11 Resource mercantilism and the militarization of resource management
Rising Asia and the future of American primacy in the Persian Gulf

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In a broad sense, the “militarization” of resource management describes the growing inclination of energy producers and consumers to base decisions about their behavior in global energy markets on political and strategic calculations as well as on commercial and economic considerations. As this volume attests, the ongoing militarization of resource management is generating profound challenges for American interests around the world, challenges that will shape the US foreign and defense policy agenda for at least the next quarter century.

Some of the most significant policy problems associated with the militarization of resource management are posed by the deepening engagement of the world’s two most important rising powers, China and India, with the world’s most important energy-producing region, the Persian Gulf. Although the United States has long enjoyed effective hegemonic status in the Middle East, China and India are intensifying their economic, diplomatic, and strategic ties to energy-producing states there, driven by their exploding demand for imported hydrocarbons. More particularly, these states seem to be pursuing energy security through what can be described as “resource mercantilism” – that is, the use of economic and foreign policy instruments by national governments to help their state-owned national energy companies (NECs) secure access to overseas hydrocarbon resources on more privileged bases than simple supply contracts based on market prices.

Considerable attention has been focused on the presumptively destabilizing impact of China and India’s global “hunt” for hydrocarbon resources on global energy markets and international relations. In the Persian Gulf, the coincidence of closer Chinese and Indian ties to energy-producing states in “west Asia” with an ongoing decline in America’s strategic standing in the region prompts concerns, in some quarters, about the risks of arms races and even military conflict over access to Middle Eastern oil and gas supplies in the future. In particular, some analysts see the potential for China to project military power into the Persian Gulf, either directly or indirectly, in ways that will challenge US interests. Others see the potential for Sino–Indian conflict over access to the Gulf’s
hydrocarbon resources. Such scenarios are frequently used to bolster the case for US–Indian strategic cooperation to contain China's rising influence.7

This chapter argues that concerns about China and India’s energy-driven engagement in the Persian Gulf fueling either the destabilization of global energy markets or the militarization of resource management in the Middle East are overdrawn. Additionally, this chapter argues that, if such concerns become the basis for policy-making, the results are likely to be counterproductive to US interests. As will be discussed, there are significant limits on how far Chinese and Indian NECs can go to “lock up” access to Middle Eastern oil and gas reserves. Moreover, the prospect of military confrontation between the United States and either China or India over access to Persian Gulf energy resources seems remote. In all probability, Beijing and New Delhi will each seek to balance the other's efforts to expand its naval capabilities in the Indian Ocean, aggravating what Mikkal Herberg has aptly described as the “potential future problem of military maritime competition to control the Sea Lanes of Communication in Southeast Asia.”8 Nevertheless, for the foreseeable future, the United States will maintain unique capabilities to exercise military power in the Gulf. This is true with regard to deploying naval forces and maintaining maritime supremacy in the Gulf.9 It is also true with regard to the projection of ground forces into the region. US logistical capabilities to lift sizeable infantry and armored forces into the Persian Gulf by air and sea will remain unequalled for the foreseeable future.

There is certainly a risk that the United States could find itself in a competition for geopolitical influence with rising Asian powers – especially China – in the most strategically critical area of the world.10 To some degree, such a competition may already have started. But this risk is largely self-generated. If Washington pursues policies aimed at stabilizing and managing shifting geopolitical balances in the Gulf, the United States should be able to maintain its strategic primacy in the region, with China and India effectively legitimating that primacy. If Washington supplements that articulation of a new grand strategy for the Middle East with efforts to bring China and India into the International Energy Agency (IEA) and encourage the further internationalization of Chinese and Indian NECs, the United States can help Beijing and New Delhi transition to more market-oriented approaches to energy security. If, on the other hand, the United States continues to pursue policies that are perceived to be regionally destabilizing, its strategic standing will continue to decline. Under these circumstances, China and Middle Eastern energy producers may ultimately forge a de facto strategic alliance and look collaboratively for non-military means to contain American influence in the Gulf.

This chapter develops these arguments in six sections. The first section looks at resource mercantilism as a particular manifestation of the militarization of resource management, conditioned by continuing structural shifts in global energy markets. The second section then looks more closely at resource mercantilism as practiced by China and India in the Persian Gulf as a “top down,” strategic response to perceived challenges to their energy security. The third section
takes a different approach, focusing on the interaction of Chinese and Indian NECs with their governments to present resource mercantilism as a fundamentally “bottom up” phenomenon driven by the corporate agendas and interests of individual NECs. Against this backdrop, the fourth section assesses the economic and political limits of resource mercantilism as an energy-security strategy, while the fifth section draws implications for US policy. Finally, the sixth section draws out the likely consequences of poorly conceived US policy.

Conditions for militarization

Resource mercantilism, particularly as practiced by China and India, needs to be understood in the wider context of the geopolitics and geoeconomics of energy, which are being reshaped by continuing structural shifts in global energy markets, on both the demand side and the supply side. These shifts have encouraged the militarization of resource management in various ways, including the emergence of resource mercantilism.

On the demand side, the world has witnessed sustained and robust growth in the demand for crude oil, refined products, and natural gas since the beginning of the millennium. More specifically, a consequential portion of the increase in aggregate demand for oil and natural gas during the past five years or so has been conditioned by the emergence of new major demand centers in Asia, especially China and India. During 2001–4, 35 percent of the increase in oil demand worldwide was generated by China alone. During 2002–5, that figure increased to 40 percent. Indeed, the “explosion” of demand for crude oil and refined products in Asia has been one of the most important contributors (along with continued demand growth in the United States) to the dramatic rise in energy prices since late 2003.11

The International Energy Agency and the US Department of Energy’s Energy Information Administration, among other sources, project that oil demand in Asia will continue growing robustly over the next 20 to 25 years. However, much cyclical dynamics or idiosyncratic (and, thus, at least theoretically changeable) national policies may have contributed to the recent expansion in Asian energy demand, this expansion is fundamentally grounded in the developmental trajectories of the most important emerging Asian economies, China and India – trajectories that are not likely to change radically in the foreseeable future.12

On the supply side, there has been a lag in the growth of installed productive capacity in upstream oil and gas sectors to accommodate rising demand. Historically, there has always been a cyclical quality to upstream energy investments; to some degree, the present lag is the predictable outcome of “underinvestment” in productive capacity since the mid 1980s.13 But, in the current environment, the potential to expand productive capacity is conditioned by the ever increasing concentration of the world’s hydrocarbon reserves under the control of national governments and NECs in the Middle East and former Soviet Union. Combined with continuing demand growth, this trend means that, among other things, the import dependence of major energy-consuming states and regions will continue
growing during the next two decades. This trend also means that, in the future, state actors, not international energy companies (IECs) and private investors, will largely determine the pace at which hydrocarbon reserves are developed and the direction in which they are marketed.

As these trends play out and play off one another, they are prompting strategic and political responses by producer and consumer states alike. On the supply side of global energy markets, many observers have commented on the rise of “resource nationalism” in energy-producing states, as national governments seek to derive greater economic and political power from the monetization of their countries’ hydrocarbon reserves. On the demand side, resource mercantilism is, in many respects, an analogous strategic response by rising consumer states to structural shifts in global energy markets. At the heart of contemporary resource mercantilism is the increasing reliance of energy-importing states, especially in Asia, on their own NECs to acquire equity stakes in oil and gas reserves abroad, with national governments extending various kinds of support to their NECs’ efforts to conclude such deals.

The outstanding exemplars of resurgent resource mercantilism in Asia are, of course, China and India. In broad terms, these two countries – rhetorically collectivized under the neologism, “Chindia” – work within similar parameters in trying to define their external energy strategies. Both perceive increasingly acute vulnerabilities to their energy security stemming from their growing reliance on imported hydrocarbons to fill critical portions of their energy mix. Both have state-owned energy companies – originally established to develop significant indigenous reserves of crude oil and natural gas – that have become increasingly active overseas. Both have sought to integrate their NECs’ overseas acquisition efforts into national strategies for energy security. And, for both countries, the Persian Gulf is an inescapable focus of their external energy policies.

