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China's growing appetite for oil and natural gas imports is reshaping geopolitical relationships in its neighborhood and has implications for U.S. foreign policy. China became a net oil importer in 1993 and since then has worked assiduously to build its ties and assets (including upstream and pipelines) in Russia and Central Asia and has extended its interests into Iran. Chinese state companies have begun to eclipse the output of U.S. firms Chevron and ExxonMobil in Kazakhstan, and Chinese firms are challenging the U.S. in Turkmenistan, Uzbekistan and in Iran, where they are getting access to important exploration and production opportunities while U.S. companies remain sidelined. China concludes its business deals on a government to government basis, a process of entry for its state firms that is very different from the way private U.S. companies do business.

Chinese companies are partnered with regional state entities in oil and gas pipelines in Kazakhstan and in a gas pipeline from Turkmenistan that crosses Uzbekistan and Kazakhstan. China's status as a cash rich economic powerhouse needing energy to fuel its industries, and with money to pay for it, makes it a magnet for Central Asian suppliers that will serve to draw their resources to the East. It is proving particularly attractive to these landlocked producers. Kazakhstan shares a 1,700 kilometer border with China.

With countries to its north, west and southwest that have major resources, China has embarked on a course of getting on the ground in all these places and it is gaining leverage over considerable energy wealth. This can be seen as a win-win situation for China and for the Central Asians. China strengthens its energy security, while Central Asian countries diversify their export options and get investments and cash. By extending its reach into Central Asia, China also helps to develop its western Xinjiang Province, where the Muslim Uighur minority poses a risk of separatism. Thus, oil and gas supplies from Central Asia help fuel the Chinese economy and contribute to both its energy and political security. Central Asian gas links will tie Turkmenistan, Uzbekistan and Kazakhstan to China giving them all a stake in this infrastructure's security and making it more likely that these countries will cooperate with China on other security and anti-terrorist measures.

While some governments and state companies, most notably in Kazakhstan and Russia, are suffering the fallout from the financial crisis and lower oil prices, China is primed to take advantage of the opportunities this offers for coming to the rescue of its resource rich neighbors. What's more, China's economy, along with other Asians like India, will be future drivers of both oil and gas demand. In earlier days, it was thought that Iran would be the best conduit for accessing Asian energy markets from the Caspian but once Iran's role was limited by U.S. and multilateral sanctions, it was clear that another route to Asia would need to be found. A decade ago it was difficult to imagine such long distance pipelines like the ones China is now constructing as being the solution but this has become the means to reach energy hungry eastern markets. Clearly, China's inevitable demand uptick over the next years will exert an important influence on global oil markets.

After the United States, China has become the world's second largest consumer and importer of oil (buying about 3.5 million barrels per day on world markets) and relying on the Middle East (including Saudi Arabia, Oman, Iran and Kuwait) for about 45% of its imports. While its oil production from Central Asia is minor, about 10% of its import demand, China's expanding pipeline connections will support access to growing oil and gas volumes from Central Asia and Russia, in addition to volumes it produces in these areas. China may then be able to at least diversify it supplies away from Middle East oil, although this reliance is bound to remain significant. Eventually, competition could result between the West and China for the Caspian region's supplies.

In terms of natural gas, China's consumption has been rising at a more modest pace than oil. Until 2007, it was able to meet its needs largely from domestic production. But its gas import requirements are starting to take off, which is why China now pays as much attention to building gas pipelines from Central Asia as it does to oil. In fact, the gas connections to Central Asia may eclipse the importance of oil in the years ahead, as China tries to increase the clean fuel component of its energy mix and mitigate the impact of its heavy dependence on coal.

The most active Chinese company investing in Iran, Kazakhstan, Turkmenistan and Uzbekistan is China National Petroleum Corporation (CNPC), with Sinopec and other smaller players also taking stakes. CNPC is also increasing its ties with Russian state company Rosneft, with which it has an exploration JV in East Siberia and is looking to cooperate in refining in China. CNPC is the pipeline construction expert among Chinese companies and this makes its regional role a natural phenomenon as China seeks to deepen its energy ties with infrastructure links.

CNPC is the provider of the latest loans for oil deals in both Russia and Kazakhstan. As a result of the arrangement with Russia, by 2011 CNPC will import 300,000 barrels per day of oil through a new pipeline from Skovorodino in East Siberia, a project that has been on the drawing boards for a number of years. It was only with the conclusion of a $25 billion loan in February ($15 billion to Russian state company Rosneft and $10 billion to pipeline monopoly Transneft) that China was finally able to secure this 20-year, 300,000 b/d oil flow to its northeast. How much oil CNPC draws away from West Siberia and other export routes for the new pipeline will depend on the level of oil produced by Russian companies by 2011 in East Siberia. Eventually, CNPC may also produce oil in East Siberia. There are plans to expand the Russia- China pipeline to 600,000 b/d at some undefined future date.

