CHINA'S THIRST FOR OIL

Asia Report N°153 – 9 June 2008

International Crisis Group
WORKING TO PREVENT
CONFLICT WORLDWIDE

TABLE OF CONTENTS

CHINA'S THIRST FOR OIL

EXECUTIVE SUMMARY AND RECOMMENDATIONS

China's need for energy is growing faster than any other country's. Record economic growth results in demand that outstrips domestic supply, leading Beijing to look outward to ensure growth and stability. Concerns about the global oil market have led state firms to buy stakes around the world, often in countries shunned by Western firms. The investments are an important factor in Beijing's foreign policy. They also drive concerns that China's actions fuel or exacerbate conflict in the developing world and cause tensions with other major oil-importing countries as it locks up energy resources. China's energy needs have led it to play a more prominent role in international markets in recent years. This has generated concerns about the potential impact on other countries' energy security, and global and regional security generally. These are largely overstated, but China could take a number of steps, as its policymaking and implementation evolves, which would help create a more cooperative international environment on both energy and wider security issues.

Chinese companies cannot dominate international oil supplies. They are small players outside of China, and the oil they bring online expands global supply, benefiting all consumers. The majority of oil they produce is sold on the open market, not shipped back to China. Furthermore, Beijing's idea of energy security is showing signs of evolving from a mercantilist approach based on distrust of international markets, and therefore a desire for physical control of oil supplies, to a more open approach favouring international energy markets and cooperation. Chinese leaders are coming to understand that their state companies' investments abroad have contributed far more to those companies' profits than to improving the country's energy security.

Industrialised countries are also worried about China's subsidised lending to its state-owned oil companies, use of tied aid and support for repressive regimes. China has a long way to go to harmonise its investments and foreign assistance practices with those recommended by the World Bank and the International Monetary Fund (IMF), particularly in regard to transparency. But such fears are often also overblown. While China's energy investments in countries in or at risk of conflict have sometimes contributed to prolonging or making conflicts more difficult to end, their effect is exaggerated. Nor is China alone in these practices.

In some cases, Chinese support to unsavoury regimes indeed makes conflicts more difficult to resolve, as it softens or thwarts international action. At the same time, China is starting to play a less obstructive, and even constructive, role in multilateral processes and supports some forms of international intervention. Chinese officials are finding that their long-cherished concept of non-interference in the domestic affairs of sovereign states is not always practical or in line with national interests. As it seeks increased legitimacy for its rise as a great power, China does not want to be seen as heading a league of the world's worst dictatorships. It has been embarrassed by the levels of criticism it has faced in the world media over Darfur and for its backing of problem regimes more generally.

The direct economic, political and security risks are at least as important as the reputational ones. While unquestioned support for problem regimes such as Sudan has been useful to state companies in signing initial energy agreements, it is less helpful in securing Beijing's long-term energy interests, especially as it is confronted with mounting risks to its investments, citizens and security. Simply consolidating ties to the leadership of a regime without cultivating broader relationships in the country can alienate segments of both public and elite opinion, and lead to instability that threatens investments. In Sudan, for example, the bulk of the Chinese oil fields are in the South, which anticipates a self-determination referendum in 2011, following which it could secede. In addition to its stakes there, China's new investments in Chad give it an even greater interest in the region's stability. While Beijing's interests also increasingly converge with the

West's on issues such as nuclear non-proliferation and stability in the Middle East, its overseas investments are exposing tensions between its energy concerns and diplomatic aims.

China's quest for resources abroad is also strongly linked to its internal energy policy. To achieve energy security, the leadership recognises that domestic policy must focus more on conservation, raising efficiency, reducing pollution, diversifying the energy mix, upgrading clean technologies and allowing energy prices to send proper signals to suppliers and consumers. However, both policymaking and implementation in China are hindered by competing interests at the central, state, provincial, local and private levels. The central government has great difficulty enforcing energy regulations and policies. With inflation expanding at its fastest pace in more than a decade, Beijing is also fighting to control the prices of energy and food. The need for a coherent energy policy and institutional apparatus to manage energy is more urgent than ever.

All countries share an interest in ensuring an adequate oil supply, oil prices conducive to economic growth and a stable international environment. They can help shape the way in which China's quest for energy security develops by encouraging cooperative rather than competitive behaviour.

RECOMMENDATIONS

To the Government of China:

1. Reorganise and strengthen scattered regulatory and policymaking organs into a central, ministerial-level body, such as an energy ministry, with the authority, independence and resources to manage energy security and which pays particular attention to reconciling competing interests in the public-private and state-provincial sectors.
2. Reconfigure national oil companies (NOCs) as purely commercial entities, with the government at arm's length as the largest shareholder.
3. Strengthen energy conservation and efficiency policies; clearly identify the responsible entities for each energy efficiency target; and improve the system for inspecting and evaluating targets.
4. Expand the use of energy efficiency standards to evaluate the performance of local officials.
5. Continue to diversify both fuels and supply sources and allow market prices to reflect true costs and those price signals to help guide supplier and consumer behavior.
6. Increase transparency through improved reporting and greater disclosure of energy, trade and environmental statistics.
7. Ensure that energy investment tied to sovereign lending and aid is done in line with global best practices and that aid is a response to economic and social development in the country, not tied to commercial investments.
8. Cease arms sales to customers, including governments and other parties, who use them to violate mandatory resolutions of the UN Security Council or otherwise in violation of international conventions, including human rights conventions.
9. Employ local workers on overseas projects and transfer knowledge, where possible, to encourage sustainable development.
10. Increase transparency on military acquisitions and exercises in conjunction with energy security.
11. Support UN and regional organisational efforts to prevent and resolve deadly conflict, and refrain from policies and practices which might undermine such efforts.

To the Governments of China, Japan, South Korea, the U.S., India, Australia, Europe and ASEAN:

12. Begin to prepare the groundwork for Chinese membership in the International Energy Agency (IEA) and other international cooperative bodies, so that China has a greater stake in the success of, and can become more integrated into, the international system.
13. Diversify the energy mix to make wider use of clean and alternative energy through expanded collaboration in research and development of the relevant technologies.
14. Strengthen cooperation on strategic oil stocks to promote international energy security.
15. Improve transparency of data in the market through better sharing of information so as to enhance oil market stability.
16. Encourage extensive and in-depth cooperation between business sectors in areas such as energy efficiency, alternative energies and transportation.

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CHINA'S THIRST FOR OIL

I. INTRODUCTION

China was self-sufficient in energy until 1993, but after three decades of rapid growth, it has turned abroad for its growing energy needs.[1] The country became the second largest oil consumer after the U.S. in 2003[2] and is expected to lead global consumption in around twenty years.[3] Energy security is now a major focus of the leadership in Beijing, which has been trying to secure supplies of petroleum from around the world. This has led to discussion about how China's growing need will affect global energy security and raised some concerns that are related to conflict:

- **How and where China invests**. Subsidised lending and tied aid give Chinese national oil companies (NOCs) an advantage in gaining access to overseas oil and gas supplies and undermine efforts to improve governance and investment standards in weak states. There are also fears that it is "locking up" resources through equity deals, thereby diminishing overall energy security by reducing the oil available to the world market.
- **Support for problem states**. Beijing's diplomatic and financial support for countries such as Sudan and Iran is seen as impeding the resolution of conflicts and weapons proliferation threats.[4]

Such concerns are not unique to China. They apply to other fast-growing economies and to the practices of Western countries. This report aims to examine their validity with respect to China, as well as assess the impact of Beijing's energy policies on the resolution of conflicts, in particular with Sudan and Iran. China has energy investments in many other troubled countries including Kazakhstan, Nigeria, Angola and Venezuela, but Sudan and Iran were chosen as case studies because of their importance and the level of international engagement in them. The report also looks at the way domestic energy policy affects China's actions abroad. It does not cover environmental issues such as climate change,[5] nor does it look at

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[1] "World Energy Outlook 2007: China and India Insights", International Energy Agency, November 2007. For Crisis Group's energy-related research, see Crisis Group Africa Report N°135, *Nigeria: Ending Unrest in the Niger Delta*, 5 December 2007; Crisis Group Africa Briefing N°47, *Sudan: Breaking the Abyei Deadlock*, 12 October 2007; Crisis Group Asia Report N°133, *Central Asia's Energy Risks*, 24 May 2007; and Crisis Group Latin America Report N°19, *Venezuela: Hugo Chávez's Revolution*, 22 February 2007.

[2] Country Analysis Briefs, Energy Information Administration (EIA), U.S. Department of Energy, August 2006, at www.eia.doe.gov/emeu/cabs/China/Background.html.

[3] China's oil consumption is growing faster in both percentage and absolute terms, and is projected to grow 410,000 barrels per day (bpd) in 2007 and 470,000 bpd in 2008, compared with 280,000 bpd in 2007 and 250,000 bpd in 2008 for the U.S. "Table 3a. International Petroleum Supply, Consumption, and Inventories", in Short-Term Energy Outlook, Energy Information Administration (EIA), U.S. Department of Energy, September 2007, at www.eia.doe.gov/emeu/steo/pub/3tab.html. "World Energy Outlook 2007: China and India Insights", International Energy Agency, November 2007. See Appendices B below.

[4] For recent Crisis Group reporting on these regions, see Africa Report N°134, *Darfur's New Security Reality*, 26 November 2007; Briefing, *Breaking the Abyei Deadlock*, op. cit.; and Middle East Report N°51, *Iran: Is There a Way Out of the Nuclear Impasse?*, 23 February 2006.

[5] The environmental implications of China's energy policy are well covered elsewhere. See Elizabeth C. Economy, "The Great Leap Backward?", *Foreign Affairs*, September/October 2007, and *The River Runs Black: The Environmental Challenge to China's Future* (New York, 2004); "Introduction: The New China, a Different United States", in Lionel M. Jensen & Timothy B. Weston (eds.), *China's Transformations: The Stories Beyond the Headlines* (Lanham, Maryland: 2007); Judith Shapiro, "The Political Roots of China's Environmental Degradation", in ibid; Detlef van Vuuren, Zhou Fengqi, Bert de Vries, Jiang Kejun, Cor Graveland and Li Yun, "Energy and emission scenarios for China in the 21st century: exploration of baseline development and mitigation options", *Energy Policy*, vol. 31, no. 4 (March 2003), pp. 369-387; Warwick J. McKibbin, "Environmental Consequences of Rising Energy Use in China", *Asian Economic Policy Review*, vol. 1, no. 1 (June 2006), pp. 157-174; "Promoting Environmental Regulatory System Reform, Energy Savings, and Environmental Protection", China Sus-

territorial disputes[6] and concerns over shipping, both of which are linked to oil. It is based on interviews and other research in China, Sudan and Iran, as well as with international oil companies and analysts.

tainable Energy Program, November 2006; and Alex L. Wang, Barbara Finamore and Christopher Williams, "Environmental Governance in China: Recommendations for Reform from International Experience", Natural Resources Defense Council, June 2007.

[6] For Crisis Group reporting on territorial disputes in North East Asia, see Asia Report N°108, *North East Asia's Undercurrents of Conflict*, 15 December 2005.

II. CHINESE ENERGY USE AND POLICYMAKING

China's policies abroad cannot be understood without looking at consumption and policymaking at home. At the heart of the issue is a changing view of energy security. The country is moving from a planned economy based on self-sufficiency toward a market-based economy that increasingly relies on the international system and seeks to diversify energy sources.

This is being done in a situation where policymaking and implementation are hindered by competing interests at the state, provincial and private levels. China's NOCs regularly evade government policy when it conflicts with their interests. The government also struggles to find an effective balance of administrative and market mechanisms. A new draft energy law and White Paper are signs that China is trying to develop a comprehensive policy. No scheme will be successfully implemented, however, unless there is a central government body that has the necessary authority and resources to manage energy security and reconcile competing bureaucratic and corporate interests.

A. ENERGY PROFILE

1. Production

China meets most of its energy requirements at home, a fact that it highlights to downplay concerns about its activities abroad.[7] Vast, recoverable coal reserves – the world's third largest, behind the U.S. and Russia[8] – have fuelled the country's growth and are likely to continue to do so for at least a generation, despite growing environmental and safety concerns.[9] Coal is

[7] "For a long time China has relied largely on domestic energy resources to develop its economy, and the rate of self-sufficiency has been above 90 per cent, much higher than that in most developed countries", "White Paper on Energy: China's Energy Conditions and Policies", Information Office of the State Council, 26 December 2007.

[8] China has recoverable reserves equal to 114.5 billion metric tons (Crisis Group metric conversion). "Country Analysis Briefs: China", Energy Information Administration (EIA), U.S. Department of Energy, August 2006, at www.eia.doe.gov/emeu/cabs/China/Coal.html.

[9] See Appendix D below. In June 2007, the Netherlands Environmental Assessment Agency said China's greenhouse gas (CO_2) emissions surpassed those of the U.S. in 2006, making it the world's largest source of emissions. "China now no.1 in CO_2 emissions; USA in second position", press

responsible for 69 per cent of total primary energy consumption, making China the world's largest producer and consumer of that commodity.[10]

Since 1993, China has been a net oil importer and is now the third largest, behind the U.S. and Japan.[11] It is also the second largest consumer of oil, though it presently consumes two thirds less oil than the U.S., and its 2006 increase in oil demand was 46 per cent of the world's total increase.[12] China's oil consumption has been growing by about 8 per cent a year since 2002, while oil production has been growing slowly, only by 1.5 per cent in the last decade.[13] With oil consumption reaching 350 million tons in 2006, the country now imports almost half the oil it consumes, and domestic supply is not expected to improve that proportion in the future[14] since production declines in the oldest and largest oil fields in the north east are unlikely to be offset by increased output from new fields;[15] the International Energy Agency (IEA) expects total national output to peak in 2012.[16] The gap between demand and production has reached 166 million tons per year.[17]

2. Consumption

Heavy industry – steel mills, cement kilns and aluminium smelters – accounts for more than two thirds of energy demand.[18] Commercial, transportation and residential demand make up just 2, 7 and 10 per cent respectively, tiny shares in comparison with most Western countries.[19] Demand is mostly driven by the manufacturing of goods sold on global markets, not least in the U.S. Much energy in China is dedicated to the creation of infrastructure factories, roads and ports – that makes possible an economy that supports overseas consumption.[20] Concern about the effects of an

release, Netherlands Environmental Assessment Agency, 19 June 2007, at www.mnp.nl/en/service/pressreleases/2007/20070619Chinanowno1inCO2emissionsUSAinsecondposition.html. In March 2007, the World Bank released an early draft of a report, "Cost of Pollution in China", for a conference in Beijing, stating that "the combined health and non-health cost of outdoor air and water pollution for China's economy comes to around U.S. $100 billion a year (or about 5.8 per cent of the country's GDP)". In July 2007, reports surfaced that the Bank had been pressured to remove statistical modelling showing that as many as 750,000 people die prematurely each year in China due to air and water pollution. The country director confirmed receipt of "comprehensive comments … by the Chinese Government" and that some calculations had been "left out of this conference edition due to still some uncertainties about calculation methods and its application", "Statement from World Bank China Country Director on 'Cost of Pollution in China' Report", World Bank, 11 July 2007. China reported 898 deaths in 236 mine accidents from January to November 2007. In December 2007, a coal mine gas explosion in Shanxi province killed 105. "China will curb coal bed gas blasts in 2008", Xinhua, 25 December 2007.

[10] "Country Analysis Briefs", August 2006, op. cit.

[11] Ibid.

[12] China consumed approximately 7.3 Mmbbl/d, an increase of 550,000 barrels per day from 2005. World Petroleum Consumption table, Energy Information Administration (EIA), U.S. Department of Energy; Crisis Group calculation.

[13] Lia'nyong, Feng; Junchen, Li; Xiongqi, Pang; Xu, Tang; Lin, Zhao; Qingfei, Zhao, "Peak Oil Models Forecast China's Oil Supply, Demand", Oil and Gas Journal, 14 January 2008.

[14] Consumption is projected to exceed production through 2015: in 2015 it is expected to reach 10.5 Mmbbl/d, and production 3.7 Mmbbl/d. "2007 International Energy Outlook", Energy Information Administration (EIA), U.S. Department of Energy, tables A.5 and G.1. For the first ten months of 2007, about 44 per cent of crude oil imports came from the Middle East, about 4 per cent from elsewhere in the Asia Pacific region, about 32 per cent from Africa, about 13 per cent from the former Soviet Union and about 7 per cent from the Americas and Western Europe. "FACTS", *China Oil and Gas Monthly*, December 2007. See Appendix E below.

[15] Daqing, China's largest oil field, has been in operation since 1960. It has been declining since 2002 when it accounted for one third of national output. By 2020, crude oil output from the field is expected to fall to 31 million tons from 43.4 million tons. "China's CNPC sees Daqing oilfield output around half current levels by 2060", Forbes.com, 26 February 2007.

[16] "World Energy Outlook 2007", op. cit. Jidong Nanpu has 405 million tons (slightly less than three billion barrels) of proven reserves. Wang Ying and Winnie Zhu, "Sinopec Discovery May Hold 200 Million Tons of Oil", *Bloomberg*, 20 May 2007. Another major oil discovery, at Block 12 in Tahe, Xinjiang, may contain as much as 1.47 billion barrels of reserves. David Winning and Peng Renya, "Interview: CNPC Woos Foreign Partners to Boost Oil Recovery", Dow Jones, 19 December 2007. For a map of China's Oil and Gas Supply Infrastructure, see Appendix A below.

[17] Lianyong, Feng; Junchen, Li; Xiongqi, Pang; Xu, Tang; Lin, Zhao; Qingfei, Zhao, "Peak Oil Models Forecast China's Oil Supply, Demand", op. cit.

[18] This is a large proportion by both developing and developed world standards.

[19] Daniel H. Rosen and Trevor Houser, "China Energy: A Guide for the Perplexed", Center for Strategic and International Studies and the Peterson Institute for International Economics, May 2007.

[20] At 6 per cent of global GDP, China accounts for 35 per cent of steel production, up from 12 per cent a decade ago. Its share of global aluminum production has grown from 8 per cent to 28 per cent over the same period and now accounts for nearly half of all cement and flat-glass produced worldwide. In 2002, for example, its steel imports exceeded

investment-led heavy industry boom has led to consideration of "rebalancing" growth, away from investment toward consumption and from industry toward services.[21] But while consumption-led demand from cars, air conditioning and lighting will rise along with incomes and urbanisation,[22] it is still negligible compared with investment-led demand.

B. ENERGY SECURITY

For China, it remains a priority to develop its domestic energy resources.[23] However, ideas about energy security are evolving from a vision of tight government control and self-reliance to a more liberal outlook that accepts market forces and diversified energy types and sources.[24] There is growing recognition of the necessity to create efficient markets and raise energy efficiency, as well as the value of joining multilateral energy institutions.[25] As part of its "go out" strategy, Beijing has nurtured energy relations with an increasing number of countries.[26]

China's strategy still reflects a sense of vulnerability over energy and the government's distrust of oil markets.[27] It is difficult for the leadership to accept that something so crucial for security can be left to an amorphous international system that is dominated by Western importing countries, global oil companies and often unstable exporting nations. It fears that the most influential players in the market – particularly the U.S., but possibly also OPEC or powerful international oil companies (IOCs) – could one day deny China access to the energy it needs.[28] The drive to acquire "equity oil"[29] is rooted in the belief that in a crisis – when the world market is unable or unwilling to supply energy – national oil companies could be pressed into service. As a Chinese diplomat said of

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exports by 450 per cent. In 2007 exports exceeded imports by 230 per cent, making China the world's largest steel exporter as well as producer. Trevor Houser, "China's Energy Consumption and Opportunities for U.S.-China Cooperation to Address the Effects of China's Energy Use", Testimony before the U.S.-China Economic and Security Review Commission, 14 June 2007.

[21] Nicholas R. Lardy, "China: Rebalancing Economic Growth", Peterson Institute for International Economics, Washington DC, 2007.

[22] Ibid.

[23] These include coal with high efficiency and clean burning technology; improving the electricity supply structure for higher efficiency; increasing the supply of natural gas; speeding up the development of new energy and renewable energy sources; building up strategic petroleum reserves; and enhancing energy resources survey capabilities. "Vice Premier Zeng Peiyan's Speech to the People's Congress", Xinhua, 27 December 2005, at www.gov.cn/ldhd/2005-12/27/content_139182.htm.

[24] 曹葵, 邹鹏 [Cao Kui, Zou Peng], 《谈中国石油和能源安全》 ["Discussion of China's Oil and Energy Security"], 教学月刊 [*The Teaching of Politics*], November 2005; 王东海 [Wang Donghai],《论中国的石油资源安全 战略》 ["China's Oil Resources Security Strategy"] , 北京理工大学学报 [*Journal of Beijing Institute of Technology*], vol. 5, 2003; 夏义善 [Xia Yishan], 《中国能源安全问题解决前景》 ["China's Energy Resources Security and the Ways of Its Solution"], 和平与发展 [*Peace and Development*], vol. 4 (2003); 《能源安全问题研究》 ["A Study of Energy Security"], Chinese Academy of Social Sciences website, 5 December 2007, www.cass.net.cn/file/20071205106095.html; and Liu Zhiyan, San Feng, Long Xiaobai, "Chinese Perspectives on Energy and Climate Security", Chatham House and Chinese Academy of Social Sciences, February 2008, at www.eu-china-energy-climate.net/documents/Chinese%20 Perspectives.pdf. China sees diversifying its sources and types of energy as the "most important principle in energy security" and "the basic starting point for examining energy security at any time".《能源安全的真正含义》 ["The Real Meaning of 'Energy Security'"], Office of the National Energy Leading Group,18 September 2006, at www.chinaenergy.gov.cn/.

[25] 《能源安全问题研究》 ["A Study of Energy Security"], Chinese Academy of Social Sciences website, 5 December 2007, at www.cass.net.cn/file/20071205106095.html; 《能源安全的真正含义》 ["The Real Meaning of 'Energy Security'"], op. cit.;《中华人民共和国能源法（征求意见稿）》 ["Energy Law of the People's Republic of China (Draft for Public Comments)"], Office of the National Energy Leading Group, 3 December 2007, at www.chinaenergy.gov.cn/data/upload/download/xNzUtLeo1ffH89 LivPu45dDeuMQ=_rdnRp0.doc; and "Renewable Energy Law of the People's Republic of China", China Climate Change Info-net, 9 November 2005, at www.ccchina.gov.cn/en/NewsInfo.asp?NewsId=5371.

[26] In 1999, the Central Committee of the Communist Party announced the "go out" (走出去, *zouchuqu*) strategy, offering investment incentives for companies, including reform and liberalisation of regulatory systems, financial regimes and administrative rules. Xu Xiaojie, "Chinese NOCs' Overseas Strategies: Background, Comparison and Remarks", The James A. Baker III Institute for Public Policy, Rice University, March 2007. See Section III below, "How and Where China Invests".

[27] Mikkal E. Herberg, "China's Energy Consumption and Opportunities for U.S.-China Cooperation to Address the Effects of China's Energy Use", testimony before the U.S.-China Economic and Security Review Commission, 14 June 2007.

[28] Erica Downs, "The Brookings Foreign Policy Studies Energy Security Series: China", The Brookings Institution, December 2006.

[29] Equity oil refers to the oil that comes out a company's share of a concession that may be co-developed with another.

his country's similar insecurity regarding the global financial system, "Western countries can feel secure purchasing oil internationally because they created the system – China did not".[30]

C. Energy Institutions and Policymaking

1. Government structures

The past two decades of bureaucratic restructuring and shifting from a planned to market economy have resulted in fragmented control over the energy sector, preventing the development of a national energy strategy. Since 1993, China has not had an energy ministry or an equivalent body responsible for making and overseeing a national energy policy.[31] This lack of a central authority is compounded by the intervention of state oil companies in policymaking, the weakness of the legislative branch and the absence of strong enforcement of regulations.[32] Policymaking is a lengthy bargaining process among diverse actors, each of which has strong vested interests and conflicting objectives.[33] The result is a failure to develop effective policies on exploration, consumption, conservation and reserves.[34] Policymaking and statistical bodies are also woefully understaffed.[35] The government has been unable to build up independent expertise and remains largely dependent on often self-serving advice from NOCs.

