Managing Pacific Rim Security Risks With U.S. Energy

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INTRODUCTION

Chinese policymakers are grappling with the country's growing dependence on oil imports. Self-sufficient in crude as recently as the early 1990s, China is expected to buy roughly 70 percent of its oil from foreign sources within the next few decades. In contrast, U.S. oil import reliance has dramatically fallen — from a high of 60 percent in 2005 to an estimated 14 percent by 2020. This divergence creates challenges as well as opportunities for relations between both countries.

Some Chinese officials fear that the United States — overflowing in oil and natural gas because of its innovation-driven shale revolution — now has more flexibility to pursue aggressive policies that could reduce the global supply of energy, for example, by imposing sanctions or pursuing military action against pariah energy suppliers. Moreover, suspicions remain in the upper echelons of the Chinese political elite that the United States aims to control global energy resources to the detriment of Beijing. "China-bashing" in the United States only reinforces such fears, resulting in Beijing becoming more aggressive in locking up energy resources, including those located in the South China Sea.

Fortunately, the increased abundance of U.S. energy supplies provides an opening for the United States to help strengthen and stabilize global energy markets, particularly if China is engaged as a partner in doing so. Free trade in U.S. energy, including a lifting of the crude oil export ban and an end to restrictions on natural gas exports, would increase confidence in long-term world supply and help reduce the level of Chinese anxiety.[1]

While many U.S. policymakers and legislators have focused on the potential role that U.S. energy resources could play in enhancing the security of Eastern Europe vis-à-vis Russia, very few have taken the time to understand the energy insecurity dynamic in East Asia. Undeniably, China's increasing dilemma should be a far greater geopolitical concern to the United States than similar problems in Eastern Europe given the importance of Asia Pacific to the global economy — a region accounting for one-third of global trade and home to more than 60 percent of the world's population.

Accordingly, this report aims to bring greater attention to China's energy insecurity and the potential importance of U.S. energy trade in helping manage regional political and security risks. In particular, much consideration is given to one aspect of Beijing's quest for increased energy security — the South China Sea. Given the U.S. media's coverage of the issue, it is important to discuss the role that energy plays in that dispute. China's energy strategy, nonetheless, is unquestionably much more complex; it involves financial and technological issues as well as resource availability and diversity. The Russian-Chinese energy relationship, for example, is certainly growing in importance for both countries and is a topic that deserves its own paper.

SHIFTING ENERGY LANDSCAPES WILL SHAPE THE CHINA-U.S. BILATERAL RELATIONSHIP

A theory of energy scarcity largely informed U.S. energy policymaking beginning in the early 1970s with the Arab Oil Embargo and lasting through the Iraq War, effectively providing the key policy justification for several major conservation and petroleum-displacement initiatives including Corporate Average Fuel Economy Standards (CAFE) and the Renewable Fuel Standard (RFS).[2] In recent years, however, the American oil and gas shale revolution produced a largely unforeseen, transformational shift in the economics and

1 Often overlooked is the potential role that U.S. crude exports could play in helping mitigate the negative impact of oil price shocks on major economies that depend largely on imports. Higher crude prices certainly increase the risk of the spread of contagion. Accordingly, U.S. free trade in energy would help insulate the American economy.

2 To understand the beginnings of the U.S. energy scarcity narrative, please review President Richard Nixon's national radio address on January 19, 1974 at http://www.presidency.ucsb.edu/ws/?pid=4208. Energy insecurity became more important as a policy driver as U.S. oil import dependence grew — about 35 percent at the time of the 1973 Arab Oil Embargo to a high of roughly 60 percent in 2005. However, that dependence fell sharply to 27 percent by 2014, thanks largely to the shale revolution and increased fuel efficiency. See http://www.eia.gov/todayinenergy/detail.cfm?id=20692. Also see Yergin, Daniel. "Congratulations, America. You're (Almost) Energy Independent." *Politico Magazine*. Nov. 2013 at http://www.politico.com/magazine/story/2013/11/congratulations-america-youre-almost-energy-independent-now-what-98985.html?ml=m_b1_2#.VdDvsv-FPIV.

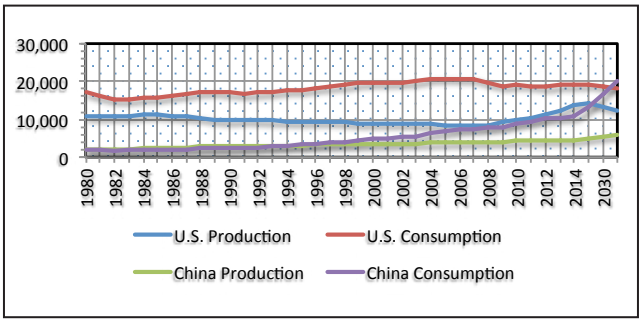
the politics of the country's energy landscape — seemingly shifting overnight its narrative from fear of scarcity to overabundance.

