

World Energy Markets and China's Relations with West Asia

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Abstract: *Energy ties constitute the foundation of the relations between China and West-Asian countries. Therefore changes occurring in the international energy markets present a new perspective for studying these relations. This paper formulates two new concepts, namely the regionalization of the international oil market and the de-regionalization of the international gas market, and analyzes their impact on the relations between China and the major oil and gas exporting countries in West Asia. The conclusion underlines that these two structural changes in the international energy markets mean that at the core interest level, West-Asian oil and gas exporting countries are moving away from the West and moving closer to China. Therefore, they can inject positive energy for the development of relations between China and West-Asian oil and gas exporting countries by promoting their mutual trade and economic cooperation and by making China play a greater role in ensuring peace and stability in the Middle East.*

Key Words: *Oil Market; Gas Market; China-Middle East Relations*

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Since China became a net oil importer in the mid-1990s, energy ties have been an important part of the relations between China and West-Asian oil and gas exporting countries. Constant changes in the international energy markets have also become an important factor affecting the relations between China and these countries. Two structural changes occurring in the international energy markets during the past four decades are worthy of our attention. One is the regionalization of the international oil market and the other is the de-regionalization of the international gas market. However, the two opposite trends may produce the same impact on the relations between China and West-Asian oil and gas exporting countries. They have played and will continue to play an important role in promoting strategic partnership between China and West-Asian oil and gas exporting countries.

I. Structural Changes of the International Oil and Gas Markets

(1) Regionalization of the international oil market

More than 30 years ago, the international oil market was rather a more unified market centered on West Asia, which was the only major source of global oil imports. In 1976, 61% of global crude oil imports were supplied by West-Asian countries and 41% of US crude oil imports came from West Asia (Writing Team, 1981). However, this market structure began to change in the 1970s. In 1973-1974, the Organization of Arab Petroleum Exporting Countries (OAPEC) imposed a massive oil embargo on Western countries and substantially raised oil prices in response to Western countries' aid to

Israel in the fourth Middle East War, which triggered the first international oil crisis and facilitated the structural changes in the international oil market.

On the one hand, the rise in international oil prices spurred enthusiasm in oil exploration across the world. Oil fields outside West Asia, used to have no price advantages because of high production costs, availed themselves of the price hike and gained opportunities for rapid development. Oil from fields in the North Sea and the Gulf of Mexico began pouring into the international market. In the 1990s after the disintegration of the Soviet Union, oil from Russia and the Central Asian countries also entered the international market. Since the beginning of the new century, Africa has become a new hotbed of oil exploration. Emerging oil producers such as Angola and Sudan emerged in the international oil market. Several rounds of oil exploration fever outside West Asia soon diversified international oil supply, relatively reducing the role of West Asia in international oil supply. In 2012, only 36% of the international oil supply came from West Asian countries (*BP Statistical Review of World Energy 2013*). Diversification of international oil supply sources created the necessary conditions for major oil importers like the United States and the EU to eliminate overdependence on West Asia and also put an end to the dominance of West Asia in the international oil market.

On the other hand, after the OPEC's embargo (1973) and outbreak of the oil crisis (1979), the United States and other developed countries felt profoundly that their dependence on energy supplies from West Asia contained political risks. In order to promote the diversification strategy of energy supplies, the key is to shake off energy dependence, especially dependence on oil supplies from West

Asia. Through the platform of the Organization for Economic Cooperation and Development, developed countries reached the Agreement on an International Energy Program and created the International Energy Agency in 1974 to increase their strategic reserves of oil, improve their emergency response mechanism and promote the development of alternative energy. Meanwhile, they hoped to take this opportunity to adjust their structure of oil imports and turned to other emerging oil producing countries, especially their neighboring sources. In reaction to the OAPEC oil embargo, US President Richard Nixon announced, on November 7, 1973, the *Project Independence* initiative, which aimed at achieving energy self-sufficiency by 1980. To wean America off oil dependence in the Middle East was an important step of the plan. Since then energy self-sufficiency has gained attention and support of every US president and has become a long-term national strategic goal, although the United States has not realized it until now. On March 30, 2011, the Obama Administration released a *Blueprint for A Secure Energy Future*, a strategy “that will—within 10 years—allow us to reduce our consumption of oil by more than we currently import from the Middle East and Venezuela combined.”

