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# ANALYSIS

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## Foreword

Over the years I have pointed out that China's rise as a global power is likely to be the most significant event in international affairs in the 21st century. One dimension of China's growing impact is its rapid emergence as a major force in world energy markets and global energy geopolitics. Beijing's booming energy consumption and intensifying search for energy security have raised a new range of contentious issues between China and the United States that are adding a new layer of issues to an already complex and dynamic relationship. The clearest example of growing problems was the Congressional furor surrounding the China National Offshore Oil Company's (CNOOC) bid for U.S. oil company Unocal last summer, but there are also added U.S. concerns revolving around China's growing energy ties with energy-rich problem states, such as Iran and the Sudan, and apparent efforts to "lock up" equity oil supplies around the globe. Alternatively, from China's perspective, the Congressional furor over the CNOOC-Unocal bid and U.S. opposition to its involvement in problem states confirm the view of many in Beijing that the United States is intent on blocking China's efforts to secure future energy supplies. In sum, energy now is adding a new layer of mistrust and suspicion to U.S.-China relations that threatens to further undermine efforts to forge a cooperative and constructive long-term relationship.

This issue of the *NBR Analysis* examines China's global search for energy security, draws implications for U.S. global energy and security interests, and recommends policies that the authors contend will allow the United States to respond more effectively to China's expanding global energy impact.

Kenneth Lieberthal and Mikkal Herberg bring an exceptional blend of experience from government, business, and academe to the special study. Kenneth Lieberthal is currently Arthur F. Thurnau Professor of Political Science at the University of Michigan and formerly Senior Director for Asia on the National Security Council. Mikkal Herberg is Director of the Asian Energy Security Program at NBR and previously spent twenty years in international strategic planning roles for a major U.S. oil company.

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## China's Search for Energy Security: Implications for U.S. Policy\*

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## Executive Summary

This report examines China's global search for energy security, draws implications for U.S. global energy and security interests, and recommends policies that will allow the United States to respond more effectively to China's expanding global energy impact.

### *Main Argument:*

China is rapidly emerging as a major force in both world energy markets and global energy geopolitics, and key aspects of China's new global energy activities are creating new challenges for U.S.-China relations. As the world's two largest energy consumers, however, the United States and China share key common interests in the energy sector. Both nations can benefit if improved cooperation replaces the current drift toward a competitive energy relationship. The issue of trust will inevitably weigh heavily in determining future levels of cooperation. This paper proposes a sober U.S. policy that will enhance trust and strengthen multilateral, regional, and bilateral cooperation on energy issues.

### *Policy Implications:*

There are a number of ways to promote constructive relations between the United States and China:

- The United States should seek creative ways to integrate China into the International Energy Agency (IEA) and the Group of Eight (G-8). By helping to give Beijing a "seat at the table," the United States can increase the chances that China will become a "stakeholder" in the major efforts of these institutions to deal with energy supply issues.
- The United States should begin taking measures to promote the development of a Northeast Asia Security Community consisting of the United States, Japan, the Republic of Korea (ROK), China, and Russia. This group over time can take up regional energy issues.
- Washington needs to promote an invigorated bilateral energy dialogue with Beijing. The United States would benefit from a set of policies that focuses on achieving the following goals: raising the importance of energy in bilateral dialogue at a policymaking level, avoiding measures and rhetoric that needlessly aggravate China's sense of energy vulnerability, discouraging mercantilist competition for oil supplies in China and elsewhere in Asia, and encouraging energy efficiency, diffusion of new energy-saving technologies, and energy market reform in China.

China is rapidly emerging as a major force in both world energy markets and global energy geopolitics. This emergence reflects the scale of China's rising oil demand and Beijing's increasingly active strategic diplomacy designed to secure future energy supplies. Now the second largest oil consumer in the world and the third largest oil importer, China has experienced oil demand growth that has accounted for nearly one-third of the world's total oil demand growth during the past decade, and is adding the equivalent of a medium-size country to world oil demand each year. In the course of less than a decade, China's three national oil companies (NOC) have become significant new players on the global oil industry scene, with increasing investment stakes in the Persian Gulf, Central Asia, Africa, and the western hemisphere. China is now an important factor that impacts world oil demand and prices, production prospects in key energy-exporting countries, and the competitive rules of the game for the world's international oil companies. Moreover, energy investments abroad are expanding China's diplomatic role in key energy-producing regions, most importantly the Persian Gulf, Central Asia, Africa, and Russia. Additionally, China's efforts to secure energy supplies and transport routes in Asia are increasingly affecting the shape and tenor of China's diplomatic ties, as well as rivalries, in Northeast and Southeast Asia.

