, the gas field which is 22,000 square km in size is said to straddle the Chinese EEZ, into the disputed EEZ area.[1] This on-going dispute adds to the list of issues the two East Asian powers have locked horns over. The current Sino-Japanese relations have been marked by historical nationalist animosity, rival power relations in the context of China's rise as a regional power, disputed maritime territories and the Taiwan issue.

The significance of the two's latest rivalry over energy resources, especially those in the East China seabed is to be understood in the context of China's growing thirst for energy supplies. According to the International Energy Agency's statistics, China's oil demand has grown from 2.3 million barrels per day (mb/d) in 1989 to 5.5 mb/d in 2003. The demand is expected to continue to grow to 7.15 mb/d in 2006 and is estimated to reach about 13.5 mb/d in 2030. In 1989, domestic Chinese supply was 2.8 mb/d and China was able to export its extra oil to Japan. Yet beginning in 1993, China became a net oil importer. Despite further domestic exploration, supply has leveled off at 3.4 mb/d in 2003 and around 3.6 mb/d as of August 2005. In the context of rising oil price in the world, the short supply has caused rationing problem in some areas in China in August 2005.

China's Energy Security and the East China Sea

The implications of a serious disruption in China's energy import supply are severe. The greatest concern is that it could stall China's economic development plans, leading to unemployment and social unrest. At present, China's over-reliance on Middle-Eastern oil makes it feel particularly vulnerable. Two-thirds of China's total oil imports which exceeded 100 million tons in total in 2003 originate from the Middle East. Due to the Middle East's politically unstable landscape, China is concerned that any threat of war or further outbreak of terrorist activities in the Middle East would affect the oil (and gas) output from the region.

In response, China has adopted five measures to mitigate foreign dependency. These include a reduction of excessive waste and improved

[1] The Chunxiao site is located N 28 degree 10'-40' and E 124 degree 50' and E 125 degree 20'. Total area of the site is about 22,000 square km. It is only five kilometer away from the "middle line," but about 600 km to Japan's Kyushu. It is about 400 km to China's Zhejiang Province.

consumption efficiency; a diversification of energy supplies[2] and a reduced reliance on imported energy supplies; innovations of new energy sources to reduce reliance on oil consumption; raising the ratio of other energy sources such as liquid natural gas, hydropower, solar power energy, and nuclear power; and finally, to introduce foreign capital and technology to accomplish the above stated goals. China's activities in the East China Sea are thus part of its strategy to reduce reliance on imported energy. China has high expectations pinned to the East China Sea, which is believed to be rich in oil and gas. China estimates that reserves of crude oil and natural gas stand at 25 billion tons and 8,400 billion cubic meters respectively, and the crude oil reserve is believed to be equivalent to eighty times that of China's oil consumption in 2004. The significance of the findings and China's aggressive quest for energy security therefore goes a long way in explaining why warships were sent to patrol China's Chunxiao oil site.

Based on the geographical proximity and similar geological structure, Japan has argued that it shares with China the same source for crude oil and natural gas in the seabed. Japan is concerned that China could siphon away those oil and gas on Japan's side of the territory and has thus requested China to provide related geological structure information and data to Japan. China's position concerning the dispute over the East China Sea median line with Japan has been straightforward. It does not recognize the median line which, China charges, was drawn unilaterally by Japan without negotiation with the Chinese. If the median line is not legitimate, the crude oil and natural gas delivered at the eight sites thus belongs to China. In any case, China argues that the Chunxiao site is situated on China's side of the median line which Japan has drawn. Accordingly, Beijing has no obligation to provide Tokyo any information requested.

Despite the Chinese hard line, Beijing has entered into talks with Tokyo over this issue. However, the outcome of such talks remains unclear. While three rounds have taken place, no concrete progress has been made except agreement for continuing dialogue. It is also likely that the strained Sino-Japanese relations, in particular, over Japanese Prime Minister Koizumi Junichiro's continuing visits to Yasukuni War Shrine would make any settlement improbable anytime soon. In the midst of Japan's protest and continuing talks, the Chunxiao site is expected to deliver gas to China by the end of 2005. The Chinese naval fleet's activity

[2] As a means to increase and diversify suppliers, Beijing has also actively sought to engage in energy projects outside the Middle East, in Central Asia, Africa, Canada and Latin America.

in the area is thus a timely demonstration of force ahead of the beginning of gas delivery at the Chunxiao field.

A Growing Point of Conflict in East Asia?

Seeking a secure long-term energy supply has become part of China's strategic policy. In addition to securing energy imports and improving energy efficiency, China has also taken to modernizing its naval fleet, as a means to protect its energy interests. It has been reported that in recent years, every Chinese shipyard has been operating in full capacity, and that new naval warships are among those being built. There is no doubt that the Taiwan issue presents a strong call for the increase in the production of military hardware.

However, China's military goal is beyond the Taiwan issue. The rising oil demand is likely to bring the protection of maritime oil sites into consideration. Having recognized that energy supplies is the grease for its economic engine, China cannot afford to have its energy supply disrupted for fear of a stalled economy leading to social unrest. Under this circumstance, building sufficient warships to protect oil sites (and shipping lanes) against potential disruptions is one of the strategies the Chinese government has pursued.[3] The concern is that as China rushes to secure its own energy security, friction between Japan and China over energy resources in disputed territories, which is presently framed as a zero-sum game, may spillover into the other areas of tension between the two countries.

[3] The Chinese government is also looking into other conflict prevention and management options.

China's Energy Security and Its International Relations[†]

Zha Daojiong (查道炯)[*]

Contemporary China began with an ambitious goal of rapid industrialization and modernization but a very low base of oil production and consumption. In 1959 China's crude oil production stood at 3.73 million tons (Mt). It was only in 1963 that China ended its century of dependence on imported oil and oil products. In that year, the Daqing oil field in Northeast China produced 4.3 Mt of crude, making up the bulk of the 6.48 Mt of nationally produced oil. From the 1950s to the early 1970s, China was self-sufficient in energy. But its international relations prevented that self-sufficiency from serving the country's goal of economic and social development. Soviet supply of oil and technological assistance for developing the oil industry in China were critical for China to reach its level of self-sufficiency. However, along with the termination of Soviet aid program in July 1960, China found itself having to devote much of its energy resources to prepare for war with a major power. In addition, the U.S.-led comprehensive embargo, which began in 1950, did not end until the Sino-American rapprochement in 1971.

In other words, for two decades China had self-sufficiency under strained international circumstances. A country has meaningful energy security only when its management of balance in energy supply and demand serves the purpose of developing its economy and society well. But by mid-1970s, the Chinese economy was on the verge of collapse. China had energy self-sufficiency but not energy security. Improvement in China's international relations in the early 1970s began an era of China moving to lose its self-sufficiency in energy but improving its energy security. Energy, particularly oil and coal, became a primary export commodity for China, in exchange for industrial plants and technology from developed countries. Japan topped the key destinations for Chinese oil and coal exports. Indeed, oil and coal served a valuable strategic purpose for China to re-open its economic linkages with the industrialized world economies. In addition, China took advantage of the first international oil crisis by

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[†] This paper is a slightly updated version of a paper, under the same title, presented to the Third IISS Global Strategic Review, Geneva, 16-18 September 2005.

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exporting crude oil to Thailand, the Philippines and other Asian countries as part of its drive to cultivate a favorable regional environment for modernization.[1] China continued to export crude oil to Japan according to negotiated annual quotas until 2004. In short, Chinese export of oil earned China the much-needed hard currencies for importing equipment and technology for developing its export-oriented economy, which in turn has proved critical for developing the Chinese economy and society.

The volume of China's crude oil exports peaked in 1985, reaching 30 Mt. Slower growth in domestic production coupled with growing levels of domestic demand contributed to the decline in Chinese oil export. China began to import crude oil from Oman in 1983, originally as a temporary measure for dealing with domestic transportation bottlenecks in moving crude oil from northern China to refineries located along the upper stretches of the Yangtze River. In 1988, due to increased demand, Chinese imports of crude and processed fuels began to rapidly rise. In 1993, China became a net oil importer of oil products and in 1996 China became a net importer of crude oil. The rest is history.

Since China lost its self-sufficiency in oil supply, China's access to oil imports has not been interrupted for politically motivated reasons. There have been no reported incidents of embargos being imposed by an exporting country or a third party. The only event that might have threatened the transportation of foreign oil to China's shores was the 1993 *Yinhe* (Galaxy) ship incident. The Chinese *Yinhe* container ship was the subject of a forced inspection by the United States in the Persian Gulf because it was suspected of carrying precursors and chemical production equipment on route to Iran. The incident concluded without there being any interruption to the Chinese import of oil from Iran. In 1993 China's import of crude from Iran did see a significant drop in comparison with the 1992 level, but the annual volume of the oil trade between China and Iran had previously been volatile (see Table 1).

Table 1. Chinese Import of Crude Oil from Iran, 1989-1994 (10,000 tons)

Year	1989	1990	1991	1992	1993	1994
Volume	26.62	30.12	5.50	11.50	6.79	6.90

Source: Chinese Customs Statistics

[1] Other key destinations included the Philippines, Thailand, Romania, and Hong Kong. See A. Doak Barnett, *China's Economy in Global Perspective* (Washington, DC: The Brookings Institution, 1981), 461.

Chinese concerns about oil supply security became widespread in 2000, when the volume of China's oil imports almost doubled from 36.6 Mt to 70.2 Mt (see Chart 1). The dramatic rise in import volume had several causes. First, domestic crude production was insufficient for consumption. Second, China's oil refining capacities had significantly improved, making it possible for China to import more types of oil for refining. Third, in June 2000 China began to reform its pricing system for processed fuel by pegging the domestic sales price level to that in the Singapore commodity futures market. This reform led to four separate increases in domestic oil prices within six months. The higher sales price encouraged Chinese oil refineries to increase imports, amidst concerns about supply interruptions worldwide. Fourth, China's customs statistics more accurately reflected the actual volumes of oil imports, thanks to a nation-wide campaign against oil smuggling between 1998 and 2001.[2]

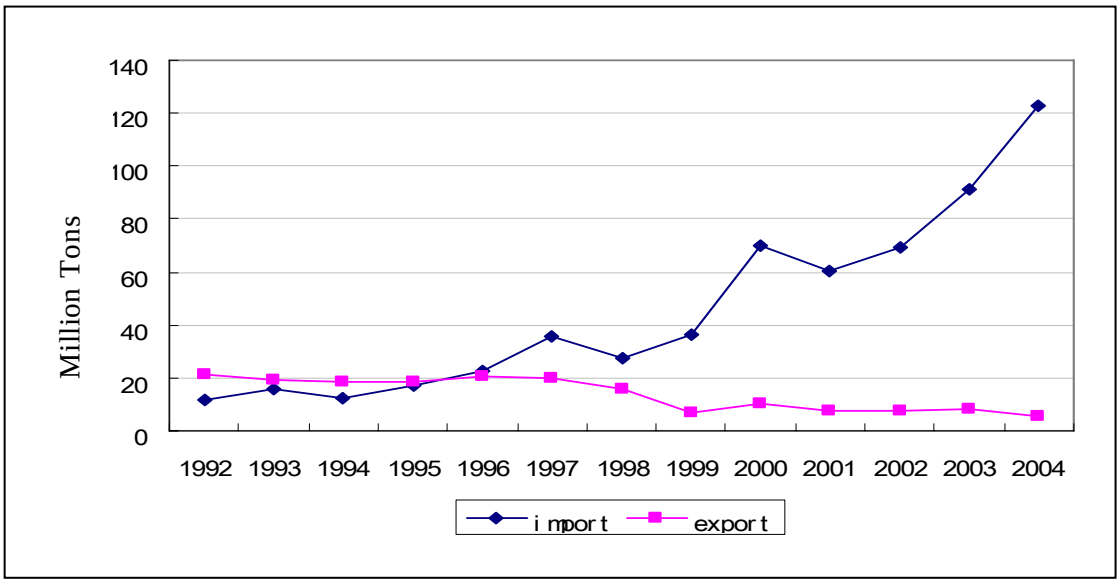


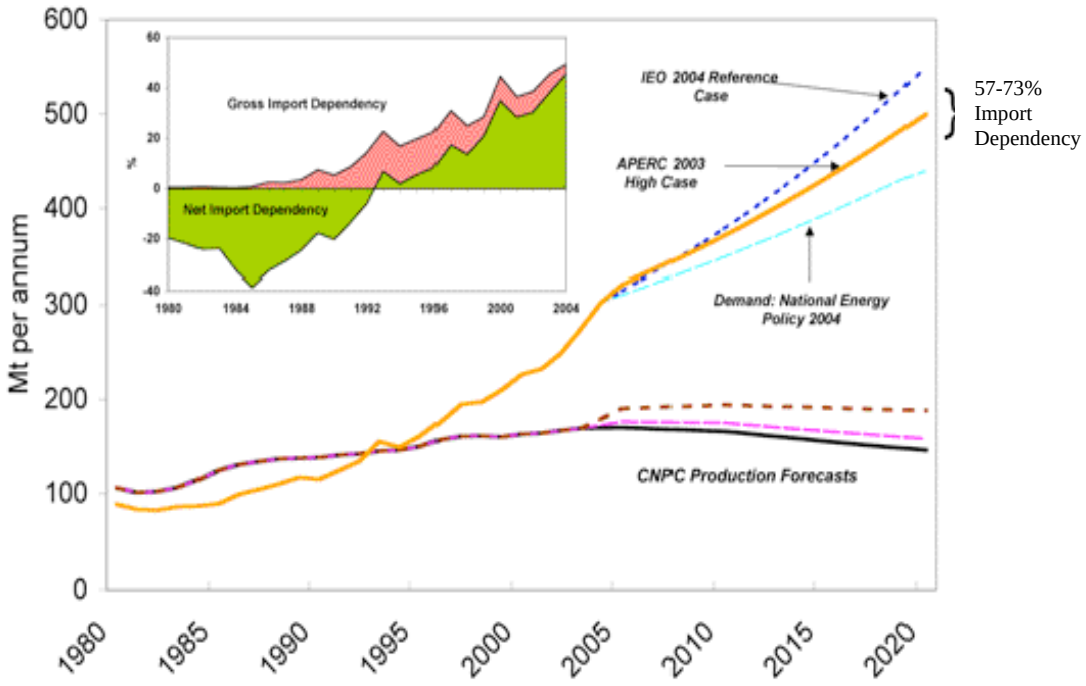
Chart 1. China's Crude Oil Import and Export, 1992-2004, Source: Chinese Customs Statistics

Coupled with interest in the rapidly growing levels of China's oil imports and their broader impact, international attention began to turn to Chinese oil companies "going abroad," i.e., acquiring concession rights in foreign oil fields. Chinese oil companies first entered the upstream of the international oil market in 1993, when a subsidiary of China National Petroleum Corporation (CNPC) bought the Talara Block in Peru for $25 million. Since then, Chinese oil companies, principally CNPC, have entered into an array of overseas oil investments. However, as a RAND

[2] Tian Chunrong, "Analysis of Oil Import and Export in 2000," *International Petroleum Economics*, (March, 2001): 6 (original in Chinese).

study concludes, "CNPC's foreign oil exploration and development projects are moving slowly and probably will not produce enough oil to offset China's projected growth in oil imports over the next 20 years. Furthermore, transportation and logistical costs may well prevent most of the oil produced in China's overseas oil fields from entering China. This oil will most likely be sold on the international market or swapped for other oil that would enter the Chinese market."[3] Research on China's energy market changes and future possibilities has become a highly prolific industry both in China and internationally. The associated issues are numerous. There is, however, convergence on one conclusion: no matter how China plans and carries out its energy policies, dependence on imported oil will have to continue. [4] There is also convergence over the view that domestic oil production will stagnate. China therefore will have no choice but to rely on imported oil accounting for a growing proportion in its total oil consumption to satisfy the demands of its economic development (Graph 2).

Graph 2. A Projection of China's Oil Production and Import Dependence



Source: Jonathan E. Sinton, et al, *Evaluation of China's Energy Strategy Options* (The China Sustainable Energy Program, May 2005), 5.

[3] Erika Downs, *China's Quest for Energy Security* (Santa Monica, CA: Rand, 2000), 22-23.
[4] Development Research Center of the State Council, National Energy Strategies and Policies, 2003 <http://www.efchina.org/documents/Draft_Natl_E_Plan0311.pdf> (November 1 2005).

The accuracy of this and other projections is not the key issue here. What matters are the conclusions that should be drawn concerning China's energy security. In terms of historical experience, China's security was under threat in the 1950s through the 1970s. Embargo from both land and sea at the same time contributed to a policy of self-reliance in overall economic policymaking. Since the early 1970s, when China launched its modernization drive, domestic energy reserves soon became insufficient for meeting demand. Gone is the era of energy independence for China. Also gone for China is the viable application of self-reliance as an ideology guiding its energy policymaking. China's dependence on overseas consumer and technology markets means it has no choice but to learn how to live in a world of interdependence.[5]

As such, at the turn of the new century, as far as China is concerned, the concept of energy security has to be seen in terms of economic threats and market solutions rather than in terms of military threats and diplomatic responses.[6] Indeed, China's sources of oil imports have been diversified. China does rely heavily on the Middle East for its supplies (see Table 2 below). But the possibilities of a politically motivated embargo against China by a Middle Eastern exporting country remain low. There are several reasons for this optimism. First, China has pursued a balanced foreign policy toward the long running Arab-Israeli conflict in the region. This reduces the possibility of Arab oil exporters joining hands to blockade against China. Second, China, by way of opening talks with the Gulf Cooperation Council member countries toward establishing a free trade area, has moved from singly focused on obtaining oil supplies to enlarging the scope of economic exchanges with key oil exporting countries in the Middle East. Deepening of economic ties implies that Middle Eastern countries will have to consider the losses to their own economies in considering punitive actions against China in the area of oil supply. In short, growing levels of interdependence between China and the Middle East serves as a useful warrant against blockade against China.

In the mid-stream of Chinese oil importing, there is no clear threat of a transportation embargo against China. The risk of a military conflict across the Taiwan Straits involving the United States has been existent for decades. The worst-case scenario is that the United States repeats its policy of the 1950-1970 period by organizing China's maritime Asian

[5] Zha Daojiong, "Interdependence and China's Energy Supply Security," *World Economics and Politics*, 298 (June 2005): 15-21 (in Chinese).

[6] For this distinction, see Dennis O'Brien, "Mightier than the Sword," *Harvard International Review* 19, 1 (Summer 1997): 8-13.

neighbors to launch a comprehensive blockade against China, in the event of the Chinese mainland initiating a military attack on Taiwan. Nonetheless, as China's economy becomes more deeply integrated into the regional production chain, the associated costs of launching such a blockade are increasing as well. Economic interdependence again serves as perhaps the single most powerful deterrent against an embargo or blockade by China's neighbors.

To sum up, China has lost its self-sufficiency in energy, particularly oil and gas. But in terms of traditional military-related risks, the possibility of a risk turning into a threat to China's energy security is getting lower, thanks to the forces of economic globalization. As long as China does not initiate a military conflict with Taiwan or its neighbors, particularly its maritime neighbors, the primary actor in maintaining the stability-based security China has enjoyed for the past three decades is China itself, not an external actor.

China's Structural Weakness in Managing Energy Security: Governance

On an everyday basis, the key energy security risk for China is to manage its demand, which is as important as, and indeed more important than, securing adequate foreign supply. China accounted for nearly 40 percent of the increase in world demand for oil in 2004. Most estimates conclude that energy efficiency in China has worsened since 2001. High oil prices directly cut into profits in the Chinese economy and force the Chinese government as well as oil companies to pursue more aggressively international sources of supply, both short term and long-term. This in turn drives up international apprehension about China draining an already tight international oil trade market. In short, China is paying a growingly high price for being the central party in this vicious cycle.

In 2005, the Chinese government again launched a comprehensive campaign for curbing consumption, with improving consumption efficiency as the centerpiece of its stated strategy. International media analysis was quick to cast doubt on the prospects of such plans.[7] As a matter of fact, China has had great difficulty in finding an appropriate mechanism for governing its energy industry. A case in point is the frequent re-formation of its energy ministries since the founding of the People's Republic. China's Ministry of Fuel Industries was abolished in 1955, when separate ministries for coal, electricity, and oil were established. Then in 1970, a new Ministry of Fuel and Chemical

[7] Geoff Dyer, "China on mission to quench thirst for petrol: The need to restrain energy use has become imperative, but doubts persist about the efficacy of Beijing's plans," *Financial Times*, June 29 2005, p. 9.

Industries combined the functions of those three ministries, but it had to be dissolved five years later. In 1988, a Ministry of Energy was launched to oversee coal, oil, nuclear and hydropower development, but it was again dissolved in 1993. Since 1993, the country has lived without a ministerial-level agency devoted to the country's energy development. The absence of a central government level ministry to oversee the country's energy development policies greatly reduces the value of strategic plans the central government intends to implement. Frequent changes to and confusion in the lines of authority in energy development policy also created great difficulties for foreign participation in the Chinese energy markets.[8]

It was not until 2002 when industry experts began to call for the strengthening of the macro-management of China's energy system.[9] Widespread public discussions about the wisdom of decentralized energy management did not emerge until later the year, when concerns about United States military action in Iraq and its impact on Middle Eastern oil exports began to concern Chinese society.

Today, China still does not have a ministerial level agency to oversee the country's energy development. While it is wishful thinking to expect such an agency to magically transform China's energy industry, the fact is that in "a quasi-market economy, energy issues must reach the top of the policy agenda to meet China's ambitious goals. This emphasis on government leadership reflects both China's tradition as a planned economy and current interests of major economic players."[10] In other words, the Chinese government must learn how to guide its various vested interests in the domestic energy market for its announced policy goals to be successful. In the oil sector, two large state-owned companies, CNPC and China National Petrochemical Corporation (Sinopec), continue to enjoy a monopoly of the domestic upstream and downstream markets respectively. The third largest Chinese oil company is the China National Offshore Oil Corporation (CNOOC), whose domain of activities is to develop oil and gas resources in China's exclusive economic zones. It was only after China began to implement its obligations under WTO rules that the government began to quicken the pace of reforms to open the oil industry to competition. China does have a regulatory commission for the electricity industry but no similar

[8] Such difficulties are partially discussed in Zha Daojiong, "Changes in China's Electricity Industry Governance: implications for energy cooperation in Northeast Asia," *ERINA Report*, 42 (October 2001): 31-37.

[9] Pan Wei'er, "A Discussion about Our Country's Energy Management System," *China Energy*, (September 2002): 9-12 (in Chinese).

[10] Jonathan E. Sinton, et al., *Evaluation of China's Energy Strategy Options* (The China Sustainable Energy Program, May 2005), 4 <http://china.lbl.gov/publications/nesp.pdf> (November 1 2005).

agency to oversee oil, gas, and coal development. The proper independence of a regulatory agency also poses a challenge. As analysts of China's energy policy environment have pointed out, the skewed nature of China's energy industry levies heavily against the country's economic and social interests. It is fair to say that the threat from ineffective energy industry governance is probably as great as that from the international energy market.[11]

The issue of energy industry governance is critical for the future evolution of China's energy sector. For example, if a level of energy independence is a key strategic objective, then the trajectory of China's nuclear power industry development does not demonstrate any significant attempt to achieve that aim. Nuclear-generated electricity accounts for a miserable 1.4 percent of China's total power supply, compared to a 16 percent average for developed countries. It was only in 2004 that China decided to quicken the pace of nuclear power construction.[12] China does not have to look far from its borders to learn about achieving independence in power supply. South Korea, a country that is totally dependent on offshore sources of energy, has managed to have forty percent of its electricity consumption met by nuclear power.

Today, development of nuclear power in China can have a particularly profound bearing on China's energy consumption and by extension the pressure China presents on the world energy market. China's coastal cities are the main driving force of industrial activity in China and therefore are also the major consumers of energy. There will be significant dividends when these areas—which are naturally suited for nuclear energy supply—become dependent on nuclear energy supplies. China's coal reserves are located in the north, making transportation to the southeast and south a serious bottleneck.[13] Nuclear power construction requires strong and consistent national-level leadership and resource commitment. It is naïve to expect provincial government leadership, which survives by producing instant high GDP growth figures, or corporate actors to foot the bill for providing an essential public good for the country's development.

Another area of China's energy industry that requires serious improvement in governance is the coal industry. "Coal as the primary" is both a reality of Chinese energy supply and a national energy industry

[11] Philip Andrews-Speed, *Energy Policy and Regulation in the People's Republic of China* (Hague: Kluwer Law International, 2004).

[12] "China's nuclear electricity to hit 36 mln kw in 2020," *People's Daily*, September 1, 2004 <http:// english.people.com.cn/200409/01/eng20040901_155568.html> (November 1 2005).

[13] The World Bank noted this challenge soon after it began operating in China. See, the World Bank, *China: the Energy Sector* (Washington, D.C.: World Bank, 1985).

strategy.[14] China is not just the world's largest coal producer and consumer but also the country where the largest number of deaths in mine accidents occurs, in addition to the heavy environmental costs that are also incurred. In order to put a stop to the "race to the bottom" trend in lack of investments in coalmine safety, the government must intervene in the interest of the coal miners and that segment of the population affected by coalmining. It goes without saying that in order for China to address its environmental challenges and be a responsible actor in combating global warming, it must deal with the challenge of its energy governance head on.[15]

The Chinese government has certainly proved itself to be inefficient in making decisions on energy policies aimed at encouraging conservation. For example, going back to 1996 the government controlled media endorsed calls for creating a fuel tax.[16] After nearly a decade of academic and public discussions, including debates in the national people's congress, China is still waiting for the "opportune" time to actually establish such a tax. In short, runaway growth in energy consumption, i.e., growth in total amounts of energy consumed without significant improvement in efficiency, is posing a real threat to China's energy security. To address inefficiency, there has to be changes to China's policy instruments and mechanisms of the Chinese energy industry. Without significant improvement in Chinese energy governance, China cannot hope to get out of the vicious cycle in the world energy market it is in today.

Energy and China's International Relations

China today is on the defensive when it comes to the international reaction to the Chinese pursuit of supply security through the exploitation of offshore sources of energy, particularly oil and gas. The state of affairs is in some ways a repetition of the Japanese experience in the 1970s and 1980s, when the pursuit of high economic growth by going global led to serious debates about the impact of Japan on the world economic and political structures. A critical difference here though is that China is not regarded as a "like-minded" country, in the way that Japan was, when it comes to the international structures established for managing the world economy. For example, China has only just begun to

[14] See International Energy Agency (IEA), *Coal in the Energy Supply of China* (Paris: IEA, 1999).

[15] For an overview of China's environmental challenge, see The World Bank, *Clear Water, Blue Skies: China's Environment in the New Century* (Washington, DC: The World Bank, 1997).

[16] Liu Aihong, "How about Levying Fuel Tax instead of Road Tax?" *Liaowang*, 37 (September 1996): 22-23 (original in Chinese).

participate in the G8's dialogue mechanisms for developing countries, whereas Japan was, from the start, a participant in the process of consultation among the most developed countries. The structural gap between China and the major industrialized powers of the world is significant for us to put difficulties in China's energy-related international relations in perspective: lack of symmetry in policy dialogue contributes to misperception and even undue apprehension about future prospects.

International concerns about how China's economic growth will translate into geopolitical clout are an integral part in the lack of symmetry in China's overall international relations with the major powers of the world. China's search for overseas oil supplies has led the Chinese government to pursue close diplomatic ties with Iran, Sudan, Uzbekistan, and Venezuela. These are countries that pursue questionable domestic policies and in many cases foreign policies in defiance against American and European interests and/or preferences. The situation leads to concern about the strategic intent behind China's oil- and gas- related diplomacy. As one article on China's oil diplomacy questions: why is China seemingly working to challenge the interests of industrialized countries in North America, Europe, and Northeast Asia, while logic tells us oil should serve as a linchpin of closer relations instead?[17]

As mentioned earlier, for over a decade China has lived without a central ministerial agency to oversee the country's energy industry. This makes it difficult to ascertain whether a particular oil/gas venture overseas is the result of the Chinese government dictating its state-owned energy company to carry out a governmental mission or the domestic energy industry seeking diplomatic assistance from the government. In any case, the Chinese government has to be responsible for its foreign policy actions. It should be noted that Chinese energy companies have a short history of managing the political risks in venturing into an overseas market. It should also be noted that the international energy market has not been generous to intended entry by newcomers. For example, in 2003 both CNOOC and Sinopec were blocked from participating in the development of an oil field in the Caspian Sea after the existing partners decided to increase their own stakes.[18] When one views such developments from a strategic perspective based on China's interests, a question arises: where can Chinese oil companies go and not incur either political or business, or both, obstacles from the international community? Meanwhile, the political question the international community poses for China is how China matches its commercial power

[17] Amy Myers Jaffe and Steven W. Lewis, "Beijing's oil diplomacy," *Survival* 44, 1 (Spring 2002): 115-133.
[18] "China Oil Giant Dealt a Setback," *New York Times*, 13 May 2003, p. C9.

with responsibility? The above review tells us that the challenge is for China and other leading consumers of the world's energy resources to learn to work together to cooperate in defining and addressing the political and social challenges that arise in many of the oil states of the world.

The Middle East has been and is likely going to continue to be the largest source of energy supply for China (Table 2). At the industry level, the oil refining industry in China faces the challenge of coping with expanding crude oil imports, increasing processing volume for Middle East high-sulfur crude (sulfur content of 1 percent or more) and improving the quality of oil products with the increase in domestic demand for petroleum products.[19]

Table 2. China's Sources of Crude Oil Import by Region, 1999-2004 (in percent)

Year	1999	2000	2001	2002	2003	2004
Middle East	46.1	53.5	56	49.5	50.8	45.4
Africa	19.8	24.1	22.4	22.7	24.3	28.7
Asia Pacific	18.6	15.1	14.4	17	15.2	11.5
Europe and Western Hemisphere[20]	15.4	7.2	6.9	10.6	9.5	14.3

Source: Chinese Customs Statistics

The one lesson that China has not yet learned, in sharp contrast to Japan after the oil crises of the 1970s, is the need to massively increase its capacity to process heavy oil from the Middle East. This means that China for some time to come will have to rely on selective brands of oil from the Middle East, thereby leading to a tight supply market in the lighter types of crude oil around the world. In addition, along with the expansion of China's oil refining capacity, the Chinese market would then be able to consume a larger portion of high-sulfur oil from the Middle East. In either case, Chinese dependence on Middle Eastern oil will grow.

Since the 1980s, China's pursuit of relations with the Middle East has been a contentious issue with the United States. China is routinely accused by the United States of selling weapons in exchange for oil and

[19] Guo Sizhi, *Oil Refining Business in China* (Japan Energy Economics Institute, May 2005) <http://eneken.ieej.or.jp/en/data/pdf/285.pdf> (November 1 2005).

[20] Note: Russia, Kazakhstan, Brazil, Argentina, Venezuela and Norway are recorded as 'Europe and Western Hemisphere'.

thereby undermining the global campaign against the proliferation of weapons of mass destruction. China's behavior over the two Iraq wars indicates that China does have shared interests with the United States and other powers in supporting stability in the Persian Gulf region. That shared interest is to keep Middle Eastern oil flow to the rest of the world, even when it means a heavy U.S. military presence in the region.[21] In the more recent years, China has become more active in Middle Eastern affairs. Securing energy supply is a primary objective.[22]

In the Middle East, China and the United States seem to be on a political collision course over China's pursuit of oil supplies from Iran. For example, in 2004, Sinopec, which accounts for over eighty percent of Chinese oil imports and is the single most important refiner in China, continued with its bidding for developing 16 Iranian oil fields in spite of attempts by the United States to persuade it to drop out of the race. This episode, while still unfolding, underscores the seriousness of Sino-American differences.