Multiple sources in the international oil market and diversified importing strategies adopted by Western major oil importers have brought remarkable structural changes in the international oil market. Consequently, a comparatively unified oil market with one major source and several oil importers has been gradually divided into three major segments—the American segment, the European segment and the Asian segment. The strategy that the United States and the EU adopted to break away from West-Asian oil supply has taken effect, so

that West Asia lost its status as the major source for the US and EU oil supply. In the American segment, the United States began narrowing down its sources to America, which has become the largest source of the US market. In 2013, 56.5% of the US oil imports came from America and the percentage of West-Asian sources fell to 20.1%. In the European segment, European countries turned to Russia and Central Asia for oil supply. In 2013, 59.1% of European oil imports came from Russia and Central Asia, while the percentage of West-Asian sources was only 18.2%. The Asian segment is different from the other two. Major oil importers in East Asia are close to West Asia geographically and maritime transport is convenient. Therefore, their dependence on West-Asian oil supply has not suffered any remarkable decline. Emerging oil importers like China and India also mainly rely on West-Asian supplies. In 2013, West Asia continued to be the largest source of oil imports to China, Japan and India, with 40.8%, 75.0% and 63.9% of their respective oil imports coming from West Asia (*BP Statistical Review of World Energy 2013*).

The three segments in the international oil market are different not only in the demand and supply structure, but also in prices. Difference in prices became apparent after the “Arab Spring” occurred in the Middle East in 2010, especially after Libya suspended oil production in 2011. For a long time, the price difference between West Texas Intermediate (WTI) in the US market and Brent Crude in the London Market was stable, with the former usually higher than the latter. However, Libyan oil production suspension in 2010 had a direct negative impact on the supply of Libya’s light “sweet” crude in the London market. In contrast, the US market had a sufficient supply of the light “sweet” crude coming from Canada. Against this backdrop,

Brent Crude price went up higher than the WTI price and two benchmark prices were finally turned upside down. West-Asian countries adopt the Dubai Crude as a price benchmark, which is linked closer to Brent Crude. The upward trend of Brent Crude inevitably affected the Asian market. Prices of West Asia's oil exports to East Asian countries grew faster than prices in the American market, thus making East Asian countries, like their European counterparts, suffer a lot more than the United States from the same halt in Libyan oil supply. In 2012, Brent Crude was traded at \$111.67 a barrel, Dubai Crude was at \$109.08 a barrel, and WTI, \$94.13 a barrel (*BP Statistical Review of World Energy 2013*). This means, in the regionalized international oil market, a halt in one supply source may have different impacts on oil importers in different regions.

(2) De-regionalization of the international gas market

Unlike the oil market, the international gas market has changed in the opposite direction and tends to be de-regionalized. Compared with oil market, the international gas trade started late and hasn't formed a unified market mainly because of the inconvenience in transportation. The international gas market also has three segments—North American segment, Asia-Pacific segment and the European Rim segment, which operate separately from relative point of view. Although the three segments interact with one another to some extent, they are quite different in demand and supply, transportation modes and pricing systems. A globally unified gas market is yet to be formed.

