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**JENNIFER RICHMOND** is STRATFOR's China Director, a role involving the management of all information coming from China, developing and maintaining in-country contacts, identifying and researching trends and events, and investigating specific areas of China for clients, including emerging trends in China's leadership, political economy and internal security environment. Ms Richmond joined STRATFOR as an East Asian Analyst in early 2006. Before coming to STRATFOR, she lived and studied throughout East Asia – including China, Myanmar, Thailand and Indonesia, and taught Chinese Politics at Trinity University. Ms Richmond is a published author on East Asian affairs, and is proficient in Mandarin. She has been featured or cited in numerous journals, newspapers and international television and radio programmes including *The Wall Street Journal*, *Xinhua*, *The Manila Times*, *Asia Times*, *The Globe and Mail*, *China Economic Review*, *Forbes*, and *U.S. News & World Report*. Ms Richmond has a Master's degree in International Relations from Johns Hopkins SAIS and the Hopkins Nanjing Center.



# Energy Consumption in China: Regional and Global Implications for the Future

Jennifer Richmond  
China Director STRATFOR

## Summary

This article analyses China's impact on world energy consumption, an impact that can be appreciated throughout all the regions of the world, and which is partly responsible for the increase in competition for a scarce resource – namely non-renewable energies: natural gas and oil. Thus, in the first section the author outlines the world energy panorama which has been affected not only by the Chinese variable, but also by new financial practices and, of course, by the economic crisis which, on one hand, has eroded many of the reserves possessed by many countries with respect to opening sectors that are of key importance to Chinese investment, and on the other, it has combined with a redoubled commitment by Chinese companies to "come out into the world" and to invest part of their abundant reserves in sectors that are strategic for all. The second half of the text pays particular attention to the aforementioned double coincidence, marked by the commitment of China's National Oil Companies (NOC) to take up positions in (mainly) three geographical areas: the Middle East and Africa, South America and the Russian Federation and Central Asia. The article also tackles China's links with natural gas, which is being increasingly viewed as an alternative to coal, in spite of the fact that coal still supplies 70% of China's total energy consumption. And finally, with one eye on the dynamics of security, the author examines how China will manage to build and defend its supply routes, a requirement that could give rise to tensions with China's neighbors as competition increases, for example, in the eastern and southern China Seas.

## Introduction

With prices of oil heading over \$120 a barrel, the speculation that China is the culprit is once again gaining momentum. While it is true that China's energy consumption appears insatiable, with its net import of crude and oil prod-

ucts expecting to come close to 6 million barrels per day in 2011, there are other factors driving the price of oil that are not as often discussed. Before embarking on an analysis of China's energy consumption and its regional and global impacts, it should be noted that the rules of the game in energy supply and demand have been altered dramatically in the past decade. This alteration has implications for all nations, including China, which is desperately trying to catapult its economy and society into the modern world.

While China makes an easy scapegoat, and is indeed in part responsible for the growing global demand of natural resources and therefore their rising prices, the advent of online trading has done much to imbalance the perception of supply and demand in energy markets. Commodity markets were once the domain primarily of commodity traders who based their trades on market principles. However, as Internet trading platforms expanded the market to individual traders, quick and easy access to energy-indexed investments ballooned, and with this new trading volume, so did prices. Energy prices are being distorted by this new phenomenon, making it difficult to predict prices and geopolitical movements based on supply and demand alone.

That said, China's growing demand, coupled with its inflationary monetary policies, is having an indelible impact on commodity prices that has both regional and global ramifications. In the past five years, money supplies the world over have increased, especially as the financial crisis in 2008 spurred governments to stabilize markets with emergency monetary and credit expansion. Over the past six years, the global money supply has approximately doubled. The world, flush with cash, has used this liquidity to invest heavily in commodities, especially China, which has led in part to the rise in commodity prices. The United States money supply has increased by 38 percent since January 2005, but it is hardly the only actor. During the same time, Japan's money supply has risen 39 percent, the Eurozone's 52 percent and China's a stunning 250 percent – roughly half of

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the total increase worldwide. Even discounting the fact that China's economy grew much faster than others, this monetary expansion is still very impressive.

The changing dynamics of commodity trading, the doubling of the money supply and the growing demand for commodities and increased energy consumption in China, in particular, are all shaping the future of energy consumption and demand globally. China's economic model rewards throughput over profit in its bid to keep employment high and lessen the risk of citizens protesting in the streets. In this model there is no upward limit to the amount of money that China may print – and by extension lend to its various firms at subsidized rates – but as we have seen in 2011, this comes with the risk of inflation, an economic issue that also has social implications seen in rising incidents of protest throughout China. The 12<sup>th</sup> five-year plan does not grapple with this issue and gives no indication that China plans to upend this policy despite the talk of increasing domestic demand. Hence, there is no curb on its natural resource demand, and without price sensitivity, China will continue to buy and invest in natural resources even at the high current world prices, pressuring prices to rise even further. Unless social unrest becomes so unmanageable as to force a drastic change in policy, which is not beyond the realm of possibility, China will continue to operate according to this model.