So quick was this transformation that many Americans remain concerned that the United States suffers from an overwhelming oil import dependency, a simple lack of awareness that complicates efforts to repeal or even modernize antiquated domestic laws that restrict the trade of U.S. energy.[3] Today, thanks to American innovation that has increased oil and gas production and improved efficiency of U.S. vehicles, the United States is largely "energy secure" or effectively self-sufficient in hydrocarbons[4] when North American supplies are considered. U.S. oil import dependence is expected to fall from a high of about 60 percent in 2005 to just 14 percent by 2020, with immediate neighbors and allies Canada and Mexico accounting for the vast majority of remaining imports, according to the U.S. Energy Information Administration (EIA).

In contrast, energy scarcity, as it pertains to oil, is a relatively new phenomenon for Chinese policymakers who are increasingly concerned with the country's growing dependence on crude imports.[5] Unlike Japan and South Korea, China is not a resource-poor country, including in terms of oil production. The Middle Kingdom[6] has consistently placed fourth in global hydrocarbon production for decades, a little known fact to most American policymakers.

Until 1993, China was actually self-sufficient in oil, i.e. its demand was met by domestic production. Imports began to increase rapidly in the 2000s and, in 2013, the country surpassed the United States as the world's largest net importer of petroleum and other liquids.[7] Recent EIA forecasts suggest an import gap of roughly 14 million barrels per day by 2040 or more than 70 percent of consumption of petroleum and other liquids — a staggering number when compared to projections for the United States.[8] Such forecasts certainly weigh heavily in Beijing's long-term strategic planning and policymaking, especially in connection to relationships with key suppliers and naval powers — with the vulnerability of chokepoints and sea lanes being a chief concern.

Total Petroleum & Other Liquids Production & Consumption
(thousand barrels per day)



Source: Energy Information Administration (EIA)

Economic self-sufficiency has been a top priority for Chinese policymakers since the Communist Revolution of 1949, making their growing dependence on oil imports that much harder to accept. Although market reforms and industrialization over the past several decades have forced the country to accept, albeit grudgingly, greater Chinese integration in the global economy, Beijing has not totally abandoned Mao Zedong's principle of self-reliance, particularly in key sectors of the economy.[9]

3 See September 2014 poll sponsored by a coalition opposed to lifting the crude oil export ban at http://crudecoalition.org/app/uploads/2015/02/UNH-EX-SUMMARY.pdf where two-thirds of New Hampshire voters believed that the United States is importing too much oil from foreign countries. However, almost two-thirds of respondents knew little or nothing at all about U.S. crude production, and only about a quarter had any familiarity with the U.S. ban on crude exports.

4 Compound of hydrogen and carbon, the chief components of petroleum and natural gas.

5 Fei, Lang. "Nation Facing Energy Security Threat: Experts." Global Times. March 14, 2013 at http://en.people.cn/90778/8166447.html.

6 The Middle Kingdom is the Chinese name for "China," dating from the Chou Empire around 1000 B.C. The Chou did not know of the existence of other civilizations, such as Egypt and Mesopotamia, and believed their empire, surrounded by barbarian tribes, was located in the center of the planet. Even today, the Chinese view themselves in much the same way.

7 See http://www.eia.gov/todayinenergy/detail.cfm?id=15531.

8 Some Chinese estimates reach the 70-percent level by 2030 — ten years earlier than the EIA forecast.

9 See Tisdell, Clem. (2013). "Economic self-reliance and China's development: changing perspectives." *International Journal of Development Issues*. Vol. 12 Iss: 3, pp.239 – 252.

This quest manifests itself in the "hoarding" of strategic resources, such as oil, rare earths, or gold.[10] China, for example, has pursued unconventional approaches in securing foreign supplies or reserves outside of normal trade practices, for example purchasing equity stakes in natural resource companies and negotiating long-term procurement contracts for materials.[11] These practices have raised U.S. concerns that Beijing desires to lock up these resources around the world, including energy supplies and, in the process, supporting rogue regimes to the detriment of U.S. national security and even broader American interests.[12]

While those actions, at first glance, have appeared provocative, U.S. policymakers should recognize China's desire to determine its own economic destiny independent of the international trade regime. Despite the substantial commercial benefits gained by joining the World Trade Organization (WTO) in 2001, the Middle Kingdom does not share the same level of historical commitment to the principle of free trade as the United States[13] — where the policy is viewed as a means to generate wealth largely for the benefit of the consumer. China, in contrast, has accepted the current trade regime as a means to achieve the economic growth necessary to accelerate industrialization and attain an adequate level of modernization. Given its experience with European colonial powers in the nineteenth century, and later with an imperial Japan endeavoring to dominate a Greater East Asia Co-Prosperity Sphere, Beijing has long viewed economic development as key to enhancing national security.[14]

Accordingly, it is important to view China's energy policy and its concerns about scarcity and import dependency through this lens. Despite the frequent, political use of the phrase "energy independence" in the United States, the quest for energy self-sufficiency in China carries with it a different meaning rooted in a different history.

