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Hearing on “China’s Global Quest for Resources and Implications for the United States”
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I first would like to thank the members of the Commission for the opportunity to testify to this important group. It is an honor and a privilege.

I have been asked to speak about China’s approach to securing its energy supplies and implications for the United States. I will discuss China’s approach, whether it is impacting global energy markets and the competitive prospects of American energy companies, how Beijing’s energy security drive is influencing maritime territorial and sea lane disputes in the seas around Asia, and some suggestions on U.S. policy towards the developments.

The global energy market impact of China reflects the enormous scale of its rising oil demand and Beijing’s increasingly active strategic diplomacy designed to secure future energy supplies. Energy security has become a critical political and economic concern for Beijing’s leadership. First, at a visceral level, China’s leaders fear that energy shortages and rising energy costs could undermine the country’s economic growth and thus seriously jeopardize job creation which could potentially lead to serious social instability. For a regime that increasingly stakes its political right to rule on economic performance and rising living standards, the threat of economic stagnation could threaten the continued political monopoly of the Chinese Communist Party (CCP). Hence, energy security is a strategic domestic political concern for the leadership. Beijing also has been alarmed by the huge rise in global energy prices over the past decade and the increasing risk of long-term global oil “scarcity.”

The enormous rise in oil demand in China which has roughly doubled in each of the past two decades has meant that China increasingly must rely on imported oil to meet the majority of its needs. China now imports over 50% of its total oil consumption of nearly 10 million barrels per day and consensus forecasts suggest this dependence will rise to 75-80% over the next two decades. Those oil imports will inevitably have to come largely from the Persian Gulf but also from Africa, Russia and Central Asia, and even Latin America. China will also become increasingly dependent on imported natural gas from many of these same regions. This is a leadership for whom self-sufficiency and national control of resources and energy remain important ideological underpinnings. The specter of heavy and growing dependence on imported oil and gas resources from a wide range of unstable regions of the world transported through lengthy sea lanes controlled by the U.S. Navy and other regional powers is deeply unsettling to the leadership in Beijing.

Beijing’s instinctive impulse for national control over key resources and energy in the face of chronically growing dependence on imported oil is what has driven its push for control over overseas oil and natural gas resources embodied in its “Go Out” strategy adopted after 2000. The go out strategy reflects the growing politicization of energy security in China but is symptomatic of the reaction to growing energy security anxieties across the region in Asia among the big oil importers. My own term for this is “energy nationalism” which can be thought of as an energy version of economic nationalism and mercantilism prevalent in Asia. This is different than what is commonly termed “resource nationalism” which generally refers to host governments of large oil and gas reserve and producing countries maintaining

tight political control over access to their resources by international oil companies (IOCs). The energy nationalism of China and Asia is a reflection of the angst of big importers over access to future oil and gas supplies and the increasingly national competitive character and energy rivalries of Asia's scramble for control over and access to oil and gas resources abroad.

China's energy drive abroad has been manifested in a number of ways that have been well-documented. First, Beijing has sponsored and supported the overseas acquisition of oil and gas resources by China's three main national oil companies (NOC) with state bank funding, loans, and expanding state diplomacy in the key oil and gas exporting regions. The NOCs often pay significant premiums to other market bidders to acquire these assets. Second, Beijing has sponsored a range of long-distance overland pipeline projects through its major NOC CNPC to bring oil and gas from Central Asia, Far Eastern Russia, and more recently Myanmar to diversify its oil and gas import slate and limit to the extent possible its dependence on seaborne oil and gas supplies. More recently as the energy security strategy has evolved, Beijing has mobilized its large financial reserves through its state banks, most importantly, the China Development Bank (CDB), to make large, long-term loans to key energy exporting countries to be repaid by a guaranteed, secure stream of future oil exports. Large loans have been extended to Russia, Kazakhstan, Brazil, Venezuela, Ecuador, Angola, and several other countries. These are effectively long-term forward purchases of oil that are locked-in more directly than term contract oil supplies. All these measures have been accompanied by active Beijing energy diplomacy to strengthen diplomatic and economic ties with key producers to improve the competitive position of its NOCs and seek to strengthen access to long-term contract supplies. For example, Wen Jiabao made a major trip just a few weeks ago to visit Saudi Arabia, UAE, and Oman to seek to ensure access to crude supplies in case of an Iran disruption.

