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## ENERGY INSECURITY: CHINA, INDIA AND MIDDLE EAST OIL

### EXECUTIVE SUMMARY

*The rapid expansion of their economies has seen China and India become voracious consumers of energy. Oil, much of it imported from the Middle East, has become an increasingly important part of their energy needs. Both governments are conscious that this growing reliance on one of the world's most unstable regions leaves their countries vulnerable to supply disruptions and/or price fluctuations. As a result, energy security has become a key foreign policy objective and, particularly in the case of China, is shaping their approach to the Middle East. This issues brief provides an overview of current energy demand trends and raises for discussion some of the potential longer term strategic implications of this growing dependence on Mid-East oil.*

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**Enter the Dragon... and the Elephant**

The contours of the world economy are being reshaped by the emergence of Asia's two billion-plus economies, China and India. China in particular is at the forefront of a geographic redistribution in economic power towards Asia: by 2003 the Chinese economy was the seventh largest in the world when global output is measured in US dollar terms, and the second largest when purchasing power parity (PPP) exchange rates are used (Table 1). In the same year China had also become the world's fourth largest merchandise exporter, and its largest recipient of foreign direct investment (FDI).

Table 1: China and India in 2003

	China	India
GDP at market exchange rates (US\$b)	1,409.8	598.9
Rank in world economy	7	12
Share of world GDP (%)	3.9	1.6
GDP at PPP exchange rates (\$)	6,435.8	3,096.2
Rank	2	4
Share of world GDP	12.4	6.0
Population (millions)	1,288.4	1,064.3
Rank	1	2
Share of world population	20.5	17.0
Merchandise exports (US\$ b)	438.4	54.7
Rank	4	31
% of world exports	5.9	0.7
Services exports	44.5	24.9
Rank	9	20
% of world exports	2.5	1.4
Inflows of FDI (US\$ b)	53.5	4.1
Rank	1	c.20/21

Sources: World Bank, World Trade Organisation, UNCTAD.

India, Asia's other emerging economic power, is still some years behind China in terms of becoming a major player in world markets: according to the World Bank, in 2003 India's economy was less than half the size of China's, and its population roughly half as wealthy. Nevertheless, the subcontinent is poised to join China in helping transform the global economy.<sup>1</sup> Indeed, in areas such as the offshore outsourcing business, where India on some estimates has a global market share of around 50%, that transformation is already under way.

The rise of these two economic superpowers will inevitably transform the global economic – and strategic – environment. There will of course be consequences for a whole range of markets, sectors and institutions, but one area where these changes are set to be particularly pronounced is energy security, and in particular the global oil market.

**Fuelling the beasts**

The basic argument is relatively straightforward. Thanks to a combination of strong economic growth, rapid industrialisation, rising living standards and increasing urbanisation, China and to a lesser extent India are becoming ever-larger consumers of resources in general and of energy in particular.<sup>2</sup> China is already the second largest consumer of energy in the world (after the United States), while India has moved into sixth place, and

<sup>1</sup> See for example Mark P Thirlwell, *India: the next economic giant*. Lowy Institute Paper 01. Sydney, Lowy Institute for International Policy, 2004.

<sup>2</sup> See for example David Hale, China's growing appetites. *The National Interest* (Summer) 2004. And Martin Wolf, China makes its mark. *Financial Times*, 20 April 2004.

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both countries are likely to see their role in global energy markets continue to rise.<sup>3</sup>

Over the past two decades, China and India have been among the world's fastest growing economies. Between 1980 and 2003 Chinese real GDP has risen at an average annual rate of around 9½%, while India's average growth has been closer to a more modest, but still respectable, 5½% pa.<sup>4</sup> As a result, the share of the two economies in world GDP has risen from just 6% in 1980 to almost 18% in 2003. China's share of this gain has been particularly pronounced, with its share of world output rising from 3% in 1980 to around 12½% in 2003 (Figure 1).

There is a close empirical connection between economic growth and energy demand. According to the International Energy Agency (IEA), since 1971 each 1% increase in global output has been accompanied by a 0.6% increase in primary energy consumption.<sup>5</sup> As China and India have become increasingly important contributors to world growth, so have they become more important drivers of global energy demand. The joint share of the two economies in world primary energy consumption has roughly doubled over the past two decades, rising

from 8% in 1980 to almost 16% by 2003. China accounts for the lion's share of this trend with its share in global consumption climbing from roughly 6½% to 12%, but India's share has also risen significantly, climbing from 1½% to about 3½% over the same period (Figure 2).

Moreover, China's economic boom has been powered by industrialisation, with a central role for energy-intensive sectors as iron and steel and chemicals. The rate of growth of industrial value added in China has consistently and significantly outpaced its global counterpart.