Gas consumption in North America accounts for one quarter of the world's total. The United States is the major importer and Canada is its major supplier. Although the United States has abundant natural

gas reserves, and its gas self-sufficiency rate reached 94% in 2011 (Zeng, X., 2012), it still needs to import to meet its huge demand. The United States mainly imports pipeline natural gas from Canada. In 2012, the United States imported 83.8 billion cubic meters of pipeline natural gas, accounting for 11.1% of the world's total import volume of pipeline gas. Canada is the only pipeline gas supplier to the United States. In 2012, the United States also imported 4.9 billion cubic meters of liquefied natural gas (LNG), with 1.7 billion cubic meters coming from its major supplier Qatar. Gas consumption in Europe accounts for one third of the world's total. Most European countries produce small volumes of natural gas except Russia and Norway. The whole continent's gas self-sufficiency rate is less than 60% and it depends much on imports. In 2012, Europe imported 377.2 billion cubic meters of pipeline natural gas, accounting for 53.5% of the world's total pipeline gas imports and Russia and Central Asia constituted its major sources. Europe also imported 69.3 billion cubic meters of LNG in 2012, mainly from Qatar, Algeria and Nigeria. In the Asia-Pacific market, Japan, South Korea and China are major gas consumers and their combined consumption accounts for one fifth of the world's total. East Asian countries' natural gas reserves are limited and they depend much on imports. East Asian gas consumers are far from the world's main producing areas of natural gas. Until recent years, East Asian countries have been equipped with pipeline transport facilities. They imported 55.5 billion cubic meters of pipeline gas in 2012, accounting for only 7.9% of the world's total pipeline gas imports. But, East Asian countries are major importers of LNG. In 2012, the combined import volume of China, India, Japan, South Korea and Thailand accounted for 69.3% of the world's total LNG imports, and 30% of their LNG

imports came from Qatar. Taking three other LNG suppliers—Oman, UAE and Yemen—into account, West Asia contributed 53% to East Asian countries' total LNG imports (*BP Statistical Review of World Energy 2013*).

The three gas markets have remarkable price discrepancy, because their demand and supply situations are different and their interaction is often affected by underdeveloped transport facilities. Since the global financial turmoil triggered by the US sub-prime mortgage crisis in 2008, demand and supply in different gas markets have been affected by the crisis to various degrees, which could better reflect the price discrepancy. In the Asian market, some large importers have better economic performance, bringing along rapid growth in demand of natural gas. China's natural gas import has grown the fastest in the world. China has seen an average annual growth rate of 102% in natural gas imports since 2006 when it began importing (CNPC Economics and Technology Research Institute, 2013). Meanwhile, East Asia has made little progress in gas exploration. Therefore, the Asian market is witnessing high demand and tight supply and gas prices are increasing. In Europe, a number of countries are mired in the sovereign debt crisis, thus stifling their economic growth and further dampening their demand for natural gas. However, natural gas output in the European Rim market is still increasing. This has led to an oversupply in the market, depressing gas prices. The US natural gas consumption has remained stable, but the country is exploring shale gas on a large scale, which has substantially increased natural gas supply and depressed gas prices. Therefore, price discrepancy among different markets is remarkable. According to BP statistics, in 2011, Japan's LNG CIF price was \$14.73

per million btu on average, UK's Heren NBP index was \$9.03 per million btu, and the US Henry Hub natural gas price was only \$4.01 per million btu (CNPC Economics and Technology Research Institute, 2013). When the three gas markets haven't fully interconnected, East Asian countries and regions are suffering from high gas prices, which are much higher than the prices major gas importers in other markets face.

However, what is worth mentioning is that the three markets have shown signs of integration, or "de-regionalization." The tendency may intensify in the coming decade. The US shale gas revolution is the main driving force behind the integration. In the long run, another driving force may come from Iran, which has abundant natural gas reserves.

In recent years, the United States has made a breakthrough in shale gas exploration. Rapid growth of shale gas output has made the United States exceed Russia to become the largest natural gas producing country in 2009. The shale gas revolution has injected new vitality to the country's energy independence initiative and will have a significant impact on the structure of the international gas market. On one the hand, the United States is likely to achieve its goal of gas self-sufficiency in the near future. The US Energy Information Administration forecasted that the United States would become a net exporter of LNG by 2016, an overall net exporter of natural gas by 2018 and a net exporter of pipeline gas by 2035. As natural gas is a possible alternative to oil, rapid growth of natural gas output in the United States will eclipse oil consumption, although the US oil self-sufficiency rate reached only 37% in 2011 (Zeng, X., 2012). The United States self-sufficiency means that the international gas market