Those state firms, such as China National Petroleum Corporation (CNPC), China Petroleum and Chemical Corporation (Sinopec) and China National Offshore Oil Corporation's (CNOOC) dominate the policy process.[36] They have been able to exploit institutional weaknesses, resulting in a fragmented energy policy driven by company objectives rather than a compre-

[30] Crisis Group interview, 8 May 2007. The diplomat added that China would like to be part of the game, making rules, and so needs to be a player internationally [ie, have its oil companies investing abroad]. Highlighting the importance of self-reliance, Chapter 2 of the White Paper on Energy states: "China mainly relies on itself to increase the supply of energy", "White Paper", op. cit.

[31] An energy ministry was established in 1988, but because its administrative functions overlapped with other departments and it was unable to overcome the vested interests of other institutions, it was dismantled five years later.

[32] Competition among bureaucratic agencies seems to be condoned by Chinese leaders, who expect that representatives will defend their organisation's interests. Philip Andrews-Speed, "Energy Policy and Regulation in China", *Kluwer Law International*, The Hague, 2004, pp. 32, 53. See also Bates Gill and James Reilly, "The Tenuous Hold of China Inc. in Africa", *The Washington Quarterly*, Summer 2007, pp. 37-52.

[33] Christian Constantin, "Understanding China's Energy Security", *World Political Science Review*, vol. 3, no. 3 (2007).

[34] "Every actor tries to further his own personal or institutional interests, breeding rivalry and mistrust. State-run enterprises are increasingly concerned with profitability, but at the same time their directors must maintain good ties to high-ranking officials in order to operate effectively. Rather than following explicit government directives, they are more likely to use government policies to justify decisions they would like to make for commercial reasons. The wording of most government edicts is so evasive that it is usually possible to find a clause validating any sort of action". Linda Jackobson, "The Burden of 'Non-Interference'", *China Economic Quarterly*, Q2 2007, p. 15.

[35] "Under the existing structure, energy regulatory bodies in China are severely understaffed. At the central government level, the State Energy Leading Small Group (LSG), the State Energy Office, the Energy Bureau under the NDRC, the State Electricity Regulatory Commission (SERC) and the State Administration of Coal Mine Safety (SACMS) constitute the country's energy governance architecture. The total staff numbers for the above agencies are sixteen, 24, 57, 98 and 48 respectively, adding up to a meagre 243. In addition, the Energy Research Institute (ERI) under the NDRC employs about 70 researchers, and the MLNR's Strategic Research Center of Oil and Gas Resources keeps 50 researchers to provide research support for the central government. This miniscule number of stalwarts is tasked with challenges of staggering magnitude. For example, the 48 people at the SACMS are charged with monitoring and regulating production safety for more than 28,000 coal mines in China. Similarly, the 57 people at the Energy Bureau are overwhelmed by a superabundance of project approvals and evaluations while expected to formulate and craft the country's long-term energy policies. To deal with policy requests, these regulatory agencies must outsource tasks to other ministries, or to energy companies, who will seek every opportunity to promote and protect their own vested interests. Consequently, policy outcomes become reactive, ad-hoc, and pro-status quo". Kong Bo, "Time to reinstitute", *China Stakes*, 9 December 2007, at http://inezha.com/p/2997228/item20.

[36] For example, the Ministry of Land and Natural Resources (MLNR) is responsible for approving geological exploration and collecting resource taxes, the Ministry of Agriculture for overseeing energy development in rural areas, the Ministry of Water Resources for guiding hydropower development, the Ministry of Commerce for administering energy import and export quotas, the Ministry of Science and Technology for regulating R&D in the energy sector, and the State Environmental Protection Agency for tackling the environmental issues of energy development. Ibid.

hensive national strategy.[37] For example, the environment and climate change chapter in a draft of the "Energy Law of the People's Republic of China" was withdrawn following pressure from Chinese oil companies. And given that equity oil does little to promote energy security, CNPC has profited from investments in Sudan that have come with diplomatic and reputational costs for China that could make them inconsistent with national interests. Officials in the Energy Bureau of the National Development and Reform Commission (NDRC), the country's main economic decision-making body, are mostly powerless in the face of pressure from these state-owned firms. The bureau is ranked lower in the bureaucracy than CNPC and Sinopec, which hold ministry-level status and have general managers of vice-ministerial rank.

Energy shortages in 2003 and 2004 prompted the government to create the National Energy Leading Group (NELG) in 2005 directly under the State Council to help manage the energy industry.[38] Many functions relating to the energy sector are split between it and the Energy Bureau. The NELG does not draft regulations but sets guiding principles for the bureaucracy.[39] The disconnect between the development of a national energy strategy and its actual implementation at the lower levels of government continues to be a major problem.

In June 2006, the World Bank and the Development Research Centre of the State Council, a state-sponsored think tank, joined many others in urging the government to reconstitute the energy ministry.[40] At the Communist Party Congress in October 2007, delegates submitted proposals to create such a ministry.[41] A month later, Li Keqiang, a member of the Politburo Standing Committee, was asked to head the institutional reform of the State Council. Soon thereafter, plans leaked regarding the creation of a system of "super ministries" to be put forward at the March 2008 session of the National People's Congress (NPC).[42]

A new energy ministry would integrate the energy functions of the NDRC, the State-Owned Assets Supervision and Administration Commission (SASAC), the Ministry of Land and Natural Resources, the Ministry of Water Resources and the State Electricity Regulatory Commission (SERC), and would guide all state-owned energy conglomerates.[43] A drafter of the "Energy Law of the People's Republic of China" said in January 2008 that there was a 99 per cent chance of a ministry being formed.[44] He cautioned, however,

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[37] Downs, op. cit. An example can be traced to their recent intervention on a draft of the energy law. Trevor Houser, "The Roots of Chinese Oil Investment Overseas", *Asia Policy*, no. 5 (January 2008), pp. 141-166.

[38] The NELG is led by Premier Wen Jiabao with Ma Kai, chairman of the NDRC, leading its administrative body, the National Energy Office. Though the latter is physically located within the NDRC, it is separate from the Energy Bureau. Barry Naughton, "The New Economic Program, China's Eleventh Five Year Plan and What it Means", *China Leadership Monitor*, no. 16, Fall 2005.

[39] "Energy Leading Group Set Up", *China Daily*, 4 June 2005.

[40] Fu Jing, "New ministry recommended to handle energy challenges", *China Daily*, 2 June 2006, at www.chinadaily.com.cn/china/2006-06/02/content_606838.htm; 《中国能源专家呼吁设立新的能源部》["China's energy experts call for the establishment of a new energy ministry"], Dow Jones, 15 November 2007, at www.oilchina.com/newshtml/syxw/20071115/news2007111508312719049.htm;《呼吁设立能源部》["Call to establish new energy ministry"], 石油企业杂志 [*China Petroleum Enterprise Magazine*], 19 November 2007, www.cpechina.com/system/2007/11/19/001139176.shtml; 《成立能源部尚需时日》["It is not yet the time for the establishment of an energy ministry"], 中国产经新闻报 [*China Industrial Economy News*], 15 October 2007; 《能源体制性短缺明显国家能源部二度呼出》["Shortcomings of the energy system are clear, again there are calls for a national energy ministry"], 中国产经新闻报 [*China Industrial Economy News*], 5 June 2007, www.sina.com.cn. An explanation for why China has lagged behind other oil-importers in developing a strategic reserve is that energy policy has been devised by a host of party and government departments. Corporate and individual consumers increasingly complain that the three oil companies indiscriminately raise prices despite having made large profits in 2007. The official media has run dozens of stories on the high pay and perks of oil company executives, which are more than ten times those of other state-owned companies (*Nanfang Daily*, 19 December 2007; *Legal Daily*, 26 November 2007). Willy Lam, "Beijing Unveils Plan for Super Ministries", *China Brief*, Jamestown Organisation, 4 January 2008.

[41] 《人大代表三度建议重组能源部 专家称近期难实现》["Formation of energy ministry raised at the People's Congress for the 3rd time, experts say it will be difficult to realise in the near future"], 中国石油网[*China Oil News*], 6 March 2006, at www.oilnews.com.cn/gb/misc/2006-03/06/content_657463.htm.

[42] The concept of the "big ministries system" (大部委体制) came about after Hu Jintao, Wen Jiabao and other leaders studied bureaucratic systems in countries ranging from Singapore to the U.S. The reform was intended to facilitate the formulation and execution of policy by streamlining an overlapping array of agencies, commissions and ministries around core issues: environmental protection; energy; social services; housing and construction; transportation; and industry and information.

[43] Ibid.

[44] Crisis Group interview, Beijing, January 2008.

that the institution would not resemble, for example, the U.S. Department of Energy. In its early stages, it might have a staff of only 200 drawn from the Energy Bureau, the State Council and various industry associations. It would not have the large-scale scientific, statistical and forecasting functions of the U.S. Department of Energy, nor become a centralised agency for the country's nuclear activities.

However, the "super ministries" plan that was put forward at the NPC in March 2008 stopped short of reviving an energy ministry. Authority was instead divided between a new National Energy Commission responsible for developing strategies and an expanded Energy Bureau under the central planning agency to control administration and oversight.[45] The plan is widely seen as a political compromise shaped by opposition from energy companies. A State Council statement said the restructuring was "aimed at resolving long-term problems and contradictions as China's economy grows", but energy experts doubt that there will be much improvement in government coordination.[46] It is possible that the bodies could eventually become a full ministry, but not for several years.[47]

Only a strong ministry would be able to manage China's dynamic energy industries effectively. The institution's effectiveness would depend on addressing the issues that led to the failure and dissolution of the previous energy ministry. It would require the authority, staffing, and financial resources to manage energy security policy and reconcile competing interests within the vast government bureaucracy. It would also need to be well staffed; have access to quality data to support decisions and policies; possess the ability to integrate energy demand, supply and security issues; and enjoy the necessary standing to interact with other ministerial-level agencies on an equal level.[48]

In addition to the authority to stand up to entrenched interests of oil and coal companies, a new energy ministry must be structured to allow for representation of the interests of all stakeholders, including those with weak institutional power, such as energy consumers and environmental protection agencies.[49] It would need to allow the government to improve its own expertise, so that it can be a competent and impartial rule-maker, rather than depend on advice from companies. An adviser to government officials in planning the restructuring has noted that real change in the way the Chinese government operates requires deeper political reforms to expose officials to greater public accountability.[50] Government officials will find that they can improve their "governing capability through greater policymaking transparency and a system of policymaking checks and balances, as well as public debate during the policymaking process".[51]

2. The draft energy law

In December 2007, the government released the "Energy Law of the People's Republic of China (Draft for Public Comments)".[52] This is a general directive with broad guidelines which identify and discuss the most

[45] The National Energy Commission lacks jurisdiction over the three state oil and gas monopolies and other government-controlled energy and electricity conglomerates. Jim Yardley, "China Reorganises Government Ministries", *The New York Times*, 12 March 2008; *China Brief*, Jamestown Foundation, 28 March 2008. See Appendix F below, "China's Energy Policymaking Bodies".
[46] Yardley, "China Reorganises", op. cit.
[47] Ibid.
[48] For further information on options for a national energy strategy and what an effective energy ministry would entail, see Jonathan E. Sinton et al., "Evaluation of China's Energy Strategy Options", Lawrence Berkeley National Laboratory and National Renewable Energy Laboratory, 16 May 2005.
[49] Ibid. "Many Chinese officials also hold that energy security means trying to create large, national champion energy firms. There are clearly benefits from having financially stable, technically competent firms with the scale to undertake large investments. But the desire to create strong energy companies should be balanced by an equally strong commitment to the interests of Chinese consumers. This does not mean simply cheap energy prices – rather, it means encouraging competition among suppliers, and engaging in sustainable energy practices – including fuel mix diversification, sustainable industrial, urban construction, and transport policies, and energy prices that reflect the true social cost of using energy". Sun Yu, "China and Global Energy Security: Inevitable Conflict?", Business and Economics Reporting Program, New York University, 4 December 2007.
[50] Chris Buckley, "China 'super-ministry' plan faces super challenges", Reuters, 11 March 2008.
[51] Sun Yu, op. cit.
[52] 《中华人民共和国能源法（征求意见稿）》["Energy Law of the People's Republic of China (Draft for Public Comments)"], op. cit. While the comment period ended on 1 February 2008, the law is unlikely to go into effect until at least 2009. Crisis Group interview, energy analyst, Beijing, January 2008. Days after the release of the draft, the Information Office of the State Council released China's first White Paper on "Energy Conditions and Policies", which, unlike the draft energy law, is available in English and geared to an international audience, "White Paper", op. cit.

pressing energy issues, such as energy security.[53] Because it is just an outline, specific measures for emissions reductions and other environmental issues are not mentioned. Its eventual implementation will require more detailed regulations, a national energy strategy and an energy plan. Nevertheless, the draft law is a significant achievement, particularly given energy policymaking problems and the strength of competing interests.

The law makes conservation one of its top priorities.[54] While it indicates that state funds will be allotted for conservation, the primary goals are to reduce consumption through taxation and pricing mechanisms as well as provide incentives for clean energy. Prices are to be set by both market and government forces, with priority given to the market.[55] But this provision has already been challenged by the government's introduction of price controls in January 2008, the first such measures in over ten years.[56] Discussions in Beijing have focused on balancing the risk of social disturbance from rising prices against the risk that artificial moderation of prices could aggravate the problems of unrestrained demand and an unprofitable downstream sector for China's NOCs.[57]

On the international front, the draft law indicates that China will levy taxes and regulate energy-intensive exports, which is a progressive step.[58] It also identifies clean and alternative energy as important goals, and promotes the use of new types of energy over traditional types of energy, such as renewable energy for fossil energy and low carbon for high carbon energy.[59] However, the chapter in a previous draft devoted to the environment and climate change was withdrawn following pressure from Chinese oil companies.[60] The law would also authorise some state activism on behalf of overseas Chinese energy endeavours.[61] Its emphases on energy security, international cooperation and energy management are explored below.

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[53] The draft law seeks to "standardise energy development, utilisation and management; construct a stable, economic, clean, and sustainable energy supply and service system; enhance energy efficiency; ensure energy safety; accelerate the development of a resource-conserving and eco-friendly society; and promote coordination between energy, the economy, and society", 《第一条：立法目的》["Article 1: Purpose"], 《中华人民共和国能源法（征求意见稿）》["Energy Law of the People's Republic of China (Draft for Public Comments)"], op. cit.

[54] The law calls on all of society to "practice energy conservation and enhance energy efficiency".《第三条：节约优先》 ["Article 3: Give Priority to Conservation"], 《中华人民共和国能源法（征求意见稿）》 ["Energy Law of the People's Republic of China (Draft for Public Comments)"], op. cit.

[55] 《第八十七条：能源税收限制》 ["Article 87: Restrictions on Energy Taxation"], 《中华人民共和国能源法（征求意见稿）》 ["Energy Law of the People's Republic of China (Draft for Public Comments)"], op. cit.

[56] During a 10 January 2008 State Council executive meeting presided over by Premier Wen Jiabao, the government issued the following statement: "Prices of gasoline, natural gas and electricity shall not be adjusted in the near future, and charges for gas, water, heating and public transport in cities shall not be raised". "China vows to stabilise prices, prevent price hikes", Xinhua, 10 January 2008, at www.china.org.cn/english/photo/238772.htm.

[57] Of particular concern are the spiking prices in basic necessities such as food and energy, which are compounded by already troubling inefficiencies in the economy, monopolistic pricing, and corruption. Such sharp price rises can quickly produce public distrust and anger. Some Chinese analysts have cautioned that tampering with prices will make matters worse: 《价格干预宜守边界 市场调控应循规则》 ["Price interventions to control the border; Market adjustments should follow regulations"], 经济观察报 [*Economic Observer*], 21 January 2008, www.eeo.com.cn/eobserve/eeo/jjgcb/2008/01/21/91265.html; 王延春 [Wang Yanchun], 《价格管制对抑制通胀作用有限》 ["Expert: China's Price Intervention Six Months at Most"], 经济观察报 [*Economic Observer*], 18 February 2008, www.eeo.com.cn/eobserve/eeo/jjgcb/2008/02/18/92393.html. The downstream sector is becoming unprofitable for NOCs due to controlled product prices and the high price of crude oil. PetroChina reportedly faces losses of $18 billion in its refining business in 2008 at current crude oil price levels; Sinopec received a $1.7 billion government grant in March to help compensate for losses on price-controlled petroleum products. Ed Crooks and Robin Kwong, "PetroChina Pays for Oil's Surge", *Financial Times*, 19 March 2008.

[58] Renewables and low-carbon substitutes often require specific subsidies to compete with cheaper conventional, high-carbon alternatives (eg, coal).《第十七条：能源进出口管理》 ["Article 17: Management of Energy Imports and Exports"], and 《第九十七条：能源税收限制》["Article 97: Restrictions on Energy Taxation"], 《中华人民共和国能源法 （征求意见稿）》["Energy Law of the People's Republic of China (Draft for Public Comments)"], op. cit.

[59] The law also states, "The state gives priority to developing new fuels to replace oil". 《第三十七条：替代能源开发》 ["Article 37: Development of Alternative Energy"], ibid.

[60] Insiders say that environmental issues are to be addressed in a separate law. Even if so, it would delay accountability. Crisis Group interview, Beijing, January 2008.

[61] See Article 110, Chapter 12 of the draft law, op. cit.

3. Local-national tensions

Tensions between the central and local governments are another obstacle to the effective implementation of energy policies. The central government has difficulty enforcing policies due to a disconnect with the provinces. This has always been a critical issue in Chinese politics – the emperor's powers stopped at the village gate.[62] While Beijing sets directions for national policy, local governments are tasked with implementation. Unfortunately, the draft energy law does not address how to reduce this tension. It provides that the State Council holds primary authority over the energy system but becomes vaguer when referring to "other related departments under the State Council" executing tasks "within their responsibilities". Furthermore, many articles task "all levels" or "various levels" of the government. These provisions add up to a confusing picture that is likely to continue to be characterised by inefficiency and overlap, even while recognising that decentralisation and adaptation to local conditions are necessary for a large and diverse country.

Central-local tensions manifest themselves, for example, in the issue of conservation. President Hu promoted a "conservation culture" of reduced carbon emissions, as well as a sustainable balance between economic growth and environmental preservation in his report to the Party Congress in October 2007.[63] However, because the performance of provincial government officials – and their promotion – has been measured by economic growth, many local governments have ignored directives on energy efficiency.

In July 2006, the NDRC noted that some local governments were turning a "blind eye" to planned reductions in energy consuming sectors and urged the government to address the link between increased economic output and promotions.[64] Having recognised that energy efficiency and the environment are often sacrificed for growth, the central government has begun to link career prospects to compliance with directives on energy conservation and the reduction of emissions.[65] At the same time, however, policies at the central government level also contradict a strict conservation message, as seen in the February 2008 announcement of subsidies for products such as refrigerators, as part of a campaign to boost rural consumption.[66]

[62] This issue was reflected in Mao's writings. See, for example, Mao Zedong, "On the Ten Great Relationships", in Stuart Schram (ed.), *Chairman Mao Talks to the People: Talks and Letters: 1956-71* (New York, 1974), pp. 61-83.

[63] Hu Jintao, "Political Report to the 17th National Congress of the Communist Party of China", 15 October 2007.

[64] On 22 July 2007, NDRC officials said, "some local governments are investing heavily in high resources consuming sectors, ignoring the central government's decision to save energy and reduce greenhouse gas emissions. Failure to meet the central government's green targets, the officials fear, could 'indirectly hinder social harmony'". He Bingguang, deputy director of an NDRC department said, "the central government is committed to achieving the (green) targets, but some local governments have turned a blind eye to them", "Local governments 'ignoring' green model", *China Daily*, 23 July 2007.

[65] Xie Zhenhua, deputy chief of the NDRC, recently announced that officials who failed to meet environmental targets would have to give a public explanation and undergo public supervision. Such officials and enterprise leaders would also not be entitled to honorary titles that year, and high-pollution, high-consumption projects planned for their regions would be suspended. The NDRC also increased fees on high-polluting, high-energy-consuming enterprises to be deposited with local governments, thus creating a local incentive for more aggressive enforcement of environmental laws. See "Officials face scrutiny for emission reduction shortcomings", Xinhua, 29 November 2007.

[66] Jason Subler, "China farmers to get fridges, TVs to boost consumption", Reuters, 20 February 2008, available at www.reuters.com/article/worldNews/idUSPEK26642620080221.

III. HOW AND WHERE CHINA INVESTS

A. GOING OUT

The late 1990s saw an intensification of China's resource-driven commercial diplomacy through its "go out" strategy that encouraged state companies to invest abroad. Backed by generous government support such as preferential loans, state-owned enterprises were encouraged to explore strategic investment opportunities in oil and gas fields worldwide, marking a shift from a purely export-led growth strategy toward an emphasis on foreign direct investment (FDI), mergers and acquisitions. This policy of heavy state support was largely the result of a perception of vulnerability in access to energy supplies, but it also came about due to NOCs' requests to the state for help in becoming more competitive with multinationals.[67]

This sense of insecurity has been accentuated by price increases and fears about disruptions in the supply of oil from key supplier states, as well as acute local fuel shortages. The fears were also reinforced by the post-11 September expansion of U.S. influence in the Persian Gulf and Central Asia and concerns about access to Western markets following U.S. Congressional opposition to CNOOC's efforts to buy Unocal.[68] The Unocal affair was interpreted by Beijing as a message that Washington was hostile to and would block attempts by Chinese oil companies to buy U.S. firms, and that Washington viewed energy as a zero-sum competition between consumers.[69]

NOCs looked to purchase overseas assets even before the "go out" policy was established. As China became a net importer in 1993, CNPC made its first overseas purchases of stakes in oilfields in Thailand, Canada and Peru.[70] In 1994-1995, CNOOC acquired a stake in Indonesia's Malacca Strait oil block. In 1995 CNPC acquired its first assets in Sudan;[71] in 1997 it entered Kazakhstan; and in 1998 it bought two fields in Venezuela. Initially, China's leaders did not consider equity investments abroad a sound strategy, instead encouraging NOCs to pursue domestic projects.[72] The 1996 investment in Sudan went ahead without central government approval, at high risk to the company. CNPC justified the move by saying it needed to expand its resource base to remain competitive.[73]

The NOCs are still taking the lead and working to shape government policy to suit their economic interests.[74] Because the upstream (exploration and production) sector is the most profitable part of the business,

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[67] Companies often cite government policies as the reason for decisions that are actually taken for commercial reasons.

[68] In 2005 the U.S. Congress blocked CNOOC's acquisition of Unocal. The deal largely played out in the court of public opinion; sound economic reasons for the deal were rejected. CNOOC initially offered $67 in cash per share, a total value of approximately $18.5 billion, $1.5 billion higher than Chevron's bid. Unocal entered discussions with CNOOC, and the issue quickly became politicised. The House of Representatives resolved by 398-15 that the merger could "threaten to impair the national security of the United States", and if it proceeded, "the President should initiate immediately a thorough review of the proposed acquisition, merger, or takeover". CNOOC's chairman and CEO Fu Chengyu tried to assuage anxieties, but Unocal accepted a higher, but still financially inferior offer from Chevron on 20 July, and by 2 August CNOOC withdrew its offer stating, "the unprecedented political opposition that followed the announcement of our proposed transaction, attempting to replace or amend the CFIUS [Committee on Foreign Investment in the U.S.] process that has been successfully in operation for decades, was regrettable and unjustified". Some analysts have argued that because Chevron's bid, unlike CNOOC's, was mixed cash and stock, it may have been more competitive than first appeared. Analysts have also asserted that U.S. objections to CNOOC's takeover should have been economic, not political, because CNOOC's backing by the Chinese government allowed it to outbid any competitive commercial company, and China's state-owned companies are not reciprocally open to foreign purchase. U.S. oil companies' complaints about being unable to invest in China are as much economic as political. "CNOOC Limited Proposes Merger with Unocal Offering US$67 per Unocal Share in Cash", CNOOC press release, 23 June 2005, at www.cnoocltd.com/en/news_info.aspx?newsid=20070620164150843; "H. Res. 344", U.S. House of Representatives, 30 June 2005, at www.congress.gov/cgi-bin/query/D?c109:2:./ temp/~c109IY1fjk; "CNOOC Limited to Withdraw Unocal Bid", CNOOC press release, 2 August 2005, at www.cnoocltd.com/en/news_info.aspx?newsid=20070620163702296; Fu Chengyu, "Why is America Worried?", *Wall Street Journal*, 6 July 2005; and "Keep China on Track – Beijing Must Do More to Set State Companies Free", *Financial Times*, 2 November 2005.

