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Promoting Energy Partnership in Beijing and Washington

Although China and the United States do not rely on one another for energy supplies, energy security has ironically become a necessary agenda item in Chinese-U.S. relations. As the world's second-largest and largest consumers of oil, respectively, China and the United States are becoming more sensitive to each other's pursuit of energy sources from other countries. Likely because the Chinese and U.S. economies have absorbed the impact of the most recent global oil price spikes and still enjoyed steady growth, energy remains mostly an issue for dialogue rather than a cause for confrontation. Yet, the prospects for energy to become a cause for more serious clashes are high, with demand in both countries set to rise continuously, even rapidly.

In an age of global interdependence, Beijing and Washington should seek to ameliorate differences on tense energy issues. Although dialogues on energy security conceptualizations and policy preferences are positive, they must move beyond talking toward a true partnership that can confront the common challenges they face as importers.

A New Source of Tension

Beginning in the mid-nineteenth century, the United States was the sole source of supply of kerosene and other oil products to the Chinese market. Those market ties came to an end in the late 1930s, when World War II made it impossible for distribution in China to continue. Then, from 1950 to

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the Nixon-Kissinger detente in 1971, China was placed under a comprehensive U.S. economic embargo. The two countries did not reconnect in energy supply until a formal diplomatic relationship was established in 1979. In the 1980s, the United States became the second-largest export destination behind Japan for Chinese crude oil. By 1993, the year China became a net importer of refined oil, crude oil exports to the United States accounted for 14 percent of total Chinese oil exports, although this contribution to total U.S. oil imports was negligible.¹

Since 1980, China has allowed international oil companies to participate in developing its offshore oil and gas reserves and to conduct oil-related business on land. Chinese law, however, requires that international oil companies enter into joint ventures on Chinese territory with Chinese counterparts. Because the Chinese oil industry is state owned and operates monopolistically, such joint ventures have been limited, especially in distribution.

Moreover, China's oil production peaked in volume in 1985, and domestic consumption began to increase rapidly. The significance of oil as an export item for earning hard currency began to decline.² Coincidentally, world oil prices were decreasing in the mid-1980s. International oil companies that had established dominance in other regions of the world did not find it necessary to establish a stronger presence in China. Thus, contrary to U.S. expectations in the early 1980s for China to be a major energy source,³ the United States instead secured its supplies from other states.

The absence of meaningful trade and investment ties in the energy sector is a striking phenomenon. Since 1979, U.S. business interests in trade and investment in China have generally served as a key lobbying force, successfully petitioning Beijing and Washington to compromise when differences threaten fragile diplomatic ties. Yet, oil and other forms of energy have hardly been represented in that business lobby because of a lack of major trade and investment in those sectors. The political establishments in Beijing and Washington have therefore not been as educated on the importance of managing bilateral ties from the perspective of the energy sector. This lack of education facilitates alarmist views over energy security on both sides.

Chinese Perceptions of U.S. Intent: The Malevolent Hegemon?

Although China became a net importer of oil products in 1993 and of crude oil in 1996, energy as a national security matter did not begin to feature prominently in China's political discourse until several years later. The most powerful trigger was the dramatic rise in China's oil imports in 2000: 72 million tons (roughly 25 percent of total Chinese consumption), compared with 37 million tons in 1999. The tripling of world oil prices from January 1999 to January

2000 compounded these new considerations. Ironically, part of the cause for alarm was that Chinese government statistics on oil imports began more accurately to reflect reality, thanks to a three-year campaign against oil smuggling into the country.⁴

As energy security began to be publicly discussed as a national security challenge for China, assessment of China's external environment inevitably turned to focus on the role of the United States. Chinese discussions about bilateral relations in the late 1990s were permeated with several incidents pointing to a pattern of strategic volatility: U.S. opposition to China's bid to host the 2000 Olympic Games in 1993, granting a visa to then-Taiwanese leader Lee Teng-hui and the ensuing crisis across the Taiwan Strait in 1995–1996, President Bill Clinton's refusal to sign an agreement on China's entry into the World Trade Organization in April 1999, and the "accidental" U.S. bombing of the Chinese embassy in Belgrade one month later. Coupled with ongoing debates within U.S. security studies circles between engagement and containment as a strategy for dealing with China's rise, Beijing's assessment of U.S. strategic intent on China's search for energy security easily became suspicious.