India's development model to date has been more services-based, with industry taking a back seat in relative terms.<sup>6</sup> However India too is now recording strong industrial growth numbers, and there are indications that manufacturing could yet play a bigger role in the Indian development story.

Energy demand in both economies is also being boosted by rising incomes and growing urbanisation. According to the United Nations, for example, the share of the population living in urban areas in China has risen by more than 16 percentage points between 1980 and 2000 (Figure 3). It is expected to rise another 25 percentage points in the years through to 2030. While the pace of urbanisation in India is slower, it too will provide a significant spur to energy demand.

With output, industrialisation, urbanisation and living standards all set to increase over coming decades, the two countries' share of global energy consumption will continue to rise. According to the US Energy Information Administration (EIA)'s latest

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<sup>3</sup> Energy Information Administration. *China country analysis brief*. EIA 2004: <http://www.eia.doe.gov/emeu/cabs/china.html>. Energy Information Administration. *India country analysis brief*. EIA 2004: <http://www.eia.doe.gov/emeu/cabs/india.html>.

<sup>4</sup> By comparison, world GDP grew at an average rate of 3.3%pa over the same period.

<sup>5</sup> However, the income elasticity of energy demand (that is, the increase in energy demand relative to the increase in output) has fallen over time, sliding from 0.7 in the 1970s to 0.4 in the period 1991-2002, thanks to a combination of improved energy efficiency and a series of warmer winters in the Northern hemisphere, which has depressed demand for heating fuels. International Energy Agency, *World Energy Outlook 2004*. Paris, IEA, 2004. pp41-42.

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<sup>6</sup> As of 2003 industry's share of GDP in China was 53%, compared to just 27% in India. World Bank. *World Development Indicators online*. 2004: <http://www.worldbank.org/data/wdi2004/>.

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International Energy Outlook, for example, demand for energy in developing Asia – with China and India leading the way – is expected to double between 2001 and 2025, accounting for about 40% of the total forecast increment in world energy consumption over this period.<sup>7</sup> Similarly, the IEA in its World Energy Outlook predicts that China's share of world primary energy demand will increase from 12% now to 16% by 2030, and that China will account for 21% of the growth over this period.<sup>8</sup> While this increase in energy demand will have implications across all energy markets, the consequences for the oil market are likely to be particularly striking.

## The thirst for oil

The previous section reviewed projections for overall energy demand and the role of China and India. One sub-sector where these issues look particularly interesting however is in the oil market. At present oil is an important but not dominant source of energy in both China and India: as of 2003, oil accounted for a little over 23% of total energy consumption in China and roughly one-third of energy consumption in India, with coal the major source of energy consumption for both economies (Figure 4).

However, both China and India have experienced a steady increase in oil demand over recent years, and both economies are now heavily intensive oil users, especially compared to the advanced economies of the OECD (Figure 5).

<sup>7</sup> Energy Information Administration, *International energy outlook 2004*. Washington DC, EIA, 2004. p7

<sup>8</sup> See International Energy Agency, *World Energy Outlook 2004*. p265

In particular, China's demand for oil has doubled over the past decade, and in 2003 China overtook Japan to become the world's second largest oil consumer, accounting for 7.6% of global oil consumption.<sup>9</sup> Preliminary data for last year suggest that China contributed to almost one-third of the estimated increase in global consumption, as Beijing's imports of oil jumped by 0.6 million barrels per day to 2.1 million barrels per day.<sup>10</sup> This in turn contributed significantly to the fastest annual increase in global oil consumption since the 1980s.<sup>11</sup> According to the EIA, China has been the source of around 40% of the growth in world oil demand over the past four years.<sup>12</sup>

India was the world's sixth largest oil consumer last year (accounting for 3.1% of world consumption) and has seen its demand for oil grow by more than 80% over the past ten years.

Even more importantly, both economies have become growing importers of oil. Figure 6 for example tracks the evolution of Chinese oil production and consumption over time. Until 1993, China actually produced more oil than it consumed. But since then the gap between production and consumption – which is met by net imports – has exploded, jumping from just 25,000 barrels a day in 1993 to 2,586,000 barrels a day in 2003.

Unlike China, India has long been an oil importer: the gap between oil production and oil consumption stood at 450,000 barrels per day in 1980. But here

<sup>9</sup> BP. *Statistical review of world energy 2004*. BP 2004: <http://www.bp.com/subsection.do?categoryId=95&contentId=2006480>.

<sup>10</sup> International Energy Agency, *World Energy Outlook 2004*. p64

<sup>11</sup> Ibid. p83

<sup>12</sup> Energy Information Administration. *China country analysis brief*.

