Research Paper

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China and the Middle East in a New Energy Landscape

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Summary

- The fall in global oil prices, due to rising supplies and slowing demand, since mid-2014 has been an economic boon for China. The import bill for the world's largest buyer of crude oil has more than halved in the space of a year. At the same time, with slowing domestic growth in oil demand, Beijing has been able to buy more oil at lower prices in order to boost its strategic petroleum reserves.
- In light of the United States' reduced need for oil imports, thanks to the 'tight oil' revolution, more West African and Latin American producers are competing with China's traditional Middle Eastern suppliers for market share. Even within the Gulf, Saudi Arabia's dominance as a supplier to the Chinese market is being challenged by Iraq and Iran, which are gradually boosting their output.
- China's decision-makers still view the country's high dependency on imported oil as a source of vulnerability. Instability in the Gulf, which supplies half of China's imports, is a constant concern for Beijing. At the same time, the United States' declining need for Middle Eastern oil raises questions about Washington's broader involvement in the region and its willingness to stabilize oil production there.
- These shifting energy and geopolitical dynamics are prompting decision-makers in China to review their country's involvement in the Middle East. Increasing oil imports, combined with Beijing's ambitious foreign policy designs, are paving the way for a deeper commercial and diplomatic engagement. Gulf producers are also increasingly looking eastwards to expand their exports, as they seek to capitalize in particular on China's economic and geopolitical rise.
- While China will continue to expand its commercial footprint in the Middle East, its appetite for a deeper security engagement remains limited. Contrary to many depictions of China's nascent relations with the Middle East, Beijing has maintained ties with the region dating back to the Maoist years. Beijing is therefore aware of the political and security complexities of the region, and will want to keep such issues at arm's length.

Introduction

The international energy landscape has changed dramatically since the onset of the US 'shale revolution' in 2008. US producers have exploited technological advances to extract oil and gas from previously hard-to-access deposits trapped inside rock formations. The consequent rise in US hydrocarbons output has enabled the country to go from being the world's largest importer of oil and gas to one of the world's largest producers. This transition is reshaping energy trade flows and, in the process, geopolitical dynamics. US reliance on foreign sources of oil and gas is diminishing rapidly, increasing the availability of supplies for other consumers. With rising American 'tight oil'[1] output threatening OPEC's traditional leading role in the market, major Gulf producers have launched a price war to squeeze out US tight oil producers. This has sent oil prices into free fall.

In some respects these developments are a boon for China. They mean a greater availability of oil supplies at lower prices, and a chance for the world's largest oil importer to bolster its relations with oil and gas producers. But while the US shale boom and subsequent reconfiguration of global energy markets have benefited China in an economic sense, some other implications are causing concern. The changed geopolitical landscape raises questions about the external environment for Beijing's pursuit of supply security, most notably in the Middle East and Asia-Pacific.

Indeed, the energy shift in the United States has generated growing anxiety in several countries – including China – about Washington's commitment to the security and stability of Gulf oil producers. Despite Washington's repeated affirmations that it remains engaged in the region, capitals in the Middle East and Asia have started to question where US strategic priorities now lie. And as geopolitical turmoil in the Middle East shows no signs of abating, Beijing's efforts over the past year to promote a free-trade agreement (FTA) and revive its strategic dialogue with the Gulf Cooperation Council (GCC) will lead to deeper Chinese engagement in the Middle East.

A changed energy landscape

China's presence in global energy markets has increased dramatically in the past decade or so, accounting for 60 per cent of the growth in global energy demand between 2003 and 2013. Spurred by average annual GDP growth rates exceeding 10 per cent in the same period, China's oil demand increased by an average of 450,000 barrels a day (b/d) in each year. In 2014 China consumed 10.4 million b/d, up from 6.4 million b/d in 2004.

Although China holds Asia's largest oil reserves, domestic output cannot satisfy soaring demand. As a result, the country's oil imports have jumped from under 2 million b/d in 2002 to 6.2 million b/d in 2014 — reaching highs of 7.4 million b/d in mid-2015 — with roughly two-thirds of these supplies coming from the Middle East and Africa. China's efforts to diversify its sources of imported oil have

1 In most non-technical contexts, the terms 'tight oil' and 'shale oil' are largely interchangeable. 'Tight oil' is often preferred in the industry, as it more accurately reflects the fact that techniques such as hydraulic fracturing are used to extract oil not only from shale but also from other types of rock. Tight oil is considered a sub-category of what the industry refers to as 'unconventional oil', which includes oil sands, shale oil and coal conversion.

had some success, yet the country still relies on a small number of producers for two-thirds of its imported crude oil. These states include Saudi Arabia, Angola, Iraq, Iran, Russia and Oman.

