

THE NEW ENERGY SILK ROAD:

The Growing Asia–Middle East Energy Nexus

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The New Energy Silk Road: The Growing Asia–Middle East Energy Nexus

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Since the mid-1990s Asian energy demand has increased at truly stunning rates as consumption of the full range of fossil fuels—oil, natural gas, and coal—has rapidly grown. Though China has been at the center of this demand surge, growth has also been strong in developing Southeast Asia, India, and the rest of South Asia. At the same time, the Middle East and the Persian Gulf have remained at the center of the global oil supply system because the region is home to some of the largest oil producers and exporters in the world and holds roughly two-thirds of the world’s proven oil reserves. The Gulf has also become a much larger supplier of liquefied natural gas (LNG) over the past decade, as Qatar’s rapid LNG growth has added to LNG supplies from the United Arab Emirates (UAE) that have been flowing to Japan and other parts of Asia for two decades.

Quite naturally then, energy trade and investment between Asia and the Gulf have boomed since the mid-1990s. This is one important manifestation of a rapidly shifting architecture of global oil and gas markets away from a system dominated by flows of oil and LNG from the key producing regions to the rich, industrialized world of the United States, Europe, and Japan and toward fast-growing markets in developing Asia. New capital flows, energy partnerships, and strategic relationships are rapidly being built based on this historic shift in energy demand.

In an effort to explore this historic shift in some depth, The National Bureau of Asian Research (NBR), in coordination with the Global Energy and Environment Initiative at the School of Advanced International Studies of the Johns Hopkins University, organized a major conference in May 2009 in Washington, D.C., that brought together a select group of experienced analysts and policy experts. The conference, entitled “The New Energy Silk Road: The Growing Asia–Middle East Energy Nexus,” was supported by the generous contributions of ExxonMobil, Chevron, Conoco Phillips, and the Japan Oil, Gas and Metals National Corporation.

In addition to nearly two days of discussion, four essays were commissioned for the conference that focus on the key state players in this growing nexus of energy and political ties: China, India, Saudi Arabia, and Iran. The conference also included presentations and discussion on the energy and diplomatic roles and interests of Japan, Korea, and Russia in the Middle East, and a concluding panel sought to draw together the various strands of the discussion toward a better understanding of the long-term strategic and energy implications for the United States of this rapidly evolving process. This report includes those four essays along with a review of the discussion of long-term U.S. strategic interests. Read as a group, the essays convey a range of the issues raised in the conference. In addition, each essay provoked an active panel discussion that provided a wider range of issues and opinions and added immeasurably to the exploration of the issues under discussion. Hence, this brief introduction seeks to place each of the essays in the context of the broader discussion it provoked.

Asia–Middle East Energy Ties

Japan and South Korea have long been major buyers of both crude oil and LNG from the Gulf. Both countries are virtually 100% dependent on imports for their oil and natural gas supplies and the Gulf provides between 80%–90% of their crude imports and a significant share of their LNG needs. Japan and South Korea have become major investors in upstream LNG projects in the Gulf and have also sought to invest in upstream oil development, although with much less success. Both have been active in forging stronger diplomatic ties with the Gulf producers. With the emergence

of China and India as booming new markets for crude and LNG, these two countries have now also become prominent buyers, investors, and diplomatic players in the Gulf alongside Japan and Korea. All four of the major Asian powers are intently focused on broadening their access to energy supplies in all the main exporting regions of the world and each is raising its future targets for so-called equity oil to be controlled by their own national oil companies (NOC) and boosting their financial and diplomatic support for their NOCs or quasi-NOCs. In particular, they all are intensifying supply efforts among the key Gulf oil and LNG exporters.

Importantly, the rise of China and India as major energy buyers and investors in the Gulf coincides with their broader rise as economic and political powers regionally and globally. This is clearly most salient in the case of China whose economic and political rise promises to transform the global economic and security environment. Yet India too seems destined to play a far larger role economically and geopolitically—probably more as a regional power but also to some extent as an important player in global affairs. The convergence of both countries' growing energy as well as geopolitical impact suggests that they are likely to have increasingly important influence in key energy exporting regions in the future, with especially significant implications for the future of the Gulf and Middle East.