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too this gap has widened steadily over time, climbing to 1,634,000 barrels per day in 2003 (Figure 7).

This rising reliance on oil imports has made both China and India increasingly vulnerable to supply disruptions and/or price increases. For example, a quantitative exercise carried out by the IEA, IMF and OECD estimates that a sustained US\$10 a barrel increase in oil prices would produce an output loss equivalent to 0.8% of GDP in China and 1% of GDP in India.<sup>13</sup>

Growing Chinese and Indian demand has also had consequences for the world economy, where over the past year or so the combination of a rapidly expanding new source of energy demand, and limited existing capacity, has placed upward pressure on international oil prices with adverse consequences for the global growth outlook.<sup>14</sup>

The same factors that lie behind the forecast rise in overall energy demand in China and India - continued growth, industrialisation and urbanisation - also imply that both economies' demand for oil will also continue to expand. According to the EIA, for example, world oil consumption will increase by about 44 million barrels per day between 2001 and 2025. Of that increase, China and India will

between them contribute about 13.1 million barrels per day, or about 30% of the total.<sup>15</sup>

Similarly, the IEA forecasts that demand for oil will increase from 77 million barrels a day in 2002 to 121 million barrels per day in 2030.<sup>16</sup> Developing Asia is expected to account for about 18 million barrels per day of this increase, and China alone is forecast to account for nearly half of the region's contribution, with the country's share of world oil demand forecast to increase from 7% to 11%, accounting for almost one-fifth of incremental oil demand over the IEA's forecast period (Figure 8).<sup>17</sup>

A similar message is presented in a recent assessment by Goldman Sachs, which again forecasts that the two countries will contribute significantly to global oil demand in coming years. Interestingly, their analysis shows China's contribution to growth in world oil demand peaking around 2011, with India's possibly overtaking China's within about 15 years. China's share of total demand is forecast to peak at around 16 1/2% of the world total in 25 years time, with India's share expected to gradually converge on China's.<sup>18</sup> In other words, while China is the main story in terms of current and near term oil demand, India is likely to become an increasingly important player in the future.

One clear implication of all these forecasts is that the dependence of both China and India on imported oil is set to increase markedly over coming years, with the rate of increase particularly pronounced in the

<sup>13</sup> International Energy Agency. *Analysis of the impact of high oil prices on the global economy*. IEA 2004: [http://library.iaea.org/dbtw-wpd/textbase/papers/2004/high\\_oil\\_prices.pdf](http://library.iaea.org/dbtw-wpd/textbase/papers/2004/high_oil_prices.pdf). p10

<sup>14</sup> See for example Kevin Morrison, China's voracious appetite for energy. *Financial Times*, 21 May 2004. Also Victor Mallet, Asia's race to meet energy demand. *Financial Times*, 11 May 2004. Demand has only been part of the story however. Fears about supply disruption due to instability in the Middle East have added a significant risk premium to the oil price.

<sup>15</sup> Energy Information Administration, *International energy outlook 2004*. p28 and p.176

<sup>16</sup> International Energy Agency, *World Energy Outlook 2004*. p58

<sup>17</sup> Ibid. p66 and p265

<sup>18</sup> Dominic Wilson, Roopa Purushothaman and Themistoklis Fiotakis, *The BRICs and global markets: crude, cars and capital*. Global Economics Paper No. 118Goldman Sachs, 2004. p5

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case of China (Figure 9): by 2030 imports will meet 74% of China's oil demand, equal to the current volume of imports into the US.<sup>19</sup> India's dependence on oil imports will be even higher, with imports forecast to meet 91% of oil demand by 2030.

**It's all about the Middle East**

While much of the increase in global oil demand in coming years will come from Asia, and specifically from China and India, the bulk of the supply response is likely to come from the Middle East. This reflects the fact that although there are some significant discrepancies between the various estimates of proven global oil reserves, nevertheless all of those estimates tend to agree that the world's reserves are concentrated in the Middle East (see for example Figure 10).<sup>20</sup>

Moreover, in addition to being the home of the world's largest proven reserves, Middle East producers also benefit from low production costs (the average production cost for OPEC's Persian Gulf members is less than US\$2 per barrel) and relatively low investment costs (their investment spend to increase production capacity by one barrel per day is less than US\$6,000). In contrast, for OPEC producers outside the Persian Gulf for

example, the cost to expand capacity is considerably greater (exceeding US\$12,000 in some member nations).<sup>21</sup>