The United States, on the other hand, is the reigning "superpower" of global energy and, therefore, China's energy "rise" potentially holds major implications for U.S. power and influence. The United States imports nearly thirteen million barrels per day (MMBD) (almost twice the total oil consumption of China, the world's second largest oil consumer) and accounts for one-quarter of the world's daily oil consumption. The United States is the third largest oil producer in the world after Saudi Arabia and Russia. As the dominant geopolitical power in the Middle East and Persian Gulf, the United States has thrice in the past two decades put its military might behind securing access to Persian Gulf oil supplies.<sup>1</sup> In the wake of September 11, that power and influence are also being extended into Central Asia. The U.S. Navy controls the sea lines of communication (SLOC) in all the key energy transit bottlenecks, including the Straits of Hormuz, the Malacca Straits, and the Southeast Asian sea lanes. The United States is also a dominant power in global energy institutions such as the International Energy Agency (IEA), and is home to many of the largest and most technologically sophisticated energy companies in the world. As John Mitchell, a well-known specialist on the geopolitics of energy, has

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<sup>1</sup> These include military interventions in Iraq both in 2003 and in 1990-91 and the Persian Gulf "tanker war" in the mid-1980s.

noted, “For every issue on the energy geopolitical agenda, there is at least one telephone line to Washington.”<sup>2</sup>

Consequently, China’s rapidly rising global energy impact and diplomatic reach pose many of the same challenges for U.S.-China relations as does China’s broader economic and geopolitical “rise.” Yet there still is no systematic analysis of either the energy and strategic implications for the United States of China’s emergence as a global energy player or how the United States should respond. Does China’s booming oil demand and seemingly more statist approach to securing future oil supplies really constitute a threat to U.S. economic and energy security interests? If so, then how? Is China’s oil demand a threat to the stability of global oil markets? Will China’s growing influence in key energy regions and countries significantly challenge U.S. diplomacy, or can Beijing be persuaded to choose an overall energy policy more consistent with U.S. interests? To use U.S. Deputy Secretary of State Robert Zoellick’s term, can China become a “stakeholder” in the global energy system’s norms and rules?<sup>3</sup>

Both the United States and China will benefit if they can develop a collaborative relationship on energy issues—as opposed to the current trajectory characterized by growing mistrust, suspicion, and competition. In reality, the fundamental global energy interests of China and the United States largely converge. China’s new energy security challenges mirror the United States’ own long-standing energy security challenges. Both countries share an interest in avoiding global supply disruptions, maintaining stability in the Persian Gulf, accelerating the development of new oil and gas resources, expanding the development and use of clean coal technologies, increasing global energy supply diversification, creating greater transit and fuel flexibility, expanding and improving emergency oil-sharing arrangements, and managing the environmental fallout from unrestrained fossil fuel consumption. What can the United States do to make constructive cooperation more likely? Is attaining such cooperation a feasible objective for U.S. policy?

Thus far the U.S. response to China’s energy rise has been relatively ad hoc, reactive, and counterproductive. Compounded by China’s own lack of transparency, U.S. reactions have suffered from a poor understanding of China on many levels, including China’s energy dilemmas, the complex interests driving Beijing’s global energy approach, the goals and relationships that characterize Chinese energy institutions and

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<sup>2</sup> John V. Mitchell with Peter Beck and Michael Grubb, *The New Geopolitics of Energy* (London: Royal Institute of International Affairs, 1996), 186.

<sup>3</sup> See Robert B. Zoellick, “Whither China: From Membership to Responsibility?” (speech, National Committee on U.S.-China Relations, New York City, September 21, 2005); and Richard Baum, Kurt M. Campbell, James A. Kelly, and Robert S. Ross, “Whither U.S.-China Relations?” *NBR Analysis* 16, no. 4 (December 2005).

state energy companies, and the linkages between energy and other issues in the People's Republic of China (PRC). U.S. Congressional reaction to China National Offshore Oil Corporation's (CNOOC) 2005 bid for Unocal both revealed how little some U.S. policymakers understand about China's global energy push and showed how divisive these issues have become for an already strained U.S.-China relationship. The failed bid also demonstrated that, in today's atmosphere of high energy prices and fears over long-term energy scarcity, both the United States and China are focused intently on their national energy security and tend to assume the worst of the other's intentions. Moreover, the energy policymaking institutions of both China and the United States make effective energy cooperation very difficult.

Therefore, the central question hinges on whether the United States and China will be able to reduce their existing mistrust, which is exacerbated by broader strategic tensions, and devise prudent and serious ways to begin working together to achieve mutual interests in energy. In fact, energy cooperation could actually contribute to building the trust required for potentially broader international cooperation between China and the United States.

The United States and China seem to hold fundamentally different views of global energy markets. This reality makes effective dialogue on energy issues both more difficult and more necessary. China's energy strategy currently appears rooted in a statist, mercantilist mentality among political leaders in Beijing. The United States, on the other hand, has a stated policy of relying largely on global markets to deliver energy supply security.<sup>4</sup> The United States does not always fully appreciate how its own colossal weight in global energy and geopolitics affects China's concerns regarding U.S. ability to threaten China's energy interests. Ed Morse, an expert on energy and politics, sums up the problem by asserting that, "The U.S. is mostly 'brawn' and limited 'brain'."<sup>5</sup> Suspicions remain high both in Beijing and Washington regarding the other's intentions on key energy security and supply questions.

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**"The United States does not always fully appreciate how its own colossal weight in global energy and geopolitics affects China's concerns regarding U.S. ability to threaten China's energy interests."**

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<sup>4</sup> In reality, this policy has been augmented over the past 50 years by major interventions of U.S. power, influence, and diplomacy designed to keep oil flowing to world markets.

<sup>5</sup> Edward L. Morse, "The Oil Market in 2006: Observations on Fundamentals and Geopolitics" (presentation, Washington Institute for Near East Policy, November 29, 2005).