will see a relative decrease in demand, which amounts to one tenth of the world's gas imports. The current gas supply countries to the United States should have to turn to other countries and regions. Once the United States becomes a net exporter of natural gas, supply in the international oil market will further increase and the United States will become a competitor to current natural gas producing countries. While Europe cannot achieve economic recovery in the near future and the outlook for rapid growth in the long term remains uncertain, spare capacity in Canada, Qatar and even the United States would have to target East Asia, where the economy grows fast and demand of natural gas is high.

When talking about the prospects of international gas supply, Iran, holding the world's largest natural gas reserves, will come to one's mind. Its proven reserves of natural gas accounted for 18% of the world total in 2012 (*BP Statistical Review of World Energy 2013*). Iran has already made a grand plan for the development of the giant South Pars gas field, which attracted great interest among international oil and gas developers. The plan has been disrupted by international sanctions, but it will not stagnate forever. After the presidential election in 2013, Iran has taken a more pragmatic and flexible approach in dealing with the nuclear issue. In November 2013, Iran and the P5+1 countries signed a pact, under which Iran agreed to limit enrichment of uranium to the 20% purity level and the United State and the EU would relax their sanctions. This provided an opportunity for the peaceful settlement of the Iranian nuclear issue. Once sanctions on Iran are eased or lifted, its potential of natural gas exploration would be unleashed, which would create obviously a boost to the global gas supply. Iran's geographical location and the prospect of the

world market indicate that East Asia is definitely its key export destination.

From a long-term perspective, the three separate segments of the international gas market are merging. A new pattern with East Asia and Europe being major importers and North America and West Asia being major exporters is taking shape in the international gas market. West Asia's strong supply and East Asia's strong growth in demand will make Asia the world's most vibrant gas market. The prospect for de-regionalization in the international gas market will ensure a more sufficient gas supply, and correct price discrepancy or distortion caused by the separation of the market.

II. Impact on the Relations between China and West-Asian Oil and Gas Exporting Countries

From the perspective of political and economic ties between the Gulf countries and East Asian countries, China in particular, whether the regionalization of the international oil market or the de-regionalization of the international gas market will produce the same result, i.e., increased strategic interdependence between China and West-Asian oil and gas producing countries, which will strengthen their relations and inject positive energy to their political and economic cooperation.

(1) Deepening strategic interdependence

Strategic interdependence between countries is not a mutually beneficial relationship based on short-term interests, but a long-term mutually-beneficial relationship based on the core interests of both sides. Energy ties between China and West-Asian oil and gas

producing countries belong to this kind of relationship.

China will depend on oil imports from West-Asian countries for a long time and would probably substantially increase natural gas imports from these countries. To ensure the security of oil and gas imports from West-Asian countries constitutes one of the core interests of China's development. Restricted by China's national conditions and the current development stage, China's economic growth still relies on energy intensive industries. Its energy efficiency is still low, with energy consumption per unit of GDP much more than that of developed countries. Since the beginning of the new century, China has made remarkable achievements in saving energy and raising energy efficiency. Its energy elasticity dropped from 1.03 during the 2000-2005 period to 0.66 during 2005-2010, but was still higher than that of developed countries.^① In 2012, China's oil consumption accounted for 11.7% of the world total, making it the world's second largest oil consumer ranking after the United States. However, China is not a country with abundant oil resources. As of the end of 2012, China only possessed 1 percent of the world's total proven petroleum reserves and its reserves-to-production ratio was 11.4 years (*BP Statistical Review of World Energy 2013*). From the mid-1990s till now, China changed from a net oil exporter to the world's largest oil importer in less than 20 years. In 2012, China's dependence on oil imports reached 56.4% (CNPC Economics and Technology Research Institute, 2014). According to Chinese experts' forecast, China's oil imports can reach 300 million tons by 2020, accounting for 60% of the country's total oil consumption (Cui, M.,

^① Energy elasticity is a term indicating the energy intensity of GDP. It is the percentage change in energy consumption to achieve 1% change in national GDP.