### China's Oil Consumption and Investment

After the financial crisis in mid-2008, China was one of the few countries that reacted quickly, flooding its economy with stimulus money, including a massive drive to push its energy companies overseas. The stimulus was not just the nearly \$600 billion development package but in addition also adding an average of roughly \$50 billion in bank loans each month on top of previous monthly levels of lending since January 2009. Loans, which dried up for many global energy companies, were in abundance for Chinese national oil companies (NOCs), namely PetroChina and its parent company China National Petroleum Corporation (CNPC), China Petrochemical Corporation (Sinopec) and China National Offshore Oil Corporation (CNOOC). After these companies initially faced international resistance to their investment overtures, the crisis opened up new doors and they went on a massive spending spree, acquiring assets across the globe through various investment strategies.

Many of China's large state-owned enterprises (SOEs) had already started flexing their muscles internationally over the previous decade, but their assumed connections to the Chinese government left many wary of their objectives and several large deals were blocked due to security concerns,

including CNOOC's failed bid for Unocal in 2005. However, companies and governments that could afford to be picky prior to the crisis quickly turned to these Chinese companies after the crisis. Chinese companies flush with cash that was unavailable to their international competitors aggressively took advantage of the worldwide "fire-sale," expanding their influence and investments all over the globe.

This "going-out" strategy was not entirely new, but the financial crisis reinvigorated both the government and the companies' policies to invest abroad. Chinese banks were eager to lend to these national champions whose profits continued to expand, and Beijing stood behind the companies to ensure that they received favorable financial treatment for their global ventures. The priority of China's going-out strategy was to strengthen its national companies, making them competitive in the international realm as China's economy and influence continued to grow globally. This economic objective was also underlined by a very important strategic objective – as China became more internationally interdependent and its domestic growth required more inputs for sustainability, Beijing became acutely aware of its dependence on sea lanes for the transportation of its commodities.

Most of China's commodities, especially oil from the Middle East and Africa, travel through the Malacca Strait chokepoint. Furthermore, with the U.S. Navy's dominance on the oceans, in a crisis China's dependence on these sea lanes could easily be jeopardized with blockades, grinding its economic engines to an abrupt halt. Even in normal times, China saw vulnerability in its deep dependence on politically unstable and geographically distant countries and in its exposure to contingencies like piracy. Therefore, Beijing has long recognized the importance of finding alternative sources and routes to ensure a continued supply of natural resources. Although the Chinese were making headway in Central Asia prior to the financial crisis to develop oil and gas corridors, the financial crisis prompted more deals to ensure overland energy networks.

The going-out strategy received a further boost after the financial crisis as inflation returned to plague China in spring 2010, due to its massive monetary expansion and continued fast growth. As excess liquidity continues to threaten China's markets with asset price rises and bubbles, new preferential policies aimed at encouraging Chinese companies to invest overseas continue to be implemented in an effort to cool an overheated domestic market. China's national oil companies, having developed traction overseas in the aftermath of the financial crisis, continue to relish Beijing's support and have started to expand outside traditional energy investments to include investments in shale oil and gas sands as they look to augment their technological

capabilities, enabling them to both cooperate and compete with the big international oil majors.

In addition to these new investments, the NOCs have also adopted new investment strategies to ease security tensions. Typically, in its effort to control the entire commodity supply chain, ensuring it greater energy stability and security, China was known to prefer big projects with total or majority control. Foreign governments were usually overwhelmed by these large-scale investments and their potential security implications. For example, Chinalco's \$19.6 billion bid for Rio Tinto failed in large part because of Australia's concerns over its total control of a nationally vital and strategically placed company by a Chinese company assumed to be controlled by Beijing.

Chinese NOCs learned from these experiences and began to revise their strategy. After the crisis hit, China was sensitive to the perception of its massive drive overseas and instituted various ways to ensure a continued and growing energy supply via various investment structures. These include partnering with International Oil Companies (IOCs) in strategic bids, service agreements and loan-for-oil and loan-for-gas agreements. These different strategies were implemented in different regions depending on the assets and the reception of the foreign government. Despite China's success in enhancing its global energy footprint, each region presents varied challenges that both Beijing and the NOCs are trying to manage and incorporate into their investment strategies.