CHINA'S CONCERNS ABOUT U.S. "ENERGY INDEPENDENCE"

The U.S. energy renaissance has certainly garnered attention in Beijing given the simple fact that the United States is both China's main partner and rival. Interestingly, some Chinese commentators view the U.S. quest for energy independence as an effort aimed in part to provide "political cover for the gradual rise of trade protectionism" in the United States.[15] Arguments made by some members of Congress and other interests that continuation of U.S. energy trade restrictions is necessary to promote American "energy independence" and shield domestic industries do nothing more than feed that perception, particularly when "China-bashing" features in the same context.[16]

Beijing has carefully followed the impact of the U.S. shale revolution on domestic and international energy markets, and Chinese officials understand the indirect benefits flowing from the growth in U.S. energy production, even if the Middle Kingdom cannot directly import U.S. oil from the Lower 48 or U.S. natural gas supplies.[17] While the United States itself accounts for a relatively small share of total global oil

10 "China's Been Hoarding Gold and It Isn't Likely to Stop." *Bloomberg Business*. July 19, 2015 at http://www.bloomberg.com/news/articles/2015-07-19/china-s-no-longer-secret-hoarding-of-gold-may-not-be-finished.

11 See Moran, Theodore. "China's Strategy to Secure Natural Resources: Risks, Dangers, and Opportunities." Peterson Institute for International Economics. July 2010 at https://www.piie.com/publications/briefs/moran5126.pdf.

12 Ho, Prudence. "Venezuela Oil Loans Go Awry for China." *Wall Street Journal*. June 18, 2015 at http://www.wsj.com/articles/venezuela-oil-loans-go-awry-for-china-1434656360. The China Development Bank has loaned about $37 billion to Venezuela since 2008 in order to secure millions of barrels of oil every year.

13 That is not to say that China has not promoted trade liberalization. Beijing has signed free trade agreements with 14 countries. See http://en.people.cn/n/2015/0628/c90883-8912267.html.

14 It is important to note that China suffered directly from European-inspired colonialism for over 100 years, starting with the First Opium War of 1839.

15 See Hongtu, Zhao. "An Analysis of U.S. Energy Independence." China Daily Forum. April 17, 2013 at http://blog.chinadaily.com.cn/blog-1057682-9245.html.

16 See "U.S. Crude Oil Exports Next Stop: China." Consumers and Refiners United for Domestic Energy (The CRUDE Coalition). June 23, 2015 at http://crudecoalition.org/us-crude-oils-next-stop-china/. For a Chinese viewpoint, see Weihua, Chen. "U.S. State of the Union Address Smacks of China Bashing." *China Daily*. January 2015 at http://usa.chinadaily.com.cn/opinion/2015-01/30/content_19449240.htm.

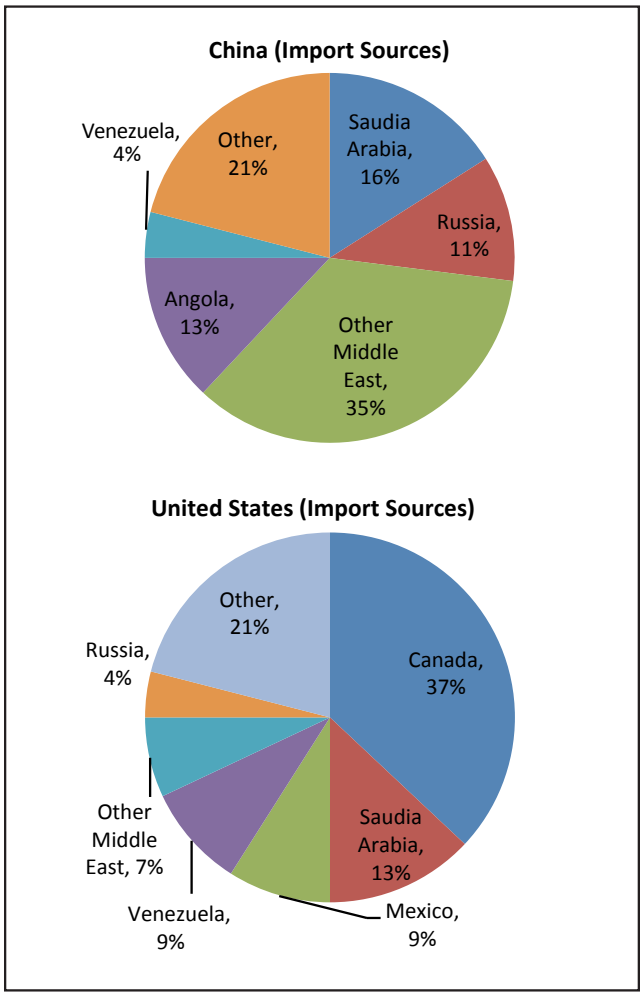
17 Certain fields in California can export heavy oil. In addition, Alaska is exempt from the ban on U.S. crude exports. From 1996-2004, the state exported 2.7 percent of its production to South Korea, Japan, China, and Taiwan, according to EIA. No Alaskan oil was exported overseas until April 2014 when a shipment was delivered to South Korea. See Muskal, Michael. "Alaska oil, exported for first time in a decade, heads to South Korea." *Los Angeles Times*. September 30, 2014 at http://touch.latimes.com/#section/-1/article/p2p-81546910/.

