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## CHINA'S INTENTIONS FOR RUSSIAN AND CENTRAL ASIAN OIL AND GAS

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## FOREWORD

In 1997 China National Petroleum Corporation (CNPC) surprised many oil industry analysts by outbidding a number of U.S. companies to acquire the rights to develop Kazakhstan's Aktyubinsk and Uzen oil fields. As part of its \$9 billion commitment, CNPC pledged to build a pipeline stretching from Western Kazakhstan to Xinjiang Province in Western China—at an estimated cost of \$4 to \$4.5 billion—and a shorter pipeline from Kazakhstan to Iran. China's successful entry into the competition for Central Asia's energy resources comes at a time of concern about rising energy demand in East Asia and of heated debate in the United States about China's foreign policy intentions. China's expanding presence is also accompanied by continued Sino-Russian agreements to develop East Siberian natural gas fields and to build a gas pipeline from the Irkutsk region into China, and possibly continuing on to Japan and South Korea.

In this issue of the *NBR Analysis*, Dr. Gaye Christoffersen examines China's political, economic, and security intentions for Russian and Central Asian oil and gas reserves and analyzes the implications of Sino-Kazak and Sino-Russian oil cooperation. While some industry analysts have voiced skepticism about the economic logic of these agreements, Dr. Christoffersen asserts that the projects are logical in the context of Beijing's concerns about energy security. Since 1986, when Chinese leaders first recognized that the country could not be self-sufficient in oil, China has rapidly increased crude imports, and Chinese oil companies have expanded their presence internationally—a policy that has been encouraged by the United States and Japan. According to Dr. Christoffersen, Beijing intends to position China between Central Asian and Middle Eastern crude oil and the consuming markets of the Asia Pacific.

Dr. Christoffersen points out that China's increased influence in Russia and Central Asia raises a number of challenges for policymakers, including: lack of transparency in the bidding process; the potential exclusion of meaningful U.S. involvement; and a possible military component to petroleum agreements. Nevertheless, she concludes that pipelines through China from Central Asia and Russia would help to diversify Northeast Asian energy supply—reducing the region's dependence on supplies from the Middle East, helping to meet the growing demand for resources, and offering American companies alternative routes to transport their oil and gas from the former Soviet Union.

Dr. Christoffersen's paper is a product of NBR's ongoing research program on the politics and economics of energy in the former Soviet Union. Lead funding for the program is provided by The Henry M. Jackson Foundation, The International Research and Exchanges Board (IREX), the United States Institute of Peace (USIP), Unocal, and ARCO. In the coming months, this research series will continue with studies examining Japanese interests in the energy resources of the former Soviet republics, energy-policy concerns in the Russian Far East, and the relationship between energy and conflict in Central Asia and the Caucasus.

Richard J. Ellings  
Executive Director  
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### **Commonly Used Abbreviations**

ADB	Asian Development Bank
APEC	Asia-Pacific Economic Cooperation forum
ASEAN	Association of Southeast Asian Nations
CIS	Commonwealth of Independent States
CNOOC	China National Offshore Oil Corporation
CNPC	China National Petroleum Corporation
CNODC	China National Oil Development Corporation
COGC	China Offshore Geophysical Company
COOLC	China Offshore Oil Logging Corporation
E&P	Exploration and Production
EOR	Enhanced Oil Recovery
JNOC	Japan National Oil Corporation
LPG	Liquefied Petroleum Gas
MFA	Ministry of Foreign Affairs
MOFTEC	Ministry of Foreign Trade and Economic Cooperation
PLA	People's Liberation Army
PRC	People's Republic of China
Sinochem	China National Chemicals Import and Export Corporation
Sinoil	China National United Oil Corporation (also called Chinaoil)
Sinopec	China National Petrochemical Corporation
WTO	World Trade Organization

# CHINA'S INTENTIONS FOR RUSSIAN AND CENTRAL ASIAN OIL AND GAS

*Gaye Christoffersen*

## Introduction

When China National Petroleum Corporation (CNPC) invested in Iraqi, Kazak, and Russian oil and natural gas fields in the summer of 1997, many oil industry analysts were surprised. Was CNPC suddenly becoming an aggressive “resource warrior” in the international oil market and in Central Asia, posing a challenge to American multinational corporations? Was the Sino-Russian gas project one more aspect of the “new strategic partnership” Beijing and Moscow are developing in Northeast Asia? What is the *modus vivendi* that allows Beijing and Moscow to cooperate in developing Siberian gas while competing for Kazak oil? Was this still another dimension of the “China threat,” indicating China’s intentions to establish a new hegemony in Central Asia and Northeast Asia?

China’s strategy for Central Asia and the Asia Pacific has not been formulated unilaterally but rather in consultation with countries in each of these regions. This strategy involves the formation of natural economic territories that transcend borders, extending from China’s domestic economy into surrounding countries. Called the “Northwest Economic Circle” and the “Northeast Economic Circle,” they open up inner border areas to international trade, with the hope that the interior will gain the same benefits as the coastal region. Oil and gas pipelines are the sinews that integrate and link these natural economic territories. These economic circles require multi-lateral fora, which have operated successfully in China’s relations in Central Asia but are only in the initial stages of formation in Northeast Asia.

China’s strategy for oil relations has been to position its coastal refineries between Middle Eastern crude oil supply and Northeast Asian petroleum product demand. This has not yet been implemented, partially because it would have required a heavy dependence on Middle Eastern oil imports. The recent availability of Russian and Kazak oil and gas led to a modification of the strategy, permitting diversification in sources of supply and markets to avoid excessive dependence on the Middle East. This Chinese strategy for energy security requires extensive collaboration, initially with Middle Eastern countries, Japan, and South Korea, and more recently with Russia and Kazakstan.

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Gaye Christoffersen was a participant in the “Workshop on Sino Russian Relations, 1992–1997” at Princeton University, Carnegie Endowment for International Peace, and the Woodrow Wilson Center, as well as a participant in the Energy Program at the East-West Center. Dr. Christoffersen’s studies focus on regional politics, foreign relations, and energy policy in China. Her publications include: “China and the Asia-Pacific: The Need for a Grand Strategy,” *Asian Survey* (November 1996) and “Socialist Integration and Energy Regimes,” *Pacific Review* (1990). Dr. Christoffersen would like to thank the University of Hawaii Political Science Departments at Manoa and Hilo for their assistance and support, and Fereidun Fesharaki, director of the Program on Energy and Minerals at the East-West Center, for access to the program’s resources.

Most of this collaboration is carried out in bilateral meetings, making sequencing of these meetings important. The strategy for overseas investment, driven by rapidly expanding domestic oil demand, became possible only after restructuring the country's oil industry.

The Chinese policy for opening its inner borders would appear to come into conflict in Central Asia with the Russian strategy for political, military, economic, and energy security, which has been to try to maintain a monopolistic control over Central Asian oil transport. The geopolitics of oil in Central Asia and Kazakhstan's efforts to gain independence from Russian domination of its energy infrastructure have created the "Great Oil Game." The result has been considerable international competition in the region, which is Kazakhstan's strategy for energy security. Chinese and Kazak tactics coincided sufficiently in June 1997 to lead the government of Kazakhstan to award the bid for the Akt'yubinsk oil field to CNPC. China bid \$4.3 billion, acquiring 60 percent of the stock in Kazakhstan's Aktobemunaigaz oil corporation, beating out Russian and American corporations by promising to contribute \$3.5 billion to a pipeline eastward that would decrease Kazak dependence on Russia. China's motives were partially domestic. A pipeline for Kazak oil would make a domestic pipeline from China's western Xinjiang province to the Pacific commercially more viable.

American reaction to this was surprise and alarm. Texaco and Amoco felt bested after losing out to CNPC in the bidding contest. The *Asian Wall Street Journal* raised the possibility that China would assert a hegemony over Central Asia similar to Russia's.<sup>1</sup> The media referred to China as the "New Bigfoot in Global Oil," implying that CNPC had suddenly become a key strategic player in the international oil market. The Sino-Russian entente was expected to be strained in Central Asia, but has not to date been ruptured. Russian acquiescence to the formation of a natural economic territory in Central Asia is based on the expected benefits to Russia of a natural economic territory in Northeast Asia. China's intentions and behavior in Central Asia were considered problematic primarily by the West.

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*[China's integration into the international oil market] has been nurtured by the United States and Japan, resisted by Chinese cultural conservatives, and driven by the need for foreign technology and by rising domestic energy demand. . . .*

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Explaining the events in the summer of 1997 requires some understanding of China's integration into the international oil market, a process that has taken more than two decades since the initial oil exports following the first oil crisis of 1973. This integration has been nurtured by the United States and Japan, resisted by Chinese cultural conservatives, and driven by the need for foreign technology and by rising domestic energy demand during the economic reforms. The major decision to relinquish the status of oil self-sufficiency was made in 1986 when China's State Planning Commission decided that the country must import foreign oil, publicly admitting that the country would not be self-sufficient in oil. The following 10 years saw rapidly increasing imports of petroleum product and crude oil, legal and smuggled, as oil markets emerged and the Chinese state lost control of domestic demand. Every effort to rationalize oil production and consumption was permeated with political struggles that immobilized China's State Council, which delayed important decisions and left others unimplemented. CNPC's overseas corporate strategy was discussed for several years.

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<sup>1</sup> "Resource Warriors," *Asian Wall Street Journal*, July 23, 1997, p. 8.

The problem for Chinese oil production domestically has always been lack of price reform. Maintaining low prices for crude oil subsidized the refining industry (which realized windfall profits during the economic reforms) and powerful industrial consumers, and left insufficient profits for CNPC to invest in domestic exploration. The State Council delayed decisions on price reform, which left no investment for expanding domestic proven reserves, and delayed decisions on refinery expansion, which led to increased dependence on petroleum product imports. CNPC and the State Council were divided on whether to intensify domestic oil development and resist a return to dependence on foreign oil, or to develop transnational corporations that would explore for oil abroad. Given declining domestic reserves, for many years Chinese oil industry representatives argued that China should develop an “outward-looking oil economy” that was genuinely global and diversified. Each delay led to the energy crisis of the 1990s and the need by 1997 to invest rapidly in several overseas oil fields.

In 1991 opinions differed on where China should focus its oil exploration efforts—the Asia-Pacific or the Middle East. The argument for focusing on the Asia-Pacific was that the Middle East was more unstable, and because of its distance, less critical to China’s national security than contiguous states. Moreover, patterns of energy supply and demand in the countries of the Asia-Pacific, especially Japan, the United States, Russia, South Korea, and Indonesia, were thought to be most important for Chinese decisions regarding the mix of exports, imports, production, and consumption. China had begun participation in the international oil market through state-to-state agreements with Japan and the United States, and had exported oil primarily to the Asia-Pacific. China vied with Russia, Australia, Indonesia, and Vietnam for limited foreign investment in resource exploration, and competed for the energy markets of South Korea and Japan. China would increasingly compete with Japan for petroleum supply. Because of these conditions in the Asia-Pacific, Chinese proponents of this argument claimed that China’s response should be to change its energy product structure to meet Asia-Pacific market demand, develop natural gas to meet environmental concerns of consuming countries in the region, and participate in regional energy cooperation to increase foreign investment.<sup>2</sup>

The counterargument was that the Asia-Pacific by the year 2000 would supply almost none of China’s petroleum imports, 90 percent of which were projected to come from the Middle East. The Asia-Pacific region itself would be 58 percent dependent on the Middle East, up from 48 percent in 1995. Iran and Iraq needed investment funds after years of oil embargoes and destructive fighting (with weapons sold to them both by Beijing). By the mid-1990s, Chinese proponents of this argument supported not only importing oil but also investing Chinese capital in the Middle East’s oil industry, “utilizing the Gulf’s oil resources to realize the magnificent goal of turning the Chinese oil industry into a multinational industry.”<sup>3</sup> (Although no Chinese leader would say so, the volatility of the Middle East presented opportunities for arms sales and bartering arms for oil. The region’s volatility was only a problem when considering long-term investment.)

In 1991 there seemed to be only these two choices: the Asia-Pacific or the Middle East. However, the disintegration of the Soviet Union by the end of that year and the opening of the post-Soviet economies would offer alternative sources from Russia and Central Asia. Since Central Asian states contain abundant resources and are critical to Xinjiang Province, they could provide a solution to the problem of dependence on Middle Eastern imports and the looming resource competition in Northeast Asia with Japan and South Korea. Sino-Russian oil and gas projects could offer the same possibility of promoting peaceful cooperation with contiguous territory, Siberia and the Russian Far East, and lessening Northeast Asian dependence on the Middle East.

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<sup>2</sup> Wang Nengquan, “Yatai jingji hezuo zhong de nengyuan wenti ji wo guo de duice” [Energy problems of Asia-Pacific economic cooperation and China’s Response], *Zhongguo Nengyuan*, no. 12 (1991), pp. 10–13.