In both the Chinese and the Indian cases, resource mercantilism needs to be understood on two levels. On one level, external energy strategies grounded in the logic of resource mercantilism are shaped by high-level calculations in Beijing and New Delhi about national interests and strategic vulnerabilities. From this perspective, the overseas acquisition efforts of Chinese and Indian NECs are structured primarily through “top down” guidance and support from national governments. But, on another level, Chinese and Indian external energy strategies are shaped by the corporate agendas and interests of individual Chinese and Indian NECs. From this perspective, the overseas acquisition efforts of Chinese and Indian NECs are driven primarily from the “bottom up” – that is, by the NECs themselves.

Neither perspective captures “the whole truth” about resource mercantilism as pursued by China and India; both must be taken into account in any analysis of China and India’s external energy strategies.
Resource mercantilism and energy security

At the strategic level, the attempts by Chinese and Indian NECs to secure access to oil and natural-gas reserves abroad are part of wider national efforts to deal with perceived vulnerabilities created by increasing dependence on imported hydrocarbons. With regard to crude oil, China and India already have strategically meaningful levels of import-dependence.20 Rising demand for transportation fuels makes it highly likely that demand for crude oil and refined products in China and India will continue to grow significantly in coming years; in turn, this prospect means that, like other major consumer countries, China and India will become even more dependent on foreign sources of oil through the next decade and beyond.21 China and India only recently started to import natural gas. Looking forward, though, rising demand for electricity in both countries means that China and India will almost certainly develop significant import-dependence for natural gas in coming years.22

As China and India’s import-dependence for crude oil has grown over the past decade, Persian Gulf producers have assumed a central role in supplying both countries’ energy needs. As China and India increase their imports of crude oil and natural gas in coming years, the Persian Gulf will figure even more prominently in both countries’ external energy strategies. Currently, almost half of China’s oil imports are sourced from the Middle East, largely through supply contracts of varying durations. More than two-thirds of India’s oil imports today come from the Gulf, also through supply contracts supplemented by spot purchases. Although policy-makers and strategic planners in Beijing and New Delhi alike stress the importance of diversifying the sources and transport routes for hydrocarbon imports, for a variety of reasons the Middle East will continue to hold a leading position in supplying Chinese and Indian energy markets through the next decade and beyond. There is little reason to anticipate that China or India will be able to reduce the percentage of their oil imports sourced from the Persian Gulf in the next 10–20 years; indeed, the percentage of Chinese and Indian oil imports sourced from the Gulf is more likely to grow during this period.

For policy-makers and strategic planners in Beijing and New Delhi, this growing reliance on imported hydrocarbons – and, especially, hydrocarbons from the Persian Gulf – is at the heart of the energy-security challenge facing their countries. In this context, the attractiveness of resource mercantilism to Chinese and Indian elites, as a strategy for managing this challenge, flows naturally from their acceptance of certain propositions about the workings of international energy markets, and optimal ways to achieve energy security – propositions that are, in many ways, at odds with liberal economic orthodoxy.

From the resource-mercantilist perspective held by many elites in Beijing and New Delhi, the energy-security challenge facing China and India has at least two dimensions. First, Chinese and Indian elites are concerned about “volume risk” – that is, the adequacy of oil and gas supplies available on international markets. Volume risk is an inescapable feature of energy markets because of
their inherent physicality and complexity. During the past 30 years or so, trading in various types of crude oil and refined products has become much more integrated on a global basis. This effectively reduced volume risk by making it more difficult for exporters to use oil as a "weapon" merely by cutting off supplies to particular customers.

But, as market conditions have tightened all along the supply chain for crude oil in recent years, the prospective impact of potential supply disruptions – as a result of natural disaster, accident, terrorism, political instability within oil-producing states, or interstate conflict – has grown. Moreover, despite significant movement toward the creation of a single, integrated market for crude oil and refined products, there remains a profound degree of "regionalization" in oil-supply relationships. Thus, today, two-thirds of the Middle East's oil exports are delivered to Asia, and the most important "growth" markets for future production from the Persian Gulf also lie to the East.

This means that rising Asian economies will be looking to access ever larger supplies of oil, particularly from the Middle East, at the same time that established customers, such as Japan and Korea, are looking to expand their own access to those supplies. In reality the global oil market has already been divided up to a great extent through investments in field development and transport, the historical predominance of Western energy companies, and the relative stability of supply flows in that market. These conditions have created, and continue to reinforce, perceptions in Beijing and New Delhi that, in developing overseas upstream positions and ensuring secure supply flows from abroad, China and India are doing no more than playing "catch up" with the advanced industrial countries of the West.

The regionalization of energy-supply relationships is even more pronounced for natural gas. As natural-gas usage expands in coming years, analysts, policy-makers, and strategic planners in Beijing and New Delhi anticipate that there is likely to be intensifying competition – involving China and India along with established energy consuming states in Asia, Europe, and North America – for access to pipeline and liquefied natural-gas (LNG) exports, particularly from the Persian Gulf.

In light of these considerations, a significant number of Chinese and Indian elites are skeptical of the view propounded by most Western analysts that oil and gas will always be available, albeit at varying prices, on international markets. From their perspective, energy security is simply too important to be trusted to the uncertainties of energy markets. In addition to their concerns about volume risk, many Chinese and Indian elites are also worried about heightened "price risk" – that is, volatility in the prices of crude oil, refined products, and natural gas. Given their skepticism about the workings of international energy markets, some Chinese and Indian elites are more interested in insulating their societies from the effects of price-volatility than in allowing their economies to respond efficiently to price signals.

Elite skepticism in Beijing and New Delhi about the functioning of international energy markets has been bolstered by the rise of resource nationalism,
as discussed above. In this regard, many Chinese and Indian elites believe that, if national governments in energy-producing states across the Middle East, the former Soviet Union, Latin America, and Africa increasingly treat hydrocarbon reserves as strategic assets, and not simply as economic commodities, China and India have no choice but to take a similar perspective as energy consumers. In the Chinese case, the suspicion of international energy markets is further reinforced by a sense that the United States will not always let these markets work in a disinterested fashion where Chinese interests are in play.27

Given their view of the energy-security challenge confronting their countries, many policy-makers and strategic planners in Beijing and New Delhi recommend the acquisition of equity positions in overseas oil and gas assets by Chinese and Indian NECs so that, if their countries were in a situation in which they had adequate financial resources, but were unable to buy oil or gas on international markets because of constrained supply, the NECs’ foreign equity production could be sent home. Similarly, Chinese and Indian advocates of “equity oil” maintain that hydrocarbons produced abroad by Chinese and Indian NECs are insulated from fluctuations in market prices and could provide home-country consumers with cheaper energy supplies than those available on the international market.