production, 11 percent in 2014, U.S. shale production unquestionably has put downward pressure on the global price of oil by cutting U.S. imports and reducing foreign demand for oil in response to the increase in U.S. exports of refined product.[18]

From Beijing's perspective, however, increased U.S. energy security is a double-edged sword — *and in Chinese society, attention is always focused on the potential negative impact or cost*. While U.S. self-sufficiency in energy is viewed as reducing the probability of future competition over supply — thereby lowering the risk of political or military confrontation, Beijing perceives, at the same time, a growing gap in national interests. Simply put, China trusted the United States more when U.S. oil import dependency was higher and Washington actively sought increases in global oil production, a mutually-shared objective. In Beijing's view, the U.S. shale revolution has increased U.S. immunity to a reduction in global supply resulting from military conflict, political instability, or international sanctions, thereby making Washington a less reliable partner in managing the world's energy markets.

In an article published last year in *The People's Daily*, the flagship newspaper of the Chinese Communist Party, Li Wei, head of the Development Research Center of the State Council (DRC), argued that "reduced dependence on foreign oil will make the United States more hawkish in advancing its agenda" in the Middle East, increasing uncertainty in global energy markets.[19] Li further warned that growing U.S. "energy independence" would not likely result in a "softening" of the U.S. grip on oil supplies in the Persian Gulf, reflecting the general Chinese view that the United States seeks to control energy supplies (and their price) to the detriment of its rivals, including China.[20]

Top Oil Suppliers for China and the United States, 2014



Source: Energy Information Administration (EIA)

Concerns of U.S. "control" over Middle East crude — real or not — are troublesome to China, particularly given its growing import dependency and the percentage of its oil supply originating from the region. In 2014, the United States bought about 20 percent of its overseas crude from the Middle East while Canada and Mexico accounted for roughly 45 percent. In contrast, the region supplied more than half of China's foreign oil purchases.

18 In 2008, U.S. crude production accounted for 7 percent of global production. See Kilian, Lutz. "The Impact of the Shale Revolution on U.S. Oil and Gasoline Prices." June 26, 2015 at http://www-personal.umich.edu/~lkilian/kilian120514r1.pdf.

19 See "China Outlines Strategy for Energy Sector." *China Daily*. February 2014 at http://usa.chinadaily.com.cn/epaper/2014-02/17/content_17287160.htm.

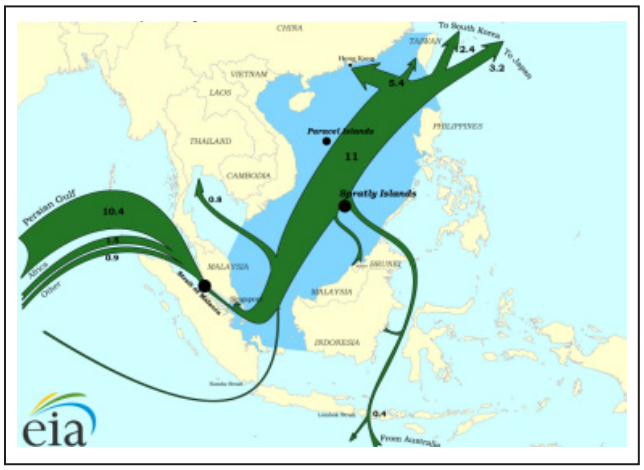
20 Speech of Wei, Li, minister of the Development Research Center of the State Council (DRC), at *Caijing* magazine's annual meeting for 2015, on Nov 27, 2014. http://www.chinadaily.com.cn/m/drc/2014-12/11/content_19065537.htm.

As U.S. crude imports from the Middle East are expected to fall substantially to a negligible amount in the coming decades, the International Energy Agency (IEA) has projected that Asian economies will import almost 90 percent of the region's oil by 2035.[21] Such a shift in oil markets will likely increase arguments in the United States that U.S. taxpayers should no longer shoulder the burden to pay for the protection of shipping lanes in and around the Persian Gulf, especially when such a use of the U.S. military primarily benefits China. However, few U.S. policymakers would be comfortable with handing that responsibility over to Beijing and, even if they were willing to do so, China does not own the naval assets to adequately perform the task — at least not yet.

CHINA'S ENERGY INSECURITY AND THE STRAIT OF MALACCA

Despite the impressive growth of its internal market, the Chinese economy remains heavily dependent on merchandise trade, accounting for 41.5 percent of GDP.[22] The vast majority of that trade, including energy imports, relies on sea routes, placing the country's economic and energy security partly in the hands of the U.S. Navy, which has become the primary guarantor of the freedom of the seas. With the vast majority of Chinese oil imports coming from Africa, the Persian Gulf, and other points west of the Pacific, Beijing is particularly concerned about the security of the Strait of Malacca, which is the most direct route between those suppliers and China.