2011). Foreign observers even thought China's dependence on oil imports could rise to 76% by then (Andrew-Speed, P., 2001).

Under the regionalization of the international oil market, China's growing demand for oil imports highlights its increasing dependence on West Asia's oil. China has made efforts in diversifying its oil import sources and tried to find new suppliers, but its diversification is limited. Imports from Russia and Central Asia are restricted by the transport capacity of pipelines. In 2012, oil from the two regions accounted for 12.9% of China's oil imports. However, the proportion is hard to increase in the coming years because of China's rapid growth in oil imports and limited pipeline transport. The designed capacity for the China-Russia oil pipeline and the China-Kazakhstan pipeline is 15 million tons and 20 million tons per year, respectively. Even if China's oil imports reached 300 million tons by 2020 and the two pipelines carry their full capacity, oil imported through the two pipelines could reach only 11.7% of China's total oil imports, which is even lower than the 2012 level. In recent years, China's oil imports from Africa have been on the rise, but the prospect is uncertain. First, oil reserves in Africa are unclear, with its proportion in the world's proven reserves only rising from 5.9% in 1992 to 7.8% in 2012, but still very low compared with the 48% of West Asia. Second, Africa is also the main target area of the United States and European countries, when they promote diversification of oil supplies. Therefore China may face competition from these countries. In 2012, 40% of African oil flew to Europe, 17% exported to the United States and also 17% to China. In brief, importing oil from Russia, Central Asia and Africa could probably not change the fact that China will still mainly rely on West-Asia as the main source of oil import in the foreseeable future.

Natural gas, as a clean energy, has already received much attention by China, which is seeking sustainable development. Gas consumption has surged in the country, with its elasticity of consumption increasing from 1.43 during the 2000-2005 period to 1.67 during the 2005-2010 period (*BP Statistical Review of World Energy 2013*). However, domestic natural gas output is limited. There is a growing need for imported gas to meet the fast increasing domestic demand. China began importing natural gas in 2007 and its dependence on gas imports already reached 32.1% in 2012. Chinese experts estimated that the country's dependence on gas imports would exceed 50% by 2020. To prepare for large-scale imports of natural gas, China is expanding LNG imports facilities as a strategic task and has made a plan to increase the East coastal region's receiving and transferring capacity of imported LNG from 9.3 million tons per year to 30 million tons per year during 2010-2015 (Cui, M., 2011). West Asia countries are also abundant in LNG resources and they possessed 43% of the world's proven reserves in 2012. China has shifted its major LNG import source from the Asia-Pacific region to West Asia. In 2012, imports from West Asia accounted for 79.3% of China's total LNG imports (Cui, M., 2011). LNG trade has become a new hotspot in the cooperation between China and West Asian countries and mutual cooperation is growing.

However, China's energy ties with West-Asian countries do not just mean China's unilateral strategic reliance on West Asia. Oil and gas exporting countries in West Asia are also strategically reliant on the Chinese market and will become more reliant along with the structural changes in the international energy markets. Security of oil and gas exports is undoubtedly the core interests of major West-Asian

oil and gas exporting countries, which not only determines the prosperity of their single pillar industry, but also is the guarantee of their economic growth, international payments and fiscal revenue, and the only source of capital accumulation for economic development.

While structural changes are occurring in the international oil and gas markets, the United States and European oil and gas importers are intentionally distancing themselves from West-Asian exporting countries. The sluggish economy in the United States and Europe has also reduced their demand on oil and gas imports. To ensure their core interests—the security of oil and gas exports--West-Asian oil and gas producing countries need to consolidate and develop relations with China and other East Asian markets. In 2012, 45.3% of West-Asian oil was exported to China, India and Japan, 11.5% went to Europe and only 11.0% to the United States. Distribution of West-Asian's gas exports shows they've become more reliant on the Asian market. In 2012, West-Asian LNG exporters, including Qatar, Oman, Yemen and UAE, exported a total of 131.3 billion cubic meters, 69.4% of which was sold to China, Japan, India, South Korea and Thailand (*BP Statistical Review of World Energy 2013*).