In 2005, the Bush administration responded to what it sees as a continued Chinese challenge to American efforts to contain Iran by supporting India's pursuit of nuclear energy while maintaining its sanctions against Chinese acquisition of the same technologies.[23] Such policies may produce unintended consequences by giving weight to voices in China that see politically motivated diplomacy as the ultimate instrument for securing China's oil supplies.

It is true that the Shanghai Cooperation Organization (SCO) granted Iran, together with Pakistan and India, observer status in 2005. In contrast, while the United States has wanted to be formally involved in the SCO process, it has not been granted such status. It is also true that the SCO is one of the regional organizations that China actively supports as part of its "new security concept", which emphasizes the importance of consultation and cooperation as a means for achieving security with its neighbors. But it should be noted that inclusion of Iran in the SCO framework does not necessarily mean a deliberate challenge to U.S. interests and dominance in the Persian Gulf and the wider Middle Eastern region. After all, to have Iran in the SCO is meaningful for the organization to be effective in combating terrorism in Central Asia, which has a direct bearing on China. A possible compromise would be to

[21] Toshi Yoshihara and Richard Sokolsky, "The United States and China in the Persian Gulf: challenges and opportunities," *The Fletcher Forum of World Affairs* (Winter/Spring 2002): 69-75.

[22] Jin Liangxiang, "Energy First: China and the Middle East," *Middle East Quarterly* 12, 2 (Spring 2005) <http://www.meforum.org/article/694> (November 1 2005).

[23] Steven R. Weisman, "U.S. to Broaden India's Access To Nuclear-Power Technology," *New York Times*, July 19, 2005, p. A1.

include the United States, China, Iran and other key partners for the purpose of building regional consensus to address Iraq and Afghanistan, and then turn it into a regular forum for the purpose of reducing animosity.[24] Indeed, if the North Korean nuclear crisis leads to considerations of a Northeast Asian Regional Forum, there is no reason why the same idea cannot be applied to the Middle East and Central Asian energy-security regions too.

China shoulders a good part of the blame for the current state of affairs because it has been very poor at making its energy transactions with countries such as Iran and Sudan transparent. Lack of transparency fuels speculation that China has a well-coordinated project of countering U.S. influence, particularly when it comes to dealing with what the United States labels "rogue states."[25] For example, there is little information about CNPC's Sudan operation except that it started as a four-way joint venture involving Canadian, Malaysian, and Sudanese oil companies. Only through off the record interviews can one learn that a small fraction of CNPC's Sudanese oil production gets transported back to China due to its high level of sulfur. The majority is sold in the international markets.[26]

In addition, international energy companies have tried hard to enter the Chinese markets but met with varying levels of difficulties. Out of frustration grew imaginations about China doing all it can, and doing it alone, to protect and expand its acquisition of oil reserves worldwide. Lack of synergy in business cooperation between Chinese and international oil corporations has led to high profile competition for access to international oil fields. The clash of business interests between Chinese and international oil majors becomes political when an international oil major seeks political assistance from their home government. CNOOC's competition with Chevron-Texaco for Unocal is the latest case that may have long-term geopolitical ramifications for Sino-American relations. [27]

Central Asia is another region where images of a new "Great Game" easily re-emerge due to China's thirst for oil and gas. At present, the only

[24] James Dobbins, "Iraq: winning the unwinnable war," *Foreign Affairs* 84, 1 (Jan/Feb 2005): 16-25. But Robbins does not suggest a more permanent forum.

[25] Borzou Daragahi, China Goes Beyond Oil in Forging Ties to Persian Gulf, *New York Times*, 13 January 2005, p. C8.; Howard W. French**,** "China in Africa: All Trade, With No Political Baggage," *New York Times*, 8 August 2004, p. 1.

[26] Author interview with a CNPC researcher, Beijing, July 10, 2005.

[27] Bernard Wysocki Jr. and Jacob M. Schlesinger**,** "For U.S., China Is a Replay of Japan; Washington Sees Parallels To '80s Battles With Tokyo, But Oil Changes the Stakes," *Wall Street Journal*, 27 June 27 2005, p. A2.

country in Central Asia from which China imports oil is Kazakhstan. The amount of oil involved is small (Table 3).

Table 3. Chinese Import of Crude Oil from Kazakhstan, 1999-2004 (in 10,000 tons)

Year	1999	2000	2001	2002	2003	2004
Import Volume	49.08	72.42	64.96	100.36	119.82	128.56
Percent of Total Import	0.013	0.010	0.010	0.014	0.013	0.013

Source: Chinese Customs Statistics

The oil pipeline under construction linking Kazakhstan and China may indeed have a geopolitical significance, since a bilateral pipeline binds the interests of the two countries together. Additionally, a successful experience in running the pipeline can serve as precursor to the realization of an eventual Eurasian pipeline network to China. By extension, China would be placed in a strategic position in deciding whether or not Eurasian oil and gas can pass through China to reach Japanese and South Korean markets.

However, Central Asia cannot be expected to play a significant role for China to meet its energy supply. Transporting Central Asian oil and gas to China's eastern and southern regions, where chronic energy shortages exist and where blackouts impose a heavy toll on economic growth, is against economic logic. This has been made clear by China's domestic West-East pipeline. When Xinjiang gas reaches Shanghai, it loses competitive value when compared with imported liquefied natural gas from such sources as Australia and Indonesia. Increased Chinese use of oil and gas from Central Asia can be helpful in altering the energy mix of China's northwestern provinces. This in turn is conducive to improving the environmental and atmospheric conditions in those localities, thereby providing an important public good for the rest of China and the entire Northeast Asian region.

China has in the past few years worked hard to improve its ties with Africa. This has included frequent visits to Africa by top Chinese leaders, increasing the Chinese profile in U.N. peacekeeping operations in Africa, the launching of a cooperation forum with Africa, and the offer of debt reduction to African states. China's differences with the United States in the United Nations over dealing with the Darfur atrocities in Sudan led to media speculation that China was "staking a claim" to Africa before America gains a stronger foothold in the region, especially the countries

around the oil-rich Gulf of Guinea basin.[28] Put in the broader context of Chinese diplomacy, the contention has to do with long-running Sino-American differences over economic sanctions as a diplomatic instrument. But clearly China also faces the challenge of doing its share to address questionable domestic policies in Sudan.

China's dependence on imported sources of energy is spreading Chinese economic and diplomatic presence to wherever there is spare supply. Out of this dependence arises the question of China's relations with the major powers in the world: how can China and the major industrialized nations co-exist with each other in the field of energy diplomacy? As a consumer country, China does not really have much of a choice in choosing its source of supply. Combined with the learning curve Chinese oil companies are going through as they interact with international oil majors in the Middle East, Central Asia, and Africa, contention between China and United States and its allies over China's pursuit of energy supplies can be expected to last for some time to come.

Conclusion

For China, dependence on foreign sources of energy supply is not in itself a threat to its energy security. Over the past two decades, the rest of the world has not attempted to use energy as a weapon against China's pursuit of growth and prosperity. A key source of threat to China's energy security is ever growing consumption in China without significant improvement in China's energy efficiency. China's energy security, meanwhile, is increasingly an international concern. At the market level, Chinese consumption has become an important determinant of change in the global economic scene. At the political-diplomatic level, the international community increasingly demands China to behave in politically acceptable and responsible ways in its pursuit of energy supplies. China must enhance its transparency in those government-business interactions associated with its pursuit of energy interests overseas, so as to increase the level of confidence the international community can have on China's geopolitical intents.

A sensible direction in policy interactions between China and the international community over China's pursuit of energy security is to make China's efficiency in energy consumption a priority area for international collaboration. Focus on energy efficiency in China is probably the single most effective way to prevent against the nightmarish scenario of China crowding out the global energy market, at the expense

[28] Karby Leggett, "Staking a Claim: China Flexes Economic Muscle Throughout Burgeoning Africa; Beijing Forges Deep Alliances With War-Torn Nations, Countering U.S. Influence; A Dam Gets Built on the Nile," *Wall Street Journal*, March 29 2005, p. A1.

of energy needs of both industrialized and industrializing countries. This focus should include working with China to improve its mechanisms for energy governance. In a nutshell, by giving priority to improving energy efficiency in China, the entire world can benefit from having a managed rise in Chinese demand for overseas oil and gas. It goes without saying that such an orientation is conducive to deepening interdependence between China and the rest of the world and thereby reducing the risk of more diplomatic clashes between China and major industrialized countries of the world.

The Dilemmas of China's Energy Governance: Recentralization and Regional Cooperation

Gaye Christoffersen[*]

Before 2003, Sino-Japanese-Russian energy relations held promise of multilateral cooperation, yet in the last two years, cooperation turned to competition as China and Japan promoted alternative oil pipeline projects to Moscow. The rivalry began with an oil pipeline from Angarsk, shifted to the East China Sea dispute over the Senkakus/Diaoyutai, and threatened to spread into further issues and spiral out of control. The image of Chinese competitive behavior was fueled by the Going-Out Strategy of the Chinese national oil companies—China National Petroleum Corporation (CNPC), China National Offshore Oil Corporation (CNOOC), China Petrochemical Corporation (Sinopec)—collectively referred to as the National Oil Companies (NOCs).

The way in which this intense rivalry coexists with ongoing discussions on energy cooperation requires some explanation. Japan offered a set of rules for competition and cooperation. Russia, which had originally spurred this Sino-Japanese rivalry, rethought the impact this would have on Russian long-term objectives for Northeast energy relations, and developed a pipeline project that would satisfy both Tokyo and Beijing. Chinese would eventually offer their own rules. Many pundits have noted the competition for energy resources while few have studied the simultaneous efforts at cooperation. The primary factor that allows cooperation and competition to occur simultaneously is the nature of the East Asian multilayered security order.[1] Japan and China maintain one layer for U.S.-China-Japan strategic competition, and another layer for Asian multilateralism and regional cooperation such as ASEAN+3.[2] Each layer is occupied by different sets of Chinese and Japanese actors with different foreign policy preferences.

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[1] Muthiah Alagappa, ed., *Asian Security Order: Instrumental and Normative Features* (Stanford: Stanford University Press, 2004).

[2] ASEAN+3 is a regional framework in the process of evolving into an East Asian community. Members include the 10 members of the Association of Southeast Asian Nations and the 3 Northeast Asian countries—China, Japan and South Korea.

This article will examine Sino-Japanese competition for Russian oil resources and the steps that were taken to manage the rivalry through the issuance of principles, norms and rules that would eventually form the basis of a regional regime.

The Struggle for Angarsk and Pipeline Routes

The concept of a Northeast Asian regional energy regime has a long history.[3] China, Japan and Russia, in what could be called a two-level bargaining game, each took a path towards regional cooperation that involved reconciling conflicting domestic interests into a national consensus, necessary before there could be a regional consensus. When Prime Minister Junishiro Koizumi announced in January 2002 that Tokyo intended to form an Asian Energy Community, using ASEAN+3 as the framework, he appeared to be in the process of forming an East Asian regional regime based on norms, principles and rules, that would create an "international public good," regional energy security, for all Northeast Asian countries. From 2002 to the present, the idea of an East Asian Energy Community has continued to evolve.

The year 2003 was a difficult time for those following the workings of Northeast Asian regional energy cooperation as endless meetings in Moscow by delegations from Beijing and Tokyo produced no agreement on the direction of oil and gas pipelines from Angarsk. Russia developed a plan for Siberian and Russia Far Eastern oil and gas resources but postponed decisions on pipelines. Japan's Ministry of Economy, Trade and Industry (METI) had announced in spring 2003 that a 10-year long-term energy policy that would consider alternatives to dependency on Middle Eastern supply would be finished by the summer. By September, Japan's plan was still not published because it was awaiting decisions made in Moscow. China had announced the formulation of an Energy Security Plan with Chinese Premier Wen Jiabao personally overseeing its prompt formulation, but domestic planning was contingent on regional energy plans and decisions made in Moscow. Each of these three countries had domestic plans requiring coordination with the other countries in a regional framework that did not exist in 2003.

Russia's domestic plan, Main Provisions of the Russian Energy Strategy to 2020, originally approved in November 2000, with a newer revised version approved May 22, 2003, seemed to settle Russian domestic priorities. However, the question of which pipeline to give priority to was not finalized in a clear manner at that time. It seemed to be a long, drawn-out convoluted process, mixing geopolitics with technical

[3] See Gaye Christoffersen, "Socialist Integration and Energy Regimes," *Pacific Review* 3, 1 (1990).

questions, with lots of simultaneous domestic and international bargaining. Moscow had conducted parallel negotiations with CNPC and the Japan National Oil Company (JNOC) during 2003 without a means to make the two dialogues coherent.

There were actually 3 proposals on the table:

1. Japanese proposal: Angarsk to Nakhodka 50 million metric tons (MMT) capacity with export possibilities to all of Asia-Pacific including the U.S. [preferred by Japan, Rosneft, and Transneft]; called the "northern route."
2. Chinese proposal: Angarsk to Daqing 30 MMT capacity, confined to China market [preferred by China and Yukos]; called the "southern route."
3. Russian Energy Ministry and energy experts' proposal: A compromise to combine Japanese and Chinese projects into one project that would first go to Daqing, and then when there was sufficient oil, extend to Nakhodka. Beijing was agreeable to the compromise but Tokyo was not.

The Chinese had thought that the feasibility study was finished, and that the Sino-Russian agreement that had been signed in Moscow in May 2003 was a final contract, but it was only a general agreement on basic principles signed between Yukos, a private oil company, and CNPC without a final decision by the Russian government on the pipeline feasibility study. According to Nezavisimaya Gazeta, controlled by Boris Berezovskiy, private Russian companies were required to act on their own because the Russian state continued to fail to formulate energy policy.[4]

Political struggles over the three proposals all took place within Russia—struggles over the Russian Energy Strategy to 2020, struggles between Transneft and Yukos, struggles between the Russian government and the Russian oil companies. In May 2003 the Russian Energy Strategy to 2020 had been "largely approved." It was originally reported to have an Angarsk-Nakhodka pipeline in it. Some reports claimed it included both projects. Thus the Russian government seemed to have opted for the compromise proposal. And yet everything depended on the unending feasibility study (or perhaps numerous feasibility studies) that after nine years still did not have closure. Transneft claimed the decision would be made 2 weeks after the energy strategy was final. Rosneft proposed that its gas pipeline be integrated with the Yukos oil pipeline in the southern route as a means to make the project more economically feasible.

[4] M. Borisova and P. Orekhin, "China will Grow on Russian Oil," *Nezavisimaya Gazeta*, May 29, 2003.

Rosneft, however, was more supportive of the northern route. Tyumen Oil Co. Manager Sergei Tulinov claimed, "A feasibility study has not yet been carried out for any project in the region and as there are no feasibility studies, there is no sense in talking about transport schemes."

The original rationale for a Sino-Russian oil pipeline years ago was that, because Sino-Russian trade driven by market forces had not expanded as expected, what it needed was a "mega-project" to "kick-start" bilateral economic and trade relations. The proposed pipeline became the mega-project. Why a nine-year feasibility study can never find closure is a consequence of both sides evolving away from planned economies, but not necessarily in coordination with each other, so that the concept of "economic feasibility" has different meanings over time. In the past, Soviet and Chinese planners would have worked out a mega-project without a cost-benefit analysis. However, unlike Russian and Chinese energy decisions made under the old systems, economic feasibility is a more important criterion than it was in the past.

Entering into the equation during summer 2003 was the "Yukos Affair," which came to be referred to as the "Kremlin versus Yukos war" and indicated a crisis in relations between the Russian state and business. Although there were much larger issues involved than the question of pipelines, this attack on Yukos made the southern route seem less viable.[5]

The pipeline became an issue for Primorski Krai in the Russian Far East during summer 2003. Primorye Governor Sergei Darkin, in trips to Tokyo and meetings with Japanese officials in Vladivostok, lobbied for the northern route. A Primorye delegation on a visit to Tokyo met with Japan's Foreign Minister, the METI Minister, and the Japan National Oil Corporation. Possibly as a result of his efforts, the northern route came to include an oil refinery in one of Primorye's ports. Although the decision would not be made in Primorye, the Japanese lobbied at all levels of government. A delegation from the Japanese Association for Trade with Russia and Eastern Europe (ROTOBO) and Keidanren visited in June 2003 to further economic links between Primorye and Japan. Governor Darkin expressed his distrust of Yukos, accusing the company of intentionally underestimating resources as a means of promoting the southern route.

Zolotoy Rog reported that the Russian public had little information about the choice of a Chinese or Japanese pipeline and believed that the Russian oil companies were withholding information. Conferences were organized by the krai administration and United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) to discuss local

[5] "The YUKOS Affair and the Consequences for Russia's Future," *Novoe Vremya*, August 24, 2003.

financial and environmental impacts of the project. In a July meeting between Russian President Vladimir Putin and Darkin, the Primorye Governor argued for the need for a political solution, which would define Primorye's future and integrate the krai into the Asia-Pacific.

In August 2003, a joint Russian-Japanese group began work on a feasibility study for the northern route with the promise the study would be finished by December 2003, remarkably fast given the nine years the Sino-Russian feasibility study had taken. The Russian Energy Ministry in late August 2003 asked the Chinese side to postpone the August 27-29 scheduled meeting of the Subcommittee for Energy Cooperation of the intergovernmental commission. The committee's agenda would have focused on the pipeline in preparation for the September 22 meeting between Prime Minister Mikhail Kasyanov and Premier Wen Jiabao. Officially the Ministry claimed the feasibility study for the pipeline was not yet finished, but also confirmed speculation that Moscow would shift to the northern route, not a decision the Ministry would have made, giving the appearance of a highly politicized decision-making process. Rather than being in control of the bargaining, Russians were worried that Russia was allowing itself to be a card to be played in a high-stakes geopolitical game between Japan and China.[6] Prime Minister Kasyanov signed the Russian Energy Strategy 2020 on September 5, and had announced on September 6, 2003 that further deliberations were needed on the pipeline decision.[7]

In early February 2004, the Russian Deputy Foreign Minister Aleksandr Losyukov announced that Russia was considering several options, not mutually exclusive, and would "give priority to its own interests when selecting which option to follow" rather than posing it as a choice between China and Japan.[8] Transneft presented a plan that it announced was a completely new export pipeline: it begins at Taishet, extends to Buryatia further away from Lake Baikal, and then follows the path of the earlier Angarsk-Nakhodka route. The pipeline would be 4,130 kilometers, transport 56 MMT/year, and have 32 pumping stations [13 will have storage facilities]. This Transneft plan had gotten the approval of local governments in Primorye, Khabarovsk, and the Amur region. An alternative plan had been drawn up by the Sakha Republic [Yakutia], Gazprom, Surgutneftegaz, and the Natural Resources Ministry. Their route would construct a single network, combining oil and gas pipelines,

[6] Yuriy Aleksandrov, "Japan Counterattacks: Intensity Rises in Battle between Two Asian Superpowers over Russian Oil Pipeline," *Nezavisimaya Gazeta*, August 22, 2003, in Foreign Broadcast Information Service (hereafter FBIS), CEP20030822000231.
[7] *Interfax*, September 5, 2003.
[8] *ITAR-TASS*, February 11, 2004, in FBIS, CEP20040212000278.

6, 224 kilometers, that linked all oil and gas fields in Yakutia, Irkutsk, and Krasnodarsk, ending in Nakhodka.[9]

On December 31, 2004, Russian Prime Minister Mikhail Fradkov approved the Taishet-Nakhodka oil pipeline without mentioning a branch to China. It appeared to be a clear win for Japan. However, when Japan and Russia held ministerial talks on the Taishet-Nakhodka pipeline in April 2005, unresolved historical issues, the northern territories issue, impeded further progress. In April 2005 Khristenko announced that there were two stages to construction of oil pipelines that would create a unified system across Eastern Siberia to the Pacific Ocean. The system would achieve two strategic goals: comprehensive regional development and diversification of energy export routes. This plan was presented as benefiting both China and Japan.[10]

The first stage goes from Taishet, Ust-Kuta and Kazachinskoye in the Irkutsk region to Tynda and Skovorondino in the Amur region. This oil would be shipped by rail to China's Daqing from Skovorodino. Work would begin in 2005 and finish in 2008. The second stage goes from Skovorodino to Primorye's Perevoznaya Bay, exporting oil to Japan and other Asia-Pacific importers. Japanese fear the oil will never make it to the Pacific port.

North-East Asian Energy Cooperation – Formulation of Rules

While Tokyo and Beijing competed for the pipeline, the Japanese press referred to a Sino-Japanese resource war over the pipeline.[11] At the same time, Japanese energy experts continued to strategize a regional energy regime. In July 2003, the Managing Director of the Institute of Energy Economics Japan (IEEJ), Tsutomu Toichi, pointed out that because of several trends—the insecurity of 9/11, increasing regional economic integration—Japanese energy policy was in transition, thus "...new energy security measures that include the greater Asian region are needed to replace those based on unilateral thinking."[12] Toichi argued Japan needed to coordinate energy policy with security policy, and coordinate energy diplomacy and environmental diplomacy. Japan needed to develop greater influence with Middle Eastern producers by building up cooperative relations with China, Korea, and Taiwan to increase the bargaining leverage of a Northeast Asian bloc. Oil and natural gas

[9] *Interfax Oil & Gas*, March 25-April 1, 2004.
[10] Alela Kornysheva and Evgenia Sokolova, "Russia has chosen an Eastern draw: Oil will flow both to China and Japan," *Kommersant*, April 29, 2005.
[11] *Kyodo*, August 27, 2003.
[12] Tsutomu Toichi, *Energy Security in Asia and Japanese Policy*. The Institute of Energy Economics Japan, July 2003 <http://eneken.ieej.or.jp/en/data/pdf/200.pdf_> (November 1 2005).

pipelines from the Russian Far East would also increase leverage with the Middle East.

His proposals included an Asian version of the International Energy Agency (IEA). He expressed frustration with the China-Russia negotiations for a pipeline as "mired in disagreements over selection of a pipeline route, pricing, and various other issues," which he claimed had led Russia to encourage South Korea and Japan to become more actively involved rather than passively waiting to participate in a Sino-Russian pipeline.[13] This suggests the motivation for the northern route pipeline is not simple Japan-China rivalry but rather a Japanese impatience in waiting for private companies, and concern that the southern route would undermine rather than support an East Asian multilateral energy regime.

Suspicion of Japanese intentions emerged in the popular Chinese press. In summer 2003, *China Daily* was openly referring to a Sino-Japanese rivalry for Russian oil, recognizing that Japan had lobbied heavily, and dangled financial incentives. The Chinese suspected that Japan was "playing on Russian historical fears of China." The newspaper referred to Governor Darkin's office as stacked with Japanese electronics, gifts from the Japanese lobbying for the northern route. Nevertheless, the Chinese had felt the southern route had the best chance because it was the most cost-effective and furthest along in planning.[14] *Jingji Cankao* claimed "Japan's muddling" in the Yukos-CNPC deal was testing China's energy strategy, which was still in the process of being formulated. Japan was at an advantage because it had a "matured energy strategy" and a strategic reserve of 172 days [China had not yet created a strategic reserve].[15]

In the midst of heated rhetoric in both the Chinese and Japanese press, the Institute of Energy Economics Japan published a paper in early 2003 stating the "rules of cooperation" for Northeast Asian energy cooperation meant to address the challenge of whether to cooperate or compete.

The IEEJ "rules of cooperation" for Northeast Asian energy cooperation were:

1. Cooperation should happen at the governmental level, with government support for markets and private companies, creating an even playing field for competition, which should happen at the business level. [cooperation-competition rule];

[13] *Ibid.*
[14] "Old Rivalry Flares as China, Japan Vie for Russian Oil," *China Daily*, July 13, 2003.
[15] Li Dingxin, "Fighting for Oil Pipeline Tests China's Energy Policy," *Jingji Cankao Bao*, August 8, 2003.

2. Every country must clearly recognize that each benefited from cooperation as all were in the same situation and in the same region. [regional identity rule];
3. Every country should take "equitable responsibility" if it were to obtain its share of benefit [the no free-rider rule];
4. Regional institutional design for cooperation must realize a win-win situation. [co-prosperity rule];[16]

At the November 2003 Northeast Asia Petroleum Forum, one Japanese analyst suggested additional rules that included the Angarsk issue:

5. Energy security through cooperation between East Asian and West Asian countries, between energy consumers and producers. [the rule of Northeast Asian unity in dialogue with the Middle East];
6. Preparation of energy infrastructure, especially in "continental inland region." [the rule regarding Northeast Asian infrastructure as an international public good];
7. Construction of an international framework covering the upstream to downstream supply network in East Siberia and Russian Far East. [the rule regarding Russian resources as an international public good];
8. Preparation of international rules as a foundation for work with East Siberia and Russian Far East. [the rule that Russian resource development would follow mutually agreed upon rules];
9. Strategic issues for regional cooperation: oil stockpiles; stabilization of crude oil prices and oil market; development of a Northeast Asian oil market. [the rule that oil is both a strategic and market issue];
10. Asia's three E's: energy investments must simultaneously promote economic growth, energy security and environmental conservation. [three E's rule];
11. Formation of a common perception among Asian consumer countries that would unite them in government and private sector policymaking.[17] [the rule regarding policymaking based on common identity].

[16] Kensuke Kanekiyo, Toward Energy Cooperation in Northeast Asia, Institute of Energy Economics Japan (March 2003) <http://eneken.ieej.or.jp/en/data/pdf/189.pdf> (November 1 2005).

[17] Yoshiki Ogawa [IEEJ], "Long-term Views and Strategic Issues on Oil Supply-Demand in Asia," Northeast Asia Oil Forum (Tokyo: November 2003), <http://eneken.ieej.or.jp/en/seminar/other/NAPF/NAPFrecords.htm> (November 1 2005).

Another presentation insisted that China, South Korea, and Japan were not mere competitors but had common concerns and goals including diversification of supply through projects such as Angarsk (both pipelines), and relations with the Middle East (Saudi Arabia and Iran). It proclaimed that co-prosperity in Northeast Asia was possible.[18] Still another Japanese presentation analyzed the Taishet-Nakhodka pipeline project as comparable with Sakhalin I & II projects, which would benefit all of Asia by increasing the region's bargaining power with the Middle East and consequently reducing the "Asian premium" for all Northeast Asian countries.[19]

Chinese participants at the November 2003 Forum offered principles, discussed achieving win-win solutions;[20] and implementing the "Going Out" Strategy further;[21] but it was unclear whether they contributed to rule formation for a Northeast Asian multilateral energy regime. Chinese have previously commented favorably on a Northeast Asian energy community but referred to the formula (regional division of labor) rather than specified rules for cooperation. Also with regard to Russian resources in this formula, Chinese analysts have stated "China has the geographical advantage to utilize the energy resources of these [Russian] adjacent areas,"[22] reflecting the principle of *zhoubian waijiao* [good neighborly relations] rather than abstract rulemaking for the region.

Chinese Lessons from the Angarsk Struggle

The Russian retreat from the southern route posed problems for Chinese domestic planning. China had put oil imports from the Russian pipeline into its five-year plan (2000-2005). During Hu Jintao's May 2003 visit to Moscow, Putin had expressed much optimism on future energy cooperation and partnership, but also seemed to distance the issue from

[18] Yasushi Kono [Nippon Oil Corp.], "From Competition to Co-prosperity," Northeast Asia Oil Forum (Tokyo: November 2003), <http://eneken.ieej.or.jp/en/seminar/other/NAPF/NAPFrecords.htm> (November 1 2005).

[19] Taro Shoji [Japan Petroleum Dev. Assoc.], "Energy Related Projects in Northeast Asia" Northeast Asia Oil Forum (Tokyo: November 2003),<http://eneken.ieej.or.jp/en/seminar/other/NAPF/NAPFrecords.htm> (November 1 2005).

[20] Shen Wenxiang [CNOOC], "Holding onto Opportunities, Enlarging Cooperation, Promoting the Development of China Offshore Oil Industry," Northeast Asia Oil Forum (Tokyo: November 2003) <http://eneken.ieej.or.jp/en/seminar/other/NAPF/NAPFrecords.htm> (November 1 2005).

[21] Zhao Houxue [Sinopec], panel "Present situation and development strategies of the oil industry," *Ibid*.

[22] Qingzhe Jiang and Lei Song, "Establishing a Northeast Asian Energy Community: China's Perspective," in *A Vision for Economic Cooperation in East Asia: China, Japan, and Korea*, Lee-Jay Cho *et al*, eds. (Seoul: Korea Development Institute, 2003): 226.

politics when he said "it is up to experts to decide on the construction of oil & gas pipelines from Russia to China and their routes." A few days later, Putin and Koizumi in St. Petersburg also talked energy projects.

In June 2003, China's oil strategy had required adjustment. The "struggle for Angarsk" challenged the "Going Out" Strategy and led Chinese to rethink whether the bilateral Sino-Russian strategic partnership could ensure Chinese energy security. This had followed several other incidents: CNPC was forced to give up participation rights in the auction of Russia's Slavneft company; CNOOC was shut out of the North Caspian Sea Project. Analysts argued that China would have to draw lessons from other major oil-consuming nations, the US and Europe, for methods for dealing with oil-producing nations, and change its oil strategy.[23] Criticism of the Going-Out Strategy was indirect criticism of the Chinese NOCs and their supply-side energy policies.

The Energy Research Institute (ERI) in Zhongguo Nengyuan [China Energy] promoted domestic strategies as the solution including energy conservation, clean coal technology, and optimization of energy utilization, as it has always done since the 1980s.[24] In May 2003, a report was initiated under Premier Wen Jiabao by the Strategic Research Group for Sustained Development of Petroleum in China.[25] In June 2003, another report by a different group mapped out a long-term energy strategy to be used for planning by the National Development and Reform Commission (NDRC). The report had identified ten new oil and gas development zones domestically. The research groups emphasized development of both domestic and international resources.[26] A meeting of the Chinese Society of Asia-Pacific Studies in August 2003 promoted the establishment of an East Asian energy community as a logical follow-on in regional institution building to the financial network already created.[27]

In September 2003, it was announced that China was "gradually formulating a brand new plan for its energy strategy" because the Angarsk-Daqing project was unreliable. A report, "China's Strategy on Sustainable Development of Oil and Gas Resources," was presented to Wen Jiabao. In November 2003, the publication Guoji Luntan published

[23] Zhou Yonggang, "China's Oil Strategy Needs to be Repositioned," *Zhonghua Gongshang Shibao*, June 3, 2003, p. 2, in FBIS, CPP20030709000153.
[24] Zhang Jianmin, "Sustainable Energy Strategy to Meet the Goal to Quadruple China's GDP by 2020," *Zhongguo Nengyuan* 25, 8 (2003): 1.
[25] Chen Ting, "Sino-Russian Oil Pipeline has Obstacles and Takes Time; China Initiates New Energy Strategy," *21 Shiji Jingji Baodao*, September 22, 2003.
[26] *Ibid.*
[27] Yu Xintian, "East Asian Cooperation in the Early 21st Century," paper presented at the Fifth Annual Meeting of the Chinese Society of Asia-Pacific Studies, in *Dangdai Yatai* 10 (2003): 3-9.

a piece which claimed that the struggle for Angarsk demonstrated that China's oil diplomacy lacked capacity to respond to crises. Suggestions for strengthening capacity all focused on greater integration with the world oil economy and strengthening cooperation with major oil-consuming states and international oil organizations by joining the IEA. All of this would augment China's capacity to withstand oil shocks.[28] Cooperation with Japan was presented by reformers as a source of solutions for Chinese energy conservation.[29]

At a November 2003 conference on "China's Energy Strategy and Reform," energy planners blamed the current crises on the abolishment of the Ministry of Energy a decade before. They felt the "petroleum crisis" demonstrated the need for a unified state institution to manage energy. The Energy Bureau established in March 2003 lacked authority and a clear mandate. It was not the strong institution needed.[30] The Energy Bureau had been examining other countries energy strategies for lessons. Chinese have expressed the view that Russian, American, and Japanese energy diplomacy and oil security strategies are more fully developed than China's, leaving China to face competition in an uneven playing field.[31]

By late 2003, Chinese contemplated responses to what was considered a looming oil crisis. The State Development and Reform Commission Minister, Ma Kai, stressed energy conservation, which had been officially promoted for 24 years but neglected in investment priorities that continually expanded supply instead. Energy conservation was now constituted as an energy security issue that required better state planning in the 11th five-year energy conservation plan.[32] Energy reformers criticized the planning approach, calling for the government to move from making project decisions to a coherent energy policy framework. [33]

In November 2003, the State Council's Development Research Center issued an initial draft of the National Energy Plan to senior leaders at the China Development Forum which proposed making energy efficiency a

[28] Gong Xuzheng, "Viewing China's Oil Diplomacy from the 'Angarsk-Daqing Line' Tussle," *Guoji Luntan* 6 (November 2003): 46-52, in FBIS, CPP20031217000209.

