Freeman Chair in China Studies

費和中國研究講座

Event Summary

China's Emergence in Central Asia: Security, Diplomatic, and Economic Interests

***Forum Three**: Energy and Trade in China-Central Asia Relations*

April 22, 2003

Overview

In our third forum on China's emergence in Central Asia, five speakers examined the issues of energy and trade in China-Central Asia relations. The first speaker, Charles William Maynes, president of the Eurasia Foundation offered keynote remarks discussing energy and trade relations in the context of ongoing changes in Central Asia and the region around it. A panel discussion followed with Dr. Bob Ebel, Director of the Energy and National Security Program at CSIS, discussing developments in Caspian energy and the effect it is having on China. Next, Dr. Martha Blaxall of SAIS described the status of cross-border trade and investment. Dr. Kang Wu of the East-West Center followed with a description of increasing Chinese energy demand and what Beijing is doing to meet its forecasted shortfall. The panel concluded with Steven Mann, Senior Advisor for Caspian Basin Energy Diplomacy at the State Department, briefing the participants on the current state of Caspian energy diplomacy.

Charles William Maynes

Mr. Maynes focused on the role of three core foreign policy considerations: proximity, access, and affinity. These were discussed in the context of future relations between China and Central Asia. He began by noting that after independence Central Asian states initially focused on national consolidation and security, explaining the need for a continuing presence of Russian troops to secure borders. Additionally, most Central Asians did not initially fear China, although they did maintain some apprehension. But today, Central Asian governments worry less about a returning Russia than Chinese intentions and the rise of Islamic fundamentalist groups such as the Taliban. Mr. Maynes then explained how four new developments have altered security perceptions in the region: 1) Russia is in no position to return to Central Asia as a dominant or colonial power; 2) growing fears of civil unrest and Islamic fundamentalists in the region is closing the security perception gap between the states of Central Asia and outsiders; 3) the poor economic performance of the Central Asian states progressively brought them to the realization of the need for help from outside; and 4) the arrival of the United States after September 11 as a relevant military power in the region has brought a new balance to the security equation in Central Asia and will perhaps make Central Asians more confident in their dealings with China and Russia in the future.

On the issue of proximity, Mr. Maynes noted Chinese concerns about its three Central Asian neighbors, and the influence they may have on China's Uyghur population based on religion, historic and ethnic links. This point is underscored by the way in which China conquered Xinjiang militarily in 1759, but failed to change the ethnic status quo until recently and a policy of steady “Sinification.” With this policy, China has attempted to change the demographic balance by “filling in sand,” encouraging the migration of more Chinese to the province. The Chinese portion of the population has risen from perhaps 5 percent to more than 40 percent in Xinjiang. Uprisings by the local population have occurred against the new policy with the employment of terrorist tools to offset the overwhelming military superiority of the occupying power. Mr. Maynes recommended that the governments in the region think of cooperative measures that might ease the economic strain and rampant poverty in this part of the world. The dilemma is that precisely those measures of openness and freedom could make it easier for sympathizers in Central Asia to help their co-religionists in Xinjiang.

Regarding the issue of access, Mr. Maynes explained that usually countries that abut one another want access to one another’s markets, resources, and seaports, especially in the case of a landlocked area like Central Asia. The Central Asians are particularly disadvantaged in this regard because of the collapse of the Soviet subsidy, distribution, and market system and the lack of new sources of equivalent support. China beckons as one of the best new market prospects for Central Asia, with cross-border trade more active than many in the West realize. Beijing recently contended that total Chinese investment in the five countries had reached US$ 500 million. The overall amount is still small but important. Access to the resources of Central Asia, particularly oil and gas, is an extremely important consideration for China. Central Asia could become China’s own national petroleum reserve, a necessary investment for China’s national security.