[69] Erica S. Downs and Jeffrey A. Bader, "Oil-Hungry China Belongs at Big Table", *Calgary Herald*, 8 September 2006.

[70] "China's Overseas Investments in Oil and Gas Production", Eurasia Group, 16 October 2006.

[71] See Section IV A on Sudan below.

[72] Xu Xiaojie, "Chinese NOCs' Overseas Strategies: Background, Comparison and Remarks", The James A. Baker III Institute for Public Policy, Rice University, March 2007.

[73] Crisis Group interview, Beijing, 28 April 2007.

[74] "Energy projects and agendas are often driven by the corporate interests of China's energy firms rather than by the national interests of the Chinese state", Downs, "Brookings", op. cit.

foreign investments are generally made for purely commercial reasons, without any state influence.[75] When government economic reforms in the late 1980s and early 1990s led to a gradual cessation of direct financial allocations to the three main NOCs (CNPC, Sinopec and CNOOC), their management teams were forced to assume responsibility for their own balance sheets.[76]

Yet, China maintained retail petroleum product price controls, making it difficult to profit on downstream operations (refining and marketing).[77] While shielding domestic consumers from the impact of higher oil prices and encouraging rapid economic growth, artificially low prices had the side effect of pushing NOCs overseas, given the limited growth potential of China's own upstream sector.[78] As their reserve-to-production ratios shrunk, NOCs went abroad. Overseas investment is also attractive for the acquisition of technology and best practices from fields in which NOCs have a partial share.[79]

A false, yet commonly held perception is that Chinese national oil companies are locking up resources through equity deals, thus "removing" assets from the global market. In fact, Chinese firms' international production accounts for a very small percentage of the global oil trade – less than 2 per cent by one account.[80] Within that amount, Chinese companies sell most of their oil produced overseas on the open market.[81] Not only does this make economic sense – NOCs profit more from world oil prices than subsidised domestic ones – but it is also consistent with China's current refining capacities, which are unsuitable for processing some grades of overseas oil.[82] Even if all the NOCs' equity oil were actually shipped home, it would merely displace what China would otherwise have to purchase on the market and so free that amount for other countries. From a purely economic standpoint, China's willingness to extract oil

[75] Houser, "The Roots"op. cit.

[76] For more details, see ibid.

[77] Oil products in China are heavily subsidised at prices set by the State Development and Reform Commission. "Soaring oil price exposes weakness of China's oil product pricing system", *China Daily*, 8 August 2005. The government pays compensation to refiners who sell their oil products to consumers at below-cost prices. Over the last two years, China has paid Sinopec 15 billion yuan (approximately $2 billion) as compensation. See "G7 calls for an end to oil subsidies in India, China", *The Economic Times*, 9 February 2008.

[78] In some cases, the government has encouraged NOCs to continue investment in less-profitable domestic fields (rather than invest abroad in more profitable projects) to maximise domestic production. Houser, "The Roots", op. cit.

[79] This aim to improve technology and practices may be a reason why state companies are often willing to bid more for assets than established Western firms. According to a recent Chinese Academy of Social Sciences study on energy and climate security, "there are significant gaps between China and developed countries in terms of energy extraction, supply, transformation, transmission, industrial production and other end-use technologies. Moreover, out-of-date techniques are common in China's key industries. For example there is a difference equivalent to 200 kg of coal in the energy used to produce a ton of steel between large- and small-scale foundries. The difference is 300 kg for producers of synthetic ammonia. The combination of backward techniques and a lack of advanced technology means that China's energy efficiency lags 10 percentage points behind more advanced countries, and products requiring the largest energy inputs require 40 per cent more energy in China", Liu Zhiyan, San Feng, Long Xiaobai, "Chinese Perspectives", op. cit.

[80] "Statistical Review of World Energy", BP, June 2007; and Rosen and Houser, "China Energy", op. cit., pp. 32-33. In Africa, where China is under particular heat for edging out Western investors, the commercial value of NOC investments, according to Wood Mackenzie, an energy industry consulting firm, is just 8 per cent of the commercial value of the IOCs' investment in African oil and 3 per cent of all companies invested in that commodity. Erica S. Downs, "The Fact and Fiction of Sino-African Energy Relations", *China Security*, vol. 3, no. 3 (Summer 2007).

[81] There are different estimates of how much Chinese companies produce through their equity shares abroad and how much of this production returns to China. Houser, "The Roots", op. cit., estimates Chinese equity production at 681,000 bbl/d in 2006. Crisis Group's own estimate is that the figure could be as high as 1.1 MMbl/d, though this includes equity production from all Chinese companies, not just the three large NOCs considered by Houser. Eurasia Group has estimated that 320,000 bbl/d of production flows back to China. "China's Overseas Investments in Oil and Gas Production", Eurasia Group, 16 October 2006.

[82] Chinese NOCs and government planners are seeking to increase China's capacity to handle less expensive heavy, sulphurous or acidic crude grades. This would reduce reliance on more expensive imports and allow diversification of supplies as well as increase yields. It would also raise the amount of equity oil that could be imported. While there has been speculation that the decision to allocate the new $2 billion Qinzhou City refinery to CNPC rather than Sinopec was a result of a decision to support equity oil production of hard-to-refine Dar Blend crude oil from Sudan, a refinery being built in Sudan by Petronas (Malaysian) will likely take much of CNPC's Dar Blend. See David Winning, "China energy watch: equity oil behind CNPC refinery decision", Dow Jones, 28 February 2007; Tom Holland, "China's big oil companies not as black as painted", *South China Morning Post*, 27 December 2007.

from places that other companies – for ethical or practical reasons – avoid, results in a greater global supply and less price pressure.[83]

The pursuit of equity oil is rooted in a belief that this type of investment provides a more secure and affordable source of energy, particularly in the event of a world crisis. In reality, equity oil cannot buffer China from price shocks or meaningfully contribute to national supply security. If a world crisis resulted in a supply disruption – for example, because of a weather disaster or military situation – equity oil could not be redirected to the Chinese domestic market in any way different than other oil.[84] With regard to price shocks, the global oil market ensures the equalisation of crude prices worldwide, and China is protected from price discrimination as a member of the World Trade Organisation (WTO).[85]

While internal discussion has taken place on the possibility of developing a tanker fleet to transport equity oil, this would likely leave China more vulnerable, since a foreign naval force could more easily identify and target Chinese-flagged vessels.[86] Host countries are also susceptible to war, terrorism and other disruptions of supply, risks from which the international market might be slightly more insulated. Given some of these considerations, Chinese analysts increasingly question whether pursuing equity oil best serves national interests.[87]

B. How China Invests

China's participation in oil production increases supplies, thereby overall international energy security, but it also raises significant concerns about where and how the country invests. Its growing investment in resource-rich but underdeveloped countries has meant deals with regimes that the many in the West find distasteful. In furthering these relationships, China often takes advantage of its longstanding ties with developing countries; the absence of Western competition;[88] diplomatic support (including at the UN); and benefits such as aid, development and infrastructure packages.[89] Critics argue that Beijing is an obstacle to promoting more responsible behaviour, and that its seemingly single-minded focus on commercial relations frustrates the efforts of donor nations and international organisations to promote good governance, accountability and transparency.

1. Financing

China Development Bank[90] and China Export Import Bank (China ExIm) are responsible for overseeing and administering state financing and foreign aid packages.[91] China ExIm has provided significant sums

[83] Linda Jakobson and Zha Daojiong, "China and the Worldwide Search for Oil Security", *Asia-Pacific Review*, vol. 13, no. 2 (November 2006).

[84] Discussion of all the factors that would relate to energy supply in the event of serious conflict between China and another major power is beyond the scope of this paper, but equity oil would be a relatively minor factor in such a situation.

[85] John Mitchell and Glada Lahn, "Oil for Asia", Chatham House, March 2007.

[86] This perceived vulnerability to a naval blockade is one reason the Chinese government has been actively pursuing equity assets in and has piped supplies from Kazakhstan. A slight advantage of a government-owned tanker fleet is that in the event of a perceived or potential, rather than actual, threat, it would likely not incur higher insurance costs. However, a U.S. diplomat told Crisis Group it would ultimately be targeted, "if it ever came down to it." Crisis Group interview, Beijing, December 2006.

[87] Academics at the Chinese Academy of Social Sciences, for example, argue that as long as China is willing to pay the market price for oil, the world market will provide China the oil it needs. Downs, "The Brookings", op. cit.

[88] Åshild Kolås, "China in African oil: Guilty as charged?", senior researcher and program leader of the Conflict Resolution and Peace Building Program at the International Peace Research Institute, Oslo (PRIO), June 2007, at www.epsusa.org/ publications/newsletter/june2007/kolas.htm.

[89] Other governments, such as South Korea and India, have started to provide more active support to their state oil companies' efforts to acquire assets abroad, though it is difficult to say whether this is in response to Chinese policies. India, which has been more sensitive about its NOCs overbidding on assets, has tried to overcome this by signing the "Memorandum for Enhancing Cooperation in the Field of Oil and Natural Gas" with China. "India, China Sign Landmark Energy Agreement", Agence France-Presse, 12 January 2006.

[90] In the first week of March 2008, the State Council approved a plan to restructure the China Development Bank into a listed company that would assume responsibility for the risks of its investments, take deposits from the public, sell shares in an initial public offering and make loans based on its own commercial interests rather than political considerations. See Jamil Anderlini, "Beijing clears way for CDB to go commercial", *Financial Times*, 3 March 2008.

[91] Peter C. Evans and Erica Downs use this phrase in "Untangling China's Quest for Oil Through State-Backed Financial Deals", Brookings Policy Brief #154, May 2006, at www.brookings.edu/~/media/Files/rc/papers/2006/05china_evans/pb154.pdf. The distortion of market-based competition through subsidies to NOCs is not just applicable to China. However, when the subsidies go beyond commercial advan-

in lines of credit to oil companies to use in their overseas expansion efforts.[92] It has also provided special lines of credit with below-market rates to finance infrastructure projects in countries where NOCs are competing with oil companies from other countries for assets or rights.[93] The loans are important foreign policy tools in cash-strapped but resource-rich countries, particularly those with major infrastructure needs which can use resources as collateral.[94]

These financing arrangements also address structural unemployment in China. According to China ExIm's concessional loan requirements, Chinese contractors must be awarded the infrastructure contract financed by loans.[95] Trade agreements accompanying large investments can also lead to a flood of imported Chinese goods with which local manufacturers cannot compete. Further, Chinese companies often bring in their own labour force, furthering perceptions that the local population does not fully benefit from Chinese investment. This stifles market competition and displaces African companies in local markets, while creating few jobs and sometimes taking existing jobs from local workers.[96] As a result, these types of assistance have proven unpopular with some countries.[97]

The provision of state-subsidised financing and infrastructure packages also lowers the commercial criteria that oil companies must apply in their global operations.[98] Given intense competition for energy and its economy's surging demand, Beijing believes that its national firms require state assistance to secure access. It operates under the perception that it is hampered in the global competition for resources because it is a latecomer, with young and inexperienced companies pitted against established Western oil giants. Beijing also believes that state financing is commonly employed by other governments to benefit their own oil companies.[99] While most major international oil companies have received similar support in the past – including in some of the same countries where Chinese firms are now active[100] – Western governments

tage to perceived energy security advantages, the distortional effect with Chinese NOCs may be more significant.

[92] For example, in June 2006, China ExIm was awarded a $1.6 billion loan to help pay for its 45 per cent interest on the OML 130 license in offshore Nigeria. "ExIm Bank Finances CNOOC", *Africa Energy Intelligence*, 7 June 2006. China has been rolling out concessional loans in Africa, of which China ExIm Bank is the sole lender. Essentially, the debtor country's finance minister negotiates a minimum RMB 20 million ($2.4 million) loan. The interest rate and grace period are separately negotiated, with, in the case of Angola, repayment due on 21 March and 21 September each year following the negotiation. Loans are given for infrastructure, social or industrial projects. Martyn Davies, "How China delivers development assistance to Africa", The Centre for Chinese Studies, University of Stellenbosch, February 2008. In other examples, China ExIm loaned $25 million to the Turkmenistan State Bank for Foreign Economic Affairs as part of a framework agreement for Chinese companies work in Turkmenistan's oil and gas sector. China ExIm has given Angola a soft $2 billion line of credit and is negotiating another such loan. Angola's finance minister, José Pedro de Morais, denied that successful Chinese bids were connected to such assistance, stating: "China has very aggressive oil companies. They bid well, and we sell the oil for a good price. The trade for oil is made in absolutely competitive terms. There are no privileges". "East Asia – Finance: Chinese Bank Loans U.S. $25 Million to Turkmenistan to Lift Gas Production", *Gas Matters Today Asia*, 22 May 2006; and Denis McMahon, "Interview: Angola Negotiating $2B Loan with China ExIm Bank", Dow Jones Newswires, 16 May 2007.

[93] For example, in Nigeria, Sinosure, China's export credit guarantee agency, offered up to $50 billion in facilities to help fund projects; Nigeria's minister of state for petroleum said that the infrastructure investment might be in return for access to oil blocks. Matthew Green and Richard McGregor, "China Offers Nigeria $50bn Credit", *Financial Times*, 1 April 2008. Sinosure presumably can only extend its insurance line to Chinese companies wanting to invest in Nigeria's infrastructure. Later in April 2008, China ExIm offered a $2.5 billion loan parallel to talks on exploration rights with Nigerian officials. According to the same Nigerian official, "they've [the Chinese] basically committed to these facilities, and we're exploring with them their interest in investing in the upstream. We're working out the details". Matthew Green, "China Oils Nigeria Talks with Loan", *Financial Times*, 21 April 2008.

[94] Martyn Davies, Hannah Edinger, Nastaya Tay and Sanusha Naidu, "China's Engagement of Africa: Preliminary Scoping of African case studies Angola, Ethiopia, Gabon, Uganda, South Africa, Zambia", Centre for Chinese Studies, University of Stellenbosch, 2008, at www.ccs.org.za/downloads/RF_Paper_Final.pdf.

[95] Ibid.

[96] Ibid; Harry Broadman, "China and India go to Africa", *Foreign Affairs*, March-April 2008, pp. 95-109.

[97] Houser, "The Roots", op. cit.

[98] China's unconditional aid has made it easier for some African countries to refuse conditional aid from others. Kolås, "China in African oil", op. cit. China has also been criticised for tying its aid to the purchase of Chinese goods and services as well as oil deals.

[99] Evans and Downs, "Untangling China's Quest for Oil", op. cit. See also fn. 86 above.

[100] Rosen and Houser, "China Energy", op. cit., p. 33.

have reduced non-commercial interventions in recent years.[101]

2. The structure of national oil companies

Even countries with large domestic reserves that have majority state-owned companies, such as Norway/ StatoilHydro, have found that minimising the government's role in the company is the best way to maximise profits.[102] The role of the government is that of a shareholder, while the board employs a corporate executive committee that manages the company to increase shareholder value – similar to a company with entirely private sector shareholders.[103]

China's NOCs are influenced by the government in three main ways: regulation, ownership and personnel.[104] While regulation takes place in all countries and influences all types of companies, ownership in China is exercised through the State-owned Assets Supervision and Administration Commission (SASAC). It is a passive investor, since no dividends are paid to the state, and there are no higher-return alternatives. As for personnel, unlike StatoilHydro, whose board of directors is largely independent and whose corporate executive committee is elected based on competence, the senior managers of Chinese NOCs are appointed by the Ministry of Personnel.[105] Because company directors are powerful politicians in their own right, they also influence policy, making for a bi-directional flow of authority. But business considerations rather than governmental policy directives generally motivate NOC investments.[106]

In most circumstances, the NOCs rely heavily on retained earnings for financing, not special loans from state-owned banks (as, unusually, was the case in CNOOC's attempt to purchase Unocal), suggesting that state financing might be less important than some analysts suggest.[107] As the NOCs do not pay dividends to their shareholders (principally the government),[108] and the rates of return on domestic exploration and production investment are very low, their bar for returns on foreign investment is lower than than that of IOCs.[109]

An even more important factor in the competitiveness of Chinese firms is their willingness to take high risks in unstable areas and accept low returns.[110] Many of the unexplored oil and gas fields worldwide not already controlled by a powerful oil or gas firm are of a type less suitable for exploitation by the NOCs (thus making the Chinese firms less competitive in head-to-head bids with IOCs).[111] Many developing countries with large oil reserves still prefer Western multinationals to Chinese or other Asian oil companies due to their better technology and large project management capacity, thus their higher oil extraction potential, es-

[101] All buyers are clearly worse off if they add beyond-market rate inducements in negotiations. Equally worrying is that states like India and South Korea feel pressured to adopt similar methods to secure the energy they need, especially as states like Angola and Nigeria have indicated that they will prefer not the bidder who pays market price, but the one who offers the most attractive side benefits. Evans and Downs, "Untangling China's Quest for Oil", op. cit.

[102] As in the case of private shareholders that seek to influence a company's behaviour on issues such as the environment, labour rights, corruption policies, etc., a government may also affect the broader aims of policies of company of which it is a major stakeholder without micromanaging daily operations.

[103] For more on this, see www.statoilhydro.com/en/InvestorCentre/Share/Shareholders/Pages/StateOwnership.aspx.

[104] Houser, "The Roots", op. cit.

[105] Ibid.

[106] Ibid, pp. 141-166.

[107] Ibid. Nevertheless, loans with concessionary terms as sweeteners to energy deals are likely to continue to be received favourably by host governments.

[108] State-owned Enterprises (SOE) have been freed from the obligation of delivering their earnings to the government, as long as they properly pay enterprise and other taxes. Many major SOEs are listed on a stock market and do pay dividends to their state and private shareholders. However, those referred to as state-owned shareholders are, in most cases, a corporate group, parent to an SOE, not SASAC, which should serve as a shareholder for the government. Therefore, profits earned by SOEs are not incorporated into the national budget. Chi Hung Kwan, "Who Owns China's State-owned Enterprises?", Research Institute of Economy, Trade and Industry, 28 July 2006, available at www.rieti.go.jp/en/china/06072801.html.

[109] When high rates of return cannot be made from reinvested earnings, IOC shareholders usually demand profits as dividends. In recent years, it has been common for IOCs to repurchase shares so as to redistribute cash to existing shareholders.

[110] Chinese NOCs often operate in regions where IOCs are either prohibited from investing or are hesitant to operate due to political risk.

[111] Rosen and Houser, "China Energy", op. cit., p. 31. IOCs (according to the PFC 50, a ranking of the world's largest listed energy firms by market capitalisation, the biggest are Occidental, Encana and Devon Energy) focus almost exclusively on upstream (exploration and production) operations, with little downstream (refining and marketing) activity. CNOOC, unlike CNPC and Sinopec, is mostly an exploration and production company, but is generally not considered "independent" because it is majority state-owned.

pecially in the case of deepwater, ultra-deepwater and other difficult projects.[112]

CNOOC's aborted bid to acquire Unocal further persuaded Chinese firms they had less chance for success in bidding for U.S. and European energy firms than by drilling for oil in Sudan or Iran. The perception of a "China threat" appears to have convinced some within China that they must pursue energy deals with problematic governments because they lack opportunities in places such as the U.S.

The history of exploitation in developing countries by industrialised nations and their continued close relations with many repressive and corrupt regimes make it more difficult to press for change in China's behaviour.[113] Elf Aquitaine, the formerly state-owned French oil company, once considered bribes a tax-deductible expense.[114] No conditions on human rights or transparency were attached to the $870 million signature bonus paid by BP-Amoco, TotalFinaElf and Exxon for Angola's ultra-deepwater blocks 31, 32 and 33 in 1999, which set an industry record.[115] Since 1995, the U.S. Export-Import Bank has provided $9.8 billion in financing and the Overseas Private Investment Corporation (OPIC) $5.4 billion for oil, gas and extraction pipelines and other projects abroad,[116] including to help finance projects of ExxonMobil and Chevron in countries with severe human rights problems, most notably Indonesia and Myanmar/Burma.[117]

Other priorities also sometimes outweigh Western governments' attachment to principles. The U.S. maintains a relationship with Sudan for coordinating counter-terrorism efforts,[118] even as it keeps it on its list of states that sponsor terrorism.[119] All major U.S. allies in Africa, including Kenya, Egypt, Ethiopia, Nigeria and Angola, have poor human rights records, accord-

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[112] The gap between the top Western multinationals and top Asian companies is diminishing. "Oil Revenue Transparency: A Strategic Component of U.S. Energy Security and Anti-Corruption Policy", Global Witness, March 2007, at www.global witness.org. Petrobras of Brazil, which is increasingly competitive internationally with Western multinationals and Asian NOCs, is perhaps in another category: Latin American, majority state owned (but the state holds a smaller percentage than in comparable Chinese NOCs), and able to compete in sophisticated deepwater offshore operations with the top multinationals.

[113] "In 1973 … Gulf Oil admitted funneling more than $10 million to U.S. and foreign politicians over several years. When the Securities and Exchange Commission responded with a questionnaire asking American corporations if they paid bribes, more than 400 corporations – including major oil companies like Exxon – acknowledged making questionable payments to foreign government officials, politicians and political parties. The result was the passage in 1977 of the Foreign Corrupt Practices Act – the world's first, and toughest, anti-bribery legislation….[This legislation] does-contain some significant loopholes, such as the exemption for 'facilitating payments,' defined as 'payments to facilitate or expedite performance of routine governmental actions.' These actions include processing of permits, licenses or visas, but 'do not include any decision by a foreign official to award new business'." According to some analysts, the exemption also covers signature bonuses. Phillip van Niekerk and Laura Peterson, "Greasing the Skids of Corruption", 4 November 2002, at www.publicintegrity.org/bow/report.aspx?aid=150. A Chinese sovereign wealth fund bought a 1.5 per cent share in Total, which is no longer state-owned, in April 2008.

[114] A former executive with Elf Aquitaine, which merged with TotalFina to form TotalFinaElf in 2000 (renamed Total in 2003), testified in July 2001 before French prosecutors that the frim had "skimmed pennies off every barrel of African oil" since the 1970s to maintain secret slush funds in Liechtenstein and Switzerland for payouts to the heads of state of Gabon, Congo-Brazzaville, Cameroon, Nigeria and Angola. According to Elf's Andre Tarallo, "All international oil companies have used kickbacks since the first oil shock of the 1970s to guarantee the companies' access to oil", Tarallo said. "You have official 'bonuses' as part of a contract: the company seeking to exploit an oil field commits itself to building a school, a hospital or a road. Then you have 'parallel bonuses,' which can be paid to increase the likelihood of obtaining the contract". Phillip van Niekerk and Laura Peterson, "Greasing the Skids of Corruption", op. cit.

[115] Ibid.

[116] Steve Kretzmann and Meg Boyle, "The Best Congress Oil Could Buy", January 2007, at http://priceofoil.org/wp-content/uploads/2007/01/BestCongress4Oil.pdf.

[117] In Indonesia, Mobil Oil has admitted to supplying food, fuel and equipment to soldiers hired to protect oil installations. The soldiers were later implicated in massacres in Aceh and reportedly used Mobil's equipment to dig mass graves. In the 1990s in Myanmar, a Unocal official admitted to hiring troops to protect two natural gas pipelines and supplying them with intelligence, such as aerial photographs; according to human rights groups and media reports, Unocal's French partner, Total, hired and supplied its own Burmese troops with food and trucks. See van Niekerk and Peterson, "Greasing the Skids", op. cit.

[118] John Prendergast and Colin Thomas-Jensen, "Blowing the Horn", *Foreign Affairs*, March-April 2007. Reports indicate that the U.S. embassy in Khartoum – the largest in Africa – also houses the biggest Central Intelligence Agency (CIA) listening post outside the U.S. "Glittering towers in a war zone", *The Economist*, 7 December 2006; "US to build largest CIA centre for East Africa in Sudan", *Sudan Tribune*, 13 March 2007.

[119] "Country Reports on Terrorism", U.S. Department of State, Office of the Coordinator for Counter-terrorism, 30 April 2007, at www.state.gov/s/ct/rls/crt/2006/82736.htm.

ing to its own assessments.[120] And in 2006, the U.S. renewed its friendship with Equatorial Guinea, considered one of the most corrupt states in Africa, where human rights abuses are prevalent but U.S.-based oil companies dominate.[121] Beyond Africa, the U.S. government is prosecuting James Giffen for allegedly paying bribes to Kazakhstan's President Nursultan Nazarbayev on behalf of Western oil companies, while it feted Nazarbayev during an official visit in September 2006.[122] In the Middle East, Western countries remain buyers of oil from many countries with repressive regimes, such as Saudi Arabia.

