



ENERGY SECURITY
PROGRAM

NBR REPORT BRIEF
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ASIA'S RISING ENERGY AND RESOURCE NATIONALISM

*Implications for the United States, China,
and the Asia-Pacific Region*



Energy and resource security have become critical strategic issues in Asia as energy demand and import dependence rise rapidly. Regional powers have responded with nationalist and mercantilist strategies to secure control over energy and commodity supplies. Given that political stability and economic prosperity in Asia are vital to long-term U.S. interests in the region, the United States has a major stake in preventing competition over energy and commodities from fueling regional strategic distrust and conflict.

With this in mind, The National Bureau of Asian Research (NBR) set out to examine these issues by commissioning this year's Energy Security Report, "Asia's Rising Energy and Resource Nationalism." The report analyzes major risks emanating from Asia's growing energy and resource insecurity, and suggests that insecurity among key powers is affecting existing political and strategic rivalries. In particular, growing competition among Beijing, Tokyo, Seoul, and New Delhi to promote their own national oil companies and gain control over foreign oil and gas supplies is undermining confidence in fair access to future supplies, changing the competitive landscape, and increasing strategic distrust. Asia's toxic atmosphere is also present in the maritime realm, as efforts to control energy sea lines of communication fuel a potential naval arms race. Moreover, conflicts such as the controversy surrounding China's policies on rare earth exports have demonstrated how other resources and commodities can be drawn into national rivalries, and used as political tools that add to regional mistrust.

These concerns highlight how important it is for U.S. and Asian decisionmakers to begin working to address common challenges in collaborative rather than competitive ways. Regional stakeholders must work together on building trust, promoting new supplies, developing new regional infrastructure, and ensuring open sea lanes for energy transport. Such efforts will require strong and visionary leadership, most importantly from Washington and Beijing.

This brief outlines the main findings and key policy implications of the report.

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RESOURCE NATIONALISM IN THE ASIA-PACIFIC: WHY DOES IT MATTER?

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In assessing the risks of resource nationalism, it is worth noting that a key trend of the past three decades has been for governments in oil importing countries to reduce support for national oil companies (NOCs). Market liberalization in the major oil importing states and the weakening or severing of links between governments and NOCs are the two biggest ownership changes since the 1970s. This means that there are fewer governments that see control over oil as a useful market strategy. It also means that even as China and India increase their market interventions, they are less likely to come into conflict with other NOCs.

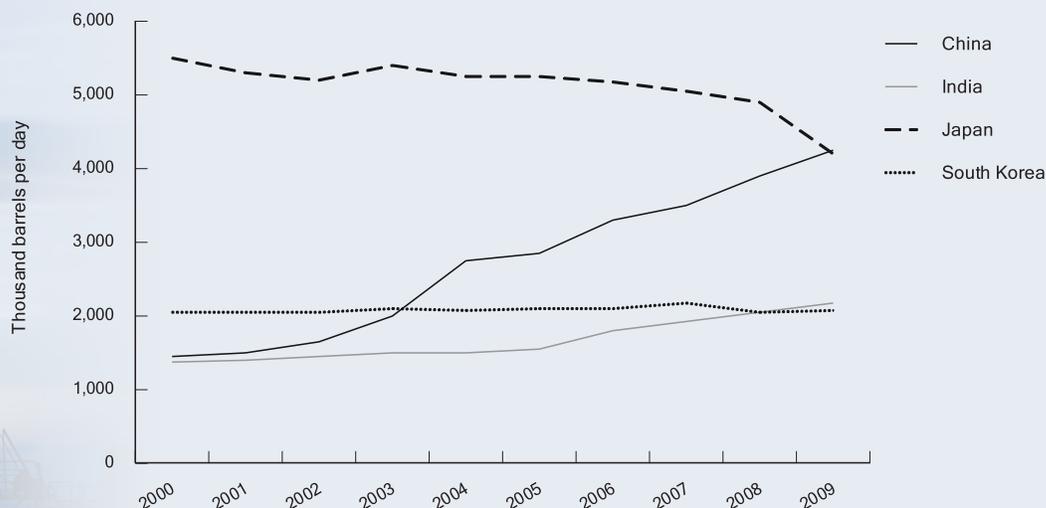
However, Asia's rising energy demand is leading to an increase in state-backed competition among the region's NOCs in a way that poses new and complex challenges for policymakers. While the energy strategies of Asia's rising powers are reminiscent of those of Europe and Japan at similar growth stages, the later powers were allies of the United States, which mitigated risks from competition among states. U.S. diplomacy cannot be expected to act as the same handbrake that it may have in the past. Yet even as this implies a relative weakening of U.S. influence, the United States remains a critical regional player that is economically interdependent with several states in the Asia-Pacific. This, along with

cost-benefit assessments about the value of energy resources in disputed territories, is likely to restrain regional powers.