For insight into the implications of China's energy security strategy, it is important to note that while this broad energy security drive was originally shaped by Beijing's leadership, over time as China's NOCs have become more capable internationally they have become powerful proponents of this collaborative approach. Often it is now the NOCs who shape and lead their overseas expansion with Beijing and the state banks following along in support. Today it is best seen as a convergence of interests between Beijing's perceptions that China's energy security is served by the global acquisition of oil and gas resources by its NOCs combined with the increasingly sophisticated commercial and competitive drive of the three NOCs and their promotion of this notion. In this sense the energy security strategy is evolving toward "industrial policy" aimed at strengthening the domestic and global competitiveness of China's NOCs into "national champions", not unlike Beijing's efforts in many key industrial and technology sectors. The interests of China's state banks also converge insofar as large oil-backed loans are an excellent investment in an environment where they are short of credit-worthy investments for such a large horde of capital. Other interests also now increasingly reinforce this "China Energy Inc." template. China's shipbuilders seek state support by arguing that China's oil and gas imports will be more secure if transported on Chinese-built and owned tankers. Even the PLA Navy reinforces this template as it increasingly defines one of its key future missions to be guarding the security of China's energy sea lanes in the South China Sea and Indian Ocean.

Despite the concerns of many that China is "locking up" oil supplies for the future that won't be available to others and, therefore, distorting oil markets and undermining the energy security of other countries, China's NOCs and Beijing's support for acquiring overseas "equity barrels" controlled by national companies are very unlikely to have a significant impact on the availability of oil in global oil markets. China's three major NOCs currently produce an estimated 1.5 million equity barrels of oil per day (MMBD) abroad. However, this represents less than one-third of China's daily oil imports.

Moreover, China's oil import demand is growing at an average of nearly one-half million barrels per day each year so the reality is that China's oil import needs are rapidly outrunning their NOCs' ability to accumulate investments in equity production abroad. China will increasingly be deeply dependent on the stability of the global oil market; the equity oil strategy is hopelessly inadequate as an energy security strategy. Many analysts in China understand this already. In any event, most oil produced by China's NOCs abroad is not sent back to China but, instead is sold into regional markets at the best netback value just as other IOCs do. And the global market of internationally traded oil is over 50 MMB/D which dwarfs China's equity barrels. And to the extent China sources its crude imports from one set of countries, it leaves other barrels from other countries available to other buyers. The more Persian Gulf crude it imports, the less West African crude it imports. The global oil market is quite fungible, transparent, and flexible. Certainly China's large and rapidly growing oil demand does impact global prices since China is the largest single source of world oil demand growth. But the choice of countries from which it imports does not directly impact prices.

However, the growing competitive strength of China's NOCs and continuing state support for their expansion has begun to impact the competitive landscape of the international oil industry. In just the past 2 years China's NOCs accounted for nearly one third of global oil and gas mergers and acquisition activity (M&A) making a number of large acquisitions of significant, high quality fields and projects. China's NOCs are more often bidding against the large international oil companies (IOCs) for high quality assets in West Africa, Latin America, Central and Southeast Asia. The NOCs are moving up the technology and project management learning curve that the IOCs have dominated in the past with growing investments in heavy oil development, large liquified natural gas (LNG) projects, and shale gas projects in the U.S. At the margin, this is adding to some of the major competitive challenges facing the American oil companies. U.S.-based IOCs like ExxonMobil, Chevron, and ConocoPhillips (and other IOCs from Europe and elsewhere) face a competitive squeeze from two sides. On the one side from growing international competition for opportunities from NOCs from the big producing countries like Russia, Brazil, and Malaysia which is now being reinforced by new competition for investment opportunities from the big importing countries NOCs from Asia such as China, India, Japan, and South Korea. China's NOCs are by far the most active and capable of this new group. On the other side, U.S.-based IOCs face new incursions into their traditional opportunities from the large oil service companies, such as Schlumberger, who increasingly are working directly with the NOCs of producer countries to partner with them to develop their resources without the need for the IOCs. So the Chinese NOCs are adding to an already challenging competitive environment for U.S.-based IOCs facing a very limited global opportunity set.