Working from these premises, the Chinese and Indian governments have adopted external energy strategies grounded, to a considerable degree, in the logic of resource mercantilism. In broad terms, China has taken the lead in developing a resource-mercantilist approach to energy security, with India effectively following China’s example. These strategies seek, inter alia, to utilize Chinese and Indian NECs to improve – indeed, to maximize – China and India’s access to overseas hydrocarbon resources, including in the Persian Gulf. Within the Gulf, the region’s major energy producers are the highest priority “targets” for Chinese and Indian “energy diplomacy.” These targets include the “OPEC Five” – Saudi Arabia, Iran, Iraq, Kuwait, and Abu Dhabi in the United Arab Emirates – for oil, and Iran and Qatar for natural gas.28

These strategies also seek to diversify the sources and transportation routes for China and India’s foreign energy supplies.29 For many Chinese elites in particular, diversification of transportation routes is especially important, given that 80 percent of China’s oil imports – including all of its imports from the Persian Gulf – currently must pass through the Straits of Malacca, where they are vulnerable to piracy, terrorism, and interdiction by US naval forces.30 Within the Persian Gulf, Iran is uniquely important for Chinese and Indian efforts to diversify transportation routes for oil and gas supplies, as it is the only major energy-producing state in the region whose geographic position would permit transport of oil and gas exports to Asian markets via pipeline as well as via sea routes.31

China’s external energy strategy is codified in the so-called “going out” (zou chu qu) policy. This policy was elaborated in 2002–3 as the current, “fourth-generation” leadership cadre was consolidating its accession to power; in substance, though, it reflected positions that had guided official practice under
China’s “third-generation” leadership of President and party chief Jiang Zemin and Premier Zhu Rongji. In keeping with the basic precepts of resource mercantilism, this policy explicitly encourages Chinese NECs to create more secure energy supplies for China by purchasing equity shares in producing oil and gas assets overseas, the exploration and production of new fields abroad, and the construction of refineries and pipelines. Under the rubric of “going out”, China’s three major NECs – the China National Petroleum Corporation (CNPC), China National Petrochemical Corporation (Sinopec), and China National Offshore Oil Corporation (CNOOC) – have emerged as prototypes for a new kind of actor on the global energy scene: the “INOC”, or “international/national oil company”, as one Chinese energy executive describes it.32

Broadly speaking, India has followed the Chinese approach to crafting an external energy strategy rooted in the logic of resource mercantilism. The Indian government first began to articulate elements of its resource mercantilist external energy strategy during the tenure of Prime Minister Atal Bihari Vajpayee’s most recent BJP-led coalition (1999–2004). Although the focus of the Vajpayee government’s energy policy-making was the reform of India’s domestic energy sectors, its principal policy document on energy issues included some discussion of state-supported overseas acquisitions by Indian NECs.33 During the tenure of the current Prime Minister, Manmohan Singh, New Delhi has deliberately emulated the Chinese approach to empowering NECs as part of its external energy strategy.34 Singh’s first Minister of Petroleum and Natural Gas, Mani Shankar Aiyar, publicly articulated an ambitious agenda for overseas acquisitions and projects by Indian NECs; although lower profile, Aiyar’s successor, Murli Deora, is also publicly committed to encouraging foreign “equity oil” deals by Indian NECs.

From a strategic perspective, external energy strategies grounded in the logic of resource mercantilism, like those of China and India, unfold in three stages. First, the Chinese and Indian governments seek to build a wide range of diplomatic links to key energy-producing regions, including the Persian Gulf, to pave the way for Chinese and Indian NECs to develop positions in these regions.

In the Persian Gulf, Chinese leaders have concluded a number of such agreements with local regimes. These include the elaboration of a “strategic energy partnership” with Saudi Arabia (starting in 1999 and continuing through the reciprocal visits of Saudi King Abdallah to China and Chinese Premier Hu Jintao to Saudi Arabia in 2006), multiple trade and investment agreements with Saudi Arabia and smaller Gulf Arab states over the last several years, an energy cooperation agreement with Kuwait, and a variety of economic and technological cooperation agreements with the Islamic Republic of Iran.35 Additionally, China has instituted a regular series of dialogues with the Gulf Cooperation Council (GCC) and is currently negotiating a free trade agreement with the GCC.36 More recently, Beijing cancelled Iraq’s Saddam-era official debt to China.37 In 2005, China supplemented its diplomatic engagement with energy-producing states in the Persian Gulf and with the GCC by opening a regular dialogue with OPEC.

In connection with its external energy strategy, India has launched its own
"energy diplomacy" directed at hydrocarbon exporters in the Persian Gulf. Although an extensive Indian expatriate presence in the Gulf has long provided a basis for positive ties, Indian governments have, in recent years, sought to forge an expanding array of connections to the region to facilitate greater access by Indian NECs to oil and gas supplies.38 In January 2006, during Saudi King Abdallah's visit to India, the Saudi monarch and Prime Minister Singh signed the so-called "Delhi Declaration." This document structures the development of Saudi–Indian relations in a number of strategic issue areas; with regard to energy, the Delhi Declaration commits the two countries to developing a "strategic energy partnership", including long-term contracts for the supply of Saudi oil to India and joint ventures in upstream and downstream projects.39

Indian governments have been pursuing closer ties to the Islamic Republic of Iran since the end of the Cold War. Since the beginning of the new millennium, however, energy interests have compelled the Vajpayee and Singh governments to take Indo-Iranian relations to a new level.40 Since 2006, finalization of a nuclear cooperation agreement between the United States and India has induced some rhetorical caution on the Singh government's part regarding Indo-Iranian energy ties; nevertheless, Indian officials and NECs continue to pursue energy-related agreements (as well as oil and gas deals) in Iran.41 Since 2002, the Vajpayee and Singh governments have worked steadily to develop bilateral relations between India and Qatar. The most recent step in the process was the conclusion of a bilateral defense agreement in 2007, under which India will provide military-to-military assistance to Qatar.42 Currently, India is negotiating its own free-trade agreement with the GCC.

To some extent, Chinese and Indian efforts to formalize closer ties to energy-producing states in the Gulf are intended to help Chinese and Indian NECs conclude larger and longer-term supply contracts. But, in keeping with the logic of resource mercantilism, these diplomatic efforts are also meant to help Chinese and Indian NECs secure "equity oil" and gas deals in the upstream and develop strategic assets in the downstream (i.e., refineries and LNG trains). Thus, in the second stage of their countries' external energy strategies, Chinese and Indian NECs take advantage of the openings created for them by their governments' diplomatic engagement in energy-producing regions around the world to develop upstream and downstream positions.

In the Persian Gulf, Chinese NECs have concluded a number of investment agreements and are continuing to pursue additional deals. In Saudi Arabia, Sinopec won one of the three initial concessions for developing non-associated gas in the Kingdom in March 2004. Sinopec has also entered into two joint ventures with Saudi Aramco to develop new refining capacity in China (one of which also includes ExxonMobil as a partner). In June 2007, CNPC won a contract to build a pipeline carrying oil from Saudi fields to Fujairah in the United Arab Emirates.43 In Kuwait, CNPC won a contract in the late 1990s to build two oil-gathering centers for the Kuwait Petroleum Company (KPC). More recently, Sinopec has concluded a preliminary agreement with KPC to develop a joint venture refinery project in China.44
In Iran, Sinopec signed a memorandum of understanding (MOU) with the National Iranian Oil Company (NIOC) in 2004, prospectively valued at $70 billion to $100 billion, to develop and buy LNG from the South Pars field and to participate in developing the Yadavaran oil field. Since then, China's two other major NECs, CNOOC and CNPC, have signed MOUs to undertake significant LNG and upstream oil and gas projects in Iran. And, in December 2007, Sinopec concluded an initial investment contract from its MOU with the NIOC, covering the initial phase of developing the Yadavaran field. Sino–Iranian energy cooperation agreements also envision the construction of a pipeline to connect Iranian oil production to the Kazakhstan–China pipeline.

In June 2007 – shortly after Beijing announced the cancellation of Iraq's official debt to China – CNPC received a commitment from the Iraqi government to revive the company's agreement with the Saddam Hussein regime to explore and develop the al-Ahdab oil field. Chinese NECs have also signed production contracts (including service contracts as well as equity participation) in Oman and Yemen.

Like their Chinese counterparts, Indian NECs are seeking to take advantage of the diplomatic openings created by their government to develop commercial positions in the Persian Gulf. The most prominent Indian NECs with regard to overseas acquisitions and operations are: the Oil Natural Gas Corporation (ONGC) and its international subsidiary, ONGC Videsh Limited (OVL); the Indian Oil Corporation (IOC); Oil India Limited (OIL); Bharat Petroleum Corporation Limited (BPCL); Hindustan Petroleum Corporation Limited (HPCL); and the Gas Authority of India Limited (GAIL).

