

# CHINA BALANCE SHEET

## ENERGY

The direction that China and U.S.-China relations take will define the world's future. For the United States, a rising China increasingly affects American prosperity and security, calling for some clear-eyed thinking and tough economic, political, and security choices. As the twenty-first century unfurls, the stakes have never been higher for getting U.S. policy toward China right. By untangling the complex, sometimes contradictory, strands of this vast and dynamic country, *China: The Balance Sheet* lays the foundation for informed and effective U.S. policy toward China, the world's emerging superpower.

### BACKGROUND

- China is poorly endowed with natural resources, with the exception of coal.
- This lack of resources, combined with rapid sustained growth, has caused **China to become increasingly dependent on imports of petroleum and other natural resources.**
- **China's energy consumption grew 80 percent in 1995–2005**, and its share of world energy consumption increased from 9 percent to 12 percent.
- **China has been the world's number two oil consumer after the United States since 2002** and now relies on imports to meet almost half of its demand for oil.
- According to the International Energy Agency (IEA), **China accounted for under a tenth of global petroleum demand, but accounted for almost one third of incremental world oil consumption between 2004 and 2006**, contributing materially to upward price pressure in global markets.
- Similarly, **China is the world's leading importer of iron ore, aluminum, and paper and pulp**, and drives marginal global demand growth for copper, steel, and cement.
- China continues to rely on the Middle East for almost half of its oil imports, although in recent years, **Beijing has sought to diversify the types and sources of energy supply**—particularly through gaining control of energy production assets or acquiring stakes in overseas energy companies.

### CURRENT SITUATION

- Difficulties faced by Chinese companies in acquiring mainstream energy companies, such as CNOOC's controversial bid for Unocal in 2005 (see box), have fueled China's search for energy assets along its periphery, and in countries where Western companies have limited access due to self-imposed sanctions for human rights and other reasons, such as in Sudan, Angola, Burma, and Iran.

For further information, see Chapter 2: "China's Domestic Economy: Continued Growth or Collapse?" and Chapter 5: "China's Foreign & Security Policy: Partner or Rival?"

*China: The Balance Sheet: What the World Needs to Know Now about the Emerging Superpower*

Authors: C. Fred Bergsten, Bates Gill, Nicholas R. Lardy and Derek Mitchell



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- These energy deals have proceeded in tandem with diplomatic initiatives, humanitarian aid and assistance, infrastructure investment, and cooperation in international organizations. For example, **China's reluctance to refer Iran's nuclear ambitions to the UN Security Council for action or permit humanitarian intervention in the Darfur region of western Sudan is linked to its growing energy dependence on both states.**
- **Ninety percent of China's imported oil is transported by ocean-going tanker;** 80 percent of China's oil imports transits through the Strait of Malacca alone, a major potential chokepoint.
- As a result, China has sought to develop new port facilities, such as in Pakistan at Gwadar, Bangladesh, and Burma, and more overland pipelines extending from South, Southeast, Central, and Northeast Asia.
- Aside from the risk of collisions, piracy, and terrorist attacks, China's oil tankers are dependent on the U.S. Navy to patrol and secure these sea lanes, which China views as a strategic vulnerability should U.S.-China relations turn sour. Energy security is one rationale behind China's efforts to upgrade its naval capacity.

## IMPLICATIONS

- **The supposition that fundamental U.S. and Chinese interests diverge on global energy issues is profoundly incorrect.**
- **Both the United States and China are large net energy importers and thus share an interest in a stable Middle East,** increased global investment in oil and natural gas production, and the development of economically viable alternative energy technologies.
- **China's ownership of foreign oil and gas assets need not adversely affect U.S. interests.** In the long-run, Chinese firms are likely to invest at least as much as alternative owners in expanding oil and gas production in foreign locations, which, of course, benefits the United States and all other energy importing countries.
- **In the short run, however, there is an important divergence of interests as China thwarts U.S. efforts to impose economic sanctions on Sudan and Iran, for example.** Concerns over China's expanding naval ambitions also have the potential to undermine U.S.-China cooperation on energy, and lead to suspicion and rivalry in U.S.-China relations.
- **These challenges should be managed so the two countries can work together to meet their common energy objectives,** which importantly include increasing energy efficiency and conservation.

### Energy Efficiency and Pricing

*China has made substantial progress toward increasing energy efficiency as it gradually raised the domestic price of crude oil and refined petroleum products starting in the late 1980s.*

*By June 1998, convergence of domestic and international prices was complete when China adopted a formal policy of pricing domestic crude oil at the international price and not allowing any price subsidies for refined petroleum products sold at the retail level. When global crude oil prices began to rise sharply in 2004, however, the government partially abandoned this policy. As a result, refined product prices in China in late 2005 were the lowest of any major global economy – roughly one-third below U.S. levels, which by a wide margin are the lowest of any advanced industrial economy.*

*China is unlikely to continue on its long-term trajectory of increased energy efficiency unless it ends its policy of partially insulating domestic consumers of refined products from higher global prices.*

### CNOOC's Bid for Unocal

*In 2005, the China National Offshore Oil Corporation (CNOOC) bid to purchase the American oil company Unocal. U.S. critics charged that the transaction would make the United States more dependent on foreign oil and thus harm U.S. interests. This charge, and the fear that China's energy investments elsewhere are allowing it to "lock up" long-term supplies, reflect a fundamental misunderstanding of the global energy market.*

*Had China acquired Unocal and diverted its entire output to China, the net effect on the United States and the global markets for oil and natural gas would have been negligible. For every unit of oil or natural gas China imported from Unocal fields, it would import a unit less from other sources, so the net effect on the global energy market would be nil.*

*China's impact on the global markets for energy depends on the pace of its domestic growth and the efficiency with which it uses energy.*