The combination of growing Chinese and Indian energy demand and the concentration of supply response in the Middle East will influence the direction of oil trade flows. For example, the EIA estimates that while in 2001 China sourced about 45% of its oil imports from the Gulf, by 2025 such imports will account for roughly two-thirds of the total, and meet almost three-quarters of the increase in projected imports.<sup>22</sup> The IEA also judges that Middle Eastern economies will account for most of the forecast oil production increase over the next three decades, particularly in the years after 2010. For example, of a projected 31 million barrels per day increase in world oil demand between 2010 and 2030, the IEA thinks 29 million barrels per day - over 90% - will come from OPEC Middle East economies, with Saudi Arabia, Iraq and Iran likely to contribute the bulk of this increase in supply (Figure 11).<sup>23</sup>

**The quest for energy security**

As a globally traded commodity, oil flows to where the (dollar) demand is. The economically rational option for both India and China would be to rely on the international oil market to meet their requirements. But neither seems, at this stage, willing to rely wholly on market mechanisms. Both see their reliance on oil imports as a strategic and economic vulnerability. In China's case in particular, energy security is linked to the legitimacy

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<sup>19</sup> International Energy Agency, *World Energy Outlook 2004*.p117

<sup>20</sup> However the region's share of total reserves varies quite significantly across different estimates due to different projections for the largest economies in the region. See Ibid. pp90-91, especially table 3.2. It is also worth noting that 'proven' oil reserves are generally taken as those quantities that geological and engineering information suggest can be recovered in future from known reservoirs under *existing* economic and geological conditions. Changes in prices and/or technology would mean that these proven reserves could be supplemented by additional supply in the form of non-conventional sources such as oil sands and shale oil.

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<sup>21</sup> Energy Information Administration, *International energy outlook 2004*.p37

<sup>22</sup> Ibid.pp40-41

<sup>23</sup> International Energy Agency, *World Energy Outlook 2004*.p110

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of the ruling regime which is dependant on continued strong – but energy-thirsty – economic growth. Both countries have, therefore, encouraged their national oil companies to invest in long-term supply contracts, production sharing agreements and exploration blocs around the globe as a hedge against supply disruptions and, in China's case, possibly against price fluctuations as well.<sup>24</sup>

Chinese and Indian oil companies are, however, newcomers to the global oil scene and face strong competition from US, European and Japanese rivals (and often from each other). This has meant reinforcing their commercial efforts – which in China's case has already seen them bid above market value for exploration and exploitation contracts – with a more active energy diplomacy. For China, energy security has already become a key foreign policy priority, while for India it is quickly becoming one.<sup>25</sup>

Unsurprisingly the quest for energy security is seeing both countries become more active players in the Middle East. Of course neither is yet in the league of the UK, France and Russia, let alone the US, as a strategic actor in the region. Unlike these established powers, India and China currently have a more limited ability to provide the advanced military technology that states in the Middle East seek and, in particular, to project military power into the region. But this is rapidly changing, with potentially far reaching strategic implications for the Middle East and beyond.

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<sup>24</sup> It has been argued that in the event of an oil shock the Chinese Government would pressure state-owned oil companies to supply oil to China at artificially low prices. See Erica Strecker Downs, *China's Quest for Energy Security*, Rand Corporation, 2000. p. 20.

<sup>25</sup> For example, India's Ministry of Petroleum recently established an oil diplomacy committee aimed at providing a more integrated political approach to overseas oil investments.

**Engaging the rogues**

China and India's approach to oil diplomacy in the Middle East is often marked by opportunism. The best illustration is their engagement with so-called "rogue states", notably Iran, Sudan and until recently, Iraq. Washington's imposition of sanctions on these countries means that Chinese and Indian oil companies do not face competition from their US counterparts. And even other western firms, not subject to US sanctions, are sometimes forced by human rights or other lobby groups to abandon or eschew investments in these states.

In 1997, for example, Washington's imposition of sanctions on Sudan allowed China to replace a US oil company, Occidental, in a major oil and pipeline deal.<sup>26</sup> In 2003 the Canadian oil company Talisman Energy was pressured by human rights groups to sell its stake in Sudan's Greater Nile Petroleum Operating Company which was quickly snapped up by ONGC Videsh, a subsidiary of the Indian state-owned oil company.<sup>27</sup> Nonetheless, even in rogue states China and India still face stiff competition from European and Japanese firms.

The strength of this competition raises an obvious question: what might India and China ultimately offer these states in return for energy security? One possibility is nuclear and missile technology. In 2003 India signed a strategic cooperation accord with Iran which reportedly includes provision for the provision of technical military assistance. And there is already a concern that China has been assisting

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<sup>26</sup> David B. Ottaway and Dan Morgan, China pursues ambitious role in oil market. *The Washington Post* 1997.

<sup>27</sup> US Department of Energy Energy Information Administration. *Global Energy Sanctions*. 2004: <http://www.eia.doe.gov/emeu/cabs/sanction.html>.