Stressing the importance affinity plays in international relations, Mr. Maynes demonstrated that after independence, the countries of Central Asia felt little affinity toward China and Afghanistan and much less for Russia than had previously been the case. However, this trend is changing, especially as China, slowly but steadily continues to soften its heavy measure of authoritarianism and communist control while Central Asia slowly but steadily continues to harden its current brand of authoritarianism and personalized leadership. Mr. Maynes suggested that if this affinity continues to grow, Central Asian states may shift orientation away from the West to the dynamic economies if the East. Conversely, if the Central Asian states were to become more democratic, the new affinity with China might wane. If these states offered greater opportunity to their Muslim populations to express their views, it might be that the Central Asian states would become increasingly concerned about the fate of the Uyghur populations in Xinjiang, thereby increasing tension between China and its Western neighbors. In this case, the harsher China acts toward these minority groups, the more tensions with Central Asia could rise.

Mr. Maynes concluded that China’s relations with its immediate neighbors to the West will continue to deepen for now. However, the policies of Western countries, including Russia, will influence this development. The Chinese market is near, two-way investment investments could be enormous, and the relationship would not demand political reforms from the local elite that Washington or Brussels are likely to request, but the countries of the region fear China more for its size than for its policies. A constructive Western involvement in the developments and security of the region could provide a useful balance and lead to a more stable equilibrium in the area.

Robert Ebel

Dr. Ebel began by expressing his shock that China, which accounted for just 4 percent of world oil demand in 1990, could consume as much as 12 million b/d by the year 2003, 82 percent of which would be imported. China’s domestic oil production will not be able to reverse the anticipated declines in capacity and net imports in 2030 are foreseen as averaging 9.8 million b/d, roughly comparable to the volumes imported by the United States in the year 2000. Moreover, China lacks a strategic petroleum reserve, unlike virtually all industrialized countries, meaning the country has no emergency supply to draw upon should oil imports be disrupted. There are major political and financial implications in this, not just for China, but also for all exporting and importing countries, including the United States. Nations around the world are doing what they can to ensure that continued economic growth will not be constrained by limits on energy supplies, including looking to Russia for balancing volumes of natural gas. Also, in the coming years, energy demand in developing countries will exceed energy demand in the industrialized world. At the same time, the oil and gas supplies are originating largely in the developing world, which makes for a precarious future in energy security. Projections for the United States out to the year 2025, place net oil imports at 19.8 million b/d—comparable to present level of consumption-- and equal to more than two-thirds of consumption in 2025. That is, incremental consumption in the coming years will have to be covered largely by incremental imports.

Dr. Ebel continued that in the not-too-distant future, just two countries alone—the United States and China—will be prowling the world oil market looking to import a total of almost 29.6 million b/d, closely matching, if not exceeding, total current OPEC producing capacity. Importing countries know that security of supply comes with diversity of supply. The United States has been doing what it can, including encouraging domestic oil companies to search for oil outside the United States but not in the Persian Gulf. Moreover, the United States has the advantage of nearby Canada, Mexico and Venezuela as sources of imports. On the other hand, China only has Russia, but no other nearby oil suppliers. China has begun to diversify its import sources, but it is still heavily dependant on Middle Eastern oil, with a small stake even in Iraq. It has also branched out into the import of LNG with projects in Indonesia and Australia.

Dr. Ebel then went on to detail China's promising commitment to Kazakhstan, starting with plans to develop two oil fields and to construct a pipeline that would move oil from Kazakhstan eastward to China. For a pipeline of that length, substantial volumes would have to be committed to justify its construction, but the reserve base of these two fields was far too small to justify going forward. However, KazMunaiGaz and CNPC have built the first part of the pipeline running between Atyrau and Kenkiyak, although it was purportedly built to move oil westward from Kenkiyak, not eastward. Nonetheless, designing the second stage, leading eastward 1,300 km between Atasu in central Kazakhstan to a rail junction at the Kazakh-Chinese border, is reportedly now under way. A pipeline from western Kazakhstan to China, to be commercially viable, because of its length would have to transport a minimum of 400,000 b/d. As of now, it is unclear if China would have to pay a so-called "security fee" of several dollars per barrel; yet another determining factor in the viability of this project.