As part of Beijing's 'new normal' approach to development (meaning tolerance for slower aggregate economic growth), President Xi Jinping has called for an 'energy revolution' to reduce the pace of growth in fossil fuel consumption.[2] Still, overall oil demand in China is set to rise. BP expects the country to remain the largest contributor to world demand growth. It projects that Chinese consumption will reach 18 million b/d in 2035, surpassing demand in the United States, which is forecast to consume 17 million b/d by that date.[3]

While China's rapid economic growth has made it the world's largest oil buyer, the United States is moving down the list of top importers. Throughout the 2000s, as oil prices surged above $100 a barrel, investors were incentivized to develop capital-intensive fields. In the United States, hydraulic fracturing ('fracking') and horizontal drilling to extract oil from shale formations became economically viable. This led to the boom in tight oil. The growing prominence in the market of tight oil, which is produced with the same technology as shale gas, has led US oil production to rise from 8.5 million b/d in 2008 to 12.8 million b/d in 2014.

Global oil prices are now adjusting to the state of oversupply generated by surging US production, and moving in line with market fundamentals. Until recently prices had not fully reflected the growth in global supply because of the impact of geopolitical strife. Libya's civil war, an uncertain outlook for Iraq, and US and European sanctions on Iran[4] combined to take almost 3 million b/d off the market, starting in 2011.[5] US tight oil production merely cushioned the blow, preventing prices from climbing even higher.

The oil price collapse …

The picture changed in the summer of 2014, as supply disruptions in OPEC's most vulnerable member states started easing and as the reality of softer demand from the world's largest consumers, including China, became more palpable. Just as political turbulence and insecurity in Libya had been a major factor in the global oil price spike in 2011, the situation in the country played a key role in the price downturn in the summer of 2014. Libyan production had halted in August 2011 as the civil war shook the country and paralysed oil facilities, but by March 2012 production had resumed. It increased to 1.5 million b/d, where it stayed throughout 2012. After the civil war ended, labour-related protests began disrupting operations at oilfields and installations. The protests peaked during the summer of 2013, when they crippled the oil sector and once again led to a near halt in production. After this markets did not expect a rapid restoration of Libyan production, but in June 2014, when blockades were unexpectedly lifted at two terminals, Libyan crude was back in the game.

2 'China faces tough task in energy revolution', *China Daily*, 26 June 2014. See http://www.chinadaily.com.cn/bizchina/greenchina/2014-06/26/content_17616566_2.htm, last accessed on 18 May 2015.
3 *BP Energy Outlook 2035*, http://www.bp.com/content/dam/bp/pdf/Energy-economics/energy-outlook-2015/Energy_Outlook_2035_booklet.pdf, last accessed on 18 May 2015.
4 Daniel Yergin, 'The global Impact of US Shale', Project Syndicate, 8 January 2014, http://www.project-syndicate.org/commentary/daniel-yergin-traces-the-effects-of-america-s-shale-energy-revolution-on-the-balance-of-global-economic-and-political-power, last accessed on 18 May 2015.
5 Michal Meidan, Rosealea Yao, 'How China Will Gain From Low Oil Prices', *China Economic Quarterly*, March 2015.

Global oil markets looked to OPEC, and in particular to Saudi Arabia, to cut production and support prices. But the cut never came. At a much-anticipated OPEC meeting on 27 November 2014, Saudi Arabia decided to abandon its role of swing producer, sending oil prices tumbling under $50 a barrel. Saudi Arabia had been expected to balance the market by compensating for other OPEC states' unwillingness to reduce their output. Yet with Iraq steadily ramping up its production and offering discounted barrels to Asia, Saudi Arabia was unwilling to lose market share and therefore maintained its level of output. At the same time Iran, despite the sanctions regime, was targeting Asian markets and supplying them with cheap oil, while West African crudes that were no longer in demand in the United States were also being shipped east. Together, these factors not only supported the global supply of oil but also ensured that more of it was headed towards Asia, and especially China.

… has been a boon for China

Through this process, China has been able to fulfil some of its energy security priorities. First, falling oil prices have allowed Beijing to increase its strategic petroleum reserves at an astounding rate: in April 2015, just as China's economy and oil demand growth were slowing, imports of crude oil reached a record high of 7.4 million b/d, an 8.6 per cent year-on-year increase, thanks to robust stockpiling.[6] Indeed, as the oversupply in the global oil markets has worsened, Chinese imports have increased. In 2014 China is estimated to have stockpiled 100 million barrels. In 2015 it is likely to add another 100 million barrels to its reserves. If this happens, in just two years the country will have amassed almost half of its target of having 500 million barrels in strategic petroleum reserves by 2020.

