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Before the Commission on U.S.-China Economic and Security  
Review

*Hearing on  
China's Energy Needs and Strategies*

Thursday, October 30, 2003

Mr. Chairman, I am Robert Ebel and I chair the Energy Program at the Center for Strategic and International Studies. I am pleased to be able to contribute to this hearing on China's energy needs and strategies.

In today's context, national security and energy security are so closely intertwined that it is inconceivable to consider them as separate issues. First, what do we mean by national security? I would suggest that the best answer, at least in my judgment, was provided a number of years ago by the eminent American diplomat, George Kennan, who offered perhaps the least complicated definition: "(national security means) the continued ability of this country to pursue its internal life without serious interference."

What is meant by energy security? For the American consumer, the answer is simple. He has only two concerns: price and availability. Little else matters, and I would suggest that these concerns hold for most consumers everywhere.

Importing governments have a different view and seek energy security or security of supply through diversity of supply and as well diversity among the kinds of fuels we consume.

China's current and future energy needs have already been defined by the preceding speakers. Clearly, China must have access to adequate and timely supplies of crude oil and natural gas if it is to successfully sustain economic growth. To do so, it must compete in a world market where supplies are not always available in the amounts desired nor at prices acceptable to the consuming population.

China, like all importing nations, seeks diversity among suppliers and diversity amongst fuels consumed, with emphasis today on oil and natural gas, although domestically produced coal is still by far the dominant fuel.

At present all the oil imported by China arrives by tanker, there are no pipeline deliveries. That adds to China's vulnerability, in that pipelines, although themselves are subject to sabotage and thievery, are comparatively easier to protect than sea lanes.

Vulnerability is not limited to volumes imported. Rather, true vulnerability may be found in the prices paid for imported oil and moreover in the the volatility of these prices. Will the Chinese economy be strong enough to absorb the impact of such volatility?

When the United States looks north, we see Canada, our leading source of imported oil and also the supplier of one-sixth of all the natural gas we consume. When China looks north, it sees Russia, rich in oil and natural gas but found in fields far distant, in western Siberia and the Arctic.

Eastern Siberia is far more attractive as a source of oil and gas for China, in that it is much closer to points of consumption in China. This region has a recognized natural resource potential but this potential has not been realized in the absence of both a domestic and an export market. Now, the prospect of development, based on exports to China and elsewhere, has emerged.

Just as importing nations seek security of supply through diversity of supply, exporting nations seek security for their oil sales through market diversity. That is a driver behind a proposal by Yukos, Russia's largest oil company, to export oil to China via a pipeline originating at Angarsk, in eastern Siberia.

But diversity of markets is not the only driver, nor is it the most important one. Rather, Yukos and the Russian oil sector as a whole need new export markets if production and oil-derived income are to expand. China, the Far

East and Southeast Asia are the growth oil markets of the future. Thus the justification for new pipelines to move Russian oil eastward. At present, all Russian oil—and gas—exports move westward.

Moreover, without these new export markets and absent the justification to develop new oil production bases in eastern Siberia, the prospect for growth in Russian oil production is taken away.

An internal study undertaken by the Russian oil company Yukos foresaw Russian oil production peaking by the year 2010, holding at some 10 million barrels per day out to the year 2015, and then slowly declining. However, because the leading oil producing regions of the country were expected to peak as well in 2010, then begin to decline, where would the growth needed to offset this decline come from?

The growth needed to offset production declines is projected to be provided by the Russian shelf, largely Sakhalin Island, and by eastern Siberia. Absent new supplies from these two regions, especially from eastern Siberia, Russian oil production by the year 2020 was projected to be about 1.5 million barrels per day less than what it is today.

Thus, Russia has much at stake in its negotiations with China and with Japan, with future oil sector growth very much dependent on the outcome of these negotiations.