<sup>3</sup> Shen Qinyu and Wu Lei, “Focus on Gulf Region in Developing Oil Industry,” *Guoji maoyi [International Trade Journal]*, no. 2 (1995), pp. 9–12.



By the mid-1990s, Chinese thinking had arrived at a more global orientation not positing involvement in the Middle East against cooperation in the Asia-Pacific but rather integrating the two regions in a strategy that made Central Asia a link between them. By 1996, the State Planning Commission and the State Scientific Research Institute of Petroleum Exploration and Development referred to a “Pan-Asia continental oil bridge” of gas and oil pipelines that would link China with Central Asia, Russia, the Middle East, South Korea, and Japan. The Chinese expected that construction of the domestic pipeline would be speeded up by its incorporation into the proposed international pipeline network.<sup>4</sup>

Chinese oil trade and investment between the Asia-Pacific, the Middle East and Central Asia would situate China in the center with a comparative advantage in refining, making China’s coastal region the refining link between Middle Eastern and Central Asian crude oil and Asia-Pacific markets. It is expected that this interdependence and enmeshment in the international oil market will be highly advantageous to China, but it requires large investments in the coastal refineries and in pipeline infrastructure.

This Chinese strategy has had considerable encouragement from Japan and the Middle East, with the Japanese considering investment in pipelines and Middle Eastern countries investment in refineries. Japan has always been concerned with containing Chinese oil demand and limiting the environmental impact of Chinese oil consumption as China becomes Japan’s largest potential competitor. Japan prefers to refine Middle Eastern crude in China to avoid the environmental problems of refining in Japan. In April 1995, the Japanese Institute of Energy Economics urged the Chinese State Council to “make a decisive move,” an indication of Japanese impatience with the State Council’s oil policy impasse and its incapacity to decide on renovation of the coastal refineries to process Middle Eastern crude oil. Beijing’s delay and China’s expanding demand, the Japanese worried, would lead to havoc in the Asian oil market, affecting Japan’s oil supply security. The Institute exhorted Beijing to make a decisive move soon because Chinese processing of Middle Eastern crude oil was important for all of Asia. The delay in refinery upgrading made China more dependent on oil product imports. All the Middle Eastern countries sought to secure access to the Asian oil market through China’s coastal refineries producing for export.<sup>5</sup> Up to the present time, years of negotiations have not resolved Sino-Middle Eastern differences over coastal refinery operations, delaying joint ventures that would have helped to meet China’s domestic oil product demand.

It was not easy for the Chinese to accept that China was once again dependent on *yang you*, foreign oil, sold to the Chinese by *yang guizi*, foreign devils. The loss of state control over domestic oil production and consumption was ameliorated somewhat by the realization that China could have an expanded presence internationally. That was the tradeoff. State capacity was redefined from the ability to be self-sufficient in oil to the ability to invest in, explore for, and import oil as needed for the domestic economy. That redefinition occurred at the end of 1993 when China became a net importer of petroleum products.

### **Domestic Determinants: The Production-Consumption Gap**

China’s rate of growth in oil demand has outpaced production since 1979, the year economic reforms were introduced. Most government programs for energy conservation have remained only partially implemented because there has been no economic incentive to reduce consumption. Of CNPC’s total production, 80 percent has been sold at state-allocated (first-tier) prices, which subsidized consumption. Chinese oil consumption in 1990 was 2.1 million barrels per day (b/d).

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<sup>4</sup> Beijing XINHUA, in Foreign Broadcast Information Service-China (hereafter, FBIS-CHI), 96-117, June 16, 1996.

<sup>5</sup> “China Looms Larger as Investment Target for Mideast States,” *Petroleum Intelligence Weekly*, September 12, 1994, pp. 4–5.



The following two years the consumption growth rate was 10 percent per year, with a total consumption of 2.8 million b/d by 1993. In 1994 and 1995 the growth rate decreased to 4.9 percent per year, resulting in a total consumption of 3 million b/d by 1995, 3.3 million b/d in 1996, and 3.5 million b/d in 1997.

By 1994, the amount of total annual crude export had been reduced to 18.49 million tons, while 12.35 million tons of crude had been imported to meet domestic demand, most of which was processed at coastal refineries in Maoming, Zhenhai, Guangzhou, and Dalian. The domestic oil industry had 293 oilfields and 25 oil and gas production bases, but had that year only produced 145 million tons of crude oil, from which 126 million tons of petroleum product had been processed, while the apparent domestic consumption reached 140 million tons of petroleum product.

China currently ranks fifth in crude oil production among the world's major producers, (behind Iran, Russia, Saudi Arabia, and the United States). Chinese crude oil production has had an average annual growth rate of only 2.4 percent since 1980, increasing from 2.1 million b/d in 1980 to 3.21 million b/d in the first half of 1997. The average production growth rate from 1990–1995 slowed to only 1.5 percent.

Of the total increase in onshore production during this period, 80 percent of incremental onshore production came from Xinjiang. Total production for Xinjiang was 253,000 b/d in 1995, 287,000 b/d in 1996, and was predicted to reach 325,000 b/d in 1997. China has begun the 4,200 km domestic oil pipeline from Xinjiang to the coastal region. The first phase of the pipeline project, from Korla in the Tarim oil field to Shanshan in the Turpan-Hami oil field, was completed in mid-1997. From there it will extend to the Dunhuang base of the Qinghai oil field and then to Lanzhou. At Lanzhou, it will split into two lines, one eastward to the Luoyang petrochemical plant and one south to the Penzhou refinery in Sichuan Province. Preparatory work on the sections from Shanshan to Luoyang and Penzhou has begun.<sup>6</sup>

The combined production of the three major oil fields, Daqing, Shengli, and Liaohe, decreased from 74.3 percent of total national production in 1990 to 68.2 percent in 1995. However, Daqing output has declined less than expected, providing 38 percent of total Chinese crude production. In 1980, China's refining capacity was 1.8 million b/d, which doubled during the economic reforms to 3.6 million b/d by 1996. China ranks fourth in the world for distillation refining capacity and fourth for consumption of refined petroleum products, and will surpass Japan by 2010 in refining capacity and oil product consumption.<sup>7</sup>

It is estimated that by the year 2000 Chinese production will be 3.2 million b/d, refining capacity 3.9 million b/d, and domestic consumption 4.3 million b/d. China's oil import dependence will be 31 percent in the year 2000, up from 7 percent in 1993. Some exports will continue in order to meet CNPC foreign currency requirements or to meet the conditions of long-term supply contracts, but China will still be a net importer, importing 760,000 b/d of crude and 770,000 b/d of petroleum products. Of these petroleum product imports, 58 percent will be diesel.<sup>8</sup>

If the future were a linear projection of present conditions, China's demand-supply gap would continue to widen, leaving China importing 38 percent (2 million b/d) of total consumption. In 1994 China was dependent on the Middle East for 40 percent of total crude imports, and was projected to be 60 percent dependent by 1997, 77 percent in the year 2000, and 92 percent in

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<sup>6</sup> China Energy Project, *China Energy Update*, vol. 4, no. 2 & 3 (1997), Honolulu, East-West Center, Program on Resources: Energy & Minerals.

<sup>7</sup> Fereidun Fesharaki, Kang Wu, and Frank C. Tang, *China's Oil Industry in the 21st Century: Challenges and Opportunities*, Honolulu, East-West Center, Program on Resources: Energy & Minerals, Paper prepared for the China Petroleum Conference, Beijing, 1996.

<sup>8</sup> Frank C. Tang and Fereidun Fesharaki, "China: Evolving oil trade patterns and prospects to 2000," *Natural Resources Forum*, vol. 19, no. 1 (1995), p. 57.

2005.<sup>9</sup> That projected dependency created discomfort for the Chinese, who understood that rising oil demand that could not be met by domestic production would have consequences for Chinese foreign policy choices.

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*Chinese energy security would be better assured  
by access to Russian and Central Asian sources. . . .*

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Dependence on Middle Eastern oil imports and significant Middle Eastern control over joint ventures in the coastal refineries could not look attractive to Chinese oil planners who argued for increased diversification. Chinese energy security would be better assured by access to Russian and Central Asian sources as well as to new sources of crude oil imports from Angola and Vietnam. Energy cooperation with contiguous states—Russia, Kazakstan, and Vietnam—would provide incentives for improving border relations.

### Domestic Restructuring for Overseas Expansion

The economic reforms of the Deng Xiaoping era loosened state control over a significant share of domestic energy production and consumption. The chaotic and rapidly expanding domestic demand for petroleum products placed a large burden on China's trade deficit and forced Chinese oil firms to restructure themselves to better meet demand. This represented an expansion of state capacity in foreign economic relations and was part of a larger effort to create socialist transnational corporations as China became more confident of its comparative advantage in world markets.<sup>10</sup> Increased state capacity generated acceptance that China's "interdependent" relationship with the world economy promotes rather than hinders economic growth.

It was clear that as China became a net oil importer there was no choice but to globalize its oil industry. Membership in the World Trade Organization (WTO) would force the oil and petrochemical industries to become more internationally competitive.<sup>11</sup> The creation of Chinese socialist transnational corporations required a restructuring of domestic industry. A number of industries were placed into an export-oriented enterprise group with a foreign trade organization that acts as the group's "dragon head."<sup>12</sup> An enterprise group is a merger of small and large state-owned enterprises backed by a financial institution, forming a union based on cross-shareholding by corporate bodies. Formed as a defensive response to the increasing liberalization of the Chinese domestic market, these groups are expected to operate as Japanese *keiretsu* do and "protect" China's economy from foreign economic penetration after Beijing joins the WTO regime. In the formation of Chinese petroleum enterprise groups, two models of multinational oil corporation were considered, the Japanese and the Euro-American. Chinese oil companies were set up along the lines of the Japanese model of enterprise groups, which are considered more stable and efficient due to the intra-enterprise links that reduce transaction costs and the higher concentration of shareholders' equity in the corporation.<sup>13</sup>

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<sup>9</sup> Kang Wu and Fereidun Fesharaki, "Petroleum Links between China and the Middle East: The Implications for United States-China Relations," *Energy Advisory*, no. 157 (July 25, 1995).

<sup>10</sup> Lu Jiarui, "Lun shehui zhuyi kuaguo gongsi" [On the socialist transnational corporation], *Xuexi yu tansuo*, no. 4 (1990), pp. 80–86.

<sup>11</sup> Shi Ying and Chu Xiaomao, "Zengqiang shihua gongye de jingzheng li yingjie ruguan," [Improve the petrochemical industry's competitive power, welcome rejoining GATT] *Zhongguo nengyuan*, no. 8 (1993), pp. 26–31.

<sup>12</sup> Li Lanqing, Foreign Economic Relations and Trade Minister, "Foreign Trade Enterprises Should Rapidly Change Their Operational Mechanisms," *Guoji Shangbao*, December 3, 1992, pp. 1–2, in FBIS-CHI-93-004, January 7, 1993, pp. 32–41.

<sup>13</sup> Lin Ye [Sinochem], "Gongsi zhi moshi yu shiyou qiye jituan de fazhan," [Corporate systems and the development of petroleum enterprise groups] *International Petroleum Economics*, vol. 2, no. 5 (September 1994), p. 14. Wang Yongfan, Li Haiqing, and Wang Dequn, "Guanyu jianli wo guo xiandai shiyou qiye zhidu de tantao," [Considerations on the establishment of a modern petroleum enterprise system in China], *International Petroleum Economics*, vol. 3, no. 2 (March 1995), p. 26.

In December 1994 the State Council gave China National Chemicals Import and Export Corporation (Sinochem) permission to transform itself into a multinational enterprise group, to integrate trade, investment, and finance for the purpose of linking the domestic and international markets. China Trust and Investment Corporation for Foreign Relations was transferred from Ministry of Foreign Trade and Economic Cooperation (MOFTEC) to Sinochem by the State Council and merged with Sinochem Finance Co. Ltd. The purpose was to strengthen Sinochem to compete with foreign *sogoshosha* (a Japanese-style trading company). Sinochem was the first trading company chosen to become a *sogoshosha*. Sinochem's president, Zheng Dunxun, declared "We can't overtake Mitsubishi right away, but that's our direction."<sup>14</sup> In 1994 Sinochem's earnings reached \$6.7 billion, half of which was earned abroad. Sinochem's goal was to reinvent itself as an integrated multinational oil corporation that could explore, refine, and trade oil.