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Iran develop its ballistic missile and nuclear programs (alongside China's provision to Iran of tactical missiles<sup>28</sup>).

In China's case the provision of military technology seems largely driven by commercial imperatives, rather than energy security. By and large Beijing is also being responsive to Washington's proliferation concerns, not least because it wants to avoid open disputes with the latter that might ultimately threaten its continued economic growth. And China is already important enough to Iran; at this point Beijing doesn't really need to offer additional inducements.

Over the medium to longer term, however, this equation could change. As the Sino-Iranian relationship deepens, Iran becomes both a major supplier of oil and a destination for Chinese energy investments, and given Iran's strategic location, China could come to see Iran's security as a key interest. Lacking the ability to project power into the region there is a strategic logic to China's helping Iran to deter any US military action against it by providing it with critical military systems, most notably missiles, or potentially even assisting Iran to develop a nuclear deterrent.

**Projecting power**

Over the medium to longer term it is likely that India and China will join the ranks of other major powers currently engaged in the Middle East. Indeed, illustrating the extent to which China already takes the security of its interests in the region seriously, among the 5-10,000 Chinese labourers sent to build an oil pipeline and refinery in Sudan is a sizeable

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<sup>28</sup> See for example Robert Hewson, China aids Iran's tactical missile programme. *Janes Defence Weekly*, 17 November 2004.

security detachment (though they are probably not PLA regulars).

Currently both India and China lack the ability to project power into the Middle East. China has neither the blue water naval capabilities nor regional bases needed to secure its long sea lines of communication (SLOC) from the region. India is in a better position given its geographic proximity and its more advanced blue water capability. But the Indian Navy still lacks the capability for sustained out-of-area deployments.

This will eventually change. India's future plans call for a three aircraft carrier navy by 2015-25, even if the reality of India's naval development often falls short of its ambitions.<sup>29</sup> Meanwhile China's naval development is continuing apace and it could eventually acquire access to naval facilities in Burma and Pakistan. China has been helping to modernise Burma's ports and provided finance for and helped construct a deep water port at Gwadar on the Western coast of Pakistan near the entrance to the Gulf. China provided US\$198 million, of the total US\$ 248 million cost of phase one of the project through grants, interest-free loans and buyer's credit.<sup>30</sup>

**Unsettling the neighbours**

The strategic implication of China and India's growing reliance on Middle East oil is not limited to the Middle East. Japan and South Korea have traditionally been north Asia's largest consumers of

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<sup>29</sup> Rahul Bedi, Interview with Admiral Arun Prakash Indian Chief of Naval Staff. *Janes Defence Weekly*, 3 November 2004.

<sup>30</sup> Pakistan Board of Investment Website. *Gawader*. 2004: [http://www.pakboi.gov.pk/News\\_Event/Gawadar.html](http://www.pakboi.gov.pk/News_Event/Gawadar.html).

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Middle East oil and Japan has invested heavily in the oil sector in the Middle East, particularly in Iran. Competition from China for investment in the Middle East is likely to be unwelcome, particularly when China can offer things Japan cannot (such as missile technology).

The heavy reliance on Middle East oil gives the security of Asia's SLOCs a new edge, in particular the congested waterways of the Malacca Straits (between Indonesia, Malaysia and Singapore – the main oil route for Asia and only 2.5 km wide at its narrowest point). The Malacca Straits currently handles 11 million barrels of oil per day, a figure which on current oil demand trends would need to double by 2030.<sup>31</sup> Yet the Straits are already close to capacity in terms of shipping traffic. Indeed much of the forecast increase in oil trade between Asia and the Middle East outlined above will involve transport along what the IEA describes as routes at risk of sudden closure.

Protecting these waterways from non-conventional threats is a possible area for regional naval cooperation, which in turn might provide a useful confidence-building exercise. Conversely as China's naval reach develops, and Japan becomes more assertive about using its already significant blue water capability, a significant naval rivalry might develop that extends all the way to the Gulf region. Indeed, prompted by a more assertive Chinese posture in the Middle East, Japan could give its already considerable commercial and financial interests in the region a military dimension.

Likewise Pakistan views India's budding relationship with Iran with concern. Iran has long been a Pakistani rival, not least in Afghanistan. There have also been claims that one element of the Iranian-

Indian security accord is an agreement by Iran to allow India to use its bases in time of war with Pakistan, though this has never been confirmed. All of which may in turn reinforce Pakistan's ultimate willingness to deepen cooperation with China, including offering naval facilities.