China's energy security drive and anxieties are not the root cause but contribute significantly to growing tensions over maritime territorial disputes in the South and East China Seas and also to tensions over control of the major sea lines of communications (SLOCs) through Southeast Asia and the Indian Ocean. As regional anxieties over future oil and energy supplies grow, the potential for large resources in and around the South China Sea has a "multiplier" effect by raising the already high stakes in sorting out extremely sensitive maritime sovereignty issues. China's recent more assertive posture on sovereignty disputes towards Vietnam and the Philippines and its bellicose pronouncements about the South China Sea being a "core interest" vis-à-vis U.S. involvement in the region, in part, have roots in China's view that the potential oil and gas resources in the region would be extremely valuable as nearby and, therefore, extremely secure sources of energy. China's growing dependence on oil and LNG flowing through the Indian Ocean, Malacca Straits, and South China Sea is also a key driver of its naval modernization and move towards "Blue Water" power projection capabilities by the PLA Navy, which, in turn is setting off alarm bells across the region and contributing to a regional naval arms race. For China,

the security of energy flows is not the fundamental driver of their effort to extend their naval and strategic power in the region but has become an increasingly important factor among others driving these developments.

U.S. Implications and Policies

U.S. policy on China's energy security drive to acquire overseas oil supplies needs to separate fact from fiction.

First, as suggested earlier, China's efforts to secure overseas oil and gas supplies does not fundamentally threaten U.S. or western energy security. U.S. rhetoric to this effect simply needlessly feeds the fears of those in Beijing who believe the U.S. seeks to deny China access to the oil it needs to build its economy and develop peacefully. Beijing's belief that acquiring overseas barrels will strengthen national control over its energy is an illusion built on mistrust of global oil markets and an antiquated, politicized view of how these markets work. China's energy security, like that of the U.S., Europe, Japan and other large oil importers, is destined to depend on promoting stability in global markets, reliable and growing supplies flowing from the key producers and producing regions to the market, increasing investment in new global supplies to meet gradually rising global oil demand, and policies to slow oil demand growth and take pressure off a chronically constrained global oil supply picture. China and the U.S. have profound common interests in working together to strengthen the stability of global oil markets and reduce the chances for damaging oil price shocks which undermine both our and world economic growth. The U.S. and China crafted pious words to this effect during the most recent SAED talks but little has been done to implement any of this.

The Congress should push the administration to work with China and the other major Asian oil importers to create a regional oil forum or working group to find common ground on ways to enhance stability in global oil flows and prices. China convened such a group including the U.S., Japan, South Korea, and India in 2007 but the initiative died from inattention after 2009. It should be revived. It should be aimed at confidence-building and developing a dialogue to begin to de-politicize energy security tensions in the region. It could complement the work of the International Energy Agency since China and India are not members of the IEA. It should be built on the premise of our obvious common interests in stable and effective global oil supplies and prices.

Second, investment by China's NOCs in the U.S. and North American energy development should be encouraged, not discouraged. China's new investments in U.S. shale gas and oil development are positive signs. Investment in the U.S. will impose greater transparency on their operations, expose them to world-class safety, environmental, and human resource practices, and reduce their need to focus on investment in countries where we have major political differences, such as Iran. Rhetoric from Congress is often unhelpful and feeds negative perceptions in Beijing.

Third, as part of our dialogue we should explicitly identify Beijing's support for its NOCs overseas as crude mercantilist industrial policy and press for Beijing to free its NOCs to compete as other oil companies do. The NOCs no longer need the state support; they are increasingly highly competitive on straightforward energy industry terms.

Fourth, while our energy security interests are highly convergent, there are a number of foreign and strategic policy cases where energy investment and supply security feed other bilateral tensions. These need to be managed carefully. One example is Iran where China's continued energy involvement with

the regime has weakened U.S. and western efforts to isolate Tehran over its nuclear program. Beijing's approach to Iran is driven by many factors, of which energy is only one. These other interests are likely to continue to make Beijing reticent to sign onto more than the minimum sanctions that can pass UN Security Council agreement. Another area where energy plays a "multiplier" role is in maritime disputes in Southeast Asia. Energy clearly is a strong interest in Beijing's South China Sea and SLOC policies but, in my view, not the fundamental determinant of Beijing's approach to the region. It is much more about sovereignty and managing long-term adjustments to U.S.—China naval power and interests in the region. As such, strategic shifts in the maritime balance will determine when and if the region can come to terms with rising Chinese power and influence. Energy will remain in a secondary role rather than driving Beijing's view on sovereignty in the region. But tensions over energy's role will need to be managed carefully.