Second, Beijing's ability to diversify its import sources has increased. Producers looking to secure an outlet for their oil must outbid each other for a share of the Chinese market. This shift has been under way gradually, in tandem with the realization that US imports of crude oil were set to decline. Indeed, since 2012 Saudi Arabia, the largest exporter of crude oil to China, has failed to expand its market share even though Chinese imports have increased by 700,000 b/d. China's imports of Iraqi oil, in contrast, have increased by 70 per cent over the same period. Oil supplies from Latin America to China have also increased, rising from an average of 500,000 b/d in 2013 to a record 760,000 b/d in September 2014, supported by attractive prices and by producers' need to repay loans.[7]

An evolving Chinese relationship with the Middle East

Despite the growing availability of oil and gas at diminishing costs, the change in the American market is greeted with mixed feelings in Beijing. The rapid success of the 'tight oil' revolution in the United States has come as a surprise to many in China. There are at least two possible explanations for China's surprise regarding the change in the energy landscape. First, the idea of China importing oil and gas from the United States has yet to register as a realistic possibility among policy-makers in either country. This state of affairs can be said to 'desensitize' Chinese observers to changes in US

6 Michal Meidan, Amrita Sen and Robert Campbell, 'China: the "new normal"', Oxford Institute for Energy Studies, February 2015, http://www.oxfordenergy.org/wpcms/wp-content/uploads/2015/02/China-the-new-normal.pdf, last accessed on 18 May 2015.
7 Ibid.

energy production. It fosters an environment in which Chinese discussions tilt towards speculative aspects of oil-related geopolitics. For example, questions have been raised over whether or not the United States is going to reduce its involvement – aimed in part at stabilizing oil production – in the Middle East.[8]

To be sure, US oil imports from the Middle East can be expected to decrease thanks to rising US domestic output and imports from other sources, mainly Canada.[9] Yet even before the 'shale revolution', oil imports were not the determining factor in Washington's Middle East policy given that the Gulf provided only about 10 per cent of total US supplies.[10] Rather, it was the importance of oil production and flows to the global economy that helped define US strategic interests in the Middle East.[11]

Second, the notion of a 'trust deficit' in geopolitical relations between China and the United States plays a powerful role in Chinese discussions about the external environment and ensuring China's energy security. This is despite the lack of obvious grounds for distrust on energy matters alone. Notwithstanding the history of the US-led comprehensive embargo against trade in all 'strategic materials' with China, since Henry Kissinger's trip to China in 1971 uncertainties in diplomatic and political relations between China and the United States have not led to deliberate US interruption of China's access to Middle Eastern or other foreign sources of oil supply.[12] Still, the logic of geostrategic distrust has a force all of its own. The sense of apprehension remains: now that the United States is less reliant on oil supply from abroad, it may have less reason to hesitate about disrupting supply to China.

Chinese reliance on Middle Eastern oil supplies is determined in no small measure by the technical match between refineries in China and the types of crude oil imported from that region.[13] In addition, it is important for China that the international finance and shipping networks that enable trade between the Chinese and the Middle Eastern markets are maintained. Even in a scenario in which China eventually starts to access oil and gas supplies from North America, there is little prospect of China becoming less interested in Middle Eastern sources of energy.

China feels its way into the Middle East

As China's energy ties to the Middle East continue to deepen, efforts to bolster diplomatic ties with the region are also under way. But before examining these, it is worth pointing out that contrary to many depictions of China's nascent relations with the Middle East, Beijing is not a newcomer to the region.

8 Yao Kuangyi, 'Readjustments and Difficulties in the United States' Middle East Policy', January/February 2014, China Institute of International Studies, http://www.ciis.org.cn/english/2014-03/19/content_6756327.htm, last accessed on 18 May 2015.
9 Daniel Yergin, 'The global Impact of US Shale', Project Syndicate, 8 January 2014, http://www.project-syndicate.org/commentary/daniel-yergin-traces-the-effects-of-america-s-shale-energy-revolution-on-the-balance-of-global-economic-and-political-power, last accessed on 18 May 2015.
10 Ibid.
11 Richard McGregor and Ed Crooks, 'US energy boom will not result in isolationism', *Financial Times*, 18 November 2013.
12 Zha Daojiong and Hu Weixing, 'Promoting Energy Partnership in Beijing and Washington', *The Washington Quarterly*, Vol. 30, No. 4, Autumn 2007, pp. 105–15.
13 Zha Daojiong discusses this in his chapter 'China and Iran: Energy and/or Geopolitics', in Mikkal Herberg et al., *Oil and Gas for Asia: Geopolitical Implications of Asia's Rising Demand*, National Bureau of Asian Research, September, 2012, pp. 19–28.