Major Crude Oil Trade Flows in the South China Sea (2011) million barrels per day



The Strait's importance to Beijing's policymakers has increased significantly with the growth of China's economy and energy demand. In 1993, the last year of Chinese self-sufficiency in oil, about 20 percent of global seaborne oil trade relied on the Strait, according to the Center for Naval Analysis. By the end of 2011, EIA estimated its share had grown to about one-third.[23] Today, roughly 80 percent of Chinese crude imports transit the Strait.[24] It's no wonder why some Chinese commentators have argued that "whoever controls the Straits of Malacca will also have a stranglehold on the energy route of China."[25] Certainly, China's leadership strongly agrees that they face a "Malacca dilemma" — a term actually coined in 2003 at a Communist Party Conference by President Hu Jintao, who also went so far to argue that "certain major powers" — no doubt referring to the United States — were determined to control the passage.[26]

Accordingly, much of Beijing's energy security doctrine has been focused on reducing the country's dependence on Middle East oil and the use of the Strait by diversifying supply and infrastructure, increasing domestic production, and investing in the military capacity that would defend the chokepoint in time of crisis.[27][28] In particular, China is pursuing

21 World Energy Outlook 2012. International Energy Agency at http://www.worldenergyoutlook.org/publications/weo-2012/#d.en.26099.

22 In comparison, merchandise trade accounts for about 23 percent of U.S. GDP. See http://data.worldbank.org/indicator/TG.VAL.TOTL.GD.ZS.

23 "The South China Sea is an Important World Energy Trade Route." April 4, 2013 at http://www.eia.gov/todayinenergy/detail.cfm?id=10671.

24 See "Sino-Myanmar pipeline boosts energy security." *China Daily*. January 29, 2015 at http://en.people.cn/business/n/2015/0129/c90778-8842625.html.

25 See *China Youth Daily,* June 15, 2004.

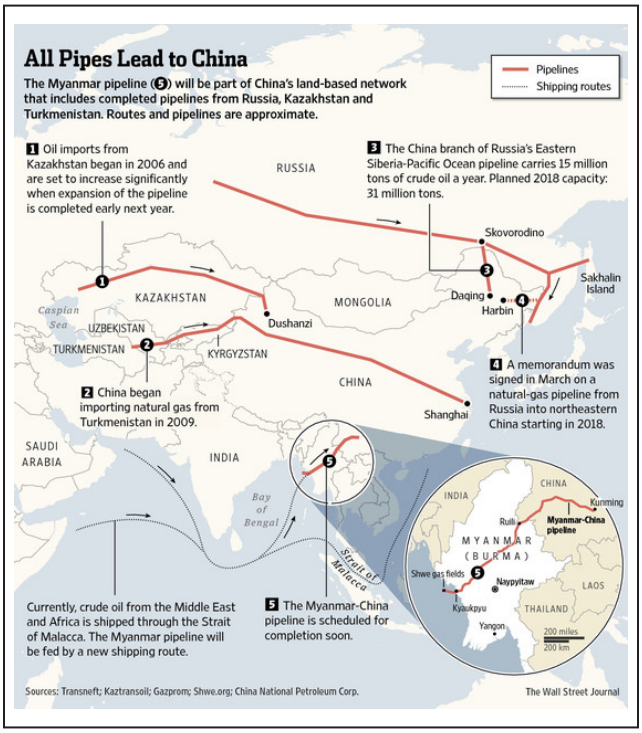
26 Lanteigne, Marc. "China's Maritime Security and the 'Malacca Dilemma'." *Asian Security*. 4:2, 143-161, 2008.

27 Other steps taken include bolstering their strategic petroleum reserve and investments in alternative technologies and fuels, such as coal-to-liquids and biofuels, and programs designed to increase fuel conservation and energy efficiency. See Wen, Ling. "Shenhua's Evolution from Coal Producer to Clean Energy Supplier." Cornerstone at http://cornerstonemag.net/shenhuas-evolution-from-coal-producer-to-clean-energy-supplier/.

28 A blue water fleet — especially one that could effectively challenge the United States for regional supremacy — would take decades to build.

the construction of new overland oil and natural gas pipelines — often in partnership with other countries, including Russia. Earlier this year, the nearly 1,500-mile Sino-Myanmar crude pipeline, which directly bypasses the Strait, began operation with a capacity of 500,000 barrels per day, representing about 7 percent of current Chinese imports.[29] Needless to say, pipelines traversing thousands of miles of often hostile terrain are not only expensive but laden with security risk, given insurgent threats in parts of Central and South Asia.[30]

Operating and Proposed Pipelines Linking China with Suppliers



Source: *The Wall Street Journal*[31]

China's domestic production of petroleum and other liquids is expected to increase by more than one million barrels per day between now and 2040.[32] Although impressive, this growth will only cover about 12 percent of the anticipated surge in consumption. Despite its substantial shale reserves,[33] China's ability to fully tap its unconventional resources is years, perhaps decades, away — held back by geological challenges, as well as the lack of expertise and water.[34] In the near term, China must therefore import the rest — or find new domestic reserves to help fill the gap.