[29] Zhang Jifeng, "Chinese-Japanese cooperation in auto industry will create win-win situation, reduce competition for energy," *Guoji maoyi*, January 20, 2004, p. 32-36, in FBIS, CPP20040213000167.

[30] Wang Yichao, "China's Energy Woes," *Caijing*, December 10, 2003.

[31] Feng Yujun, Ding Xiaoxing and Li Dong, "Russia's New Energy Diplomacy and Its Impact," *Contemporary International Relations* 12, 10 (2002).

[32] Ma Kai, "Vigorously Push Forward Energy Conservation Work, Strive to Build Energy Conservation Society," *Jingji Ribao*, Nov. 4, 2003, p. 6, in FBIS, CPP20031110000135.

[33] Xie Ye, "Energy Sector Reform Urged," *China Daily*, Jan. 8, 2004.

priority in China's energy strategy.[34] This was a victory for demand-siders over supply-siders (the NOCs). The senior leaders endorsed the draft which then underwent revising for several months while the Chinese media aired many of the disputes.

Although China has always been dependent on the Sea Lines of Communication (SLOCs) passing through the Malacca Straits since it first started importing oil from the Middle East, it was in December 2003 that Hu Jintao mentioned a "Malacca Strait Predicament" which constituted a "crisis" requiring several measures:

- Construction of routes into Southeast Asia: the Bangkok-Kunming Mekong waterway, the Kunming-Bangkok highway, the Pan-Asian railroad, and the Nanning-Hanoi highway. All of these would "pave the way for China's oil strategy."
- Construction of a supertanker fleet with sufficient capacity; China depended on chartered vessels giving other countries control.
- Construction of a powerful naval force to ensure security of the SLOCs.
- A governmental report suggested that China, Japan, and South Korea jointly construct a canal, the Kola Canal, through Thailand's Isthmus of Kra, an "Asian Panama Canal" of approximately 90-100 kilometers, depending on which route is chosen, which would reach the Andaman Sea.[35]

The China Institute of Contemporary International Relations (CICIR, Xiandai guoji guanxi yanjiusuo) merged energy and maritime security issues in an analysis supportive of regional energy cooperation and People's Liberation Army (PLA) naval development. In an article published in the Chinese journal World Economics and Politics (Shijie jingji yu zhengzhi), Zhang Wenmu from CICIR argued that under the impact of globalization, a nation's energy security is both an economic and military issue. The author further argued that China's position was becoming increasingly vulnerable as its oil import dependence grew because it lacked the diplomatic and military influence of a country such as the U.S. Because the Chinese navy could not secure the SLOCs from the Middle East as the U.S. navy could, the author felt China should not adopt an energy security policy modeled on the U.S., at least until it had expanded its naval capacity. Rather, "China must consider the needs of

[34] Development Research Center of the State Council, *China's National Energy Strategy and Policy 2000-2020* (Beijing: November 2003).

[35] Zhang Yuncheng, "The Malacca Strait and World Oil Security," *Huanqiu Shibao*, Dec. 5, 2003, in FBIS, CPP20031217000202. Guo Ling, "Experts Suggest Need to Build a 'Panama Canal' in Asia," *Wen Wei Po*, Jan. 14, 2004.

other energy-hungry countries in Asia, especially in northeastern Asia, as it formulated its energy security policy." Japan in particular should benefit from China's east-west natural gas pipeline, building a common bond through energy cooperation.[36]

It was unusual to discuss energy cooperation and military security in the same analysis but it was the Iraq War that had changed the rules, indicating increasing securitization of energy issues. CICIR published a volume related to the energy-maritime security nexus: Global Energy Structure (quanqiu nengyuan da qiju) which examined the energy security strategies of the U.S., Japan, India, the EU, and South Korea, none of which it perceived to be market-driven. China's energy security strategy was presented as both an economic, political and military issue.[37]

In June 2004, the State Council adopted the Medium and Long-term Energy Development Program from 2004 to 2020. Emphasis was on recentralization of control over energy policy, energy security, diversification of oil supply, regional energy cooperation, and the need to build a Strategic Petroleum Reserve.

The lessons from the struggle for Angarsk were added to the lessons from the Iraq War. Both contributed to the securitization of Chinese energy issues. Even before 9/11, the need for an oil security system was widely discussed in the Chinese press, including participating in international energy regimes, APEC conferences on energy, dialoguing with OPEC, and strengthening cooperation with the Middle East, Russia, Central Asia, and Africa.[38] Following the beginning of the Iraq War, the need to map out a new oil strategy became even more urgent.[39]

The Iraq War influenced China as it did Japan, motivating it to consider better strategies for oil security. Chinese knew that with the U.S. military present in Iraq, Chinese NOCs had no hope they would develop petroleum projects there. Middle Eastern turmoil had led Chinese oil companies into panic buying. Chinese examined numerous attempts to invest overseas that had suffered setbacks. The SLOCS from the Middle East were fragile. The Caspian Sea had become an empty promise. And Beijing was surprised when "Japan and Korea tried to derail the Angarsk-

[36] Zhang Wenmu, "China's Energy Security and Policy Choices," *Shijie jingji yu zhengzhi* 5 (2003): 11-16, in FBIS, CPP20030528000169.

[37] Zhongguo xiandai guoji guanxi yanjiuyuan, jingji anquan yanjiu zhongxin. *Global Energy Structure* (quanqiu nengyuan da qiju). (Beijing: shishi chubanshe, 2005).

[38] Wang Chun and Qi Yanqiu, "Strategic Considerations on Establishing China's Future Oil Security System," *Duiwai Jingji Maoyi Daxue Xuebao* 2 (2001).

[39] FBIS Report, "China: Mapping Out New Oil Strategy to Avert Oil Crisis," in FBIS, April 4, 2003, CPP20030404000159.

Daqing oil pipeline" after so many years of discussing regional energy cooperation.[40]

In April 2003, a roundtable discussion at People's University focused on the impact of the Iraq War on Chinese energy interests. The meeting identified five questions on China's energy security requiring further research: finding the appropriate energy mix, determining the greatest threat to Chinese oil imports and security of the SLOCs, promoting an East Asian Energy Community, the appropriate governmental organization for managing energy (either an energy commission or an energy bureau), and creating strategic oil reserves.[41] The Iraq War had a major impact on Chinese perceptions on what were the rules of the world oil market. The U.S. was perceived to be less market-oriented, and more willing to use military force whenever it was deemed necessary (clearly stated in the Carter Doctrine), which heightened anxiety regarding Chinese dependence on the SLOCs from the Middle East. Chinese analysts widely believed that the American Grand Strategy and motive for the Iraq War was hegemony over the Middle East and control of the region's oil resources.[42] The Chinese NOCs were encouraged to diversify the Going-Out Strategy away from the Middle East. Some analysts downplayed an East Asian Energy Community and did not view it as a primary means to energy security.

Domestic and Foreign Criticism of the Going-Out Strategy

The NOCs were forced to explore overseas as China's onshore production failed to meet domestic demand, and offshore production was lower than expected. CNPC's China Petroleum Economics and Information Research Centre claimed in December 2004 that, "It is increasingly difficult for Chinese oil companies to find good assets overseas as the good ones are already taken by western companies...So Chinese companies are increasingly going into less developed countries and offering infrastructure in order to secure oil and gas assets."[43] If Western countries monopolized global oil resources, China's niche would be in LDCs such as Sudan or Iran that the West shunned. CNPC's corporate expansion into these areas would create tensions between Beijing and Washington.

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[40] Wang Yiwei, "China's Foreign Oil is Hanging by a Thread," *Zhonghua Gongshang Shibao*, June 30, 2003, p. 5, in FBIS, CPP20030730000198.

[41] Zha Daojiong, "China's Energy Security after the Iraq War: summary report of a roundtable discussion," Center for International Energy Security, Renmin University of China, Beijing, April 8, 2003.

[42] Peter S. Goodman, "Big Shift in China's Oil Policy: With Iraq Deal Dissolved by War, Beijing Looks Elsewhere," *Washington Post*, July 13, 2005, p. D 1.

[43] "China looks further away for oil," *The Standard (HK)*, December 7, 2004.

Zhang Dawei, deputy director of the Oil and Gas Strategy Research Centre under the Ministry of Land Resources, claimed that because onshore oil and gas resources were limited, China must focus on offshore oil and gas exploration. The South China Sea, with more than 200 oil & gas-bearing structures was one of China's 10 major oil and gas strategic sites.[44] China has begun joint exploration of the disputed areas in the South China Sea with the Philippines and Vietnam.

Most of China offshore is managed by CNOOC. However, PetroChina in July 2004 was granted a licence to explore oil and gas blocks offshore. The only areas left for PetroChina are in disputed territories such as the Spratlys.[45] Thus PetroChina's corporate expansion could nudge China into confrontations in the South China Sea. Also in 2004, Sinopec was granted a license for offshore exploration. Both newcomers lacked experience and technology in offshore and were thus needed to form joint ventures with foreign companies. However, only CNOOC was authorized to explore in domestic waters with foreign oil companies. Forced to go overseas, Sinopec is looking at Saudi Arabia, Iran, Nigeria, and the Ivory Coast. Petrochina looked to Indonesia, Kazakhstan, Venezuela, Sudan, Iraq, Iran, Peru and Azerbaijan.[46]

Chinese analysts recognize that China's energy diplomacy had ramifications for a new activism in foreign policy especially in the Middle East. As a result of the effect of the Iraq War on Chinese energy thinking, Beijing had shifted to a much more activist Middle East policy. Chinese claim some Middle Eastern countries encouraged Beijing to become more activist to counter the U.S., such as Syria's President Assad. Ambassador Wu Jianmin, now president of China Foreign Affairs University, asserted that China's diplomacy was shifting from responsive diplomacy (fanying shi waijiao) to proactive diplomacy (zhudong shi waijiao).[47]

The logic of China's Going-Out Strategy was clear yet there were critics. Japanese media referred to China's Going-Out Strategy as an aggressive strategy for securing energy supplies internationally that caused anxiety in Japan. Japanese journalists advocated a more aggressive Japanese oil

[44] "South China Sea one of China's 10 major oil and gas strategic sites," *AsiaPulse*, April 13, 2005.
[45] *Ibid*.
[46] "Sinopec looking across the globe for overseas acquisitions," *The Standard (HK)*, November 15, 2004.
[47] Jin Liangxiang, "Energy First: China and the Middle East," *Middle East Quarterly* (Spring 2005), <http://www.meforum.org/article/694> (November 1 2005).

strategy as counteroffensive to "China's aggressive oil offensive."[48] This securitization of energy issues in the media focused on the Sino-Japanese struggle for the Russian oil field, Angarsk, and the Sino-Japanese struggle for the resources surrounding the Senkaku/Diaoyutai islands. Japanese media linked energy security to another issue, maritime transport security, especially in the Malacca Strait, which has taken on enormous symbolic importance for Japan, China and the U.S.[49] Japan had been as unsuccessful as China in 2004-05 in convincing the littoral states—Malaysia, Indonesia, and Singapore—that Japan should have a military role in the Malacca Strait. One Japanese rightist newspaper promoted zero-sum thinking, proclaiming "Asia is an oil battleground," and quoting a Chinese researcher on the East China Sea dispute as stating, "Chinese people think Japan is destroying China's energy security."[50] It implied that China was destroying Japan's energy security.

While Japanese journalists securitized Sino-Japanese energy issues, Japanese energy specialists did not. According to Ken Koyama, a senior researcher at the Institute of Energy Economics Japan (IEEJ), Japan and China are so tightly linked that a Chinese energy crisis would become a Japanese crisis. Thus, "Japan should take actions to enhance energy security in the whole Asian region by helping China and other Asian countries set up systems to stockpile energy resources and provide them with energy-saving technologies."[51]

Within the United States, it is the Pentagon and Congress that are securitizing China's oil demand, viewing China's Going-Out Strategy as a strategic challenge.[52] The Department of Defense (DoD) claims that China's need for secure oil supply is a key driver in Chinese foreign policy. Additionally, DoD expects China to expand its naval capability to protect assets overseas. And it is the Pentagon that has found what it believes is China's Achilles heel—dependence on oil imports. The Pentagon's "Annual Report to Congress: The Military Power of the People's Republic of China 2005," repeated this theme that resource needs drove China's foreign policy in Africa, Latin America, and the Middle

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[48] Asahi Shimbun Editorial, "Energy diplomacy: Diversification is needed to secure stable sources," *Asahi Shimbun*, August 24, 2005, <http://www.asahi.com/english/Herald-asahi/TKY200508240140.html> (November 1 2005).

[49] See the author's paper on "Chinese and ASEAN Responses to the U.S. Regional Maritime Security Initiative," presented at conference on "China's Diplomacy of Multilateralism," University of Victoria, British Columbia, December 2004.

[50] "Japan and China face off over energy," *Asia Times July 2, 2005.* This is a summary of a series of articles in the *Yomiuri Shimbun.* <http://atimes01.atimes.com/atimes/Japan/GG02Dh01.html> (November 11 2005).

[51] *Ibid.*

[52] David Zweig and Jianhai Bi, "China's Global Hunt for Energy," *Foreign Affairs* 8, 4 (2005): 25-38.

East, and led China into conflict with Japan in the East China Sea. The Pentagon report mentioned the "Malacca Straits Dilemma" and Chinese concern over the SLOCs.[53]

The U.S.-China Economic and Security Review Commission contributed to securitization in its Report to Congress 2004, taking note of China's growing sense of insecurity regarding the SLOCs from the Middle East that passed through the Malacca Straits. The Commission was critical of the Chinese NOCs Going-Out Strategy with pariah states. The report questioned whether the U.S. should assist China with energy conservation since this would reduce Chinese oil imports which might "reduce U.S. energy leverage in the event of any U.S.-China conflict."[54] "U.S. energy leverage" is the U.S. Navy's capacity to interdict the SLOCs China depends on for oil imports. A former American government official has advocated integrating US-China discussions on energy security with discussions on non-proliferation and maritime security, and to create a new modality for a multilateral, senior level energy security dialogue, or strengthen APEC's energy dialogue.[55] The Center for Naval Analyses has published similar suggestions.[56] These American analyses mirror CICIR's analysis of the energy-maritime security nexus.

In contrast, the U.S. Department of Energy (DoE) continues US-China energy cooperation that it began soon after normalization of diplomatic relations in 1979. Cooperation focused on U.S. DoE-funded technology transfer with training programs, scientist exchange, and demonstration projects. In 1995, DoE began bilateral consultations with China's State Planning Commission [now National Development and Reform Commission (NDRC)]. This continued technology transfer in energy efficiency, nuclear energy and fossil energy. Most recently, in May 2004 China and the United States signed a Memorandum of Understanding for a bilateral energy forum, the China-U.S. Energy Policy Dialogue. The Dialogue included energy policymaking, supply security and regulatory reform. Specifically, the Dialogue will exchange views on international energy markets, assess the ways in which China's energy practices and policies impact US energy security, technology transfer,

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[53] Office of the Secretary of Defense. Annual Report to Congress: The Military Power of the People's Republic of China 2005, <http://www.defenselink.mil/news/Jul2005/d20050719china.pdf> (November 1 2005).

[54] 2004 Report to Congress of the U.S.-China Economic and Security Review Commission. 180th congress, 2nd session, June 2004 (Washington, DC: GAO, 2004): 152.

[55] Written Statement of Randall G. Schriver, before the U.S. Senate Committee on Foreign Relations. Hearing on *Energy Trends in China and India: Implications for the U.S.*, July 26, 2005.

[56] Henry J. Kenny, "China and the Competition for Oil and Gas in Asia," *Asia-Pacific Review* 11, 2 (2004): 36-47.

and environmental mitigation. The first meeting was held June 30, 2005 to discuss common challenges. DoE announced it will open an office in Beijing which will assist in assessing the impact of Chinese energy policymaking on US energy security.[57]

The most spectacular failure of the Going-Out Strategy was CNOOC's bid on Unocal, an American oil company, setting off a firestorm in the U.S. American analysts suspected Beijing of strategic motivations in acquiring Unocal's Southeast Asian fields rather than purely commercial motivations. But, in the end, CNOOC was outbid by Chevron.[58] There had been other failures including CNPC's failure to acquire the North Caspian Sea Project in Kazakhstan in 2003 when ENI Agip, Shell and ExxonMobil exercised pre-emptive rights.

The domestic Chinese criticism of the Going-Out Strategy claimed it focused excessively on physical control of oil and gas irrespective of international political consequences.[59] Caijing's editor, Hu Shuli, noted that the years of energy dialogue between the U.S. DoE and the Chinese NDRC had shifted recently from energy conservation to a focus on energy security. The Unocal affair indicated a preference for zero-sum competition in US policy even though CNOOC was emulating US oil corporations in pursuit of oil resources. Fu Chengyu, President of CNOOC, reflected a similar sentiment after failing to acquire Unocal, claiming "We are following a system that was set up by Western leading companies, especially the United States. We are walking along a path that they paved, so we thought, 'This is natural.'"[60] Fu implied he would have to rethink everything he had learned about markets and free trade from working with American companies. The rules Fu had learned were the old American rules regarding dependence on markets. Since the U.S. began securitizing energy relations with China, the rules had changed.

Recentralizing Control over Energy Policy

The Angarsk-Daqing pipeline project's failure provided a lesson regarding dependence on increasing oil supply and dependence on too few suppliers, enhancing the sense that China had an energy crisis.

[57] Statement of David K. Garman, Under Secretary of Energy, before the U.S. Senate Committee on Foreign Relations. Hearing on Energy Trends in China and India: Implications for the U.S., July 26, 2005.

[58] Bill Powell, "The Energy Game: A Chinese oil company is thinking of bidding for a U.S. one. Does that make sense?" *TIME*, May 30, 2005.

[59] Hu Shuli, "CNOOC, Unocal and the 'Going-Out Strategy,'" *Caijing Magazine* 139 (July 2005) <http://caijing.hexun.com/english/detail.aspx?issue=139&id=1251372> (November 1 2005).

[60] Peter S. Goodman, "China Oil Exec Dismayed Over U.S. Reaction to Unocal Bid," *Washington Post* Foreign Service, July 6, 2005.

Numerous measures would have to be taken beyond increasing supply. China's energy bureaucracy had sufficient capacity to manage a bilateral arrangement, the Angarsk-Daqing pipeline, but since that was at risk, greater state capacity was needed.

Although China's energy crisis could be dated from mid-2003, it was only in 2005 that Beijing reacted by reorganizing the government. In 2004, China imported 120 million tons of crude oil, an increase from 2003 of 34.8 percent. China was severely impacted by high oil prices in 2005 as prices went over $50/per barrel (bbl), with some analysts predicting that the country would need to pay 2% more of its GDP for oil imports in 2005 than it did in 2004.[61] Moreover, outside pressure from other net importers (especially Japan and the U.S.) and the IEA, made Chinese domestic oil demand an international issue. Oil imports constituted 40% of total Chinese oil supply. Moreover, outside pressure from other net importers (especially Japan and the U.S.) and the IEA, made Chinese domestic oil demand an international issue.

Key to recentralizing control and mapping out an energy strategy was a joint study by the NDRC's Energy Research Institute and the State Council's Development Research Center that outlined an energy strategy for China to 2020, suggesting China's economic development pattern be transformed, domestic demand better managed, with China joining international cooperation frameworks to purchase oil from the international oil market. The initial draft had come out in November 2003, but the final draft was issued in June 2004.[62] The report, China National Energy Strategy and Policy 2020, summed up the lessons of the past two decades, most of which focused on the lack of governance capacity: lack of comprehensive national energy strategies with legal authority, lack of scientific decisionmaking, lack of law enforcement capacity for energy laws, and lack of policy coordination between oil, coal, electricity and nuclear. The report was critical of the Chinese NOCs which it claimed had inappropriate control of oil policy formulation and implementation.

China's most important response to its energy crisis in 2005 was to reorganize the energy bureaucracy and policymaking process. Premier Wen Jiabao created a Leading Group on Energy to take charge of China's fragmented, decentralized energy industry. The Group's purpose was to provide macro leadership for a uniform, nation-wide energy plan while

[61] Andy Xie, "Asia/Pacific: Oil Is a Bubble," Morgan Stanley's *Global Economic Forum*, March 1, 2005, <http://www.morganstanley.com/GEFdata/digests/20050301-tue.html#anchor1> (March 1 2005).

[62] Development Research Center of the State Council and the Energy Research Institute, *China National Energy Strategy and Policy 2020* (June 2004).

not interfering in the work of the nation's oil companies.[63] The Leading Group on Energy includes 13 top leaders from the country's major ministries and agencies, Vice Premier Huang Ju and Zeng Peiyan. Responsibilities include: energy exploitation and conservation, security and emergency systems, and international cooperation. The Group will make proposals to the State Council.

A ministerial-level State Energy Office (SEO) will provide administrative support and strategic planning. Ma Kai, head of the National Development and Reform Commission, was appointed Director of the Office. Ma Fucai, former president of China National Petroleum Corp and Xu Dingming, director of NDRC's Energy Bureau were appointed Vice Directors. The SEO will not replace the NDRC's Energy Bureau but rather coexist. The SEO will focus on policymaking and the Energy Bureau on policy implementation. The reorganization addressed the need for stronger management and greater institutionalization. The SEO will supervise energy companies, design an energy master plan, and monitor potential energy crises both domestic and international. The State Energy Office's mandate in overseas energy will be to secure foreign gas and oil, supervise China's oil companies and the newly created strategic petroleum reserve. The Office's domestic mandate will be to manage coal supply, electricity shortages, pollution, and energy efficiency. Of all the responsibilities the new SEO will have, management of international cooperation augers well for Chinese multilateral cooperation. Without this strengthening of the Chinese energy bureaucracy, multilateral energy cooperation could not progress.

It was difficult to assess during most of 2005 how much of a shift in control over energy policy from the supply-side NOCs to the demand-side ERI and the SEO had occurred. The Unocal Affair during summer 2005, where China's CNOOC bid of $18.5 billion to takeover Unocal had failed, demonstrated that the shift had real consequences. The Chinese government never gave CNOOC official support in its daring takeover bid of Unocal, which contributed to the bid's failure. Chinese official support for the Going-Out Strategy seemed weak due to the strategy's construction of an image of China as a "thirsty oil dragon." During the uproar caused by the Unocal Affair, the U.S. Department of Energy met with officials from the National Development and Reform Commission. They did not discuss the Unocal bid and no one from CNOOC was present. Instead they discussed energy efficiency and management of Chinese energy demand.

[63] "China to set up task force dealing with growing energy crisis," *Petroleumworld*, May 2, 2005.

The need for an oil law had been under consideration since 1996 after China became a net importer of crude oil in 1995, which was more of a shock than when it became a net importer of petroleum products in 1993. In October 2001, an energy analyst from the National Development and Reform Commission claimed to have submitted a draft for an oil law to the National People's Congress to ensure Chinese oil security and to create a regulatory framework for the domestic oil market.[64] In March 2004, China's National People's Congress was still calling for new laws to control petroleum demand and create a strategic oil reserve in order to respond to "the oil crisis." NPC lawmakers wanted oil conservation slogans to be codified into law so that those that squander oil were punished.[65] In October 2005, the National Development and Reform Commission's Energy Bureau indicated it would be another two years before a general law on energy security could be drafted. There were numerous specific laws on electricity, coal, renewable energy, energy conservation, and oil that needed to be rationalized and made compatible with a general law on energy. The law was needed to provide a legal foundation for establishing a strategic petroleum reserve.[66]

Chinese Rules for Cooperation

Prior to Chinese President Hu Jintao's visit to the United Nations and meeting with President Bush, the Chinese Foreign Ministry announced that "China has followed the rules of the international oil market" in its oil interactions, and that "China has no intention to scramble for world energy supply with other countries." Instead China intended to achieve energy relations that were "mutually beneficial and win-win through cooperation."[67]

But whose rules was China following—American or Japanese? The U.S. and Japan have had an ongoing dispute over what constitutes energy security and how it is best achieved. Americans promote market solutions while Japanese promote regional cooperation such as the East Asian Energy Community based on ASEAN+3. Chinese NOCs maintain they had followed U.S. rules in their "Going-Out Strategy." Foreign critics claim the Chinese NOCs' Going-Out Strategy ignored

[64] Gong Zhengzheng, "PRC Analyst Views State Law Proposed to Strengthen Oil Security," *China Daily*, (Business Weekly Supplement), October 30, 2001.
[65] "Chinese Legislators Propose Law on Development of Oil Resources," *Xinhua*, March 11, 2004.
[66] "New Law to Strengthen Energy Security," *China Daily*, October 22, 2005.
[67] "Chinese president to convey message of peaceful development during US visit," *People's Daily*, August 31, 2005, <http://english.people.com.cn/200508/31/eng20050831_205404.html> (November 1 2005).

regional energy cooperation.[68] Up until 2005, regional cooperation has been constructed according to Japan's rules. Chinese needed to contribute their own ideas and rule-making.

The domestic energy security debate was fundamentally between the NOCs on one side promoting supply-side solutions to energy security, while on the other side were energy experts based at the Energy Research Institute and other institutes promoting a more balanced approach between supply-side and demand management as a means to greater security. The implementation of China's Medium and Long-term Energy Development Program From 2004 to 2020 was a victory for the ERI energy experts. The impact this would have on international cooperation was apparent. Supply-side energy strategies were inherently competitive, a zero-sum game as oil consumed by one country is not available to another. Supply-siders would rationally pursue bilateral agreements with producing countries, viewing China's national interest in very narrow terms. Demand management requires technology transfer from the very countries supply-siders would compete with—Japan and the U.S. Recognizing the condition of interdependence between the economies of China, Japan and the U.S., Chinese energy experts took a broader non-zero sum view of China's national interest, a win-win or lose-lose situation.

Adoption of the Program, and recentralization of control over energy policy, strengthened the position of experts who promoted multilateral cooperation with Northeast Asia [and the U.S.] rather than bilateral oil deals. By summer 2005, experts from Energy Research Institute and the State Council's Development Research Center would articulate further their logic to regional audiences, citing the Program. The Program prioritizes energy conservation, adjusts the energy structure towards less emphasis on oil, emphasizes domestic exploration while drawing on overseas resources and markets. Construction of a strategic petroleum reserve would be accelerated. Energy security would be attained with better energy policies and broader, more democratic input in the decision-making process on energy issues.[69]

The Sino-Japanese "struggle for Angarsk," because of its destructiveness on the overall relationship, had produced a lesson for Chinese energy experts: "[It] taught us that the basic principle of Northeast Asian oil development and trade is strengthened dialogue and cooperation...

[68] Philip Andrews-Speed and Ma Xin presentation at the China Environment Forum, Woodrow Wilson Center, "The Role of the National Oil Companies in China's International Energy Policy," May 26, 2005.

[69] Gao Shixian, "National Energy Security and China's Perspective on Regional Energy Cooperation," Paper presented at Northeast Asia Economic Conference, June 2005, Niigata, Japan.

countries concerned should understand, cooperate, and tolerate each other, and balance the interest of the major stakeholders."[70] This suggests that there is a learning curve for Chinese energy analysts which produced a principle that was not operative under Chinese NOC operations.

Further lessons came from energy cooperation in Europe, suggesting an Asian Energy Charter based on the European Energy Charter. The learning process produced a Chinese rule: "China and Japan should not take energy as a tool to contain the other's development."[71] Economic interdependence between them is too pervasive. Japan's economic recovery depends on China's economic growth, while China's status as the world's factory is a consequence, in part, of Japanese and Korean investment. An additional Chinese rule produced: it is impossible for a single country to guarantee its energy security. Security is only attained in a regional or international framework, guaranteeing energy security in common.[72] A third Chinese rule: Northeast Asian cooperation is only possible with government participation. This permits cooperation to include not only trade and investment, but also energy conservation and environmental protection, market stability and uninterrupted supply security [SLOC security]. These areas are the international public good that all Northeast Asian countries benefit from. It is governments that have the capacity to devise a multilateral cooperative framework, not the Chinese NOCs.[73]

Due to shared interests in market stability and SLOC security which were collective goods, China, Japan and South Korea should jointly analyze and formulate an oil security strategy, emphasizing overlapping interests and avoiding vicious competition.[74] This could only be carried out within an intergovernmental framework. Chinese suggestions for principles of the regional framework include: recognition of sovereign rights over energy resources, promotion of free trade, collaboration in

[70] Zhang Jianping, "Prospects and Possible Scenarios of Cooperation in Developing and Trading Oil in Northeast Asia," paper presented at Northeast Asia Economic Conference, June 2005, Niigata, Japan.
[71] *Ibid.*
[72] Gao Shixian, "National Energy Security and China's Perspective on Regional Energy Cooperation," Paper presented at Northeast Asia Economic Conference, June 2005, Niigata, Japan.
[73] Zhang Jianping, "Prospects and Possible Scenarios of Cooperation in Developing and Trading Oil in Northeast Asia," paper presented at Northeast Asia Economic Conference, June 2005, Niigata, Japan.
[74] *Ibid.*

emergencies, and enterprises (the NOCs) should be involved through government-enterprise coordination.[75]

A Chinese proposed roadmap to attaining a Northeast Asian Free Trade Agreement (FTA) suggested a four phase process:

1. Regional cooperation on energy supply and demand;
2. A Northeast Asian oil community for oil development and trade;
3. A Northeast Asian energy community of diversified energy sources;
4. A FTA that would emerge from the process of energy cooperation.

In October 2005, Japan's Ministry of Economy, Trade and Industry had made a policy shift from market liberalization to a more mercantilist policy for ensuring security of supply, justifying it as a reaction to the Chinese and Indian drive to secure resources. And yet, ASEAN+3 was still the framework Japanese hoped to use for regional cooperation with China, especially in energy conservation.[76] Also in October 2005, a Japanese energy analyst proposed a roadmap on steps that needed to be taken in the process towards the formation of a regional energy regime. China and Japan would begin with a non-binding dialogue, followed by a joint study on the regional energy outlook. From the dialogue and joint study, a road map would be constructed which would eventually lead to creation of a regional organization.[77]

Conclusion

The primary lesson for Russia, Japan and China is that it is difficult to make domestic energy plans when planning is contingent on other countries' domestic plans. The real utility for Chinese oil security of the "Struggle for Angarsk" was the way it mobilized the country to address oil scarcity issues coherently, a step necessary for China to implement the Medium and Long-term Energy Development Program From 2004 to 2020, to finally take conservation seriously, and to participate with greater transparency in a Northeast Asian energy regime.