Chinese state oil enterprises had accumulated technical know-how from Western joint venture partners since the 1970s. By the 1990s these state enterprises felt sufficiently confident of their expertise to begin offering it within the international oil industry. They complained that government cadres, whose thinking and mentality were accustomed to the planned economy, remained an impediment to transnational operations and globalization as long as these state enterprises remained under the domestically oriented Ministry of Energy.<sup>15</sup>

At the time China became a net importer of petroleum products, the president of the China National Petrochemical Corporation (Sinopec), Sheng Huaren, announced that China's petrochemical industry would be formed into enterprise groups that would carry out transnational operations, a joint-stock system, and diversification. These transnational corporations needed to have the yoke of the planned economy removed, with decision-making fully delegated to them to operate in world markets.<sup>16</sup>

In March 1993, the State Council reorganized the oil industry, took CNPC, China National Offshore Oil Corporation (CNOOC), and Sinopec out of the Ministry of Energy's jurisdiction, gave them ministerial level status, and placed them under the State Economic and Trade Commission. These companies are now directly responsible to the State Council. The Ministry of Energy's mandate was to produce energy domestically. The State Economic and Trade Commission's goals were more compatible with an outward shift in orientation by the Chinese oil industry.

Under the planned economy, there had been a division of labor between Sinochem (imports and exports), CNPC (exploration and development), and Sinopec (refining). The division left each corporation uncompetitive in the international market, and led to calls for vertical integration as a defensive measure in anticipation of foreign penetration of domestic markets. According to a Sinochem executive:

We must lose no time in forging several high-powered companies that can explore, refine and trade oil and oil products before foreign companies are allowed in after China joins the World Trade Organization.<sup>17</sup>

There had always been competition between Sinochem, CNPC, and Sinopec, even under the planned economy when they were presumed to be coordinating their work. When each inte-

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<sup>14</sup> Joseph Kahn, "Major Chinese Firms are Modeling Themselves on Japanese Conglomerates in their Expansion," *Asian Wall Street Journal Weekly*, June 26, 1995, p. 2.

<sup>15</sup> Sun Yan, Ji Weiyang, and Yao Fei [Daqing Petroleum Administrative Bureau], "Woguo daxing shiyou qiye kuaguo jingying tantao," [Inquiry into the transnational operations of Chinese large petroleum enterprises] *International Petroleum Economics*, vol. 2, no. 1 (January 1994), p. 42.

<sup>16</sup> Sheng Huaren, "Grasp the Opportunity, Revitalize the Pillar Industry," *Renmin Ribao*, April 19, 1994, p. 2, in FBIS-CHI-94-098, May 20, 1994, pp. 48-50.

<sup>17</sup> Wang Yong, "State Is Urged to Reform Petrochemical Industry," *China Daily*, May 28-June 3, 1995, p. 1, in FBIS-CHI-95-103, May 30, 1995, p. 59.

grated vertically, expanding both upstream and downstream, market competition in China's oil industry became overt. There are only a few countries—China and India, for example—that have multiple state oil companies, which invariably leads to competition that is criticized by oil analysts as wasteful.<sup>18</sup>

### ***China National Petroleum Corporation***

The China National Petroleum Corporation was created out of the Ministry of Petroleum Industry in 1988 with the intent to make domestic petroleum production more market-oriented. Greater profitability would generate capital for reinvestment in exploration to expand domestic reserves. Nevertheless, CNPC continued to suffer from insufficient profits and investment for exploration due to underpricing of crude, leaving production outpacing the expansion of proven reserves. In 1994 the investment shortfall in the onshore oil industry was 10 billion yuan. The solution to this pending crisis had two parts.

The first solution has been to streamline CNPC, reducing its 1.5 million employees by restructuring. Below CNPC, the 18 Petroleum Administration Bureaus (PABs) located in the less profitable oil fields were made into independent oil companies—semi-private enterprise groups responsible for their own profits and losses. The operations of the PABs were distributed to enterprise groups, with each enterprise performing some part of the exploration, production, and refining that previously had been done by the petroleum administration bureau. The State would still purchase their output at international prices but not supply operating funds. CNPC would continue to retain control over the three main producing fields, Daqing, Shengli, and Liaohe, which account for 70 percent of total production.

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*While decentralizing control of petroleum operations domestically, CNPC also established subsidiaries for overseas oil exploration to purchase shares, operating rights, and rental rights.*

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While decentralizing control of petroleum operations domestically, CNPC also established subsidiaries for overseas oil exploration to purchase shares, operating rights, and rental rights. CNPC's initial strategy was to develop a market niche in smaller projects and enhanced oil recovery (EOR) of older fields, thereby minimizing the risk involved. CNPC's first overseas activities were in Canada in 1992 when the corporation purchased 22 million cubic meters of asphalt. CNPC Canada produced the corporation's first overseas barrel of crude in the North Twinning Oil Field.

By 1993 CNPC had purchased oil fields in Canada and Peru, and bid on projects in India, Russia, Papua New Guinea, Indonesia, and Venezuela. In 1995 CNPC signed an agreement with Peru Petroleum Corp. for enhanced oil recovery in the Talara Basin in northern Peru. The corporation also considered projects in Thailand, Mongolia, the United States, and Pakistan.<sup>19</sup> CNPC signed an agreement with the Japanese corporation Marubeni for downstream joint ventures in third countries such as Uzbekistan.

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<sup>18</sup> Private communication with Fereidun Fesharaki, director of the Program on Resources: Energy & Minerals, East-West Center, Honolulu.

<sup>19</sup> "CNPC: innocent abroad?" *China Oil, Gas & Petrochemicals*, September 15, 1995, pp. 8–9.



In addition to CNPC Canada, numerous subsidiaries were created that initially had some autonomy in overseas agreements: CNPC Central Asia Co., CNPC Asia-Pacific Ltd., MC-CNPC Oil (Hong Kong) Ltd., CNPC Latin America Ltd., CNPC International Ltd., and China National Oil Development Corporation (CNODC). Overseas firms were staffed by officials who had been in charge of domestic oilfields: the former head of the Liaohe oil producing complex became president of CNPC Central Asia and the former head of the Shengli complex became president of CNPC Latin America. In Heilongjiang Province, Daqing oil producing complex initiated, on its own, negotiations for rights to oil fields near Irkutsk, Russia.<sup>20</sup> Provincial leaders had expected to be the beneficiary of a future Sino-Russian natural gas project. However, the June and November 1997 pipeline agreements indicate that Heilongjiang had no part in negotiations.

In response to initiatives from below, CNPC claimed that subsidiaries had “bid for overseas projects separately, sometimes against each other, resulting in a waste of our financial resources,”<sup>21</sup> and subsequently imposed centralized administrative authority for overseas project evaluation, negotiations, and contracts. Through an administrative reshuffling, CNPC created an International Cooperation Bureau that became coterminous with CNODC and staffed by the same people. This overlay of CNPC’s bureaucracy onto China National Oil Development Corporation was meant to give CNODC more authority with local oilfields, which had previously ignored CNODC’s directives, and to give CNODC more authority for operations overseas.<sup>22</sup> The International Cooperation Bureau would determine which domestic agency would implement which foreign contract. The problem of jurisdictional disputes between central ministries and local governments under the planned economy was not compatible with the transnational operations of a large oil corporation.<sup>23</sup> By 1997 CNODC had been reorganized into an enterprise group, CNODC Group, mandated to incorporate all of CNPC’s overseas operations and coordinate their activities. It was claimed that CNODC Group would be the “only window through which CNPC subsidiaries can participate in overseas upstream projects.”<sup>24</sup>

But even domestically CNPC’s centralized control could be challenged. The Ningxia Petroleum Company signed an exploration and production (E&P) agreement with South Korea’s Samsung for exploration in Ningxia. CNPC’s Law and Regulation Bureau claimed the project was illegal since only CNPC was authorized to sign cooperation agreements with foreign companies or issue licenses for E&P within China. The State Planning Commission threatened to investigate the agreement.<sup>25</sup>

Because CNPC’s E&P funds were insufficient for domestic oil development, when CNPC decided to expand overseas the company originally planned to allocate no more than 3 to 4 percent of its E&P funds for overseas development. These initial activities overseas, in smaller projects and EOR, were referred to by a CNPC official as “tiny eggs laid by a giant hen.”

The State Council has incrementally increased the state-allocated (first-tier) price for crude, slowly recognizing that decades of underpricing had impoverished CNPC and hampered its domestic E&P. The April 1996 price hike was from 700 to 810 yuan/ton (US \$84.14 to \$97.36/ton) for first-tier crude, which constitutes 80 percent of CNPC’s crude sales. CNPC had fought long and hard for this increase, which was retroactive to January 1, 1996. The price rise was expected to give CNPC 6.5 billion yuan in profits annually while costing the petrochemical com-

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<sup>20</sup> *Oil & Gas Journal*, May 9, 1994, p. 59.

<sup>21</sup> “CNPC Moves a Step Closer to Globalization,” *China Oil, Gas & Petrochemicals*, vol. 5, no. 13 (July 1, 1997), pp. 1–3.

<sup>22</sup> *China Oil, Gas & Petrochemicals*, June 15, 1994, pp. 2–3.

<sup>23</sup> Sun Yan, Ji Weiyang, and Yao Fei, “Inquiry into the transnational operation of Chinese large petroleum enterprises,” *op. cit.*, p. 43.

<sup>24</sup> “CNPC Moves a Step Closer to Globalization,” *China Oil, Gas & Petrochemicals*, vol. 5, no. 13 (July 1, 1997), pp. 1–3.

<sup>25</sup> “Samsung Skips CNPC to sign E&D contract in Ningxia,” *China Oil, Gas & Petrochemicals*, vol. 5, no. 11 (June 1, 1997), p. 5.

pany Sinopec almost as much. There was an additional price hike in January 1997 that raised first-tier crude another 120 yuan/ton and increased CNPC's projected annual revenue by 7.2 billion yuan.

The World Bank and numerous foreign and domestic experts had long advocated this policy decision to get the prices right for crude oil and to stop subsidizing domestic consumers and refiners. The ever-cautious State Council called out the army to quell any potential protests but none occurred: consumers just paid. CNPC soon realized enormous profits and knew that they would have to be invested quickly or they would be confiscated by the government.<sup>26</sup> To invest these windfall profits domestically would take time and have uncertain results. The Chinese Energy Research Institute advocated investing overseas and delaying development of domestic reserves since they were so limited. The international oil industry offered better prospects for an immediate increase in petroleum supply.

CNPC was divided over whether to allocate funds domestically or overseas. Dr. Wang Tao, longtime president of CNPC, believed steadfastly in the prospects for developing the reserves of Xinjiang Province and domestic E&P. Many others felt Xinjiang could not meet domestic demand quickly enough and advocated overseas investment. This CNPC division was resolved when Wang was retired (presumably by the State Council) in December 1996, and was replaced by Zhou Yongkang, who is more outward-oriented and advocates overseas E&P. He felt that a globalization strategy would increase corporate profits and promote expansion of the firm, in addition to promoting the broader goal of national petroleum security. In its January 1997 issue, *China Oil, Gas & Petrochemicals* reflected a change in thinking, stating that "Tarim has failed to yield an expected huge discovery."<sup>27</sup>

The first half of 1997 indicated that Beijing was confronting the strategic choices it needed to make, and that these choices had geopolitical consequences.<sup>28</sup> The State Council decided in late 1996 to halt expansion of refining capacity, which would put on hold Western and Middle Eastern investment in the coastal refineries. International oil corporations that had hoped to invest were disappointed, having reportedly already spent \$200 million on feasibility studies, trips for Chinese oil officials, meetings, and other expenses as a prelude to investing in joint ventures in the coastal refineries.

Petroleum security was made a priority in spring 1997.<sup>29</sup> Dependence on the Middle East had reached 50 percent of crude imports in 1996, and the decision was made to diversify away from the Middle East rather than assume that the Gulf region would remain peaceful. Africa was targeted as a new source. It was also determined to establish a strategic reserve, for which 2 billion yuan was allocated to build storage facilities in the coastal region. Beijing planners turned to overseas sources for help in building China's strategic reserve through a long-term supply contract with Iran and investment in Iraq's Al-Ahdab oil field.

A surge in imports also spurred overseas investment. In the first quarter of 1997, crude oil imports increased 50 percent over the previous year and product imports increased 71 percent. In the first half of 1997, while Middle Eastern imports (from Oman, Yemen, and Iran) declined—accounting for only 41 percent of total crude imports—Angola supplied 13 percent of Chinese crude imports. Russian supply increased to 18 percent of petroleum product imports.<sup>30</sup>

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<sup>26</sup> Interview with Fereidun Fesharaki, September 1997.

<sup>27</sup> "CNPC streamlines structure to renew vitality," *China Oil, Gas, & Petrochemicals*, vol. 5, no. 2 (January 15, 1997), p. 1.

<sup>28</sup> Xu Xiaojie, "China Reaches Crossroads for Strategic Choices," *World Oil*, April 1997, pp. 95–100.

<sup>29</sup> "Oil Security Risk, Wolf at Door?" *China Oil, Gas, & Petrochemicals*, vol. 5, no. 10 (May 15, 1997), pp. 1–3.

<sup>30</sup> China Energy Project, *China Energy Update*, vol. 4, no. 2 & 3 (1997), Honolulu, East-West Center, Program on Resources: Energy and Minerals.