3. Aid and oil policy

As Western donors acquire a better understanding of how to link aid and reforms to avoid the problems of the "Washington Consensus",[123] the Chinese government's model of state-led development keeps it distinctively separate.[124] The major international financial institutions (IFIs) have recognised a role for the state, employed debt forgiveness as an incentive to implement reforms and identified the elimination or reduction of corruption as a precondition for lending. Chinese loans, however, appear to follow none of the lessons learned after years of mistakes by IFIs: corruption is disregarded, while concessionary terms are offered regardless of the existence of plans to put the funds to good use. It is hoped that China's promise to cooperate with the World Bank in its development efforts in Africa might bring about some positive change in its investment practices.[125] But as China tries to crack down on corruption at home,[126] there is a need for tougher standards of accountability, greater transparency and increased oversight of its state-owned enterprises' operations overseas.

Many within China's foreign policy circles have expressed a growing frustration with the behaviour of some in the energy sector and resulting incoherent policies. To align business interests with its own long-term vision for the country and to assess the wider political implications of the "go out" strategy, the leadership convened the Politburo, government ministers, ambassadors, provincial governors, party secretaries, officials from state-owned enterprises and senior officers of the People's Liberation Army (PLA) at the August 2006 Central Foreign Affairs Work Conference, the largest foreign policy gathering in recent years. Participants discussed how the behaviour of companies abroad risked damaging the country's image, the need to establish a more coherent grand strat-

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[120] "2007 Country Reports on Human Rights Practices", U.S. Department of State, released on 11 March 2008.

[121] Secretary of State Condoleezza Rice called President Teodoro Obiang a "good friend" when they met in 2006 to discuss reestablishing diplomatic ties. Equatorial Guinea's dismal human rights record is well-documented, and there are allegations of serious mismanagement of its oil revenues. Obiang's alleged money laundering involvement was a reason for the collapse of U.S.-based Riggs Bank in 2005. Equatorial Guinea was ranked 168 of 179 countries on the Transparency International Corruption Perceptions Index 2007. See Condoleezza Rice, "Remarks With Equatorial Guinean President Teodoro Obiang Nguema Mbasogo Before Their Meeting", Washington DC, 12 April 2006, at www.state.gov/secretary/rm/2006/64434.htm; Chris McGreal and Dan Glaister, "The tiny African state, the president's playboy son and the $35m Malibu mansion", *The Guardian*, 10 November 2006, at www.guardian.co.uk/world/2006/nov/10/equatorialguinea.danglaister; Ken Silverstein, "Obiang's Banking Again: State Department and Washington insiders help a dictator get what he wants", *Harpers Magazine*, 9 August 2006; Joshua Kurlantzick, "Putting lipstick on a dictator", *Mother Jones*, 7 May 2007, at www.motherjones.com/news/outfront/2007/05/extreme_makeover.html; Justin Blum, "Equatorial Guinea, USA: US Oil Firms Entwined in Equatorial Guinea Deals", *The Washington Post*, 9 September 2004; and Henri Astier, "Elf was 'secret arm of French policy'", BBC, 19 March 2003.

[122] See Ron Stodghill, "Oil, Cash, and Corruption", *The New York Times*, 5 November 2006.

[123] The "Washington Consensus" originally referred to a set of economic policy prescriptions for countries suffering from economic crisis, as recommended by Washington-based institutions such as the World Bank and International Monetary Fund. However, the term has come to refer more broadly to neo-liberal policies associated with expanding the role of market forces and limiting the role of the state. For example, the IMF imposed structural adjustment packages (SAPs) on Asian countries receiving funding from it to avoid default in the wake of the 1997 Asian financial crisis. In the 1980s and 1990s, various Latin American countries were urged by the IFIs to restructure their economies in accordance with principles of the Washington Consensus, including trade liberalisation, privatisation and fiscal discipline.

[124] "Transparency and good governance should not be the preconditions for development but a result or a consequence of development", Li Ruogu, chairman and president, China ExIm, cited in "China Official Downplays Africa Governance Concerns", Reuters, 13 June 2007. The only political condition borrowers must accept is support for the "one China principle" of reunification with Taiwan.

[125] Alan Wheatley, "World Bank eyes joint Africa projects with China", Reuters, 18 December 2007.

[126] "China premier urges crackdown on corruption", CNN, 5 March 2000; "CPC vows harsher crackdown on corruption", Xinhua, 15 February 2006; and "China to step up anti-corruption crackdown", Xinhua, 21 February 2008.

egy and how to strengthen soft power.[127] There is increasing debate about how overseas investment in countries such as Sudan has damaged and in some cases "hijacked" foreign policy.[128]

C. CHINA'S ROLE IN INTERNATIONAL AGENCIES

One way to tackle state subsidies is through international arrangements that monitor and regulate official finance, such as export credits, tied aid, government guarantees and other publicly supported financial instruments. No single institution covers all aspects of international finance; rather, each institution plays a distinct role, including the International Energy Agency (IEA),[129] the Arrangement on Guidelines for Officially Supported Export Credit of the Organisation for Economic Cooperation and Development (OECD),[130] and the World Trade Organisation (WTO). Of the three, China is only a member of the WTO. It is also an observer in the Energy Charter Conference, an inter-governmental organisation that serves as the governing and decision-making body for parties to the Energy Charter Treaty.

1. IEA

The IEA, a group of energy-consuming countries and originally established as a counterweight to the Organization of Petroleum-Exporting Countries (OPEC), includes only OECD countries.[131] A small number of non-OECD countries, including China, hold observer status. Bringing emerging major oil consumers, such as India and China, into the IEA could assist in securing the stability of oil supplies for all major importing countries. The IEA operates on the premise that it is in the interest of all consuming countries to make as much oil as possible available on the world market and for countries to cooperate in the event of supply disruptions, whether due to natural or man-made crises. Without its own mechanism to monitor or regulate compliance, however, it relies on the shared interests of its members.

Upon assuming office, the IEA chief, Nobuo Tanaka, indicated that cooperation between the agency and China (and India) would be a priority;[132] in early January 2008, he spoke positively in private conversations about the possibility of China joining.[133] In May, the U.S. called for China to join the IEA.[134] Engaging

[127] See Bonnie Glaser, "Ensuring the 'Go Abroad' Policy Serves China's Domestic Priorities", *China Brief*, Jamestown Foundation, 8 March 2007, at www.jamestown.org/publications_det ails.php?volume_id=422&issue_=4030&article_id=2371986.
[128] Scholars at leading Chinese think tanks and universities have expressed concern about overseas investments and have singled out the conduct of state-owned China National Petroleum Corp, or PetroChina, in Sudan. Zhu Feng, at Beijing University's Centre for International and Strategic Studies, said the likes of PetroChina had sometimes pursued profits at the expense of broader national interests: "These state-owned companies have become very powerful interest groups. They even hijacked China's foreign policy in Sudan. That's truly worrisome to me", Richard McGregor, "Chinese diplomacy 'hijacked' by companies in Beijing", *Financial Times*, 17 March 2008.
[129] South Korea, for example, a member of the OECD and the International Energy Agency (IEA), is bound by agreements to limit government-sponsored predatory financing. Evans and Downs, "Untangling China's Quest for Oil", op. cit.
[130] The Export Credit Arrangement disciplines subsidisation of overseas credits to spur exports, including tying aid to export goals. But if China subsidises an NOC's purchase of an oil block in a developing country, it is not exporting so much as fuelling its imports. Further, China is not an OECD member. Rosen and Houser, "China Energy", op. cit.

[131] The agency serves as a policy adviser (particularly on energy security, economic development and environmental protection), coordinates action in the event of oil-supply disruptions and "conducts a broad program of energy research, data compilation, publications and public dissemination of the latest energy policy analysis and recommendations on good practices", www.iea.org/about/index.asp.
[132] Although OECD membership is a prerequisite, Nobuo Tanaka, the IEA executive director, has expressed interest in finding a way to get around the 90-day stock requirement and other membership prerequisites. Mari Iwata, "Interview: IEA's New Chief Sees China, India as Members", Dow Jones Newswires, 24 August 2007. After focusing on China and India in its World Energy Outlook 2007 (November 2007), the IEA moved forward on its decision to engage the world's two largest emerging economies by inviting high-level delegations to participate in Committee Week – several days of discussion on key energy-related issues including emergency response preparedness; outlook for oil, gas and coal markets; technology collaboration; and energy efficiency measures. "IEA engages China, India in energy interaction", *The Hindu Businessline*, 8 December 2007, at www.thehindubusinessline.com/2007/12/08/stories/2007120852401400.htm.
[133] Crisis Group interview, Beijing, January 2008.
[134] U.S. Assistant Secretary of State Daniel Sullivan said at a 20 May conference in Beijing, "China should consider a declaration that it plans to pursue membership in the IEA. This could help ameliorate the anxiety expressed in some quarters over China's intentions as it pursues greater energy security".

with China and India would enhance the IEA's global relevance.[135] Further, as long as China remains outside the organisation, there is an increased risk of price volatility[136] and a "free-rider" problem. Should a crisis trigger an emergency release of reserves from IEA countries, China would benefit from increased availability (and lower prices) without having to release any of its own reserves.[137]

China has already collaborated on data collection and oil security workshops and seminars.[138] While it wishes to cooperate more closely with the agency, Chinese officials say they cannot join because the group is part of the Organisation for Economic Co-operation and Development (OECD).[139] Indeed, careful consideration should be given to how China might enter the IEA since it does not meet the requirements for OECD membership.[140] Even if an alternate solution can be found for China to enter, it would take time to complete the negotiation of a framework for acceptance and accession, including requirements.[141]

A national petroleum reserve is a requirement for IEA membership, and China has started to create one, which will allow it to mitigate damage from any supply disruption.[142] Once completed, it will have a storage capacity of 102 million barrels, equivalent to approximately fourteen days of Chinese consumption.[143] The medium-term goal is to attain a 30-day stockpile by 2010;[144] the long-term goal is a 90-day stockpile, the requirement for IEA members.[145] Oil reserves as a means of protection against soaring oil prices were the focus of the 7 June Five-Party Energy Ministers Meeting held in Aomori, Japan, the second of its kind since the five-party ministerial meeting was held in Beijing in December 2006.[146]

Shei Oster, "US asks China to join Global Energy Group", *Wall Street Journal*, 21 May 2008.

135 "IEA must do more to engage China, India, says next chief", Agence France-Presse, 5 January 2007.

136 For example, around the time of the 2003 Iraq War, China went on a huge oil-buying spree in anticipation of supply disruptions, thereby aggravating the oil price spike that occurred prior to hostilities. Kenneth Lieberthal and Mikkal Herberg, "China's Search for Energy Security: Implications for U.S. Policy", NBR Analysis, vol. 17, no. 1 (April 2006).

137 The free-rider problem holds for all countries. All importers benefit from strategic reserves, as their existence sets limits on the OPEC cartel's behaviour. Importers without such reserves or which do not draw on them in a crisis "free ride" on those that do.

138 Brett Jacobs, presentation at the 4th Meeting of the East Asia Summit, Energy Co-operation Task Force Jakarta, Office of Global Energy Dialogue, IEA, Paris, 26 July 2007.

139 Shei Oster, op. cit.

140 According to the OECD, "each candidate country must have demonstrated its attachment to the basic values shared by all OECD members: an open market economy, democratic pluralism and respect for human rights. The applicant country must also state its position vis-à-vis the OECD 'legal instruments' (including the Decisions, Recommendations and Declarations adopted within the framework of the Organisation). Candidate countries must show both the will and the ability to adopt the main principles of the Organisation, as well as the legal and political obligations that result therefrom". Therefore, on a technical level alone, China cannot yet be a member of the OECD.

141 The latter would likely include requirements similar to those of current members, such as oil stock holding requirements, equal market access requirements and sharing of information guidelines. See the IEA website and the Agreement on an International Energy Program at www.iea.org/about/docs/IEP.PDF.

142 Though it never publicly announced when it started to fill its strategic oil reserve, it had done so for more than a year before the release of the draft energy law.

143 "China Starts Up Second Strategic Petroleum Reserves Depot: Report", *Platts Commodity News*, 30 May 2007.

144 "China to Increase Strategic Oil Reserve Gradually – State Planner", *AFX Asia*, 21 April 2007.

145 Crisis Group interview, Beijing, March 2007. David G. Victor and Sarah Eskreis-Winkler argue that the 90-day rule is arbitrary and ineffective. Rather than basing petroleum reserves on the volume of imports, they advocate that IEA members be required to hold reserves in proportion to the amount of oil they consume. They also argue for an overhaul of the U.S. approach to petroleum reserves, which would offer a better opportunity to engage China and India. David G. Victor and Sarah Eskreis-Winkler, "In the Tank: Making the Most of Strategic Oil Reserves", *Foreign Affairs*, July-August 2008, pp. 70-83.

146 China, India and South Korea, all of which participated in the Five-Party Energy Ministers Meeting on 7 June, also participated in the 8 June G8 Energy Ministers Meeting, which discussed responses to energy issues with regard to climate change, including promotion of energy-saving, introduction of clean energy, and development of innovative energy technology, in addition to the issue of energy security. Announcement of the G8 Energy Ministers Meeting and the Five-Party Energy Ministers Meeting, Japanese Ministry of Economy, Trade and Industry (METI) Press Release, 1 May 2008. See also Xinhua, Energy officials from 5 countries discuss measures against surging oil prices", 7 June 2008.

2. The Shanghai Cooperation Organisation

The Shanghai Cooperation Organisation (SCO)[147] was formed in the mid-1990s to resolve border and disarmament disputes between China and Russia. In recent years, experts have cited a convergence of interests among members in responding to the perception of growing U.S. influence in Central Asia, an area rich in oil and gas reserves. At the Bishkek conference on 16 August 2007, the leaders of the SCO agreed to function as an "energy club" by creating a "unified energy market" to bring oil and natural gas from member countries with those resources to those that require them to promote their development.[148] The declaration stressed the importance of energy resources as "the basis for continued economic growth and security".[149] China has expressed willingness to provide credit and financing support for the SCO's multilateral and bilateral programs in areas such as transportation, communications and energy.[150]

The SCO denied the U.S. observer status in June 2005, issued a declaration the next month calling for the U.S. to set a timeline for withdrawal of its military forces from the region and extended observer status to Iran in 2006.[151] Such actions have led to a debate in Washington over the organisation's implications for American interests.[152]

3. World Trade Organisation (WTO)

China's accession to the WTO required it to end its state monopoly on the oil sector by lifting restrictions on petroleum distribution, including wholesale, direct supply, retail, maintenance and transportation.[153] As it

[147] In April 1996, Russia, China, Kazakhstan, Kyrgyzstan and Tajikistan signed the "Treaty on Deepening Military Trust in Border Regions", thus forming the "Shanghai Five". Uzbekistan was admitted in 2001, after which the group was known as the Shanghai Cooperation Organisation (SCO). Iran, Mongolia, Pakistan and India hold observer status. For more information see the Shanghai Cooperation Organisation website, www.sectsco.org/html/00030.html.

[148] Kazakhstan's prime minister, Nursultan Mazarbayev, said, "we think that a mechanism of meetings of energy ministers from the SCO member and observer states should function in the context of the idea of an energy club. This, in our view, might become one of the main elements of an Asian energy strategy". "Nazarbayev comments on formation of energy club", BBC, 17 August 2007, at http://news.bbc.co.uk/2/hi/asia-pacific/6949021.stm.

[149] The SCO website, op. cit. While not yet the case, the SCO could become a forum for increased cooperation between China and Russia on developing energy trade. China has been eager to import oil from East Siberian fields, and when the Eastern Siberia Pacific Ocean Pipeline's first stage to Skovorodino is completed (in late 2008 or early 2009), China will build a spur to the border which it is financing in addition to the main pipeline, potentially allowing up to 300,000 bbl/d to reach China.

[150] Official Chinese statement on SCO summit by Hu Jintao, 16 August 2007, at www.mfa.gov.cn/eng/wjdt/zyjh/t353202.htm.

[151] On 24 March 2006, in Tajikistan, Foreign Minister Manuchehr Mottaki said Iran had submitted an official request for full membership to the SCO Secretariat, which Tajikistan supported. Under current circumstances, China is highly unlikely to agree to full Iranian membership. In a statement aimed mainly at Iran, Russia's deputy foreign minister, Alexander Losyukov, said at the August 2007 SCO Summit in Bishkek that SCO countries "have come to a decision on the expediency of reaffirming the moratorium on expanding its membership". Pyotr Goncharov, "Iran wants full SCO membership", Russian News and Information Agency RIA Novosti, 26 March 2008.

[152] "To be candid, we don't fully understand what the Shanghai Cooperation Organisation does. We know what its members have said: They adopt communiqués. They issue joint statements. They make declaratory commitments. We know the Shanghai Cooperation Organisation holds meetings – a lot of them, actually: summits, foreign and defense ministerials, working groups, and so on…. But what does the Shanghai Cooperation Organisation actually do to promote enduring cooperation in this part of the world? Is it a security group? A trade bloc? Something else? What is the Shanghai Cooperation Organisation members' vision of their own organisation? Because merely holding an exercise, however large and impressive, does not in itself produce enduring security cooperation". "The Shanghai Cooperation Organisation and the Future of Central Asia", speech by Evan A. Feigenbaum, Deputy Assistant Secretary of State for South and Central Asian Affairs, the Nixon Center, Washington DC, 6 September 2007, at www.state.gov/p/sca/rls/rm/2007/91858.htm; and "The Shanghai Cooperation Organisation: Is it Undermining U.S. Interests in Central Asia?", hearing, United States Commission on Security and Cooperation in Europe, 26 September 2006, at www.csce.gov. However, the U.S. has been supportive of backchannel discussions between NATO and the SCO on potential cooperation in Afghanistan. In April 2008, while visiting Beijing, President Pervez Musharraf of Pakistan said the SCO could join with U.S. and NATO forces in Afghanistan to end the crisis there. Crisis Group interview, Washington DC, February 2008; and "SCO may join NATO in Afghanistan", Associated Press, 14 April 2008.

[153] Mehmet Ögütçü, "Foreign Direct Investment in China's Energy Sector Petroleum Industry", OECD/DAF Secretariat, 26 March 2001, at www.dundee.ac.uk/cepmlp/journal/html/vol8/article8-4.html.

fulfils its obligations, it will gradually allow private traders to import oil products and foreign firms to set up gas stations.[154] Western oil and gas companies have also been playing an increasingly prominent role in China's energy industry. Some foreign companies have purchased shares of major Chinese oil companies, and U.S. firms are active in development operations off China's shores.[155] While Beijing has made progress in meeting WTO commitments with regard to the energy sector, foreign companies looking to enter the market face difficulties, including lack of access to geological data, information on a site's history and uncertainty about how prices are set.[156]

4. OECD Export Credit Arrangement

The OECD Export Credit Arrangement[157] is an international regime that restricts subsidised export promotion. Because higher exports are viewed as a vital national interest, countries often financially subsidise the inputs, production or sales of export industries.[158] Acting like a cartel, the Export Credit Arrangement cooperates to set terms and conditions on official export credits and foreign aid. While it does not cover all forms of finance, it has the advantage, compared with other institutions such as the WTO, of smaller membership, thus avoiding mixing sellers with capital-constrained buyers. It also speeds up its processes by rejecting the use of third-party dispute resolution.[159] Because it is not a member, China is not subject to the same rules as OECD countries, and can use export credits to its advantage. But being outside also increases export finance costs for Chinese exporters, which means there is an incentive to join.[160] As with the IEA, China must meet OECD standards to become a member.

5. Energy Charter Treaty

The Energy Charter Treaty (ECT) requires parties to observe certain rules on the protection of foreign investment; non-discriminatory treatment of energy trade and transit; dispute resolution; and promotion of energy efficiency and environmental practices.[161] Its provisions are "designed to promote energy security through more open and competitive energy markets. The ECT was originally conceived to focus on the energy sectors of the former Soviet Union and Europe, but China is an observer. Its ratification of the treaty could bring about a more cooperative and rules-based energy relationship, but the fact that Russia has not ratified has made Beijing reluctant. The ECT does not deal with issues such as energy investment methods in third-party countries or anxiety over sea-borne oil imports.

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[154] "Impact on China Sectors after WTO Entry", Reuters, 19 September 2000.
[155] Energy Policy Act 2005, Section 1837: National Security Review of International Energy Requirements, U.S. Department of Energy, February 2006, at www.pi.energy.gov/documents/EPACT1837FINAL.pdf.
[156] "China's WTO Implementation: An Assessment of China's Fourth Year of WTO Membership", testimony of the U.S.-China Business Council, 14 September 2005, at www.uschina.org/public/documents/2005/09/ustr_testimony.pdf.
[157] The Export Credit Arrangement was born out of the failure of the General Agreement on Tariffs and Trade (GATT) to constrain export credit competition between Europe, Japan and the U.S. in the 1960s and 1970s.
[158] The Arrangement seeks to prevent the shifting of profits from one supplier state to another via predatory export finance and to control unintentional transfers of wealth from suppliers to buyers. Evans and Downs, "Untangling China's Quest for Oil", op. cit.
[159] Ibid.
[160] Crisis Group interview, export credit banker, Istanbul, 23 April 2008.
[161] Energy Charter website, www.encharter.org.

IV. THE IMPACT ON CONFLICT – TWO CASE STUDIES

The damage that oil can do to the development of healthy economies and governments is well documented. One-third of the world's civil wars take place in oil-producing states.[162] In addition to the havoc wreaked on a country's economy by the so-called resource curse, oil makes it easier for insurgents to fund rebellions and aggravates ethnic grievances.[163] And while countries wracked by internal conflict and massive human rights abuses have provided an investment environment free from Western competition and some strategic advantages, they have brought China closer to situations of conflict and internal strife. This, along with Beijing's stated policy of non-interference in domestic affairs, has led to accusations that it is enabling the regimes in such states to resist demands from the international community to end conflict, stop human rights abuse or halt suspected nuclear weapons programs.[164]

While continuing to shield these countries from criticism, China is shifting from outright obstructionism to a more nuanced strategy of balancing its short-term resource needs with its desire to be seen as a responsible power. It is playing a more constructive role in multilateral processes and supporting some forms of international intervention in ways that were unimaginable just a few years ago.[165] In particular, its cooperation is becoming an increasingly central factor in diplomatic efforts to find solutions to the crises in North Korea, Iran, Sudan and Myanmar/Burma.[166] And it now contributes more troops to UN peacekeeping missions than any other P-5 Security Council member.[167]

While this shifting approach can be attributed in part to a desire to project a good international image in the lead-up to the 2008 Olympics, it also reflects the need

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[162] This figure is up from one fifth in 1992 and is expected to rise as high oil prices push more developing countries to produce oil and gas. An oil-producing developing country is twice as likely to suffer internal unrest as a non-oil producer. Michael Ross, "Why oil wealth fuels conflict", *Foreign Affairs*, May-June 2008, pp. 2-8.

[163] Ibid. Some resource-rich countries are said to be afflicted with the oil curse. The money that flows into energy-rich countries frequently feeds corruption and spending on security forces, while governments fail to diversify their economies, educate their population or develop the rule of law, leading to poverty, repression, environmental degradation and labour tensions. The concentration of wealth in a particular region of the country further leads to grievances which can fuel separatism and civil war. One aspect of this problem is the "Dutch disease", whereby increased natural resource revenue causes rapid currency appreciation which results in decreased competitiveness of and thus decline in other exports. The country loses economic diversification, becoming more dependent on its resource sector. The low incomes and ineffective governments of many oil-rich countries result in political and economic activity focused on acquiring a share of resource revenues rather than promoting general economic and social development, making these countries more prone to internal instability and conflict.

[164] An emphasis on sovereignty and non-intervention has long been a key theme of China's foreign relations. Its "Five Principles of Peaceful Coexistence" (和平共处五项原则), which date to the 1950s, reject interference in other states' sovereign discretion and authority at home and insist on "respect" for other states' sovereignty. Former leader Deng Xiaoping called for China to: "Observe calmly; secure our position; cope with affairs calmly; hide our capabilities and bide our time; be good at maintaining a low profile; and never claim leadership" (冷静观察站稳脚根、沉着应付、韬光养晦、善于守拙、绝不当头). Beijing's objections to intervention have a long history. They were central to critiques of Soviet interventions in Eastern Europe and continued through the U.S.-led NATO intervention in the former Yugoslavia, which China denounced as "hegemonist". Beijing has often expressed similar distaste for milder means of trying to alter other states' domestic policies.