The above trend indicates that driven by structural changes in the international energy markets—regionalization of the international oil market and de-regionalization of the international gas market, major West-Asian oil and gas exporting countries are, willingly or unwillingly, moving away from the United States and the EU and moving closer to East Asia. The security of their future oil and gas exports will become more and more dependent on their energy relations with China and other East Asian countries.

Therefore, the security of energy import in China and other East Asian countries and the security of energy export to major West-Asian oil and gas exporters are a kind of strategic mutual reliance and mutual guarantee. In fact, both sides, to maintain their common core interests – energy security, are inseparable in a community of mutual security. Structural changes in the international oil and gas markets have deepened their strategic interdependence.

(2) Calling on China to contribute more to regional stability

A key issue to the security of energy in West-Asian countries is to ensure peace and stability in energy producing areas and transportation corridors. In the post-World War II international oil market, the majority of major international oil supply interruptions and ensuing increases in price, or price hikes caused by actual and expected rising supply risks are directly related to geopolitical conflicts and tensions in the Middle East. Major local wars including the 1973 Middle East war, the 1980 Iran-Iraq war, the Gulf war in 1990-1991 and the Iraq war in 2003 as well as the escalation of the Iranian nuclear crisis in the new century have all posed threats to global oil supply security. Therefore, from the perspective of energy security, preventing and resolving conflicts and maintaining peace and stability in the Middle East should be the primary concern of both oil importers and exporters.

Since the beginning of the new century, the Middle East has been unstable and even more turbulent than in the last two decades of the last century. None of the original national and ethnic conflicts have been resolved. The Iraq war has left an uncertain security situation and the Iranian nuclear issue has led to a crisis situation several times. The Arab Spring has caused regime changes in several countries and

further led to long-term turmoil with all political forces fighting against each other. The Syrian civil war triggered the rivalry between global powers and regional powers. Religious conflicts continue have not abetted. Most of the countries in the region have no idea as to how to tackle unemployment and their economic problems have become more serious. Accumulation and new outbreaks of these conflicts will all pose threats to oil supply security. In addition, transportation corridors from West Asia to East Asia have hidden security risks, including the security of passing through the Strait of Hormuz, which is directly related to the Iranian nuclear issue. Maintaining oil supply security in West Asia still faces severe challenges.

Since the end of the Cold War, the United States has exerted decisive influence on the Middle East. It once prioritized ensuring oil supply security in its foreign policy towards the Middle East and played a decisive role in the stability of the Middle East. Whether the 1991 Madrid Conference, which was jointly held by the United States and the Soviet Union and initiated the Middle East Peace Process or US long-term Middle East strategy, featuring “dual containment” of Iraq and Iran in the East and promotion of Arab-Israeli peace in the West, both reflect its strategic intention of maintaining stability and ensuring oil supply security in the region. Since the beginning of the new century, due to the regionalization trend in the international oil market and US decreasing dependence on oil imports from West Asia, ensuring energy supply security has not been a priority of America’s Middle East policy any more. Its Middle East stabilization strategy has also changed. During the past decade, facing an increasingly tight supply in the international oil market, the United States started wars in Iraq and Libya, announced the strategy of democracy promotion in

the Middle East after the Iraq war, threatened to use force on the Iranian nuclear issue and imposed unilateral sanctions on Iranian oil. The US is responsible for the current turmoil in West Asia which has brought negative impact on oil supply security in West Asia, causing supply interruptions and sharp increases in international oil prices. Oil importers, including China, have paid a heavy price for these events. Since 2008, the United States has been caught up in the financial crisis and fiscal problems and its strategic focus has shifted eastward, thus diminishing its willingness and ability in controlling the Middle East situation. The geopolitical situation in the Middle East has been quietly moving toward a multi-polarization. However, there is still no other country to be capable of replacing the US decisive role in the Middle East. Maintaining peace and stability in the Middle East needs more countries in the world and in West Asia to cooperate and to establish new cooperative mechanisms.