Another alternative discussed by Dr. Ebel is the prospect of Russian oil moving by pipeline to China, from Angarsk in East Siberia to Daching. This project has reportedly been agreed on recently. Eastern Siberian reserves are sufficient for this line, initially to carry 400,000 b/d, later rising to 600,000 b/d.

Lastly, Dr. Ebel explained that natural gas is becoming important to China for two reasons. First, to help cover energy requirements and, second, as a substitute for coal, a major contributor to the country's serious pollution problems. Chinese officials believe demand for gas will reach 100 billion cubic meters (bcm) by the year 2010, with that growth in demand far outpacing in relative terms the growth in demand for oil. Much of the Chinese demand will have to be met through imports. Both Russia and Central Asia possess natural gas resources large enough to satisfy much of China's import needs. But distance and the absence of supporting infrastructure question the commercial feasibility of any proposed gas export pipeline. However, there is the prospect of Central Asian gas, from Kazakhstan, tying into the western end of the West-East natural gas pipeline now under construction in China. The West-East pipeline is designed to move gas from the Tarim Basin in western China to Shanghai in the east; a distance of some 4,200 km, at a reported cost of $18 billion, though reserves behind the pipe are questionable. East Siberia is also rich in natural gas but development has never gone forward, but this new Chinese need for imported gas has sparked renewed interest in East Siberian natural gas. Plans have been developed to lay a pipeline from the Kovyka gas field to northeast China, a distance of 3,800 kilometers. In contrast to oil, the gas reserves are more than sufficient to justify pipeline construction, but consumers have to be prepared to absorb the volumes carried. Conversely, for oil, the market is there, it is just that adequate reserves are missing. Dr. Ebel concluded that the pipeline linkages between Kazakhstan and China and between Russia and China, in addition to the oil and gas delivered, serve the purpose of binding supplier and consumer closer, both commercially and politically, creating an interdependence of value to both sides. These linkages may serve the national interests of China and of Russia, but they might run counter to the national interests of the United States.

Martha Blaxall

Dr. Blaxall focused her presentation on four points. First, Dr. Blaxall drew attention to the volume of trade between China and Central Asia. These numbers, which do not include shuttle trade with Kyrgyzstan and Kazakhstan (equaling another 18% and 10-12% in volume respectively according to some studies), are incredibly small from China's perspective. They are so small that it is unlikely China will focus attention on Central Asia, particularly in terms of consumer good exporting. From the Central Asian perspective on the other hand, their exports to China comprise a larger part of their total trade, particularly in the case of Kazakhstan, which lists China as one of its five most important trading partners. Of all the relationships China-Kazakh trade is the most significant, with Kazakhstan becoming China's second largest trade partner, after Russia, among the former Soviet republics.

Secondly, Dr. Blaxall discussed the composition of Chinese-Central Asian trade. Generally speaking, the Central Asian Republics principally export raw materials and commodities to China and import consumer goods. For example, Kazakhstan exports energy, iron ore, steel, copper, and non-ferrous metals, all of which are demanded by China's high priority Western development projects. Also, the Kyrgyz export copper waste and scrap, as well as raw materials like cattle hides, lambs, sheepskins and wool and the Uzbeks have contributed to the mix by also exporting cotton lint, cotton fiber for the production of paper, cellophane, and man-made fiber. Interestingly, China's import of copper from Central Asia is growing at a significant rate now that China is upgrading its power and telecommunication grids in the West. A positive result of this trade has been the adoption by Central Asia of Chinese production standards, which are higher than those inherited from Russia.

Thirdly, Dr. Blaxall highlighted possible areas for trade growth. The best opportunity is for energy exports from Kazakhstan to China, though Kazakhstan also should have opportunities in ferrous and non-ferrous metals and wheat. The Kyrgyz could increase their hide skin and hydropower industries. Uzbekistan's primary export has traditionally been chemicals and mineral fertilizers, which are produced domestically, though Uzbek horticultural products may find Chinese as well as Russian markets. Through the region, tourism from China will also likely grow over time, particularly if transit routes have improved, something that will help the economy as a whole.