### Middle East and Africa

In the Middle East, China has forged forward in Iraq and Iran signing service agreements with low service fees in an effort to gain a foothold in these countries. Since 2009, Chinese NOCs have won contract bids and gained rights to develop the Rumaila, Halfaya and Missan oil fields in Iraq with IOCs such as BP and Total. Partnering with foreign companies reduces the risk of investing in a shaky regulatory environment and also provides them with access to more technological know-how as they try to advance their technological capabilities.<sup>1</sup> Chinese NOCs have also made significant investments in Iran. In 2009, CNPC signed a \$4.7 billion agreement to develop Phase 11 of the South Pars field. Unlike in Iraq, China has benefited from the lack of investor interest in Iran due to sanctions. Its strategy to gain a foothold in the country has had some success, but this will be hampered by fears of instability, war and questionable

returns and its lack of technical expertise to operate in Iran.

China's investments in the Middle East and Africa outside of Iraq and Iran are also facing new challenges as protests and internal troubles raise questions of the viability of current and future contracts. China currently gets about 3 percent to 3.5 percent of its oil from Libya and increased its investment in the country as recently as 2010. This brings up tricky issues for China, which has made a policy of investing in countries where other IOCs were more hesitant, particularly in African countries such as Angola, Sudan and Uganda. However, as turmoil rocks the

region, China's energy investments and its ties to questionable regimes may disrupt its supply chain.

In Africa, China's oil investment strategy has focused primarily on equity shares, creating greater exposure for Chinese NOCs to internal crises. In Africa, their equity shares are located primarily in Sudan and Angola.<sup>2</sup> There is great concern over unrest in Sudan and its impact on Chinese oil contracts. Currently the Chinese government and its NOCs are trying to maintain diplomatic ties in both Khartoum and Juba to ensure continued oil imports from the country that is set to split in July 2011. However, there has yet to be a solid agreement on how oil interests between the north and south will be divided, which is critical since the south has most of the oil but no means of shipping it out, and such uncertainty could impact China's imports and investments. Angola, China's second largest oil provider, does not appear as problematic because of the government's tight security grip on society. But the country suffers from all of the social, economic and political ills that have caused revolt in other countries and remains divided along the lines of the decades-long civil war that ended less than 10 years ago, underlining how even ostensibly reliable sources of energy are riskier than they appear.

### Latin America

After the financial crisis, China initiated a loan-for-oil program that secured more supplies to fuel its increasing demand. This program was most visible in deals with Russia, Brazil and Venezuela. Unlike countries in Africa that are more willing to engage in equity investments, resource-rich countries are not as easily swayed. However, the financial crisis provided an opening for China to secure resources in these countries while not touching on politically sensitive security issues.

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Since 2009, China has signed numerous loan-for-oil or loan-for-gas deals in Latin America. The most notable among these were two deals signed with Venezuela and one with Brazil. In February 2009, CNPC and PetroChina put \$4 billion into a joint development fund with Venezuela's national oil company PDVSA. The contract secures 200,000 barrels per day (200 kb/d) of oil. Similarly, in 2010 CNPC signed another contract with PDVSA for \$10 billion and 70 billion yuan to form a joint venture to develop Venezuela's Junin 4 block. The loan is repayable in oil. Also in 2009, China's Development Bank signed an agreement with Brazil's Petrobras for a \$10 billion, 10-year loan in exchange for 150 kb/d of oil per day to Sinopec for one year and 200 kb/d for nine years.

China's strategy in Latin America differs from its strategy in the Middle East and Africa, since the development of oil resources in the former region is not necessarily to boost its domestic supply chain. Much of the oil developed in Latin America is sold back into regional markets, profiting China's NOCs. Nevertheless, China still looks to establish energy resources globally that it can rely on if energy markets ever become so volatile as to outweigh the increased transport costs from Latin American countries.

#### Russia and Central Asia

The 2008 financial crisis fast-forwarded energy negotiations between Russia and China, which had been languishing, providing China with another avenue to secure resources and providing Russia with much needed funds. The contiguous land borders between Russia and several Central Asian states make them particularly attractive to China as it seeks to diversify its dependence on sea routes for transporting commodities. However, negotiations with Russia were never smooth and often fell apart on pricing disagreements. The financial crisis served to grease the wheels of these negotiations and China was able to entice Russia with a loan-for-oil deal.

Rosneft, needing cash to finance its heavy investments, agreed to the China Development Bank's enticing loan with a favorable interest rate giving CNPC the right to buy 300 kb/d of crude at market prices for 30 years. Similarly, a deal was struck with Transneft with a \$10 billion loan to complete the East Siberia-Pacific Pipeline System (ESPO) from Skovordino to China's Daqing refinery.