Indeed, China's relations with the region date back to the Maoist years, when ties were shaped by the broader strategic and ideological context of the Cold War.[14] China provided aid and logistical support to revolutionary groups, even though trade and commercial ties were limited. For China, the Middle East was a welcome observation ground for the balance of powers between the United States and the USSR. Building on these foundations, ties expanded following the initiation of Deng Xiaoping's reform and 'opening up' of the Chinese economy from 1978 onwards. Nascent commercial ties followed in the mid-1980s. Beijing allowed individual workers, and then groups and companies, to provide labour, participate in construction projects and offer consultation services in Middle Eastern markets.[15]

Host countries in the Middle East welcomed the Chinese workforce because of their shortages of skilled manpower and because the Chinese 'were not Muslim, did not intend to settle down, and were well organized, disciplined, and industrious'.[16] Many of the firms engaged in construction and services were subsidiaries of China's state-owned oil and gas companies. For example, China Petroleum Engineering and Construction Corporation (CPECC), a subsidiary of China National Petroleum Corporation (CNPC, China's largest state-owned oil and gas firm), started operations in Kuwait and Iraq in the early 1980s. As CPECC established its foothold in the region, it extended its activities into Sudan and Egypt. Another CNPC subsidiary, Greatwall Drilling Company, also became increasingly active in the region, with drilling operations in Egypt, Iran, Libya, Oman, Qatar, Sudan, Tunisia, the United Arab Emirates and Yemen.[17]

The second major thrust of the Chinese presence in the Middle East came in the early 1980s with weapons sales, as countries including Egypt, Iran, Iraq and Saudi Arabia became some of China's largest military customers. As a result, arms became the most important component of China's exports to the Middle East, representing 78 per cent of the total in 1984 and 72 per cent in 1987.[18] However, from the early 1990s onwards China's arms sales to the Middle East began to decline, stopping almost completely by the end of the decade. This was due in part to the arms embargoes imposed by the United Nations and the United States on Iran and Iraq; in part to US efforts to curb military proliferation and the pressure this placed on China as a result; and also in part to the realization in the Middle East that Chinese arms, although inexpensive, were ineffective under battlefield conditions.[19]

Sino-Middle Eastern trade fell to more modest proportions in the early 1990s but ramped up again shortly afterwards as China's need for imported oil increased. Chinese economic planners' efforts to facilitate oil supplies from the region required the upgrading of China's refining capacity. This was because China's downstream sector had traditionally been geared towards domestic low-sulphur crude oil but would now need to process the high-sulphur crude from the Middle East. Gulf producers were happy to invest in Chinese refineries that would then strengthen their foothold in

14 See Yitzhak Shichor, *The Middle East in China's Foreign Policy: 1949-1977* (London: Cambridge University Press, 1979).
15 刘中民 Liu Zhongmin, '中国中东外交三十年' 'Thirty years of China-Middle Eastern Diplomacy', 宁夏社会科学， *Ningxia Social Sciences*, September, 2008, pp. 8–13.
16 Yitzhak Shichor, 'China's Economic Relations with the Middle East: New Dimensions', in P. R. Kumaraswamy (ed.), *China and the Middle East: The Quest for Influence* (New Delhi and London: Sage Publication, 1999), pp. 178–99.
17 CNPC Annual Report 2003.
18 Yitzhak Shichor, 'Mountains out of Molehills: Arms Transfers in Sino-Middle Eastern Relations', *Middle East Review of International Affairs* (MERIA), Vol. 4 No. 3, September 2000, pp. 27–39.
19 Ibid.

the market. Negotiations began in the mid-1990s, but Saudi and Kuwaiti attempts to penetrate the Chinese market were stymied by the pricing structure for oil products, which remained administratively set and squeezed refiners' margins. After lengthy negotiations, in 2005 Saudi Arabia secured a joint venture refinery project in China's Fujian Province.[20]

Energy rises up the diplomatic agenda

While China's energy ties with Iraq, Iran and even Kuwait emerged from strong foundations of service and labour exports, Sino-Saudi ties strengthened significantly only after 2001. The tensions in Saudi-US relations following the 9/11 attacks prompted Riyadh to diversify its global alliances.[21] In addition, after China joined the World Trade Organization in late 2001, the country's oil demand surged. China became the largest source of oil demand growth globally, and the single most important export market for Saudi Arabia. Trade and energy cooperation between Saudi Arabia and China increased rapidly as two-way trade reached $74 billion in 2012, more than a tenfold increase from 2002.