**Strains with the US**

China and India's reliance on Middle East energy could also bring their respective relationships with Washington into question. This is less of a prospect for India than it is for China. The war on terror has helped crystallise common Indo-US strategic interests manifest in joint military exercises and a relaxed US attitude to Israel's provision of military technology to India (in contrast to the negative US attitude to Israel's provision of military systems to China). Indeed, Israel has become a major supplier of key defence systems including advanced military electronics and avionics, unmanned aerial vehicles (UAVs), an advanced early warning (AEW) system and possibly in future, anti-ballistic missile systems.

The question for India is whether it can continue to balance the conventional security imperatives that drive it toward a closer relationship with the US and Israel, with the energy security interests that dictate a closer relationship with Iran and Arab countries. The new Congress-led government has already hinted that it may revisit policy toward the Middle East. The problem is that military ties with Israel have become so significant to the maintenance of India's military edge over Pakistan that the relationship has developed a logic and importance all of its own.

Like India, China has enjoyed a positive relationship with the US in recent years, in part because it has sought to avoid international disputes with

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<sup>31</sup> International Energy Agency, *World Energy Outlook 2004*. p119

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Washington. China will continue to pursue such a small target strategy where it can. And even in cases where it opposes the US, as in the lead-up to the US invasion of Iraq, it will take cover behind others (in that case fellow P-5 members France and Russia). Nonetheless the importance China places on energy security suggests it will be difficult for the two countries to stay out of each other's way in the Middle East.

This is illustrated by recent positions that China has taken in the Security Council on Iran and Sudan. China publicly voiced its opposition to bringing Iran's nuclear program before the Security Council. Meanwhile, on Sudan, China threatened to veto any oil embargo imposed as a result of the Sudanese government's complicity in sectarian fighting in the province of Darfur. These actions will have reinforced existing suspicions in Washington about China's intentions in the Middle East which, whether soundly based or not, could in turn feed into tensions between the two countries more generally. Another independent player in the Middle East will also undermine US efforts to isolate states of concern in the region. China has already become a major source of cheap consumer goods for Iran, undercutting the impact of US sanctions.

Potential Sino-US tension on Middle East issues is not simply a function of China's relations with "rogue states". Instability in the region is as inimical to China's energy security interests as it is to the US. But China does not view the US as a stabilising factor in the region, a view reinforced by the US invasion of Iraq. The prospect of US military action against Iran over Tehran's nuclear program is also likely to be viewed with alarm. And more broadly China remains conscious of the US Navy's ability to

interdict or interrupt China's long SLOCs to the Middle East.<sup>32</sup>

Moreover, China's growing interest in, and engagement with, the Middle East is occurring at a time when US relations with many regional states have reached their lowest ebb. The recent decision by Saudi Arabia to award the first foreign contracts for natural gas exploration to Chinese (and Russian) firms, at the expense of a US bid, raised eyebrows, though was hardly surprising given the residual strains in the Saudi-US relationship. Saudi Arabia is quickly becoming a key oil supplier for China, while the Saudi national oil company ARAMCO is investing in China's refining sector.

Given its inability to project military power into the Gulf region China does not currently represent a serious strategic alternative to the US for Saudi Arabia.<sup>33</sup> But as they have done with European countries in the past, the Saudi regime will use its relationship with China to signal its displeasure with the US from time to time. This could in turn fuel Sino-US tensions. Over the longer term, however, the possibility of a more significant strategic alignment is not outside the realms of possibility.

**New strategic axes?**

For the moment at least both India and China have been able to pursue pragmatic relationship with a wide variety of Middle Eastern states, many of which do not see eye to eye with each other. Thus China has managed growing relations with Iran and Saudi Arabia (and Pakistan), while India seems to have successfully quarantined its military

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<sup>32</sup> Downs, *China's Quest for Energy Security*. pp. 44-45.

<sup>33</sup> Although in the mid-80s China supplied CSS-2 medium range missiles to Saudi Arabia.

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relationship with Israel from its burgeoning relationship with Iran. In future, however, the inherent contradictions in some of these alignments may become more difficult to manage.

India might well decide that military links with Israel are simply too important to abandon and come to view cooperation with the US military presence in the region as the best guarantee of its energy security requirements. Japan could also come into this axis should its competition with China in the Middle East become more intense. There is a more or less natural set of interests between Saudi Arabia, Pakistan and China. Each has something the other lacks: Saudi oil and money for investment; Chinese economic power and missile and nuclear technology; and Pakistani naval bases and military manpower. And as already noted above, China's relationship with Iran could develop a strategic dimension.

### Conclusion

While, at this stage, we can only speculate about the longer term implications of China and India's growing reliance on Middle Eastern oil, their economic weight and in future, military power, leaves little doubt that both will become major players in the Middle East over coming years. This is not simply a function of their growing energy interests in the region, but the willingness of a number of regional states to view them as an alternative or counterweight to US power. And while India may well settle for strategic accommodation if not cooperation with the US in the Middle East, the trajectories of Chinese and US policy in the region seem more likely to collide.