In this regard, energy resource development in the South China Sea is a critical objective for Beijing, including the protection of related maritime claims. According to *Oil & Gas Journal*, China currently holds proved reserves of 24.6 billion barrels of oil (bbl) and 164 trillion cubic feet (Tcf) of natural gas.[35] In contrast, the South China Sea has proved and probable reserves of roughly 11 bbl and 190 Tcf of natural gas. The U.S. Geological Survey suggests that there could be much more in undiscovered resources — between 5 and 22 bbl and 70 to 290 Tcf — although these potential supplies are not currently considered commercially viable.[36] In addition, the vast majority of the South China Sea's estimated oil and gas reserves are located in coastal, non-disputed areas — with the majority concentrated off the coasts of Vietnam and Malaysia — not China.

29 "Sino-Myanmar pipeline boosts energy security." *China Daily*. January 29, 2015.

30 See Storey, Ian. "China's Malacca Dilemma," China Brief Volume: 6 Issue: 8, at http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=3943#.VeyXav-FPIU.

31 Gronholt-Pedersen, Jacob. "Myanmar Pipelines to Benefit China," *Wall Street Journal*. May 12, 2013 at http://www.wsj.com/articles/SB10001424127887324326504578466951558644848.

32 Tables at http://www.eia.gov/beta/international/, http://www.eia.gov/forecasts/ieo/pdf/appa.pdf, and http://www.eia.gov/forecasts/ieo/pdf/ieotab_4.pdf.

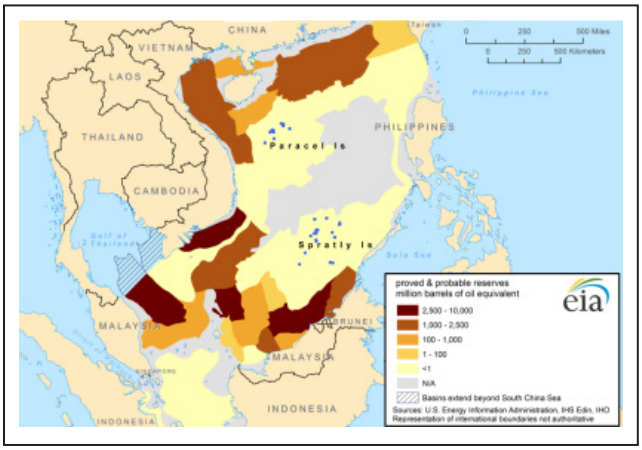
33 China is estimated to have almost as much technically recoverable shale gas reserves as the United States and Canada combined, according to the EIA. For more details on the challenges facing Chinese shale development, see Fensom, Anthony. "China: The Next Shale-Gas Superpower." October 9, 2014 at http://nationalinterest.org/feature/china-the-next-shale-gas-superpower-11432.

34 Chinese companies have very quietly purchased some shale assets in the U.S. for the sole purpose of learning about new production technologies. Also see Kilian, Lutz. "The Impact of the Shale Oil Revolution on U.S. Oil and Gasoline Prices." University of Michigan. CEPR. June 26, 2015 at http://www-personal.umich.edu/~lkilian/kilian120514r1.pdf.

35 "Global reserves, oil production show increases for 2014." *Oil & Gas Journal*. December 1, 2014 at http://www.ogj.com/articles/print/volume-112/issue-12/special-report-worldwide-report/global-reserves-oil-production-show-increases-for-2014.html.

36 See http://www.eia.gov/beta/international/analysis.cfm?iso=CHN.

South China Sea Oil and Natural Gas Proved and Probable Reserves



More importantly from China's perspective, the chairman of the Chinese National Offshore Oil Company (CNOOC) told *The Financial Times* in 2012 that the South China Sea could possess undiscovered resources of up to 125 bbl and nearly 500 Tcf of natural gas — a number that dwarfs U.S. estimates.[37] While these claims are debated,[38] the fact remains that the broader South China Sea area is rich in energy resources — to say nothing of fisheries, which are estimated to account for nearly 10 percent of the world's catch.[39]

The ability to exploit this wealth would reduce China's Malacca vulnerability over the long term. Nevertheless, geological and technological challenges in the South China Sea present substantial hurdles for extraction efforts far beyond the shoreline. Moreover, low oil prices and political uncertainty regarding maritime claims, not likely to be resolved anytime soon, make it unlikely that any real Western investment, along with the needed technological expertise, will flow into the region. Accordingly, any substantial, "game changing" energy development in the South China Sea, particularly far from the shoreline, is unlikely for decades.

Therefore, Chinese policymakers must still worry about the security of the Strait and work to diversify energy supply routes. On this point, it is worth noting that the Chinese construction of islands and military installations in the South China Sea better enables Beijing to monitor, protect, and more effectively intervene militarily — along both the rim of the South China Sea and in the Strait.[40]

RATIONAL U.S. ENERGY POLICY COULD REDUCE THE RISK OF CONFLICT

Friction in the South China Sea between China and its neighbors is frequently reported in U.S. newspapers and other media.[41] While the current tensions in the area are rooted in a complex history, there is little doubt that competition over energy resources plays a major role in exacerbating the problem. At least in the case of China, the perception of increased economic security resulting from gaining a military position in the South China Sea that enables at least some control of the Strait of Malacca is also a significant factor. [42]

37 Hook, Leslie. "Gas finds give impetus to China Sea claim." *Financial Times*. November 9, 2012 at http://www.ft.com/intl/cms/s/0/a782a6f8-2a73-11e2-a137-00144feabdc0.html#axzz3l6f3fvrz.