In the Gulf, Indian NECs have made their greatest progress in developing commercial positions in Iran. In 2002, OVL and OIL acquired rights to explore and develop the offshore Farsi oil block. In 2004, OVL signed a memorandum of agreement taking a roughly 20 percent stake in the development of Iran's Yadavaran oil field (alongside the primary foreign stakeholder, Sinopec). In 2005, IOC signed a memorandum of agreement with Petropars, a subsidiary of the National Iranian Oil Company (NIOC), to develop part of the South Pars gas field and an associated LNG train; that same year, GAIL concluded a similar memorandum of agreement with the NIOC. Perhaps most significantly, Indian officials are continuing to negotiate with Iranian and Pakistani counterparts to finalize a framework agreement for a pipeline that would transport Iranian natural gas to Pakistan and India. Such an agreement would almost certainly open up new commercial opportunities for Indian NECs.

Besides Iran, Indian NECs are also developing positions in Qatar and Iraq. In 2004, Petronet, a consortium of Indian NECs – including OVL, IOC, and GAIL – with Gaz de France as a strategic partner, concluded the first contract to begin importing LNG to India from Qatar. (The contract was concluded with RasGas II, a joint venture between Qatar Petroleum and ExxonMobil.) In 2005, OVL won a 100 percent stake in the exploration and development of Qatar's Najim offshore oil block. In the aftermath of the decision to revive CNPC's Saddam-era agreement to explore and develop the al-Ahdab oil field, Iraqi
energy officials said that a Saddam-era agreement with OVL to explore and
develop a block in western Iraq will also be amended and restored. The Iraqi Oil
Ministry has also invited IOC to consider building new refineries in Iraq.52

Finally, in the third stage of Chinese and Indian external energy strategies,
Beijing and New Delhi continue providing various types of support to their
NECs as the companies follow up on the openings created for them by China
and India’s energy diplomacy. As Chinese NECs pursue and implement
“equity” oil and gas deals in energy-producing regions around the world, the
Chinese government provides them with both financial and political support.

Financially, the Chinese government provides direct support to the NECs
through the provision of loans, at below-market rates and sometimes even
without interest, by state-owned “policy banks” to underwrite the companies’
overseas acquisitions. The government also provides indirect support to Chinese
NECs by extending a variety of incentives for energy-producing states to offer
investment opportunities to the companies; these incentives include the provi-
sion of foreign aid and the construction of basic infrastructure by Chinese
firms.53 With considerable variation across specific cases, Beijing has employed
all of these measures to support Chinese NECs’ acquisition efforts in the Persian
Gulf.54

Politically, the Chinese government supports its NECs with high-level meet-
ings between Chinese leaders and their counterparts in energy-producing states,
the involvement of China’s leaders in negotiations over specific projects, and the
use of China’s membership in various international organizations to cover the
interests of important energy exporters.55 Beijing has employed all of these tools
in supporting acquisitions by Chinese NECs in the Persian Gulf, in addition to
the financial tools just discussed.

In the context of the Gulf, the most salient example of Chinese policy-makers
using their country’s political influence to buttress its external energy strategy is
Beijing’s handling of the Iranian nuclear issue. All of China’s energy agree-
ments with Iran run against long-standing US policy, which seeks, in effect, to
keep the Islamic Republic’s oil and gas reserves in the ground. On the nuclear
issue, China is working to balance its interests in continued good relations with
the United States and acting as a “responsible stakeholder” on non-proliferation
with its interests in developing closer energy ties to Iran, and in defending what
policy-makers see as important principles in Chinese foreign policy, including
the peaceful resolution of disputes and non-interference in the internal affairs of
other states.56

In the Indian case, the government requires its NECs to finance their overseas
acquisitions on international capital markets, for the most part. The Indian
government, however, is stepping up its political support for the efforts of Indian
NECs to develop positions abroad, particularly through high-level meetings
between Indian leaders and their counterparts in energy-producing states and
other manifestations of “energy diplomacy.”
Resource mercantilism and corporate interests

Looking at China and India’s external energy strategies as “top down” initiatives, Chinese and Indian NECs seem to be more or less interchangeable instruments through which unitary state apparatuses in Beijing and New Delhi pursue well-elaborated programs for securing privileged access to hydrocarbon resources in targeted countries, including in the Persian Gulf. But there is another level on which China and India’s external energy strategies need to be understood. This level focuses on the corporate agendas and interests of individual NECs.

Chinese and Indian external energy strategies are not solely the reflection of national efforts to assuage strategic vulnerabilities stemming from these countries’ growing reliance on imported hydrocarbons. These strategies are also the evolving products of bargaining and competitive maneuvering between various elements of the bureaucratic apparatuses in Beijing and New Delhi, on the one hand, and Chinese and Indian NECs, on the other. And, in this process, the autonomy of Chinese and Indian NECs vis-à-vis their respective national governments is growing. This trend is especially pronounced in the Chinese case, but it is observable in the Indian case as well.

The increasing autonomy of Chinese and Indian NECs is a function of their origins and evolution as corporate enterprises in a policy environment characterized by continuing economic liberalization. In the Chinese case, all three of the major NECs were created out of ministerial structures in the 1980s as part of the initial reform program championed by Deng Xiaoping and China’s “second-generation” leadership. Under China’s “third-generation” leadership, all three NECs became ever more market-oriented and profit-driven in their strategic orientation and operational practices as a result of additional restructuring.

Between 1997 and 1999, CNPC and Sinopec were restructured as vertically integrated energy companies operating across the whole supply chain for oil and gas – upstream, midstream, and downstream. Both companies retained some of their original strengths and weaknesses after the restructuring, with CNPC still more established as an upstream player and Sinopec more established in the downstream and each still maintaining regional strongholds in different parts of China. At the same time, though, vertical integration helped them become more efficient and expanded their political resources vis-à-vis the state. Between 1999 and 2001, all three of the major Chinese NECs were transformed into holding companies that transferred most of their assets to operational subsidiaries that were then publicly listed on various stock exchanges. While the Chinese government remains the majority shareholder in all three NECs, the fact that the companies are listed on international stock exchanges through these subsidiaries reinforces their market orientation and focus on profitability.

In the Indian case, the major NECs were created out of previously established state agencies in the early days of Indian economic reform in the 1990s. Thus, India’s Oil and Natural Gas Commission, established originally to oversee the development of the country’s upstream oil resources, was converted into ONGC
in 1991 and later partially privatized through the public offering of a minority of its equity. Similarly, IOC – originally established as a state-owned enterprise (SOE) focused on downstream activities – was corporatized and partially privatized in the late 1990s.

The autonomy of Indian NECs has been reinforced by other policy initiatives. Most importantly, since 1997, the Indian government has granted its most profitable SOEs – in India, state-owned enterprises are formally described as central public-sector enterprises (CPSEs) – considerable operational autonomy and a more limited degree of financial autonomy. So far, nine SOEs/CPSEs – collectively described as navaratnas (“nine jewels”) – have been treated this way. The major Indian NECs – including ONGC, IOC, and GAIL – are all in this special category.

From a “bottom up” perspective, the increasing autonomy of Chinese and Indian NECs has had a critical impact on the formulation and implementation of China and India’s external energy strategies, in at least three important ways. First, the corporate agendas and interests of Chinese and Indian NECs were at least as important as the strategic preferences of policy-makers in Beijing and New Delhi in launching these strategies. In the Chinese case, it was NECs – specifically CNPC – and not the state that initially pushed for overseas investment opportunities in the early 1990s. Initially, the Chinese leadership did not support overseas investments by Chinese NECs, but, as China’s oil imports increased over the course the 1990s and CNPC began to earn money from its initial investments abroad, the Chinese government became more supportive of its NECs’ overseas activities.

As in the Chinese case, the interest of Indian NECs in investing abroad preceded but eventually overlapped with the strategic interests of national-level policy-makers. According to Indian energy executives and researchers, both ONGC and IOC were prompted to undertake their initial overseas investments because economic reform and restructuring in the 1990s had made them more profitable, and corporate leaders did not want to lose their higher profits to a revenue-hungry government.