In summer 2005, the Chinese Energy Research Institute felt that U.S.-China cooperation since 1979 had been only minimal as it moved from

[75] Gao Shixian, "National Energy Security and China's Perspective on Regional Energy Cooperation," Paper presented at Northeast Asia Economic Conference, June 2005, Niigata, Japan.

[76] Tsutomo Toichi, *Japan's Energy Situation: Present and Future*. Tokyo: October 2005, <http://eneken.ieej.or.jp/en/data/pdf/303.pdf> (November 1 2005).

[77] Kensuke Kanekiyo, *Energy Outlook of China and Northeast Asia and Japanese Perception toward Regional Energy Partnership* (Tokyo: IEEJ, October 2005)<http://eneken.ieej.or.jp/en/data/pdf/302.pdf> (November 1 2005).

project to project rather than a relationship that strengthened over time. ERI had expectations that with the 2005 government reorganization and implementation of the Program, it would become a more stable relationship.[78]

A reading confined only to the popular press in China, Japan and the U.S. on China's struggle for oil in the Going-Out Strategy would be misleading, as it focused on only one layer of the East Asian order. Unlike sentiments in the popular media, the epistemic community of Northeast Asian energy experts from China and Japan continued on as they had before 2003, meeting periodically and continuing to construct rules for energy regime formation. The pipeline issue, rather than interrupt this process of regime formation, was a crisis that required participants to adapt the regime to the challenges presented, incorporate the issues into the rules, and in the process strengthen the regime.

These two layers of the East Asian order coexist uneasily as Northeast Asian geopolitical struggles become more heated and proposals for energy cooperation keep emerging. Both Chinese and Japanese energy experts have a shared expectation that energy mega-projects are the means to lessen the geopolitical tensions between Russia, Japan and China, suggesting that in the long-term, the layer of regional cooperation could displace the layer of regional competition.[79]

[78] Interview in Beijing, June 2005.

[79] Zha Daojiong, Vladimir Ivanov, and Shoichi Itoh, "China, Japan and Russia: Towards a New Energy Security Nexus," *ERINA Report*, 62 (March 2005).

An Asian Oil and Gas Union: Prospects and Problems†

*Niklas Swanström**

Eurasia, herein defined as Northeast and Central Asia, has been ravaged by historical and current conflicts of both military and political nature, such as Japan or Russia's occupation of their neighbors, border disputes etc. This has created an environment where there is a chronic lack of trust among the regional actors and relations are often seen as a zero-sum game, or in relative gains. From an international perspective, it is symptomatic that there is very little cooperation in the military and political fields. For instance, Northeast Asia has no institutionalized regional organization that deals with political and military conflicts while trans-regional organizations that include cooperation between Northeast Asia and Central Asia states are far limited only to exercises against terrorism.[1] There have been several organizations initiated in Central Asia working on cooperation but their viability is limited. This is due to limited political support from the respective Central Asia governments and also because of the intra-regional rivalry between the five Central Asian states.[2] Thus, these organizations remain relatively weak and their future prospects uncertain. In order to have conflict management and resolution frameworks in place, and to establish greater trust between the different actors, these organizations would need to integrate deeper into the region, politically and economically.

The present situation has not passed without criticisms from the regional powers. For instance, China has repeatedly highlighted the need for more substantial areas of cooperation in the region especially in the field of

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[1] Swanström, Niklas L. P., "The Prospects for Multilateral Conflict Prevention and Regional Cooperation in Central Asia," *Central Asian Survey* 23, 1 (March, 2004); Swanström, Niklas L.P., "Regional Cooperation and Conflict Prevention," in Niklas L.P. Swanström (Ed), *Conflict Prevention and Conflict Management in Northeast Asia* (Uppsala & Washington: CACI & SRSP, 2005).

[2] Annette Bohr, "Regionalism in Central Asia: new geopolitics, old regional order," *International Affairs* 80, 3 (2004).

energy.[3] Japan has also similarly called for greater integration within Central Asia in cooperation with Japan.[4] Among the list of regional organizations present in Central Asia, a promising trans-regional organization is the Shanghai Cooperation Organization (SCO). The SCO is presently limited to Central Asia, China and Russia, but its attempt to promote multilateral cooperation is praiseworthy. Although it has only relatively modest accomplishments to speak of, outside of the successful resolution of the border disputes between China and the Central Asia states, cooperation carried out via this organization has thus far proven to be a success without parallel in Eurasia. However, it will be a long time before we are able to witness an institutionalized regional structure, like that of the European Union, which could act as a platform to mitigate the rivalry and distrust by entrenching interdependence between member states. As with the case of Europe, in order for greater regional integration to occur politically in Eurasia, focus has to be shifted to true economic integration in Eurasia. As economic ties grow, politicians have to coordinate their policies better and this will lead to further developments in the field of political cooperation and integration.

Today, China, Japan and Russia are competing for influence and market shares internationally and such rivalry is most intense in Central and Northeast Asia. The competition we are presently witnessing has been accentuated by a lack of trust between the different actors due to their age old military and political conflicts with one another. Meanwhile, the smaller actors in Eurasia, especially in Central Asia have their own agenda aimed at diluting the influence of the major actors in the region and preventing domination by specific actors, such as Russia in Central Asia.[5] This potentially explosive situation is compounded by the fact that the states in Northeast Asia are increasingly facing a perceived energy crisis due to increased competition over energy resources and high energy costs. A growing number of policy-makers are beginning to believe that an energy crisis or an intense struggle over resources is imminent. This sense of emergency is created by the lack of cooperative structures in the field of energy and because of the intense competitive behavior between the states seeking energy security, especially China and Japan. Within Eurasia, Russia and Central Asia have significant amounts of oil and gas they would like to export but they have been using their

[3] Talgat Baimukhambetov, *Kazinform*, July 2 2005; David Kruger, "Prosperity Tied to Regional Cooperation" *ADB Review* (November, 2004); "Hu Jintao expounds China's stance on win-win cooperation" *Xinhua* , November 18, 2005.

[4] Address by Prime Minister Ryutaro Hashimoto to the Japan Association of Corporate Executives (Provisional Translation), Prime Minister of Japan and His Cabinet (Kantei), July 24 1997, <www.kantei.go.jp/foreign/0731douyukai.html> (October 30, 2005).

[5] Roy Allison, "Strategic reassertion in Russia's Central Asia policy," *International Affairs* 89, 2 (2004).

resources as political leverage which in turn contributes to zero-sum thinking among energy-hungry China and Japan. For Northeast Asia, the failure to integrate and cooperate on energy issues have thus resulted in higher energy prices, reliance on Middle Eastern oil and dependence on Sea Lines of Communications (SLOCs) for the transportation of oil to Northeast Asia, not to mention greater rivalry.

Furthermore, as a result of such competition, the full potential of Central Asia's resources is therefore not fully realized. This explains the slow pace of Central Asia's economic modernization programs, limited investment in the region and why Central Asia continues to fall under Russian influence. Thus, while there are a high number of proposed cooperative structures, very few actually seem to implement their strategies and have direct impact on the multilateral relations in the region.[6] In essence, regional integration is very limited with dire political and economic consequences as a result.

Increased Tension in Eurasia and the European Experience

Access to and use of energy in the region is closely linked to the economic development in Eurasia. Among the Eurasian states, China has been singled out as the one with the most urgent need for new energy resources. Due to the pace of China's growth, and the resources needed to sustain its modernization program, China has been put in a position of growing dependence on energy imports.[7] The shortage of oil supply forced China to become a petroleum product importer since 1993 and a net importer of crude oil in 1995. Official Chinese statistics show that the volume of imported oil increased from over 20 million tons to 70 million tons from 1996 to 2002. Research by China's Ministry of Communications on marine oil transportation predicted that the country would import 100 million tons of crude oil in 2005, 150 million tons in 2010 and in 2020, the number would soar to 250 to 300 million. It is beyond doubt that China will see an increasing dependency on crude oil imports, with the amount

[6] Annette Bohr, "Regionalism in Central Asia: new geopolitics, old regional order," *International Affairs* 80, 3 (2004); Swanström, Niklas L. P., "The Prospects for Multilateral Conflict Prevention and Regional Cooperation in Central Asia," *Central Asian Survey* 23, 1 (March, 2004); Swanström, Niklas L.P., "Regional Cooperation and Conflict Prevention," in Niklas L.P. Swanström (Ed), *Conflict Prevention and Conflict Management in Northeast Asia* (Uppsala & Washington: CACI & SRSP, 2005).

[7] Swanström, Niklas L. P., "China and Central Asia: A New Great Game or Traditional Vassal Relations," *Journal of Contemporary China* 14, 45 (2005):569-584.

of crude oil imported rising from 31 percent in 2002 to 50 percent four years later in 2007.[8]

As a result, China's economic growth is increasingly perceived as a threat to its neighbors because of its high energy demand and China is now perceived as a competitor of energy resources, particularly by Japan who is another major player in the quest for energy security.[9] Japanese demand for energy has been stagnant in recent years as a result of its slow economic growth. However, the issue of energy security continues to be an important national security issue. This is because Japan lacks significant domestic energy resources and as a result, almost all of its energy needs are imported. In 2001, the country's dependence on imports for primary energy stood at more than 79 percent.[10] Japan was also the second largest importer of oil just behind the United States until late 2003 when China overtook it. Japan and China's quest for energy security has resulted in competition over Iran. Japan is currently Iran's biggest importer of oil and gas but will be overtaken by China soon. Last year, Iran and China signed a preliminary accord under which China will buy 10 million tons of liquefied natural gas (LNG) per year for 25 years in a deal worth $100 billion.[11]

Meanwhile, the Russians, while being heavily courted by both China and Japan for its Far Eastern energy resources have been wary of both. Russia is concerned that the demographically and economically rising China would overwhelm the Russian Far East which is suffering from a high incidence of population decline. During the late 90s, a weakened Russia needed China to maintain international relevance while China considered Russia as a potential junior ally. By 2004, the reverse has happened with Russia seeing China as a potential threat to its Far Eastern interest while China sees Russia as its route to energy security.[12] Russia's relationship with Japan is also not without hitches. There is also a leftover sense of historical distrust over the Japanese occupation of Siberia in the early 20th century. Furthermore, territorial disputes between Russia and Japan over the Kuril islands north of Japan which the Soviets seized at the end of the Second World War remain a prickly

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[8] "Half of China's oil consumption will depend on imports within four years," *China Daily*, 11 Dec 2003<http://www.chinadaily.com.cn/en/doc/2003-12/11/content_289499.htm> (March 15 2004).

[9] "Strategy and Approaches of Japan's Energy Diplomacy," Ministry of Foreign Affairs, Japan, April 2004 <http://www.mofa.go.jp/policy/energy/diplomacy.html> (June 10 2004).

[10] "Japan Country Analyses Brief," Energy Information Administration, Department of Energy, U.S., July 2003.

[11] "Iran wants China to Replace Japan as Top Oil Importer," *Channel News Asia*, November 7 2004.

[12] "As Russia Goes Western, China Pays the Tab," *Stratfor*, 20 August 2004.

issue between both sides.[13] Whoever the trading partner, energy has been identified as a key plank to Russia's diplomacy in the East and its growing energy exports to the region would result in Russia gaining considerable political leverage and strategic influence there.[14]

South Korea is also entering into the energy competition foray. Until the end of 2003, South Korea was the seventh largest oil consumer and fifth largest net oil importer in the world.[15] During the South Korean President's recent visit to the Kremlin in late September 2004, South Korean and Russian firms signed $4 billion worth of energy contracts, most of them focused on oil. Among these, a significant deal is the $250 million agreement signed between Rosneft, an oil corporation with close links to the Kremlin, which is about to be merged with the natural gas giant Gazprom, and the Korea National Oil Corporation to explore the oil reserves of remote Kamchatka at Russia's far northeastern tip and also the oil reserves of Sakhalin island. This deal is likely to irritate Japan especially—South Korea's historic rival in Northeast Asia. Sakhalin is right next door to it and has historic links to Japan.[16] In fact, Sakhalin oil supplied Japan through most of World War II and the Japanese are presently engaged with the Russians to develop the gas fields over there.[17]

Russia and South Korea also agreed to speed up construction projects to link Russia's Trans-Siberian railroad with the Trans-Korean Railroad in order to transport eastern Siberia's oil and gas from Russia, via North Korea, directly to its new South Korean markets. South Korean leaders appear eager for Russia to take a more active role in interceding with Pyongyang and playing a reassuring, stabilizing role in relations with it since U.S. engagement with the North Koreans have stalled.[18] It is also important to note that unless North Korea's dire current energy needs are

[13] After the Russo-Japanese War of 1904-1905, Japan owned the southern portion of the island below the 50th parallel. Stalin's troops captured it--or recaptured it, depending on who you ask--at the end of World War II, together with the Southern Kurils (Islands), which to this day Japan claims are theirs. During a brief period between 1920 and 1925, Japan owned all of Sakhalin and even had a consortium of companies extracting oil from the northern part of the island, one of which was Mitsubishi Mining. Lucile Craft, "The Sakhalin Oil Boom Part I," Japan, Inc, July 2003.

[14] "The Energy Dimension in Russian Global Strategy," Baker Institute Study, October 2004. p. 10-13.

[15] "South Korea Country Analyses Brief," Energy Information Administration. Department of Energy, U.S., Dec 2003.

[16] Martin Sieff, "Russia, S. Korea Become Energy Partners," *Washington Times*, September 23, 2004.

[17] Lucile Craft, "The Sakhalin Oil Boom Part I," Japan, Inc, July 2003.

[18] Martin Sieff, "Russia, S. Korea Become Energy Partners," *Washington Times*, September 23, 2004.

resolved, tension in Korean Peninsula is unlikely to be resolved.[19] Without energy, it would be unable to develop economically.

Overall, we see that the rivalry and promises of bilateral cooperation which has surfaced during this process is a reflection of the complex relationship between the governments in Northeast Asia. At present, the segregation of the region is making the quest for energy security a zero-sum game played out mainly among Japan, China and Russia on a bilateral basis. It is important to note that these three countries have all been at war with each other at some point in history.

Despite the fact that tensions threaten the interaction between the Asian states today, the situation is better than it was in Western Europe directly after the Second World War. The post WWII situation in Western Europe was significantly more insecure and the political and military situation was as bleak as or bleaker than Asia today, not to mention the lack of social and economic interaction that served as a strong factor for future conflict. The European economies was in rumbles and the US and a few European states that stayed outside the war had the only effective production capacity. The few factors that where positive after the war was the immense sense of war tiredness and the strong pressure that the U.S. placed on the Western Europeans to cooperate. The Marshall Plan and the political weakness in Western Europe were prominent factors in the post war period. Despite, or possibly as a result, such conditions served to facilitate peaceful relations created among the Western European nations at a rapid phase. Focus was on how to rebuild the political and economic structures after the war, unlike after the First World War when revenge was the prime motive behind the peace negotiations.[20] It seems, in retrospect, evident that Western Europe would not have been able to succeed without its strong economic focus and active U.S. involvement despite the impressive growth of integration. In the 50's Europe was already relatively well integrated both politically and economically. The present-day European Union is in fact testimony to the assertion that cooperation and interdependence is the best means to achieve prosperity for all European states and for preventing future military conflict. Looking at the European Union blueprint, we would see that economic cooperation served as a good starting point for further integration of the region.

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[19] Kent E. Calder, "The Geopolitics of Energy in Northeast Asian," *Energy Focus* Issue 3, KEEI, (2004): 72; Niklas Swanström, "Can China Untie the Gordian Knot in North Korea?" *Korean Journal of International Studies* No. 1 (2004); Niklas Swanström & Mikael Weissmann, "Chinese Influence on the DPRK Negotiations," *Peace Review* 16, 2 (July, 2004).

[20] Matthew Hughes & Matthew Seligmann, *Does Peace Lead To War: Peace Settlements and Conflict in the Modern Age* (Gloucestershire: Sutton Publishing, 2002).

In 1951, the European Coal and Steel Community (ECSC) was created, and successfully helped the devastated economies of Western Europe, especially France and Germany, to rebuild the economic structures closely together. As a result of ECSC, it was virtually impossible to rebuild the military without the knowledge of other states since such a process would require large amounts of steel. As economic activity increased, so did the level of trust among the European states and cooperation from the economic sphere improved relations which in turn spilled over to the military and political sectors. Today the warring European states of the Second World War is integrated to an extent unheard of and this has made war between the different states very difficult and unlikely, if not impossible. What was very difficult to accomplish politically after a violent war, was accomplished through economic means and through the assistance of the U.S. that committed both political and financial resources to the rebuilding of Western Europe.

The situation is in many ways more positive in Asia today, even if political and military tensions from past military conflicts and occupations still persist. The economic and social interaction among all actors is higher than Western Europe in 1945, save North Korea and Turkmenistan. This is especially true in Northeast Asia where all economic entities are closely integrated, even in the case of Taiwan and mainland China. Nevertheless, the overall situation in Eurasia, both from an economic and political perspective, remain dire and is in need of formalized cooperation and confidence building measures that would tie the states together both politically and economically. While the lack of multilateral energy cooperation appears dismal, it also presents an opportunity for states in the region to work together. An oil and gas union could in fact serve as a common ground for discussion on energy security that could impact economic and investment decisions as well as the political interaction, a request that has been raised before.[21] The question of energy cooperation is in this context important as multilateral energy cooperation could create permanent relations of mutual engagement and cooperative interdependence thus mitigating the potential of violent conflict in Eurasia.

Possible Implications of an Asian Oil and Gas Union:

That there are tremendous gains from an Asian oil and gas union is obvious, not only in terms of bringing state together in the long run, but more importantly in the short run there are economic improvements and

[21] Vladimir Ivanov, "An Energy Community for Northeast Asia: From a Dream to Strategy," *ERINA Report* 52 (June 2003) <www.erina.or.jp/Jp/Research/db/rep15/RS-EE/04070.pdf> (October 30, 2005).

visible economic gains for the states involved. The benefits could be divided into political trust, economic development, deregulation, environmental improvements, decreased political reliance on oil exporters, increased national security etc. of which a few will be discussed here but other issues could be found elsewhere.[22]

Politically, increased energy diversification and increased energy security would be a tremendous asset. By decreasing its reliance on one, or a few states, each individual actor would have more possible actors to trade with at more financially sound levels and not as today pay an Asian Premium for oil deliveries.[23] This is high on most states agenda, but fear of strengthening other actors have hindered this much needed diversification, a diversification that could be gained through Russian, Central Asian and Iranian oil and gas.

The economic implications with an increased cooperation among the Eurasian states would be tremendous. Enhanced regional cooperation would decrease the reliance on the SLOCs and the reliance on Middle Eastern oil that today is the most important provider of oil in Northeast Asia. Currently, there is a premium on the oil that is imported to Northeast Asia on $1-2 per barrel, this is due to the reliance on Middle Eastern oil and the lack of competition, but also due to the simple fact that Middle Eastern oil is high cost oil and that freight costs are prohibitive.[24] The waterways are today forced to be drawn outside of the normal waterway due to water depth in the Malacca Straits which forces the prices up. There is also a lack of transparency in the oil industry that has made the price much higher than it should have to be. The total import of oil was 13.7 MBD in 2000 and with the above mentioned

[22] Shoichi Itoh, Vladimir I. Ivanov and Zha Daojiong, "China , Japan and Russia : The Energy Security Nexus," in Niklas L.P. Swanström (Ed), *Conflict Prevention and Conflict Management in Northeast Asia* (Uppsala & Washington: CACI & SRSP, 2005); Kyudok Hong, "Dilemmas of South Korea 's New Approaches to Conflict prevention," in Niklas L.P. Swanström (Ed), *Conflict Prevention and Conflict Management in Northeast Asia* (Uppsala & Washington: CACI & SRSP, 2005); Ingolf Kiesow, A Perspective from Pyongyang through Foreign Glasses," in Niklas L.P. Swanström (Ed), *Conflict Prevention and Conflict Management in Northeast Asia* (Uppsala & Washington: CACI & SRSP, 2005); Philips Andrews-Speed, "Energy Security in East Asia: A European View," Paper presented at the Symposium on Pacific Energy Cooperation 2003, Tokyo, 12-13 February 2003, pp. 6-8; Kim Hyun-Jae and Shim Sang-Yul, "Operation and Support of the SOM and Conference for Energy Cooperation in Northeast Asia," KEEI (March 2004).

[23] Karen Teo, "Big Three to Fight 'Asian Premium' on Saudi Oil Sales," *Energy Bulletin* November 24, 2004 <www.energybulletin.net/3349.html> (October 30 2005); Masayoshi Soga, "Regional Cooperation for Resolving the Asian Premium," *IEEJ*, (March 2004) <http://eneken.ieej.or.jp/en/data/pdf/245.pdf> (October 30 2005).

[24] Henry Kenny, "China and the Competition for Oil and Gas in Asia," *Asia-Pacific Review* 11, 2 (2004); Masayoshi Soga, "Regional Cooperation for Resolving the 'Asian Premium,'" *IEEJ* (April, 2004).

premium it would equal $5-10 billion per year in extra costs for the Northeast Asian economies. Opening up the Central Asian and Russian energy resources to Northeast Asia would thus significantly decrease the economic costs for the regional economies, as well as increase investments in the economically weaker Central Asian states and Russia.

The energy need is growing quickly in Eurasia. In 1971 the Asia Pacific region was responsible for a mere 14.8 percent of the worlds primary energy supply and this has increased to 28.1 percent in 2000 and will increase to 34.9 percent in 2030.[25] The bulk of the increase is in the developing states in Asia, especially China, which has a growing need of energy resources.[26] This will result in increased dependency on the Middle East if diversification of energy imports is not realized and if domestic energy alternatives are not found. Dependency on oil in Asia was little above 70 percent in 2000 but could be significantly higher than 90 percent in 2030.[27] It is apparent for most analysts that if this continues Northeast Asia will face severe energy shortages, both short and long term. This will have a negative effect on energy security in the region and should force the regional economies to collaborate with each other to decrease the reliance on external actors. The financial gains should be a significant motivation alone, if not for any other reason.

However, it could be argued that there is no shortage of energy, it is much more a lack of energy efficiency. This in terms of transit, refinery, and usage. Japan is the only state in the region that has sufficient energy efficiency, South Korea's energy efficiency is weaker and in the other states it is dismal.[28] There is a need to increase the energy efficiency, in terms of production, transit, and usage that are badly managed in today's Eurasia. Improvements would not only decrease prices, but also increase availability and reduce environmental degradation. It would also improve the technical expertise on a general level in the region. This would imply that energy would be much cleaner than it is today, and could substantially improve the environment in Eurasia, an improvement worth attention in itself.

Creation of a more competitive and transparent energy market is a crucial factor if the economy behind the oil and gas union would have

[25] Secondary source: Kazuya Fujinme, "Asia needs to construct a framework of energy cooperation & joint research," *IEEJ* (March 2003): 1.

[26] *Ibid.*, p. 2.; Pak Lee, "China's quest for oil security: oil (wars) in the pipeline?," *The Pacific Review* 18, 2 (June 2002).

[27] Kazuya Fujinme, "Asia needs to construct a framework of energy cooperation & joint research," *IEEJ* (March 2003).

[28] Emma Chanlett-Avery, Rising Energy Competition and Energy Security in Northeast Asia: Issues for U.S. Policy, CRS Report for Congress, The Library of Congress (July 14, 2004).

any substantial effect; currently the energy market in Eurasia is markedly regulated and inefficient from an economic perspective.[29] The improvement of the energy market, deregulation, transparency and harmonization of standards, would have positive repercussions on the overall economic integration and stimulate trade if it would follow the European experience. It should be noted that the benefits from initiating such multilateral cooperation does not bear fruit only with the completion of such an energy network. The process which involves technical complexity, uncertainty, and longer time horizons could in fact foster peace-making types of cooperation and enhance inter-state relations as it requires greater interaction and coordination of policies between governments which, in turn, would help to facilitate greater understanding and foster goodwill among participants.[30]

Energy Drain and Possibilities

The need for oil and gas cooperation is very high in all states. The economic gains would be tremendous for all states involved, especially as the energy needs are increasing rapidly in all states in the world. However, energy cooperation is not a new phenomenon in Eurasia. For example, energy cooperation was an idea that facilitated the Sino-American rapprochement in the 1970´s that brought China and the U.S. together for the first time since 1945. It was also a central factor behind the Sino-Soviet normalization in the 1980's and Russian-Korean normalization in the 1990's.[31] In all of these three cases energy functioned as something facilitating and soothing on the political relations. Historically there are several more examples of how energy has been utilized to bridge poor political relations, even if this can be perceived as more controversial. Despite this, governments in the region have been very reluctant to further integration. This is partly a result of the political competition, but also of a traditional realist fear that the economic gains are relative and that strengthening the enemy is all but an option.

Despite this, energy integration is a crucial measure in Eurasia, both from a political and an economic perspective. Politically it would greatly benefit the cooperative structures that has been initiated in the region, but which has encountered problems progressing. Energy integration would also increase trust between actors at all levels of society.

[29] Kazuya Fujinme, "Asia needs to construct a framework of energy cooperation & joint research," *IEEJ* (March 2003).

[30] Philips Andrews-Speed, "Energy Security in East Asia: A European View," Paper presented at the Symposium on Pacific Energy Cooperation 2003, Tokyo, 12-13 February 2003, pp. 6-8.

[31] Gaye Christoffersen, Problems & Prospects for Northeast Asian Energy Cooperation, Paper presented at IREX, March 23, 2000.

Economically it would greatly benefit the states in the region by decreasing costs, improving technical issues and securing long term energy security. Currently we have seen several attempts to bilateral and trilateral energy cooperation and even some cases of multilateral energy cooperation such as ASEAN+3, Shanghai Cooperation Organization and Northeast Asian Economic Forum. A problem is that neither cooperative structure takes into account the need to include all actors starting from the source of the natural resources (Central Asia and Russia), refining point (mixed), transit (Central Asia, Mongolia, Russia, China and possibly Iran) and consumer states (primarily Northeast Asia). In order to create a common strategy over oil and gas in Eurasia it is crucial to create a sound economy behind this cooperation and this can only be accomplished with all actors being involved and integrated. Successful integration needs to include all available actors in a truly multilateral forum. There have been several suggestions how to go about regional cooperation in energy issues.[32] Still, there are unfortunately very few mechanisms in the region to further such integration.

Lack of trust between the different actors, internal economic considerations, failure to open up the economies and energy sector because of sovereignty fears have limited cooperation avenues. What is needed is political commitment and strong economic incentives for the regional economies and non-state economic actors to integrate and work closely together. Each individual state has its own strong commitment to this, but they are rarely compatible with other states unless they are directed towards a third state. In fact, it has been noted that the key problem in realizing such an energy cooperative network is the issue of coordination and distrust. The competing countries have to date depended on their own limited solutions in pursuing their own cooperative measures bilaterally without concerted policy directions between countries and often at the expense of their neighbors thus producing animosity. Furthermore, the business sector has been developing and doing its cooperative energy projects without clear policy directions at the government level.[33] Thus, we note that realist thinking and zero-sum game strategies are very apparent in the thinking of many policy-makers. This has made it very difficult for any structure in the region to over bridge the lack of trust. To accomplish this it is necessary

[32] Vladimir Ivanov, "Creating a Cohesive Multilateral Framework Through a New Energy Security Initiative for Northeast Asia," *ERINA Report* 55 (December 2003) < www.erina.or.jp/En/Research/Energy/Ivanov55.pdf> (October 30 2005).
Vladimir Ivanov, "An Energy Community for Northeast Asia: From a Dream to Strategy," *ERINA Report* 52 (June 2003) <www.erina.or.jp/Jp/Research/db/rep15/RS-EE/04070.pdf> (October 30 2005).

[33] Kim Hyun-Jae & Shim Sang-Yul, "Operation and Support of the SOM and Conference for Energy Cooperation in Northeast Asia," KEEI (March 2004): 3.

to rely on an organization that has an excess of political capital and currently there are no such organization in Eurasia.

One organization that is partly an exception is the SCO which is well positioned to initiate such cooperation over energy, both in an effort to improve political relations but more importantly to improve the economic situation for all actors. This is possible due to the strong political commitment China and a few Central Asian states have placed in the organization. It would play into the strategy that China has to further this organization as the primary multilateral organization in the region, this is however an attempt that Russia and Uzbekistan is less enthusiastic about. Russia would like to promote Commonwealth of Independent State as the primary organization in the region, as it controls it while Uzbekistan would like to engage the Central Asian states either bilaterally or in a truly Central Asian organization it would dominate. However, in order for the SCO to act as the vehicle for an oil and gas union, the SCO would need to include some of the more important energy consumers such as South Korea, Japan and even possibly Taiwan and production states such as Iran in order to make it economically viable. There are currently very little economic incentives to further such a plan and the capital investments involved are so large that the private sector would be reluctant to take all the cost by themselves.

This is not impossible, and most states acknowledge the need for further integration. China developed a strategy for energy security in the 1990´s called the "Pan-Asian Continental Oil Bridge" that would link Japan with Middle East under Chinese control.[34] This is seen as something positive from a Chinese perspective where the regional economies could be tied up against one other, other actors in the region meanwhile viewed this as an attempt by China to dominate the regional markets. It is without doubt that states that would control the transit routes to the consumers would have increased influence in the region. Politically they would be able to impact the foreign policy of the states dependent on the transit. This is also one reason that Japan and Taiwan have opted for the sea lanes before a Chinese pipeline and why the Japanese proposed a pipeline from Angarsk to Nakodha which skirts around Chinese territory. Politics, not economics was the key factor of consideration in such a pipeline.[35] This proposal has taken precedent over the Daqing initiative that was proposed by China and that was less than half as expensive to construct compared to the Nakhodka pipeline. However,

[34] Gaye Christoffersen, Problems & Prospects for Northeast Asian Energy Cooperation," Paper presented at IREX, March 23, 2000.

[35] "Daqing Pipeline Still Most Feasible," China.org.cn website, March 11, 2004 <www.china.org.cn/english/2004/Mar/89979.htm> (October 15 2005).

political and other economic considerations in Russia have made the Japanese initiative a more likely option, even if the Chinese will do anything in their power to prevent this from realizing. From an economic perspective, keeping more than one transit route will at the current market structure prove to be economically unviable and would threaten the commercial involvement in any pipeline that are under construction or planning.

Other initiatives that have been considering energy cooperation, either as a purely economic initiative or as a peace creator, has been Council for Security Cooperation in the Asia Pacific (CSCAP), the Japan America China Conference, ASEAN+3[36], Northeast Asian Economic Forum, Tumen River Area Development Program as well as the APEC Energy Working Group (EWG). The EWG's structure makes it an interesting organization, but as Central Asia is outside EWG's focus, it is not applicable here and all Northeast Asian states have included Central Asia in their energy strategy which thus makes EWG and the above mentioned organizations somewhat obsolete.[37] The other organizations suffer from several shortcomings that make them less likely to be used effectively. Politically there is a problem getting the different states to compromise over the energy structure as energy is seen as a political tool in many capitals. The political considerations are particularly problematic as they prevent economic development and increased trust at levels other than the political. There are also huge hurdles for the private sector who would like to venture into this project. If the private sector is to assume this role and bear the cost, the market would have to deregulate quickly and open up negotiations on transit fees. States would also have to commit to future engagement in carrying out such liberalization programs.