38 Tweed, David. "What do weak oil prices mean for the South China Sea." *Bloomberg Business*. January 20, 2015 at http://www.bloomberg.com/news/articles/2015-01-20/all-about-the-base-oil-drop-won-t-stop-china-in-south-china-sea.

39 Estimate from the Southeast Asian Fisheries Development Center. See http://iwlearn.net/iw-projects/885/reports/South-China-Sea-Project-Knowledge-Document-Fisheries-Refugia.pdf.

40 Chinese aircraft can patrol the East China Sea with relative ease from bases in eastern China, but can't operate effectively over the Spratlys and other far-flung parts of the South China Sea without refueling and ground support. Page, Jeremy and Barnes, Julian. "China expands island construction in disputed South China Sea." *Wall Street Journal*, February 18, 2015 at http://www.wsj.com/articles/china-expands-island-construction-in-disputed-south-china-sea-1424290852.

41 While Western media has focused on China's activity in Southeast Asia, Beijing recently sent a flotilla of five vessels to the coast of Alaska while President Obama spoke there at a conference on Arctic cooperation— most likely to send a strong signal that China has a direct interest in Arctic resources and potential shipping lanes in the Northeast and Northwest Passages. Pentagon officials were quick to state that this was the first time Chinese naval vessels had operated offshore Alaska. As the *Wall Street Journal* reported, "[t]he presence of the Chinese ships so close to U.S. shores is the latest demonstration of how China's military is rapidly expanding its operations far from its own coast to oversee the nation's growing global interests." Indeed, the news report served to remind Americans that "Beijing also has shown growing interest in exploiting energy resources in the Arctic region and in 2013 became a permanent observer to the Arctic Council, whose members are Canada, Denmark, Finland, Iceland, Norway, Russia, Sweden and the U.S." See Page, Jeremy and Lubold, Gordon. "Five Chinese Navy Ships Are Operating in Bering Sea off Alaska." *Wall Street Journal*. September 2, 2015, http://www.wsj.com/articles/pentagon-watches-as-chinese-navy-ships-sail-in-bering-sea-1441216258.

42 Such a position also gives China tremendous leverage vis-à-vis South China Sea rim countries, particularly Vietnam, which relies significantly on the South China Sea for trade.

These motivations are more likely than not to grow in importance as energy security becomes a greater concern in the coming decades — not only for China but for other Asian economies as well. In this sense, geography is destiny as long as energy supplies to Asia Pacific primarily flow from the Middle East and Africa through the Strait of Malacca. Accordingly, investments in pipeline infrastructure directly linking energy suppliers, like Russia, to the markets of East Asia enhance political security. Still, the diversification of supply routes, while very important, does not go far enough in alleviating potential concerns or rivalry over resources.

- **A multilateral, regional commitment, in partnership with China, is required — one that would guarantee the free flow or trade of energy resources, technologies, and services between countries that abide by international law.**[43] Such an arrangement, which should encourage joint development of resources, should at least include Australia, China, Japan, Russia, South Korea, the United States, and the countries bordering the South China Sea and Strait of Malacca.

Undeniably, strong U.S. support and leadership is indispensable to achieving this diplomatic goal. However, the United States simply *cannot* lead as long as it does not support the free trade of its own energy resources. A set of antiquated laws, the "*1975 Energy Policy and Conservation Act"* and "*The Natural Gas Act of 1938,"* restricts crude oil and natural gas exports, respectively — even to some U.S. military allies. These energy trade restrictions undermine global security by sending a signal to other countries that blocking one's strategic resources from entering the international marketplace is acceptable. Furthermore, they harm the free trade regime and set a dangerous precedent of protectionism and unilateralism — actions that history shows, time and time again, increase the probability of conflict.

Discussion of resource nationalism policies has become more prevalent in the U.S. Congress.[44] Last year, nearly two dozen senators stressed that the United States must, "not squander what is clearly an American competitive advantage right now for American manufacturers and for the American economy" by permitting a more open trade of liquefied natural gas (LNG).[45] Last June, 13 Senators echoed this theme in a letter on crude oil to President Barack Obama, warning that an end to the export ban "could adversely affect the ability of some refineries to compete with foreign refineries."[46] Such rhetoric projects weakness to Chinese policymakers, who increasingly view the United States as a declining economic power that cannot compete against China in an open, free trade regime.

Moreover, an argument made by some interests — *that U.S. oil should not be exported because it would only benefit China* — feeds the perception in Beijing that the United States wishes to control oil resources in part to limit the power of China. This belief, in part, is based on the history leading up to the Pacific War[47] — when the United States used its dominant market position in oil to punish Japan for its own resource-driven aggression in the Far East.[48] Now, the U.S. energy renaissance, in the eyes of Chinese policymakers and strategists, may offer Washington that type of leverage again.