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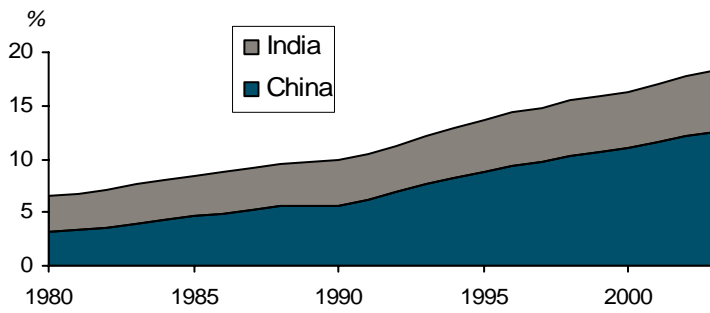
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Figure 1

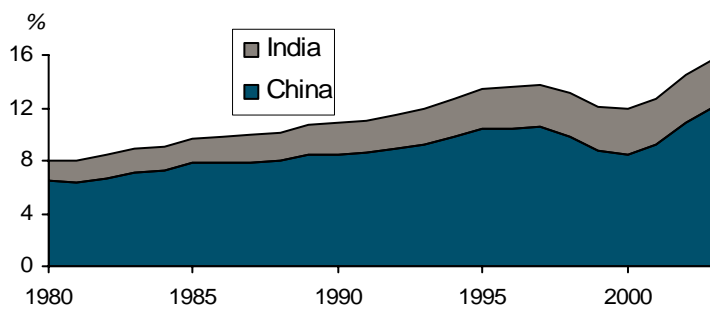
**Share of world output at PPP exchange rates**



Source: International Monetary Fund (2004)

Figure 2

**Share of world primary energy consumption**

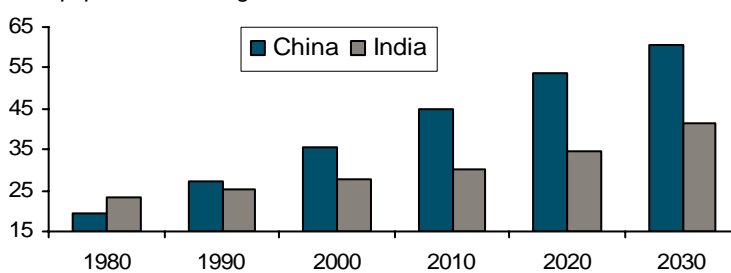


Source: BP (2004)

Figure 3

**Urbanization in China and India: history and forecasts**

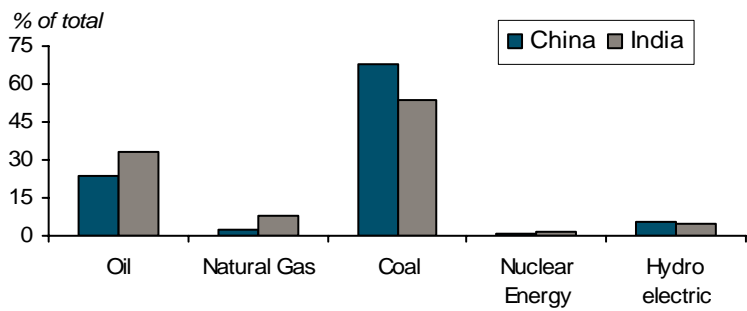
*% of population residing in urban areas*



Source: United Nations Population Division (2004)

Figure 4

**Composition of energy consumption, 2003**

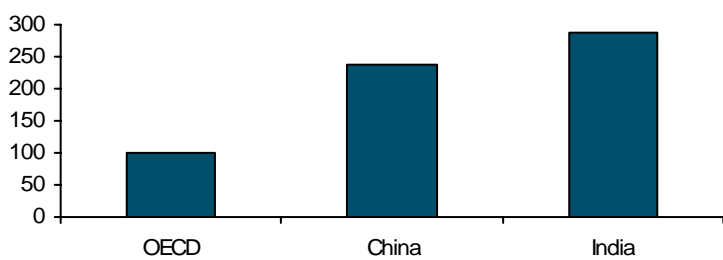


Source: BP (2004)

Figure 5

**Oil intensity of production**

*Index, OECD = 100*

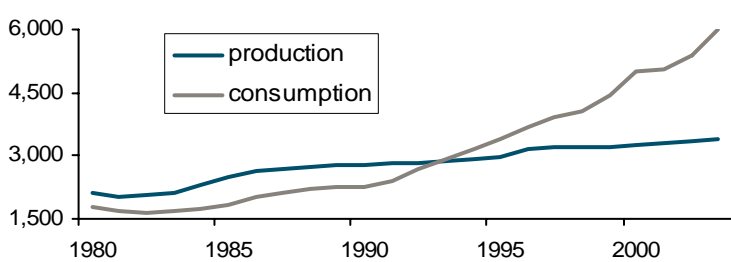


Source: International Energy Agency (2004a)