The prospects for energy to become a cause for more serious clashes are high.

Some Chinese analysts have perspectives on U.S. policy that do not bode well for bilateral interactions in the energy sector. From their point of view, the United States is in a prime position to use oil as a weapon against China.⁵ One alarmist view even predicts an inevitable war over oil.⁶ They reason that the United States has historically worked to control the production and movement of oil supplies worldwide. As China pursues domestic and international economic expansion and the United States sees China as a major challenge to its preeminent role in global affairs, U.S. control of the world oil industry can be used at least indirectly to check Chinese ambitions by manipulating movement of world oil prices. Finally, the United States controls vital sea lanes in the Persian Gulf, the Indian Ocean, and Southeast Asia, making unfettered transportation of oil from Middle Eastern and African ports to Chinese shores a matter of U.S. choice.

Such arguments do not stand the test of intellectual scrutiny. Accusing the United States of working to control international oil production and movement is common among those in the developing world dissatisfied with U.S. diplomacy. Yet, since China began to import oil in the early 1980s, there has not been a single case of the United States intercepting oil moving into or out of China. In 1993 a U.S. warship did stop and board the *Yinhe* (*Milky Way*), a

Chinese freighter carrying what the CIA incorrectly claimed to be chemical weapons materials to Iran, leading to Chinese assessments of U.S. meddling in China's economic ties in the Persian Gulf.⁷ That unfortunate episode in Chinese-U.S. relations, however, was related to nonproliferation rather than the Chinese acquisition of Middle Eastern oil.

The argument that the U.S. government conspires to manipulate world oil prices fails to consider the implications of the United States' place as the largest importer of oil in the world. It would be self-destructive for the U.S. government to support a rise in world oil prices, as oil is openly sold to whomever is willing to pay the highest bidding price. If the price were manipulated in any direction, any damage to China would also hurt the United States.

Moreover, China benefits from the freedom of commercial navigation through the Strait of Hormuz, which since the late 1970s has been protected by the U.S. naval presence in the region. Chinese analysts who complain about U.S. hegemony in the Middle East fail to take note of their own country's need for security in maritime transport. It is certainly in China's interest for movement of oil through the Strait of Hormuz to continue to be safeguarded against sabotage.

Such alarmist Chinese views have serious energy policy implications, prompting Beijing to take measures to minimize its exposure to volatilities in international energy trade markets. In response to international concerns about Chinese demand posing a threat to global oil supply, for example, the Chinese government decided to continue to support extraction of coal in China despite coal extraction's serious social and environmental consequences. In addition to being a major contributor to greenhouse gas emissions, coal mining in China led to some 6,000 deaths in 2005.⁸ Despite coal's abundance in the country, Beijing should instead be offering more robust political and financial support for developing alternative and cleaner sources of energy supply.

China has also decided to support energy investment abroad wherever access is possible, including in countries such as Sudan and Ethiopia that most major international energy corporations avoid due to serious political and social risks. Chinese energy operations in these and other countries do levy heavy costs on China's international diplomacy. Still, under the assumption that major powers such as the United States are working to deny China the energy supply it needs to grow, it is easier to justify securing supplies wherever possible before access to foreign sources of supply becomes even more difficult.

U.S. Perceptions of Chinese Intent: Energy as the Trojan Horse?

A popular view among U.S. analysts is to see China's pursuit of foreign energy supply as an integral part of China's grand strategy to build up the country's

power. Resource diplomacy “will become one aspect of an intensifying [Chinese-U.S.] struggle for mastery in Asia and on the wider world stage.”⁹ More pointedly, Chinese grand strategy is “expand[ing] its wealth and influence to achieve regional preeminence in East Asia at the expense of the now-dominant United States.”¹⁰ From this more alarmist point of view, the stage is set for a head-on collision.