China signed a similar deal with Kazakhstan in 2009 offering a loan of \$15 billion for 300 kb/d for 20 years. In addi-

tion to this deal, China has been expanding in Central Asia tapping both oil and natural gas resources. The Central Asian states have taken advantage of China's interest in seeking alternative energy supplies as Russia's own demand for Central Asian energy supplies has diminished. While many Central Asian states hope to gain a valuable customer in their voracious neighbor, Russia monitors these deals closely and could disrupt any negotiations if it feels that its control over these former Soviet States is waning.

#### China's Natural Gas Consumption and Investment

Natural gas investments have been almost as ambitious as oil investments, especially since the financial crisis. As part of China's drive to reduce its overwhelming dependence on coal (which still constitutes upwards of 70 percent of its energy mix) and cut pollution, natural gas has been seen as a prime alternative.<sup>3</sup> Over the past few years, natural gas demand has grown over 10 percent per year, which is roughly the same rate as overall economic growth and not necessarily notable. Natural gas consumption currently accounts for a little less than 4 percent of energy demand, but Beijing is dedicating more effort to supporting its development so that its share is set to increase to over 8 percent by 2015. From 2000 to 2009, China's annual

natural gas output increased from 27.2 billion cubic meters (bcm) to 85.2 bcm, but it has been outpaced by consumption since 2007, resulting in imports and shortages. Total natural gas imports in 2009 were 7.64 bcm, a 72 percent increase from 2008.

In order to make up for the shortfall in domestic supply, China has turned to natural gas imports. It has developed a pipeline infrastructure from Central Asia with the 1,833-kilometer Central Asia Pipeline, which passes through Turkmenistan, Uzbekistan and Kazakhstan and connects with the western section of China's West-East Gas Transmission Project II. The second phase, completed in October 2010, helped increase the capacity to 15 bcm. China has also signed several significant deals for the import of liquefied natural gas (LNG). Long-term LNG contracts have been signed with numerous countries, including Australia, Malaysia, Indonesia and Qatar. For example, on April 21, 2011, Sinopec signed China's second largest LNG purchase agreement, worth \$85 billion over 20 years by some estimates, in a deal that also gives it 15 percent of the Australia Pacific liquefied natural gas project.

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In addition to LNG imports and pipelines from Central Asia, China has also begun construction of the 1,100-kilometer China-Myanmar oil and gas pipeline, running from the port of Kyaukpyu on Myanmar's west coast into China's Yunnan province. Once completed in 2013, the pipeline is expected to transmit 12 bcm annually.

China's inefficient domestic pricing structure has made future investments in domestic infrastructure development unappetizing. As it does with the similar problem of crude-oil pricing, China faces a domestic conundrum: how to go about raising prices without triggering a massive social backlash. This problem has become even more cumbersome as energy prices continue to rise throughout the world. The problem with pricing in natural gas is even more troublesome for Beijing. In an effort to boost the consumption of natural gas and raise its ratio in the energy mix, Beijing has kept the price of natural gas artificially low. While this strategy may make natural gas more attractive for consumers, it also discourages significant investment in domestic natural gas infrastructure for its big oil and gas majors, Sinopec, PetroChina and CNPC, and CNOOC.

Moreover, the Central Asian states disagree with each other, especially on natural gas transit fees, leading to problems agreeing on prices with Chinese companies. For instance, Kazakhstan and Uzbekistan see little reason to agree to a lower price simply because Turkmenistan is desperate to sell. Meanwhile, Chinese companies cannot accept prices that are too high because they have to sell the natural gas at artificially low prices domestically due to government price caps. Because of price differentiation in the natural gas market, the Chinese continue to have trouble negotiating with both the Russians and the Central Asians. The Chinese do not want to pay the same price for natural gas as these states charge the European market. As a result of these difficulties, China is focusing more on the LNG market, which takes its price from the target market, so LNG suppliers are used to selling the same product at different price points. Therefore, China can import LNG at prices that are more suitable for its particular domestic consumption rather than being forced to buy natural gas from Central Asia and Russia at the same high prices they set for the European markets.

These concerns may have dampened the enthusiasm of China's NOCs to invest in domestic infrastructure, but one area that is receiving a lot of attention is in unconventional gas, namely shale gas and coal-bed methane gas. The abundance of unconventional gas reserves in China, estimated to

be up to five or more times larger than its domestic natural gas supply, could eventually diminish China's investment and reliance on gas imports. However, it would be at least a decade before there is enough information on the disposition of China's shale gas deposits, and only after this assessment can they begin to address the difficult extraction process that requires much experimentation and differs with each shale gas location, not to mention an abundant supply of water. Nevertheless, Beijing has encouraged investment in developing these resources with subsidies and cooperation with foreign energy companies. Currently, China does not possess the technological expertise to develop these resources on its own. This dearth has been

the primary impetus for some of China's largest overseas investments in the last few years.