[165] Crisis Group President Gareth Evans and Deputy President Donald Steinberg have described four signs of transition in Chinese foreign policy. First, China is moving slowly from a foreign policy based on strict adherence to non-interference in others' internal affairs to one fully engaged in addressing such transnational concerns as terrorism, trafficking in arms, drugs and humans, health pandemics and climate change. Secondly, China increasingly sees that it is in its interest to promote long-term stability and responsible behavior in other countries. Thirdly, China is adjusting to the reality that its bilateral relations with countries like the U.S. cannot be disentangled from certain difficult third-country issues, such as North Korea, Iran, and Sudan. And fourthly, while actively pursuing its immediate global economic interests, China is increasingly adopting a longer-term and more nuanced perspective. Gareth Evans and Donald Steinberg, "Signs of Transition", *The Guardian*, 11 June 2007.

[166] Stephanie Kleine-Ahlbrandt and Andrew Small, "China's New Dictatorship Diplomacy: Is Beijing Parting with Pariahs?", *Foreign Affairs*, January-February 2008, pp. 38-56; Joshua Kurlantzick, *Charm Offensive: How China's Soft Power Is Transforming the World* (New Haven, 2007).

[167] China provides 1,978 troops to UN peacekeeping missions. France is next (1,924), then the UK (348), the U.S. (297) and Russia, last among the P-5 (290), UN Department of Peacekeeping Operations, as of 31 March 2008, at www.un.org/Depts/dpko/dpko/contributors/.

to protect more basic national interests. Beijing is learning the perils of entrusting its energy security to unpopular and, in many cases, fragile regimes.[168] While non-interference may have been useful to it in signing initial energy deals, it is less helpful in securing these interests over the long term in the face of mounting risks to its investments, citizens and security. Political crisis and conflict lead to defaults on loans and investments and threaten equity oil. Escalation of the Darfur conflict, for example, jeopardises China's investments in Sudan, as the conflict's spread threatens its nascent investments in Chad. Direct threats to Chinese citizens are growing, as seen in attacks and kidnappings in Ethiopia and the Niger Delta,[169] as well as Sudan, and in anti-Chinese demonstrations in Zambia.[170] These human and political costs are causing some in the leadership to question the merits of the "go out" strategy.[171]

The shift has been modest and tentative, without the backing of a firm consensus. While changing its calculus in light of international pressure and security threats, the government continues to pursue its energy deals and dilutes international community policies that are deemed harmful to its economic interests. Foreign ministry personnel are generally supportive of the new tack, but the old guard opposes pressuring Sudan or imposing sanctions on Iran, citing as justification traditional principles of Third World solidarity and non-interference, or the need to counterbalance U.S. power. It is joined by many Chinese arms and energy companies and their powerful supporters in government, who frequently oppose and attempt to circumvent the costly restrictions implied by a more responsible foreign policy. China's current strategy thus appears to be an effort to balance political and economic interests by blending a more constructive diplomatic approach with continuation of its usual energy activities.

A. SUDAN

1. Energy

Oil was discovered in southern Sudan in 1979, prompting then-President Jaafar Nimeiri to begin a long series of efforts to re-draw the country's north-south boundaries in order to move the fields under northern jurisdiction.[172] Chevron was the first company to explore and develop, but suspended its activities in 1984 after attacks from the insurgent Sudan People's Liberation Army/Movement (SPLA/M).[173] During much of that period, Khartoum was unable to extract oil, and it defaulted on payments of its large external debt in 1990. Chevron sold its concession in 1992.[174]

Oil has been a key issue in Sudan's many internal conflicts. Wars between the ruling National Congress Party (NCP) and several rebel groups have resulted in massive numbers of civilian deaths and large-scale

[168] Kleine-Ahlbrandt and Small, op. cit.
[169] The January and June 2007 kidnappings of Chinese nationals in Nigeria showed Beijing the perils of operating in the political minefield of the oil-rich Niger Delta, where foreign workers, especially oil workers, have long been targets of armed militants protesting environmental devastation and acute poverty. In January 2007, gunmen stormed the government-owned Chinese National Petroleum Company office in Bayelsa state and took nine Chinese employees hostage, releasing them as Hu Jintao's Africa visit began. In southern Nigeria's Rivers State in June, five Chinese telecommunication workers were kidnapped and held hostage for two weeks. Militants have shown they can strike in cities, and violence over illegally acquired oil brought the Delta to the brink of all-out war in October 2006. "Gunmen in Nigeria kidnap 5 more foreigners", Associated Press, 15 June 2007.
[170] Anti-Chinese riots occurred following the September 2006 Zambian elections in which the Chinese ambassador threatened to sever relations if the opposition candidate, Michael Sata, won. Sata campaigned on anti-China sentiment, including complaints of low wages, lack of basic safety standards and loss of jobs to Chinese workers. Although he lost the national elections to incumbent Levy Mwanawasa, his Patriotic Front swept seats in key municipalities in the Copperbelt and Lusaka provinces and many urban constituencies in the Northern and Luapula provinces. In February 2007, anti-Chinese demonstrations confined Hu Jintao's visit to Lusaka and forced him to forego trips to a Chinese-run copper mine in Chambeshi and a stadium construction site in Ndola.
[171] Houser, "The Roots", op. cit.
[172] See Crisis Group Africa Report N°96, *The Khartoum-SPLM Agreement: Sudan's Uncertain Peace*, 25 July 2005.
[173] The Sudan People's Liberation Army (SPLA) and its political wing, the Sudan People's Liberation Movement (SPLM), are known collectively as the Sudan People's Liberation Army/Movement (SPLA/M) and are now the minority partner in the government of national unity in Khartoum and the leading party in the southern regional government.
[174] Jakobson and Zha Daojiong, "China and the Worldwide Search for Oil Security", op. cit. In 1997, U.S. President Bill Clinton signed Executive Order No. 13067, imposing comprehensive economic, trade and financial sanctions on Sudan, including a total asset freeze against the government, in effect ending U.S. involvement in the oil industry. "An overview of the Sudanese Sanctions Regulations", U.S. Department of Treasury, Office of Foreign Assets Control, 27 April 2006, at http://treas.gov/offices/enforcement/ofac/programs/sudan/sudan.pdf.

displacement.[175] The impact of oil exploration was particularly acute in the South – where 80 per cent of Sudan's oil is located[176] – during the 1983-2005 civil war between successive Khartoum-based governments in the predominantly Muslim North and the SPLA/M, based largely in the semi-autonomous and Christian animist South. Civilian populations were forcefully cleared from oil-producing areas, which became the frontline from the late 1990s until the January 2005 Comprehensive Peace Agreement (CPA).[177]

Oil wealth has benefited the NCP, and infrastructure and investments have focused on Khartoum and the surrounding areas, while outlying regions continue to be neglected. Conflicts in the South, West and East have proliferated in part due to the concentration of power and wealth in a small elite.[178] Despite years of international isolation (the U.S. has imposed extensive sanctions since 1997), and even in the aftermath of the CPA, access to new oil revenues has allowed the NCP to restock its military capabilities. The CPA provides for significant sharing of power and of oil revenues between the national government and the new, semi-autonomous Government of Southern Sudan. It also grants the South a self-determination referendum in 2011. Should the vote be for independence, the North would no longer be able to reap direct benefits from the South's oil other than through transit fees. This time pressure is fuelling aggressive exploration for new oil sources by the NCP, which is one of several factors jeopardising the fragile peace.[179]

2. China's energy relationship with Sudan

In 1996, when most Western oil companies pulled out of Sudan due to legal, shareholder and U.S government pressures, China National Petroleum Corporation (CNPC) purchased 40 per cent of the Sudanese oil consortium, the Greater Nile Petroleum Operating Company.[180] China has since come to dominate the oil sector, with more than $8 billion invested in fourteen projects.[181]

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[175] Other ongoing or recent military conflicts of Sudan have involved Eritrea, Chad (alleged to host Sudanese rebels), and the Central African Republic.

[176] "The majority of proven reserves are located in the south in the Muglad and Melut basins. Due to civil conflict, oil exploration has mostly been limited to the central and south-central regions of the country. It is estimated that vast potential reserves are held in northwest Sudan, the Blue Nile basin, and the Red Sea area in eastern Sudan", Energy Information Administration (EIA), "Sudan Country Brief", July 2007, at www.eia.doe.gov/emeu/cabs/Sudan/Full.html. The map of the energy consulting firm IHS of the Muglad and Melut Basins shows the entire main oil-producing region as south of the thirteen degrees north line of latitude.

[177] The CPA, signed on 9 January 2005, ended Sudan's 21-year civil war, in which more than two million people died and four million were displaced. It granted the South an autonomous government, led by the SPLM, and arranged for significant power sharing in the central government. It established a democratisation process to lead to national elections in 2009, and a self-determination referendum for the South in 2011. See Crisis Group Briefing, *Breaking the Abyei Deadlock*, op. cit; and Crisis Group Africa Reports N°130, *A Strategy for Comprehensive Peace in Sudan*, 26 July 2007; and N°106, *Sudan's Comprehensive Peace Agreement: The Long Road Ahead*, 31 March 2006.

[178] According to the Sudanese investment minister, 70 per cent of all foreign money flowing into Sudan goes to Khartoum state, the heart of the regime, binding people there more closely to the ruling party. "Glittering towers in a war zone", *The Economist*, 7 December 2006.

[179] See Crisis Group Briefing, *Breaking the Abyei Deadlock*, op. cit.; and Crisis Group Reports, *A Strategy for Comprehensive Peace* and *Sudan's Comprehensive Peace Agreement*, both op. cit.

[180] CNPC signed its first contracts for operations in Sudan's Block 6 in 1995 during President Bashir's visit to China (blocks are areas apportioned for exploration and production rights). In 1997, CNPC bought in as the largest stakeholder in the Greater Nile Petroleum Operating Company (GNPOC), which acquired a concession in Blocks 1, 2 and 4, straddling the North-South boundary. The rights to those blocks were first acquired by Canadian State Petroleum, then by another Canadian company, Arakis Energy, Inc., which developed fields discovered by Chevron and embarked on intensive exploration. China brought 10,000 Chinese labourers so GNPOC could produce oil in the Heglig and Unity fields by the ruling National Islamic Front's tenth anniversary (30 June 1999). Similarly, the Chinese subcontractor brought in two Chinese crews for the seismic phase of the Lundin operation in Block 5A. According to a CNPC press release, China Petroleum Engineering & Construction Corporation (CPECC), CNPC's construction arm, participated in building a 1,500-km pipeline from south-central Sudan to the Red Sea. The oil field served by the pipeline was the "first overseas large oil field operated by China". CPECC used 10,000 imported Chinese labourers to build the pipeline. "Our workers are used to eating bitterness ... they can work 13 to 14 hours a day for very little", its vice president told the *Wall Street Journal*. It also built a refinery near Khartoum with a 2.5 million-ton processing capacity. Walden Bello, "China Eyes Africa: The New Imperialism?", *Multinational Monitor*, Jan/Feb 2007, at www.multinationalmonitor.org /mm2007/012007/bello.html.

[181] See: "Country Analysis Briefs: China", op. cit. In addition to its 40 per cent stake in the three blocks, CNPC has a 41 per cent equity stake in Blocks 3 and 7, a 40 per cent stake in Block 13, a 35 per cent stake in Block 15, and a 95 per cent stake in Block 6, which straddles the administrative border

Sudan accounted for only 6 per cent of China's total oil imports in 2007 and less than 1 per cent of its total energy consumption,[182] while crude oil exports to China were about 40 per cent of Sudan's output. Chinese companies in Sudan sell a significant percentage of their equity share on the world market to non-Chinese buyers.[183] Japan was the largest buyer of Sudanese crude in 2006 (though China took that position in 2007).[184] South Korea, Indonesia and India also import significant quantities.

Indian and Malaysian companies are large equity investors in Sudan along with the Chinese.[185] Other firms with equity investments come from a range of countries including France,[186] Jordan,[187] the Netherlands,[188] Saudi Arabia,[189] South Africa,[190] Sweden,[191] the United Arab Emirates,[192] the UK and Yemen.[193] France-based Total's partners in Block B include the Kuwait Petroleum Corporation and, until 2007, U.S.-based Marathon Oil Corporation.[194] While Block B is not currently active, Total has been paying Khartoum $1.5 million annually to maintain its rights until it decides on further action.[195]

Nevertheless, China is Sudan's most important foreign investor. The combination of Beijing's desire to protect its NOCs' investments, enhance energy security through equity oil and its traditional policy of non-interference have led it to insulate the Sudanese regime from international pressure. Combined with its growing influence and Security Council veto, this has made it a very attractive partner to Sudan. But this situation could dramatically change should the South secede in 2011. Already, China's steps toward a sepa-

between Darfur and the rest of Sudan. See "European Coalition on Oil in Sudan", map at www.ecosonline.org, and "Country Analysis Briefs: China", op. cit. Sinopec has a 6 per cent equity stake in Blocks 3 and 7, for an initial investment of about $90 million. Subsidiaries of CNPC and Sinopec, as well as other Chinese companies, have been involved in substantial oil industry infrastructure construction. "Sudan Hydrocarbon Concession Blocks", Sudan Ministry of Energy and Mining, Sudanese Petroleum Corporation, September 2006.

182 Testimony of J. Stephen Morrison, Subcommittee on Domestic and International Monetary Policy, Trade, and Technology, Committee on Financial Services, U.S. House of Representatives. "H.R. 180, Darfur Accountability and Divestment Act of 2007", 20 March 2007, at www.house.gov/apps/list/hearing/financialsvcs_dem/htmorrison032007.pdf. See also "Investing in Tragedy: China's Money, Arms, and Politics in Sudan", Human Rights First, March 2008.

183 With the exception of Block 6 (which is not yet producing), Chinese companies only own minority stakes in Sudanese concessions. Oil from these concessions is not divided precisely according to stakeholder shares, but instead sold in tanker-size quantities to buyers, including Chinese buyers.

184 Sudan's largest purchaser changes monthly. In 2007, China imported 207,000 bbl/d, Japan 102,793, according to government statistics in both countries. Song Yen Ling, "China's Oil Imports Soar", *International Oil Daily*, 25 January 2008; and Mari Iwata, "Japan Refiners, Traders 2007 Crude Imports -1.8% on Yr – METI", Dow Jones, 31 January 2008. In 2006, Japan received 124,000 bbl/d of crude, China 99,000 bbl/d. "Country Analysis Briefs: Sudan", op. cit.

185 India's Oil and Natural Gas Corporation, Ltd. (ONGC), and Malaysia's Petronas are also major equity stakeholders in Sudan through GNPOC and other collaborations. See "European Coalition on Oil in Sudan", map, op. cit., and "Country Analysis Briefs: China", op. cit.

186 The French company Total and White Nile, registered in the UK, started a legal battle when the SPLM granted the latter – a joint venture between British investors and the southern state petroleum parastatal, Nile Petroleum Corporation – Block Ba, which overlaps with Block B, already granted to Total by Khartoum. See, Crisis Group Report, *The Khartoum-SPLM Agreement*, op. cit; and "Total's presence in Sudan: Questions and Answers", at www.total.com/en/corporate-social-responsibility/Ethical-Business-Principles/Human-rights/Questions-Answers_9151.htm.

187 Dindir Petroleum International Co., Ltd. has a 15 per cent stake in Block 12A. "Sudan Hydrocarbon Concession Blocks", Sudan Ministry of Energy and Mining, Sudanese Petroleum Corporation, September 2006.

188 Tamoil, part of Oilinvest (Netherlands), is another recent addition to Block 12A. "Sudan Hydrocarbon Concession Blocks", op. cit; Edmund Sanders, "Search for oil raises the stakes in Darfur", *Los Angeles Times*, 3 March 2007; and "Tamoil Wins Acreage in Sudan", *Africa Energy Intelligence*, no. 437 (28 March 2007).

189 Abdel Hadi A. Al-Qahtani & Sons of Saudi Arabia has a 22 per cent stake in Block 12A. "Sudan Hydrocarbon Concession Blocks", op. cit.

190 The Petroleum Oil and Gas Corporation of South Africa (PetroSA), a state-owned company, has an 80 per cent stake in Block 14. "Sudan", PetroSA, at www.petrosa.co.za/Content/490.html.

191 Lundin Petroleum of Sweden has a 24.5 per cent stake in Block 5B, www.lundin-petroleum.com/eng/operation_sudan.php.

192 Al Thani Corporation of the United Arab Emirates has a 5 per cent equity stake in Blocks 3 and 7, "Sudan Hydrocarbon Concession Blocks", op. cit.

193 Ansan Wikifs of Yemen has a 20 per cent stake in Block 12A, ibid.

194 "Total seeks south Sudan participation in oil exploration", *The Sudan Tribune*, 13 March 2007.

195 "Total disburses $1.5 mln annually to maintain Sudan's oil rights", Dow Jones, 4 November 2006.

rate relationship with the Government of Southern Sudan are worrying Khartoum.

Activists in Europe and the U.S. have sought to encourage government entities, universities and others to divest from portfolios related to Sudan in the hope of replicating the impact such a measure had on apartheid South Africa.[196] CNPC has taken two steps to make it more difficult for activists to target the company with divestment measures or other forms of sanctions. First, its listing on the New York Stock Exchange – PetroChina – excludes overseas investments from its portfolio, making it difficult for international shareholders to affect those operations.[197] Secondly, a general boycott is more difficult to sustain against an entire company than a subsidiary, and CNPC runs the operations in Sudan itself.

3. The conflict in Darfur

The Darfur conflict began in February 2003 with small attacks on government outposts by the Sudan Liberation Army (SLA), a Darfur-based insurgency against the region's political and economic marginalisation. After a number of rebel military victories, the Khartoum government unleashed a wave of attacks against civilian populations from the Fur, Zaghawa and Massaleit tribes, using both regular forces and proxy Arab militias called Janjaweed.

International attention did not focus on the situation until the spring of 2004, when Crisis Group and Human Rights Watch issued reports on the emerging crisis.[198] Shortly thereafter, in May 2004, in a presidential statement, the Security Council expressed "grave concern".[199] In line with its non-interference policy, China insisted that the conflict was an internal matter and used its position on the Council to substantially shield Khartoum from targeted sanctions or other punitive measures.[200] Until the adoption of Security Council Resolution 1769 in July 2007, China consistently abstained on all major resolutions, serving to lessen their weight and undermine their chances of implementation.[201] It also played a central role in

[196] 24 U.S. states have divestment policies on Sudan, sixteen of which have met the Sudan Divestment Task Force model. Several U.S. institutions have led the way, including the California Public Employees' Retirement System (Calpers), the University of California, Harvard University and Yale University. Berkshire Hathaway CEO Warren Buffet, the largest PetroChina stockholder, first rejected divestment calls, but by late 2007 had sold all his 2.3 billion shares in PetroChina. The University of Chicago decided not to divest. See Sudan Divestment Task Force, at www.sudandivestment.org/announcements.asp; Holly Hubbard Preston, "Doing good by voting with your dollars", *International Herald Tribune*, 23 April 2006; Nathan C. Strauss, "Divestment not an easy affair", *The Harvard Crimson*, 16 May 2007; Steven Siegel, "Fiscal ties to Sudan persist", *The Yale Daily News*, 26 February 2007; "UC Regents vote to divest from companies with business ties to Sudan government and acts of genocide", press release, University of California, Office of the President, 16 March 2006; Robert J. Zimmer, "University of Chicago response to crisis in Sudan", press release, University of Chicago, Office of the President, 2 February 2007; and "Buffett says Berkshire Hathaway sold last of PetroChina shares", Associated Press, 18 October 2007.

[197] PetroChina is traded on the New York, Hong Kong, and Shanghai stock exchanges. When created from parent company CNPC, for the most part only domestic assets were spun into PetroChina.

[198] Crisis Group Africa Report N°76, *Darfur Rising: Sudan's New Crisis*, 25 March 2004; and Human Rights Watch, "Darfur in Flames: Atrocities in Western Sudan", 2 April 2004.

[199] Press release SC/8104, UN Security Council, 25 May 2004, at www.un.org/News/Press/docs/2004/sc8104.doc.htm.

[200] Deputy Foreign Minister Zhou Wenzhong famously said in 2004, "Business is business. We try to separate politics from business….the internal situation in the Sudan is an internal affair, and we are not in a position to impose upon them". Keith Bradsher, "Two Big Appetites Take Seats at the Oil Table", *The New York Times*, 18 February 2005. On Resolution 1564, the Chinese ambassador said, "it must be particularly noted that the original draft implied … automatic implementation of sanctions…. Due to pressures from various parties, especially the explicit stance of our country to oppose sanctions, the submitter of the draft made important modifications….First, the text clearly says that there will not be automatic implementation of sanctions….Second, if measures are to be taken, the AU should be consulted first. Third, the measures should be finally reviewed again by the Security Council….Under such circumstances, and given that the major content of the resolution is to support the expansion of deployment of the AU in Darfur, China has refrained from blocking the adoption of the draft resolution, based on support for the role of the AU". "Wang Guangya's Remarks on the New Resolution", foreign ministry, 20 September 2004. Two days after Resolution 1591 authorised the sanctions regime, Foreign Ministry Spokesman Liu Jianchao stated: "Both the Sudanese government and the international community should make efforts to resolve the Darfur issue…. We don't support sanctions or constant pressure. It's no good for a peaceful resolution of the issue". "China opposes UN sanctions against Sudan", *Sudan Tribune*, 31 March 2005.

[201] China also abstained on Resolution 1593, which mandated the International Criminal Court (ICC) to investigate crimes against humanity committed in Darfur since 2002. This angered the Sudanese government, which had expected a Chinese veto. Nafie Ali Nafie, then federal affairs minister,

watering down the substance of multiple draft resolutions by directly or indirectly threatening to use its veto.

Already by the summer of 2006, however, the risks to Chinese interests had become greater. The Darfur Peace Agreement struck in May 2006 unravelled,[202] and fighting escalated, spreading across the border into Chad,[203] which had just withdrawn its recognition of Taiwan and in whose nascent oil sector Beijing had begun to invest.[204] Growing international demands to halt the genocide in Darfur, bilateral pressure from the U.S. and other countries[205] and the propect of such states taking unilateral actions that could menace China's friends and weaken its position started to change the calculus. Attacks in 2006 and 2007 by Darfur rebel groups on Chinese oil installations also challenged Beijing's assumption that its partnership with Khartoum was sufficient to ensure the safety of its operations.[206]

In late 2006, China started encouraging the Sudanese government to accept a three-phase deployment of a peacekeeping force. On 13 September 2006, Premier Wen Jiabao stated that he was "very much concerned about stability in Darfur" and reiterated his support for sending in peacekeepers. Beijing also summoned Sudanese presidential assistant Nafie Ali Nafie to explain the deterioration of the conflict. Chinese Vice President Zeng Qinghong was reported to clarify that the UN mission in Darfur would not undermine the position of the Sudanese government and recommended starting "constructive negotiations" on the

publicly criticised China. Crisis Group Africa Briefing N°24, *A New Sudan Action Plan*, 26 April 2005. China abstained on six Sudan resolutions: 1556 of July 2004 (two abstentions: China and Pakistan); 1564 of September 2004 (four abstentions: Algeria, China, Pakistan, Russia); 1591 of March 2005 (three abstentions: Algeria, China, Russia); 1593 of March 2005 (four abstentions: Algeria, Brazil, China, U.S.); 1672 of 25 April 2006 (three abstentions: China, Qatar, Russia); and 1706 of August 2006 (three abstentions: China, Qatar, Russia).

[202] The Darfur Peace Agreement (DPA) was signed in May 2006 by the Sudan government and one rebel faction, the SLA-wing of Minni Minawi. It was heavily pushed by the international community, in part because of a promise by First Vice-President Ali Osman Taha to allow a UN force into Darfur once a peace deal was signed. The NCP quickly reneged, and the DPA led to more conflict and factionalism, rather than peace. See Crisis Group Africa Briefing N°39, *Darfur's Fragile Peace Agreement*, 20 June 2006; and Crisis Group Africa Briefing N°43, *Getting the UN into Darfur*, 12 October 2006.