Second, the relative autonomy of NECs, in both China and India, means that there is no comprehensive national strategy, let alone a specific plan, for acquiring oil and gas assets abroad. On a project-specific basis, the foreign investments of Chinese and Indian NECs are driven primarily by the companies themselves, even in countries where the Chinese and/or Indian governments have concluded “strategic energy partnerships” or other similar agreements. For both Chinese and Indian NECs, the primary motives to invest overseas are to acquire new reserves, generate profits, and become more internationally competitive.

Third, in both China and India, the NECs are applying market- and profit-oriented criteria in making investment decisions. Particularly in the Chinese case, the leading NECs are developing ever greater independence in this regard. While preferential financing through state agencies may give the NECs a lower “capital hurdle” than that of IECs, Chinese NECs nonetheless seem to consider anticipated return on capital carefully in making investment decisions. Indeed,
there are a growing number of instances in which Chinese NECs have refused, on business grounds, to pursue overseas (and domestic) initiatives that were favored by the national government. In this context, it is interesting to note that there is a growing public debate in both China and India about the relationship between NECs' foreign acquisitions and energy security. In China, several NEC executives have said publicly that they fundamentally disagree with the notion that the acquisition of oil and gas assets abroad can enhance China's energy security.

In India, as noted, the government requires its NECs to finance their overseas acquisitions on international capital markets, for the most part. Just last year, the State Planning Commission recommended that NECs undertake overseas investments only in accordance with sound commercial criteria. A recent study of overseas investments by NECs by two analysts at the Wood Mackenzie consultancy found that ONGC is making its investment decisions according to criteria comparable to those applied by private energy companies.

In the Persian Gulf, the agendas and interests of individual NECs and the increasing autonomy of NECs vis-à-vis their governments have significantly affected "on-the-ground" outcomes with regard to Chinese and Indian energy investments. The pattern of Chinese and Indian investments in energy projects in Iran illustrates this with particular clarity. With regard to the behavior of individual Chinese NECs, it is noteworthy that Sinopec — the Chinese company with the most developed downstream capabilities and a strong interest in using overseas acquisitions to compensate for its weakness relative to CNPC in the natural-gas sector — was the first Chinese company to conclude a memorandum of agreement for an LNG project in Iran. Both CNPC and CNOOC were subsequently motivated to sign their memoranda of agreement with Tehran for LNG projects to avoid being left out of potential opportunities in Iran. More significantly, with regard to the NECs' interaction with Beijing, all three companies have sought to develop positions in Iran even after initial enthusiasm for their efforts in some parts of the Chinese government has cooled as the Iranian nuclear issue has heated up.

Nevertheless, it is also noteworthy that the three Chinese NECs have been slow to conclude actual investment contracts for their planned projects in Iran, particularly for LNG. While it is tempting to conclude that the companies are responding to directives from Beijing, their behavior is actually shaped far more by the agendas and interests of the NECs themselves. Like Royal Dutch Shell, Total, and other European IECs that are negotiating contracts for planned LNG projects in Iran, all three Chinese NECs perceived a significant measure of political risk posed by the possibility of US military action against the Islamic Republic over Tehran's nuclear activities. Furthermore, like their European counterparts, the major Chinese NECs are all concerned about the impact of rising costs for LNG projects on the profitability of their prospective investments in Iran. The companies are unlikely to proceed to conclude contracts and make sizeable investments in the projects until these concerns are resolved.

A similar dynamic is reflected in the Chinese NECs' handling of potential
upstream oil deals in Iran. Apart from supply contracts, only one of the upstream oil projects in Iran to which Chinese NECs have committed themselves has moved to an actual investment contract, much less implementation of that contract; the one investment contract concluded so far is Sinopec’s December 2007 agreement with the NIOC regarding the initial phase of developing the Yadavaran field. Even that deal – coming in the immediate aftermath of the public release of the December 2007 US National Intelligence Estimate on Iran’s nuclear program – primarily reflects Sinopec’s interest in protecting the position it staked out in its 2004 MOU. Again, concern about the profitability of upstream oil projects under the notoriously difficult terms offered to foreign investors under the Islamic Republic’s “buy-back” system seems to be the principal constraint to more fulsome investment by Chinese NECs. As a Beijing-based analyst for a leading Western oil and gas consultancy says, “At the end of the day, Chinese companies are out to make money. If they just wanted oil they would have signed more ‘buy backs’.”

Indian NECs have also been slow to move beyond MOUs to actual contracts on upstream oil and gas and LNG projects in Iran. In this regard, Indian and Iranian consultants and energy executives suggest that Petronet has used IOC and GAIL’s commitments to LNG projects in Iran to leverage better prices for future LNG supplies from Qatar. They also suggest that Indian NECs are reluctant to conclude LNG contracts in Iran for the same reasons as their Chinese counterparts. Similarly, despite the Indian government’s strong interest in moving ahead with the Iran–Pakistan–India “peace pipeline” (as long as security issues can be adequately addressed), Indian NECs are and will continue to be reluctant to make contractual commitments to the project until the price for Iranian gas supplies is set on terms they consider commercially sound.

Limits of resource mercantilism

Of course, resource mercantilism is not a new phenomenon, “invented” by Chinese and Indian policy-makers and energy executives during the past decade. Both France in the 1960s and 70s and Japan in the 1970s and 80s crafted external energy strategies based on state-supported NECs working to access crude-oil reserves abroad. Ultimately, these policies’ excessive costs and lack of results forced Paris and Tokyo to move toward less statist and more market-oriented approaches.

If Chinese and Indian external energy strategies are viewed as “bottom up” initiatives, driven largely by the corporate agendas and interests of Chinese and Indian NECs, it is striking how serious are the limits on resource mercantilism, as either a potential threat to the stability of international energy markets, or as a long-term basis for Chinese and Indian energy-security strategies. While increased demand from China and other rising Asian economies has had a very direct effect on global oil prices, there is little evidence that Chinese and Indian “equity” oil and gas deals, in the Persian Gulf as well as other energy-producing regions, are keeping or will keep an economically or strategically significant part
of the world’s hydrocarbon reserves “locked up” and unavailable to international markets. Currently, oil produced from Chinese and Indian overseas equity assets worldwide represents less than 1 percent of the oil produced and traded globally. If the most optimistic projections of Chinese and Indian acquisitions abroad prove correct, overseas equity oil production by Chinese and Indian NECs might represent as much as 2 percent of total worldwide production in 2020 – hardly a major “blow” to the stability of the global oil market.

Just as Chinese and Indian “equity” oil and gas deals will not fundamentally alter the structure of international energy markets by themselves, there is little evidence that they will significantly ameliorate the energy-security challenges posed by China and India’s growing reliance on imported hydrocarbons. Today, the amount of oil produced by Chinese NECs from equity assets outside China equals roughly 11 percent of the country’s domestic oil production, and constitutes approximately 15 percent of its total oil imports and 8 percent of its overall oil consumption. The amount of oil produced by Indian NECs from equity assets outside India represents an even smaller portion of India’s oil demand. Given projections of growth in demand for oil and natural gas in China and India, and the intensity of international competition for upstream positions around the world, it is difficult to imagine that, in the next one to three decades, Chinese and Indian NECs, will be able to fill a dramatically higher portion of their countries’ demand for imported hydrocarbons from overseas “equity” oil and gas projects. As the limits of resource mercantilism as an energy-security strategy become ever more apparent in coming years, it seems highly likely that the pursuit of state-backed “equity” oil and gas deals by Chinese and Indian NECs will increasingly be justified as industrial policy rather than as external energy policy.

Beyond the issue of how much “equity” oil and gas Chinese and Indian NECs will produce in coming years, the direct contribution of that production to China and India’s energy security is subject to serious question. In most of their overseas equity projects, Chinese and Indian NECs are minority stakeholders, not majority stakeholders and/or operators. Thus they do not really “control” most of the foreign assets in which they have invested. Moreover, much of the “equity” oil produced from these foreign assets is not likely to be physically transferred to China and India. Rather, it will be sold on local markets to reduce transportation costs and generate higher profits for the producing companies.