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*In the space of three weeks in June 1997, CNPC surprised oil analysts and foreign oil corporations by cutting deals with Kazakstan, Venezuela, and Iraq that totaled \$5.6 billion. Investment in Kazakstan reached \$9 billion by September.*

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It was these three decisions—on price reform, overseas E&P, and reduced dependence on Middle East imports—that converged in 1997 as a necessary prelude that made large investments overseas possible. In the space of three weeks in June 1997, CNPC surprised oil analysts and foreign oil corporations by cutting deals with Kazakstan, Venezuela, and Iraq that totaled \$5.6 billion. Investment in Kazakstan reached \$9 billion by September.

While CNPC recentralized authority over subsidiaries, it also demanded and received more autonomy from government interference and increased decision-making authority overseas. With greater autonomy, CNPC could move more quickly to take advantage of market opportunities as they occurred. Thus, when CNPC reinvented itself as a multinational, it simultaneously strengthened corporate discipline domestically and corporate autonomy internationally.

### ***China National Chemicals Import & Export Corporation***

China National Chemicals Import and Export Corporation, China's largest foreign trade company, initially was the only authorized importer and exporter of crude and product operating under the jurisdiction of MOFTEC. Drawing on this global network of contacts from export deals, Sinochem began investing overseas in 1987. In 1988, Sinochem invested in the American Coastal Corporation, acquiring a 50 percent interest in the corporation's West Coast refining and marketing operations. Sinochem had first begun doing business with Coastal Corporation in 1978 when the company became the first American corporation to import Chinese crude.<sup>31</sup> After Sinochem lost its monopoly over Chinese petroleum imports and exports, the corporation diversified, investing abroad in shipping, retail, industrial projects, and a movie studio.

### ***China National Petrochemical Corporation***

At the same time, China National Petrochemical Corporation was transforming itself into a transnational corporation. It justified this change as a means for the petrochemical industry to escape five domestic shortages: oil and natural gas resources, funds, technology, markets, and skilled manpower. These domestic problems, Sinopec argued, had solutions overseas, if the corporation took advantage of the globalization of the international petrochemical industry. Sinopec maintained that China's national interests could best be served by transnational operations.<sup>32</sup>

The industry's need for oil and natural gas resources as feedstocks for its products had depended on an unreliable domestic market. Sinopec's refineries were operating at half capacity because crude oil distribution could no longer be guaranteed by Beijing in the planned economy. The uncertain domestic supply situation had held back the expansion of the petrochemical industry. Emulating Japanese and American industries by obtaining supply abroad appeared to be the solution.

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<sup>31</sup> James P. Dorian. *Minerals, Energy, and Economic Development in China*. Oxford, Oxford University Press, 1994, pp. 227–228.

<sup>32</sup> Li Shuqing, "Transnational Operation Pushes China's Petrochemical Industry Into a New Golden Age," *Jingji guanli [Economic Management]* no. 5 (May 1993), pp. 10–11, in FBIS-CHI-93-136, July 19, 1993, p. 35.

The shortage of investment funds domestically made it imperative for Sinopec to raise foreign capital on international markets, and to invest in petrochemical plants overseas. Chinese investment in third-world countries was attractive because of preferential rates from international lending organizations such as the World Bank, IMF, and the Asian Development Bank (ADB) that lowered the cost of borrowing foreign capital.

After twenty years of importing foreign petrochemical technology into China, at a cost of \$5 billion in the refining and petrochemical industries from 1972–1992, China was still technologically behind industrialized countries. Chinese investment in the United States, Japan, and Europe, it was argued, would enable Sinopec to “bypass their technological control and blockade” and gain access to the advanced technology previously “withheld” from China by these countries.

Sinopec production could only meet 60 percent of domestic oil product demand, leaving 40 percent to be imported. Sinopec’s transnational operations could expand its markets overseas—producing sufficient products to sell in the host country and for transfer back to China. Investment abroad could also make use of foreign skilled labor rather than bring that technical expertise to China, as Sinopec has done in the past.

Sinopec had been lobbying for oil trading rights since it was established in 1983, placing it in a rivalry with Sinochem, which retained a monopoly on oil trade. As a compromise between the two rival state oil corporations, Sinopec and Sinochem formed a 50-50 joint venture, Unipec, in January 1993 to carry out import and export of oil products and petrochemicals and to set up joint ventures in downstream production in refining and petrochemicals.

At the same time, CNPC and Sinochem formed Sinoil (China National United Oil Corporation, also called Chinaoil) to import and export crude oil, to import equipment needed by CNPC, and to engage in exploration and development of oil fields overseas. Sinoil was formed to be a “global industrial conglomerate,” able to compete in the world oil economy for exploration contracts in foreign oilfields. Initially Sinoil obtained most of its crude exports from Daqing and exported these primarily to Japan (9.3 million tons in 1994). The corporation will concentrate on retapping old oil fields. Forming a joint venture with an American partner, Sinoil bought 98 old oil wells in east Texas. Sinoil will expand overseas into Japan, South Korea, Singapore, and the United States. Sinoil invested in a Hong Kong holding company, Seaunion Holdings Ltd., to develop fields in Indonesia and Mongolia.<sup>33</sup>

Sinopec has promoted the sale of the petrochemical industry’s expertise to Thailand. In August 1993 Sinopec formed a joint venture with Charoen Pakphand, a Thai conglomerate, to set up integrated oil enterprises covering all downstream activities throughout the Asia-Pacific. Called PetroAsia, the venture was interested in Vietnam, Laos, Cambodia, and Kazakstan.<sup>34</sup> Malaysia’s Petronas and Sinopec signed a contract for Petronas to supply feedstock to Sinopec’s petrochemical industry and Sinopec to participate in Petronas’ refining. Sinopec has opened new markets in Russia, Central Asia, and Latin America. The company has offices in South Korea, Hong Kong, Japan, the United States, Thailand, Singapore, Italy, Germany, and Ecuador.

### ***China National Offshore Oil Corporation***

In 1993, after China National Offshore Oil Corporation was permitted to go transnational, it formed a Department for Overseas Development to evaluate potential projects. CNOOC established an ISO 9000 System Office to ensure that service companies within the CNOOC Group meet international quality standards. By 1997 eight companies had been certified and it was

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<sup>33</sup> *China Oil, Gas & Petrochemicals*, July 1, 1994, pp. 6–7.

<sup>34</sup> “CP and Sinopec to set up integrated oil ventures in Asia,” *Oil & Gas News*, August 16–22, 1993, p. 3.

expected that all would be by 1999. Certification indicates that a company has reached international standards and is ready to shift to operating in the international market.

CNOOC's first overseas project was in Indonesia. The company acquired a 32.58-percent stake in the Malacca Straits block (13 oilfields) by purchasing shares from ARCO. CNOOC became the majority shareholder, joining Lasmco (Britain), Nippon Oil (Japan), Oryx (U.S.), and Kondur (U.S.). The first shipment of Malacca oil reached Nanjing in March 1995.<sup>35</sup> CNOOC claimed that all capital investment and interest had been recouped by the end of 1996, with its share of Malacca oil from 1994 to 1996 totaling 400,000 tons.

As a consequence of disappointing results in offshore production in China's coastal waters, Beijing directed CNOOC, before it became a transnational, to expand exploration further into the South China Sea, which is an area with overlapping resource claims by six countries: China, Taiwan, Vietnam, the Philippines, Malaysia, and Brunei. The Nansha Islands (Spratlys) are currently the most contested area. China's expansion into the South China Sea, however, is not driven by a single factor, and it is generally understood that the Spratlys' strategic value overshadows their oil potential, estimated by the Energy Information Administration to be 1–7 billion barrels. Available evidence indicates a complex rationale as justification for expansion. Although this expansion is rationalized by the PLA in terms of oil resource needs, Western analysts find the PLA's own internal bureaucratic politics to be shaping its presence there.<sup>36</sup> Expansion is given overall justification with a Chinese version of Lebensraum, *shengcun kongjian* (survival space).

In February 1992, Beijing unilaterally promulgated a territorial waters law claiming the Spratlys and their surrounding waters. Three months later, CNOOC signed a contract with the American company Crestone for exploration in the Vanguard Bank area despite Vietnam's jurisdictional claims, knowing Hanoi would not act against an American company as it progressed in normalization talks with the United States. This petroleum concession was Beijing's way of asserting its jurisdiction in the area. A well, Nanyang 1, was reportedly drilled on Fiery Cross Reef.<sup>37</sup>

China and Vietnam agreed in November 1994 to negotiate a solution to the Spratly dispute, which will probably lead to joint development of the Vanguard Bank area. Participation by a major international oil corporation would bring technology, training, and capital, and would stabilize the joint development. Mobil Oil Corporation is the most likely candidate because it is already drilling for Vietnam in an area near China's claim, and has been told by both sides they intend to resolve their dispute peacefully.<sup>38</sup>

China's disputes with other countries in the region have not been as intense. Among the more promising prospects for joint development are CNOOC discussions with United States-based Chevron Oil Corporation and Taiwan's China Petroleum Corporation on the possibilities of a joint venture for exploration in the South China and East China Seas.

Although Beijing has resisted internationalizing the question of overlapping resource claims in the South China Sea, since 1991 China has participated in multilateral discussions to resolve outstanding issues peacefully. This effort is supported by the Ministry of Foreign Affairs (MFA). At the same time, China has carried out a naval buildup in the area which is supported by the PLA Navy. These contradictory positions derive from the fact that the MFA and the PLA dis-

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<sup>35</sup> '94 *China Petroleum Industry*, Beijing, China Petroleum Information Institute, 1995, p. 25.

<sup>36</sup> John W. Garver, "China's Push Through the South China Sea: The Interaction of Bureaucratic and National Interests," *China Quarterly*, no. 132 (December 1992), pp. 999–1028.

<sup>37</sup> Mark J. Valencia, *China and the South China Sea Disputes*, Adelphi Paper, no. 298, International Institute of Strategic Studies, London, Oxford University Press, 1995, p. 10.

<sup>38</sup> *Ibid.*, p. 38.

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*The expansion of China's offshore exploration into more promising areas seems dependent on both a naval capability and success in multilateral negotiations on joint resource development.*

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tinctly differ on what China's South China Sea policy should be.<sup>39</sup> Most recently, in July 1995 China announced at the ASEAN Regional Forum that it would resolve the Spratly issue through negotiations according to the International Law of the Sea and within multilateral discussions with ASEAN.<sup>40</sup> The expansion of China's offshore exploration into more promising areas seems dependent on both a naval capability and success in multilateral negotiations on joint resource development. It is possible that CNOOC, as it becomes a more autonomous multinational oil corporation, will develop a third set of bureaucratic interests that differ from those of the PLA Navy and the MFA.

CNOOC's overseas activities will be conducted through CNOOC Overseas Oil and Gas Co. Ltd., which only received formal approval from MOFTEC in November 1996. CNOOC plans to produce 1 million tons in its overseas fields by 1998, and by the year 2000 to have 50 to 80 million bbl of overseas recoverable reserves and produce 2 million tons. CNOOC will focus on Iran and Kazakstan's sector of the Caspian Sea for its overseas expansion.

### ***Chinese Petroleum Service Companies***

China Offshore Oil Logging Corporation (COOLC), established in 1981 for offshore China oil logging, formed a joint venture with the Dressor Atlas Wireline Services Co. Ltd. The company had provided services to foreign oil companies in the South China Sea and the Bohai Sea. COOLC launched its first overseas operation in a joint venture with a Russian oil company to provide services to Western and Russian oil companies in Sakhalin. CNPC has also offered labor and engineering services abroad which earned \$206 million in 1993.

China Offshore Geophysical Company (COGC) was created to survey in Chinese waters. Participating in the shift overseas, COGC refitted its small fleet (five bluewater and three shallow water vessels) to capture a share of the international offshore seismic market in India, the Russian Far East, Korea, and Southeast Asia.<sup>41</sup>

### ***Other Chinese Oil Companies***

Capital outflows by Chinese companies are often irregular, unaudited, and unauthorized investments abroad, and overseas profits are not remitted back to China.<sup>42</sup> One means that all Chinese state enterprises have employed is to set up shell companies overseas, especially in Hong Kong, to hide funds and to channel hard currency abroad. Eighty percent of Hong Kong investors in Guangdong are actually mainland enterprises with a Hong Kong shell that allows them to obtain all the benefits of foreign investors.

A number of new Chinese oil companies had been set up in Hong Kong before 1997: Sinolink, Far East Petroleum, Civil Star, Sinojinlink, Callany, and Artland, most of which are linked to

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<sup>39</sup> John Garver, "China's Push Through the South China Sea," *op. cit.*, p. 1025.

<sup>40</sup> Mark J. Valencia, Jon M. Van Dyke, and Noel Ludwig, "The Solution for the Spratly Islands Ought to Look Like This," *International Herald Tribune*, October 10, 1995.