Numerous research projects are seeking to identify the relationship between Chinese government diplomacy and its oil companies’ decisions to pursue energy projects in other countries, more popularly known as China’s *zou chuqu*, or “going out” (of the country for energy), campaign. An accurate and authoritative assessment of China’s energy and resource strategy, however, has yet to emerge because China does not yet have a govern-

The absence of meaningful bilateral trade and investment energy-sector ties is striking.

ment agency to coordinate implementation of its going-out campaign, despite foreign analysts’ impressions of Chinese policymaking coherence on this issue. In fact, confusion among the Chinese government’s multiple bureaucracies with responsibilities over energy production at home and abroad is one powerful reason behind China’s prevailing sense of insecurity about its energy supply.¹¹ In 1988, China abolished its ministries of coal and oil to form a ministry of energy, which was in turn abolished in 1992. Since then, no ministerial-level agency has performed the basic function of compiling and presenting authoritative data on the country’s energy industry, including overseas investment activities.

U.S. anxiety over China’s pursuit of foreign oil supply also stems from the fact that the major Chinese oil companies engaged in going-out are national oil companies (NOCs). An NOC easily lends itself to the perception that its senior managers are passive subjects of government control rather than autonomous business agents. Furthermore, Chinese NOCs have reached deals with NOCs of several other countries on a diplomatic collision course with the United States, including Iran, Sudan, and Venezuela. Such a combination can easily lead to an uncomfortable if not ominous conclusion that, because China uses its NOCs as diplomatic agents, U.S. diplomatic and strategic interests are at risk.

In assuming the sinister intentions of Chinese imports of oil from countries in the Middle East, Africa, or South America, it is often easy to overlook the path dependency built into China’s oil refining facilities and the foreign origins of supply.¹² Although it is tempting to conclude that China obtains oil from one particular country for the sake of strengthening political relations,

a key consideration for Chinese oil importers is the technological match between the Chinese oil refining facilities and the type and blend of oil that is available. China is not necessarily purposefully seeking out oil exporters with which the United States takes issue. If there is a technological match between available refining facilities in China and supply from a foreign country that the United States finds questionable, China has no choice but to live with international complaints or protests. What appears to be a matter of willful disregard of U.S. concerns may instead be a necessary evil given China's need to feed its tremendous growth.

China is often also identified as the key factor behind spikes in oil prices in recent years and as a member of a new "axis of oil" posing a direct challenge to the United States' search for energy security.¹³ Chinese officials try tirelessly to convince international audiences that China is not the cause of rising global oil prices. Quite the contrary, China is a positive force in safeguarding energy security on a global scale. China continues to maximize reliance on domestic sources of energy supply to meet its overall demand. It pursues its foreign sources of supply through peaceful means, as opposed to the West's practices of colonialism during their own history of industrialization. China also makes conservation a key component in energy cooperation with advanced industrial countries, the United States included.¹⁴

In the wake of the politically contentious competition between the China National Offshore Oil Corporation (CNOOC) and Chevron Corporation for acquiring California-based Unocal, it is tempting for Congress and the Bush administration to misinterpret China's geostrategic intent in its overseas energy activities. This carries a risk. Just as China risks misperceiving U.S. intentions in managing global energy movements, such heightened attention may simply reinforce preconceived suspicions and may not necessarily produce a more productive understanding by energy and foreign policy officials of the two governments.

Expedient assumptions and conclusions about the strategic rationale behind U.S. and Chinese energy policies are inaccurate and confining, and the risks of acting on these inferences are high. The challenge is to prevent instinctive strategic rivalry and suspicion from prevailing to become the operational norm.

The Common Interests Underlying Resource Competition

Chinese-U.S. energy relations are full of ironies. For the past 30 years, China and the United States have in reality gained from each other's energy policies. China has benefited from the security that U.S. "hegemony" has wielded in stabilizing volatile spots of the energy-producing world. Meanwhile,

the U.S. economy has on the whole benefited from a steady flow of cheaply made exports from China. Because a sufficient energy supply is crucial to meeting trade demands, the United States and China, as the largest and third-largest trading nations in the world, respectively, must treat energy as a key factor in economic interdependence.