IMPLICATIONS

- Governments that are interventionist in oil markets also tend to be highly interventionist across the economy. Knowing this, it may be more appropriate to understand energy policies pursued by these governments through the lens of industrial policy rather than resource nationalism.
- U.S. policymakers should focus on maintaining a regional presence, while keeping up military-to-military contacts with China, as a way to avoid strategic miscalculations.
- Standard-setting initiatives, such as the Extractive Industries Transparency Initiative, could further reduce the potential for negative competition while enabling governments to capture benefits associated with resource investments.

Net Oil Imports of East Asian Countries and India



SOURCE: Energy Information Administration, 2011, <http://www.eia.gov/>.

ENERGY RESOURCE NATIONALISM AT SEA

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Maritime disputes in the Asia-Pacific stem from unsettled territorial claims. In the past decade, concerns about securing offshore energy production and fisheries, and the sea lanes used to transport imports have increasingly inflamed these disputes. Rising energy prices and fears about supply scarcity, combined with rapid increases in oil import dependency in countries such as China and Indonesia, have helped drive resource nationalism among regional governments.

Such nationalism incentivizes states to build naval forces capable of deterring rival claimants in potentially resource-rich areas, and in some cases, forces that can also deter threats to major maritime energy transport corridors. For the Asia-Pacific, energy nationalism is inherently a military topic because overlapping claims are held by major energy consumers and military powers whose current and historical relationships are adversarial. Yet as energy security concerns become a more important driver of regional arms procurement, it is critical to understand that the high-probability threats to regional maritime energy security come from non-state threats rather than states. This provides compelling rationale for regional cooperation.

IMPLICATIONS

- Extreme weather, seismic activity, and piracy pose the highest-probability threats to maritime energy security in the Asia-Pacific, while interstate conflict is a low-probability threat.
- Greater cooperation can help change regional perceptions in ways that substantially reduce the chances of armed conflict between states.
- Regional civil maritime organizations offer a more effective and less-politicized vehicle for engagement than navies do. Major energy producers and consumers can also work to increase “maritime domain awareness” by integrating information on key energy assets and the locations of weather, piracy, and terrorist threats along major sea lanes and production areas.
- Asian countries with offshore energy production interests in disputed areas should consider creating joint development zones.

Ranking of Threats to Maritime Security in Asia

	Incident frequency in East or Southeast Asia	Most affected sectors	Duration	Likely magnitude of disruption
Piracy	High	Transport	Short	Low
Tropical weather	High	Production	Short	Low
Seismic activity	Medium	Production	Medium	Medium
Terrorist attack	Medium	Production and transport	Medium	Low to medium
Interstate armed conflict	Low	Production and transport	Medium to long	High

NOTE: For the purposes of this table, Asia includes the Indian Ocean as well as the South China and East China seas.



ASIA'S NATIONAL OIL COMPANIES

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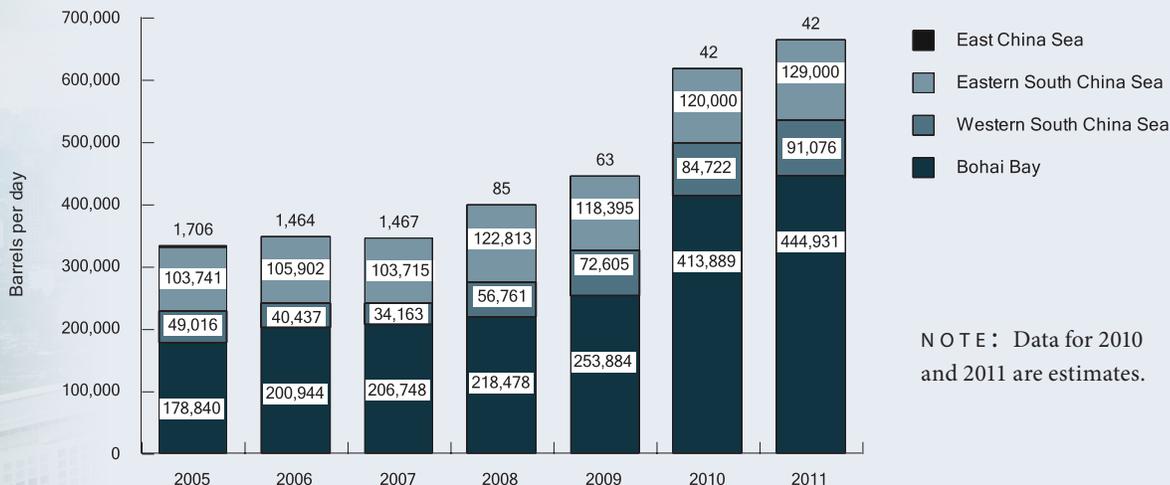
The expansion of Asia's national oil companies (NOCs) has been driven by both energy security concerns and a commercial drive to access new opportunities. Over the past decade, Asian NOCs have become increasingly competitive with international oil companies (IOCs), with Chinese NOCs representing the largest winning group in the bidding for Iraqi oil field development. Beyond China, India's Oil and Natural Gas Corporation (ONGC) and others have become significant investors in the global oil and gas industry since 2000. Japan and South Korea also have sought to reinvigorate their earlier NOC drive abroad.