Challenges and National Considerations

Challenges to an Asian Oil and Gas union are many and politically there is a growing conflict over influence in Central Asia and Northeast Asia. China and Russia is engaged in a more or less open, conflict over influence in Central Asia. The traditional Russian influence is decreasing

[36] Shoichi Itoh, Vladimir I. Ivanov and Zha Daojiong, "China , Japan and Russia : The Energy Security Nexus," in Niklas L.P. Swanström (Ed), *Conflict Prevention and Conflict Management in Northeast Asia* (Uppsala & Washington: CACI & SRSP, 2005).

[37] Vladimir Ivanov proposes that APEC should be the structure on which a Northeast Asian security initiative should be built, however APEC does not include Central Asia. The dependency on Middle Eastern oil should be one of the primary consideration (???) and relying solely on Russian oil and gas will not solve Northeast Asia's energy security issues. Vladimir Ivanov, "Creating a Cohesive Multilateral Framework Through a New Energy Security Initiative for Northeast Asia," *ERINA Report* 55 (December 2003) <www.erina.or.jp/En/Research/Energy/Ivanov55.pdf> (October 30 2005).

and China is attempting to move into this region rapidly, the last thing Russia is willing to do is to assist China in this strategy, CIS and SCO are thus put in a position where they could potentially be forced to compete with each other. Until now, political considerations from both Russia and China has made it valuable to cooperate to decrease the U.S. influence in the region and neither organization has become so strong as to create any stir in Moscow or Beijing. It will not be until the political relations between Russia and China is tested that SCO will be baptized. Bilateral relations between China and Russia will to a large degree determine the future of SCO, at least until it has become so powerful by its own that it can distance itself from regional power struggles. The question is of course if SCO will ever be allowed to distance itself from national considerations.

Northeast Asia suffers from a situation that in essence is the same as that which is witnessed in Central Asia between China and Russia. China and Japan is engaged in a regional power struggle, whereby China is increasing its political influence in the region at the expense of Japan. In both of the regions there is a feeling in the U.S. that China should not be given a *carte de blanc* to exert influence unchecked. This attitude is closely connected to the dissatisfaction of China's close relations with so called "rogue" states, specifically in communist North Korea and Islamic Iran. In the economic field there is also concern over how China's growing economy is casting a shadow over its neighbors, the Chinese economy is rising at a rate that is truly worrisome for states that has traditionally been stronger, such as the U.S., Japan and to a certain extent Russia. Moreover it is imperative for many smaller economies that they are not dominated by a growing Chinese economy. This said, the concerns of China are likewise many and focuses on energy security, fear of being surrounded by hostile states, and a strong concern for domestic economic development. The Chinese leadership believes that this can only be accomplished by increasing international contacts and economic integration, while maintaining Chinese sovereignty and measures to protect its national security considerations.

Iran is a state that cannot be ignored from a pan-Eurasian energy cooperation viewpoint. It can be perceived either as a problem or an advantage depending from which perspective we look at it from. While China, Japan and most Eurasian states are positive towards the inclusion of Iran in the Eurasian energy network, such a move will most certainly alienate the US and even create a dispute with the U.S. over time.[38]

[38] Emma Chanlett-Avery, Rising Energy Competition and Energy Security in Northeast Asia: Issues for U.S. Policy, CRS Report for Congress, The Library of Congress, July 14, 2004.

Iran would however serve Eurasia positively as it would increase the flow of oil to Eurasia and possibly make the pipelines economically sustainable more quickly. The Eurasian economy could be sustained to a significant degree with Iranian oil, even if pipelines with Iranian oil would spur political instability as the U.S. will work against usage of such pipelines. From an economic perspective, it would be foolish not to serve Eurasia with one single pipeline that could carry the investment costs better. One argument which could be put forward to justify Iran participation would be that by incorporating Iran into a multilateral institutional framework, it could create conditions for a more moderate Iran through interdependence linkages. On the other hand, this would of course also give Tehran some degree of political legitimacy and render sanctions useless if sanctions are the primary objective.

In the creation of the Asian oil and gas union, it must be pointed out that there are several problematic economic considerations to make, that will complicate the economic sustainability of the pipeline. For one, resources and markets are very far apart and major infrastructural projects needs to be implemented to make this possible. It is no coincidence that there are more talks about pipelines than actual pipelines being initiated, the costs are prohibitive, especially as long as there are several projects that are competing and pipelines that are not connected to each other. This infrastructural problem is one major issue that an oil and gas union would have to look at, since it is at the heart of profitability and viability of the projects.

As mentioned, the projects are too large for private businesses and there is some reluctance among the governments in the region to invest in "competing" projects and this lack of coordination is most disturbing. States and private capital need to cooperate in investing for the future, but the insecurity is too high at the moment due to lack of deregulation and because of the number of competing projects. It has been estimated that the upstream sector is an extremely high/risk sector with a success ratio of 10 percent or so, a figure far below what is accepted by private investors.[39] This calls for both economic and political initiatives by the government to create stabile transit fees and tariffs. These are measures that are not easily accomplishable without a strong regional organization that could bring the issues forward with the best interest of the region at mind, rather than for benefit of specific states only.

The picture is further complicated by the fact that many external actors would view the development of an Asian Oil and Gas Union with suspicion as it would not only increase the economic strength of the

[39] Kensuke Kanekiyo, "The Northeast Asia Natural Gas Pipeline Network," *IEEJ* (March 2004): 8.

actors involved, it would also integrate these actors economically as well as politically over time. The formation of such a bloc is perceived as a threat by many actors as it would decrease the political and economic influence that the EU, the Middle East, and most importantly, that the United States would have over Eurasia. If such a grand project is to succeed, it needs strong external support similar to that which was received during the formative period of the ECSC-EU project. Perhaps it is time for the U.S. and Europe to act and play a more constructive role in the region over this matter. Notably, the European Union has been especially weak in its support for Eurasian regional integration and energy cooperation, in disregard of its own success story.

Conclusions

It is deemed necessary to create effective regional structures to improve the overall political and economic environment in Eurasia. This has shown to be very difficult to manage with political integration, as there are a great reluctance to go further down this road. In the economic field, the situation looks much more positive and the creation of an Asian oil and gas union would be most important for the development of cooperative structures, conflict management structures and a basis to develop political trust between the different actors. The economic sector seems to be more open for cooperation than the political or the military. All states are increasingly dependent on economic development for political purposes, internal stability or international standing. This is why the economic sector is acceptable for regional cooperation and integration. Nowhere is this more acute than in the energy sector.

It seems to be very difficult to further increase the possibilities for real economic integration in the energy field without deregulation of the market and a more open energy economy. Government involvement in the energy sector have severely eschewed the market and increased the financial costs for oil. There is necessity to improve the economic sustainability of each project by large cooperative structures, i.e. oil and gas union, as there is limited profitability in the small-scale projects that we see today. It would even in some cases make economic sense to continue importing expensive oil from Middle East. A major problem that has haunted the region is the lack of willingness to compromise by the various governments in the region as each has their own national agenda; without a strong external actor, this trend is set to continue.

Economically, more intense cooperation would decrease the economic costs for the Northeast Asian actors involved whose energy needs are growing, and increase resources for the weaker economies in Central Asia; it would also decrease the reliance the regions today have on Middle Eastern oil and reduce Russia's grip of the Central Asian energy sector.

Decreased political dependence on Middle East and the SLOCs as well as decreased costs for oil and increased energy security are a few major improvements with an oil and gas union. There seems to be little real willingness of the national governments to engage fully in the creation of an oil and gas union, it seems much more likely that the private sector would be wiling to engage in this as an economic venture, provided the political conditions are right. (Private capital is already flowing back and forward between the different states and little consideration is put on the origin of the money.) However, private capital alone is however not enough for this sort of project, thus states would need to engage in this, either as the primary actors or as support actors in terms of financing and political support. In this sense, while governments may find it difficult to lead such a project due to the inter-state political rivalry, it could perhaps play a constructive role by backing their respective private sectors to venture into such a project. If every government is willing to assume such a position, their own corporations would find it easier to structure the domestic energy markets for further regional integration with the other energy markets in the neighboring economies. If the private sector in every state carries this out, and negotiation is able to take place among the private sector of the various states, with backing by their own government, the political edge of the Asian Oil and Gas Union project would be blunted and the economic viability of the project more attractive and realistic.

The general climate in the region have to change from a zero-sum game and relative gains to a more appropriate view of a win-win approach where all actors acknowledge others rights and where all try to maximize their benefits and at the same time increasing the neighbors part of the pie. This is necessary for the modern economic world where deregulation and free trade has gained in importance. APEC, WTO and other economic organizations would need to provide strong support in this endeavor, especially as some economies are more problematic than others.

In relation to the international organizations there is a strong need for other states, primarily the EU and the U.S. to better engage the region in terms of energy cooperation and assist in creating new economic structures. It is very much in the interest of the EU and the U.S. to improve the regions energy security, especially its energy efficiency and environmental record. This can best be accomplished through regional organizations, such as an oil and gas union. The problem here is for the external actors to see the win-win situation and refrain from seeing things as purely relative gains.

China, Kazakh Energy, and Russia: An Unlikely Ménage à Trois

Stephen Blank[*]

On the face of it China should not encounter unusual difficulties in buying equity stakes in Kazakh energy assets that are for sale on the market. Both states are members of the Shanghai Cooperation Organization, bilateral trade is steadily growing, and Russia and China are very clearly strategic partners who are uniting against the American military-political presence in Central Asia. Yet China has met with every conceivable kind of obstacle to the objective of obtaining reliable supplies from and access to Central Asian, and especially Kazakh, energy sources. China has encountered Kazakhstan's and Russia's growing insistence on national and state control of their valuable strategic assets, and the Kazakh population's irritation at the presence of Chinese managers and companies overseeing their workers and owning their land, and Russian opposition to China's direct presence in Kazakhstan's market.

Amid the burgeoning interest in China's efforts to obtain reliable energy access, the difficulties Chinese firms and the Chinese government have met with here suggest that China will have mounting problems ensuring that access, meeting domestic demand, and in not paying exorbitant prices for energy in order to ensure that access. At the same time, a close examination of China's ties to Central Asian states, not just energy producers like Kazakhstan, suggests that we should not be unduly surprised at this outcome and China's difficulties.

China's relatively unfavorable energy situation and efforts to rectify it could create serious problems for its international relations in Central Asia. After all, Central Asian governments and elites know what to expect from Beijing. Several Western observers clearly believe that China seeks hegemony there and anticipate its future arrival. Already in 1994 Ross Munro wrote that, "There is no uncertainty about China's intention and ability to play a major role in Central Asia for the foreseeable future. Even if China's vision of a modern Silk Road is never realized, an economically dynamic and militarily ascendant China seems

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destined to exert tremendous influence over neighboring Kazakhstan and Kyrgyzstan."[1]

Similarly Chinese observers clearly look to Chinese hegemony over Central Asia. By 2001 analysts like Guancheng Xing were assigning China a "leading" role in facilitating this integration with Asia. Indeed, he openly invoked the analogy drawn from the well-known Japanese theory that Japan was to be the lead goose in an analogy of East Asian economies which resembled flying geese. Hence China would be the lead flying goose for the fledgling Central Asian economies traveling in its wake. Moreover, he fit this analysis into the by then established official view of China as both a developing economy and key component of a pan-Asian land bridge for energy and other goods and with Xinjiang's development. According to his analysis Central Asia's economic relations with China should not be concentrated in Xinjiang lest that region think about some form of economic independence or affiliation with Central Asia. Rather that trade should be with all of China and go through large Chinese firms.

Thus China, "Should become a guide and a kind of courier station for the Central Asian states in their dealings with the Pacific countries and guide them to more economic cooperation and trade contacts in the Pacific. The 'second Eurasian bridge' is an important route for China to guide the Central Asian states through to the Pacific...China should ensure that the economic development of its north-western part is connected not only with that of Central Asia but also with overall economic development in Eurasia. Looked at in this way, there is stronger motivation and greater scope for its economic relations with the Central Asian states."[2] He also claimed that such a relationship benefits Central Asian states, an argument that they reject. As most Chinese economic trade is with Kazakhstan and Kyrgyzstan, their reluctance to become even more dependent on China clearly irks Beijing as he observed in 1998.[3]

However that reluctance is well founded given China's hegemonic behavior in the region. For example, China's economic and trade policies aim to tie Central Asian states into an expanding trade with the PRC and give them significant economic motives for not supporting Xinjiang's unrest lest Beijing terminate that lucrative trade and investment. Beijing's line that friendship with China means that support for such

[1] Ross H. Munro, "Central Asia and China," Michael Mandlebaum Ed., *Central Asia and the World* (New York: Council on Foreign Relations Press, 1994), 236.

[2] Guancheng Xing, "China and Central Asia," Roy Allison and Lena Jonson, Eds., *Central Asian Security* (Washington, D.C.: Brookings Institution Press, 2001), 157-158.

[3] Guancheng Xing, "China and Central Asia: Towards a New Relationship," Yongjin Zhang and Rouben Azizian, Eds., *Ethnic Challenges Beyond Borders: Chinese and Russian Perspectives of the Central Asian Conundrum* (New York: St. Martin's Press, 1998), 47.

insurgent movements is unacceptable clearly exploits economic programs whose underlying premise should be mutual gain rather than for China's unilateral political benefit. So while Chinese specialist writings on foreign affairs and economics have discovered the concept of win-win relationships and mutual gain, Beijing's drive for political advantage vis-à-vis weaker Central Asian governments who need the Chinese market aims at securing critical advantages, not just an end to unrest in Xinjiang but also the creation of a sphere of relationships, if not influence that constrains local options vis-à-vis Beijing as Guancheng Xing stated above. In pursuing these goals China is not shy about employing unilateral coercive measures to achieve its goals. Thus China holds foreign businessmen from Central Asia as "Collateral", i.e. hostages for their governments' good behavior on Xinjiang-related issues.[4] Despite both sides' mutual gain from expanded trade and investment, China uses its stronger position to leverage relative political gains that contradict what these states might otherwise freely do.

Under the circumstances it is not surprising that energy producers are wary of what Chinese objectives might be above and beyond purely market relationships. Indeed, in his State of the Union speech on February 18, 2005, President Nursultan Nazarbayev of Kazakhstan explicitly stated that, "Today we are witnessing superpower rivalry for economic dominance in our region. We have to address correctly this global and geoeconomics challenge. We have a choice between remaining the supplier of raw materials to the global markets and wait [ing] patiently for the emergence of the next imperial master or to pursue genuine economic integration of the Central Asian region. I choose the latter."[5]

While Nazarbayev's warnings were intended as much at Washington as they were for Beijing and Moscow, fear of Washington's policy of support for democratization across the former Soviet Union hardly will lead Central Asian governments to prefer subordination to Moscow or Beijing in place of ties to Washington. This wariness about Chinese objectives is exacerbated by the peculiarities of China's approach to the energy issue. First of all, although China's preferred instrument for most political transactions in Central Asia is the Shanghai Cooperation Organization (SCO); it has not figured in Beijing's energy acquisitions. Despite its talk of multipolarity in world politics, China will not multilateralize discussions about its access to energy. Instead it prefers

[4] Farangis Najibullah, "Kyrgyzstan: China Keeps Nationals and Business' Collateral'," *Radio Free Europe Radio Liberty*, July 21, 2003<www.rferl.org//nca/features/2003/07/21072003153733> (July 21 2003).

[5] Cited in Stephen Blank, "Kazakhstan's Foreign Policy in a Time of Turmoil," *Eurasia Insight*, April 27, 2005.

bilateral discussions with energy producers because it is in that context that it can most effectively maximize its leverage upon the individual producer.

Second, China's policy aims at maximizing the reliability of long-term supplies through control of the product or of equity stakes in the producing company from wellhead to terminal. Since China does not fully trust market forces, its energy acquisitions eschew the logic of Western purchasers. Instead Chinese oil and gas strategy follows a different logic. For example, it increasingly ties equity investment to long-term supply contracts to ensure reliable supply and guard against price shocks. As Phillip Andrews-Speed and Sergei Vinogradov concluded, "The key driving force from the government's point of view is the desire to enhance the security of the country's petroleum supply through owning both the resource in the ground and, where relevant, the transport network."[6] Normally China seeks a percentage of annual oil output by becoming a direct investor or shareholder to shield itself against significant price fluctuations for oil imports. Building up a strategic petroleum reserve also aims to ensure reliable supplies at accessible prices. China also invests heavily in buying pipeline networks at home and abroad to control the oil and gas shipped from Central Asia, the Gulf, and Russia.

But failing to obtain reliable access and control, China's only avenue of escaping excessive dependence upon any one producer or region is to diversify its sources of global access to energy. China also consistently sells arms and even missile or nuclear technology to energy producers, e.g. Iran, Iraq, Saudi Arabia, and Sudan. China's willingness to provide military assistance and even to commit its own forces beyond its borders to Central Asia as stipulated in the 2001 treaty creating the SCO closely accords with this pattern and suggests a potentially forceful reply or increased support for missile and even nuclear proliferation in reply to threats to its energy supplies. Not only does this approach make Central Asian states nervous, it has to raise Russian fears as well because Russian control over Central Asian energy is a vital interest of the regime whose economic growth and freedom of maneuver in world politics depend crucially on its ability to monopolize CIS production, refining, pipelines, and sales. Thus Russian contemplation of long-term trends connected with China's economic activities in Central Asia is influenced by its knowledge that only China has the long-term means and local presence

[6] Philip Andrews-Speed and Sergei Vinogradov, "China's Involvement in Central Asian Petroleum: Convergent or Divergent Interests?" *Asian Survey* XL, 2 (March-April, 2000): 390.

to challenge Russia's presence in Central Asia even if it now accepts Russian leadership there.[7]

China and Kazakhstan

China's record of achievement in Central Asia and for that matter elsewhere in Asia is spotty.[8] China has bought equity in fields in Azerbaijan and Kazakhstan. In late 2002 China National Petroleum Company (CNPC) acquired a 50 percent share in Salyan oil through its various affiliates and in January, 2003 CNPC acquired a 31.41 percent share in the Azeri project "Canub-Qarb Qobustan."[9] CNPC and Sinopec, a publicly listed oil and chemical firm are both seeking properties there and in the Caspian Sea. These projects hardly give China a commanding position in Azerbaijan's energy holdings and do not overcome the difficulty of getting reliable access to pipelines.

China's efforts to gain leverage and access to Kazakhstan's holdings have been more checkered. In 1997 CNPC purchased a 60 percent stake in the Aktobemunaigaz firm of Kazakhstan which was intended to be the source for an oil and gas pipeline extending from Aktyubinsk in Aktobe province to Alashankou. Yet this project encountered several difficulties to the point where in 1999 there was talk of its cancellation.[10] Since then the project has been retrieved, not least because of Russia's failure to deliver on its promised oil pipeline. Now it has greater priority so that the pipeline is now being built to Keniak in Xinjiang from where eventually it will connect to Atyrau and with China's interior.[11] This is the centerpiece of China's present holdings with regard to Kazakhstan

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[7] Stephen J. Blank, *Energy, Economics, and Security in Central Asia: Russia and Its Rivals* (Carlisle Barracks, PA: Strategic studies Institute, US Army War College, 1995), 30.

[8] Henry Kenny, "China and the Competition for Oil and Gas in Asia," *Asia-Pacific Review* 11, 2 (2004): 36-47.

[9] Hong Kong, *AFP*, in English, April 15, 2002, Foreign Broadcast Information Service Central Eurasia (Henceforth *FBIS SOV*), April 15, 2002; Baku, *Echo*, in Russian, November 29, 2002, *FBIS SOV* November 29, 2002; Baku, *MPA*, in Russian, January 28, 2003, *FBIS SOV*, January 28, 2003; Ariel Cohen, "China's Quest for Eurasia's Natural Resources," *United Press International*, March 5, 2003.

[10] Almaty, "*Delovaya Nedelya*, in Russian," May 8, 1998, *FBIS SOV*, May 19, 1998; Hong Kong, *South China Morning Post (Business Post)* in English, June 7, 1999, *FBIS SOV*, June 7, 1999; Moscow, *Izvestiya*, in Russian, August 19, 1999, *FBIS SOV*, August 20, 1999; Andrei Chebotarev, "Kazakhstan: Priority Oil Routes," *Central Asia and the Caucasus* 3, 9 (2001): 29-30; Michael Lelyveld, "Kazakhstan: Oil Pipeline to China a Victim of Diplomatic Dispute," *Radio Free Europe Radio Liberty*, September 20, 2001.

[11] *Ibid.*; Cohen, "China's Quest for Natural Resources," *United Press International*, March 5, 2003; Xu Yihe, "China Energy Watch: Oil Hunt Goes On- The Kazakh Option," *Dow Jones Energy Service*, January 15, 2003; Marat Yermukanov, "Kazakhs Fear Chinese 'Creeping Expansion,'" *Central Asia Caucasus Analyst*, June 2, 2004; "Kazakhstan Inks Oil Pipeline Agreement With China," *Eurasia Daily Monitor*, May 19, 2004.

but it costs an enormous amount to build this pipeline through rugged and austere terrain and to secure it against natural and man-made disruptions. This project also underscores the vagaries of trying to line up equity in Central Asian energy since once this contract was signed and the difficulties of terrain and of labor strife began to appear, Russian companies like Yukos offered China oil and gas, to deprive Kazakhstan of a potentially enormous market and force it into greater dependence upon Moscow, an outcome that suited neither Beijing nor Astana.[12]

But in 2003 the situation changed for both countries. The full significance of China's dependence upon foreign gas and oil from Russian sources became clear. The war in Iraq underscored the vulnerability of supplies from the Persian Gulf just as it became clear that Putin would destroy Yukos for domestic political reasons and that the line from Angara to Daqing would not be built. Meanwhile energy prices steadily rose and Kazakhstan's economy exploded, outgrowing the shackles that Moscow had tried to fasten for it. China also learned a major and unpleasant lesson in 2002-03 when Western companies excluded it from the bidding for lucrative holdings in the Kashagan fields in Kazakhstan and the Caspian Sea. Therefore both states reforged their energy ties in 2003.[13]

By 2003 China had initiated its own strategic petroleum reserve and was negotiating big deals with Australia, Saudi Arabia, and Iran. It had concluded negotiations with an international consortium to develop and ship natural gas in the mammoth West-East pipeline to take gas from Xinjiang to Shanghai that offered it opportunities for further purchases of equity holdings in Central Asian gas finds and existing fields.[14] Pipeline construction on the Atasu-Alashankou pipeline which is part of the pipeline from Aktyubinsk to Alashankou likewise accelerated. Kazakh oil and gas became more attractive because, "More recently, the completion of the Neka-Tehran pipeline offered the possibility of oil swaps of Caspian and Iranian crude to cut transport expenses from the Caspian Basin to China. Caspian crude would be transported to Iran, while a corresponding amount of Iranian crude would be transported to China by ship. Analysts speculated that these oil swaps would cast doubt upon the construction of a massive China-Kazakhstan pipeline.

[12] Andrei Chebotarev, "Kazakhstan: Priority Oil Routes," *Central Asia and the Caucasus* 3, 9 (2001): 29-30

[13] Keith Bradsher, "China Buys 2nd Stake in Huge Oil Field in Caspian Sea," *New York Times*, March 11, 2003.

[14] David Hsieh, "Mega-Pipeline Paving the Way For China's Shift to Gas," *The Straits Times*, July 7, 2002, Retrieved from Lexis-Nexis; Keith Bradsher, "Energy Companies Agree on Trans-China Pipeline," *New York Times*, July 4, 2002.

However, that pipeline (Atasu-Alashankou) seems poised for completion."[15]

China will probably retain its interests in both programs to maintain ties to both countries, and avoid excessive dependence upon any one supplier or pipeline. However, there is much local resentment of Chinese high-handedness toward the local population, labor policies, economic penetration of what is one of Kazakhstan's poorest provinces, and fears that Chinese workers will privatize the land that is now being sold out of government control. Thus Kazakhstan would like to get a 51 percent controlling share in any oil pipeline construction to China.[16] So it remains uncertain that all will go well with what has been a troubled project for which China greatly overpaid to begin with. More recently China has sought to buy Petrokaz[17] from its former Canadian owners.

Just as Washington reacted strongly and negatively to Chinese efforts to buy Unocal and thereby gain access to its Southeast Asian oil fields, Kazakhstan's reaction, described below, has turned increasingly negative with legislative and political pressure being brought to bear upon the government to take control of this and other energy firms so that Kazakhstan's most strategic asset, energy, does not pass into foreign hands. Worse yet, Lukoil, Russia's main oil firm, also tried, ultimately abortively, to tie the sale up in a Canadian court.[18] Thus once again Russia has made forcefully clear its opposition to China's control over Central Asian energy sources. Lukoil's action is, however, perfectly consistent with previous Russian policies toward Chinese efforts to gain reliable access to Central Asian energy.

Russian energy producers have steadily rebuffed China's projects for obtaining energy supplies. Russian officials have again recently reiterated their opposition to being merely China's source for raw materials and demand equal status in economic-technological exchanges with China.[19] Russia is also determined to maintain autarchic control over energy firms its strategic resource and to be able to manipulate prices in

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[15] Peter Mattis, "China's New Push for Energy," *CEF Monthly* (March, 2004).

[16] Marat Yermukanov, "Kazakhs Fear Chinese 'Creeping Expansion,'" *Central Asia Caucasus Analyst*, June 2, 2004; John C.K. Daly, "UPI Energy Watch," *UPI*, April 13, 2004, Retrieved from Lexis-Nexis.

[17] Editor's note: Petrokaz is also known as PetroKazakhstan Inc.

[18] "Kazakhs Seek "Strategic Control" Over Petrokaz," *Central Asia Caucasus Analyst, News Section*, September 21, 2005; "CNPC's Takeover of Petrokaz in Court Limbo," *Business-Times Asia*, October 24, 2005, <http://Business-Times,asia1.com/sg/sub/news/story/0,4574, 173474,00.html> (October 24 2005); Isabel Gorst, *Financial Times*, October 19, 2005, p. 312, Retrieved from Lexis-Nexis; "China Wins Approval for Kazakh Oil Acquisition," *Radio Free Europe Radio Liberty Features*, October 27, 2005.

[19] Sergei Blagov, "Russia Wants to Be More than China's Source for Raw Materials," *Eurasia Daily Monitor*, September 30, 2005.

its favor by being a monopolistic producer. Sergei Kuprianov, the Press Secretary for Gazprom, stated in 2004 that, "Sharing mineral resources with foreign companies is against our policy...In fact, sharing oil with the Chinese would be even more inappropriate. After all, their stake in Yuganskneftgaz (the former main asset of the now defunct Yukos energy company-author) could complicate future price negotiations (for oil purchased by CNPC)."[20]

Previously these officials also blocked the sale of Slavneft to China, successfully destroyed Yukos, the company that favored a direct Russo-Chinese oil sale and pipeline from Angara to Daqing, and for some time appeared to be winning the policy struggle over oil sales to Asia by proposing a much more expensive, but partly subsidized by Japan, pipeline to Nakhodka.[21] Chinese buyers would then have to buy from Japan rather than directly from Russia. Similarly Russian and American energy companies have obstructed and are still obstructing China's efforts to buy energy holdings in Central Asia.[22] While Russia is perfectly happy to sell more and more of its own energy to China directly, it resists either Chinese moves towards equity stakes and hence ownership or control in Central Asian energy markets, or the potential independence of Central Asian producers.[23] If they can sell to whomever they choose, Moscow's leverage and power over them immediately declines substantially thus putting the entire imperial project for the CIS in question. Hence monopolization of energy sales from Central Asia is an essential component of Russian neo-imperialism there and in regard to China, one of Russia's few options for gaining some leverage vis-à-vis China. As for China, since it cannot obtain equity stakes in those holdings it must accept dependence, against its instincts, on foreign producers and sellers.

Therefore despite protestations of mutual identity of interests and eternal friendship in high-level Sino-Russian meetings, the reality in energy and economics has been actually mutual suspicion and tough bargaining.

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[20] Aleksandr' Tuttushkin, Irna Reznik, Rodion Levinsky, "Without a Struggle Gazprom Talked china Out of Bidding on Yuganskneftgaz," *Vedomosti*, December 10, 2004, *FBIS SOV*, December 10, 2004.

[21] U.S.-China Economic and Security Review Commission 2004, Report to Congress, p. 157.

[22] Shiping Tang, "Economic Integration in Central Asia: the Russian and Chinese Relationship," *Asian Survey* XL, 2 (2000): 360-376, and the sources cited there; "Statement of Dean P. Girdis," *China's Energy Needs and Strategies: Hearing Before the U.S.-China Economic and Security Review Commission*, October 30, 2003, pp. 45, 51.

[23] "Russia Agrees to Nearly Double Oil Exports to China," *Radio Free Europe Radio Liberty Newsline*, November 8, 2005; "Russia, China to Launch New Energy Projects," *RIA Novosti*, November 7, 2005 <www.en.rian.ru/Russia/230051107/42012572.html> (November 7 2005).

President Vladimir Putin has at least twice publicly voiced suspicion of Chinese economic power in Asia and Russian officials have publicly opposed any Chinese military presence in Central Asia.[24] While China carefully avoids overt acts that trigger suspicions about its goals in Central Asia and clearly supports Russia's dominant position there, facts on the ground suggest mutual irritation and suspicion and not just in energy issues.[25]

Chinese policymakers face a dilemma. They can rely largely upon Russian energy but then would depend on a state they perceive as increasingly unreliable. Russian leaders want to sell China this energy because they want the market and the leverage on China that it provides since they otherwise only can use arms sales as leverage vis-à-vis China. But doing so then angers Japan and leaves Russia dependent upon a single, monopolistic consumer. Although the most recent evidence suggests that the Siberian pipeline will probably go first to China and only then to Japan, Russia's constant flirtations with both states make this an inherently unstable situation that could deteriorate for both political and economic reasons, e.g. Russia's continuing interest in a Japanese market.[26]

Simultaneously, although talks with Russian suppliers continue concerning projects in Russia or cooperative ventures abroad, this dependence contradicts Chinese policy that seeks to maximize the reliability of long-term supplies, even to the extent of sending Chinese military forces disguised as oil workers, to guard their foreign investments, as in Sudan.[27] As China is being forced into dependence upon outsiders, it has reacted accordingly by trying harder to globalize its investments. Thus it is hardly surprising that it tried to buy Unocal in the U.S. market and Petrokaz, a major Canadian owned firm with sizable holdings in Kazakhstan.

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[24] "President Putin Urges Radical Changes in Policy in Russian Far East," *ITAR-TASS*, July 21, 2000, Retrieved from Lexis-Nexis; "China Could Compete with Russia in Transport Project Involving Koreas, Trans-Siberian Railroad," *Interfax*, August 29, 2002, Retrieved from Lexis-Nexis; Interview with Deputy Foreign Minister Vyacheslav Trubnikov, Moscow, *Nezavisimaya Gazeta*, (in Russian), May 12, 2004, *FBIS SOV*, May 14, 2004.

[25] *Ibid.;* Shiping Tang, "Economic Integration in Central Asia: the Russian and Chinese Relationship," *Asian Survey*, XL, No. 2, (2000): 360-376.

[26] "Siberian Pipeline to go to China First," *Alexander's Oil & Gas Connections*, September 28, 2005, <www.gasandoil.com/goc/new/nts53998.htm> (September 28 2005).