The transport issue led to Dr. Blaxall's last point about future issues to overcome, particularly the issue of Uzbek barriers to trade. She also noted that income disparities between the Chinese and Central Asians, which limits the extent to which the Central Asian consumer is able to purchase Chinese goods. Most important, though, is the need for better infrastructure, including energy pipelines.

In concluding, Dr. Blaxall explained that if some of the restrictions that currently exist between and among the Central Asian Republic are lifted, these nations might see a change of 3%-5% per year of economic growth as a regional unit. Over five years, that could be 33%-50% cumulatively. A similar analysis has not been done for trade between China and Central Asian Republics, but Dr. Blaxall predicted that the increase in trade could be quite large and even perhaps more stimulative than the internal Central Asian numbers.

Kang Wu

Dr. Wu began by noting that China ranks second in total primary energy consumption after the United States, and third in primary energy production after the United States and Russia. Dr. Wu explained that China's primary energy consumption is dominated by coal but the importance for natural gas is rising rapidly while the share of oil remains steady. China is currently a net energy importer, and the import dependence, represented by rising oil imports, has been growing. From the 1980s to the 1990s and beyond, China has evolved from Asia's largest oil exporter to a large net oil importer and imports continue to rise at unprecedented rates. Over the next ten to fifteen years, China will continue to rely on coal to support its basic energy needs but coal's share of energy consumption is expected to decline. The rapidly increasing oil and gas demand, coupled with flat domestic oil production growth and limitations on gas production, will lead to rising oil and gas imports and therefore pose serious challenges to China with regard to its energy security.

Dr. Wu believed that the manner by which China will deal with these and other changes will have profound impact on the overall energy and economic developments in China as well as in Asia. Central Asia appears to be well positioned to supply oil and gas to China. However, because of the lack of transportation infrastructure, Central Asia's oil supply to China is very limited and there are no natural gas linkages. Options for transporting oil and gas to China in the future are not economical at present.

On the Central Asian issue, Dr. Wu detailed China's investment in the region, including CNPC's acquisition of a 60 percent stake in the Kazakh state oil company, Aktyubinskneft in 1997. The contracted investment promised by CNPC amounted to US$4.3 billion, including US$4 billion to be invested in E&P in three Aktyubinsk fields, of which the oil reserves are estimated at 1 billion bbl. As part of the agreement between CNPC and the Kazakh government, a 3,000 km (1,900 mile) pipeline was promised to be built, connecting western Kazakhstan with China's northwestern Xinjiang Autonomous Region, with an additional investment of US$3.5 billion. Aktyubinskneft was later renamed Aktobemunaygaz (Aktobe Oil and Gas) and CNPC's share is 63 percent. The pipeline alone is expected to cost US$2.3 billion. However, because it is uneconomical, the plan for building the pipeline has been shelved since the contract was signed, leading to occasional frictions between China and Kazakhstan. CNPC claims that it plans the pipeline project but insists that the contract did not stipulate that China must build the pipeline, except for making enough investment during the initial years. CNPC's attitude toward the crude pipeline from Kazakhstan and the overall investment toward the Central Asian country has become slightly more positive and active since late 2002 because of the uncertainty over the proposed crude oil pipeline from Russia's Angarsk in East Siberia to China's Daqing. In 2002, China imported a total of nearly 1.4 million b/d of crude oil, of which the share from the Middle East was around 50 percent while the share from Central Asia was only 1.4 percent. As for Russia, though the Russian oil exports to China are also mainly through rails, the volume was three times larger than Kazakhstan's exports in 2002 because of the shorter distance. Dr. Wu concluded that on an overall basis, China's options for expanding energy trade with Central Asian nations in the short run are very limited, though the chances of pipeline connections with China are likely to improve significantly toward 2010 for oil and after 2015 for natural gas.