Recently, PetroChina, in a joint venture with Royal Dutch Shell, acquired Australia's Arrow

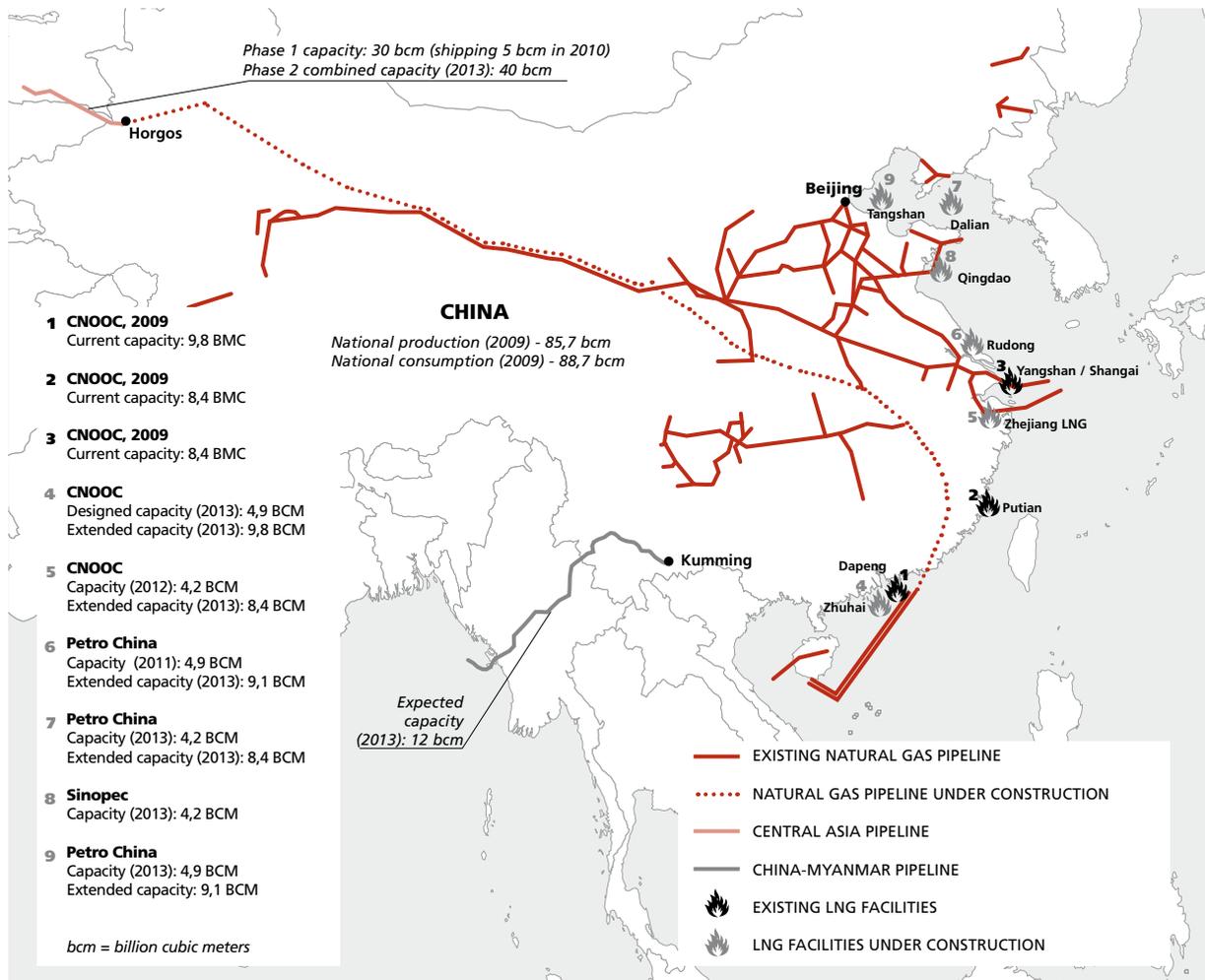
Energy coal-seam gas assets for \$3.2 billion and is in exploratory talks on taking ownership of the full production train at Santos' Gladstone LNG project, valued at \$14 billion.<sup>4</sup> In February 2010, PetroChina signed a \$5.4 billion deal with Canada's Encana to receive a 50 percent interest in its shale gas project, which contains an estimated 1 trillion cubic feet of natural gas reserves.<sup>5</sup> CNOOC also recently purchased a 33.3 percent stake in U.S. Chesapeake Energy Corp's Niobrara shale fields. All of these investments serve the dual purpose of establishing a more secure supply of natural gas and boosting China's expertise in unconventional gas extraction. This has translated not only into international investments but also into joint investments with IOCs domestically, especially in Sichuan province, where Shell is assisting PetroChina in developing its shale gas resources.