Energy considerations are rooted primarily in domestic economic and social development. Chinese public opinion, reflected in media reports and commentary, questions why consumer oil prices in China fail to change by the margins as world crude oil prices fluctuate. Yet, few appreciate the benefits that high oil prices can bring to controlling air pollution in China or reducing the grinding traffic jams that are now routine in major cities. In the

United States, conversely, although energy independence has been a 30-year political goal, voters continually shun politicians who are seen as failing to tame prices at the gas station. Until U.S. consumers start to control their consumption of oil, however, reducing dependence on foreign supply is an unattainable goal. Like China, the U.S. government has every reason to encourage investment in alternate forms of energy to reduce oil dependence.

Thus, although higher energy prices are theoretically conducive to meeting policy goals of conservation and reduction in dependence on foreign sources of supply, domestic political dynamics discourage both governments from supporting any increase in what end users have to pay for energy consumption. The politically low-risk option when prices rise is to blame a major competitor in the world energy market for the domestic woes.

The second irony is that, despite mutual suspicions, an increase in real wage levels for the mass majority of the labor force is essential for managing energy use in both countries. Labor-intensive, low-wage manufacturing has been a key contributor to China's path of growth to date. Low wages, however, place a limit on consumers' financial capacity to afford increases in energy prices and are not conducive to the introduction of newer, usually more expensive sources of energy. In several cities in China, natural gas facilities for household use have been installed and gas supplied, but consumers choose instead to return to their coal stove because the costs for using gas to meet daily household needs are several times higher than coal.¹⁵ Likewise, slow rises or even stagnations in real U.S. wage levels in recent years have inhibited market support for energy innovations leading to reductions in oil consumption. Meaningful conservation leading to a reduced reliance on energy imports can only take place when consumers are willing to pay the added costs. For both governments,

If oil prices were manipulated, any damage to China would also hurt the United States.

therefore, a significant part of managing energy security is effectively enabling demand for alternative energy sources in both countries to grow.

The third irony is that because China and the United States have a high level of dependence on energy imports, particularly oil, they are exposed to the same risks of the international oil markets. As dependent consumers, China and the United States have to choose between political preference and market pragmatism when faced with an exporting country practicing resource nationalism.¹⁶ An exporting government is in a prime position to exploit political differences between a set of big powers by threatening to curtail exports to one and offering to divert them to another.

A Proposal for Partnership

There are differences between China and the United States, but it would be a waste of resources on both sides to encourage more competition or confrontation. Both stand to lose from further complication or politicization of an already complex international energy system. The case for collaboration is easy when there is so much at stake. Collaboration on energy technology development and increasing oil extraction are two politically low-cost solutions to reduce tension between the United States and China.

Competition is not the sole feature of government or government-endorsed interactions between China and the United States. Energy technology development in China was a key component when President Jimmy Carter signed a framework agreement of cooperation in science and technology with Chinese leader Deng Xiaoping in 1979. Since then, the cooperation framework has been strengthened to include an increasing number of government agencies and a multitude of scientific and business interests from both societies.¹⁷ In fact, the United States is the country with which China has launched the largest number of collaborative energy development programs and projects. These activities have in no small part contributed to improvement in energy technology development in China. As a result of these government-sponsored projects, thousands of energy scientists and policy analysts regularly interact with each other across the Pacific.

For more than a decade, Beijing and Washington also have made energy policy an agenda item in governmental-level dialogues. Such vehicles include the U.S.-China Energy Policy Dialogue, the U.S.-China Oil and Gas Industry Forum, the U.S.-China Economic Development and Reform Dialogue, the Peaceful Uses of Nuclear Technologies Agreement, the Joint Coordinating Committee on Science and Technology, and the U.S.-China Strategic Economic Dialogue. Still, the prevailing sentiment in both capitals is that China and the United States are parties for dialogue, at best, rather than partners in concerted action.