[203] After the outbreak of fighting in Chad's capital, China evacuated most of its citizens, leaving nine embassy staff. "China pulls citizens out of Chad after violence in capital", Associated Press, 3 February 2008, at www.iht.com/articles/ap/2008/02/03/asia/AS-GEN-China-Chad.php.

[204] In 2006, CNPC Services and Engineering Ltd. signed an overseas contract for nearly $3.1 billion with Chad. "China National Petroleum Corporation to Build Chad's First Oil Refinery", *ChinaScope*, 11 October 2007, at www.chinamemo.org/chinascope/briefing/geo-strategic-development/2757. Chad has long been pressing for action to stop refugees and rebels from Darfur crossing its border. China's ambassador to the UN has noted that a solution to the Darfur issue not only concerns the region's security and humanitarian situation, 'but also bears on the peace process between the North and the South of Sudan, the neighbouring country Chad and the security and stability of … Central Africa and the sub-region as a whole". Jonathan Holslag, "China's Diplomatic Victory in Sudan's Darfur", Brussels Institute of Contemporary China Studies (BICCS) Asia Paper, 15 August 2007.

[205] During Hu Jintao's first presidential visit to Washington in April 2006, U.S. President George Bush made it a priority to raise Iran, North Korea and Sudan and kept them on the agenda in subsequent phone calls and bilateral meetings. Put to the test, China feels that stable, positive ties with the U.S. and Europe are more important for its economic growth and security than protecting such states. But this is far from a simple matter of U.S. pressure – it is an emerging view that China's interests are more like those of the other great powers than a G77 member. Chinese analysts have said that in the choice between the "advanced countries" and the "developing country club", China has chosen the former. Crisis Group interviews, Beijing, July, October and December 2007.

[206] In November 2006, the National Redemption Front (NRF), a Darfur rebel coalition, attacked a Chinese oil facility in Abu Jabra, which straddles the border between the states of South Darfur and Southern Kordofan. In October 2007, rebels from the Justice and Equality Movement (JEM) attacked the Chinese-run Diffra oilfield, days before a new round of Darfur peace talks were to begin, and said the Chinese and other oil companies had one week to leave Sudan. On 24 November, as 135 Chinese engineers arrived in Sudan to take part in the UN/AU peacekeeping force, JEM demanded their withdrawal, warning, "we oppose them coming because China is not interested in human rights. It is interested in Sudan's resources…" On 12 December, JEM hit another Chinese-operated oilfield in Southern Kordofan and vowed attacks would continue until China left. "NRF attack on Abu Jabra Oil Field", NRF military statement no. 15, 26 November 2006; "Darfur rebels attack oil field, warn Chinese to leave Sudan", Associated Press, 26 October 2007; "Darfur rebels spurn Chinese force", BBC, 24 November 2006; "Darfur rebels claim attack on Chinese-run oil field", Agence France-Presse, 12 December 2007.

possible shape of this operation.[207] On 15 September 2006, China's UN ambassador, Wang Guangya, confirmed that his government had been "pressing" Sudan both in Beijing and Khartoum.[208]

During the 16 November 2006 high-level consultation on Darfur in Addis Ababa, Ambassador Wang made important behind-the-scenes interventions to secure the Sudanese government's agreement to the plan.[209] President Hu Jintao raised the issue with his Sudanese counterpart, Omer al-Bashir, at the November 2006 China-Africa summit and publicly urged the Sudanese government to find a settlement to the issue and improve the humanitarian situation.[210] During his February 2007 visit to Khartoum, Hu privately pressed al-Bashir to comply with his commitments on the UN/AU hybrid force deployment.[211] He also delivered a rare public statement that outlined "four principles" for resolving the conflict that are "imperative to observe". While he predictably underlined the importance of sovereignty and territorial integrity, he equally stipulated the need for UN involvement in the peacekeeping mission, ensuring the delivery of humanitarian aid, and a comprehensive ceasefire.[212]

Briefing the Security Council on Hu's visit, Ambassador Wang explained: "Usually China doesn't send messages, but this time [it] did".[213] When Khartoum started backtracking on the deal, China expressed private and public discontent.[214] During this same period, the U.S. and China deepened discussions about coordinating actions on Sudan.[215]

Plans were already underway for Assistant Foreign Minister Zhai Jun to visit Sudan when the campaign calling the Beijing Olympics the "genocide Olympics" began in early April 2007.[216] During Zhai's visit, which included rare trips to internally displaced persons (IDP) camps near al-Fasher and Nyala, he encouraged adoption of the three-phase plan.[217] U.S. Deputy Secretary of State John Negroponte followed soon after, and on 16 April Sudanese Foreign Minister

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[207] Jonathan Holslag, "China's Diplomatic Victory", op cit.

[208] Wang Guangya said, "we sent a message to them that we feel the UN taking over is a good idea, but it is up to them to agree to that. We are not imposing on them. We need to have them consider it and agree to it". "China Pushes Sudan to let UN Troops into Darfur", *International Herald Tribune*, 15 September 2006.

[209] "China's Ambassador to the UN Wang Guangya played a vital and constructive role in helping to broker the Addis compromise. During his recent visit to Khartoum, Chinese President Hu Jintao encouraged Bashir to show flexibility and allow the AU/UN hybrid force to be deployed", Andrew S. Natsios, president's special envoy to Sudan, Senate Foreign Relations Committee, 11 April 2007, at www.senate.gov/~foreign/testimony/2007/NatsiosTestimony070411.pdf.

[210] "Chinese president urges to maintain stability in Darfur", *People's Daily*, 3 November 2006.

[211] Alfred de Montesquiou, "Chinese President Pushes Sudan on Darfur", *The Washington Post*, 2 February 2007, at www.washingtonpost. com/wp-dyn/content/article/2007/02/02/AR2007020200251.html. Reportedly, Hu Jintao advised al-Bashir that an efficient peacekeeping force was required to restore peace in Darfur. *The Star* (South Africa), 13 February 2007. In its reports about Hu's meeting with al-Bashir, Xinhua noted that the talks were "frank", "candid" and "sincere". Yitzhak Shichor, "China's Darfur Policy", *China Brief*, Jamestown Foundation, 1 May 2007.

[212] Testimony of J. Stephen Morrison, op. cit. At the same time, China publicly emphasised its economic ties with Sudan and made new pledges of support, including aid to build a presidential palace, both of which drew international criticism.

[213] "China told Sudan to adopt UN's Darfur plan envoy", Bloomberg, 6 February 2007, at www.sudantribune.com/spip.php?article20137.

[214] Wang Guangya responded with open frustration at Khartoum's mid-March reversal on implementing the deployment plan. Testimony of J. Stephen Morrison, op. cit; and "China seeks explanation of Sudan letter challenging UN Darfur plan", Associated Press, 12 March 2007. See also Gareth Evans and Donald Steinberg, op. cit.

[215] After his appointment as the President's Special Envoy to Sudan, Andrew Natsios stepped up U.S. engagement with China, travelling there 8-12 January 2007, to meet with State Councilor Tang Jiaxuan and Vice Minister of Foreign Affairs (now Foreign Minister) Yang Jiechi. Testimony of J. Stephen Morrison, op. cit.

[216] Crisis Group interview, Beijing, 30 March 2007. On the "genocide Olympics" campaign, see Mia Farrow, "China Can Do More on Darfur", *Wall Street Journal*, 5 October 2007, at www.miafarrow.org/genocide_olympics.html. The campaign also criticises the social responsibility of companies supporting the Games. Sudan Divestment Task Force, www.sudandivestment.org. Film director Steven Spielberg announced he was resigning as artistic advisor to the Games because of China's economic, military and diplomatic ties to the Sudanese government. "Statement from Steven Spielberg Regarding Beijing Olympic Games and Darfur", Business Wire, 12 February 2008. The Darfur outcry has heightened China's awareness of the complexity of influences on U.S. policy. It has learned that the government cannot temper the positions of advocacy and lobbying groups and that the best way to deal with them is to reach out to them directly. Chinese diplomats in Washington are trying public diplomacy with a wide variety of NGOs, activist groups, lawmakers and journalists to highlight the steps Beijing has taken to end the conflict.

[217] "Sudan approves UN 'heavy support package' for AU in Darfur", Xinhua, 16 April 2007.

Lam Akol announced that the government had approved the UN/AU "heavy support" package, an important initial element of that plan.[218] Negroponte said China "played a pivotal role in brokering the agreement".[219]

With public pressure still mounting, China appointed Liu Guijin as Special Representative of the Chinese Government for Darfur in May 2007 and sent him on a "fact-finding" visit.[220] Shortly after, it announced an aid package including $10.4 million in humanitarian assistance to Darfur and said it would send a 275-member engineering unit to take part in the second phase of the UN/AU plan.[221]

On 31 July 2007, the last day of China's presidency of the body, the Security Council authorised the UN-AU Mission in Darfur (UNAMID) to support implementation of the 2006 Darfur Peace Agreement. China went to great lengths to ensure that the text was finalised and adopted under its presidency. Although it helped to eliminate certain tough provisions, such as the threat of new sanctions and references to the arms embargo and the UN Panel of Experts, [222] the final resolution demanded cessation of aerial bombings and authorised protection of aid workers and civilians under Chapter VII, the mandatory portion of the Charter.[223] Beijing privately demanded that the government implement the resolution, and Khartoum issued a statement the next day promising it would.[224]

The Sudanese government, however, continues to obstruct the deployment of UNAMID, a force that was supposed to number 26,000 by the end of 2007 but has not yet exceeded 10,000.[225] As Khartoum was creating problems for deployment in early 2008,[226] China softened a Security Council presidential statement condemning an attack by its forces on a UNAMID convoy and refused to apply public pressure. [227]

In late January and early February 2008, the security situation on both sides of the Chad-Sudan border worsened. On 30 January, three Khartoum-backed Chadian rebel groups left Darfur to launch an unsuccessful attack on N'djamena and the Chadian government. As a result, the Darfur rebel group, the Justice and Equality Movement (JEM), which receives military and financial support from the Deby government and had recently captured large tracts of land north of el-Geneina in West Darfur, crossed into Chad to help defend against the Chadian rebel offensive. Responding to the vacuum left by JEM's move to Chad, the Suda-

[218] Ibid.

[219] "U.S. envoy defends China role in Darfur", *China Daily*, 12 April 2007, at www.chinadaily.com.cn/china/2007-04/12/content_849019.htm; and Danna Harman, "How China's support of Sudan shields a regime called 'genocide'", *Christian Science Monitor*, 26 June 2007, at www.csmonitor.com/2007/0626/p01s08-woaf.html?page=1.

[220] Liu Guijin said he "hoped that the Sudanese side would show more flexibility on the implementation of a joint peacekeeping plan between the United Nations and African Union" and stressed "the importance of accelerating the Darfur political process and making further improvement of the security and humanitarian situation in the region", "Chinese special envoy for Darfur concludes visit in Sudan", Xinhua, 24 May 2007.

[221] "Sanctions not helpful for resolving Darfur issue", Xinhua, 29 May 2007.

[222] UNAMID's mandate was reduced to permit mere "monitoring" of the arms embargo, not the original Chapter VII authority to "seize or collect" illegal arms and dispose of them as appropriate. In the Chapter VII section of the mandate, UNAMID lost the ability to "use all necessary means" and was instead instructed to "take all necessary action", Crisis Group interviews, New York, July-August 2007.

[223] UN Security Council Resolution 1769. "United Nations Security Council Authorises Deployment of United Nations-African Union 'Hybrid' Peace Operation in Bid to Resolve Darfur Conflict", at www.un.org/News/Press/docs/2007/sc9089.doc.htm.

[224] Crisis Group interview, Brussels, August 2007.

[225] The exact strength on 1 January 2008, the date its operational mandate commenced, was 9,065. Glen Segell, "UNAMID: The United Nations-African Union Mission in Darfur", *Strategic Insights*, vol. vii, no. 1 (February 2008).

[226] See "UN peacekeeping chief: New mission to Darfur needs urgent support", Agence France-Presse, 25 January 2008. Khartoum has obstructed deployment by not formally approving the list of troop contributions; rejecting troops from Nepal, Thailand and Nordic countries, insisting on only Africans; taking many months to allocate land for bases in Darfur; and not approving UNAMID night flights. Segell, "UNAMID", op. cit.

[227] China refused to support language assigning blame to Sudan and argued against Council pressure for delaying deployment of UNAMID. Even though Khartoum never apologised for the attack – and indeed blamed UNAMID for not informing it of its movements, the Council, on Chinese insistence, "welcome[d] the commitment of the Government of the Sudan to undertake a complete and full investigation into the incident". The original "demand for immediate action to ensure that there will be no recurrence of the attack on UNAMID" was replaced by more general language. The UNAMID convoy, originally described as "clearly marked", lost that descriptor during the negotiations. Crisis Group interview, diplomat, New York, January 2008. The text of the 11 January Presidential Statement is at www.un.org/News/Press/docs/2008/sc9224.doc.htm. See also, "Sudan acknowledges shooting at UN convoy in Darfur", Associated Press, 10 January 2007.

nese military, assisted by militias, launched a major offensive in West Darfur, 8-10 February. Opened by aerial bombings and supported by helicopter gunships, it resulted in thousands more displaced civilians.[228]

The rebel attacks on N'djamena were the latest round instigated by Khartoum in an effort to overthrow Chad's government and prevent deployment of a European Union (EU) protection force in eastern Chad.[229] UN officials continue to warn of the potential for a widening humanitarian crisis across the region.[230] Tensions were further heightened when Sudan cut relations with Chad on 10 May following an attack on Khartoum by rebels allied with JEM from the Darfur region, the first time in the five-year Darfur conflict that fighting has reached the capital.[231]

As these events unfolded, China's voice was muted. It sent a small contingent to join the hybrid force,[232] and its assistant foreign minister made an exasperated statement on the margins of the AU summit in January that "the world is running out of patience over what's going on in Darfur".[233] After returning from his fourth visit to Sudan, Liu Guijin said he conveyed "China's grave concerns about the deterioration of conditions in western Darfur".[234] While Beijing claims to be pressing Khartoum for full deployment of the peacekeeping force, that measure still faces serious challenges. Furthermore, there has been no let up in China's sales of weapons to Sudan – many of which end up in Darfur despite the UN arms embargo.[235] Indeed, while Beijing has been sending "hard" messages through its diplomats, Chinese generals, arms dealers and oil executives have yet to make statements or take actions in line with a policy of pressing Khartoum to end the conflict.

China has been carefully balancing various interests in its policy toward Sudan. On the one hand, the conflict affects China's ability to expand its economic and energy interests in the country and damages its international reputation. On the other hand, China supports Sudan's sovereign right to settle its internal affairs and consent to international intervention. China also knows that any significant deterioration of relations with Khartoum could allow others, such as

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[228] "12,000 Flee Darfur for Chad, U.N. Says", Associated Press, 10 February 2008, at www.nytimes.com/aponline/world/AP-UN-Darfur.html?_r=1&hp&oref=slogin; and "Darfur Town Emptied After Attack", Reuters, 15 February 2008, at www.nytimes.com/reuters/world/international-sudan-darfur-town.html.

[229] Allegra Stratton, "Chad declares state of emergency", *The Guardian*, 15 February 2008, at www.guardian.co.uk/world/2008/feb/15/sudan.france.

[230] Recent developments in Chad will be examined in greater detail in an upcoming Crisis Group report.

[231] "Sudan: Chad Denies Involvement in Khartoum Attack", IRIN, 12 May 2008.

[232] Alfred de Montesquiou, "Sudan welcomes Chinese peacekeepers", Associated Press, 1 February 2008, at http://news.yahoo.com/s/ap/20080201/ap_on_re_af/darfur_chinese_un; "China issues a warning to Sudan over Darfur crisis", *Sudan Tribune*, 30 January 2008, at www.sudantri-bune.com/spip.php?article25753.

[233] "China issues a warning", op. cit. On 30 January 2008, China's special envoy, Liu Guijin, met with Sudan's Foreign Minister Deng Alor (SPLM) on the margins of the AU summit in Addis Ababa and warned Sudan "the world is running out of patience over what's going in Darfur". Alor said the Chinese envoy reaffirmed his government's support but called on Sudan "not to do things that will cause the international community to impose sanctions". For the most part, China has avoided appearing to pressure Sudan directly over Darfur, in line with its longstanding non-interference policy.

[234] Jim Yardley, "China Defends Darfur Role", *The New York Times*, 8 March 2008.

[235] Before China had any oil interests in Sudan, it was selling weapons to the Nimeiri government (1969-1985). This increased in the 1990s after the NCP came to power. China and Russia vociferously objected to a proposed arms embargo on Sudan in 2005. Instead, the Security Council agreed on an arms embargo limited to Darfur, a largely meaningless measure in light of the region's porous borders. See Resolution 1591, para. 7. China and Russia abstained. The numerous violations of the Darfur embargo detailed by the UN Panel of Experts on Sudan and other sources have remained unpunished, in part due to Chinese and Russian efforts. Crisis Group interviews, New York, 2006-2007. The reports of the Panel of Experts are at www.un.org/sc/committees/ 1591/reports.shtml. Transfers of weapons from China to Sudan rose from $1 million in 2002 to $23 million in 2005, correlating with the beginning of the Darfur conflict in 2003. 2005 is the last year for which data is available. "Small Arms Survey, Human Security Baseline Assessment, Arms, Oil, and Darfur: The Evolution of Relations between China, Sudan, and the UN", COMTRADE, July 2007. See also "Sudan: Arms Continuing to Fuel Serious Human Rights Violations in Darfur", Amnesty International, May 2007. On proliferation in general, China tends to argue that economic reforms have weakened the central government, making it harder to ensure compliance of autonomous companies, private businesses and cooperative decision-making cells within the defence establishment. Though this is said to be a manageable problem, China must do a better job. Mohan Malik, "The Strategies and Objectives of China's Foreign Affairs & Asian Reactions to China's Rise", Testimony before the U.S.-China Economic and Security Review Commission, 18 March 2008, p. 20.

India, to compete more effectively in the country's oil sector.[236] Nor does it wish to be considered too closely associated with the West in the matter, least of all with the U.S. Consequently, Beijing has opted for the middle road, juggling its relations with all parties, while insisting that the only possible solution is political. This insistence on political consent has enabled it to buy time to try to make the UN mission more acceptable to the Sudanese regime. Indeed, others on the Security Council have agreed that it would be useful to have the government on board.[237]

But a compelling argument for significantly changing Chinese engagement in Sudan is that its main economic partner, the NCP, continues to pursue policies that might lead to a new and worse civil war, sparked by the potential collapse of the Comprehensive Peace Agreement. This would have serious consequences for China's investments in Sudan, as well as its international image, and it is increasingly likely due to the NCP's selective implementation of the peace deal and continued military actions in Darfur.[238] The NCP's push to replace the Deby regime in Chad might also hurt nascent Chinese investment there.

China's allegiance to the NCP is weakened by the fact that many of its oil interests would depend upon an SPLM-led government should the South leave Sudan after the promised 2011 referendum. In addition to the existing fields, China is also interested in undeveloped resources in the South and has already approached the SPLM to investigate access to oil deposits there. Both China and the SPLM have expressed interest in strengthening their relationship, including during the July 2007 visit of SPLM Chairman and First Vice President of Sudan Salva Kiir to Beijing, his second trip in three years. China has sent teams of experts to inspect infrastructure in the South and deployed a contingent with the UNMIS presence in Wau. It is also preparing to open a consulate in Juba, the capital of the Government of Southern Sudan.[239]

In order to solidify its ties with the SPLM, however, China will have to contend with the fact that its reputation in Sudan has been sullied by its relationship with the NCP; indeed, the SPLM and many Southerners readily recall the support for the NCP's war efforts in exchange for oil concessions. "China fattened the NCP's hand to beat the legitimate owners", explained a southern Sudanese analyst.[240] Because China has aligned itself with the government during active civil wars in both the South and Darfur, its installations have been targeted. JEM has said it will continue attacks, claiming "all the weapons we took from the soldiers were Chinese. The Sudan government is using the oil money it gets from China to buy weapons to kill our people".[241] On several occasions during the conflict in the South, CNPC even demanded that Khartoum supply troops to defend its installations from the same rebels who now run the Government of Southern Sudan.[242]

China cannot single-handedly solve the Darfur crisis.[243] Nor is the Sudanese government easy to influence. It has a wide network of supporters, including a number of Arab countries, and has benefited from powerful voices in the AU supporting the need for its consent to any peacekeeping operation. Nevertheless China is in a position to use more diplomatic, economic and military leverage than it currently employs and to work more closely with the rest of the international community on coordinating a united stance. It has been willing to tighten the screws on clients elsewhere: for example, it was quick to denounce Pyongyang and agree to Security Council sanctions following North Korea's October 2006 nuclear test – a position that was essential to the subsequent denuclearisation agreement.

There are signs that Chinese policymakers are beginning to doubt that helping their NOCs in places like Sudan, where the diplomatic and soft power costs are

[236] Jonathan Holslag, "China's Diplomatic Victory", op. cit.
[237] U.S. Ambassador Jackie Sanders stated, "practically speaking it's going to be useful to have the government on board". Judy Aita, "U.S., UK Submit Resolution on UN Peacekeepers for Darfur", State Department, Washington File, 17 August 2006, at www.america.gov/st/washfile-english/2006/August/20060817174011atiayduj0.8192713.html.
[238] The Khartoum regime is widely unpopular and views the political transformation and democratisation process laid out in the 2005 peace deal and the new constitution as a threat to its survival. Its continued refusal to implement the peace deal it signed is likely to lead Sudan back to war, putting Chinese investments there and across the border in Chad in jeopardy.
[239] Crisis Group interview, diplomat, Washington DC, February 2008.
[240] Crisis Group email correspondence, December 2006.
[241] Andrew Heavens, "Darfur rebels vow more attacks on Sudan oil fields", Reuters, 25 October 2007, at www.alertnet.org/ thenews/newsdesk/L25761873.htm.
[242] Jonathan Holslag et al., "China's Resources and Energy Policy in Sub-Saharan Africa", Report for the Development Committee of the European Parliament, 19 March 2007.
[243] Global leadership has been sorely lacking in facing down Sudan; China will not itself provide a substitute. Gareth Evans and Donald Steinberg, op. cit.

so high, really contributes to energy security. There is increasing disquiet in official circles about the diplomatic fallout of overseas investments.[244] In particular, there is increasingly vocal criticism of the pursuit of profit by state-owned companies in Sudan at the expense of the broader national interest.[245] While continuing to pursue its global economic interests, China is increasingly adopting a longer-term and more nuanced perspective. It is coming to accept that its global role vis-à-vis developing countries is no longer to simply defend them against Western interference, but also to promote their long-term stability and responsible behaviour.[246] In Sudan, China has a direct interest in the peaceful resolution of the Darfur and Abyei crises and successful CPA implementation. But while China pressured Khartoum to accept the peacekeeping operation and also to halt obstruction of deployment,[247] its arms continue to turn up in Darfur with embarrassing regularity.[248] In private, foreign ministry officials have noted that their discussions with the Sudanese government about ending the violence – as well as other efforts to redeem China's damaged reputation – are weakened as long as military cooperation continues.[249]

The Sudan case illustrates the fragmented nature of China's energy policy. The government is changing its calculus in light of international pressure and security threats, but has shown itself willing to play a stepped-up diplomatic role only to the extent that its immediate energy interests are not affected.

[244] Crisis Group interviews, New York, Washington DC and Beijing, November 2007-February 2008.
[245] Zhang Yunling, of the Chinese Academy of Social Sciences, recently dispatched international relations specialists to Sudan to prepare a report on China's conduct there. According to Zhang, "the companies feel great pressure as a result of being linked to politics….They don't care a lot about politics but it cannot be avoided. This kind of situation will emerge in many other places as well". McGregor, "Chinese diplomacy 'hijacked'", op. cit.
[246] Gareth Evans and Donald Steinberg, op. cit.
[247] Crisis Group interview, diplomat, New York, March 2008.
[248] "Investing in Tragedy", op. cit.
[249] Jakobson, "The Burden of Non-interference", op. cit.