Steven Mann

Ambassador Mann began his remarks by restating U.S. Caspian policy: to bring new Caspian oil and gas resources on line, develop multiple pipelines, compete with the old Soviet monopolies, and strengthen the independence and autonomy of the new Caspian states. This applies practically to Azerbaijan, Kazakhstan, and Turkmenistan as energy producers and Georgia as a transit state. Looking broadly, Ambassador Mann perceived several phases in Caspian energy. Phase One is the successful opening of upstream investments, especially Tengiz and ACG; and Phase Two is the development of alternative, transparent, market-based export lines for those resources. The Caspian Pipeline Consortium is now open, Baku-Tbilisi -Ceyhan (BTC) Pipeline is in the construction phase and Shah Deniz is close behind. Now, the international community is on the threshold of Phase Three: Caspian expansion in the form of upstream oil upstream including Tengizchevroil Phase Two and the Kashagan development. Another important aspect of this third phase is the long-expected sale of new Kazakh exploration blocks, which always seems to be six months away.

This is the context in which China is entering the Caspian market. China has not been on the radar in Caspian energy until the past year, because the Chinese energy industry has been unable to meet the capital requirements to become a player in the major Caspian fields and there have been more attractive opportunities internally and closer to home. To date, small Chinese firms have predominantly engaged in particular niche opportunities, but the pace has picked up in the past year. Activities include: CNPC bought into Commonwealth Gobustan in Azerbaijan for $10 million; Chinese involvement in the Salyan project also in Azerbaijan, a larger deal with the Chinese (CNOOC and CNPC-Hong Kong) having half of a 750M-barrel field; the Chinese are also in Georgia with a 25% of Frontera Partnership exploring in south-east Georgia; and lastly is China's failed attempt at purchasing a 16 2/3% of Kashagan.

Ambassador Mann went on to venture some *guesses* about why Chinese activity has increased so much. First is that China, like major countries around the world, sees energy security as a priority and wants to diversify its supplies, especially in view of events in the Middle East. Secondly, China has seen the increased U.S. attention to Central Asia and the closer U.S. ties to the region and has felt the pressure to become more substantially involved. Thirdly, the fact that this investment has taken place at a more accelerated level in the past year suggests some sort of centralized decision making. The British Gas (BG) offer was attractive to the seller and this may represent not merely a heightened appreciation of Kashagan, but also the China's desire to get in the game.

Ambassador Mann perceived no reason to consider Chinese interest in the region as a problem for the United States. Going back to the U.S. policy of multiple pipelines, he believes the region will be more stable and the governments more independent if they are able to reach out in a variety of directions for transport and for investment as well. American companies still offer a number of advantages than most other companies; Chinese firms are not going to bring such advantages to their investments. For example, American firms bring transparency in their payments and operations and cutting-edge technology into the projects. On the other hand, the Chinese have a highly restrictive view of procurement issues.

Since the Chinese took over operation of the Salyan project, 16 out of 16 procurement tenders were awarded to Chinese companies. The United States would welcome new pipelines that go into China from Central Asia. Under discussion is a natural gas pipeline from Turkmenistan into China, and ExxonMobil for some years considered that but has now walked away. The United States always supported this concept, but it is doubtful that the economics of the project would add up given the long transit distances. As a result, no one has seriously considered this project. The second concept is for exports of Kazak natural gas into China. This is a little premature, but again, the United States would support this. This plan will not take shape until greater volumes of Kazak gas are produced, but the hard parts of this project will be competing with Russian natural gas from the Far East -- and with China's own natural gas reserves. And for all of these projects, the key variables are the rates and locations of Chinese economic growth.

Ambassador Mann concluded that there would be more action in Caspian pipelines in the years ahead. There is also a coming new phase for Caspian pipelines, with new Bosporus bypasses emerging on the horizon, and the development of a Kazakhstan-BTC oil transport link, but he did not see the Chinese taking part in this. A final interesting and complex question raised by Ambassador Mann is how Chinese firms can compete in Eurasia in an age of mergers: with Yukos-Sibneft just announced, following on to BP-Transneft, and after the well-known Western examples such as ChevronTexaco, ExxonMobil, and ConocoPhillips, to name just three major players in the Caspian region.

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