Policy dialogues are certainly useful. Yet, as is true of so many other venues for government communication, they often result in being a means for defending one side's own policy orientations. Partnership, on the other hand, is action oriented. Although China and the United States are not yet strategic partners in the field of energy, actions in the spirit of partnership are certainly desirable.

First, Washington should continue to collaborate with Beijing on China's energy technology development. The logic for doing so is simple: energy saved in China means an increase in worldwide supply and a reduction of pollutants into the air, which migrate across the Pacific Ocean. The areas for action include working to increase the use of nuclear and other cleaner forms of power, improving recovery rates of coal and oil production, achieving better user efficiency, and replacing technologically obsolete plants. In addition, China and the United States can benefit from discussing how to address policy issues associated with energy use such as fuel and electric power price systems, urban planning, and the encouragement of lifestyle changes to enable energy conservation.

In order to promote energy technology development in China, it is essential for U.S. companies to see the benefits of participation. For U.S. and other international companies, two issues stand in the way of the transfer of energy-saving technologies to China: inadequate Chinese protection of intellectual property rights of foreign technology and low-cost competition from Chinese-made equipment. As such, transfer of the best available technologies, a frequent suggestion of Chinese government officials, is often regarded as undesirable by the U.S. business community.

Energy conservation in China and environmental protection is nonetheless a matter of urgency and in the interest of the entire world. The U.S. government has sound reason to provide incentives for U.S. businesses to establish a stronger presence in China's energy development and environmental protection. Intellectual property rights concerns are legitimate. One compromise is for U.S. technology companies to partner with their Chinese counterparts to produce better-than-available (though not the most high-end) energy technologies and equipments for adoption in China. This approach can establish intellectual property rights protection within the Chinese system from the start, with Chinese partners having an interest in protecting their own investments. As for concerns about competition from cheaper Chinese-made energy-saving technologies, energy conservation is a worldwide task. Such competition thus ought to be viewed as a benign if not welcome development.

**Confusion among
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Second, the governments of China and the United States ought to explore ways for their energy companies to jointly enlarge the global supply of oil and other forms of energy. Chinese oil companies are already collaborating with U.S. and other international oil companies through subcontracting arrangements. Serious competition between Chinese and U.S. companies as well as

other international oil companies takes place when they pursue wholly owned or equity investment in the same asset in a third country. Chinese oil investment decisions baffle their U.S. competitors when profit margins are estimated to be considerably lower than those of other companies, raising suspicions of political motives. When Beijing and Washington are viewed as condoning such company behavior through diplomacy, they inadvertently help strengthen the leverage of the third country, in-

creasing the cost of extraction for all. Rather than providing cover for each other's energy companies to compete in third-country markets, the two governments should find ways to encourage joint ventures in oil extraction.

Chinese-U.S. joint ventures in oil development could help to lower the costs for oil companies associated with competitive bidding for the same energy assets. They would also help dissuade the appeal of resource nationalism to oil-exporting states. This approach can certainly contribute to confidence building between the political establishments in Beijing and Washington.

Reinforcing Interdependence

Energy security as a bilateral issue between China and the United States has the potential to become contentious. Although energy has little chance of being the issue that diffuses the myriad tensions between Beijing and Washington, energy cooperation in the spirit of partnership can help improve the status quo.

Future government-level dialogue between Beijing and Washington on energy should proceed beyond understanding each other's policies and positions to partnership in the energy field. Such partnership should include strengthening U.S. cooperation with China to improve the latter's technological and administrative capacity in energy conservation and environmental protection. The two governments should also encourage their energy companies to launch joint ventures in oil extraction in other countries to lower the business and political costs of enlarging global supply.

A pattern of interdependence has been built into bilateral relations between the two countries. That interdependence manifests not just in com-

mercial trade. The United States and China, as the largest and third-largest importers of oil, respectively, must be able to count on effective energy conservation in both societies before the hopes for a less competitive international energy market can be realistic.

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