IOCs still have strong competitive advantages, but they are increasingly squeezed for major new opportunities by resource nationalism among producers/exporters and global competition from NOCs. In response, IOCs are forging new partnerships with Asian NOCs. Such partnerships trade access to the international resources of IOCs for risk capital or access to Chinese and Indian domestic oil markets. While IOCs should also focus on maintaining competitiveness, the increasing number of partnerships suggests that IOCs recognize the need to harness the benefits that Asian NOCs can bring to regional opportunities.

IMPLICATIONS

- The rapid expansion of Asia's NOCs is not the threat to U.S. energy security that some in Washington, particularly in Congress, think it is. Chinese and other Asian NOCs' efforts to acquire equity oil are not "locking up" oil supplies and undermining U.S. energy security. The common challenges and energy security threats that the U.S. and Asia face are restricted access and underinvestment in new supplies.
- Perceptions that Chinese NOCs are agents of Beijing's strategic agenda and a challenge to U.S. interests are also misguided. China's NOCs have a wide range of control over their investments and strategy and largely operate along the same lines as IOCs.
- Heavy state support from Beijing does potentially threaten the ability of U.S.-based oil companies to compete for new opportunities. The U.S. has a strong national interest in the existence of strong IOCs, and U.S. policymakers should press Beijing explicitly and firmly to reduce state support.

China National Offshore Oil Corporation (CNOOC)
Oil Production in Chinese Waters



RARE EARTH ELEMENTS: CHINESE AND JAPANESE PERSPECTIVES

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In recent years, the vast majority of rare earth elements—critical resources for clean-energy technology and high-tech manufacturing—have been mined in China. Although China accounts for only 50 percent of the world’s reserves, most competitors from other states have exited the market due to diminishing profit margins and rising environmental scrutiny, leaving China with a 97 percent share of global extraction. At the same time, the Chinese government has also attempted to restrict overall supply with tools such as export quotas. Given that increasing demand for clean energy products such as hybrid cars and energy-efficient displays is expected to double the demand for rare earths by 2015, China’s actions have led to concerns that access to this increasingly-limited resource pool could become tied to geopolitical factors.

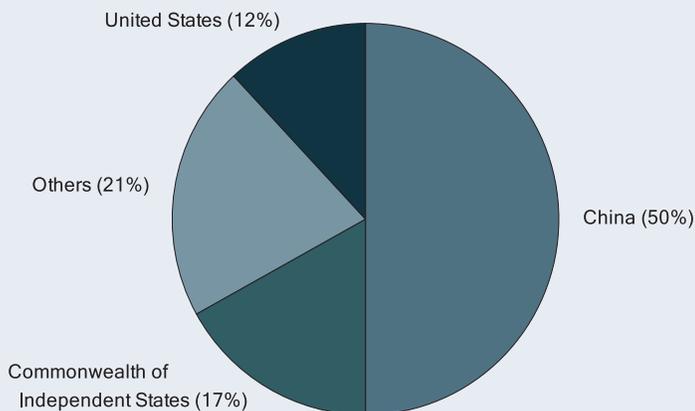
Many Chinese policymakers and industry experts argue that China’s policies on rare earths are driven by domestic concerns such as the need to address excessive mining and environmental deterioration. Thus industry restrictions are intended to improve sustainability, not reshape international relations and markets. Yet for Japan—the leading importer of China’s rare earths—the halt of Japan-bound exports following

a fall 2010 confrontation in the East China Sea was a turning point. For many Japanese stakeholders, China’s apparent willingness to link trade with politics signaled a new phase in clean energy competition, and gave the economic relationship an undertone of mistrust.