<sup>41</sup> *Offshore*, March 1995, p. 27.

<sup>42</sup> Friedrich Wu, "Stepping Out the Door," *The China Business Review*, November–December 1993, pp. 14–19.

Sinopec's provincial refineries. Mainland Chinese oil companies and refineries claim their Hong Kong subsidiaries are their "windows" to the international market and "windows" to China's domestic market for foreign investors. Industry observers think these Hong Kong firms are a means for getting around the oil import controls and for shifting profits overseas. The Hong Kong "windows" get unofficial approval for their illegal imports into China by making the Chinese state oil companies shareholders in their company. Window companies are used by Sinochem, Sinopec, and Sinoil to help coordinate their international network.<sup>43</sup> It is not certain at this time whether these window companies will continue to function in the same way following the transfer of Hong Kong to China in 1997.

Each of the above-mentioned corporations are the instruments by which Beijing develops bilateral oil relations that have always been driven by a mix of political, economic, and energy goals. As they internationalize, these corporations are becoming increasingly autonomous, which shifts the complex of goals toward corporate purposes.

It is beyond the scope of this paper to explain Sino-Japanese, Sino-Korean, and Sino-Middle Eastern oil relations, but it should be understood that the problems inherent in these bilateral relations have also been important factors driving Sino-Kazak and Sino-Russian cooperation, and making multilateral cooperation in Central Asia and Northeast Asia look like a solution. Specifically, the Chinese have felt that all three Northeast Asian countries—China, Japan, and South Korea—were overly dependent on Middle Eastern oil. China therefore has urged Japan and South Korea to finance oil and gas projects in Russia and Central Asia.

### Sino-Russian Energy Relations

Because the former Soviet Union was China's initial foreign partner in oil exploration, and there remain many traces of the Soviet style of petroleum development in China's oil industry, it could be expected that the transfer of technology to China would resume during the 1990s. Moscow had used the promise of Soviet assistance in ameliorating China's "long energy crisis" as an incentive for improving bilateral relations. One of the earliest was a Soviet offer to build a nuclear power plant, first proposed in 1985 for Shenyang but most recently proposed for Lianyungang. Another was joint development of hydropower plants along the Heilongjiang River similar to the jointly managed plants China has with North Korea on the Yalu River. However, in the oil industry, the Soviet Union's technology was no match for what the international corporations could provide, especially in offshore exploration.<sup>44</sup>

There are two defining characteristics to bilateral energy relations: (1) Sino-Russian rapprochement was initially driven by local border trade and the economic complementarity of the border regions; and (2) Chinese proposals (dating back to 1985) that placed Sino-Russian resource cooperation within a multilateral context that includes Japan and South Korea in Northeast Asian regional cooperation. For example, the Tumen River Basin Area development project, the primary multilateral project in Northeast Asia, supported by the United Nations Development Program, has considered Russia's comparative advantage in the multilateral regime as a supplier of raw materials and crude oil. Earlier discussions on regional pipelines envisioned natural gas supply from Sakhalin. Japan and South Korea were always considered to be sources of investment capital, although both countries remained ambivalent about Tumen. An alternative regional multilateral regime created by the Japanese, the Sea of Japan Rim, envisions a similar division of labor but is centered in Japan's Niigata.

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<sup>43</sup> Reuters News Service, May 3, 1995.

<sup>44</sup> Keun-Wook Paik, *Gas and Oil in Northeast Asia: Policies, Projects and Prospects*, London, The Royal Institute of International Affairs, Energy and Environmental Programme, 1995, pp. 235–237.



Despite the rhetoric of local initiatives and transnational projects, most of the agreements have been bilateral. Moscow and Beijing signed a protocol in October 1986 that covered cooperation in numerous industries including oil and gas. In 1989, bilateral development of onshore drilling technology began. That same year, a Soviet delegation visited Harbin, in Heilongjiang Province, to request technical assistance, petroleum workers, and Chinese oil equipment for the Transbaikal oil transfer depot. In 1993 Daqing Oil Corporation signed an agreement with the administration of the West Siberian Tyumen region to participate in development of the Tyumen oil basin, for which it would receive 2 million tons annually of Tyumen crude oil to be processed at the Daqing Refinery.<sup>45</sup> The Daqing oil field appears to have initiated these arrangements on its own.<sup>46</sup>

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*Russian petroleum product exports have crossed the Sino-Russian border since the late 1980s but remained insignificant until the first half of 1997.*

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In 1991 the Republic of Sakha sent a delegation to Harbin to develop markets for Sakha gas. In the following year, CNPC proposed joint Chinese-Russian-Japanese development of East Siberian oil fields. Russia's far eastern Primorskii Territory signed an agreement with the city of Suifenhe on the Sino-Russian border to establish a joint venture for liquefied petroleum gas (LPG) production. Plans exist for a pipeline from the Sakhalin gas fields to Vladivostok, from where it is expected to connect with a regional gas pipeline.<sup>47</sup> Russian petroleum product exports have crossed the Sino-Russian border since the late 1980s but remained insignificant until the first half of 1997.

In November 1995 a memorandum of understanding was signed between CNPC and Sidanco (the Siberian Far East Petroleum Co., Ltd.) on behalf of the Russian Ministry of Fuel and Energy for the development of a major gas field and pipeline in Russia's Irkutsk oblast. Some controversy arose because Sidanco did not hold a majority share in the gas reserves, and Russian estimates of the gas fields' reserves were much larger than Chinese estimates. Subsequently, Chinese geologists conducted further surveys in expectation of finding sufficient reserves to justify the project. International oil analysts remain unconvinced of the economic logic of the project. Why would China buy Russian natural gas when it could develop its own natural gas more quickly and cheaply if the country implemented price reform?<sup>48</sup> The project is logical only when understood within a multilateral context that expects Japanese and South Korean financing.

All of these agreements anticipate that Russian oil and gas would be transported through pipelines initially planned for Heilongjiang, Jilin, and Liaoning consumption, and eventually extending further to span all of Northeast Asia. Japan and South Korea are expected to provide the investment capital for projects that could meet their own oil and gas demand. South Korea signed an agreement with Russia in 1994 to invest in gas development in the East Siberian Republic of Sakha. Japan will concentrate its investment in Sakhalin offshore oil and gas fields, although progress on the Sakhalin project had been delayed until recently by the territorial dispute and by the lack of a stable tax regime and production-sharing law.

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<sup>45</sup> Alexander Nemets, *The Growth of China and Prospects for the Eastern Regions of the Former USSR*, Lewiston, N.Y., The Edwin Mellen Press, 1996, p. 33.

<sup>46</sup> *Oil & Gas Journal*, May 9, 1994, p. 59.

<sup>47</sup> Keun-Wook Paik, "Energy cooperation in Sino-Russian relations: the importance of oil and gas," *Pacific Review*, vol. 9, no. 1 (1996), pp. 79-87.

<sup>48</sup> Private communication with Al Troner, Asia-Pacific Energy Consulting, Kuala Lumpur, October 1997.



It seemed improbable that China would invest in Russian oil development when overseas investment was initially only 3 to 4 percent of total E&P. More probable were cooperative projects, such as the Sino-Russian Scientific Group, which provided scholarly, scientific input without large capital requirements. The Group has surveyed the hydrocarbon prospects for the entire Northeast Asian region, producing a resource map and report that identified 60 oil producing basins and oil resources totaling 70 billion tons.<sup>49</sup>

The purpose of identifying Northeast Asian resources as a whole is not for bilateral projects but rather for multilateral projects such as that discussed at the March 1995 First International Conference on Northeast Asia Natural Gas Pipelines, held in Tokyo, with participation by China, North Korea, Kazakstan, and Japan. A roundtable discussion, "Possibilities in Future Cooperation," resulted in the Beijing Agreement in September 1996 on regional pipeline development that was signed by China, Russia, Mongolia, South and North Korea, Japan, Kazakstan, and Russia's Irkutsk oblast.<sup>50</sup> The conferences were sponsored by the National Pipeline Research Society of Japan, China National Petroleum Corporation, and the Pan-Asian Natural Gas Pipeline Association of South Korea. The conferences' purpose was to discuss supply and demand of natural gas in the region. The Japanese association advocates a regional pipeline network, the Trans-Asian Natural Gas Pipeline Project, that would link gas fields with consuming markets.

In December 1996, *China Oil, Gas, & Petrochemicals* pondered the potential for transnational natural gas pipeline grids in both Northeast Asia and Central Asia. International joint financing was expected from Japan and South Korea for the Irkutsk-Shandong pipeline since the Chinese readily admitted that the project's cost exceeded both China's and Russia's capacity to finance it. Japanese companies had encouraged the project even though the Japanese government had not.<sup>51</sup> Most Chinese discussions on these grids give the impression that the two regions and the two multilateral projects are conceptually linked, together forming a grid to supply Northeast Asia. This conceptual linkage is important for understanding how Chinese and Russians cooperate in Siberia and compete in Central Asia.

The latter half of 1997 saw three state-to-state bilateral meetings (a shift from nongovernmental organizations and local initiatives that will be essential for shaping a Northeast Asian multilateral energy regime). The first occurred during Russian Prime Minister Chernomyrdin's June 1997 trip to Beijing. China and Russia signed an agreement for gas exploration in Kovyktinskoe gas field in Irkutsk and for a pipeline valued at approximately \$10 billion. This agreement would seem to replace the earlier Sidanco-CNPC deal, although neither is particularly firm. The details had been worked out by Deputy Prime Minister Boris Nemtsov in a meeting of the Russian-Chinese Intergovernmental Commission. Nemtsov also met with CNPC officials and Chinese Premier Li Peng, and noted that energy projects were a key component of Sino-Russian relations. The gas deal would require a pipeline that would be built from Irkutsk to China and supply 20 billion cubic meters of gas annually for 25–30 years. Earlier discussions had been for a 4,070 km pipeline that would span China's northeast provinces, but the final agreement was for a 3,000 km pipeline that would bypass the northeastern provinces and run through Inner Mongolia, extending eastward to Shandong Province and South Korea. This agreement appeared to cut out Heilongjiang, and Chinese sources at that time do not mention Japan as a final destination. There were some issues to be finalized in discussions characterized as "intense" before President Yeltsin's trip to Beijing in November 1997.

Although neither the Chinese nor Russians would discuss the deal in further detail with the international media, it was clear that the pipeline from Irkutsk would be the beginning of the

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<sup>49</sup> *China Petroleum Newsletter*, vol. 3, no. 19 (Sept. 19, 1996), p. 7.

<sup>50</sup> *China Petroleum Newsletter*, vol. 3, no. 21 (Oct. 17, 1996), p. 1.

<sup>51</sup> "Cross-country Gas Pipeline Grid, Cross-century Dream," *China Oil, Gas & Petrochemicals*, vol. 4, no. 24 (Dec. 15, 1996), pp. 1–3.

proposed Northeast Asian pipeline infrastructure. CNPC confided to one Chinese publication that finance would not be a problem because there were several international companies interested in funding the project and that a Korean company was lobbying CNPC to become a shareholder. A second project still under discussion is a gas pipeline from Tomsk in western Siberia to Shanghai via Kazakstan. This would be in addition to a proposed 8,000 km natural gas pipeline from Turkmenistan via Uzbekistan and Kazakstan to Lianyungang in China's Jiangsu Province that would extend to Japan at Kitakyushu.

Soon after this agreement was signed, Japanese Prime Minister Hashimoto announced his Eurasia diplomatic policy in July 1997. Hashimoto intended to define Japan's role in the region and integrate Japan's bilateral relations with Russia and China into a broader Northeast Asian multilateral arrangement. Japanese investment and development of the Irkutsk natural gas field and the pipeline were the "economic prop" to the Eurasia policy.<sup>52</sup> Japan National Oil Corporation (JNOC) formed a group of 10 Japanese corporations to investigate the Kovyktinskoe gas field. The Second International Northeast Asia Natural Gas Pipeline Conference met in Beijing in September 1997 and discussed a regional gas pipeline.

The second bilateral meeting of significance was the November 1997 Krasnoyarsk summit between Russia's President Yeltsin and Japan's Prime Minister Hashimoto. They discussed Irkutsk's Kovyktinskoe gas field and Japanese financing of energy projects in Siberia and the Russian Far East. Hashimoto promised that Japan would support Russia's bid for membership in APEC at the November 1997 meeting, the first time Japan had officially indicated support.