[27] "Gazprom and CNOOC in Discussion to Cooperate," *Alexander's Oil & Gas Connection*, October 11, 2005, <www.gasandoil.com/goc/company/cnr54196.htm> (November 1 2005); "Gazprom and CNPC Mull Cross-Border Gas Pipeline," *Alexander's Oil & Gas Connections*, October 11, 2005, <www.gasandoil.com/goc/company/cnr54106.htm> (November 1 2005).

The Petrokaz Saga

Here again the same problems arose again. No sooner did a Canadian court dismiss Lukoil's lawsuit against CNPC's purchase of Petrokaz, Nelson Resources Ltd. a Bermuda based energy firm that is being taken over by Lukoil, then moved to block it from taking control of the North Buzachi oil fields in Kazakhstan. Lukoil's action in many ways resembles the outcry in the United States that blocked China's attempted purchase of Unocal earlier this year. Worse still, Kazakhstan's legislature then rushed through a law empowering the Kazakh government to preempt that sale. It also appears that Kazmunigaz, Kazakhstan's state oil company "is also expected to seize a sizable chunk of Petrokaz from CNPC. Control over the Shymkent refinery, purchased by Petrokaz in 2000, will almost certainly revert to the state."[28]

Neither America nor Kazakhstan want China to own their firms or energy fields and gain undue political influence over them. Nor will they accept China having what they regard as undue access to their energy assets. Those are strategic assets to be used for the greater national interest. As Dmitry Lukashov, a Russian oil analyst at the Aton brokerage house observed, only naïve investors would believe that Kazakhstan would let China walk away with 100 percent of Petrokaz because, "Fear of China with its huge population and growing economy runs deep in Kazakhstan."[29] Lukoil's intervention shows that Russia too opposes China's quest for equity in Central Asian or Russian energy companies. Russian energy producers and government have steadily rebuffed China's efforts toward that end and are determined to maintain autarchic control over energy—Russia's strategic resource. Though they will sell China energy, Russian officials fear becoming merely China's source for raw materials and demand equal status in economic-technological exchanges with China.

China's rivalry with Russia on energy is an anomaly when one assumes an unbreakable strategic partnership with Russia against American pretensions in Northeast and Central Asia.[30] Yet that strategic and political balancing act is real and an increasingly important local political factor in Central Asia. Indeed, Russian sources revealed in August, 2005

[28] "Kazakhs Seek 'Strategic Control' Over Petrokaz," *Central Asia Caucasus Analyst, News Section*, September 21, 2005; Isabel Gorst, "Interesting Times in Kazakhstan Spell Trouble for Chinese Global Interest in the Central Asian Country's Oil and Local Fear of its Giant Neighbor Do Not Bode Well for CNPC," *Financial Times*, London, October 19, 2005, p. 31.

[29] *Ibid.*

[30] David Kerr, "The Sino-Russian Partnership and U.S. Policy Toward North Korea: From Hegemony to Concert in Northeast Asia," *International Studies Quarterly*, 49, 3 (September, 2005): 411-437.

that one reason for Moscow's haste in seeking to enter the former American base at Karshi Khanabad in Uzbekistan once U.S. forces leave was because China had made discreet but clear expressions of its interest in gaining that base.[31] Thus not only is there a visible economic rivalry, especially in regard to energy, there is also a subterranean or masked but real strategic rivalry as well. In fact the energy rivalry and Russia's position as supplier is one of the few instances of leverage available to Russia as it contemplates a rising China. Indeed, some analysts speculate that it could eventually lead to deals with European and American firms active in Central Asia against China.[32]

While it is unclear if friction over energy supplies can undermine the Russo-Chinese strategic and anti-American partnership in Northeast and Central Asia; it does indicate that not all is well in China's ties either with Russia or Kazakhstan and that it has limited success in securing its vital interests of reliable energy supplies under its control. For the moment, because Russia supplies China with considerable amounts of energy and supports its balancing act against America, the government in Beijing has swallowed Russian attacks upon its vulnerabilities even though its diplomats know they are being exploited. But we should not expect this state of affairs to last forever. Thus we could see at some future date a reversal of fortune whereby America might be able to exploit Russo-Chinese or Russo-Kazakh energy and economic tensions in order to enhance its position in Central Asia which is currently under considerable pressure from Moscow and Beijing. At the same time, neither can we rule out all other conceivable options given the complexities of international and regional politics in Central Asia. Consequently in view of the centrality of this issue for China's domestic stability, its global foreign policies, and for regional developments in and around Central Asia, the future course of its quest for Eurasian energy supplies must and surely will exercise a profound impact upon energy markets and upon both China's internal stability and international affairs in general.

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[31] Vladimir Mukhin, "Poslednaya Nabrosok na Iuge," *Nezavisimaya Gazeta*, August 8, 2005.

[32] Celeste Wallander, "Silk Road, Great Game or Soft Underbelly? The New US-Russia Relationship and Implications for Eurasia," in Shireen Hunter Ed., *Strategic Developments in Eurasia After 11 September* (London: Frank Cass Publishers, 2004), 103.

The Dragon and the Magi: Burgeoning Sino-Iranian Relations in the 21st Century

J. Brandon Gentry[*]

Over the last several years, China and Iran have significantly strengthened their bilateral ties, reaching out to one another on issues ranging from energy and nuclear proliferation to trade, tourism, and military cooperation. With a relationship bolstered by a shared suspicion of U.S. interests, China's ever-growing thirst for energy resources, and Iran's desire to maintain its position as a Persian Gulf powerhouse, the Sino-Iranian partnership looks to move forward at a steady pace into the foreseeable future.

In many ways, the close Sino-Iranian relationship is a natural one, underpinned by historical ties and enhanced by contemporary mutual interest. Both countries have rich cultural and national identities, and view themselves as heirs to proud, ancient civilizations. In terms of energy and security, Iran is one of the richest oil and gas producing countries in the world, and the Shia leaders in Tehran harbor no love for the radical Central Asian Sunni Islamist groups that so worry Beijing. And of course, both China and Iran see themselves as opponents of U.S. regional hegemony, powerful nations bold enough to challenge the world's sole remaining superpower.

Sino-Iranian contact dates back to at least the second century BCE, when the Han Dynasty of China opened up the Silk Road and initiated trade with the Parthian empire. The Parthians served as a bridge between the Asian and Mediterranean worlds until they fell to the Sassanids in the third century CE, but the Silk Road continued to facilitate the Persian-Chinese cultural exchange for centuries to come, through the Arab conquest of Persia and into the modern era. A shared Silk Road heritage links China, Iran, and the post-Soviet states of Central Asia, and serves as a historical foundation for contemporary cooperation.

Today, Sino-Iranian energy cooperation is at an all-time high as Iran ascends to an increasingly critical role in China's 21st century energy strategy. China has become one of Iran's largest foreign investors, and both countries have been promoting Sino-Iranian cultural interaction.

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More worrisome to many in Washington is Beijing's established record of arming Tehran and assisting in Iran's nuclear development programs. While the long-standing acrimony between Iran and the U.S. shows no signs of dissipating, Iran is looking to China for support and partnership. Additionally, the Shanghai Cooperation Organization (SCO) has the potential to serve as a forum for further Sino-Iranian development, as Central Asia is a region in which China and Iran share mutual concerns and interests.

Conveniently, there is little in the way of modern conflict or animosity to stand in the way of Sino-Iranian relations. China maintains no imperialist or colonialist legacy in the Middle East, something the Islamic Republic, a country with particularly bitter memories of Western exploitation, is acutely aware. Post-revolution Iran has staunchly maintained its anti-imperialist outlook, and has energetically challenged U.S. interests in the region. Though Islam and Communism are markedly different and, some might say, conflicting ideologies, both regimes have consistently favored political, economic, and strategic pragmatism over ideological fervor. It is this pragmatism that has allowed the Sino-Iranian relationship to endure and thrive.

The Cold War and Its Aftermath

The Cold War had a profound impact on Sino-Iranian relations. The U.S.-Soviet rivalry, as well as the Sino-Soviet split, shaped and guided political, cultural, and economic interactions between China and Iran, and established a foundation for the expansion of ties in the wake of the Soviet collapse.

Following the emergence of the People's Republic of China in 1949, the rabidly anti-Communist Mohammad Reza Shah Pahlavi immediately severed diplomatic relations with Beijing. Consequently, throughout the 1950s and the first half of the 1960s, Beijing adopted a strong anti-Shah position, viewing the Pahlavi regime as little more than a front for U.S. interests in the Persian Gulf. Beijing supported various anti-Shah and Iranian nationalist movements, and cheered the rise of Mohammad Mossadegh in 1952. In return, the Shah established diplomatic relations with Taiwan in 1956, securing his solidly anti-Beijing position.

However, the Sino-Soviet split and the initiation of the U.S.-Soviet détente in the 1960s drastically altered Sino-Iranian relations. Suddenly, Tehran and Beijing shared a common enemy in the Soviet Union, and the animosity between the two regimes began to thaw accordingly. The Shah's distrust of the Soviet Union was rooted in the long history of Russian-Iranian conflict; once Beijing and Moscow had declared one another enemies, Tehran was more than willing to take Beijing's side in

the struggle, especially when it appeared that Washington was starting to take a more conciliatory attitude towards Moscow.

As Maryam Daftari observes, "From the late 1960s, Sino-Iranian policies seemed to be heading towards some kind of a convergence, with Iran's increasing economic and military power on the one hand, and the growing importance of China on the other."[1] One of the critical factors in the development of this relationship was the willingness of both Beijing and Tehran to disregard existing ideological rifts in order to adopt a more pragmatic and effective strategy based on perceived threats. Though the Shah was a consistent and brutal oppressor of the Iranian communist movement, Beijing embraced the Pahlavi regime and ignored the Shah's persecution of their ideological brethren. Likewise, the Shah chose to nurture the Sino-Iranian relationship despite Beijing's political philosophies, and despite the Chinese Communist Party's persecution of Chinese Muslims. Essentially, beginning in the 1960s, a mutual distrust of the Soviet Union, the Shah's desire to secure a powerful benefactor in the event that the U.S.-Iranian relationship should sour, and China's interest in cultivating an influential relationship in the Persian Gulf all served, to drive Tehran and Beijing closer together .

The 1970s began with a major step forward in Sino-Iranian relations, as Iran supported China's 1971 entry into the United Nations. That same year, diplomatic ties between the two countries resumed. Throughout the 1970s, the Sino-Iranian relationship warmed, as Beijing and Tehran developed more substantial political and economic relationships. However, during this period the Sino-Iranian friendship was based on little more than a mutual animosity towards the Soviet Union, with little more to sustain it. There were, in reality, few substantial economic or cultural ties to bind the two nations.[2] This changed with the fall of the Shah in 1979.

Even though Beijing had supported the Shah in the 1970s, relations between the PRC and the Islamic Republic were, from the beginning, consistently cordial. Beijing immediately recognized the Islamic Republic, welcoming Tehran's new regime into the fold of non-aligned developing nations and professing admiration for the revolutionary, anti-Western spirit of its ideology. Furthermore, in the 1980s, as in the time of the Shah, both Tehran and Beijing opted for a pragmatic approach to one another as opposed to one rooted in ideology. Though Iran's new leader, Ayatollah Khomeini, was no friend to the communists, imprisoning and executing many and finally outlawing the communist Tudeh Party in

[1] Maryam Daftari, "Sino-Iranian Relations and 'Encounters:' Past and Present," *The Iranian Journal of International Affairs* 7, 4 (Winter 1996).
[2] *Ibid.*

1982, this did little to dampen the Sino-Iranian friendship. Likewise, the Islamic Republic overlooked Beijing's persistent persecution of China's Muslim population.

In the last decade of the Cold War, Beijing continued to enthusiastically support Tehran's non-alignment stance in the face of U.S. and Soviet pressures. China approved Iran's antagonism towards Iraq, a nation that Beijing had long considered a Soviet proxy state. Though China supplied weapons to both sides of the 1980-1988 Iran-Iraq War, when the conflict ended Beijing announced that it wished to facilitate post-war Iranian reconstruction when a devastated Iran had few other friends. Furthermore, the fallout from the Tiananmen Square massacre drew Beijing and Tehran even closer together, each regime by 1989 having been granted "pariah status" by most Western nations.

The end of the Cold War did little to dampen the Sino-Iranian relationship. In the early 1990s, Tehran turned to Beijing for help in rebuilding its depleted military capabilities. At the same time, China stepped-up its assistance to Iran's nuclear program. The two countries, much to the displeasure of the U.S., signed a nuclear cooperation agreement in 1992. Though U.S pressure did manage to stifle full Sino-Iranian nuclear cooperation in the 1990s, Beijing nonetheless provided Tehran with material and technical assistance throughout the decade. In 1993, the two countries established the Chinese-Iranian Joint Commission on Economic, Trade, Scientific, and Technical Cooperation, creating a forum for the expansion of ties in multiple areas. Also in 1993, China ceased being a net exporter of oil, increasing its dependence on foreign energy sources and creating a lucrative market for Iranian oil and gas. Politically, China's refusal to support the 1996 Iran-Libya Sanctions Act, drafted by the Clinton administration to punish Iran for its support of terrorist organizations such as Hezbollah, was a further indication of Beijing's desire to nurture Sino-Iranian solidarity as the 21st century approached.

Energy and Other Areas of Economic Cooperation

The Sino-Iranian economic relationship has grown at a steady pace since the end of the Cold War. In 1990, bilateral trade between the two countries totaled approximately $314 million; it rose to approximately $700 million by 1993.[3] Over the next 10 years, due in large part to China's rising energy needs, Sino-Iranian bilateral trade skyrocketed, and by 2003 was estimated to be approximately $5.6 billion. By 2004, this had

[3] Barry Rubin, "China's Middle East Strategy," *Middle East Review of International Affairs* 3, 1 (March 1999) <http://meria.idc.ac.il/journal/1999/issue1/jv3n1a4.html> (November 1 2005).

increased, by some estimates, to over $7 billion,[4] and the figures continue to climb: in the first eight months of 2005, Sino-Iranian trade was valued at approximately $6.3 billion, up over 44 percent from the same period the previous year.[5] Since 2003, China and Iran have established several sizeable energy deals, and have held numerous conferences promoting bilateral trade and economic cooperation. China has emerged as a critical aspect of the Iranian economy, a major energy customer, a source of technical expertise, and a key investor in a variety of fields. For its part, Iran has become a crucial energy source for China, and its 68 million residents represent a potentially significant market for Chinese goods.

Energy is without a doubt the most important aspect of Sino-Iranian economic cooperation, and accounts for the vast majority of bilateral trade. Generally speaking, energy has driven China's growing presence in the Middle East since the end of the Cold War. Prior to the fall of the Soviet Union, Beijing's involvement in Middle Eastern affairs was limited: Beijing viewed many Arab states as either U.S. or Soviet pawns, and China's often-close relationship with Israel further complicated its interaction with the Arab world. However, during the 1980s China began to increase its investment in Middle East energy projects, sending materials, technical assistance, and laborers to a number of Gulf states. By 1990, China was receiving approximately 40 percent of its oil from the Middle East; by 2002, this percentage had increased to 60 percent, or approximately 507 million barrels. Today, imports from Saudi Arabia and Iran account for roughly two-thirds of China's total oil imports. [6]

Circumstances have conspired to make China and Iran well-suited energy partners. Beijing's rapid and extensive industrialization and development campaigns require access to vast energy resources, and China has been dependent on energy imports for over a decade. Furthermore, China's energy security strategy largely depends on the use of overland energy pipelines, making resource-rich Central Asia and Iran attractive from a supply perspective. For its part, Tehran counts on its significant oil and natural gas wealth to help it weather the political and economic isolation imposed upon it by the U.S. since 1979.

The sharp increase in global energy demand has netted Tehran considerable revenues in recent years, and has significantly improved its economic and geopolitical standing. As OPEC's second largest oil producer (behind only Saudi Arabia) the Islamic Republic is using its energy reserves to strengthen its partnership with China (as well as India, Russia, and others) and to secure its position as a significant

[4] *Islamic Republic News Agency*, January 19 2005.
[5] *Islamic Republic News Agency*, October 13 2005.
[6] Lin Liangxiang, "Energy First: China in the Middle East," *Middle East Quarterly* 12, 2 (Spring 2005) <http://www.meforum.org/article/694> (November 1 2005).

regional power. Given China's current and projected energy requirements, the Sino-Iranian relationship shows no signs of deteriorating in the new millennium. Currently, China imports approximately 60 percent of its oil needs; by 2020, that percentage is expected to rise to nearly 77 percent.[7]

Iran's energy situation improved greatly in 2003, when Tehran announced that the Azadegan oil field, located in southwestern Iran near the Iran-Iraq border, would potentially increase the country's crude oil reserves by 38 billion barrels. In 2004, additional discoveries further boosted Iran's oil reserves to approximately 132 billion barrels, over 11 percent of the world's total oil reserves. Iran also possesses the world's second largest natural gas reserves (behind Russia), with 15 percent of the world's total. China, concerned about the increasingly severe environmental effects of its ravenous coal consumption, is looking to greatly increase its use of natural gas over the next 20-25 years.

2004 was a banner year for Sino-Iranian energy cooperation, as China and Iran announced the signing of two major energy deals. In March 2004, the state-owned Zhuhai Zhenrong Corporation agreed to import 110 million tons of Iranian liquid natural gas (LNG) over 25 years, a deal worth approximately $20 billion. Just months later, in October 2004, Sinopec, another state-owned Chinese energy company, agreed to a deal worth $100 billion over 25 years involving the import of 250 million tons of Iranian LNG. As part of the October deal, Sinopec agreed to help develop and exploit Iran's massive Yadvaran oil field, from which China will receive 150,000 barrels of oil a day for 25 years. As a result of the Sinopec deal, China has emerged as Iran's top oil importer, and currently receives approximately 14 percent of its total oil imports from Iran. Naturally, this relationship with Beijing allows Tehran to more easily weather such complications as the Iran-Libya Sanctions Act, which prohibits any one company from investing more than $20 million per year in Iran's petroleum industry.

From a security perspective, China recognizes that its sea lines of energy transport are vulnerable to disruption. In the event of a conflict with the U.S., for example, Arabian oversea oil supply lines could be easily cut by a U.S. naval blockade. Consequently, Beijing has invested in overland gas and oil pipelines throughout the Caspian Sea region. In August 2005, for example, Beijing announced that it would be willing to spend $4.18 billion to acquire PetroKazakhstan, a Canadian-owned corporation with significant oil holdings in Central Asia. In October, the company's

[7] Shuja Sharif, "Warming Sino-Iranian Relations: Will China Trade Nuclear Technology for Oil?" *Jamestown Foundation China Brief* 5, 12 (May 24 2005), <http://www.jamestown.org/publications_details.php?volume_id=408&issue_id=3344&article_id=2369793> (November 1 2005).

shareholders voted to approve the deal, but the acquisition has been put on hold by Canadian courts.[8] Nevertheless, if the deal ultimately goes through, it would represent China's largest foreign acquisition to date.[9] China has also agreed to build a 614-mile long pipeline from Kazakhstan to western China, and is interested in contributing to another project connecting the Kazakhstan pipeline to Iranian oil fields. Furthermore, China has held talks with Turkmenistan to discuss additional pipeline projects to supply Chinese markets.[10]

Though the energy trade maintains the largest portion of the Sino-Iranian economic relationship, it is clear that Beijing and Tehran are interested in expanding economic cooperation and collaboration in a variety of other areas. For instance, in April 2005, following the signing of a Sino-Iranian Memorandum of Understanding on the expansion of bilateral trade and cooperation, the Iran Khodro group agreed to manufacture automobiles in China, an arrangement worth approximately $60 million in Sino-Iranian joint investments. Production is scheduled to begin in 2006. In February 2005, Iranian and Chinese labor ministers met in Beijing to discuss the strengthening of labor ties between the two nations, and in May 2005 Chinese and Iranian aerospace officials came together in Beijing to discuss cooperation in this sector. Furthermore, in August 2005 an Iranian delegation traveled to China to participate in talks designed to explore ways in which China might help Iran join the World Trade Organization. China has also contributed to a number of domestic Iranian infrastructure projects, including the construction of a subway line in Tehran.[11] An aluminum deal worth approximately $1 billion, in which China and Iran would cooperate on a smelter to be built in the port town of Bandar Abbas, is in the works.[12] And recently, Iranian Foreign Minister Manoucheher Mottaki announced that incentives would be distributed to Iranian embassies that managed to develop international trade in areas other than energy, further indicating Tehran's desire to diversify its export capabilities.[13]

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[8] "Shareholders Back U.S. $4bn Sale of PetroKazakhstan," *Taipei Times*, October 20 2005, <http://www.taipeitimes.com/News/worldbiz/archives/2005/10/20/2003276612> (November 1 2005).

[9] Erich Marquardt, "Economic Brief: China's Energy Acquisitions," *Power and Interest News Report*, Sept 2 2005, <http://www.pinr.com/report.php?ac=view_report&report_id=359&language_id=1> (November 1 2005).

[10] "China, Turkmenistan Reinforce Solid Relationship, Seven Documents Signed," *News Central Asia*, July 20 2005, <http://www.newscentralasia.com/modules.php?name=News&file=article&sid => (November 1 2005).

[11] "Iran, China sign contract on 4th Tehran metro line," *Payvand Iran News*, May 15 2004, <http://www.payvand.com/news/04/may/1097.html> (November 1 2005).

[12] "China and Iran in $1bn aluminum deal," *Tehran Times*, October 15 2005.

[13] "Mottaki: Successful embassies in exports promotion receive incentives," *Islamic Republic News Agency*, October 19 2005.

While bilateral trade between China and Iran is on the rise, Iran ultimately occupies a small place in China's national economy. Economically speaking, China is far more important to Iran than Iran is to China, and the U.S. represents a much more lucrative market for Chinese goods. Though Sino-Iranian bilateral trade will likely top $7 billion in 2005, total Sino-U.S. bilateral trade in 2004 was valued at over $170 billion. By 2010, some predict that the total trade between China and the U.S. will reach upwards of $300 billion;[14] even taking into account China's soaring energy needs, Sino-Iranian trade will not likely approach these levels. However, Iran's energy wealth, combined with China's rapid development and increasingly westward orientation, will ensure that Tehran maintains an important position in Beijing's national strategy.

The Nuclear Issue

Though it is unclear as to exactly what extent China has contributed to Iran's nuclear program, most suspect that China has played a substantial role in the development of the Islamic Republic's nuclear capabilities. Given Iran's increasingly important place in China's energy strategy, many fear that Tehran will use its improved position to obtain further nuclear assistance from Beijing. These fears are amplified by China's recent support of Iran in the Islamic Republic's standoff with the U.S. and the European Union.

China's nuclear cooperation with Iran began in secret, in the 1980s, when Beijing supplied Tehran with a small training reactor and calutrons, used for the experimental separation of uranium isotopes. The nuclear cooperation continued into the 1990s, with a number of bilateral nuclear agreements signed between Tehran and Beijing, as well as an increasing anxiety on behalf of Washington as to China's role in the Islamic Republic's nuclear ambitions. Though U.S. pressure caused some Sino-Iranian reactor projects to be cancelled, numerous others were completed, and China also supplied Iran with technical assistance, training, and uranium enrichment and conversion facilities.[15] In 1997 Beijing pledged to Washington that it would cease all nuclear cooperation with Iran; however, there have been many reports since this pledge that the Chinese government and a number of private Chinese firms have continued to supply nuclear equipment and material to the Islamic Republic.

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[14] "Sino-US trade to double in 2010 to US$300bln amid rows," *People's Daily Online*, September 3 2005 <http://english.people.com.cn/200509/03/eng20050903_206172.html> (November 1 2005).

[15] Nuclear Threat Initiative: Iran Nuclear Profile, <http://www.nti.org/e_research/profiles/Iran/ 2867_2868.html> (November 1 2005).

Recently, China's continuing support of Iran's nuclear development programs has been a major challenge to U.S. policy. China has consistently voiced its preference that Iran's nuclear development be monitored by the IAEA, and has opposed Iran's referral to the UN Security Council for non-proliferation violations. Consequently, Iran has gained a valuable Security Council ally, though Tehran has serious doubts about whether or not Beijing would employ its veto power to help Iran avoid UN sanctions. While this scenario is a major concern of the U.S., Beijing has never promised to use its veto power in this way, and in 2004 an Iranian Supreme National Security Council official declared, "We would be mistaken if we thought China would ever stand up to the Americans and engage in an embroilment over Iran's nuclear activities," pointing out that China's trade with the U.S. is "a thousand times more than that with Iran."[16]

Even so, China's political support of Iran's nuclear development, as well as what many suspect is its continuing material and technical support, reinforces the Sino-Iranian alliance and greatly improves Tehran's position. And because China is leaning so heavily on Iran as an energy source, Beijing will likely oppose any sanctions significantly harming Sino-Iranian energy cooperation. Just as trade with China has helped Iran successfully weather the Iran-Libya Sanctions Act, Sino-Iranian energy cooperation will likely allow Tehran to absorb any adverse effects from sanctions related to its nuclear development programs. Furthermore, by helping Iran oppose the U.S., China improves its image in the region, projecting itself as a political powerhouse able to keep Washington from imposing its will on any country it likes.

Chinese Weapon Transfers to Iran

Beijing's transfer of weapons systems and technical expertise to Iran has traditionally been, from a U.S. perspective, one of the most troubling aspects of the Sino-Iranian relationship. Though it is debatable as to the exact quality and quantity of Chinese weapons obtained by Tehran, it can certainly be argued that China has played an important role in supplying the Iranian military since the early 1980s. Furthermore, though Iran is still lacking the technology and equipment needed to make the country a significant conventional threat to its neighbors, with Beijing's help, Tehran has managed to develop into a serious asymmetric threat to U.S. interests in the Gulf region.

Since the 1980s, China and Iran have been frequent and substantial partners in the international arms trade. The Islamic Republic, desperate

[16] *Iran Press Service*, November 6 2004, <http://www.iran-pressservice.com/ips/articles2004/november/china_iran_61104.shtml> (November 1 2005).

to develop a military capability to protect it from its external and internal enemies and desiring to maintain its position as an important political and military power in the Persian Gulf, has repeatedly turned to Beijing (among others) for its arms. Beijing, eager to foster positive relations with Middle Eastern nations and desiring the revenues received through the arms trade, has helped Tehran restore its depleted pre-revolutionary arsenals. As a result, the Sino-Iranian arms trade has served to bolster the overall Sino-Iranian relationship for nearly 25 years.

Today, Iran, with approximately 540,000 troops and 350,000 reserves, possesses the largest standing military of any other Middle Eastern nation.[17] Furthermore, Iran, with China's help, has developed a powerful anti-access capability, and could substantially complicate U.S security and energy interests in the Gulf. As Michael Eisenstadt points out: "The main conventional threat from Iran is... the threat it poses to the flow of oil from the region, the security and stability of the southern Gulf states, and the ability of the United States to project force in the region."[18]

Prior to the 1980s China's weapons sales to the Middle East were minimal, but during the last decade of the Cold War the Middle East represented the primary market for Chinese arms.[19] Beijing, in an attempt to counter perceived Soviet influence in the region, provided a number of Middle Eastern regimes, including Iran, with a variety of weapon systems and technologies. Though some have argued that China's weapons, most of which had been derived from older Soviet and German designs, were of questionable quality and had a minimal impact on the overall balance of power in the Middle East,[20] Beijing's transfer of arms to Tehran, in particular, significantly improved the Islamic Republic's military capabilities. Taking advantage of both the Iran-Iraq War and Iran's post-revolution political isolation, China focused a large portion of its arms trade on Iran, bringing Beijing both significant financial gain and a closer relationship with Tehran. According to Bates Gill, Iran, behind only Pakistan and North Korea, has been the largest recipient of Chinese arms and technology.[21]

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[17] Anthony H. Cordesman, "Iran's Developing Military Capabilities," Center for Strategic and International Studies Working Paper, December 2004, <http://www.csis.org/burke/mb/041208_IranDevMilCap.pdf > (December 8 2004).

[18] Michael Eisenstadt, "The Armed Forces of the Islamic Republic of Iran: An Assessment." *Middle East Review of International Affairs* 5, 1 (March 2001).

[19] Yitzhak Shichor, "Mountains Out of Molehills: Arms Transfers in Sino-Middle Eastern Relations," *Middle East Review of International Affairs* 4, 3 (September 2000).

[20] *Ibid.*

[21] Bates Gill, "Chinese Arms Exports to Iran." *Middle East Review of International Affairs* 2, 2 (May 1998).

Prior to 1979, Iran, thanks to the generosity of the U.S. and Great Britain, had one of the most advanced, well-equipped, and well-trained militaries in the Middle East. After the Shah, however, the Islamic regime, wary of a counter-coup and preferring to rely on its masses of devout (but ill-trained) irregular revolutionary forces, purged the Iranian military of many of its most capable officers. The politicization of the Iranian military and the rift which developed between the Iranian regular army forces and the Islamic Revolutionary Guard Corps (IRGC) further undermined Iranian military capabilities.[22] The Iran-Iraq War (1980-1988) greatly depleted Iran's pre-revolution military capabilities, as many of the advanced weapons systems obtained by the Shah were captured or destroyed by the Iraqi forces; those that were not lost could not be adequately maintained due to a lack of technical knowledge and Western parts. Meanwhile, Iraq was receiving advanced weapons systems from the U.S. and Russia. As a result, a desperate Iran turned to China for its military needs, and the Sino-Iranian arms trade emerged.

Since the initiation of the Sino-Iranian arms relationship, China has played a large role in transforming Iran into a powerful regional power. Perhaps most significantly, China has contributed heavily to Iran's development of long-range ballistic and anti-ship cruise missiles, as well as to Iran's naval capabilities. China has, since approximately 1986, provided entire missile systems to Iran and has also contributed to the development of native Iranian missile systems.[23] Iran has developed a fairly advanced naval mine capability with Chinese assistance, and China has also provided a number of fast-attack boats to Iran. These contributions have significantly enhanced Iran's military capabilities in the region, and have ensured that Iran maintains an important place in Middle Eastern strategic calculations.

In 1986, Iran received the first of many shipments of HY-2 "Silkworm" anti-ship cruise missiles from Beijing. Though hardly state-of-the art even in 1986, these cruise missiles, and subsequent anti-ship missile systems such as the C-801 and C-802, continue to provide the Islamic Republic with a considerable anti-access capability. The Persian Gulf is one of the busiest waterways in the world, and the U.S. has demonstrated that one of its key weaknesses is in its navy's ability to protect against asymmetric threats in littoral (i.e. coastal) areas. This was made abundantly clear in the Millennium Challenge war game, held in 2002 and designed to test various U.S military doctrines and systems against an anti-access enemy based largely on Iran. Over the course of the game,

[22] Michael Eisenstadt, "The Armed Forces of the Islamic Republic of Iran: An Assessment." *Middle East Review of International Affairs* 5, 1 (March 2001).

[23] Nuclear Threat Initiative: Iran Missile Profile, <http://www.nti.org/e_research/profiles/Iran/Missile/2420.html> (November 1 2005).

the Red Team leader, playing the part of an unfriendly Islamic regime, crippled U.S. naval forces in the Gulf using a variety of asymmetric methods, including anti-ship cruise missiles.[24] The Millennium Challenge demonstrated the significance of China's cruise-missile transfers to Iran, and underscored the potential of Iran to use this capability to undermine U.S. strategic interests in the Persian Gulf.