Rising instability in Afghanistan and Pakistan, as well as concerns in China about the potential spillover of tensions into Xinjiang, provided additional scope for Sino-Saudi cooperation.[22] While substantive cooperation on security issues remained limited, the confluence of interests gave rise to political support for the bilateral relationship at the highest level: King Abdullah made an official visit to China in January 2006 – the first by a Saudi king since the two countries established diplomatic relations in 1990. On President Hu Jintao's reciprocal visit to Saudi Arabia, cooperation was extended to cover Chinese participation in Saudi infrastructure markets.[23]

In the future, China's import sources will continue to evolve. But Saudi Arabia is likely to remain an important oil exporter for China, not least because Saudi Aramco has entered into a long-term contract to supply an additional refinery in Kunming in Yunnan Province. The oil pipeline China has built through Myanmar requires a large and, hopefully, reliable supplier like Saudi Arabia to reassure China over the security of its oil imports, continuing domestic debates notwithstanding.[24]

To be sure, Saudi Arabia's leading position on the list of oil exporters to China is being challenged by the return of other oil producers to the markets, as well as by the increasing complexity and sophistication of Chinese refining capacity, which can now accommodate a wider variety of crude grades. According to Chinese customs data, crude imports from Saudi Arabia and Venezuela declined in 2014. China has increasingly tapped supplies in Iraq, Angola and even Colombia.[25]

20 Glen Carey, 'Aramco, Exxon JV sign Contract to Expand Fujian Refinery', *Platt's Oilgram Price Report*, 83:4 (January 2005), p. 5.
21 Emile Hokayem, 'Looking East: A Gulf Vision or a Reality?'; Wu Bingbing, 'Strategy and Politics in the Gulf as Seen from China', in Bryce Wakefield and Susan L. Levenstein (eds), *China and the Persian Gulf: Implications for the United States*, Woodrow Wilson Center, 2011; Saad Raham, 'China's Energy Strategy Towards the Middle East: Saudi Arabia', in Gabriel B. Collins, Andrew S. Erickson, Lyle J. Goldstein and William S. Murray (eds), *China's Energy Strategy: The Impact of Beijing's Maritime Policies* (Annapolis: Naval Institute Press, 2009), pp. 143–62.
22 Hokayem, 'Looking East: A Gulf Vision or a Reality?; Raham, 'China's Energy Strategy Towards the Middle East: Saudi Arabia'.
23 Naser M. Al-Tamimi, *China-Saudi Arabia Relations, 1990-2012: Marriage of Convenience or Strategic Alliance?* (Routledge, 2013).
24 Zha Daojiong, 'Oil Pipeline from Myanmar to China: competing perspectives', RSIS Commentary, http://www.rsis.edu.sg/wp-content/uploads/2014/07/CO09074.pdf, last accessed on 18 May 2015. See also Gu Chi, 'PetroChina Yunnan Refinery Project Sparks Heated Debate', China Oil & Gas, June 2013, pp. 56–58.
25 'Table of China December Data on Oil, Oil Product, LNG Imports', 22 January 2014, Dow Jones Newswires, Factiva.

Oil supplies from Russia and Latin America to China are increasing. In large part this is because Russia, Brazil, Ecuador and Venezuela are using crude oil to repay a number of loans granted by the China Development Bank during the global financial crisis in 2008–09. Even within the Middle East, China has diversified its oil supply sources over the years. The most notable development has been China's oil relationship with Iraq. This has increased in significance since the US-led invasion of Iraq in 2003, contrary to Beijing's concerns that China would find itself locked out of the Iraqi oil market.[26]

In October 2006 the Iraqi oil minister, Hussain al-Shahristani, embarked on an Asia-Pacific tour to discuss the prospects for reviving the Ahdab oilfield deal with Chinese energy officials and companies. Iraq's then president, Jalal Talabani, visited Beijing in 2007 to discuss new forms of cooperation.[27] Chinese diplomats were looking to re-establish a presence in Iraq by participating in the International Compact with Iraq (ICI) when it first launched in July 2006. China's foreign minister, Yang Jiechi, attended the ICI meetings at Sharm el-Sheikh the following year. He announced that the Chinese government would give Iraq a grant of RMB 50 million (about $6.5 million at the exchange rate prevailing in mid-2007) for assistance in public health and education, and that China would also forgive Iraqi debt.[28]