The third meeting significant for regional energy cooperation was President Yeltsin's trip to Beijing, November 9–11, 1997. This was the fifth Sino-Russian summit and the highlight was the finalization of a border accord, a process that began in 1991. Prior to his trip, Yeltsin claimed that his visit was to promote energy projects, which were essential to Sino-Russian relations. Within Yeltsin's entourage were several governors from the Russian Far East and a leading member of parliament, Vladimir Lukin, who stated that energy production would allow Russia to become a key nation in Northeast Asia. This has been a controversial point for many Russian nationalists who, fearing a colonial relationship with Asian countries, resented Russia's role in Northeast Asia as a supplier of raw materials. Notably absent from Yeltsin's entourage was Primorskii Territory Governor Yevgenii Nazdratenko. Xenophobic, anti-Chinese, and opposed to Russia's role as supplier of raw materials, Nazdratenko has actively opposed the Tumen River Development project. Yeltsin also visited Harbin, the capital of neighboring Heilongjiang Province, perhaps to undo some of Nazdratenko's negative diplomacy.

Because bilateral trade had only reached \$7 billion in 1997, it is hoped that the gas pipeline can be the kind of "big ticket project" that will "kick-start" Sino-Russian trade. Deputy Prime Minister Nemtsov arrived in Beijing before Yeltsin and met with Chinese oil executives for discussions on the pipeline. Nemtsov and Chinese Vice Premier Li Lanqing signed a framework accord for the pipeline: a general framework that would leave details, such as the financing of the project, to be finalized in further documents. Japan was mentioned as a source of financing and an export destination. Of the 20 billion cubic meters the pipeline is expected to carry, China would take half, leaving 10 billion cubic meters for South Korea and Japan to share between them. The Nemtsov-Li accord proposes that the project be completed in 30 months at a cost of \$12 billion.

The APEC meeting at the end of November 1997 was also discussed. A primary goal of Sino-Russian relations is to create a multipolar world in which no one country is dominant. Yeltsin

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<sup>52</sup> *Asahi Evening News*, October 28, 1997, p. 8.

has stated his policy is not directed at the United States but rather is meant to create a harmonization of relations between the four great Pacific powers—the United States, Japan, China, and Russia. The aim is to gain widespread acceptance of Russia as a Pacific power. The day after Yeltsin's visit, Li Peng left for discussions in Tokyo, where he proposed that China and Japan push for a multilateral four-power forum for cooperation and coordination in the Asia-Pacific. This proposed forum would presumably be outside of the APEC structure.

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Russians have for many years proposed that China is Russia's pathway to the Asia-Pacific. This is meant in a physical infrastructural sense but also in a geopolitical sense—Russia and China need each other to balance the United States and Japan in the Asia-Pacific. In January 1994 then-Foreign Minister Kozyrev had requested Chinese assistance with Russian political integration into the Asia-Pacific. Russian Prime Minister Chernomyrdin indicated in May 1994 that Sino-Russian cooperation in the Asia-Pacific would take priority over potential Sino-Russian competition in the Central Asian region. During his visit to Beijing, he stated that Sino-Russian relations in the Asia-Pacific were of paramount importance and that "China's growing weight in Asia and its ties with the states of Central Asia did not worry Russia at all."<sup>53</sup> Because of this prioritization and conceptual linkage, economic competition in Central Asia can occur, within acceptable limits, without undermining Northeast Asian energy cooperation.

These three bilateral meetings in the latter half of 1997 and Japan's announcement of its Eurasia policy helped to shape a Northeast Asia multilateral regime whose foundation would be energy cooperation. (An additional bilateral meeting during this time between Jiang Zemin and President Clinton was also important for energy cooperation.) There has been no multilateral forum created for the management of this regime, which leaves its formation to the work of nongovernmental organizations and a particular sequence of bilateral official meetings, with much of the goals and purposes not transparent. The lack of transparency prompted a visit to Beijing by United States Deputy Secretary of State Strobe Talbott during Yeltsin's visit. Talbott met with Foreign Minister Qian Qichen and Vice Foreign Minister Zhang Deguang, a Chinese Russia specialist, to probe Russian-Chinese intentions.

In late December 1997, Russia, Japan, China, South Korea, and Mongolia attempted multilateral talks in Moscow on Irkutsk's Kovyktinskoe gas field and the regional pipeline. These talks did not resolve the important question of how the project would be financed. Japanese and South Koreans indicated they want exclusive rights to prospect the Kovyktinskoe field. Russia wants a consortium with no exclusive rights for any participant. It was agreed a feasibility study was needed.

Although a Northeast Asian energy regime was initially conceived of in the Tumen and the Sea of Japan Rim projects, the agreements that emerged far exceeded the local-level framework of these projects. Since Russia gained membership in APEC, multilateral arrangements for Northeast Asia energy cooperation could logically be managed within APEC. This would allow for greater transparency and additional international participation in the gas project.

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<sup>53</sup> *ITAR-TASS*, May 27, 1994, in FBIS-SOV-94-104, May 31, 1994, pp. 11–12.

## Sino-Central Asian Energy Relations

Sino-Kazak oil cooperation has evolved in a way that surprised the world because Kazakhstan has always downplayed relations with China, perhaps to assuage Russian concern. Kazakhstan hopes to become a major oil and gas producer. It has estimated oil reserves of 8.2 billion tons and natural gas of 2 trillion cubic meters. In 1996 Kazakhstan produced 23 million tons of crude oil and plans to produce 170 million tons by 2010, which would make it the sixth largest oil producer in the world.

Sino-Central Asian economic cooperation has evolved in the context of a multilateral security dialogue to reduce military forces along the borders between China and the newly independent states and to promote confidence building. Three Central Asian countries—Kazakhstan, Kyrgyzstan, and Tajikistan—participated in a Russian-led joint delegation. By January 1995 these disarmament talks had held their 14th session, which was followed by the issuance of a Chinese government statement on security assurance to Kazakhstan. The statement declared that China would not use nor threaten to use nuclear-weapons against non-nuclear weapon states such as Kazakhstan.<sup>54</sup>

Although China recognized a Russian strategic hegemony in Central Asia, Kazakhstan appeared ambivalent in 1995. The first draft of Kazakhstan's constitution referred to a policy of neutrality while the final draft did not. A scholar at Kazakhstan's Strategic Studies Institute maintained that neutrality was only a fiction because Kazakhstan could not defend itself against aggression from Russia or China. Kazakhstan, as a signatory to the Tashkent Collective Security Treaty, was under Russian protection and Kazaks had never objected to military integration with Russia. According to this scholar the "China threat" had been "heavily mythologized" in Kazak consciousness. In fact, Kazakhstan needed foreign investment and trade from China. The Russian politicians who complained that Kazak government officials were allowing Russia to be squeezed out and displaced by China did not recognize that it was an "objective process" rather than a question of choice. Economic integration with Russia, he argued, is a "union of the destitute." He felt Kazakhstan had not yet found a satisfactory balance between sovereignty and interdependence.<sup>55</sup>

The expanding Chinese economic presence that does not challenge Russian strategic hegemony has continued to the present. By the end of 1997, according to a Kazak economist at the Institute for Development of Kazakhstan, "Militarily and strategically, Russia is not worried about our relations with China, but Kazakhstan's reorientation of its economy toward China and the West is another matter."<sup>56</sup>

According to Russian sources, Beijing had Russia's tacit consent to establish direct links with the republics.<sup>57</sup> China has become a major trade partner for many of the Central Asian states since they became independent. There seems to be a shared understanding that China's expanding presence in Central Asia was acceptable as long as it was limited to an economic presence. Beijing and Moscow have a common interest in maintaining stability in Central Asia and preventing a fundamentalist Islamic movement in the region. There is an implicit joint hegemony emerging.

China and Kazakhstan at the end of 1991 signed a five-year intergovernmental economic and trade agreement that reduced tariffs on imports and exports and proposed 80 projects for greater

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<sup>54</sup> *Xinhua*, February 8, 1995, in FBIS-CHI-95-026, February 8, 1995, p. 3.

<sup>55</sup> Interview with Murat Laumulin by Mikhail Ustyugov, "There is No Realistic Military Threat to Kazakhstan Today," *Ekspres-K* [Almaty], August 18, 1995, p. 3, in FBIS-SOV-95-170-S, September 1, 1995, pp. 81-82.

<sup>56</sup> Carol J. Williams, "'4 Winds' Blow Kazakhstan to Foreign-Policy Middle Ground," *L.A. Times*, November 15, 1997, cited in Johnson's Russia List, #1369, November 15, 1997.

<sup>57</sup> Yuri Peskov, "Russia and China: Problems and Prospects of Cooperation with CIS Members in Central Asia," *Far Eastern Affairs*, no. 3 (1997), p. 12.



cooperation. The following year an agreement was signed permitting the establishment of a network of Chinese shops in Kazakstan. Hundreds of Chinese technicians found employment there, replacing the skilled Russians emigrating from Kazakstan. By 1993 Kazaks were alarmed at the thousands of Chinese “invading” their country—setting up shops and buying up apartments—many there illegally on expired and false visas, or through fake marriages to Kazaks. In 1993 unofficial claims were made that 300,000 to 350,000 Chinese lived in Kazakstan.<sup>58</sup> Han Chinese migration to Kazakstan is fed by the growing Han population in Xinjiang. Approximately 250,000–300,000 Han, part of the floating population in China, drift into Xinjiang each year, exacerbating resentment on the part of the Uighur minority at the shift in the ethnic balance.

President Nursultan Nazarbayev of Kazakstan visited Beijing in October 1993 with a mission to increase trade, investment, and technology transfer from China. China’s Ministry of Foreign Trade and Economic Cooperation promised that Chinese investment in large projects in Kazakstan would expand beyond the small traders from Xinjiang who traded inferior goods. MOFTEC encouraged Kazakstan to engage in economic cooperation with China’s coastal area and to benefit from the advanced industries there, rather than concentrate exclusively on Xinjiang.<sup>59</sup> The Kazak ambassador to the PRC stated what the *quid pro quo* with Beijing entailed: The newly established China-Kazakstan rail link would connect the Asia-Pacific and the Silk Route economies, giving Kazakstan access to the sea through Chinese territory and China access to the states of Central Asia and West Asia (Iran and Iraq).<sup>60</sup> While in Beijing, Nazarbayev encouraged Chinese oil companies to undertake joint exploration in Kazakstan and promised he would no longer harbor Uighur separatists in his country.

When Li Peng made his tour through Central Asia in April 1994, he had in his entourage a number of Chinese businessmen, one of whom was vice-president of CNPC, Zhang Yongyi. CNPC signed letters of intent and boosted Sino-Central Asian oil cooperation with all the Central Asian republics. Zhang proposed that CNPC had advantages in petroleum exploration and development in Central Asia because of proximity, because Chinese technology was appropriate for Central Asia’s needs, and because China and Central Asia were making the transition from planned to market economies. He claimed this created a special mutual understanding in Sino-Central Asian relations.<sup>61</sup>

When Li Peng visited Turkmenistan, the Turkmenistan-China-Japan natural gas pipeline was discussed and a letter of intent was signed between CNPC and the Turkmenistan Ministry of Oil and Gas to set up a commission to study the matter. The following year CNPC, Exxon, and Mitsubishi signed an agreement to build a gas pipeline that would extend from Turkmenistan through Uzbekistan, Kazakstan, China, and South Korea, to Japan.

It was clear by 1994 that Sino-Kazak petroleum trade has strong complementarity. In Xinjiang, production exceeds demand—creating petroleum product surpluses that have increased as new refinery capacity has come on line. In 1991, gasoline production reached 32,800 b/d but consumption was only 18,300 b/d; diesel production was 31,000 b/d while consumption was 20,400 b/d. Beijing viewed Kazakstan as a market for Xinjiang’s petroleum products. These Xinjiang surpluses were needed in Kazakstan, where demand for gasoline exceeded supply by 14,200 b/d, and by 27,000 b/d for diesel fuel. The deficits must be covered by imports which have traditionally come from Russia, an often unreliable source.<sup>62</sup> Xinjiang’s surplus petroleum products now

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<sup>58</sup> Viktor Kiyanitsa and Vladimir Gubarev, “Chinese immigrants find a foothold in Kazakhstan,” *Moscow News*, no. 38, September 17, 1993, p. 15.

<sup>59</sup> *China Daily* [in Chinese], October 20, 1993, p. 2, in FBIS-CHI-93-201, October 20, 1993, p. 8.

<sup>60</sup> China Radio International [in Russian], October 17, 1993, in FBIS-CHI-93-201, October 20, 1993, p. 8.

<sup>61</sup> Chang Weimin, “CNPC Looks Abroad for Oil Business,” *China Daily*, May 8–14, 1994, p. 1.

<sup>62</sup> “Sino-Kazakh Petroleum Trade Could Take Off,” *Petroleum Economist*, January 1993, p. 33.

must be shipped by rail to the Lanzhou refinery, 1,000 miles away. Shipment to Kazakhstan could utilize the newly built rail line, the so-called “Second Eurasian Continental Bridge,” and would be a much shorter distance.