This is particularly the case for the Chinese NECs. Chinese energy executives and officials say that less than 10 percent of the oil produced outside China by the three major Chinese NECs is physically transported to China. The rest is sold on local markets. Clearly, Chinese NECs are prioritizing higher returns on the sale of their production over satisfying statist perceptions of China’s energy-security requirements. It would seem that Indian NECs transfer a higher percentage of their “equity” oil production to India than Chinese NECs send back to China. Nonetheless, Indian NECs currently sell a significant share of their overseas production on international markets and are likely to increase that share in the future.
With regard to the Persian Gulf, very little of China or India’s equity oil is currently produced there. In the future, there are likely to be truly severe constraints on how far Chinese and Indian NECs will be able to go in developing equity positions there. When the prospective cumulative impact of these constraints are considered, it seems likely that China and India will increase their access to oil and gas supplies in the Persian Gulf primarily through supply contracts, rather than the expansion of equity positions by their NECs.24

Although their capabilities are steadily improving, Chinese and Indian NECs cannot yet offer the same range of technical expertise and experience as more experienced and sophisticated IECs, which puts them at a competitive disadvantage as potential operators for technically challenging projects. In three of the “OPEC Five” countries, Chinese and Indian NECs face the same barriers to foreign involvement in upstream oil and gas projects as US and European IECs. These barriers include an outright ban on foreign participation in upstream oil projects in Saudi Arabia and Kuwait, and the poor security and political environment in Iraq. In Qatar, Chinese and Indian NECs will be challenged to access more LNG in the face of an indefinite moratorium on new gas projects there. In Iran, the unattractiveness of the “buy back” system will almost certainly continue to restrain the growth of foreign investment in upstream energy projects, including investment by Chinese and Indian NECs, even with the recent decline in the perceived risk of US–Iranian military confrontation. Barring a significant shift in the Iranian approach to foreign energy investments, the expansion of the positions of Chinese and Indian NECs in the Islamic Republic is likely to proceed slowly.

Implications for US policy

The US response to Chinese and Indian engagement in the Persian Gulf should be guided, first of all, by an appreciation of the political and economic limits of resource mercantilism. US policy should also be guided by unexaggerated assessments of the ability and inclination of rising Asian powers to challenge US hegemony in the Persian Gulf directly, at least in the near-to-medium term. As two Harvard researchers note with regard to China, Beijing “recognizes that it is not about to replace the United States in this region, rather it is focusing on shifts at the margin.”25 The same could be said about India’s strategic ambitions in the region.

On this basis, the US policy response to China and India’s energy-driven engagement in the Persian Gulf needs to contain two principal elements. The first is the formulation and implementation of a new American “grand strategy” toward the Middle East, to restore the legitimacy of US hegemony in the region. The second is the renovation of the current global energy “architecture” to meet the requirements of a new era.
As previously noted, China and India’s intensifying engagement with energy-producing states in the Persian Gulf is taking place against a backdrop of an ongoing decline in America’s strategic standing in the region. Perceptions of a decline in America’s strategic standing in the Gulf may create some opportunistic openings for China and India to increase their influence in the region, and for Chinese and Indian NECs to pursue investment opportunities there. Nevertheless, America’s current difficulties in the Middle East also create profound dilemmas for Chinese and Indian policy-makers (and for decision-makers in the Gulf). On the whole, China and India have a better chance to meet their energy-security goals and other important strategic objectives if the United States is acting as an effective hegemon in the Persian Gulf. They suffer no less than other energy consumers if US policies in the region prove to be destabilizing, or are widely perceived as introducing additional risks that the market must somehow discount – as is presently the case with respect to the possibility of US military action against Iran to slow the Islamic Republic’s nuclear development.

Since the end of the Cold War and the prosecution of the first Gulf War in 1990–1, America’s exercise of hegemony in the region has played out in an international environment characterized by deepening processes of globalization. China and India’s energy-driven engagement in the Gulf reflects the intensifying participation of both Asian and Middle Eastern players in these processes. As Daniel Yergin points out, the explosion of energy demand in China and India is a globalization “success story,” as investment inflows, export expansion, and sustained economic growth lift hundreds of millions of Chinese and Indians out of poverty and these populations consume ever greater amounts of energy.76

In the Middle East as well, Saudi Arabia, smaller energy-producing states in the GCC and other regional states (like Egypt) are making their own belated, but now increasingly apparent turn toward globalization. In the 1990s, analysts of the Middle East regularly lamented the region’s slow embrace of economic liberalization. However, by the end of the decade, regional leaderships were launching serious economic reform initiatives. The intersection of those initiatives with the liquidity “boom” generated by high energy prices in recent years has turned the Middle East – especially the Gulf – into one of the world’s most economically dynamic regions, making it a global economic player in ways not seen before.77

Globalization has been closely associated with America’s economic and military primacy, both globally and in key regions. Globalization has also been linked to America’s leading role in shaping a global energy “architecture”, meaning an interconnected set of market norms and practices, together with formal and informal institutions, which are collectively intended to promote various aspects of global energy security.78 This architecture has several constituent elements that were initially put in place by the United States and other major consumer states to counter the dramatic display of market power by the
Organization of Petroleum-Exporting Countries (OPEC) in the 1970s. All these elements remain bound up with America’s role as international leader: the United States played a key role in establishing the International Energy Agency (IEA) in the 1970s, in response to the 1973–4 oil-price “shock”; it encouraged the liberalization and internationalization of upstream investment, reflected in major “plays” by IECs in the 1970s, 1980s, and 1990s, in places such as the North Sea, the North Slope, and the deepwater Gulf of Mexico; and it provided critical support to the creation of a single, integrated, and truly global market for trading crude oil and refined products, with prices based on spot transactions and the dollar serving as the currency in which crude oil is priced.79

US leadership in shaping the global energy architecture has been reinforced by America’s commitment to provide physical security for the world’s major oil flows, particularly from the Persian Gulf. Since the promulgation of the Carter Doctrine in 1980 and the “Reagan corollary” in 1981, the United States has publicly committed itself to use force to defend the security of Persian Gulf oil reserves and the free flow of oil exports from the region as vital American interests. Spurred by these commitments, the United States has built up operational capabilities over the past quarter-century that have turned the Persian Gulf, in military terms, into an “American lake.”

The rise of China and India as players on the Persian Gulf energy scene is taking place during a period in which American primacy in the region is coming under mounting strain. Much of this strain has been generated not by outside actors, however, but by US policy choices – on Iraq, Iran, Arab-Israeli affairs, and other issues – that have disappointed regional and international expectations of America’s leadership in the region during a period of continuing globalization. In a strategic sense, globalization is fundamentally about the diffusion of economic power across national boundaries. Thus, in a globalizing world, there will inevitably be shifts in geopolitical balances, both globally and regionally. The responsibility of the hegemon, in such an environment, is to manage these shifting geopolitical balances and mediate important conflicts so that increasingly cooperative frameworks can develop, both within key regions and across regions.

Unfortunately, for much of the post-Cold War period, US policy toward the Middle East – under the Clinton administration as well as under the current Bush administration – has run increasingly in directions that are incompatible with these expectations.80 Regional dismay with America’s choices is prompting Middle Eastern energy producers to explore various versions of an “Eastern option” in their foreign policies, creating openings for China, India, and other external players to expand their influence in the Gulf.

For example, Saudi Arabia is using its status as the world’s largest oil producer, oil exporter, and holder of oil reserves to cultivate closer ties to China, India, and other important energy importers in Asia; the Kingdom is forging a genuinely strategic relationship with China, in particular, partly as a “hedge” against precipitous deterioration in the Kingdom’s traditional strategic partnership with the United States.81 The Islamic Republic of Iran, for its part, has long
sought to reduce US influence and presence in the Gulf as a high foreign-policy priority. Today, Iranian diplomats describe Iran’s expanding relations with rising and established economic powers in Asia as providing it with alternatives to the United States and Europe for investment and trade partners. They also note that these relations give Tehran cover against US pressure over Iran’s nuclear activities, involvement in post-Saddam Iraq, and other points of US–Iranian contention.