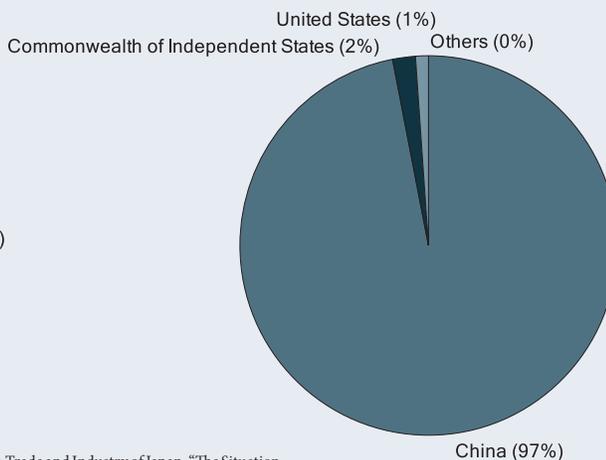
IMPLICATIONS

- In response to tightening export quotas, Japan is intensifying efforts to diversify rare earth suppliers, although China’s dominance of the production market will likely continue in the coming years.
- China has legitimate environmental concerns that stem from its mining, and could benefit from cooperation with Japan and the United States. Since rare earths are not renewable resources, attention should be given to projects that focus on resource efficiency, recycling, and rare earth substitutes.
- Regardless of intent, the export halt undermined China’s standing as a reliable trading partner to many, possibly affecting its economic appeal.

Rare Earth World Reserves



Rare Earth World Production



SOURCE: Ministry of Economy, Trade and Industry of Japan, “The Situation Regarding Rare Earth Elements,” Technology and Rare Earth Metals Center, Institute for the Analysis of Global Security, March 22, 2011, 7.



BACKGROUND ON NBR'S ENERGY SECURITY PROGRAM

Now in its seventh year, NBR's Energy Security Program convenes top energy and geopolitical experts from industry, academe, and policy for an assessment of the developments taking place in Asian energy markets and their implications for geopolitics. To inform and strengthen the public policy dialogue, experts share insights and recommendations through a number of channels, including an invitation-only spring workshop, a public fall launch event, and NBR's annual Energy Security Report.

PAST ENERGY SECURITY PROGRAM THEMES

- **“Pipeline Politics in Asia: The Intersection of Demand, Energy Markets, and Supply Routes”** (2010) analyzed the growth in overland pipelines in industrializing Asia and the resulting implications for Asian regional politics and energy security geopolitics.
- **“The New Energy Silk Road: The Growing Asia–Middle East Energy Nexus”** (2009) assessed the likely evolution of Asia's involvement in Middle East oil and gas development, including how Asia may affect future oil and gas supply development and the implications for U.S. policy.
- **“Opportunities and Constraints: Prospects for Russian Oil and Gas Supply to Asia”** (2008) examined the role of energy in Russia's strategic vision, regional perspectives on Russia as a reliable energy supplier, and implications for U.S. policy in the region.
- **“The Rise of Asia's National Oil Companies”** (2007) assessed the strategic and competitive implications of the rise of Asia's national oil companies (NOC), examining the internal structures of Asia's NOCs, their relationships with home governments, and geopolitical impacts for the United States and the region.
- **“China's Search for Energy Security”** (2005–2006) focused on China's global search for energy security, drawing implications for U.S. global energy and security interests and offering recommendations for policies that would allow the United States to respond more effectively.
- **“Asian Energy Security”** (2004) examined the geopolitical, economic, competitive, and environmental implications of Asia's growing energy security challenges and also informed the chapter “Asia's Energy Insecurity: Cooperation or Conflict” in *Strategic Asia 2004–05: Confronting Terrorism in the Pursuit of Power*.

2011 ENERGY SECURITY REPORT

The cover of the report features a photograph of an offshore oil rig in the ocean. The text on the cover includes: 'THE NATIONAL BUREAU OF ASIAN RESEARCH', 'NBR SPECIAL REPORT #31 | SEPTEMBER 2011', 'ASIA'S RISING ENERGY AND RESOURCE NATIONALISM', 'Implications for the United States, China, and the Asia-Pacific Region', and 'By Gabe Collins, Andrew Erickson, Yufan Hao, Mikal Herberg, Llewelyn Hughes, Weihua Liu, and Jane Nakano'.

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