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Differences existed between Kazakhstan and China over where to process natural resources. Kazaks wanted their resources processed domestically, although the distillation capacity of Kazakhstan’s three refineries is only 390,000 b/d. The Chinese argued that China has a comparative advantage in processing, while the Central Asian republics had a weak capability to process their own resources, thus China should process Central Asian resources.<sup>63</sup> Kazaks do not want to replace Russia with China in a colonial relationship in which they remain a supplier of raw materials. Beijing, however, had promised Xinjiang Province that it could develop a petrochemical industry rather than remain only a raw materials supplier. Xinjiang’s refineries—Urumqi, Karamay, Dushanzi, and Zepu—had a total crude processing capacity of 8.5 million tons. Output reached 10 million in 1995 after the new Korla refinery came on line. By 1994, China exported a very small amount (8,141 tons) of petroleum products to Kazakhstan, and imported an even smaller amount.

Although the Chinese conceived of energy cooperation with Kazakhstan in a natural economic territory they called the “Northwest Economic Circle,” China seemed like a fairly small player in Kazak oil production. It was only in multilateral projects that China was significant, such as the Turkmenistan-China-Japan natural gas pipeline project that would include Kazakhstan. Kazakhstan had sought numerous foreign partners as alternatives to Russia, claiming that Moscow was using a coercive oil policy to force Kazak integration into the CIS.<sup>64</sup> Until alternative pipelines were built, Moscow could block the flow of oil into or out of Kazakhstan.

In August 1995 a Kazakhstan petroleum delegation met with officials from CNOOC for the first time to discuss joint exploration in the Caspian Sea.<sup>65</sup> CNOOC sent consultants to Kazakhstan to introduce Chinese methods of cooperation with foreign companies in offshore oil development. The following month, China and Kazakhstan signed 40 agreements on cultural, economic, security, and technological cooperation—among which was an agreement for an oil pipeline that would connect Kazakhstan with China’s coastal area.

The potential benefits from transnational oil cooperation were incentives that had driven the confidence-building process. Border issues were resolved in a multilateral forum, the Sino-CIS disarmament talks, lasting four years and culminating in the Sino-Russian-Central Asian confidence-building agreement in Shanghai, April 26, 1996. Five nations (Russia, China, Kazakhstan, Kyrgyzstan, and Tajikistan) signed this treaty for confidence-building measures along their common borders. By June 1996 the Chinese had included Russia and Central Asia into their concept of the “Pan-Asia Continental Oil Bridge” and CNPC president Wang Tao that month went to Moscow to discuss the gas pipeline from Siberia.<sup>66</sup>

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<sup>63</sup> Chang Qing, “Brief Analysis on China’s Relations with the Five Central Asian Nations,” *Foreign Affairs Journal*, no. 33 (September 1994), p. 37.

<sup>64</sup> Stephen Blank, “Energy, Economics, and Security in Central Asia: Russia and Its Rivals,” unpublished paper, December 1994.

<sup>65</sup> *China Petroleum Newsletter*, August 2, 1995, p. 6.

<sup>66</sup> Beijing XINHUA, June 16, 1996, in FBIS-CHI-96-117, June 16, 1996.



In June 1997, almost two years after Almaty and Beijing had signed their pipeline agreement, CNPC surprised the international oil industry by outbidding Texaco, Amoco, and Russia's Yuzhny Most to acquire 60 percent of Kazakhstan's Aktobemunaigaz company for \$4.3 billion. This was the largest overseas investment CNPC had made to date. CNPC won the bid because it committed to building a pipeline to Xinjiang that would lessen Kazak dependence on Russian pipelines.

CNPC promised to extend the pipeline further if it won a bid for the Uzen field, and on August 1, 1997, China obtained exclusive rights to negotiate for the Uzen field, outbidding Amoco and Petronas of Malaysia. The initial United States response was surprise since Amoco had felt it had an inside track on the bid. The company had intended to become a major player in Kazak oil. If accomplished, Amoco's production worldwide would have increased by 10 percent.<sup>67</sup> The West indicated concern with China as a "Resource Warrior," raising questions about China's geopolitical ambitions in Central Asia. Chevron, on the other hand, planned to benefit from the proposed Chinese pipeline, which would give its Caspian Sea oil an alternative route out of Kazakhstan and access to Asian markets.<sup>68</sup> To test transporting oil through China prior to the pipeline's completion, Tengizchevroil signed an agreement with Sinochem to ship oil by rail through China on a trial basis at the end of 1997.

On September 24, 1997, during Li Peng's visit to Almaty, Kazakhstan and China signed an oil deal worth \$9.5 billion for CNPC to develop the Uzen and Aktyubinsk oil fields. Two pipelines were agreed upon: a 3,000 km pipeline to western China and a 250 km pipeline running south through Turkmenistan to the Iranian border. The large pipeline should be operational in five years and transport 500,000 b/d. Discussions on the smaller pipeline have not progressed as far. Uzen crude oil is similar to Chinese domestic crude and would not require refinery upgrading as Middle Eastern crude does.

International oil analysts have questioned the economics of this pipeline, which has a planned capacity of 20 million tons per year. The president of CNPC International Kazakhstan has indicated that the pipeline is open to foreign companies operating in Kazakhstan, which would improve the economics by increasing the volume, and that there might be further volume if China participated in offshore oil tenders. CNPC International Kazakhstan claims that several U.S. companies have approached CNPC about using the pipeline to transport Caspian Sea oil to China's domestic markets.<sup>69</sup> Other companies were interested in participating in the construction of the pipeline. In this sense, all Sino-Kazak bilateral oil cooperation is open to third country participation and linked to multilateral projects.

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<sup>67</sup> "Amoco makes its play for Kazak role," *Platt's Oilgram News*, vol. 75, no. 50 (March 13, 1997), p. 1.

<sup>68</sup> "Chevron likes idea of a Kazakhstan to China pipe," *Platt's Oilgram News*, vol. 75, no. 111 (June 10, 1997), p. 2.

<sup>69</sup> Mike Collett-White, "Kazak China Oil Pipeline Open to Foreign Firms," *Reuters News Service*, Almaty, October 2, 1997.

trol. Kazak-Russian relations remain tense over the issues of Caspian Sea oil and Kazakhstan's energy debt to Russia. Kazakhstan's foreign minister claimed, "The project which will work faster will become the top priority project for us."<sup>70</sup>

### Challenges and Benefits for U.S. Interests

Is China's concept of energy security—positioning itself between Middle Eastern, Central Asian, and Russian supply and Northeast Asian demand—compatible with U.S. policies for energy and environmental security? Is China's net oil importer status and increasing interdependence with Russia and Central Asia threatening the formation of a bloc that might exclude American corporations?

For the United States, the oil and gas resources of the Caspian are of strategic importance second only to those of the Middle East. U.S. policy therefore encourages diversification of energy supply and multiple pipelines from Central Asia. The United States should also encourage Northeast Asian net oil importers to be less dependent on imports from the Middle East. The United States has made it a major policy goal to combat global warming by converting domestic coal-fired utility plants to natural gas and to encourage China to restrict its emissions of greenhouse gases. To some degree, Chinese foreign relations in Central Asia and Northeast Asia have contributed to these policy goals.

Since the early 1970s, the United States and Japan have actively attempted to encourage Chinese integration into the international oil market—promising assistance, technology, and investment. It has not been a smooth integration, but it should be viewed as a policy success for the United States and Japan that the Chinese oil industry has internationalized.

Cultural conservatives within China dream that China might once again become a self-sufficient oil producer and hope that China's domestic proven oil reserves can be expanded with further exploration. Their expectations depend on a major find in Xinjiang's Tarim Basin. Dr. Wang Tao, former president of CNPC, promoted this scenario, calling the Tarim "The Great Hope of China's Oil Industry," a slogan that oilfield workers wore on their t-shirts. These hopes have been reinforced by many Japanese and South Korean analysts who speak of the need to increase China's self-sufficiency in oil. If China reduced imports and exports, Chinese oil demand would be of less concern to Northeast Asian consuming countries and have less of an impact on Asia-Pacific oil markets. This argument is made by proponents of a Northeast Asian Energy Charter, a multilateral regime that would facilitate South Korean and Japanese investment in Chinese and Russian oil and gas projects.<sup>71</sup> If the regional consuming countries provided sufficient investment to develop Xinjiang's oil fields and transport their output throughout the domestic economy by a pipeline network, it is quite likely that China would be less dependent on oil imports and there would be less concern with China's oil importer status.

Yet China's most probable oil future is that of a net oil importer. Controversy has arisen over what the foreign policy consequences of this trend will be and how it will affect U.S. interests. To some degree, questions about China's oil relations are viewed through the interpretive frameworks that have informed the ongoing debates in the United States over how to decipher Chinese foreign policy behavior. Simplifying a complex debate somewhat, opinions can be sorted into three variants.

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<sup>70</sup> Sergei Kozlov, "An Intergovernmental Commission Convenes to Resolve Kazakhstan-Russian Contradictions," *Nezavisimaya Gazeta*, Almaty, Oct. 7, 1997.

<sup>71</sup> Keun Wook Paik, *Oil and Gas in Northeast Asia*, *op. cit.*

### ***The “China Threat” Foreign Policy Consequence***

The “China threat” scenario has been presented recently by analysts who are concerned with the regional ramifications of China’s net importer status.<sup>72</sup> This alarmist scenario predicts a diminishing regional oil market that Northeast Asian powers, all net importers, will contend for, provoking geopolitical rivalries. Energy rivalries would become not just an economic problem but a security threat. The “China threat” thesis contends that by 2010, East Asian importers as a whole will be 95 percent dependent on Middle East oil and could draw both regions into an alliance of non-Western powers. China would become implacably aggressive, driven by a voracious thirst for oil that could not be sated. The result would be destabilizing to the Asian market. To protect potential offshore oil fields, the PLA-Navy would develop a blue water capability that would allow Beijing to use force in the South China Sea, East China Sea, and Indian Ocean. Tokyo would respond with a corresponding capability for force projection. Regional conflict would be inevitable.

Sino-Japanese geopolitical rivalry would be expected over diminishing oil resources as China becomes increasingly dependent on the Middle East for crude oil imports, projected to be 92 percent of total imports by 2005. This pessimistic scenario precludes Sino-Japanese cooperation and claims that Japan’s policy of developing interdependence with China is not sufficient to check Chinese aggression.<sup>73</sup> The Chinese state is portrayed as having sufficient capacity to intervene at will in foreign trade, and to restrict oil imports and promote oil exports to further its foreign policy goals. Interestingly, the expectation of inevitable Sino-Japanese conflict is not one that is widely shared in Japan or China, but rather is promoted by analysts in Taiwan, the United States, and Southeast Asia.

The alarmist solution is for the U.S.-Japan alliance to be strengthened to protect the sea lanes stretching from the Middle East to East Asia. It is suggested that the United States and Japan restrain Chinese oil imports, moderating and stabilizing China’s entry into the global economy through balance of power politics and a renewed U.S.-Japan alliance against China but with the goal of “engagement,” integrating China into the international system.<sup>74</sup>

At its most extreme, the “China threat” scenario presents China as a rising Asian hegemon with designs to displace the United States as the dominant power in the region, on a course that augurs a “coming conflict with America.” This scenario places China at the center of an informal network of non-Western states that stretches from North Africa through the Middle East and Central Asia to the Russian Far East, all of which are united in opposition to United States global hegemony. The United States-Japan alliance is urged to use military force to block China’s emergence as a hegemon, an emergence that is driven by traits of national character: “...a wounded nationalism, a sense of unredeemed historical suffering, and a powerful suspicion of foreigners.”<sup>75</sup> This scenario would produce an argument for containment of the Pan-Asia continental oil bridge, China’s strategy to situate itself between Middle Eastern, Russian, and Central Asian oil supply and Northeast Asian oil demand.

Drawing on national character as a determining factor, China is predicted to become a threat because it is the inherent nature of an authoritarian regime to engage in hostile overseas adventures. This thesis assumes that the role of economic hegemon will permit China to reject the

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<sup>72</sup> Kent Calder, “Asia’s Empty Gas Tank,” *Foreign Affairs*, vol. 75, no. 2 (March/April 1996), pp. 55–69.

<sup>73</sup> Gerald Segal, “The Coming Confrontation between China and Japan?” *World Policy Journal*, vol. X, no. 2 (Summer 1993), pp. 28–29.

<sup>74</sup> Kent Calder, “Asia’s Empty Gas Tank,” *op. cit.*, p. 66.

<sup>75</sup> Richard Bernstein and Ross H. Munro, “The Coming Conflict with America,” *Foreign Affairs*, vol. 76, no. 2 (March/April 1997), pp. 18–32.

vulnerability of interdependence, that China “will be even less dependent on outside suppliers as its economy continues to develop.”<sup>76</sup>

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The flaw in the logic of the “China threat” thesis is the assumption that China is not moving toward greater interdependence and could withdraw, through sheer political will, from the international oil market. Although China may position itself in the center of Middle Eastern supply and Northeast Asian demand, it is not a hegemon in these relations but rather is dependent on countries in these regions to a degree that creates some discomfort among Chinese. This thesis also overlooks the recent Chinese policy to lessen dependence on imports from the Middle East.