These developments are exacerbated by a relative decline in America’s economic influence in the Middle East, as other international actors – including the European Union, as well as rising Asian powers – increase their trade and investment ties to the region. Current and prospective investments by Chinese and Indian NECs in the Persian Gulf are part of this broader trend.

In this context, an important part of the US policy response to China and India’s energy-driven engagement in the Persian Gulf is the formulation and implementation of a new “grand strategy” toward the Middle East. This grand strategy should combine pursuit of a multilateral regional settlement on Iraq, carrots-and-sticks engagement with Iran and Syria, and definition of a substantive political horizon for resolving the various tracks of the Arab–Israeli conflict. A new strategy for the Middle East should also include a return to the “over-the-horizon” military posture that served US interests in the region so well in the 1980s and early 1990s, but from which American administrations have moved away since the end of the first Gulf War. Such an approach would revitalize and re-legitimate American primacy in the region, and would win broad international support – including that of China and India.

**Renovating the global energy architecture**

Beyond getting its Middle East policy “right”, the US response to expanded Chinese and Indian engagement in the Persian Gulf also needs to include a new effort to renovate the global energy architecture for a new era. Defining this agenda in full is beyond the scope of this chapter. However, it is relevant here to consider the integration of China and India into the IEA, the principal international regime for important energy-consuming states. While the IEA is working to build closer working relations with both China and India, full inclusion of these countries in the organization would require, effectively, the IEA’s reinvention.

Western officials frequently point to China and India’s deficiencies as potential members of the IEA (i.e., their non-membership in the OECD and their lack of strategic petroleum reserves specified by IEA guidelines for member states). But, it is just as important to recognize that Western powers would have to accept significant changes in the IEA regime for Chinese and Indian membership to become plausible. In particular, under current IEA rules, new members are allocated weighted voting power in the organization based on their oil consumption in 1974. This is hardly an attractive prospect for either China or India, and even if accepted would introduce a substantial degree of unreality into IEA
proceedings. To date, there has been little serious discussion among IEA members about the necessity of reforming the organization’s decision-making structure to accommodate China and India’s eventual inclusion.

In this context, the United States should also strongly support the internationalization of Chinese and Indian NECs as a way to encourage China and India to take more market-oriented approaches to ensuring their energy security. Current US policy is, at best, ambiguous on this issue. The NECs are, in many respects, already America’s best allies to promote more market-based policies in both China and India. Their further internationalization (including through joint venture projects with US and other IECs) will make them even stronger advocates of more liberal approaches.

The consequences of incorrigibility

If the United States takes these steps, it can maintain its strategic primacy in the Persian Gulf, as well as its dominant role in the global energy architecture. If, however, the United States persists in a more unilateral approach to the most strategically critical region of the world – in a manner that is dysfunctional for the interests of other important regional and international players – and eschews effective leadership in reforming the global energy architecture to accommodate rising powers like China and India, the long-term consequences for America’s regional position in the Middle East and its international standing generally are potentially serious.

Under these conditions, Middle Eastern energy producers and rising Asian energy consumers, especially China, may ultimately forge a de facto strategic alliance and look collaboratively for non-military means to contain American influence in the Gulf. Such as scenario is consistent with the conditions for and modalities of “soft balancing” against US power, as described by Robert Pape and others.85

The dramatic rise in energy prices in recent years has prompted an enormous transfer of resources from established consumer states to energy producers and to manufacturers who serve markets in energy-producing states.86 (Thus, alongside China, which is expanding its manufactured exports to energy-producing states in the Persian Gulf, Germany has built up a significant current account surplus in recent years, and Japan has maintained its surplus.) At this point, what energy-producing states in the Middle East do with their current account surpluses is at least as important to the financing of global economic imbalances as the management of China’s current account surplus. China and a number of Middle Eastern energy-producing states with significant current account surpluses seem to be in the early stages of diversifying their foreign exchange reserves away from dollar-denominated assets.

Given these realities, at least two options for strategic cooperation between China and Middle Eastern energy producers to contain US influence in the Persian Gulf present themselves.87 First, China and Middle Eastern states could ultimately move to use their continued willingness to finance America’s
burgeoning current account deficit and overall debt levels as a source of strategic leverage over US foreign policy. Second, China and Middle Eastern states with substantial influence in OPEC could coordinate their actions to effect a shift in the currency regime for international oil trading so that oil would no longer be priced solely in dollars, but rather against a basket of currencies. Such a move would put significant pressure on the value of the dollar and, by extension, on the US economy.

Either of these two options would constitute a major blow to America’s international standing. Fortunately, neither of these scenarios is likely to play out in the near term; the United States still has time to recover from its strategic mistakes in the Persian Gulf and other critical arenas. But, if these strategic mistakes are perpetuated, the long-term consequences for America’s global leadership are likely to be profound.

Notes

1 The author gratefully acknowledges the contributions of Hillary Mann Leverett and Pierre Noël to his analysis and understanding of the issues treated in this chapter. He also thanks John Mearsheimer, Robert Pape, and participants in the University of Chicago’s Program on International Security Policy Workshop; participants in the Global Public Policy Institute’s Transatlantic Energy Security Dialogue, “Global Energy Governance and the Rise of China and India”; and Fatih Birol and staff members of the International Energy Agency’s Economic Analysis Division, Oil Industry and Markets Division, and Office of Global Energy Dialogue for comments on earlier versions of arguments presented here.


4 For example, the US–China Economic and Security Review Commission claimed in its 2006 annual report to the US Congress that

China’s strategy of securing ownership and control of oil and natural gas assets abroad could substantially affect US energy security – reducing the ability of the global petroleum market to ameliorate temporary and limited petroleum supply disruptions in the United States and elsewhere.

More broadly, the Commission argued that

China’s energy policies, taken as a whole, are not consistent with the economic or geopolitical behavior of a responsible stakeholder; they distort markets and destabilize volatile regions. As China’s energy needs and consumption grows, its failure to observe these international norms becomes increasingly problematic.
Resource mercantilism and militarization


5 In this regard, Henry Kissinger has gone so far as to argue that competition over access to hydrocarbon resources will be the most likely cause for international conflict in coming years; see Caroline Daniel, “Kissinger Warns of Energy Conflict,” Financial Times, 2 June 2005.

6 For example, Ian Lesser claims that

In Asia, growing reliance on Middle Eastern ... energy sources may encourage importers to augment political and commercial ties with deeper security relationships and increased direct investment in regional energy projects. This could go well beyond existing arms transfer relationships. With China set to import ever larger quantities of oil from the Gulf, it is not inconceivable that some form of Chinese naval presence in the region will be commonplace in 2010.


and command/control will ... continue to hamper the navy's efforts to achieve a true blue water power projection status"; see Gill, "India and Pakistan: A Shift in the Military Calculus?"; in Tellis and Wills, Strategic Asia.


11 The recent trend toward higher oil prices can be dated to March 1999, when the Organization of Petroleum-Exporting Countries (OPEC) successfully increased market prices by limiting member states' production for the first time since 1985. Between March 1999 and September 2000, oil prices roughly tripled — albeit from a low base — as a result of OPEC's actions. In September 2000, OPEC publicly stated that it would work to keep its "basket" price for crude oil within a $22–28-per-barrel band. Oil prices remained relatively stable until November 2003, when rising demand from Asia began to drive prices steadily upward. Since then, world oil prices have more than tripled again.


16 Resource nationalism is often defined as a national government's assertion of ownership rights over oil and gas reserves within their territorial boundaries, usually in ways that contradict liberal paradigms for encouraging foreign investment, and work against the interests of IECs. This species of resource nationalism is epitomized by the efforts of President Vladimir Putin's administration to re-establish a dominant measure of state control over Russia's hydrocarbon resources, and by the nationalization of foreign investments in Venezuela's Orinoco region by President Hugo Chávez's administration. But, beyond this essentially economic aspect, there is a more purely political dimension to contemporary resource nationalism — namely, national governments seeking to derive strategic influence from the control over the production and marketing of hydrocarbon reserves exercised by their NECs. The political species of resource nationalism can take the blunt form of unilateral supply cut-offs, as both Chávez and Iranian President Mahmoud Ahmadinejad have threatened, notwithstanding OPEC's commitment not to use oil as a political weapon; on
this point, see Mueller, *Energy Security*. The political species of resource nationalism can also take a more subtle form, with resource-owning governments using their control over the monetization of reserves as a source of strategic leverage; on the strategic dimensions of contemporary resource nationalism, see Leverett, "The Geopolitics of Oil and America's International Standing."