The Shanghai Cooperation Organization: A Further Opportunity for Cooperation

Though the SCO is steadily emerging as a substantial, relevant partnership, there is still a great deal of uncertainty concerning its future. For the time being, the organization exists as a potential challenge to U.S. interests, but one which is in danger of being pulled apart by disparate aims and pressing economic limitations. NATO's Partnership for Peace, to which all SCO member states other than China and Russia belong, serves as a formidable counterpoint to the organization and a mechanism by which NATO can extend its influence in the region. Furthermore, the Central Asian countries, with the period of Soviet domination still fresh in their memories, seem reluctant to side decisively with any great power. Lingering, substantial Sino-Russian suspicions still exist, and it's unclear as to whether or not the two countries have the same goals for the SCO. That said, it is clear, especially given the recent expulsion of U.S. troops from Uzbekistan, that China hopes to use the SCO to further its goals in Central Asia, leveraging some countries' disenchantment with the U.S. to its advantage.

Additionally, the SCO could facilitate China's interactions with non-Central Asian countries, most significantly Iran. In July 2005 Iran (along with India and Pakistan) was granted observer status in the SCO. Afterwards, the Islamic Republic News Agency reported that First Vice President Mohammad-Reza Aref had expressed his desire for Iran to "serve as a bridge between SCO members and the Persian Gulf littoral states,"[25] something which Beijing no doubt desires, as well. More recently, Beijing reiterated the importance of the SCO to Sino-Iranian relations when Chinese Foreign Minister Li Zhaoxing declared during an October 2005 meeting with his Iranian counterpart that the SCO should serve as the "proper ground" for expansion of Sino-Iranian ties.[26]

Iran and the SCO are a good fit. Many of the SCO's primary objectives, as laid out in the organization's charter, are shared by Iran. Central Asian

[24] "Wake-up Call," *The Guardian*, September 6 2002.
[25] *Islamic Republic News Agency*, July 5 2005, <http://www.irna.ir/en/news/view/menu236/0507050960160340.htm> (November 1 2005).
[26] "China and Iran to strengthen ties," *Islamic Republic News Agency*, October 13 2005.

security is a key concern for Tehran, and the regime harbors little love for the extremist Sunni Islamist organizations the SCO has vowed to eliminate. Energy security, threatened by extremist groups looking to destroy pumping stations and overland oil and gas pipelines, is another concern for Tehran. The SCO member states have also pledged to combat heroin trafficking throughout Central Asia; Iran, with an approximate 2 million addicts, has one of the worst national heroin addiction problems in the world, and Tehran is eager to cut down on the flow of narcotics across its borders.[27]

Iran's new status as an SCO observer will also help Iran more effectively engage the Central Asian regimes. While Tehran has actively pursued relations with the post-Soviet states since their independence, cooperation has been limited due to a number of factors, including Iran's reluctance to antagonize Russia by interfering in an area Moscow still considers to be within its traditional sphere of influence. Economic challenges have also hindered more extensive Iranian-Central Asian cooperation.[28]

However, despite limited economic resources, the Islamic Republic has established some energy and economic partnerships with various Central Asian countries, including oil-swap deals with Kazakhstan and transportation cooperation arrangements with Uzbekistan. It is quite possible that the considerable revenues generated from 2004's Sino-Iranian gas and oil deals will enable Iran to pursue a more aggressive Central Asian policy, especially in the context of a cooling U.S.-Central Asian relationship.

Cultural Ties

Present day China and Iran each consider themselves heirs to ancient, advanced cultures, take great pride in the contributions their civilizations have made to history, and regularly reference the glories of the past as a means of charting a course for the future. As a result, history and culture have become a means of reinforcing more substantial Sino-Iranian ties. China has taken to using its sizable Muslim population as a means of forging spiritual ties with the Islamic Republic, and recent agreements between China and Iran to increase tourism between the two countries directly reference the Silk Road, indicating that Chinese and Iranian

[27] "Iran's battle with heroin," *BBC News*, June 7 2002, <http://news.bbc.co.uk/1/hi/world/middle_east/2031624.stm> (November 1 2005).

[28] James P. Smith, "Iran pushes for positive political engagement in Central Asia," *Central Asia-Caucasus Analyst*, December 1 2004, <http://iicas.org/libr_en/geopolit/7_12_04.htm> (November 11 2005).

officials wish to reopen this historical channel of Sino-Iranian interaction, cooperation, and collaboration.

In June 2005, Iran's ambassador to China, Fereydun Verdinezhad, declared in an interview with the BBC, "China and Iran are the most important countries in eastern and western Asia respectively, and the Silk Road has linked our two countries together since ancient times. Under the new international situation, we should rebuild the Silk Road and erect a bridge of peace and security for Asia."[29] At an August 2005 Sino-Iranian Tourism Conference, a Chinese official echoed Verdinezhad's sentiments, saying, "I hope our two highly civilized nations would succeed in revival of the ancient Silk Road at this beginning of the 21st century."[30]

Though China's Muslim Uighurs have been the victims of persecution and discrimination in the wake of Beijing's development of Xinjiang, this has not kept Beijing from exploiting its indigenous Islamic culture to achieve greater solidarity with Tehran. Iranian officials have toured important mosques and met with Muslim leaders in Xinjiang, and in October 2005, Chinese and Iranian Muslims gathered in Yinchuan for a conference on promoting Sino-Iranian Islamic cooperation and collaboration.[31]

Conclusion

Sino-Iranian cooperation is likely to continue. Any fears that Beijing may have had concerning the state of Sino-Iranian relations following Iran's June 2005 presidential election, in which the conservative mayor of Tehran, Mahmoud Ahmadinejad, defeated the more moderate former President Hashemi Rafsanjani, were quickly put to rest. At his first press conference as President, Ahmadinejad reaffirmed Tehran's desire to cooperate with Beijing, pointing out that, "Iran is intended to promote relations with all amicable countries in the world, including China." He went on to declare, "Iran is on a path of progress and elevation, and does not really need the U.S. on this path," indicating that Iran plans to use its partnerships with China and others to challenge and subvert any actions taken against it by the U.S. [32]

Ultimately, the China-Iran equation is simple: China's energy needs dictate that Beijing secure reliable energy resources, and Iran, as one of

[29] *Xinhua News Agency*, June 14 2005.

[30] *Islamic Republic News Agency*, August 5 2005, <http://www.irna.ir/en/news/view/line22/0508050808193114.htm> (November 1 2005).

[31] *Asia Pulse*, October 10 2005.

[32] *Xinhua News Agency*, June 27 2005, <http://www.china.org.cn/english/international/133219.htm> (November 1 2005).

the most energy-rich nations on earth, is ready, willing, and able to provide those resources in exchange for the hard currency it needs to boost its economy. Meanwhile, its economic might and political clout make China a valuable ally for Iran in light of Iran's contentious nuclear program, while Beijing's support for Tehran in turn raises Beijing's profile in an increasingly important region.

In February 2001, George Tenet, then Director of the CIA, warned the U.S. Senate Select Committee on Intelligence that, in addition to Al-Qaeda, China and Iran posed the greatest threat to future U.S. security.[33] While the threat from Al-Qaeda has since been made violently clear, it is always important to keep things in perspective. China and Iran are sovereign nations, not stateless terrorist organizations, and consequently the decisions of both governments are dictated by more than ideology. The Sino-Iranian friendship, while sinister to some, is an essentially pragmatic development between two supremely self-interested parties, and it remains to be seen to what extent this development will impact U.S. geopolitical interests.

[33] John E. Dougherty, "Iran, China forming major alliance" *Newsmax*, November 18, 2004, <http://www.newsmax.com/archives/articles/2004/11/17/83609.shtml> (November 1 2005).

Japan's Central Asian Diplomacy: Motivations, Implications and Prospects for the Region

Christopher Len[*]

Following the collapse of the Soviet Union in 1991, five new independent republics emerged in the Central Asian region. In the early days as young independent republics, these states had very little economical experience, financial reserves, international diplomatic exposure, and national identity consciousness to speak of. On the domestic front, there were worries about social disruption and political collapse, of conservative Islam sweeping into power, of ethnic strife erupting, territorial disputes with neighbors descending into conflict, as well as environment degradation.

From a geopolitical perspective, there were concerns among analysts as to whom the Central Asia leaders might align themselves with and whether the new republics would be able to assert their independence fitfully. Based on the stereotype of the Central Asian states as helpless states of others' design, many in the U.S. foreign policy establishment initially thought that the Central Asia republics would fall into the sphere of Iranian influence, citing Islam as a bonding factor.[1] When it soon became clear that this assumption was wrong, attention shifted to the Russians who were attempting to pull the Central Asian states back into Russia's political orbit using their former Soviet economic links as leverage.[2] Competition over the region quickly heated up while Russia was attempting to reassert itself in its backyard, with Turkey, India, Pakistan, China and the United States throwing in their lot into this game of courtship to win favor with the Central Asian regimes.

As a result of such rivalry, there have been increasing admonitions in scholarly and policy research circles about the revival of the "Great Game", a reference to the rivalry and competition between the empires of

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[1] Stephen Blank, "Energy, Economics, and Security in Central Asia: Russia and its Rivals," Strategic Studies Institute, March 1995, p. 15, <http://www.strategicstudiesinstitute.army.mil/dffiles/ub119.pdf> (November 1 2005).

[2] *Ibid*., p. 5-13.

Great Britain and Tsarist Russia over supremacy in Central Asia in the 19th Century. Central Asia is often regarded as a strategic region because of its geographical position. The region has historically served as a crossroad between East and West and is surrounded by several great powers in the Eurasian landmass. To the north lies Russia, China is east of the region, India lies southeast while, the Middle East is southwest with Iran at its border. From a strategic viewpoint, these civilizations historically used Central Asia as a buffer zone against threats from one another. Similarly during the Great Game period, British India sought to contain Tsarist Russia in Central Asia to prevent it from advancing too far south. They were afraid that Russian expansion would threaten British dominance in the Indian sub-continent. In present days, the concern has shifted to how instability within this region could spread across borders impacting these neighbors and how balance-of-power could be achieved in order to stabilize the political situation in the region.

More recently, the vast and commercially viable quantities of crude oil and natural gas reserves in the region has contributed to the premium as well as the instability of the region. Oil was discovered in the Central Asia and Caspian region over a hundred years ago. When the Soviet Union controlled the region, the existence of the oil and gas wealth was known but only partially and poorly developed. After the collapse of the Soviet Union, the Central Asian and Caspian region is once again attracting attention due to the untapped oil and gas resources available. Turkmenistan is said to have proven oil reserves of roughly 546 million barrels although some reports claim oil reserves of as high as 1.7 billion barrels, and proven natural gas reserves of approximately 71 trillion cubic feet (Tcf). Similarly, Uzbekistan is reported to possess 594 million barrels of proven oil reserves with estimated natural gas reserves of 66.2 Tcf. Kazakhstan is said to have between 9 and 29 billion barrels of oil and a sizeable proven natural gas reserve of 65-70 Tcf.[3]

For the Central Asian states, these resources offer an economic lifeline which would enable them to end their economic isolation under Russia. Kazakhstan, Turkmenistan and Uzbekistan began to use their energy supply as an incentive for energy-hungry states to invest in the region. Although there are other factors at play, the presence of energy supplies could be considered as the single most decisive factor in attracting the Great Powers to compete over the region.

Chronologically, top-contenders in the region spanned from Iran in the early nineties, Russia in the mid-to-late nineties, the U.S. from 2001 after

[3] "Central Asia Fact sheet," Energy Information Administration, September 2005, <www.eia.doe.gov/emeu/cabs/Centasia/Background.html> (October 25 2005); "Kazakhstan," Energy Information Administration, July 2005, <www.eia.doe.gov/emeu/cabs/Kazakh.html> (October 25 2005).

9/11 till recently, followed by China and, to a lesser extent, Russia, from 2004 to the present day. While there are significant overlaps as the balance-of-power transits from one player to another, this timeline reveals how slippery Central Asia is for those vying for influence in the region. More importantly, it underlines the see-sawing attitudes of the local regimes towards the external powers. Essentially, the Central Asian regimes are trying to find equilibrium in their ties with the various players as part of their "balanced-diplomacy" strategy. They are not interested in a monogamous relationship (alliance), preferring instead varied options and flexibility to adapt to new challenges and threats.

Interestingly, among the many competing powers in Central Asia, Japan has received the least attention from strategic analysts fixed on the region and generated only limited interest from a geopolitical perspective despite having been present in the region since 1992. In contrast to the shifting attitudes of the Central Asian leaders towards the other external powers, the welcome mat has always been rolled out for Japan. An examination of Japan's post-Cold War history in Central Asia would reveal the country's standing as a major aid donor in the region. Tokyo's current strategy to keep itself out of the energy rivalry unfolding in the region and its aim to stabilize the region through long-term development aid as an end has given it the reputation of a partner, rather than a player in the Great Game. This is in contrast to the other players whose key motivation in the region is the exploitation of the region's vast oil and gas resources for their own needs. As this article will show, this makes the leaders of the various Central Asia states comfortable with its presence and allow Japan to play a special role on the region. In time to come, Japan is likely to find itself increasingly having an important role to play in the geopolitical sphere, not just in Central Asia, but Eurasia.

Rationale behind Japan's Initial Entry into Central Asia

The end of the Cold War created new opportunities for Japan to engage with the post-Soviet independent states, in particular, Russia. The initial rationale in such engagement was borne not out of altruism but a result of Japan's self-interest. When the Soviet Union collapsed, the availability of energy resources from the Russia's Siberian Far East and the return of the Kurile Islands (often referred to by the Japanese as the Northern Territories) by the Russians were the subjects closest to Japan's heart.

From the perspective of the Japanese, the two issues are essentially tied together. The islands, were explored and settled by the Russians and the Japanese in the 18th and 19th century. The border between the two empires was established in 1875 with the Treaty of St Petersburg when Japan inherited the islands in exchange for ceding Sakhalin to Tsarist Russia.

Russia however invaded the islands at the end of World War II in 1945 and has held on to them ever since. While Russia's Far East energy resources was a good option for Japan's strategy to diversify its energy imports from the Middle East, Japan tied the issue of energy investment in the Russian Far East to the return of the disputed islands. This led to frosty ties between Moscow and Tokyo prompting the latter to divert its attention away from the area.

Central Asia thus presented itself as an option for Japan's quest to diversify its energy suppliers. The region proved to be an attraction as it came at a convenient time and served Japan's interests on many levels. Japan had been under pressure from France and Germany to increase aid and investment to the former Soviet Union, in particular, Russia, despite Tokyo's insistence that Moscow should first return the Northern Territories. Aiding the five Central Asian republics served as a means to deflect pressure to aid Moscow.[4] Japan was also hoping to use Central Asia as leverage against Russia to return the disputed islands. Following the 1992 visits by Japanese officials to Central Asia, Japan's initial interest transformed into active undertakings to venture into the region. At the Seventh Symposium on Pacific Energy Cooperation held in February 1993, Japan made it known that as far as its energy diversification strategy was concerned, it preferred to target the new Central Asian republics, especially Turkmenistan and Kazakhstan who were already exporters then, over Russian Far East fields in eastern Siberia. Despite in-principle interest in the Siberian fields, Kazuo Ogura, Director-General of the Ministry of Foreign Affairs' economic affairs bureau, told the symposium that "there is a limit to the extent to which (Japan) can cooperate with Russia" in light of the territorial dispute between the two countries. With Russia and Japan disagreeing over territorial issues, officials considered it easier for Japan to focus its policies on the Central Asian republics, as there would be less political baggage in its new engagement with these states.[5] Japanese officials also admitted that aid to Central Asia was intended to show Russia that more funds could be forthcoming if they agreed to hand back the Kurile Islands to Japan.[6]

In 1993, the Ministry of International Trade and Industry (MITI) produced an energy policy white paper promoting the use of natural gas as part of the diversification energy security strategy away from Middle Eastern oil, arguing also that it is a cleaner form of fuel. It noted the open

[4] Clayton Jones, "Japan Diverts Aid to Central Asia in Bid for Strategic Edge," *Christian Science Monitor*, October 20 1992, p. 3.

[5] Lisa Twaronite, "Japanese Expected to Shun Siberia, Focus Hunt for Oil on Central Asia," *Journal of Commerce*, February 8 1993, sec. B, p. 6.

[6] Ahmed Rashid, "No Smoke Screen," *Far Eastern Economic Review* 156, 50 (December 16, 1993): 46.

policies of the resource rich Central Asia republics and the potential of China's Tarim Basin, and suggested the creation of oil and gas pipelines to transport Central Asian oil and gas through China, to Japan. Through its positive report on the region, MITI encouraged Japanese oil exploration companies to invest in the region.[7]

MITI's promising report on Central Asia contrasted with the uncertainty of Russia's future. In addition to the islands dispute, there was a lack of confidence among the Japanese over Russia's energy sector which is fraught with pitfalls. Concern was expressed on the fact that Russia was undergoing a tough period of economic and democratic transition, that there would be sluggish implementation of reform legislation. Doubts were also raised about Russia's ageing infrastructure. In addition, it was pointed out that Russia's mature energy industry with its political and economic clout would most likely want control over the major projects in Russia, thereby making it difficult for foreign investment.[8]

There were also strategic reasons involved. Japan was presented with two options in its search for secure energy supplies: either help develop the Russian oil and gas fields, or support Turkmenistan's gas development along with China's Tarim Basin oil and gas development. [9] The feasibility of both projects depended on Japanese capital. The use of Japanese financial muscle as part of its diplomatic strategy for leverage and strategic positioning is a hallmark of Japan's post-World War II engagement with the outside world. Japan's entry into Central Asia and its accompanying talk of investment in Chinese energy fields could in fact be read as an early attempt to counter-balance China with Russia in the new post-Cold War environment.

Japan was also said to be concerned about rising fundamentalism in the region. It was reportedly worried about the instability of Central Asia spreading eastwards into China's Xinjiang province.[10] Xinjiang is the homeland of the Muslim Uighers and China has been combating the secessionist forces there since the 1950s. An unstable China could have repercussions for Asia, especially Northeast Asia and this presented Japan with another reason to help the Central Asian states. According to a senior Ministry of Foreign Affairs official, Japan hoped that increased Japanese aid to the region could help alleviate the situation and help the

[7] Mehmet Ögütçü, "Eurasian Energy Prospects and Politics," *Cemoti* 19 (Janvier Juin 1995): 23, <http://cemoti.revues.org/document223.html> (September 16 2005).
[8] Lisa Twaronite, "Japanese Expected to Shun Siberia, Focus Hunt for Oil on Central Asia," *Journal of Commerce*, February 8, 1993 sec. B, p. 6.
[9] "Mitsubishi to Study Gas Pipeline for Central Asia," *Yomiuri News Service*, December 28, 1992.
[10] Ahmed Rashid, "No Smoke Screen," *Far Eastern Economic Review* 156, 50 (December 16, 1993): 46.

new republics steer towards secular, rather than Islamic fundamentalist governments. [11]

There was also a certain level of romanticization of Central Asia within the Japanese calculus, especially with Kyrgyzstan. Japanese officials claim racial similarity between Japanese and the people of Central Asia as another motivating factor for its involvement in the region. They consider themselves having historical ties to the region because of the 60,000 Japanese war prisoners who were deported to Central Asia by Stalin when the Red Army invaded Manchuria in 1945.[12] Apparently, Japanese Foreign Minister, Michio Watanabe found it difficult to distinguish between Japanese and the locals in Central Asia on his first trip to the region.[13]

In sum, from 1992, Japan began to shift its attention towards away from the Russians, towards Central Asia as a form of leverage against Russia to return the Kurile Islands and as part of its energy security strategy. At the secondary level, it felt the need to help the Central Asian states stabilize and develop and because it felt a certain sense of affinity towards the people of the region. Such rationale drove Japanese engagement from 1992 up to 1997, after which, Japan's Central Asian rationale underwent reassessment. Beginning with Japan's "Eurasian diplomacy" strategy in the middle of 1997, Japan's foreign policy in the region was no longer driven by energy security or the return of the Kurile Islands. Instead, the primary motivations became the desire to help Central Asia attain stability and development as an end in itself and because Japan began to regard itself as an Asian role model for the Central Asian states.

Japan's Activities in Central Asia – Three Phases

Japan's approach towards Central Asia is best analyzed in three phases. The initial phase stretched from 1992-1997, followed by the 1997-2004 period under the banner of "Eurasian Diplomacy" and in the final phase from 2004 to the present day with the formation of the Central Asia Plus Japan initiative.

[11] Lisa Twaronite, "Japanese Expected to Shun Siberia, Focus Hunt for Oil on Central Asia," *Journal of Commerce*, February 8, 1993 sec. B, p. 6.
[12] Kent E. Calder, "Japan's Energy Angst and the Caspian Great Game," *National Bureau of Asian Research (NBR) Analysis* 12, 1 (March 2001): 21.
[13] Clayton Jones, "Japan Diverts Aid to Central Asia in Bid for Strategic Edge," *Christian Science Monitor*, October 20 1992, p. 3.

Phase 1: 1992 – 1997

Japan's first official high-level approach to Central Asia started in May 1992 with a visit by Japanese Foreign Minister Michio Watanabe. With this successful trip, the government began to set out a strategy to woo the Central Asian republics with financial development aid. Another high-level foreign ministry delegation followed in October the same year. In the same month, the Organization for Economic Cooperation and Development (OECD), under strong lobbying by Japan agreed to include the five Central Asian republics under the Official Development Assistance (ODA) program, certifying them as developing countries.[14] This enabled Japan to register aid to the region as official development aid. Japan also pushed for the Central Asian republics to be admitted into the Asian Development Bank (ADB) even though they were already members of the European Bank for Reconstruction and Development (EBRD).[15] This allowed the Central Asian republics to draw credits from both banks, an unprecedented arrangement.[16]

Japanese business groups began to enter the region seeking drilling rights and hoping to establish large-scale joint ventures with local, fellow Japanese and international oil companies.[17] As early as December 1992, Mitsubishi Corp announced that it would study the feasibility of a gas pipeline between Central Asia and Western China with plans to build a 7000km pipeline to transport gas from Turkmenistan via Kazakhstan to the oil fields of the Tarim Basin in Western China.[18] In March 1993, it was announced that Japan National Oil Corp would launch a full-fledged feasibility study for the commercial production of oil and gas in Turkmenistan, Uzbekistan and Kazakhstan.[19] By 1995, Exxon and China National Petroleum Corp (CNPC) announced a joint study on the feasibility of the gas pipeline from Turkmenistan to the Tarim Basin across China and South Korea to Japan.[20]

Besides oil and gas field studies conducted by the Japanese private sector, the Japanese government also prepared aid packages to help develop the region economically and environmentally. Examples include helping

[14] "Plan Approved for Aid to Central Asia," *The Daily Yomiuri*, October 24, 1992, p. 1.

[15] Date of entry into the Asian Development Bank (ADB): Kazakhstan (1994), Kyrgyzstan (1994), Uzbekistan (1995) and Turkmenistan (2000).

[16] Mehmet Ögütçü, "Eurasian Energy Prospects and Politics," *Cemoti* 19 (Janvier Juin 1995): 22, <http://cemoti.revues.org/document223.html> (September 16 2005).

[17] *Ibid.*, p.21-22

[18] "Mitsubishi to Study Gas Pipeline for Central Asia," *Yomiuri News Service*, December 28, 1992, p. 6.

[19] "Japan Seeks Output of Oil, Gas in Central Asia States," *The Daily Yomiuri*, March 31, 1993, p. 6.

[20] Jonathan Standing & Steve Stroth, "Exxon, Others to Study Asian Pipeline Project," *The Houston Chronicle*, August 23, 1995, p. 1.

Kazakhstan modernize its Karaganda Ironworks, conducting of environmental research at the Kazakh's refineries that were polluting, offer of assistance to modernize the cotton industry in Uzbekistan and to help it shift from exporting cotton to exporting cotton products, and projects to rehabilitate abandoned agricultural land in Kazakhstan damaged by the shrinking Aral Sea.[21] Apart from bilateral efforts, Japan also supported the Central Asian states through multilateral institutions, such as the EBRD and the ADB.

While the Japanese government had high expectations of its entry into Central Asia, Central Asian governments were equally keen to attract Japanese financial aid and investment and there were high hopes as to what Japan's assistance could do for the development of their states. Kyrgyzstan for instance talked about building a silicon valley in Central Asia with Japanese aid and technology.[22] Central Asian leaders and their officials regularly visited Japan to lobby for aid and investment and many students from Central Asia, particularly those from Kyrgyzstan studied in Japan.[23]

By 1997, the Japanese government's relations with the Central Asia regime could be considered warm, with the Japanese government playing an active role in dispensing aid to Central Asia. However, such good relations did not translate into notable gains for the Japanese private sector looking to do business in the region. This was attributed to the instability of the region, the population's low spending power and the Japanese firms own risk-adverse attitudes. In addition, contrary to the superficial sense of cultural affinities, the lack of understanding of the local operating business environment and culture led to business losses for those who dared to venture.[24]

To the disappointment of the Japanese, the government's energy security goal was also not making any concrete progress in the region. Japan was perhaps over-ambitious in planning a pipeline from Central Asia to Japan. It is clear that the attempt to develop a pipeline infrastructure from Turkmenistan to Japan is a much more monumental project as

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[21] "Japan to Aid Four Former Soviet Republics," *Yomiuri News Service*, June 7, 1993; "Japan to Restore C. Asia Wasteland," *The Daily Yomiuri*, July 24, 1996, p. 3.

[22] Toru Yoshida, "Kyrgyzstan Counting on Japan to Help build 'Silicon Valley'," *The Daily Yomiuri*, October 5, 1996, p. 13.

[23] Toru Yoshida, "Government Officials Try to Lure Japanese Capital to Central Asia," *The Daily Yomiuri*, January 4, 1995, p. 8. Refer also to the Japanese Ministry of Foreign Affairs Website for a full-listing of high-ranking official visits by Central Asian officials to Japan (and vice-versa) <www.mofa.go.jp/region/index.html> (October 30 2005).

[24] A notable example is the case of the Japanese firms Nissho Iwai and Itochu's business dealings Karaganda Metallurgical Combine in Kazakhstan. Refer to: Tomohiko Uyama, "Japanese Policies in Relation to Kazakhstan: Is There a Strategy?" in *Thinking Strategically*, ed. Robert Legvold (Cambridge MA: MIT Press, March 2003), 174.

compared to the one from the Siberian oil and gas fields. There are too many variables to consider: besides the engineering feat of running a pipeline linking Turkmenistan, Kazakhstan, Uzbekistan, through China and eventually to South Korea ending in Japan[25], multilateral talks about pipeline corridors and transit commission fees would be a massive hurdle to overcome. There is also the question of the stability of the states involved and their bilateral relations, which would be major considerations for financiers in deciding whether to fund such a project. Furthermore, looking at the example of North Sea oil, Britain and Norway took two decades to reach peak production for the North Sea oilfields and a similar timeframe is said to be envisaged for the Caspian. Since it is natural to expect that the easiest export projects which are usually the shortest routes be developed first, it follows that development of pipelines to East Asia may well be delayed until oil and gas production approach peak development. Even then, investors are prone to focus on proven and successful routes and markets rather than developing new ones.[26] As such, it would take decades for the plan of a Central Asia-China-Japan pipeline could be realized, if it all.

Overall, Japan's level of participation in Caspian energy projects paled in comparison with that of the United States and Europe and for that matter, its own past role in the Middle East and Indonesia.[27] The viability of Central Asia as an alternative to Russia and the Middle East in meeting Japan's energy security appeared to be over-estimated by the Japanese and exaggerated by the oil and gas-rich Central Asian states. While the region is certainly rich in oil and gas, the Japanese government clearly underestimated the challenges related to penetrating the energy sector in the region and the technical and political obstacles involved in transporting oil and gas to Japan. The Central Asia leaders were on their part eager to support the idea of a pipeline to Japan as their agenda was to look to alternative routes outside the traditional Russian controlled pipelines to export their oil and gas and to prevent the dominance of any particular actor. Besides, the more foreign companies there are competing in the bidding process, the better their chances in fetching higher prices and contracts for their oil and gas fields.

Japan's lack of commercial progress in Central Asia led to criticisms that Japan lacked a clearly defined strategy in engaging Central Asia. One Japanese commentator for instance noted that Japan's Central Asian

[25] Jonathan Standing & Steve Stroth, "Exxon, Others to Study Asian Pipeline Project," *The Houston Chronicle*, August 23, 1995, p. 1.
[26] "Caspian Energy: Looking East," *Energy Economist*, November 1998, Issue 205, pp. 10-15.
[27] Tomohiko Uyama, "Japanese Policies in Relation to Kazakhstan: Is There a Strategy?" in *Thinking Strategically*, ed. Robert Legvold (Cambridge MA: MIT Press, March 2003), 171.

policy was dependent on chance influence; in the beginning, a clear perception of the region was lacking and Japanese officials depended on a few high-placed bureaucrats who took it upon themselves to shape policy based on their personal relationship with those countries rather than out of a clear Japanese foreign policy guideline issue from the leadership.[28] The absence of a well-defined strategy could also be explained on economic grounds since Central Asia is not tied to Japan's economic interest the way the United States and Southeast Asia is.[29] Central Asia was essentially used as a means to gain leverage against Russia over the territorial disputes and as a matter of international prestige. Outside the field of oil and gas, Japan did not have much at stake in the region. It would appear that Japan's efforts to keep a presence in the region during the early period of engagement with Central Asia outpaced careful thinking on its actual purpose for being there and in turn, the appropriate strategies to adopt.

Phase 2: 1997 – 2004 (Hashimoto's Eurasian Diplomacy)

Despite the policy setback, it became increasingly clear to both Japan and the international community that Central Asia is a region of growing geopolitical significance and that Japan's participation adds to the region's stability. In 1997, Koji Watanabe, executive advisor to the Japan Federation of Economic Organizations (Keidanren) and former Japanese Ambassador to Russia stated in an interview that Japan should help the Central Asian states develop. Their development is important because these states could play a role as a buffer region in the Eurasian continent for the maintenance of peace.[30] Once Japan was able to define a clear

[28] For example, Edamura Sumio, Japan's well-known ambassador to Russia, actively pushed for strengthening ties with Kyrgyzstan. Not much later, an employee of Japan's Central Bank, Tanaka Tetsuji, became an advisor to the president of Kyrgyzstan, Askar Akaev, and also lobbied on its behalf. In the case of Uzbekistan, Chino Tadao, at the time an influential figure in the Ministry of Finance and now the president of the Asian Development Bank, Magosaki Ukeru, Japan's first ambassador to Uzbekistan, and Shima Nobuhiko, a prominent TV news personality and head of the Japanese-Uzbekistan Association, all actively promoted stronger ties with this country. Long after Chino's departure from the Ministry of Finance, it continues to give special attention to Uzbekistan. While these people were acting out of genuine policy concerns, they were also responding to the warm reception given them by the Kyrgyz and Uzbeks; indeed, they simply liked Kyrgyzstan and Uzbekistan. Recently, in similar fashion, parliamentary deputies Takemi Keizo and Suzuki Muneo have begun working to speed the development of relations with Tajikistan. Tomohiko Uyama, "Japanese Policies in Relation to Kazakhstan: Is There a Strategy?" in *Thinking Strategically*, ed. Robert Legvold (Cambridge MA: MIT Press, March 2003), 168.

[29] Tomohiko Uyama, "Japanese Policies in Relation to Kazakhstan: Is There a Strategy?" in *Thinking Strategically*, ed. Robert Legvold (Cambridge MA: MIT Press, March 2003), 169.