Despite an initial reluctance to make large investments in Iraq, China's national oil companies, encouraged by the government,[29] quickly established themselves in the country after the war. In 2008 CNPC renegotiated a production-sharing contract to develop the al-Ahdab oilfield, which it had previously entered into with the Iraqi government during the Saddam Hussein era. The new technical service agreement granted development rights to CNPC for 23 years. A year later, in 2009, CNPC combined with Britain's BP in a consortium that won the rights to develop the Rumaila field and to increase its output from 985,000 b/d to 2.85 million b/d.[30] CNPC also formed a consortium with Total of France and Petronas, Malaysia's state-owned oil and gas company, that successfully bid for the Halfaya field.[31] And in May 2010 China National Offshore Oil Corporation (CNOOC) acquired a stake in the Maysan oilfields along the Iraq–Iran border.[32]

Ironically, despite Chinese concerns regarding Western domination of the Iraqi upstream sector after the Iraq war, CNPC became one of the biggest beneficiaries of the war. Now, a little over a decade after the second Iraq war, Chinese companies have secured a significant foothold in the Iraqi upstream sector, with investments in roughly 20 per cent of Iraqi oilfield projects.[33] They have also signed deals that more than double Iraqi exports of crude oil to China, a process that started in 2013 as Baghdad lowered its export prices.[34] Higher crude exports from Iraq are likely to remain a permanent feature of the market not only in light of the country's production potential, but also

26 Peg Mackey, Ahmed Rasheed, 'Iraq embraces China's growing oil dominance', Reuters, 30 October 2013; Jon B. Alterman, 'China's Balancing Act in the Gulf', *Gulf Analysis Paper*, August 2013, CSIS, https://csis.org/files/publication/130821_Alterman_ChinaGulf_Web.pdf, last accessed on 18 May 2015.
27 Mehmet Ogutcu and Ma Xin, 'Growing Links in Energy and Geopolitics: China and the Middle East', *Insight Turkey*, Vol. 9, No. 3.
28 Ibid.
29 The authors thank Philip Andrews-Speed at the Energy Studies Institute at the National University of Singapore for this comment.
30 Erica Downs, 'China-Gulf Energy Relations', in Wakefield and Levenstein, *China and the Persian Gulf*.
31 Katherine Zoepf, 'Iraq Signs $3.5 Billion Deal for China to Develop Oil Field', *New York Times*, 12 November 2008; 'China's CNPC Signs First 20-Year Iraqi Service Contract', *International Petroleum Finance*, 8 September 2008.
32 Ogutcu and Ma, 'Growing Links in Energy and Geopolitics: China and the Middle East'.
33 Julie Jiang, Jonathan Sinton, 'Overseas Investments by Chinese National Oil Companies', IEA Information Paper, February 2011, http://www.iea.org/publications/freepublications/publication/overseas_china.pdf, last accessed on 18 May 2015.
34 Florence Tan and Peg Mackey, 'Iraq undercuts Saudi to snare Asian oil market share', Reuters, 18 March 2013.

because part of the upstream contractual structure involves repayment of CNPC's technical services agreement with crude oil.[35] Yet the benefits of these investments also come with a potential liability: the spread of Islamic State of Iraq and Syria (ISIS) in Iraq has made Chinese investments there more vulnerable to disruption. Thus far, production in southern Iraq, where China's oil companies operate, has been unharmed, but there are no guarantees that this will remain the case.

The Middle East for China: new geopolitical opportunities?

In recent years leaders from the Middle East, especially from the Gulf, have been flocking to China: in September 2013 Bahrain's King Hamad bin Isa Al Khalifa made his first official trip to China since the two countries established diplomatic ties in 1987. This was followed by a visit from the Saudi crown prince to Beijing in March 2014, and by Iranian President Hassan Rouhani in May of that year. Kuwait's prime minister followed, also in May 2014 with his first official trip to China in 10 years.[36]

Such events can be read as Middle Eastern capitals trying to get Beijing more involved in the region's diplomatic and strategic realities. Yet structurally China's interest in taking on a larger security role remains limited. While oil supply security is a significant consideration for China in its dealings with the Middle East, Beijing has already hedged significantly against a potential oil shock through stockpiling and diversifying its import sources.[37]

China does, however, seek to deepen its commercial presence in the region. For Beijing, conclusion of an FTA with the GCC economies would be conducive to its pursuit of a structurally stable trade relationship with the Middle East. China–GCC FTA talks have repeatedly stalled since their inception in 2004. In September 2013 China's President Xi called for a restart of the negotiations upon meeting Bahrain's King Hamad in Beijing.[38] Yet if the past record is an indicator, the central government of China will have to overcome resistance from Chinese state-owned petrochemical corporations, which are vying for domestic and overseas market shares. The GCC's consensual decision-making mechanism presents another challenge for fast conclusion.