### Rising Consumption, Rising Tensions

According to the Energy Information Agency, China's share of global energy consumption is set to increase from 15.76 percent in 2007 to 18 percent in 2015, matching that of the United States. Barry van Wyk from the Beijing Axis aptly states, "Given that China's per capita consumption level stands at only one-third of the OECD average, its future prospects are immense."<sup>6</sup> British Petroleum's Energy Outlook 2030 expects China to surpass the United States as the world's largest oil consumer by 2030, with its oil consumption reaching 17.5 million barrels per day (mb/d) (although this assumes U.S. consumption will not grow), and by 2030 to consume an amount of gas similar to that of the entire European Union today.<sup>7</sup>

**"As part of China's drive to reduce its overwhelming dependence on coal (...) and cut pollution, natural gas has been seen as a prime alternative. Over the past few years, natural gas demand has grown over 10 percent per year."**

**MAP 1. China's natural gas system**



Source: STRATFOR

China's impressive and growing energy consumption does not come without significant ramifications. In addition to having a major impact on China's domestic economy and security strategies, its impact regionally and globally is immense. According to People's Bank of China Chairman Zhou Xiaochuan in a speech at Tsinghua University on April 17, 2011, China's \$3 trillion stockpile of foreign exchange reserves has become "excessive" and called for a diversification of foreign exchange use in strategic goods, including oil.<sup>8</sup> With global oil prices already pushing highs over \$120 barrel, China's increased investment could further exacerbate global energy prices and put more pressure on domestic inflation, which is already threatening to spin out of control.

When oil prices rise the biggest losers are the countries that not only have to import oil but also are heavily industrialized relative to their economy. Countries like the United States,

in which the service sector is larger than the manufacturing sector, use less oil for critical economic functions. The energy intensiveness of heavy industry is particularly damning for many Asian countries, namely China, Japan and South Korea, which import most of their oil (all in the case of Japan) and are highly industrialized. Domestically, China's rapid industrialization is critically affected by high oil prices. As oil prices increase, the Chinese continue to import oil to feed their heavy industry and manufacturing export sectors, unable to quickly change their economic model to focus more on domestic consumption and services while they try to use administrative measures to cap prices at home. China cannot allow the economy to slow without massive unemployment and social instability. However, as Beijing tries to cap oil and gas prices to stave off any popular unrest (which is already growing due to inflation concerns), the result is erratic policy-making, a rise in protests, tensions between the government and its NOCs and massive State subsidies.

Without the price sensitivity needed to promote efficiency over massive spending and investment – inherent in the Chinese economic model – Beijing will continue to gobble up energy resources to fuel its economy until it is forced to change its policy via a major social relocation that could seriously threaten the power of the Chinese Communist Party.

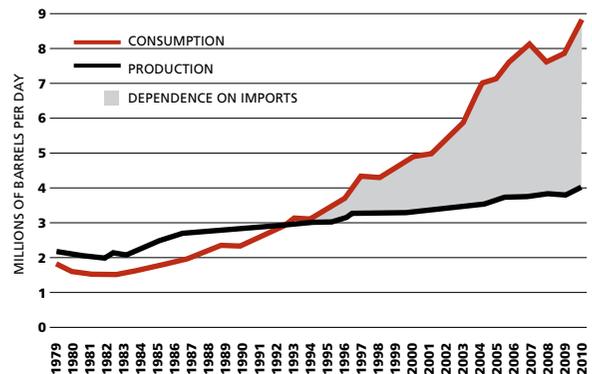
These rising tensions impact China's neighbors in the race to secure energy assets that have both economic and strategic implications to which no one is immune.

### China's Energy Drive and Regional and Global Concerns

China and Japan have been negotiating the exploration of gas and oil resources in the East China Sea for years, without reaching a workable agreement. The problem is a dispute over two conflicting borders in what each country considers its "exclusive economic zone" (EEZ). Although the two countries have held numerous talks in an attempt to resolve the issue, including a 2008 pledge to jointly develop the resources, tensions flared in September 2010 when the Japanese coast guard apprehended a Chinese fishing ship near the disputed Senkaku/Diaoyu islands, where China has claimed the exclusive right to develop the Chunxiao gas field as well as other fields. While Japan recognizes some of China's claims on specific fields, it refuses to let China develop them because of plausible fears that to do so would draw natural gas from under Japan's side of the border.