Figure 6

**Chinese oil production and consumption**

*thousands of barrels per day*



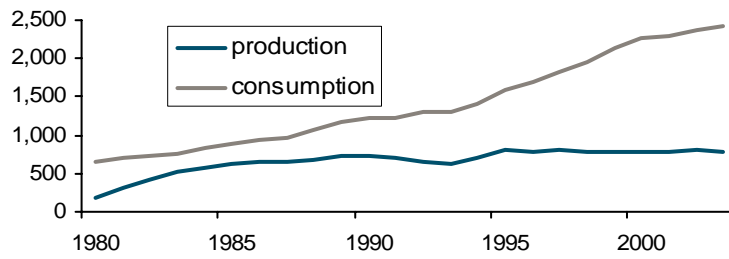
Source: BP (2004)



Figure 7

**Indian oil production and consumption**

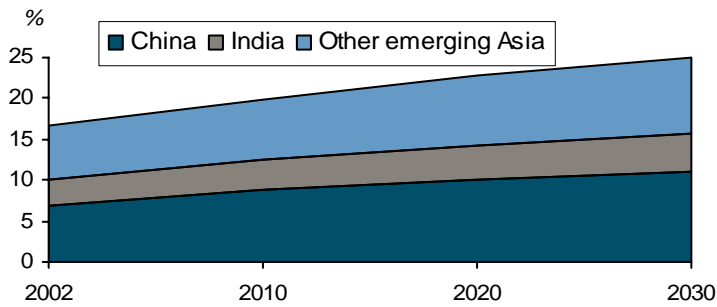
*thousands of barrels per day*



Source: BP (2004)

Figure 8

**Forecast share of world oil demand**

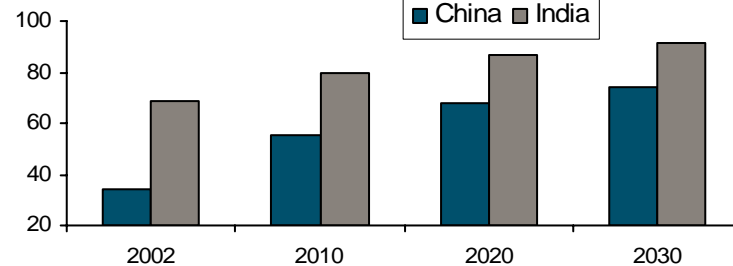


Source: derived from table 3.1 in International Energy Agency (2004b)

Figure 9

**Oil import dependence**

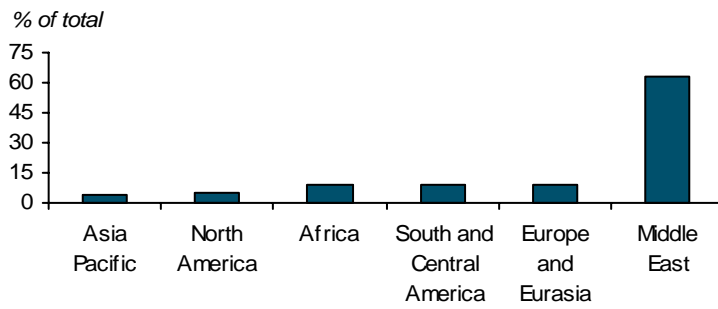
*Imports as % of total demand*



Source: derived from table 3.7 in International Energy Agency (2004b)

Figure 10

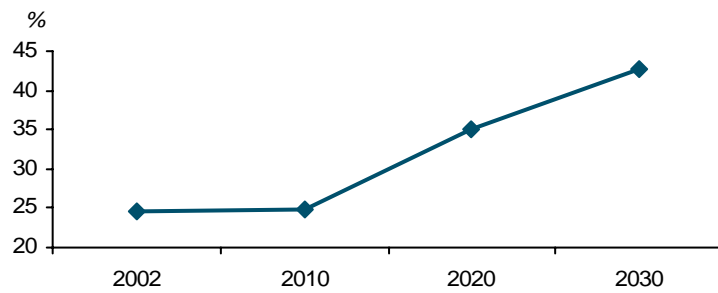
**Distribution of proved oil reserves, 2003**



Source: BP (2004)

Figure 11

**Forecast share of Middle East OPEC in world oil supply**



Source: derived from table 3.5 in International Energy Agency (2004b)

## ABOUT THE AUTHORS

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