B. Iran

1. Energy

Iran[250] has the world's second largest combination of oil and natural gas reserves.[251] However, the Islamic Republic lags in its search for new sources, only drilling a few exploration wells in 2005, and suffers from shortages of refined products.[252] It also needs to expand its refining capacity, which cannot satisfy domestic demand.[253] The problems in Iran's oil industry are the result of years of neglect and under-investment. The government has only allocated $3 billion a year for investment, less than one-third of what is needed to increase production.[254] While Tehran needs billions of dollars as well as expertise to modernise and upgrade its fields,[255] it does not allow foreign companies

[250] For recent Crisis Group reporting, see Middle East Briefing N°21, *Iran: Ahmadi-Nejad's Tumultuous Presidency*, 6 February 2007; Middle East Report N°51, *Iran: Is There a Way Out of the Nuclear Impasse?*, 23 February 2006.
[251] Iran has approximately 10 per cent of the world's proven oil reserves and is second to Russia in proven natural gas reserves. As of 1 January 2007, it held 136.27 billion barrels of proven oil reserves, according to *Oil & Gas Journal*, with ambitious plans to increase oil production to more than 5 Mmbbl/d by 2010 and 8 Mmbbl/d by 2015. However, current recovery rates are just 24-27 per cent, well below the world average 35 per cent. "Country Analysis Briefs: Iran", Energy Information Administration (EIA), U.S. Department of Energy, August 2006, at www.eia.doe.gov/emeu/cabs/Iran/Oil.html. Proven natural gas reserves are 27.6 Tcm, however, approximately 62 per cent are in non-associated fields which have not been developed, ibid, *Oil & Gas Journal* and Cedigaz (a gas industry information association) estimates as noted on the EIA website.
[252] "Country Analysis Briefs: Iran", op. cit.
[253] Iran's deficiency in domestic refining forces it to import petroleum products despite being a crude oil exporter. This is one reason why it introduced consumer fuel rationing on 27 June 2007. The same month, it made a tentative agreement to participate in the construction of five new refineries across Asia, including one in China. However, Iran needs refinery investment – about $12 billion worth, according to Iranian officials. Given U.S. sanctions and the reluctance of many European companies to commit to large Iranian investments, some of that, if it comes, may well be from China. "International Refineries, Chinese Strategic Reserve Prioritised while Fuel Rationing Looms in Iran", *Global Insight Daily Analysis*, 12 June 2007.
[254] "Surprise: Oil Woes In Iran", *Businessweek*, 11 December 2006, at www.businessweek.com/magazine/content/06_50/b4013058.htm.
[255] Tehran needs foreign investment to modernise its exploration and extraction capabilities, as well as technical expertise

to make equity investments (eg, production-sharing agreements). Instead, they sign "buyback" contracts under which they fund upfront costs and are repaid from production with a predetermined rate of return from sales over a defined number of years. Because of these unfavourable terms and concerns about the risk of conflict with the U.S., many oil companies have hesitated to invest in Iran in recent years.

The oil and gas sectors have been subject to U.S. sanctions since 1997, and Washington has threatened action against any foreign company that invests more than $20 million annually in the oil industry. To date, these sanctions have not been applied to Total, StatoilHydro, Italy's Eni and the Royal Dutch/Shell Group, though the threat has perhaps made them more careful about their investments. A slowdown in foreign investment has been aggravated by rising costs, inflexible contract terms and, more recently, difficulty in securing financing owing to the pressures exerted by the U.S. Treasury Department on international bank transactions.

2. China's energy relationship with Iran

Iran is Beijing's third largest oil supplier, behind Angola and Saudi Arabia.[256] Most Chinese investments there, such as CNPC's operations in the Masjed-i-Suleiman (MIS) oilfield and Block 3, are small projects by international standards. MIS is an old field that CNPC has reportedly spent $150 million to rehabilitate, while Block 3 is an exploration project. Sinopec has an exploration contract for the Zavareh-Kashan block but failed to find commercially viable deposits after spending at least $65 million. The largest investment, however, is its December 2007 agreement with Iran, valued at $2 billion. CNOOC is in discussions to explore the offshore North Pars field, where it would be responsible for setting up a facility to convert natural gas to liquefied natural gas for 25 years.[257] China and Iran also hope to complete construction of a 386-km pipeline across the country to take oil to the Caspian Sea, where it would link up with a pipeline running from China through Kazakhstan.[258]

Despite the U.S. sanctions, other countries have invested in Iran, and the country's massive energy exports fuel the economies of some of Washington's closest allies. Iran's largest oil export markets are Japan, China, India, South Korea, Italy, Turkey, France, South Africa, Taiwan and Greece.[259] While China does not play as pivotal a role in Iran's oil and gas sectors as it does in Sudan, it is a large enough player, with strong NOCs, to be a major alternative to Western investment, particularly if future sanctions should render the country off limits to Europe.

3. The nuclear impasse

Iran's nuclear program has sent shockwaves through the international community, apparently challenging the core of the Nuclear Non-proliferation Treaty (NPT).[260] China has a long history of cordial relations with Iran, including technical cooperation on a civilian nuclear program and the sale of dual-use chemicals, for which the U.S. has applied sanctions against

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to upgrade its fields and increase recovery potential. Until the recent extremely high petroleum prices, revenues were insufficient to do this and also pay for the many other spending programs of the government, including importing and subsidising petroleum products. As noted above, the country also needs to expand its refining capacity, which is not capable of producing enough to satisfy domestic demand.

[256] In the first eight months of 2006, China imported an average of 342,217 barrels of oil per day from Iran. William Mellor and Le-Min Lim, "China's oil deals with Iran, Myanmar/ Burma put it at odds with US", *Bloomberg*, 27 September 2006. Iran exported 247,235 thousand bbl/d in 2003, and in 2005 284,830 thousand bbl/d. "County Analysis Briefs: Iran", op. cit.

[257] Iran's North Pars field has an estimated 1.33 Tcm of gas reserves. "China's CNOOC in Talks to Explore Iranian Natural Gas Field", Agence France-Presse, 2 November 2006.

[258] Liu Xuecheng, "China's Energy Security and Its Grand Strategy", The Stanley Foundation, September 2006, p. 11.

[259] "Country Analysis Briefs: Iran", op. cit. See also www.cia.gov/library/publications/the-world-factbook/geos/ir.html.

[260] In December 2002, the U.S. unveiled photographs of nuclear installations at Natanz and Arak, saying they were proof of Tehran's "across-the-board pursuit of weapons of mass destruction". Iran agreed to inspections of the facilities by the International Atomic Energy Agency (IAEA) soon after and has consistently denied it seeks such weapons. A series of negotiations between Iran and three members of the European Union – France, Germany and the UK, the EU-3 – have failed to resolve political differences over the nuclear program. On 24 September 2005, the IAEA adopted a resolution that found Iran in non-compliance with the Agency's statute, and in January 2006, Iran ended its voluntary suspension of uranium enrichment. It has made a number of subsequent claims about progress in its enrichment efforts. See Crisis Group Briefing, *Ahmadi-Nejad's Tumultuous Presidency*, and Report, *Is There a Way Out of the Nuclear Impasse?*, both op. cit; Middle East Briefing Nº18, *Iran: What Does Ahmadi-Nejad's Victory Mean?*, 4 August 2005; Middle East Briefing N°15, *Iran: Where Next on the Nuclear Standoff*, 24 November 2004; and Middle East Report Nº18, *Dealing with Iran's Nuclear Program*, 27 October 2003.

its state-owned companies several times.[261] Nevertheless, China has been able to balance its interests in Iran with its relations with the U.S., as well as Israel, without significant harm to its international reputation. It maintained a key advantage over the U.S. by maintaining diplomatic relations with Tehran. In 2004, it opposed Security Council action against Iran's nuclear energy program and invited Tehran to be an observer to the Shanghai Cooperation Organisation.

But China's position started to change in 2006. On 31 July, it voted for Security Council Resolution 1696, demanding the suspension of Iran's uranium enrichment activities and threatening sanctions in case of non-compliance.[262] Five months later, it supported Resolution 1737, limiting the sale of nuclear equipment and technologies, prohibiting investment in the nuclear sector and freezing assets of certain individuals and entities associated with Iran's nuclear program.[263] It also backed a statement from the Financial Action Task Force – the international standard setter on money laundering and counter-terrorist finance issues – condemning Iran's nuclear activities.[264] Following two reports by the International Atomic Energy Agency (IAEA) in 2007, the Security Council in March of that year adopted Resolution 1747, which widened the scope of sanctions by banning the purchase of arms from Iran, freezing assets of additional individuals and entities and calling on states to prevent the entrance into their territory of the individuals.[265]

China also sent Foreign Minister Li Zhaoxing to meet with Deputy Foreign Minister Abbas Araghchiry in March 2007 and urge Iran to stop enrichment.[266] Days later, Li again called on Iran to step up cooperation with the IAEA.

Beijing's support for Security Council action was largely due to its increasing frustration with Iran's failure to respond to the requirements of the IAEA and UN. At the same time, it has also sought to protect its economic interests in Iran by softening punitive measures. China emphasises that sanctions will not fundamentally resolve the nuclear issue and are not an end in themselves, but rather a means to persuade Iran to resume negotiations under the conditions set by the Council. It promotes diplomacy as the best option, expressed through what it considers its "highly responsible and constructive attitude", rather than "any actions that might lead to deterioration or escalation of tension".[267] Its position also has been less exposed on the Security Council than it might otherwise be because Russia tends to set the bottom line on the issue in the Security Council.

Looking after its economic interests is only one of China's priorities with regard to the Iran nuclear file. Others include stability in the Middle East (which involves preventing a regional arms race as well as maintaining the flow of oil and gas); strengthening the nuclear non-proliferation regime; protecting its

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[261] Chu Shulong, "Iran's Nuclear Act and U.S.-China Relations: The View from Beijing", *China Brief*, Jamestown FOundation, 13 December 2007, at www.jamestown.org/china_brief/article.php?articleid=2373857. China remains Iran's second largest arms supplier behind Russia. Richard F. Grimmett, "Conventional Arms Transfers to Developing Nations, 1999-2006", Congressional Research Service (CRS) report for Congress, 26 September 2007. The Chinese state-owned armaments industry firm Norinco was sanctioned by the U.S. government in May and July 2003 for selling Iran items and technology considered variously of dual use (civilian/military) or direct military application and in September 2003 for alleged transfers to an undisclosed recipient of missile-related equipment or technology. In 2004, it was sanctioned three more times under the Iran Non-Proliferation Act of 2000, and again in December 2005. "China North Industries Group (NORINCO)", Nuclear Threat Initiative, 10 October 2003, at www.nti.org/db/china/norinco.htm; "U.S. Non-Proliferation Sanctions against China and/or Chinese Entities", Nuclear Threat Initiative, January 2007, at www.nti.org/db/china/sanclist.htm. Two of Sinopec Group's subsidiaries, Nanjing Chemical Industries Group and Jiangsu Yongli Chemical Engineering and Technology Import/Export Corporation, have also been sanctioned, in 1997, by the U.S. for selling chemical weapons equipment and technology to Iran. Jiangsu Yongli was sanctioned twice more, in 2001-2002. No action was taken against Sinopec. "U.S. Non-Proliferation Sanctions against China and/or Chinese Entities", op. cit.

[262] UN Security Council Resolution 1696, 31 July 2006, at www.un.org/News/Press/docs/2006/sc8792.doc.htm.

[263] UN Security Council Resolution 1737, 23 December 2006, at www.un.org/News/Press/docs/2006/sc8928.doc.htm.

[264] "FATF Statement on Iran", Financial Action Task Force, 11 October 2007, at www.fatf-gafi.org/dataoecd/1/2/39481684.pdf.

[265] UN Security Council Resolution 1747, 24 March 2007, at www.un.org/News/Press/docs/2007/sc8980.doc.htm.

[266] Araghchiry replied: "Iran is ready to reach a fair and reasonable solution to the nuclear issue through negotiation". See "Foreign Minister Li Zhaoxing Meets with Iran's Deputy Foreign Minister Araghchiry", Ministry of Foreign Affairs of the People's Republic of China, 1 March 2007, at www.fmprc.gov.cn/eng/wjb/zzjg/xybfs/xwlb/t301143.htm.

[267] "Remarks by Ambassador Wang Guangya … Resolution 1737", China's UN Mission, 23 December 2006.

relations with the U.S.; and promoting its image as a responsible power.[268]

Beijing fundamentally believes that as long as Iran honours its NPT commitments not to use nuclear technology for military purposes, it should not be obliged to forgo its rights under that treaty to the technology. Behind this is a belief in "fairness for weaker powers" (ie, non-nuclear) as a normative goal and a desire to demonstrate, as the fastest growing developing nation, that it does not belong to what it considers a bullying clique lead by the U.S.[269] China has long advocated that the U.S. negotiate directly with Iran and cease insisting on preconditions for such negotiations.[270]

Stepped-up U.S. military threats have led to Chinese concern over the wider political and economic fallout of a potential U.S.-Iran conflict.[271] Because it appeared to lessen prospects of U.S. military action, Beijing was relieved when a declassified summary released in December 2007 of a U.S. National Intelligence Estimate (NIE) asserted Iran had halted a secret nuclear weapons program in 2003.[272] While Washington continued to seek further Security Council sanctions,[273] China's UN ambassador, Wang Guangya, said his country preferred a "dual track", essentially a diplomatic initiative to revitalise negotiations and a new sanctions resolution, a position shared by some in the EU.[274] On 22 January 2008, after China and Russia had softened draft language,[275] the P-5 and Germany agreed on the major points of a resolution demanding (again) that Iran immediately halt enrichment and imposing mandatory travel bans and asset freezes against specific Iranian individuals and financial institutions.[276]

On 3 March, the Security Council unanimously approved the new round of sanctions, which extended some restrictions and for the first time banned trade with Iran in dual (civilian/military) use goods.[277] In line with its familiar approach, Chinese diplomats supported condemnation of the nuclear program after weakening those measures that would affect economic relations with Iran.[278] While this annoyed U.S. negotiators, China's overall role on the nuclear issue has been characterised by the Bush administration as "in sync" with that of the U.S.[279] Economic interests have not prevented it from supporting tough international measures, nor from actively seeking a solution to the nuclear impasse, most recently by hosting in Shanghai on 16 April a six-nation round table discussion on ways to restart talks with Iran.[280] Room to negotiate still exists on the nuclear issue.[281]

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[268] Shen Dingli, "Iran's Nuclear Ambitions Test China's Wisdom", *The Washington Quarterly*, vol. 29, no. 2 (Spring, 2006); and Chu Shulong, "Iran's Nuclear Act", op. cit.
[269] Chu Shulong, "Iran's Nuclear Act", op. cit.
[270] Zbigniew Brzezinski, "A Partner for Dealing with Iran? The Lessons of U.S.-China Cooperation on Pyongyang", *The Washington Post*, 30 November 2007.
[271] Crisis Group interview, Beijing, November 2007.
[272] "Iran: Nuclear Intentions and Capabilities", National Intelligence Estimate, November 2007, at www.dni.gov/press_releases/20071203_release.pdf.
[273] "US presses China on Iran sanctions", Associated Press, 18 January 2008.
[274] "January 2008: Iran", Security Council Report, at www.securitycouncilreport.org/site/c.glKWLeMTIsG/b.3750603/.
[275] "New sanctions on Iran are seen as unlikely in near term", Reuters, 22 January 2008.
[276] "Iran could face fresh sanctions from UN", Reuters, 27 January 2008.
[277] The Security Council also authorised inspections of cargo in aircraft and vessels to and from Iran that are suspected of carrying banned goods. Resolution 1803 (2008), at www.un.org/News/Press/docs/2008/sc9268.doc.htm. See also: "UN approves new sanctions against Iran", Associated Press, 3 March 2008.
[278] Crisis Group interviews,diplomats, New York andWashington DC, February 2008.
[279] "Negroponte Says China Mostly 'In Sync' With U.S. on Iran", Council on Foreign Relations interview with Deputy Secretary of State John Negroponte, 4 February 2008, at www.cfr.org/publication/15409/negroponte_says_china_mostly_ in_sync_with_us_on_iran.html?breadcrumb=%2Fpublication%2Fpublication_list%3Ftype%3Dinterview. For a history of China's WMD/missile proliferation policies, see Evan Medeiros, *Reluctant Restraint: The Evolution of Chinese Non-Proliferation Policies and Practices, 1980-2004* (Palo Alto, 2007).
[280] "China to host six-nation talks on Iran's nuclear issue," Xinhua, 8 April 2008.
[281] Before the release of the NIE, Crisis Group President and CEO Gareth Evans suggested that: "The red line that matters is the one at the heart of the Non-Proliferation Treaty, between civilian and military capability", not enrichment. That red line would hold if the international community could "get Iran to accept a highly intrusive monitoring, verification and inspection regime" with additional safeguards. It would also be helpful for Iran to agree to "stretch out over time the development of its enrichment capability and to have any industrial-scale activity conducted not by Iran but by an international consortium". Gareth Evans, "The Right Nuclear Red Line", *The Washington Post*, 5 December 2007; "The Iran Nuclear Problem: The Way Forward", panel presentation by Gareth Evans to the International Seminar on Iran's Nuclear Program and the IAEA Director-General's Report, School of International Relations, Ministry of Foreign Affairs, Tehran, 22 November 2007.

V. CONCLUSION

China's continued rise as a great world power depends importantly on whether it can secure reliable energy supplies against a backdrop of rising prices, the depletion of its domestic resources and fears of supply disruptions. These considerations have led it to focus on securing energy abroad, but the country's energy security must begin at home, by using less energy.

To a large extent, China's energy security depends on whether it addresses its needs domestically by formulating a coherent energy policy, improving the efficiency of energy use and developing alternative energy sources. While the recent draft energy law shows promise, it is years from implementation and will require more detailed administrative regulations to supplement its broad guidelines. Inadequate regulatory ability, poor execution and underfunding are the primary factors that affect the implementation of regulations and policies. There is a pressing need to create a central ministerial-level body with the authority and resources to manage energy security and effectively regulate energy policy and goals as well as reconcile competing interests between the vast state bureaucracy and state-owned companies.

China's transformation into a major energy consumer poses a number of challenges for the international system, which is dominated by the market-based OECD countries and the OPEC cartel. Tensions are likely to continue to rise as its practice of state involvement as a means to obtain investments is increasingly seen as unfair by market players. The acceptance of great risks by Chinese companies to invest in oil exploration and extraction in countries and regions suffering from deadly conflict can complicate conflict resolution. At the same time, China appears to be willing to play a more constructive role, as it increasingly engages with the international system and learns the limits of a foreign policy based on its traditional principle of non-interference. While that principle was useful when China was signing energy deals and seeking to protect itself from foreign interference during a period of relative weakness, it is proving less effective in securing its interests and helping it navigate complex political situations in which a great power inevitably must be a key player.

The potential risks to Beijing's international reputation and relationships with the West are an important driving force behind a nascent shift in foreign policy toward support of international interventions and application of discreet but more insistent diplomacy. China is increasingly willing to exert limited pressure on problem countries. The spotlight on its support for the Sudanese government and energy investments in the developing world has heightened its anxieties about not only risks to the 2008 Olympics, but also a broader backlash against its global role.

However, China's more engaged approach is designed as much to secure its own interests as to be seen as a good global citizen. Beijing is increasingly using its leverage, whether to protect its investments in Sudan and Myanmar, prevent a nuclearised East Asia or deal with greater threats to its citizens abroad. Ensuring the long-term viability of its investments is requiring a more sustainable set of relationships with different groups in the relevant countries. While still hesitant about punitive sanctions, China is starting to develop broader relationships beyond current leaders and to exercise some leverage to push the governments toward reform and international engagement. As policy options are formulated in the international community for ending crisis and resolving conflict, it makes ever more sense to assume that in the right conditions, China, far from being an unconditional obstacle, can become a limited and reluctant, but critical, partner.

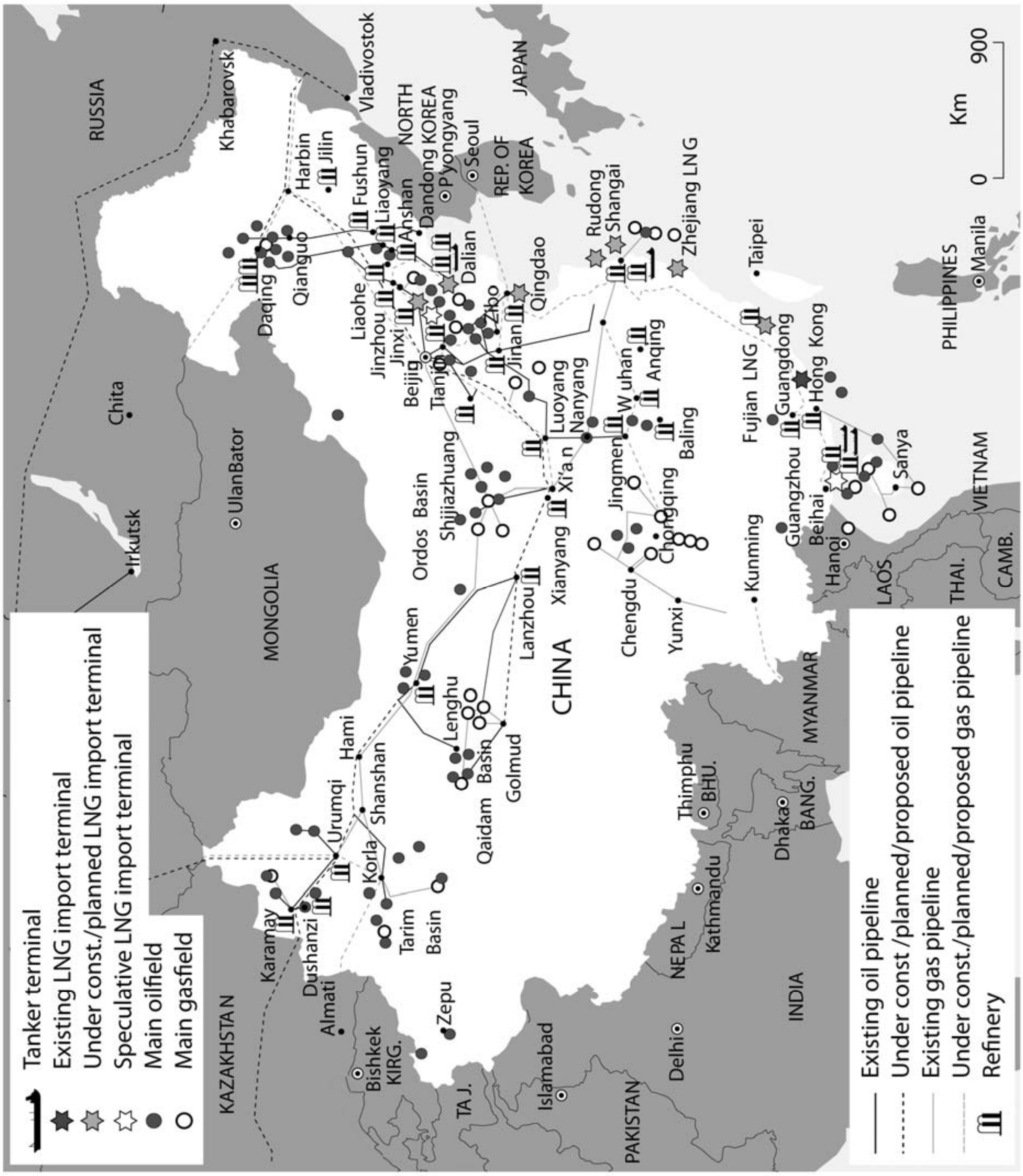
The "China, Inc" characterisation of the government in Beijing as a tightly unified and coordinated entity does not accurately describe foreign and energy policymaking processes which actually involve divided actors and contentious debates. While the foreign ministry is increasingly supportive of action on issues of international concern, military and economic actors continue to pursue their own interests. This fragmented picture is a result of Beijing's desire to satisfy international demands while pursuing bilateral relationships that further commercial and military interests.

Energy security is not a zero-sum game, and many opportunities exist for cooperation. Integrating China into cooperative arrangements presents a chance for both enhancing energy security and preserving peace with China's neighbours. The relevant international institutions, for their own legitimacy and continuity, should update the old bargains that underpinned their establishment. The world has a stake in Beijing's energy security and should use every opportunity to shape the means for it, including by convincing China that it is in its interest to be a responsible major power working in cooperation with the international system. Simultaneously, to enhance global energy security, all countries should strive to develop and implement the next generation of energy technologies, turning away in the process from the competition for control of oil.