In March of 2011, CNOOC rejected Japan's oft-repeated claims that CNOOC had begun exploration and production in the Chunxiao field. According to media reports, CNOOC Chairman Song Enlai said in March 2011 that his company was extracting oil from the field. On March 10, according to one account, Chinese Foreign Ministry spokesperson Jiang Yu, when asked about CNOOC's activities, stressed that Chunxiao was in Chinese territorial waters and that China had absolute sovereignty over the field.<sup>9</sup> There are estimates of 70 billion cubic meters of oil and natural gas at Chunxiao alone and there could be much more within the disputed area, and both China and Japan are interested in securing natural resources and affirm their territorial boundaries. And, despite a freeze on exploration during negotiations, CNOOC already has a seabed pipeline to Chunxiao and maintains an extraction platform at the field. Meanwhile, Japan has made no attempt to develop the resources itself, instead insisting that China agree to its terms for joint development. Given China's emphasis, most recently outlined in its 12th five-year plan, on resource development with a special focus on marine resources, its dispute with Japan over conflicting EEZ borders is far from resolved.

**GRAPHIC 1. China crude oil consumption and production**



Source: UN Comtrade; China National Bureau of Statistics; Platts

The issue became even more critical for Japan following the earthquake in March 2011 that jeopardized Japan's primary source of domestic energy generation -- nuclear power. The loss of a significant amount of nuclear power and the potential for public opposition to the energy source as a result of radiation leaks could drive the Japanese toward consuming more liquefied natural gas. This could motivate Japan to try to develop natural gas in the disputed waters or more staunchly resist Chinese unilateral development. It may also encourage China to move unilaterally while Japan is weak, which would certainly heighten the dispute. Many wars have been fought over access to energy resources (one primary reason for Japan's participation in World War II), and as prices rise and secure sources become scarce, tensions in the East China Sea will continue.

The South China Sea is another area of disputed resources, although there are no concrete estimates of the oil and gas reserves in the region. Still, the South China Sea could be even more contentious than the East China Sea because of numerous sovereignty claims and China's naval strategies. In July 2010, U.S. Secretary of State Hillary Clinton outlined a new policy in Southeast Asia, stating that the freedom and security of navigation in maritime Southeast Asia was in the "national interest" of the United States and all states with an interest in stable seaborne trade. She also called for an international-resolution mechanism for handling territorial disputes in the South China Sea among China, Taiwan, Vietnam, the Philippines, Malaysia, Indonesia and Brunei. Clinton's comments were in response to new assertions from Beijing that the South China Sea was a "core interest," in the same way that Tibet and Taiwan are.

For China the issue of the South China Sea is not so much about tapping potential energy resources as it is about controlling strategic sea lanes critical to the transport of energy

supplies, making the area of critical importance to China. Most recently, in April 2011, the Philippines lodged a formal protest at the United Nations over China's claim to the Spratly islands and adjacent waters. This complaint was lodged after a Chinese patrol boat reportedly threatened to ram a Philippine oil-and-gas surveying vessel in Reed Bank, a small group of islets west of the Philippine island of Palawan in the South China Sea.

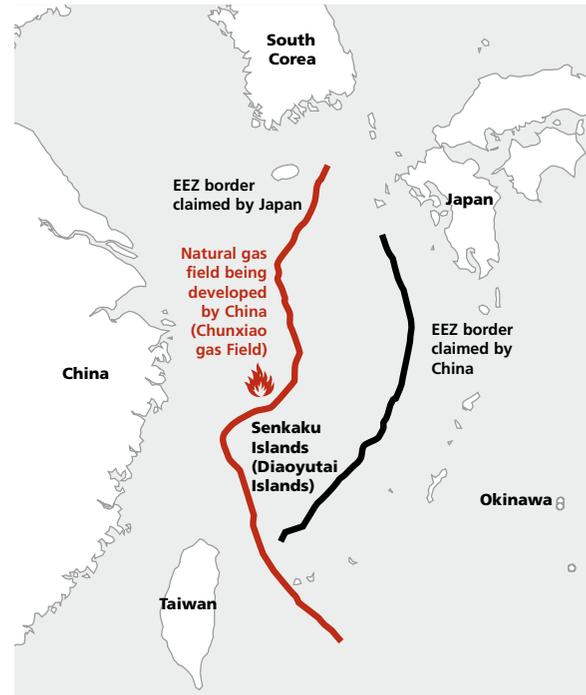
China has increased its patrolling and patrolling capabilities in both the South and East China seas, where its sovereignty claims have grown more assertive in the past few years, raising the concerns of its neighbors. As of April 2011, Beijing was signaling that it wanted to soften its stance in the region and create a more cooperative atmosphere. But Beijing's abrasiveness at times has highlighted its tendency to react in an aggressive manner to territorial competitors in surrounding waters. Thus, China's neighbors not only are anxious to develop and secure potential natural resources, they also fear a more assertive China. Ultimately, China's lack of a true blue-water navy poses little threat to the U.S. military (though Washington is wary of the long-term trajectory of Beijing's naval development; it now has one not-quite operational aircraft carrier). Closer to home, China's naval and missile capabilities are much more threatening to those that share both land and sea borders with the economic powerhouse.