### ***The “China Disintegrates” Foreign Policy Consequence***

China also presents a threat in this scenario, but from weakness rather than growing economic and political power. Disintegration is expected to result from increasing regional disparities and would further increase those disparities as regions with a high per capita GDP separated themselves from the poorer regions. Scholars that predict China’s collapse by the year 2010 rely on analogies with past historical patterns of dynastic decline and regional warlordism.<sup>77</sup> Some see China “deconstructing” as the result of increased provincial autonomy.<sup>78</sup> Other scholars refute these predictions on the imminent collapse of China and claim that the economic reforms have narrowed rather than widened the gap between the interior and the coast.<sup>79</sup>

Xinjiang’s separatist movement opposes the exploitation of Xinjiang’s petroleum resources and their shipment to Han China. The separatists draw on the claim that these resources belong to the minority Uighur population in Xinjiang. The Uighur argument is that there is a scissors’ effect in Xinjiang’s economic relations with wealthier areas. Beijing counters that Xinjiang is a net recipient of central government budgetary allocations.<sup>80</sup> The United Nations Human Rights Commission in March 1996 issued a report on the exploitation of Xinjiang’s resources that claimed the central government plans to force Xinjiang to hand over 80 million tons of petroleum and 40 million tons of grain during the Ninth Five-Year Plan (1996–2000). The State Planning Commission denied this. It claimed that most of the 14 million tons produced in Xinjiang in 1996 was processed and used locally.<sup>81</sup> In any case, according to Chinese law, all mineral resources belong to the central government. During the Ninth Five-Year Plan, Beijing will invest 75 billion yuan (US \$9.06 billion) in Xinjiang, primarily in infrastructure and resource development, and will send 2,000 Han cadres and specialists in economic development (who may exacerbate the situation).

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<sup>76</sup> Denny Roy, “Hegemon on the Horizon? China’s Threat to East Asian Security,” *International Security*, vol. 19, no. 1 (Summer 1994), pp. 149–168.

<sup>77</sup> Jack A. Goldstone, “The Coming Collapse of China,” *Foreign Policy*, no. 99 (Summer 1995), pp. 35–52.

<sup>78</sup> David S.G. Goodman and Gerald Segal, eds., *China Deconstructs: Politics, Trade and Regionalism*, London, Routledge, 1994.

<sup>79</sup> Yasheng Huang, “Why China Will Not Collapse,” *Foreign Policy*, no. 99 (Summer 1995), pp. 54–68.

<sup>80</sup> “Open the Doors, Utilize Global Means, and Accelerate the Pace of Developing Xinjiang: On the Proper Way To Develop the Minority Nationality Regions’ Resources,” *Xinjiang Ribao*, December 1, 1995, p. 1, in FBIS-CHI-96-024, December 1, 1995.

<sup>81</sup> *Xinhua* (Beijing) in English, March 26, 1997, in FBIS-CHI-97-085, March 26, 1997.



Energy cooperation projects with neighboring countries are intended to provide peace and security along the border areas. However, by increasing the economic importance of the border regions, these transnational projects concurrently make tempting targets for separatist violence. It is not coincidental that Uighur separatists have recently attacked oil installations and the Han Chinese workers moving into Xinjiang. Approximately 100,000 Han oil workers have migrated to Xinjiang, while unemployment among young Uighur men remains very high. If Chinese policymakers do not make stakeholders of the Uighur population in the Xinjiang oil industry and the pipeline project, the pipeline will be a source of instability rather than enhancing security, making it difficult to attract foreign financing. The Russian experience in Chechnya is instructive.

The disintegrationist scenario errs in assuming it would be the wealthy provinces that would separate themselves from the burden of being net donors to the central budget. Wealthy provinces such as Guangdong and the coastal region have virtually no oil resources and need the oil output of poor areas such as Xinjiang. The pipeline from Kazakhstan and Xinjiang to the coastal region should contribute to greater domestic integration in China. In 1990, when asked about Xinjiang's role in the "Northwest Economic Circle," an official of the State Planning Commission's Regional Department told the author that his department wanted Xinjiang to link with the world economy through the coastal region rather than towards the Islamic world in order to promote integration of the domestic economy.

### ***The Interdependence Foreign Policy Consequence***

There are many indications that China will participate in multilateral regimes to resolve conflicts. This requires not only "engagement" with China to draw the country into the international order, but also encouragement of active Chinese participation in international rule-making to reduce the degree of Chinese dissatisfaction with international regimes.<sup>82</sup> The interdependence argument contends that potential Chinese aggression will be deterred by constraints of the international economy, multilateral regimes, and the need for foreign investment and markets. These constraints, it is argued, make the China threat "illusory."<sup>83</sup>

Japan's China policy promotes Sino-Japanese economic interdependence, which is expected to create greater policy transparency in political, economic, and military affairs. Japan provided technical and financial support for oil field development in Xinjiang not necessarily for Japanese demand but to assist China so that the latter would not upset the global balance in oil supply and demand. Japanese investment in the Russian oil industry, onshore in East Siberia and offshore Sakhalin, has multiple goals. Not only do Japanese policymakers hope to secure oil imports for Japan, but they also want to meet Chinese demand, maintain the global balance, and reduce dependency on the Middle East.<sup>84</sup>

Moreover, China's contribution to global warming has been an ongoing concern. Japan especially has experienced the impact of China's coal-fired industrialization in the form of growing acid rain spanning the Northeast Asian region. This is an important motive for the Japanese to encourage and help finance a natural gas pipeline from Russia to China. Sino-Japanese cooperation in the United Nations, in the Cambodian conflict, on the Korean peninsula, and policy consultations on China's membership in the WTO would suggest a pattern that has been carried over into energy resource cooperation. Chinese recognize that Sino-Japanese interdependence has benefited China materially, while for Japan the benefit is a reduction of threat.

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<sup>82</sup> Robert Ross, "Beijing as a Conservative Power," *Foreign Affairs*, vol. 76, no. 2 (March/April 1997), pp. 33-44.

<sup>83</sup> Michael G. Gallagher, "China's Illusory Threat to the South China Sea," *International Security*, vol. 19, no. 1 (Summer 1994), pp. 169-194.

<sup>84</sup> Hisahiro Kanayama, *The Marketization of China and Japan's Response: Prospects for the Future*, Tokyo, Institute for International Policy Studies, 1993, pp. 25-27.

With regard to oil interdependence, one oil analyst argues that China's dependence on Middle East oil has some positive aspects because this gives Beijing an interest in the Middle East's political stability, which could cause China to find common ground with the United States and Japan. This could lead to greater Sino-American cooperation in maintaining peace in the Middle East since an interruption in oil supply would hurt the United States, Japan, and China. If China invested heavily in joint ventures that would give it a stake in Middle East stability, Beijing's trade in missile proliferation and nuclear technology, meant to pay for oil imports, would be viewed as against China's long-term interests. Thus a shared dependence on Middle Eastern oil could further the Sino-American dialogue and be a force for stability.<sup>85</sup>

How overly optimistic this assessment is depends on which set of actors will prevail in China's foreign relations with the Middle East. The arms-for-oil barter was carried out by industries controlled by the PLA, while it is Chinese oil corporations that are considering long-term investment in the Middle East. As suggested in the case of the Spratlys, where the Ministry of Foreign Affairs and the PLA-Navy pursued different foreign policies, CNPC and CNOOC could provide still a third set of interests in the Middle East and in Kazakhstan. As these state oil enterprises become transnational corporations with expanded autonomy to pursue corporate goals, they could be expected to have greater weight in the mix of economic, political, energy, and military goals that make up Chinese foreign policy. The Japanese are supportive of any framework that might be established among the United States, China, and the Middle East that would promote greater interdependence. This framework with the Middle East is implicitly linked with proposed Northeast Asian multilateral energy cooperation regimes.

Increasing oil interdependence requires a multilateral framework for managing transnational cooperation. China would comply with a multilateral regime only if it is a participant in the writing of the regime's rules.<sup>86</sup> Participation in a multilateral regional oil regime makes China a stakeholder in a stable international system and could be expected to reduce any threat that Chinese dependency on the international oil market might carry.

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*There are major impediments to China withdrawing from the international oil market: China's transnational oil corporations, the proposed pipelines in Central Asia and Northeast Asia, pending foreign investment in the refining industry, and joint ventures in China's petroleum industry.*

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China's net oil importer status is a critical factor in the country's interdependence with the international economy. There are major impediments to China withdrawing from the international oil market: China's transnational oil corporations, the proposed pipelines in Central Asia and Northeast Asia, pending foreign investment in the refining industry, and joint ventures in China's petroleum industry. Given the Chinese State Council's past history in energy decisionmaking, it is improbable that it would, through the exercise of sheer political will, withdraw China from the international oil market.

Of the three interpretive frameworks for understanding Chinese foreign policy behavior, the "China threat" scenario is the most prevalent among the American public, justifying policy

<sup>85</sup> Kang Wu and Fereidun Fesharaki, "Petroleum Links," *op. cit.*, pp. 7-8.

<sup>86</sup> Harry Harding presentation before the Policy Impact Panel, organized by the National Committee on United States-China Relations and the Council on Foreign Relations, March 29, 1996. Panel proceedings published as Barber B. Conable *et al.*, *United States-China Relations: Current Tensions, Policy Choices*, National Committee China Policy Series, no. 12 (July 1996), p. 15.



measures for containment of China. This is ironic because Chinese integration into the international oil market should be considered a U.S. foreign policy success.

Nevertheless, the internationalization of China's energy sector poses a number of potential challenges for U.S. interests:

- Pipelines that promote greater regional integration in Northeast Asia and Central Asia might exclude U.S. involvement except in a marginal way. China's "Northeast Economic Circle" and "Northwest Economic Circle" could evolve into regional economic blocs.
- There is a lack of transparency in the Northeast Asian project. This is primarily because it was initially conceived in the context of Northeast Asian non-governmental and local-level multilateral projects—the Tumen River Development project and the Sea of Japan Rim project.
- Sino-Russian and Sino-Kazak discussions on petroleum agreements seem to be held in conjunction with discussions on military agreements, which could imply an emerging military alliance. If China views Kazakhstan as a bridge to the Middle East, Iran, and Iraq, could these countries form an Oil Silk Route bloc that would present a united front against U.S. policy in such fora as the United Nations?

Confidence-building measures along China's borders have been a necessary prerequisite to building transnational energy infrastructure. China has never challenged Russian strategic hegemony in Central Asia, making a Sino-Kazak military alliance unlikely. Although China has purchased all the military technology and equipment the Russians would sell, Beijing has repeatedly stated it is not forming a Sino-Russian military alliance. China has never been adverse to arms-for-oil barter in the Middle East far from Chinese borders, but when constructing a political-economic order along her border regions, there is more interest in long-term stability. Beijing, Moscow, and conservative Central Asian political leaders share an aversion to radical Islamic fundamentalism, which makes formation of a bloc with Iran improbable.

The solution to lack of transparency would be to situate these regional projects within an existing multilateral forum that has significant U.S. participation, most logically APEC, or to create a new Northeast Asian multilateral forum for this purpose.

There are a number of potential economic, political, and environmental benefits for U.S. interests. American companies would gain an opportunity to sell technology and equipment to China. They would also benefit from an alternative transportation route from Kazakhstan and Siberia, and greater access to new markets in China. The Turkmen-Kazak-Chinese-Japanese gas pipeline benefits from Exxon's participation. Chevron will utilize the Sino-Kazak pipeline to ship oil out of the Caspian Sea area, and to gain access to Chinese domestic and East Asian markets. American oil companies could contribute to Chinese diversification of oil supply by exporting Alaska North Slope crude oil to China, which would also address the American trade deficit with China.

The potential benefits for United States interests beyond the concerns of American oil companies include:

1. Any replacement of coal by natural gas will contribute to a reduction in emissions of greenhouse gases; and
2. The opening of the inner border areas of China in the "Northeast Economic Circle" and the "Northwest Economic Circle" would guarantee that the entire country would continue to pursue economic reform. This will reduce chances for conflict over domestic economic policy between the more open coastal region and a closed inner border region.

U.S.-Japan encouragement of the internationalization of the Chinese oil industry and Chinese interdependence with the global energy market had been a win-win situation until CNPC challenged United States oil interests in Kazakstan. This could have been viewed as simply a contest between several multinational corporations. The suddenness with which this challenge invoked an American response to a perceived new dimension to the China threat indicates the deep roots of such perceptions. Although this greater Chinese interdependence should be viewed as a United States foreign policy success, the “China threat” interpretive framework remains dominant in American thinking, and could undermine United States-Japanese coordination of China policy as the Japanese continue to encourage interdependence.