With the breakthrough oil for loan deal of February, there has been a thaw in tensions between Moscow and Beijing and the precedent has been set for further energy cooperation between these two historical rivals. Still, longer term, the competitive nature of the Russian-Chinese relationship in Central Asia could emerge as a problem between these two powers and cause frictions in their energy ties with each other. This may be borne out particularly when Chinese gas purchases from Central Asia begin to escalate. Eventually, however, once Russia begins to develop its own gas resources in East Siberia, China will be a natural export destination for this gas from Russia.

Another loan-for-oil deal was concluded with Kazakhstan in April, with CNPC providing $5 billion to Kazakhstan's state company KazMunaiGaz (KMG), money it needs to purchase the country's fourth largest producer, MangistauMunaiGaz (MMG), from private owners. KMG will then give CNPC 50% of MMG, a transaction valued at $1.4 billion, probably calculated against the loan amount. In Kazakhstan, CNPC (since the 1990s) along with Sinopec and CITIC (more recently) have been building up producing assets which, when the purchase of MMG is completed in July, will reach 355,000 b/d. This level of production will be equal to the output of KMG and larger than the combined output of Chevron and ExxonMobil in Kazakhstan.

Chinese company activities in Kazakhstan are substantial and wide-ranging. These involve everything from producing oil and gas to building gas processing plants and oil and gas pipelines. By 2011, a 400,000 b/d oil pipeline will extend from the western oil fields of Kazakhstan, 3,000 kilometers across the country, to the Chinese border. CNPC already owns 50% of one of Kazakhstan's 3 refineries, in Shymkent. It is the only foreign company to have a stake in a Kazakh refinery. In addition, there are plans for CNPC to build a new joint refinery with Kazakhstan near the Chinese border. China is also providing money and participating with Kazakhstan in the construction of a gas pipeline from western Kazakhstan to the east, where it will meet up with a new pipeline China is helping to build from Turkmenistan across Uzbekistan and Kazakhstan to China. Chinese companies have recently signed a JV to produce uranium in Kazakhstan while also getting Kazakh participation in the construction of nuclear plants in China to be supplied with Kazakh uranium production. In addition to oil and gas, Kazkahstan is rich in uranium and is seeking to become the world's largest uranium producer by 2010. Because the Kazakh government is short of money, it has opened up to Chinese participation in uranium production.

In Turkmenistan, CNPC is the only foreign company to have signed a Production Sharing Agreement (PSA) to develop gas fields in the prolific Amu Darya Basin in the east near the Uzbek border. Over the next years, Chinese imports of Turkmen gas will rival the volumes currently under contract to Russia. As China moves this year to finish off construction of the 2,000 kilometer gas pipeline to its border from its Turkmen gas fields, it will create a major competitor to Russia for Turkmen gas supplies and will provide Turkmenistan with leverage to negotiate attractive gas sales prices with all its customers.

Turkmenistan's large gas reserves have attracted interest from many international companies, including U.S. firms, but since Chinese companies have been working with the Turkmen government since the mid-1990s, providing drilling rigs and services, they have succeeded in moving to the front of the queue. They are already drilling wells in the giant South Iolatan field, which UK firm Gaffney Cline and Associates (GCA) estimated in October 2008 to hold up to 14 trillion cubic meters (tcm) of gas reserves. An Iranian company is also negotiating a contract to drill in South Iolatan. This field is being eyed by our own industry as a major source of gas supplies, possibly even for a western route but U.S. companies have so far been unable to access opportunities in Turkmenistan's onshore. One reason may be the proximity of Turkmenistan's resources to Iran. In addition to exports through an existing system to Russia, a smaller pipeline was built in 1997 to export natural gas to Iran. For Turkmenistan, which values supply diversification, Russia, Iran and China are all important and more immediate export options than a western route for gas exports, which is still just in the planning stages for the future.

In Uzbekistan, CNPC has partnered in four exploration projects and is involved in constructing the gas pipeline which crosses from Turkmenistan to Kazakhstan and China. Finally, Chinese companies have either received stakes or continue to negotiate positions in some of Iran's largest oil and gas fields. For China, Iran may represent another piece of the Caspian puzzle. Its resources can be accessed by sea in the south and maybe eventually even by pipelines to the north. Piece by piece, China is building vast pipeline networks that tie this bigger region to the East.

As China's energy ties grow with Iran, Kazakhstan, Russia, Turkmenistan and Uzbekistan, these countries will develop deeper political and geopolitical ties with their eastern neighbor. U.S. leverage for various goals, whether in democratization, human rights or commercial concerns, will diminish. China's ties to Iran are a more immediate case in point. They have been forged over many years while the U.S. isolated itself from this country. These ties are deepening even as we speak. For China, this whole area is considered to be in its neighborhood and when any of these countries come calling for money and assistance, China can provide it.