## Conclusion

Rising energy prices across the globe may not be the effect solely of China's seemingly insatiable appetite for energy, but its attempts to secure resources, especially oil and natural gas, have had international repercussions. In an effort to maintain robust GDP growth in the face of slackening export demand, China has embarked on massive stimulus and infrastructure projects that have left the country awash in liquidity. Fearing excessive liquidity is causing inflation that could destabilize the country, China has become even more aggressive in pushing its national champions, oil and gas companies such as PetroChina, CNPC, Sinopec and CNOOC, outward to take advantage of investment opportunities, and these companies are only too willing to oblige. Not only does this help address immediate monetary concerns, as China's foreign exchange reserves bulge and inflation looms, but it also provides the foundation for China's energy strategy: secure resources globally and diversify resources away from traditional suppliers that rely on ocean transport.

In order to realize these goals, China has adopted various investment strategies to secure its interests in various regions around the globe. Each of these regions presents its

**MAP 2. Sea boundary claimed by China and Japan over East China Sea**



Source: UN Comtrade; China National Bureau of Statistics; Platts

own particular dilemmas and obstacles to China's energy expansion, but as a result of the global financial crisis in 2008, China has been able to gain ground and traction as it has dipped into its deep pockets to "rescue" struggling governments and energy companies in exchange for assets critical to its energy security.

There are few places where the impression of China's ambitious strategy has not been felt. And in many places in Southeast Asia, Latin America, Africa and Central Asia, the impact has been substantial. The rising influence that comes with these acquisitions has altered not only economic trajectories but also strategic calculations. For example, the United States has recently returned to Southeast Asia to provide a counterweight to China's growing influence, and Russia is watching Central Asia carefully, ready to snuff out any influence that threatens its control of the region.

The tensions of China's rising influence on energy security are felt most acutely by neighboring countries, where disputes over energy resources in the East and South China seas have scrambled alliances and prompted policy-makers to rewrite naval strategies. Beijing's 2011 proposal to lead the region into a more cooperative framework will not be viewed as genuine or lasting, though they may temporarily reduce tensions with some states.

Although the world looks to China with a mixture of fear and awe, especially as it continues to snatch up energy resources and maintain impressive economic growth, its own demand may be its downfall. While China faces looming economic pressures as it tries to transition its economy to promote domestic consumption without slowing the growth of its construction and manufacturing sectors – two conflicting objectives – inflation is rising to a threshold that is threatening domestic security. However, until social dislocation becomes an uncontrollable inevitability, China will continue its expansionary monetary policy and relentless drive to secure more energy supplies to fuel its growth despite rising costs. In short, China's financial model guarantees the juggernaut quality of its industrial effort, until the entire system breaks apart.

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1. The International Energy Agency describes the international strategies of China's NOCs in its report by Julie Jiang and Jonathan Sinton: Overseas Investments by Chinese National Oil Companies: Assessing the Drivers and Impacts, February 2011.
2. Ibid
3. Coal is not discussed in this piece since much of the global focus on China's energy consumption is on its oil and natural gas acquisitions. However, coal continues to be the most important part of China's energy-generation and will continue to be for the foreseeable future. China produces most of its coal domestically, but has increasingly been seeking overseas sources. China's overdependence on coal, pollution problems and demand outpacing domestic supply have been part of the impetus for Beijing to diversify its energy mix to include a greater share of cleaner energy sources. Its attempt to lessen its dependence on coal creates additional demand for resources that are already in high demand, including oil and natural gas.
4. "The Beijing Axis", *The China Analyst*, agosto de 2010, p. 47.
5. "The Beijing Axis", *The China Analyst*, agosto de 2011, p. 22.
6. Ibid, 6.
7. British Petroleum, *BP Energy Outlook 2030*, enero de 2011.
8. Reuters, "El gobernador del banco central de China afirma que las reservas de divisas son excesivas", 18 de abril de 2011.
9. Bijoy Das, "Relevance of an East China Sea Dispute to India". Institute for Defense Studies and Analysis, 24 de marzo de 2011.