On a geo-economic front, President Xi's vision for a 21st-century 'Silk Road' and for the revival of the Maritime Silk Road Economic Belt (via the 'One Belt, One Road' strategy) indicates an expectation of Chinese companies being welcomed by Middle Eastern markets, including in the upstream oil sector.[39] In April 2014 CNPC gained its first upstream stake in the United Arab Emirates (UAE), in a deal with its Emirati counterpart, Abu Dhabi National Oil Company (ADNOC). The deal is Abu Dhabi's first concession deal with China, and highlights the UAE's shift away from traditional Western international oil companies to Asian partners. Moreover, CNPC is ADNOC's sole partner in the venture, rather than part of a consortium. This demonstrates the growing appeal of China's oil and gas companies, which can now offer expertise and competitive

35 Interviews with industry analyst, London, February 2013.
36 Michal Meidan, 'China in the Middle East: Where Rising Powers Fear to Tread', China-US Focus, 13 June 2014, http://www.chinausfocus.com/foreign-policy/china-in-the-middle-east-where-rising-powers-fear-to-tread/, last accessed on 18 May 2015.
37 John Mitchell, *Asia's Oil Supply: Risks and Pragmatic Remedies*, Chatham House Research Paper, May 2014, http://www.chathamhouse.org/sites/files/chathamhouse/field/field_document/20140506Asia'sOilSupplyMitchell.pdf, last accessed on 18 May 2015.
38 Li Xiaokun, 'Xi Seeks to Resume FTA Talks with GCC', *China Daily*, 17 September 2013, p. 11.
39 Xinhua press agency has a site dedicated to the 21st-century 'Silk Road' concepts. See http://www.xinhuanet.com/world/newsilkway/index.htm, last accessed on 18 May 2015.

pricing along the whole energy supply chain.[40] Such developments are certainly welcome news for China, though future prospects for China's 'One Belt, One Road' project will also be conditioned by the pursuit of global diversification by Middle Eastern economies.

Meanwhile, China continues to hedge against over-reliance on the Middle East as a source of energy supply. The signing in May 2014 of a 30-year deal to import Russian pipeline gas through the Power of Siberia pipeline was widely seen as a landmark deal. Some experts believe that 'Russia's share of the Northeast Asian natural gas market [will] never [rise] above 9% by 2030 and in the next decade [will have] difficulty exceeding 3%'.[41] But the more pertinent point is that China has various options for dealing with energy suppliers around the world. The successful negotiation of the gas pipeline, facilitated by Moscow's souring ties with its traditional oil and gas consumers in Europe, suggests that more Russian oil and gas will find its way to Asia, and especially China.

To be sure, China's diplomatic engagement with the Middle East is not a new development, but the stakes are rising. In 2002 China appointed a special envoy to handle intricate Middle East diplomatic and security issues. Chinese diplomats have taken part in the E3/EU+3 nuclear negotiations with Iran. Beijing has been complying with US sanctions requiring an overall reduction in crude oil imports from Iran, and has thereby secured waivers from the United States to continue importing these lower volumes of crude oil.[42] There are thus no indications that Beijing's policy rationales for acquiescing to US sanctions on Iran are changing, at least for now.

China has differed from the United States and its NATO allies in its approach to Libya and Syria, where some Chinese observers have advocated 'responsible protection' as a moderation of the 'responsibility to protect' principle, on the grounds that the latter is often cited to justify a militarily interventionist approach.[43] The difference is certainly ideological, but in reality China is now also having to adjust to on-the-ground risks such as having to airlift 36,000 Chinese workers out of Libya at the height of the crisis. In China, there is increasing recognition that being a global actor requires a view and a presence in the top global hotspots. But it is hard to envision a China whose proactivity extends beyond joining international naval forces in patrolling the Gulf of Aden.

The emergence of ISIS presents one of the latest challenges for China's search to identify a clear position when it comes to volatilities in the Middle East. In September 2014 news emerged that Chinese were among foreigners fighting alongside ISIS. As in Western nations, the prospect of jihadists returning home is a cause for concern. In response, China has reportedly offered military assistance to Iraq.[44] Publicly, Beijing has done little more than condemn terrorist acts of all types worldwide.