20 Since China became a net oil importer in 1992, the portion of its oil supplies coming from abroad has risen steadily. China currently uses roughly 6.6 million barrels per day (mmbd) of crude oil; almost half of this figure – just over 3 mmbd – is provided by imports. India’s dependence on foreign oil is of longer standing and deeper than China’s. India currently uses at least 2.5 mmbd of crude oil; more than two-thirds of this figure – roughly 1.7 million mmbd – are provided by imports.


22 In contrast to domestic oil production, for which the best that the Chinese and Indian energy industries might do is to delay the moment at which production starts to decline, and ameliorate the steepness of that decline, both China and India have the potential to increase domestic gas production in coming years. Nevertheless, by 2020, both countries will, in all likelihood, have to import well over half of the natural gas they consume. In this regard, analyses by the IEA, EIA, and Chinese NECs project that, by 2020, China may have to import as much as 70 percent of the natural gas it consumes. The IEA projects that, by 2020, India will become at least as dependent on imports for its natural-gas supplies as China.

23 Today, 88 percent of Japan’s oil imports and 81 percent of Korea’s are sourced from the Middle East – significantly higher figures than the percentage of Chinese and Indian oil imports sourced from the region.


25 For further discussion of the regionalization of oil and gas supply relationships, see Müller, Energy Security.

26 Chinese and Indian elites are by no means alone in their concern about volume risk in global energy markets. A survey conducted in 2005–6 under the auspices of the World Economic Forum’s Energy Industry Partnership Program indicates that uncertainties about security of supply from the Middle East in the near term, and adequate growth in supply globally in the longer term, are the leading concerns of chief executive officers of international energy companies; see “Energy Community Survey” in World Economic Forum, Energy Vision Update, Spring 2006, p.6.


28 The “OPEC Five” control the world’s five largest national holdings of proven reserves of conventional crude oil. Iran and Qatar hold the second- and third-largest reserves of natural gas in the world, respectively (after Russia).

29 Of course, these external energy strategies are parts of broader energy policies that also include measures aimed at managing demand and increasing the energy
efficiency of the Chinese and Indian economies. It is beyond the scope of this chapter to consider these other dimensions of Chinese and Indian energy policies. However, in both the Chinese and the Indian cases, policy-makers have generally put more effort into policies aimed at increasing the availability of energy supplies rather than policies aimed at reducing demand and increasing efficiency.

30 See Downs, China, p. 14.
31 See Müller, Energy Security.
32 Personal communication with the author.
34 In an address to a global energy conference in New Delhi in January 2005, Singh acknowledged, “I find China ahead of us in planning for the future in the field of energy security.” Given this state of affairs, Singh argued, “We can no longer be complacent and must learn to think strategically, to think ahead, and to act swiftly and decisively. We need to strengthen our oil companies in launching them as global firms.” See Keith Bradsher, “India Finds Itself Trailing in Fight for Global Energy Deals,” International Herald Tribune, 17 January 2005, http://www.iht.com/articles/2005/01/16/business/rupee.php; and “India Must Catch Up with China on Energy, Singh Says,” Bloomberg 16 January 2005.
38 On Beijing’s forgiveness of Iraqi debt as part of an effort to re-establish and expand


40 In 2001, Prime Minister Vajpayee traveled to Iran to sign the Tehran Declaration with Iranian President Mohammad Khatami; this document committed both countries to the development of closer economic and energy ties. In 2003, the Vajpayee government took another step in building India’s partnership with Iran with the conclusion of a framework agreement for Indo-Iranian energy relations during a visit to New Delhi by President Khatami.


46 See Vakil, “Iran: Balancing East against West.”


48 In addition, Chinese NESs have signed production contracts in several Middle Eastern countries outside the Persian Gulf, including Algeria, Libya, Morocco, Syria, and Tunisia. See also Lee and Shalmon, “Searching for Oil.”

49 For further discussion see Madan, India.

Petronet was created with Indian government encouragement in 1997 as a joint venture to handle the import and marketing of LNG within India.

In addition to the positions developed by Indian NECs in the Persian Gulf, Reliance Industries – India’s largest private energy company – has developed positions in Oman and Yemen and established an overseas subsidiary based in Dubai. Indian NECs have signed production agreements in Middle Eastern countries outside the Persian Gulf, including Egypt, Libya, and Syria.


For example, Sanam Vakil notes that

it was the Chinese that helped the Iranians build the Tehran metro system, and a second transportation project is already underway. Additionally, the Chinese are building Iranian highways and airport runways, even as China’s own infrastructure development moves at breakneck speed. Furthermore, China’s Cherry Automobile Company burst onto the Iranian scene in 2003 and now manufactures 30,000 annually. Today there are more than 100 different projects percolating on the Iran-Chinese stove.

See Vakil, “Iran: Balancing East against West.”

In this context, it should also be noted that Beijing’s current efforts to expand diplomatic and economic ties to the Persian Gulf take place against a historical backdrop of China’s provision of arms and sensitive technologies to states in the region. See Daniel Byman, China’s Arms Sales: Motivations and Implications, Santa Monica, CA: RAND, 2000; and Shirly Kan, “China and Proliferation of Weapons of Mass Destruction and Missiles: Policy Issues,” Congressional Research Service Report for Congress, updated 22 October 2007, http://www.fas.org/sgp/crs/nuke/RL31555.pdf.

In recent years it has been difficult to discern a consistent pattern of Chinese arms sales to countries with which China has substantial energy interests. Overall, arms exports are probably less effective than the financial and political tools Beijing has at its disposal to facilitate closer ties to energy-producing states in the Persian Gulf, because Chinese weapons systems are generally not considered state-of-the-art by potential buyers in the region.


Over the course of the 1980s, the management and production functions of the ministries of petroleum, coal, nuclear power, and electric power were transferred to newly established state energy firms, including the three NECs. Thus, CNOOC was formed in 1982 out of the Ministry of Petroleum Industry to focus on developing China’s offshore oil and gas resources, Sinopec in 1983 out of the Ministry of Chemical Industry to focus on downstream sectors, and CNPC in 1988 out of the Ministry of Petroleum Industry to focus on onshore exploration and production of oil and gas resources.


For further discussion of how “marketization” and openness to foreign investment reinforce trends toward the “corporatization” of Chinese NECs, see Lewis, “Chinese NOCs and World Energy Markets.”
Resource mercantilism and militarization

61 In addition, ONGC and IOC swapped 10 percent of their equity with each other in 2000.
62 Originally, 11 SOEs were designated, but two of these companies were subsequently privatized.
63 Personal communications with the author.
64 This point is amplified in Rosen and Houser, China Energy.
70 Personal communications with the author.
71 In this regard, an analyst with the Wood Mackenzie consultancy says flatly, "China will never be able to satisfy its oil demand through foreign acquisitions"; quoted in Stakelbeck, "Energy Brings Beijing and Tehran Closer Together." This point is also made in Lee and Shalmon, "Searching for Oil."
72 The author is grateful to Pierre Noël for this point.
73 Personal communications with the author; see also Rosen and Houser, China Energy.
74 With regard to China, this point is also made in Lee and Shalmon, "Searching for Oil."
75 Ibid.
78 I have borrowed the concept of global energy architecture from Saad Rahim; the definition is my own.
79 See Pierre Noël, Les Etats-Unis et la Sécurité Pétrolière mondial: Politique pétrolière


86 The author is grateful to Øystein Noreng for this point.

87 For further discussion, see Leverett, “Black Is the New Green.”