Having said that, a political and economic conflict has arisen for Russia. Russia is also considering construction of an oil export pipeline to the Pacific Ocean port of Nakhodka, to serve the needs of Japan, with a branch line to China. Importantly, a pipeline to Nakhodka is viewed by Russian officials as providing the base for economic development of eastern Siberia and the Russian Far East. However, the oil reserve base in eastern Siberia is far too small at present to justify construction to Nakhodka, whereas Yukos has given assurances that it can provide 600,000 barrels per day by pipeline to China without any constraints.

Both China and Japan are pressing Russia for a decision to the question: which pipeline is going to be built first? How can Russia play both of these proposals, seeking the maximum political and economic gain, without alienating either the Chinese or the Japanese? Now, the issue is further clouded by the arrest of Yukos president Khodorkovsky.

There is a larger question in all this. That is, would pipelines linking Russia with China serve our national interests? At first glance, the answer would appear to be yes, it would. Reducing Chinese dependence on Persian Gulf oil, today the largest source of its oil imports, has to be seen as in our national interests, and in the interests of the world oil market as a whole.

But of course there is a tradeoff, as tradeoffs accompany any and all energy-related decisions we make as a nation, and these tradeoffs carry their own risks and costs.

These pipelines, when built, will bring about a closer political and economic integration of Russia and China. Moreover, pipelines carrying natural gas from Russian east Siberia might not only supply the Chinese market, but possibly would be extended beyond China to both Koreas, providing reliable fuel supplies that would support development and ease strains on their respective economies.

Yet, this prospective economic integration could eventually evolve into a regional political bloc, excluding the United States, and would in part solidify Russia's future place in the region. Once again, however, would this tradeoff meet our national interests, or would it complicate them?

China today is viewed as one of the most promising consumer markets available, particularly by Russia, where the domestic market lags, particularly outside the major cities of the country. At the same time, might Russia fear that it would come to be regarded as little more than a source of oil and gas, to be used by China as a means of developing its own manufacturing potential, a potential that could challenge Russian and other manufacturers?

Like any seller of goods, it is in Russia's interests to encourage competition among the prospective buyers of the energy it has to sell. At the same time, that competition, say, between China and Japan, must not be allowed to deteriorate into a rivalry. Japan is almost wholly dependent on imported oil while China, now second only to the United States in terms of oil consumption, is moving gradually to an oil import dependency that in the years ahead may well match the current level of relative U.S. dependency.

With demand for energy in the developing countries of the world very likely exceeding energy use in the industrialized world by the year 2020 if not sooner, the future does not appear comfortable nor secure. Current world oil demand is on the order of 77 million barrels per day. The International Energy Agency has forecast world oil demand approaching 119 million barrels per day 2020. Can we, should we safely assume that oil supply will match demand, or that competition for available supplies will heighten? Under these conditions, how might China fare?

Having been an oil importer now for a number of years, and sensitive to the workings of the market place, would China conduct itself responsibly, or would it employ political leverage to secure needed supplies? Whatever its response would very much matter to the United States and to other importers.

Current Chinese dependence on Persian Gulf oil comes to mind. If China is not especially successful in reducing its dependence on that region, through investments in other oil exporting countries, as seems to be its current program, or through pipeline linkages to Russia, and should Persian Gulf supply be interrupted for political reasons, could we expect China to react in concert with other importers, or might it seek separate arrangements to cover their losses?

Mr. Chairman, I realize that I have raised far more questions than I have answers for. But that reflects the difficulty of meaningful assessments of China's future conduct in the world of oil. The questions are easy to come by, because we can draw upon past experiences in dealing with the world oil market and interruptions in supply. We know where the pitfalls are, sometimes having learned the hard way. But, China is a relatively new boy on the block and has yet to face the realities of protecting an economy that is steadily increasing its dependency on an adequate, timely, and secure supply of oil.

Yet the country is a major participant in the global trading system, and there is reason to believe that it will take a more active, a more responsible role in keeping with its energy vulnerability.

Thank you, Mr. Chairman, and I look forward to any questions you may have.