Conversely, the Middle East Gulf producer states have also increasingly recognized that Asia, and particularly China and India, will become the region's largest and fastest-growing oil and gas export markets in the future. Already, two-thirds of the Gulf's oil exports go east to Asia, reflecting this profound shift in the balance of global oil demand. As a result, Gulf producers are busy developing new energy trade, investment, and diplomatic relationships with the newly rising Asian states while also maintaining their traditional market and political relationships with Japan and Korea. Both Saudi Arabia and Kuwait are now major new investors downstream in China in the refining and petrochemical sectors, adding to their existing large downstream investments in Japan and Korea. Iran has sought to draw the Asian powers into investing in its energy sector in order to escape the constraints of the Western sanctions effort led by the United States, with only very limited success so far. Although Iraq has only recently begun to focus on the East in order to resurrect its oil and gas industry, its enormous, low-cost oil and gas resource base promises to make the country a major factor in this Asia–Middle East energy nexus (assuming a modest level of future stability and physical security). Not surprisingly, virtually all Asian NOCs are now active participants in the new round of exploration and development contracts being auctioned in Iraq. Alongside this booming energy trade and investment nexus, the Gulf producers are also building an expanding network of cultural, economic, and diplomatic ties with the Asian powers—especially with China and India—which promises to draw the two regions ever closer together in political, economic, and strategic relations.

As Asia's geopolitical relationship with the Gulf evolves alongside the energy relationship, this seems destined to have important long-term implications for the United States. The United States has been the dominant outside strategic and energy power in the Gulf since the 1950s and has profound strategic stakes in ensuring both political stability and stable energy flows from the region. The U.S.-Saudi strategic alliance has been a cornerstone of U.S. strategic and energy policy and remains so despite the stresses and strains in the alliance since September 11. U.S. economic interests in the stable flow of energy from the Gulf have drawn the country into two major wars in Iraq/Kuwait, a series of diplomatic and military confrontations with Iran, and deep involvement in the 1980–88 Iran-Iraq War. The U.S. Navy remains the guarantor of security of the vital energy

sea lanes of communication (SLOC) in the Gulf, the Strait of Hormuz, and surrounding seas. At the same time, low domestic oil prices and consequently strongly growing U.S. oil demand until very recently have underpinned the growth of world oil demand and, de facto, growing demand for Gulf oil. This has reinforced the imperative to maintain U.S. strategic power in the Gulf to ensure stable energy flows and reasonable energy prices to help fuel U.S. prosperity.

Though U.S. strategic and energy interests in Gulf stability remain central to U.S. prosperity, the strategic ground beneath engagement with the Gulf is beginning to shift as the nexus of this new “Energy Silk Road” takes shape. Thus far the signs of change are modest and diplomatic relationships are growing gradually. Beijing’s ability and interest in seeking to project influence in Gulf geopolitical affairs appears to remain low. This seems very likely to change over time, however, as China’s capabilities, import dependence, and vital energy interests inevitably expand. As India’s regional power grows, it also seems likely to become a more active player in the Gulf region, which New Delhi has traditionally seen as crucial to regional security as well as to energy security. Japan and Korea are additionally seeking to step up diplomatic, economic, and financial engagement with the key Gulf producers in order to compete with China and India for energy access and influence, although these states have traditionally followed the U.S. lead in the Gulf’s geopolitical affairs.

Asia’s expanding footprint in the Gulf raises a range of important questions about the long-term geopolitical implications for U.S. strategic and energy interests that were the focus of this conference. Foremost from a U.S. perspective, what does growing involvement of China and India mean for long-term U.S. power and influence in the Gulf? How will these states’ growing engagement with Saudi Arabia, Iran, and Iraq impact the ability of the United States to achieve its energy security and strategic goals? Will China’s and India’s growing involvement contribute to U.S. efforts to stabilize this vital region or could their involvement lead to a damaging competition for influence and access to energy resources? Below is a brief review of the four essays, which address these and other questions, as well as the discussions that they provoked.

China

At the conference, Philip Andrews-Speed, from the University of Dundee in Scotland, presented an overview of China’s energy security strategy and how the Middle East fits into that effort. He argued that although China is seeking to diversify its sources of crude oil toward overland sources of supply such as Russia and Central Asia, the reality of the balance of oil reserves globally means that China has little choice but to seek new reserve access in the Middle East through supporting the expansion of Chinese NOCs. China’s NOCs are compelled to invest abroad if they are to become major, competitive oil companies because China’s oil reserves are limited and domestic price controls often sharply undermine profitability.

Despite their efforts, China’s NOCs have had only modest success in investing in oil and LNG deals in the Gulf, but the region has become a major supplier of crude oil to China’s refineries. The Middle East now accounts for roughly one-half of China’s oil imports, equal to one-quarter of China’s daily oil consumption. Saudi Arabia is now in most months the largest single supplier of crude oil to China. Given that Saudi Arabia’s oil and gas industry is largely closed to private investment, the relationship is based mainly on major Saudi crude sales to China and rapidly growing Saudi downstream investments in China. Iran has been a focus and is a significant crude