[30] "Central Asia Should Serve as Eurasian 'Buffer Zone'," *The Daily Yomiuri*, December 5, 1997, p. 15.

purpose in Central Asia, it managed to devise a sophisticated response to the challenges in Central Asia. Between July 2 – 9, 1997, Foreign Minister Keizo Obuchi led a high-level delegation of 60 political and business leaders to Central Asia. Soon after the visit, Prime Minister Ryutaro Hashimoto outlined the beginnings of a new Eurasian foreign policy for Japan in a speech delivered to the Japan Association of Corporate Executives.[31]

As one commentator succinctly noted, "[Hashimoto] recognized the fact, often overlooked in Western policy circles, that the Silk Road also runs east".[32] He pointed out that the new post-Cold War security structure for the post-Soviet space had the characteristics of an Eurasian diplomacy "viewed" from the Atlantic. He declared that while bilateral relations with the United States remained the cornerstone of Japanese foreign policy to maintain stability in the Asian-Pacific region, it was time Japan developed an alternative Asian approach towards the same objective, which would include Russia, China, Central Asia and the Caucasus. Japan's new "Eurasian diplomacy" would thus be based on a new diplomatic perspective but with the same basic aim of maintaining peace and prosperity in the Asia-Pacific region.

With regards to the Central Asia-Caspian region, he acknowledged that the oil and gas resources there would have an expanding influence on the world energy supply. However, Japan's economic engagement with Central Asia would be based on the development of the energy sector, not as an end but as a means to foster prosperity in the region. According to him, Japan would help towards regional integration within Central Asia itself with plans to improve communication, transportation and energy networks in the region. He recognized that Central Asia has "great expectations of Japan as an Asian country" thereby emphasizing Japan's non-Western, Asian approach to the region. His remark that the Foreign Minister, Keizo Obuchi's "impression matched exactly the line of thought I have outlined here" was meant to inform the audience that the Eurasian diplomacy initiative is a long term affair since Obuchi was well-placed as the next Prime Minister. He ended his speech by indicating that the private sector has a leading role to contribute.

In sum, Japan understood that with its small population, vast distances away from viable markets, and its land-locked geography, Central Asian states needed to deepen their level of cooperation with one another so as to create a local regional market economy. This would help lessen

[31] Address by Prime Minister Ryutaro Hashimoto to the Japan Association of Corporate Executives (Provisional Translation), Prime Minister of Japan and His Cabinet (Kantei), July 24 1997, <www.kantei.go.jp/foreign/0731douyukai.html> (October 30, 2005).
[32] Michael Robert Hickok, "The Other End of the Silk Road: Japan's Eurasian Initiative," *Central Asian Survey* 19, 1 (2000): 22.

dependence on its export economy and provide more incentives for foreign companies to enter the region because of the bigger markets available for foreign investment. Such a regional blueprint would thus generate greater stability and wealth within the region. Foreign Minister Obuchi's visit to Turkmenistan in July prior to Hashimoto's speech, during which the Turkmenistan-China-Japan pipeline was once again discussed also suggests that Japan on its part continued to hold on to the idea as a long-term project. Despite being commercially questionable, it is most likely that this pipeline has come to represent Japan's vision to create stability in Asia through multilateral energy linkages and along with it, Japanese prestige expressed via its leadership in such a project. Within the Central Asian context, the pipeline could be regarded as a carrot dangled in front of the Turkmen, Uzbek and Kazakh regimes promising even larger economic and financial investments by Japan once Central Asia attain closer integration and region stability. A motivation for such acts from Japan could be attributed to Japan's growing self-confidence in the international stage, its quest for prestige and desire for a permanent seat in the United Nations Security Council. Central Asia presents itself as a useful platform for Japan to highlight itself as a responsible international aid donor and catalyst for regional stability.

The Central Asian republics responded positively to this new initiative as reflected in the visits of top-ranking Central Asian officials to Japan in 1998 and 1999.[33] The Japanese government and business delegations also returned to the region, this time with renewed purpose. In May 1998, the Chairman of the Japan Federation of Economic Organizations (Keidanren), Soichiro Toyoda led representatives of twelve major Japanese firms on a mission to Uzbekistan and Kazakhstan in search for new investment opportunities. In Kazakhstan, he met with President Nazarbayev and it was reported that Mitsui chairman and Keidanren Vice President Naokhiko Kumagai stressed the need for Japanese business to look at the regional dynamics of oil industry development over the long term, suggesting his company's interest in the feasibility of a Chinese pipeline route for the future.[34] Japan's ambassador to Almaty, Mitsuhashi Hidekata had previously told journalists that Tokyo's vision of Eurasian cooperation coincided with Nazarbayev's commitment to a Eurasian Union. According to the ambassador, Japan was still interested in Kazakhstan's oil reserves but would like to focus spending on more urgent issues faced by the country. A $270 million loan was dispensed to help upgrade the country with projects such as the construction of a new

[33] Refer to the Japanese Ministry of Foreign Affairs Website for a full-listing of high-ranking official visits by Central Asian officials to Japan (and vice-versa) <www.mofa.go.jp/ region/index.html> (October 30 2005).

[34] Michael Robert Hickok, "The Other End of the Silk Road: Japan's Eurasian Initiative," *Central Asian Survey* 19, 1 (2000): 30.

bridge in Semipalatinsk and improvements to the rail system. Following Japan's additional pledge of $204.9 million to modernize an airport in Astana, a spokesman for Nazarbayev came out to say that such assistance indicates that bilateral relations had passed from an introductory phase. In response, Kazakhstan agreed to look at reforming its regulatory and legal systems to facilitate the entry of medium and small-sized Japanese firms into the Kazakh market.[35] In Uzbekistan, Toyoda met with President Karimov whereby Karimov pledged his government would fund the creation of new investment companies to seek international partnership in industrial projects. The business delegation in turn indicated their interest to establish a logistics centre in Tashkent as a hub for a regional transportation network and as a data-processing computer centre to control the storage and handling of cargo. [36]

In June 1998, another delegation led by Itochu President, Minoru Murofushi who was also the head of the Turkmen-Japan Committee for Cooperation, visited Turkmenistan to discuss ways to improve investment conditions in the country. Acknowledging the commercial difficulties for exporting Turkmenistan gas, Murofushi spoke about how the country needed to improve its local infrastructure so as to connect Turkmenistan more efficiently to nearby markets. In response, Tokyo approved a credit line of $40 million to modernize the locomotive depot in Ashgabat.[37] This was followed by an additional offer of a $38 million credit repayable over 20 years by Japan's Foundation for Foreign Cooperation to refurbish the country's rail transportation. At the same time, Itochu agreed to participate in the rail project by creating a north-south rail transportation corridor to link Russia to the Persian Gulf through Iran. Discussion over the long-range feasibility of a Turkmenistan-China-Japan gas pipeline was also held in Ashgabat in November.[38]

It was pointed out that these cases indicate that Japanese firms are more interested in long term investment and not just in the energy sector. Their focus is on long-term growth and alliances with local industries and governments, and on capital retention through asset acquisition while the barrier for entry into the market is still low. By looking for business opportunities across different markets in a coordinated manner, Japanese companies are said to have a relative advantage over the Western investments which focused mostly on the prospects of oil and gas resources.[39] The agenda of such delegations to Central Asia thus

[35] *Ibid.*, p.30-31.
[36] *Ibid.*, p. 31.
[37] *Ibid.*, p. 31.
[38] *Ibid.*, p. 31.
[39] *Ibid.*, p. 31.

reflects Japan's stability-oriented development goals in the region and its long term commitment. Japan also tapped into multilateral institutions to promote its vision of a stable Central Asia and this was particularly important especially at the time when Central Asia's economy was experiencing a severe slowdown in its growth between 1996 to 1998. The region only grew by 0.9% in 1996, 1.4% in 1997 and 1.9% in 1998.[40] In 1997, the ADB initiated the Central Asia Regional Economic Cooperation (CAREC) program aimed at facilitating closer regional economic cooperation. Through the EBRD, the Kazakhstan Small Business Program was launched in 1998 while the Japan-Uzbek Small Business Program was launched in 2001. The Japanese government also established the Central Asia Institution Building Cooperation Fund through EBRD.[41]

Hashimoto's foreign policy in Central Asia indeed embodied an alternative Asian approach towards the region. While Western companies are often driven by maximum returns in the shortest period, Japanese companies in Central Asia were prepared to wait long term for their investments to mature. Whereas Western governments typically use foreign policy as a tool to advance the business interests of their companies abroad, Japan in reverse used the companies as a foreign policy tool to advance the country's political interests. Finally, the willingness to take risks to develop the Central Asian economies, at a time when these markets have yet to mature underlines the Japanese (and largely Asian) belief of cultivating goodwill for building long term steady business relations. With Hashimoto, a former MITI minister as Prime Minister, Japan found sound footing in its operations by consolidating the demands of international trade, development aid and international influence into a coherent initiative for the region.

The Central Asian governments on their part became more inclined towards the Asian model as an alternative for modernization aspirations. The Western participation in their modernization has been viewed with mixed feeling in these authoritarian societies, particularly in Turkmenistan, Uzbekistan and Kazakhstan since Western governments and companies typically carry calls for structural political and economic reform as part of their engagement, something which is viewed as both intrusive and disruptive by the Central Asian regimes.[42] Kyrgyz President Akayev highlighted Japanese policies as example of how

[40] "Regional Cooperation Strategy and Program for Central Asia Regional Economic Cooperation (CAREC) Member Countries (Azerbaijan, Kazakhstan, Kyrgyz Republic, Mongolia, People's Republic of China, Tajikistan, Uzbekistan) 2005-2007," Asian Development Bank, July 2004, p. 32 (Appendix 1).

[41] "Japan and the EBRD," European Bank for Reconstruction and Development, September 2003, pp. 9-21.

[42] Michael Robert Hickok, "The Other End of the Silk Road: Japan's Eurasian Initiative," *Central Asian Survey* 19, 1 (2000): 34.

outsiders could first help local economic reintegration before focusing on the exploitation of the resources found in the region. In particular, he was grateful how Tokyo helped stabilize the Kyrgyz currency before pushing for commercial investment in the country thereby limiting the negative effects of restructuring.[43] In a speech to the people of Kazakhstan about the country's 2030 vision, Kazakh President Nazarbayev noted how many resource-rich countries continued to be poor as a result of mismanagement. East Asian countries on the other hand became the most dynamic developing countries even without resources. In line with Japan's strategy, he declared that the revitalization of the "Silk road" required first deeper cooperation of the countries in the region before pursuing extended engagement with the outside world. Thus, Kazakhstan would continue to seek partnership with countries like Japan which would lead to modernization without geopolitical polarization in the region.[44] Uzbek President, Islam Karimov similarly held Japan up as a role model in a speech to the Uzbek parliament in 1999. Like the Kazakh President, he noted that despite not having any natural resources, Japan managed to develop successfully and now ranks second in the world. Such success according to Karimov is attributed to the sense of responsibility the Japanese have towards their own society and country. Rejecting Western individualist ideals, he echoed the belief commonly held by Asian governments that the needs of the community should always be placed before those of the individual.[45] Japan's Eurasian policy thereby skewed the Central Asian leaders' governance philosophy eastwards towards Asia. For better or worse, Japanese foreign policy provided the Central Asian leaders a certain level of justification for their authoritarian regimes.

The successive Prime Ministers after Hashimoto basically continued with the Eurasian blueprint. In April 2002, after one year in office, Japanese Prime Minister Koizumi (April 2002-present) reaffirmed the Eurasian diplomacy initiative at an Asian economic forum held in Boao on Southern China's Hainan Island. He declared his intention to build a long term relationship with the Central Asian region as a strategy ostensibly to shore up Japan's energy security. He also reiterated Japan's position that Tokyo will continue with its plan for Central Asian integration and economic cooperation. A delegation dubbed the "Silk Road Energy Mission" which comprised about 10 government, business and academic experts to visit Kazakhstan, Turkmenistan, Uzbekistan and Kyrgyzstan was created. This mission, headed by senior deputy Minister of Foreign Affairs, Sekeno Sugiura was tasked with researching

[43] *Ibid.*, p.34-35.
[44] *Ibid.*, p. 36.
[45] *Ibid.*, p.37.

areas for possible bilateral and regional cooperation so that Japan can procure oil and gas from the region in the future. In 2002, Japanese companies' involvement in the upstream oil and gas ventures in Central Asia remained extremely limited. The country only had a minor stake in an oil field development project by an Italian firm in Kazakhstan.[46] As noted earlier, it is more likely that Japan is using the promise of future large-scale energy investments as an incentive to try to keep the Central Asia states focused on regional integration. This suggests that Japan would only proceed with such a pipeline once stability and deeper regional integration is attained between the Central Asian states.

Phase 3: 2004 – Present (Central Asia Plus Japan)

By 2004, Japan had given a total of 260 billion yen, (over $2 billion) in ODA to support economic and social development to the Central Asia states since their independence 13 years ago. Being fairly confident that bilateral relations with the respective Central Asian states have reached a comfortable level, Japan added a new dimension to its engagement with Central Asia through the formation of the Central Asia Plus Japan initiative. The idea is to shift the focus from bilateral ties between Japan and the individual Central Asian states to greater dialogue among the Central Asian states themselves with Japan as a facilitator. Members for this initiative consist of Kazakhstan, Tajikistan, Uzbekistan and Kyrgyzstan. Turkmenistan, maintaining its stance on positive neutrality would also attend these meeting although not as a full member. Japanese Foreign Minister Yoriko Kawagichi's visited Kazakhstan in August 2004 to formally launch the initiative which would serve as a platform for multilateral exchanges in the region.

During the inaugural meeting, the participants shared the recognition that peace and stability in Central Asia has great importance not only for the stability and prosperity of Eurasia but also to the international community. The participants discussed the importance of intra-regional cooperation aiming for stability and development of the Central Asian region as a whole and also cooperation between Japan and Central Asia in the international arena. They focused on areas such as development of energy and transportation networks in the region, as well as water resources and countering terrorism and narcotics. It was also stated that the need for development of market economies and democratization will also be stressed through future dialogues.[47]

[46] "Japan to Send Energy Mission to Central Asia," *Alexander's Oil & Gas Connections*, April 11, 2002, <www.gasandoil.com/goc/news/ntc21813.htm> (October 30, 2005).

[47] "Joint Statement 'Central Asia + Japan' Dialogue/Foreign Ministers' Meeting — Relations between Japan and Central Asia as They Enter a New Era," Japan Ministry of

During her visit, Kawaguchi also signed an agreement on a 16.4 billion yen ($140 million) aid project to build a 220km railway in the southern part of the country. Japan also agreed to take in 1000 trainees from Central Asia over the next three years to study governance and other issues. True to Japan's long term commitment to the region, a Japanese Foreign Ministry official told reporters that it expects a long time before seeing result and that cooperation with the region should be promoted looking 10-20 years ahead. The official compared cooperation with Central Asia to the formation of ASEAN which took 30 years to reap the fruits of regional cooperation. Kawaguchi was quoted as saying, "in reflection of Central Asia's geopolitical influence, Japan has no selfish objectives towards Central Asia." On that basis, she called for human rights protection, democratization, market-orientated economic reform and institutional reform for eliminating vested interests.[48] During her visit to the Uzbek capital, she also pointed out that Japan's experience in cooperation with the European Union and ASEAN is of great value for this new initiative.[49]

This was followed up by another meeting during the 12th Organization for Security and Cooperation in Europe (OSCE) Ministerial Council meeting held in Bulgaria in December 2004. Kawaguchi met up with the representatives for the Ministerial Council from the Central Asian republics of Kazakhstan, Tajikistan, Uzbekistan and Kyrgyzstan as part of the Central Asia Plus Japan dialogue. Kawaguchi also held a separate meeting with the Foreign Minister of Turkmenistan. The meeting in March 2005 was held in Tashkent whereby participants discussed regional cooperation in political, business and cultural spheres, healthcare, use of water and energy resources, as well as fighting terrorism and the drug trade. The Ambassador of Turkmenistan to Kazakhstan attended the meeting on behalf of the Turkmen Foreign Ministry.[50]

Foreign Affairs, August 28, 2004, <www.mofa.go.jp/region/europe/dialogue/joint0408.pdf> (October 30 2005).

[48] Anthony Rowley, "Japan Launches Dialogue with Central Asia," *Business Times (Singapore)*, September 7, 2004; "'Central Asia plus Japan' Dialogue/Foreign Ministers Meeting - Relations between Japan and Central Asia enter a New Era," Japan Ministry of Foreign Affairs, August 28, 2004, <www.mofa.go.jp/region/europe/dialogue/press0408.html> (October 30 2005); Keizo Nabeshina, "Japan's Diplomatic Might," *The Japan Times*, September 20, 2004.

[49] "President Meets Japanese Foreign Minister," Press Service of the President of the Republic of Uzbekistan, Aug 27, 2004, <http://2004.press-service.uz/eng/novosti_eng/n08272004.htm> (October 30 2005).

[50] "Central Asia Plus Japan meeting held in Tashkent," Republic of Uzbekistan - Portal of the State Authority, August 26, 2004, <www.gov.uz/en/content.scm?contentId=10796> (October 30, 2005).

Following the May 13 2005 Andijan violence in Uzbekistan, U.S.-Uzbek relations has soured and the latter has swung towards the SCO as a means to safeguard its regime and reassert its legitimacy. It was reported in the press that in response to the event, the Japanese government was considering holding a foreign ministerial conference involving Japan and five Central Asian states in summer 2005 in an attempt to help boost the region's political stability through expanded Japanese development assistance.[51] However there are no updates of such a conference planned in the Ministry of Foreign Affairs website and this conference appears to have been quietly shelved. To date, the Japanese government has kept a comparative low profile on the Andijan violence compared to Europe and America who vocally expressed concern and publicly tried to pressure the Uzbek government to allow for an independent inquiry. It is most likely that Japan would continue in its engagement with the Uzbek regime since it is precisely such political and social instability that the Japanese government would like to address in the region. Japan realizes that "megaphone diplomacy" does nothing to serve the interests of the local population. What is needed is continued implementation of its development strategy and further financial aid to help lift the people of Central Asia out of their current situation and this can only be done by engaging with the regime.

Implications and Prospects of Japan's role for the SCO and Central Asia

Japan has certainly got on to a good start with the Central Asia Plus Japan initiative. The initiative marks a new level of engagement between Japan and the Central Asia states with Japan enhancing its reputation as a partner to the region. While it is too early to make an assessment of this initiative, several remarks could be made based on current observation.

Complementary role of Japan and the SCO

Since its beginning as the Shanghai Five in 1994, the Shanghai Cooperation Organization (SCO) which is currently made up of Kazakhstan, Tajikistan, Uzbekistan, Kyrgyzstan, Russia and China has been the organization on the watch list of many Central Asia analysts because of the participation by the Central Asian republics in the organization.[52] The Central Asia Plus Japan initiative actually

[51] "Central Asia Confab Eyes to Aid Region," *The Daily Yomiuri*, June 7, 2005. p. 1.; John C.K. Daly, "UPI Intelligence Watch," June 8, 2005, <http://washingtontimes.com/upi-breaking/20050607-013617-6514r.htm> (October 30, 2005).

[52] For a constructivist write up on the formation of The Shanghai Five and the Shanghai Cooperation Organization by the author, refer to: Christopher Len, "Anarchy and the

complements the SCO in significant ways. The entry of Japan and the continued presence of the SCO actually draw Central Asia away from the West, both geographically and politically. The states could thus develop their own distinct Central Asian – possibly non-Western - identity with Russia, China and Japan as supporters. It is not impossible that Central Asian regimes see synergy in their engagement with both the SCO and the Central Asia Plus Japan initiative. In the future, they could look to the SCO to coordinate and address the region's security threats, especially terrorism, and turn to Japan for economic and development assistance.

Another area of converging interest is all the parties interest in deepening Central Asian regional integration. Russia and China in fact share the same regionalization and development goals for Central Asia; ultimately, all parties are working for a stable Central Asia. The two neighbors are in fact key beneficiaries of Japan's strategy of transport and trade integration in the region and could even be regarded as free-riding on Japan's development effort in the region. Russia benefits directly because it is Central Asia's largest trading partner. As for China, it also benefits from Japan's engagement of Central Asia because the Japan-Central Asia trade route cuts across China, thereby stimulating economic activities along this route. Xinjiang's strategic location means that Japan ships containers to Lainyungang in Jiangsu province and transport them by train to the Sino-Kazakh border.[53]

Next, Japan, China, Russia and the Central Asian states all understand the importance of Afghanistan to Central Asia.[54] First of all, all parties realize that instability in Afghanistan would have a negative effect for the entire region. Second, the inclusion of Afghanistan would create a potentially larger market in the Central Asian region. Thus, all parties are attempting to bring Afghanistan into the Central Asian fold. This year has been particularly significant with regards to Afghanistan's relations with Central Asia. The SCO-Afghanistan Contact Group has

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Barriers to Community: Regional Cooperation in the Post-Cold War Era – The Shanghai Cooperation Organization," Department of Peace and Conflict Research, Uppsala University (Sweden), June 2004, <www.silkroadstudies.org/new/docs/master_theses/MA_Anarchy_and_the_Barriers_to_Community-%2031_May_2004.pdf>.

[53] Nailene Chou Wiest, "Silk Road Centre a Money Spinner," *South China Morning Post*, June 10, 2005. p. 6.

[54] Japan is in fact a significant player in Afghanistan as well. The process of economic revival of post-Taliban Afghanistan was inaugurated in Tokyo in 2002 with Japan being one of the most important donor for the country. Refer to: "International Conference on Reconstruction Assistance to Afghanistan," Japan Ministry of Foreign Affairs, January 2002, <www.mofa.go.jp/region/ middle_e/afghanistan/min0201/index.html> (October 30, 2005).

just been established[55] while Afghanistan has also just been admitted into the Central Asia Regional Economic Cooperation (CAREC) organized by the ADB.[56] It should be noted that the president of the ADB, Haruhiko Kuroda, is a Japanese who used to be Japan's top financial diplomat.

Japan as a mitigating force to the SCO

While we see how the objectives of the Central Asia Plus Japan initiative complements those of the SCO member states, Japan also plays a positive role in the region as a balancing force against the SCO. To be realistic, while Japan could play an influencing role in Central Asia via the Central Asia Plus Japan initiative and compete for the attention of the Central Asia regimes, it is unlikely that the initiative would ever have the same weight and presence as the SCO does. This is due to the following reasons: To begin with, the Central Asian republics recognize China and Russia as being inherently part of the region so their level of engagement would naturally be more intrinsic from an economic and security perspective. They share borders, have closer security relations and much higher movement of goods, services and people between borders. Despite all the aid, Japan's trade and business links with the region remains weak. This is reflected by the low numbers of business workers in the region. Based on 2003 and 2004 figures from Japan's Ministry of Foreign Affairs website, the number of Japanese living (and presumably working) in Central Asia hardly added up to 400 Japanese in total.[57] To put things in perspective, there are presently approximately 20,000 Japanese national residing in Singapore in Southeast Asia, the majority of which are for work related reasons. Furthermore, Russia and China share with the Central Asian leaders the same threats and vulnerabilities with regards to terrorism and radical militant Islam. In addition, the two giant neighbors have been the most outspoken supporters of the authoritarian Central Asia regimes.

Despite being unlikely to overturn or supplant the SCO, Japan, through the Central Asia Plus Japan initiative mitigates the aspirations of China and Russia in a number of ways. Firstly, the Central Asian leadership

[55] "Shanghai Cooperation Organization and Afghanistan Sign Protocol on Establishment of Contact Group," The Shanghai Cooperation Organization Website, Nov 4, 2005, <www.sectsco.org/news_detail.asp?id=582&LanguageID=2> (November 2005).

[56] "Afghanistan Joins Central Asian Regional Economic Cooperation Programme," *UzReport*, November 6, 2005, <http://www.uzreport.com/e/index.cfm?sec=1&subsec=1&n_ID=18775> (November 7, 2005).

[57] There were 120 Japanese nationals registered in Kazakhstan in 2004; 5 Japanese nationals were registered in Tajikistan in 2004; 132 Japanese nationals in Uzbekistan in 2003 and 50 Japanese nationals and ethnic Japanese in Kyrgyzstan in 2004. Refer to: Japan Ministry of Foreign Affairs website, <www.mofa.go.jp/region/index.html> (October 30, 2005).

could turn to Japan to discuss alternative deals should they feel pressured by China or Russia to commit to projects they have reservations over, especially if it comes to investment in infrastructure for pipeline transport and communication networks all of which tend to have strategic implications. Secondly, Japan's presence in the region would dilute the influence of the SCO, something which America and Europe would prefer.[58] In fact, the West is interested to see whether Japan, which they consider as an ally having rather similar political and economical outlook, would be able to get Central Asia to undertake structural reforms economically and politically.

Japan's role is particularly important in light of SCO's growing confidence, as reflected in the most recent inclusion of India, Pakistan and Iran as SCO observers (Mongolia attained observer status in 2004) and the establishment of the SCO-Afghanistan Contact Group.[59] The latest SCO development impacts the region in the four ways. First, the entry of the latest three SCO observers makes it more difficult for Washington to establish a secure foothold there as its competitors are increasingly united. Second, by inviting these countries neighboring Central Asia into the organization as observers, the SCO has started a process of co-opting them into the institution. As founding members, being the "first among equals" within the organization, and having largely set the agenda for the SCO, Russia and China have created a playing field to their advantage. They could for instance determine which of the observers would be first admitted as a member. This presents a useful leveraging tool for China and Russia in their bilateral dealings with the observer states. Third, from a geopolitical perspective, the entry of these observers and the establishment of the SCO-Afghanistan Contact Group mean that the Central Asian region is now surrounded by SCO or SCO-friendly states. This essentially fences the Central Asian states into the SCO framework. This encirclement if successful is likely to make SCO the dominant multilateral organization in Central Asia.

Fourth and most important of all, with the inclusion of these members, the SCO is slowly but certainly expanding from being a Central Asian regional organization, to one which would have growing influence in the wider Eurasian region. The geopolitical significance of such a development is immense. From an energy perspective, oil and gas from Iran, Kazakhstan, Uzbekistan and Turkmenistan could flow into Russia, China and possibly south via the proposed Turkmenistan-Afghanistan-

[58] S. Frederick Starr, "A Strong Japanese Initiative in Central Asia," *Central Asia-Caucasus Analyst*, October 20, 2004, <www.cacianalyst.org/view_article.php?articleid=2789>.

[59] "China supports Pakistan, Iran, India Becoming SCO Observers," *People's Daily Online*, June 08, 2005, <http://english.people.com.cn/200506/08/eng20050608_188975.html> (October 30, 2005).

Pakistan (TAP) pipeline.[60] With such a development, the SCO grouping has the potential to develop into a formidable energy bloc within Eurasia. Japan's ability to engage and influence the individual SCO-associated states, namely the Central Asian states and Afghanistan thus takes on growing geopolitical significance. As an ally of the West and for the sake of its own energy security needs, Tokyo would not allow the SCO to have a stranglehold over Eurasia's energy resources.

Conclusions

Japan's presences in Central Asia between 1992 until the middle of 1997 clearly lacked strategy. However, beginning with Hashimoto's Eurasian Diplomacy and re-enforced by the Central Asia Plus Japan initiative, Japan's focus in Central Asia has shifted from alleviating Japan's energy security and leveraging against the Russians over the Kurile Islands, to positioning Japan as a regional leader actively working towards peace and stability in Central Asia. Japan's foreign policy is directed towards three considerations. First and foremost, US-Japanese relations; secondly, Japan's international standing and prestige through the promotion of multilateral institutions of cooperation and finally, relations with its two great power neighbors, Russia and China. In this sense, the new Eurasian initiative complements all three objectives clearly.

Essentially, Central Asian states are more interested in looking after their own needs than that of any regional organization, including the SCO. They would welcome all forms of assistance but are very sensitive towards attempts to interfere with their domestic affairs. They are also worried about being pulled into a particular geopolitical orbit and made pawns to the Great Powers vying for oil and gas and other natural resources in the region. In this sense, Japan presents a perfect balance through its massive financial assistance, eastern "community-over-self philosophy" and thus far limited geostrategic maneuvering behavior in the region. Its presence is welcome because engagement with these states has not come across as being over-bearing or appear to be selfishly motivated. Central Asian leaders appreciate Japan's use of economic and aid linkages rather than use of economic or security leverage when dealing with them. From an Asian perspective, it reflects the respect and recognition Japan has granted to the states as a benign patron, in contrast to the other players whose key motivation in Central Asia is the exploitation of the region's vast oil and gas resources for their own needs. Japan's challenge is to initiate greater dialogue among the Central leaders so that they would set aside their rivalry and cooperate for the greater

[60] "Technical Assistance For The Feasibility Studies Of The Turkmenistan – Afghanistan – Pakistan Natural Gas Pipeline Project," Asian Development Bank, December 2002 <www.adb.org/ Documents/TARs/REG/tar_stu_36488.pdf> (October 30, 2005).

good of the region. Japan's financial aid muscle and strong influence in the ADB and ERBD means that it has more resources to help develop the Central Asian region. As such, Japan is unlikely to be pushed out of the region by the Central Asian regimes anytime soon.

Japan's activities in Central Asia today is a reflection of the rise of a more assertive and independent Japanese foreign policy. It also reveals a subtle foreign policy that is able to accommodate both Eastern and Western value-systems. In the eyes of the Central Asian regimes, Japan has come to represent a viable Asian role-model and partner for their modernization program. Simultaneously, for the West, Japan has come to represent their liberal-democratic values, as opposed to China and Russia who insist on an indigenous – and usually authoritarian – approach towards government. While the Central Asian regimes and the West may not see eye-to-eye on a range of issues, both nevertheless recognize Japan's contribution to the region, especially because of Japan potential to counter-balance Russia and China's influence in Central Asia. From a geopolitical perspective, as the United State's influence diminishes within the Central Asian region and as SCO consolidates and expands its membership, Japan would have an increasingly geopolitical role to play within Eurasia as a counter-balance to the Russia and China-led SCO. Its engagement in Central Asia would ultimately sway the geopolitical direction of Eurasia depending on how successful it is in attempting to influence the Central Asian states, including Afghanistan to its way of thinking.

Submission Guidelines and Process of Selection

Many of the articles are solicited, but authors are encouraged to send their work directly to the Editor who will suggest changes and determine the relevance of the articles for each of the numbers. Nevertheless, articles can also be sent to any of our senior advisors, but the Editor has full responsibility on accepting or refusing individual articles. Shorter articles will be responded to within a week, whereas the response to longer analytical pieces could take up to three weeks.

Each submitted article should be sent to the Editor by e-mail attaching the word document. All correspondence will be conducted through e-mail during the process. The Editor reserves the right to edit the article to conform to the editorial policy and specifications of the CEF Quarterly and to reject the article should it not be acceptable to our editorial committee for publication. All authors should adhere to the Chicago reference system in their articles. More info on this is at the following web-page: http://www.silkroadstudies.org/new/docs/CEF/quote.pdf

Analytical articles: Analytical articles should be in-depth and offer a long-term analysis of the particular problem. References are preferred to support your evidence according to the Chicago system. The articles should aim at 7000 words.

Short articles: Short articles require a three to four sentence introduction to the article based on a news hook. Rather than a general, overarching analysis, the article must offer considered and careful "judgment" on the issue supported with concrete examples. Recommended length for short articles is 2000 words and should have the following structure:

- Key issue: A short 100-word statement of your conclusions about the issue or news event on which the article focuses.
- Background: 600-800 words of analysis about what has led up to the event or issue and why this issue is critical to the region. Include background information about the views and experiences of the local population.
- Implications: 600-800 words of analysis of the ramifications of this event or issue, including where applicable, implications for the future.
- Conclusions: 200-400 words that strongly state your conclusions about the impact of the event or issue.

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