Undeniably, "China-bashing" in the context of U.S. energy policymaking will only cause Beijing to become more stubborn in the South China Sea and more aggressive in "locking" up energy supplies around the globe. It will also cause great difficulties for U.S. producers and service companies that desire to conduct business in China.

43 Vaughn, Bruce. "U.S. Strategic and Defense Relationships in the Asia-Pacific Region." Congressional Research Service. January 22, 2007 at https://www.fas.org/sgp/crs/row/RL33821.pdf.

44 See Banks, George David. "U.S. Resource Nationalism: The Impact of Energy Trade Restrictions on National Security." American Council for Capital Formation. July 2015 at http://unlockcrudeexports.org/wp-content/uploads/2015/07/ACCF-Nationalism-Report_FINAL.pdf for a detailed discussion on the growing trend of U.S. resource nationalism.

45 See http://www.stabenow.senate.gov/?p=press_release&id=1338.

46 See http://www.markey.senate.gov/imo/media/doc/2015-06-26-OilExports-Senate-Letter.pdf.

47 The theatre of the Second World War fought in the Pacific and East Asia.

48 For an excellent treatment of the economics of war and oil during the Second World War please see, Goralski, Robert and Freeburg, Russell. "War & Oil: How the Deadly Struggle for Fuel in WWII Meant Victory or Defeat." William Morrow and Company. 1987.

- **The United States should embrace the free trade of energy by repealing or reforming existing energy trade restrictions, including the lifting of the crude export ban.** As part of a global energy market, U.S. resources would enhance security and guard against supply shocks. The ability of U.S. producers to export would also provide insurance against the possibility of a major supplier unjustifiably using energy as an economic weapon.[49]

Once U.S. energy policy follows the principle of free trade, the United States should adopt a rational approach to the overseas deployment of reliable and affordable energy, including efficient coal-fired power generation, which is affordable and necessary for economic growth in many non-OECD[50] nations. Current U.S. policy, for example, seeks to severely limit international financing of coal plants in much of the developing world, including emerging markets. Such an approach only adds to China's suspicions of U.S. motives.[51]

- **For Washington to play a meaningful role in reducing competition over energy resources and mitigating scarcity concerns in Asia Pacific, the United States should promote universal access to affordable and reliable energy.** While climate change is a problem that needs to be addressed, climate mitigation policies should not result in U.S. efforts to ration energy, reduce the supply of fossil fuels to the international market, or essentially ban the deployment of certain fossil fuel infrastructure, for example, by requiring technology that is not yet commercially available or even realistic for a developing nation.[52]

CONCLUSION

China's thirst for oil and quest for self-sufficiency will continue to shape Beijing's foreign policy in the years ahead, especially toward the South China Sea, the countries along its rim, and the Strait of Malacca. If the energy scarcity concerns of the Asia Pacific region are not adequately addressed in a multilateral context, tensions are likely to increase substantially as the demand for energy explodes over the next few decades. At the very least, pre-World War II tensions in the Pacific should inform that consideration.

Consequently, U.S. engagement is desperately needed to reduce the probability of armed conflict, but only if the United States actively promotes access to affordable and reliable energy for all countries that embrace international law. Energy efficiency and renewable energy both have important roles to play in helping reduce the demand for fossil fuels — as does civil nuclear power, but coal, gas, and oil are indispensable to powering Asian economies and ensuring improved quality of life.

Russia is playing a more constructive role than the United States in strengthening regional energy security by developing infrastructure linking its supplies with Asian consumers. If the United States is to have any credibility whatsoever in helping mitigate the risk of conflict, Washington should lift outdated U.S. trade controls on energy, including the ban on crude oil exports and remaining restrictions on the trade of natural gas. Like any other commodity, energy supplies should be available to the global market. A rational U.S. approach to energy access, financing, and trade would go a long way in helping build confidence in Washington's leadership. It would also help address misperceptions that the United States seeks to control the world's energy resources for itself.

49 With U.S. free trade in energy, we would expect investments over time in U.S. energy infrastructure that would better serve potential customers in East Asia. If the crude export ban were lifted tomorrow, most U.S. exports of light crude would likely flow to Europe and points closer to the U.S. East and Gulf Coasts.

50 Organization for Economic Co-operation and Development

51 Developing countries, as well as emerging economies, will build coal capacity with or without U.S. support (as they already are doing). With constructive engagement, the United States could promote the use of higher efficiency and emissions controls for coal-powered generation. See Banks, George David. "U.S. Coal Plant Financing Policy: A Threat to Long-Term U.S. Interests in the Developing World." American Council for Capital Formation. February 2015 at http://accf.org/wp-content/uploads/2015/02/ACCF-CPR-Special-Report_Coal-Financing-FINAL.pdf.

52 For example, linking public financing of coal plants to the requirement of carbon, capture, and storage technology, which is not commercially available at this point.