In relation to dealing with acts inspired by those of ISIS, China has a more tangible challenge at home. In the aftermath of the random killings at a railway station in Kunming in southwestern

40 'Kuwait Looks to China', Economist Intelligence Unit, 10 June 2014.
41 Amy Myers Jaffe, Kenneth B. Medlock III and Meghan L. O'Sullivan, 'China's energy hedging strategy: less than meets the eye for Russian gas pipelines', National Bureau of Asian Research, February 2015, p. 2, http://nbr.org/downloads/pdfs/eta/ES_2015_ChinaHedgingStrategy.pdf, last accessed on 18 May 2015.
42 Wayne Ma, 'China's Iran Oil Imports Surge', *Wall Street Journal*, 22 July 2014, p. 3.
43 Andrew Garwood-Gowers, 'China's "Responsible Protection" Concept: reinterpreting the responsibility to protect (R2P) and military intervention for Humanitarian Purposes', *Asian Journal of International Law*, Spring 2015, pp. 1–30.
44 Edward Wong, 'Iraq: Chinese militants captured among ISIS Fighters, officials Say', *New York Times*, 4 September 2014, p. 13.

China in 2014, the Chinese police intensified their crackdown on human smuggling. They found an increasing number of China's Muslim minorities involved in illegal border crossing into Southeast Asian countries. In response, China sought cooperation with Turkey (home to the largest Chinese Muslim diaspora), Thailand, Malaysia and Indonesia.[45] It is uncertain what a more forceful position on ISIS could mean for policing home-grown sympathizers or, conversely, how China's domestic policies will affect its ties with countries in the Middle East.

Already, China's ties with Turkey have soured following Ankara's condemnation of Beijing over violent clashes in Xinjiang in July 2009.[46] At the same time, collaboration on counterterrorism has provided an additional avenue for Israel to strengthen ties with China,[47] an issue that will be regarded with suspicion in other capitals in the region.

Last but not least, regarding complex regional questions – such as Israeli–Palestinian relations or the Iranian nuclear issue – China continues to be just one source of input, given relevant actors' highly divergent interests in these matters. Even though domestic calls for a higher profile in the region due to the increasing Chinese corporate and human presence will increase, and will lead Beijing to seek new ways of engaging with Middle Eastern governments, China can hardly diverge much from its foreign policy mantra of non-intervention.[48]

Looking ahead

China is now more actively seeking to supplement its energy trade with the Middle East with more robust commercial links. This is aimed at evening out China's trade surplus and generating new investment opportunities for Chinese firms in the Middle East, especially as Beijing looks to promote its 'One Belt, One Road' agenda. During a summit with Arab leaders in Beijing in June 2014, Beijing announced its goal of increasing Chinese non-financial investment in Arab states from $10 billion in 2013 to $60 billion in the coming decade. Beijing hopes to expand cooperation in nuclear energy, aerospace technology and new energy.

Does China seek to fill a 'geopolitical vacuum' that could result from the United States' partial withdrawal from the Middle East in the future? The question is, in reality, a speculative one. Shifts in US involvement in Middle Eastern affairs are relative – to its declared rebalancing towards Asia, for instance – and subject to interpretation. In terms of the depth of past involvement, there is no prospect of China 'unseating' the United States in the Middle East. Moreover, America has never been as dependent on oil and gas imports from the Middle East as is generally portrayed to be the case. As such, speculation about China competing with the United States to influence political developments in the Middle East in order to sustain its own energy supplies has a weak foundation.

For China's energy security, the most significant question is whether the geopolitical set-up in producer countries and regions will allow oil and gas to continue to flow from them. So long as it

45 Kor Kian Beng, 'China cracks down on Uighur exodus; Beijing fears links with militants abroad; 2 suspects shot dead', *The Straits Times*, 20 January 2015.
46 'Turkey attacks China "genocide"', BBC, 10 July 2009, http://news.bbc.co.uk/1/hi/8145451.stm, last accessed on 18 May 2015.
47 'China seeking Israeli counter-terror experts', AFP, 10 July 2014.
48 Mathieu Duchatel, Oliver Brauner and Zhou Hang, 'Protecting China's Overseas Interests: The Slow Shift away from Non-interference', SIPRI paper No. 41, June 2014.

does, the business networks built in the past will continue to serve Chinese energy industry interests well. In addition, as the technological and managerial capacities of Chinese energy and financial institutions become more internationally competitive, it will be natural for them to seek to increase their penetration of Middle Eastern energy markets, in sectors from production to servicing.

To conclude, there are already preliminary signs of a change in China's attitude towards the Middle East, due to the shifts under way in global oil markets and to Beijing's more active foreign policy since Xi Jinping's accession to power. This has resulted in deepening diplomatic relations as well as attempts to promote a free-trade deal with the GCC. But a more robust military presence in the region remains low on the list of China's strategic priorities. Chinese leaders' top diplomatic concerns will continue to be in regions geographically closer to home, on matters ranging from maritime disputes in the East and South China seas to potential instability in Central Asia (especially Afghanistan) to shifting dynamics in northeast Asia.

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