Seoul/Brussels, 9 June 2008

APPENDIX A

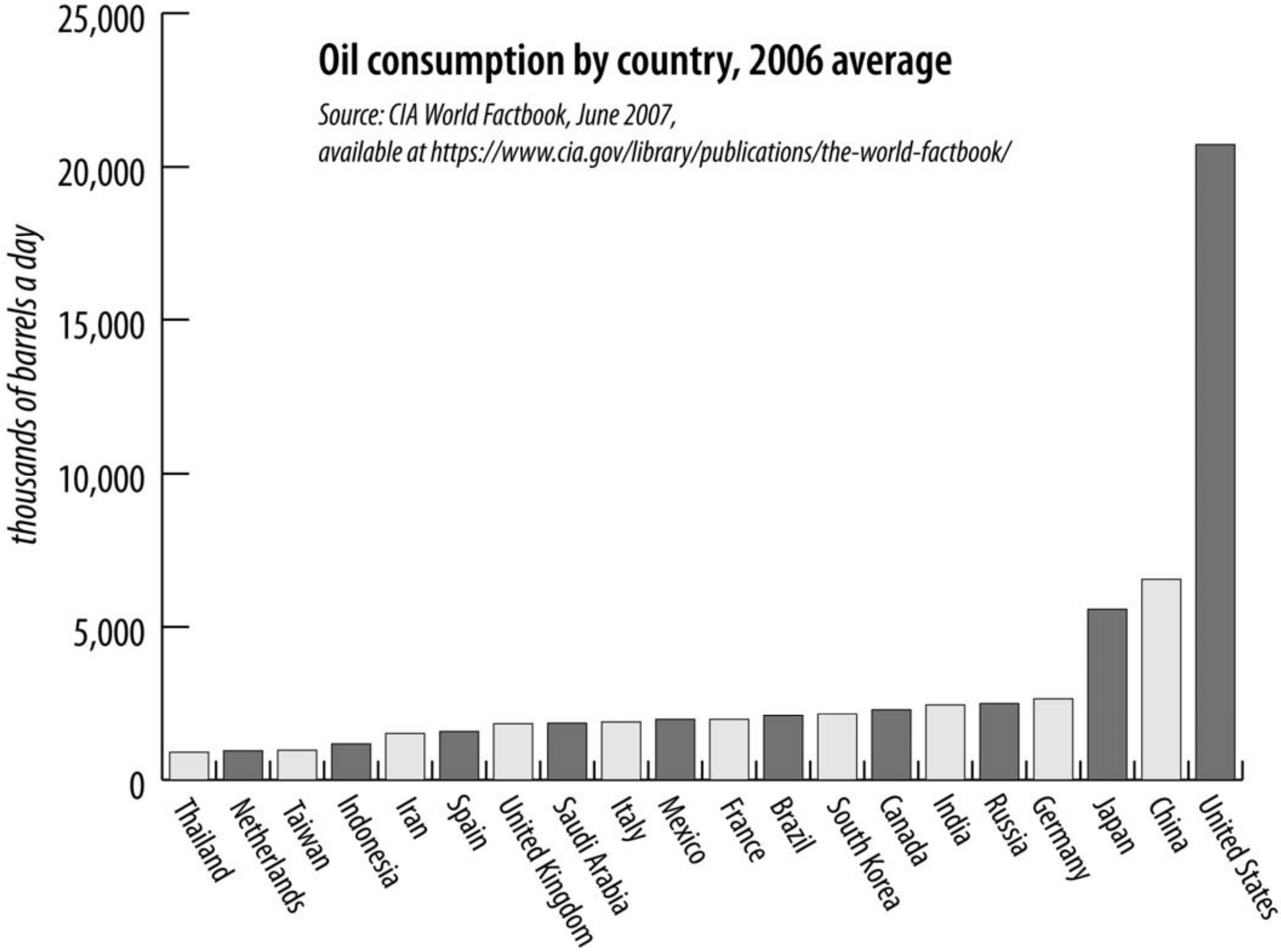
MAP OF CHINA'S OIL AND GAS RESOURCES AND INFRASTRUCTURE



The boundaries and names shown and the designations used on maps included in this publication do not imply official endorsementor acceptance by the IEA.
Source: World Energy Outlook © OECD/IEA, 2007; Figure 10.1, p.319

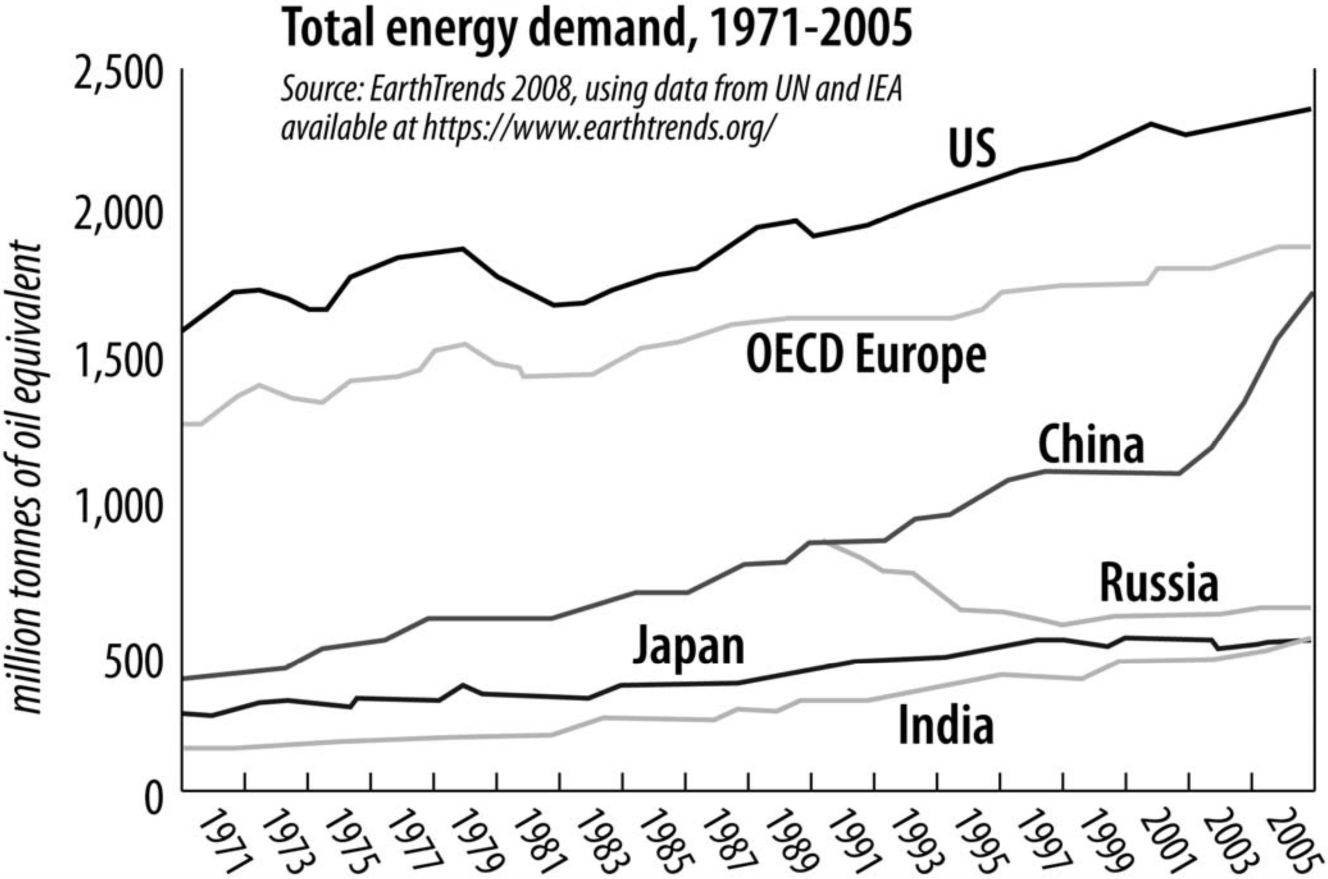
APPENDIX B

OIL CONSUMPTION



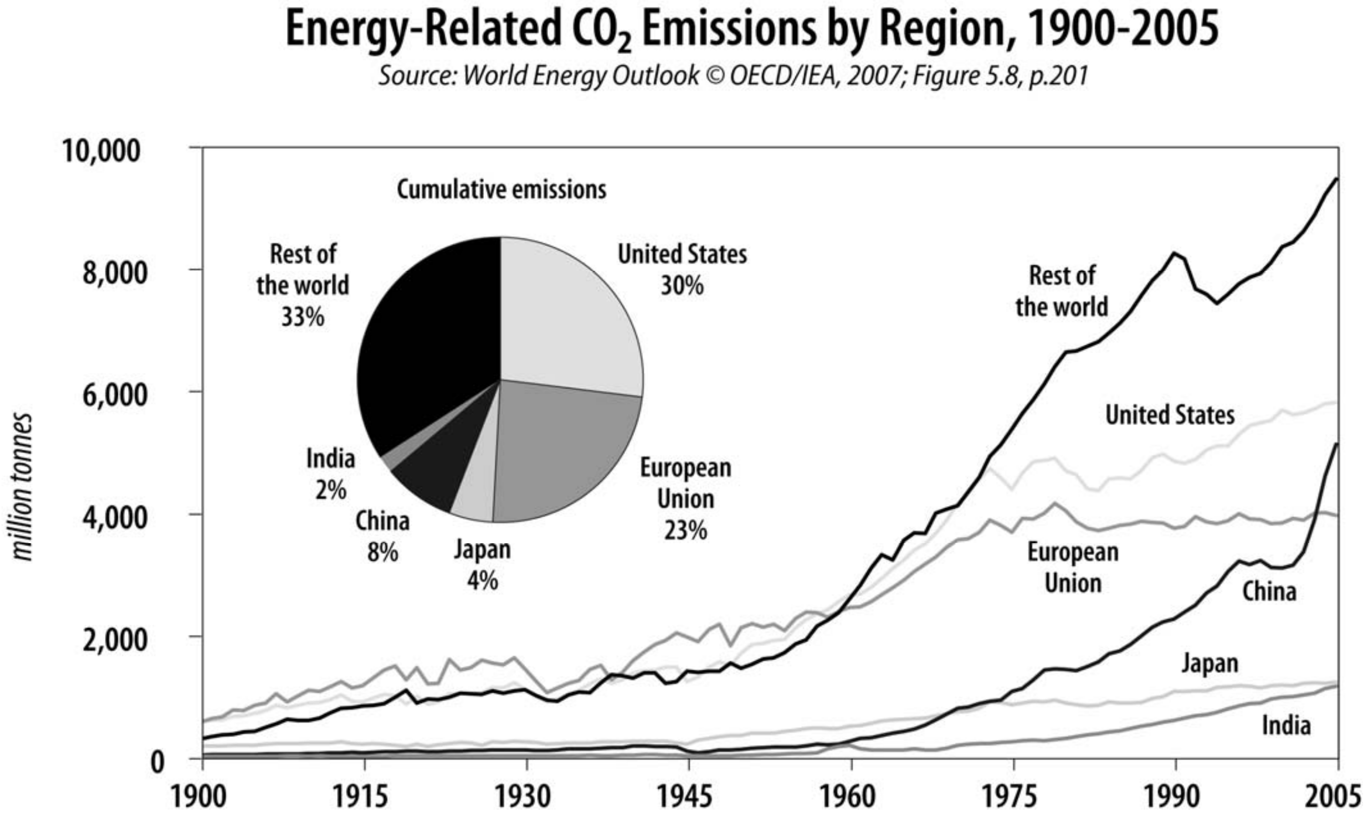
APPENDIX C

TOTAL ENERGY DEMAND



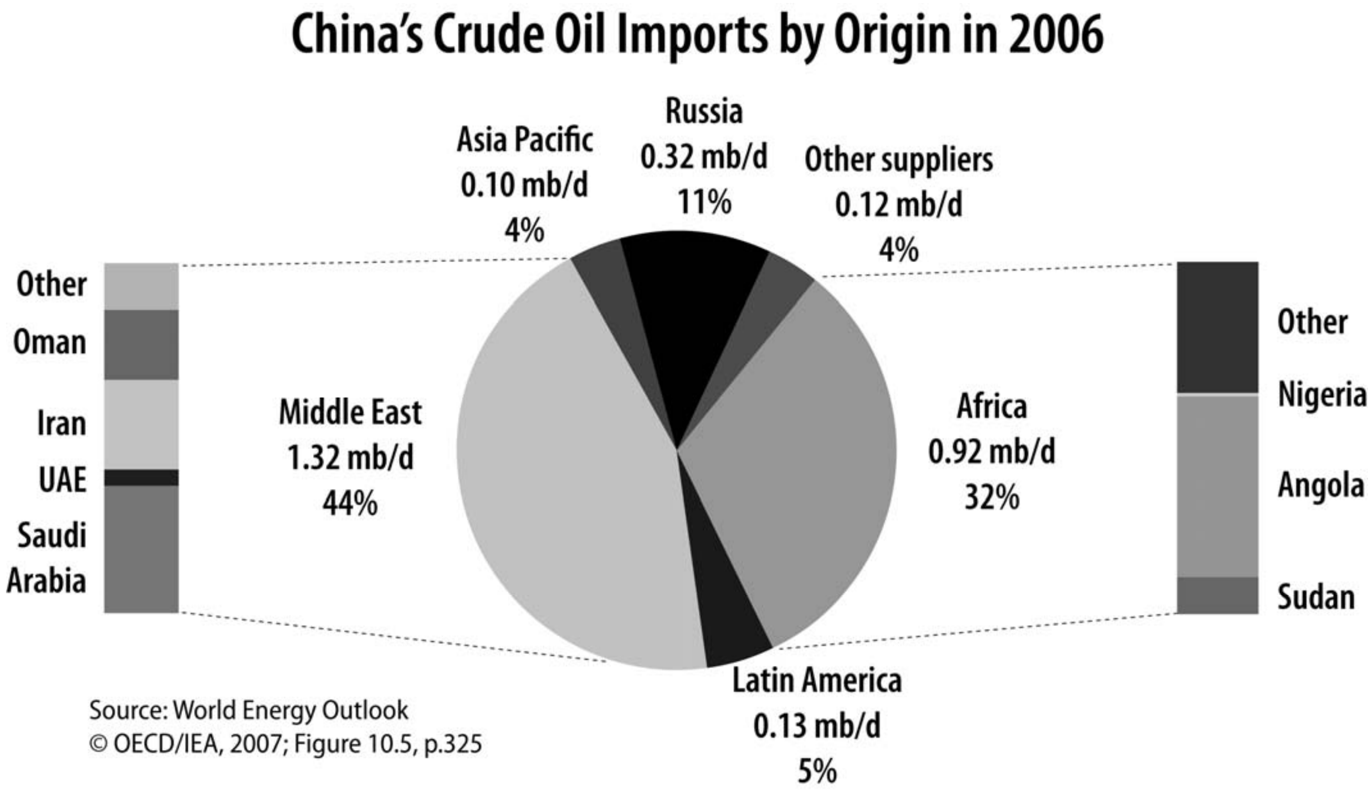
APPENDIX D

CARBON DIOXIDE EMISSIONS



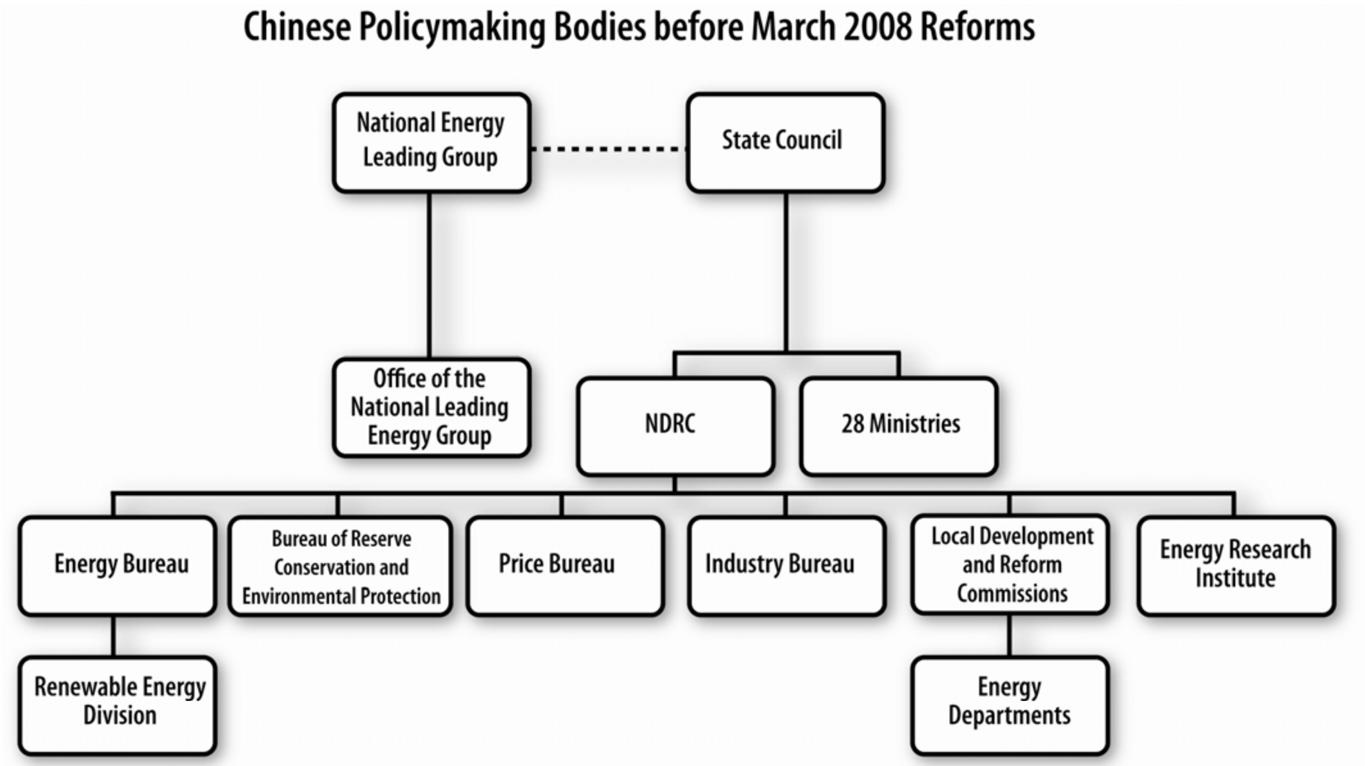
APPENDIX E

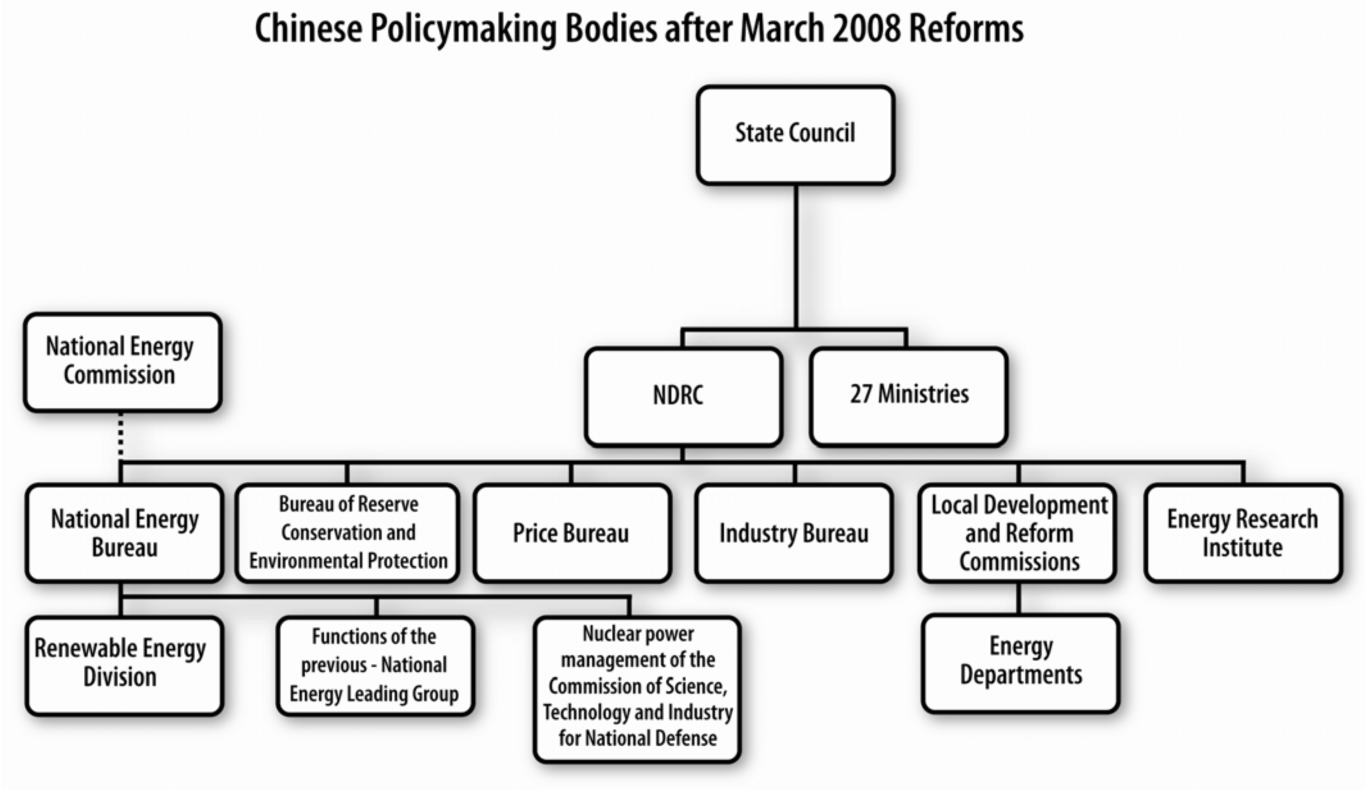
CHINA'S CRUDE OIL IMPORTS



APPENDIX F

CHINA'S ENERGY POLICYMAKING BODIES





APPENDIX G

ABOUT THE INTERNATIONAL CRISIS GROUP

The International Crisis Group (Crisis Group) is an independent, non-profit, non-governmental organisation, with some 135 staff members on five continents, working through field-based analysis and high-level advocacy to prevent and resolve deadly conflict.

Crisis Group's approach is grounded in field research. Teams of political analysts are located within or close by countries at risk of outbreak, escalation or recurrence of violent conflict. Based on information and assessments from the field, it produces analytical reports containing practical recommendations targeted at key international decision-takers. Crisis Group also publishes *CrisisWatch*, a twelve-page monthly bulletin, providing a succinct regular update on the state of play in all the most significant situations of conflict or potential conflict around the world.

Crisis Group's reports and briefing papers are distributed widely by email and printed copy to officials in foreign ministries and international organisations and made available simultaneously on the website, www.crisisgroup.org. Crisis Group works closely with governments and those who influence them, including the media, to highlight its crisis analyses and to generate support for its policy prescriptions.

Crisis Group's international headquarters are in Brussels, with advocacy offices in Washington DC (where it is based as a legal entity), New York, London and Moscow. The organisation currently operates eleven regional offices (in Bishkek, Bogotá, Cairo, Dakar, Islamabad, Istanbul, Jakarta, Nairobi, Pristina, Seoul and Tbilisi) and has local field representation in sixteen additional locations (Abuja, Baku, Bangkok, Beirut, Belgrade, Colombo, Damascus, Dili, Dushanbe, Jerusalem, Kabul, Kathmandu, Kinshasa, Port-au-Prince, Pretoria and Tehran). Crisis Group currently covers some 60 areas of actual or potential conflict across four continents. In Africa, this includes Burundi, Central African Republic, Chad, Côte d'Ivoire, Democratic Republic of the Congo, Eritrea, Ethiopia, Guinea, Kenya, Liberia, Rwanda, Sierra Leone, Somalia, Sudan, Uganda and Zimbabwe; in Asia, Afghanistan, Bangladesh, Indonesia, Kashmir, Kazakhstan, Kyrgyzstan, Myanmar/Burma, Nepal, North Korea, Pakistan, Phillipines, Sri Lanka, Tajikistan, Thailand, Timor-Leste, Turkmenistan and Uzbekistan; in Europe, Armenia, Azerbaijan, Bosnia and Herzegovina, Cyprus, Georgia, Kosovo, Serbia and Turkey; in the Middle East, the whole region from North Africa to Iran; and in Latin America, Colombia, the rest of the Andean region and Haiti.

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June 2008

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