US hegemony in the Middle East has been changing and the new regional peace and stability mechanism would inevitably be different from the past, which may further exemplify principles that the Chinese Government has advocated. First, respect international rules, give full play to the role of the UN, and oppose unilateralism and power politics. Second, seek resolutions through dialogue and cooperation, promote peace talks and oppose the use of force or the threat to use force. Third, improve peacekeeping ability of the countries in the region, give preference to regional cooperative organizations in peacekeeping, and oppose excessive intervention of external forces. Fourth, establish an inclusive powers' cooperation mechanism, promote Middle East security cooperation among interested parties in the Middle East, East Asia, America and Europe,

and oppose any countries' attempt to seek hegemony in the region.

China used to follow the principle of being "generally detached" when coping with the Middle East issues. But this is changing in the new century. Though it has so far been excluded from the quartets by the United States and other Western countries, China keeps sending special envoys to Palestine and Israel to promote peace talks and also to Sudan to relax the Darfur issue. China has participated in the negotiations on Iran's nuclear program, has encouraged the peaceful settlement of the Syrian crisis and joined the UN peacekeeping operations, thus accumulating a lot of experiences. While the geopolitical situation in the Middle East is becoming multi-polarized and China's interests in West Asia's energy security are increasing, China would play a greater role in ensuring peace and stability in the Middle East.

(3) Recycling petrodollars China benefits to West Asia

Increasing strategic interdependence between China and West-Asian oil and gas producing countries will be a strong boost to their economic and trade cooperation. China has recorded trade surplus since 1994, but the surplus has been decreasing due to the sluggish world economy and the rise of trade protectionism after the outbreak of the global financial crisis, with a sharp decline from \$298.1 billion in 2008 to \$154.9 billion in 2011. Compared to a total trade volume of \$3.6 trillion, the surplus is trivial. China will face potential trade imbalances. West Asia's oil exporting countries are one of the major sources of China's trade deficit. In 2011, China's trade deficit with West Asia's seven major oil exporters – Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia and Yemen – totaled \$83.27 billion (National Bureau of Statistics of PRC, 2012). To prevent the risks of trade

imbalance, China should find ways to recycle or “earn back” the petrodollars, i.e., it should use the petrodollars that China pays to buy West-Asian oil to flow back to China through trade and economic cooperation.

West Asia’s major oil exporting countries constitute a huge market. In 2011, the above-mentioned seven countries imported goods valued at \$313.7 billion, while China’s exports to these countries reached \$38.9 billion, with a market share of 12.4%. In fact, the economies of China and these countries are highly complementary in industrial structures and there is great room for expanding trade to recycle the petrodollars.^① West Asia’s major oil and gas producing countries have not diversified their industrial structures and have a high demand for imports of industrial and agricultural products, as well as a variety of services. The rising marginal cost of production in oil fields worldwide is keeping the international oil price at a high level. The population in these countries is also growing rapidly. In 2003, the Gulf Cooperation Council (GCC) members eliminated tariffs on trade between member nations and established common external tariffs, injecting new vigor to the expansion of the West-Asian market. This has created favorable conditions for China to expand its exports to these countries. Since the beginning of the new century, China has sped up its exports of goods, especially finished industrial products, to West-Asian oil and gas producing countries. The two sides have formed a pattern of trading China’s finished industrial products for West-Asian oil and petrochemicals. The 2000-2008 period saw the fastest growth of China’s exports of finished industrial products to

^① Chinese trade figures are from *China Trade and External Economic Statistical Yearbook 2012*, China Statistics Press; West-Asian countries’ trade figures are from *EIU Country Reports* published in 2013.

West-Asian countries, with the proportion of these products—mainly electrical, machinery and transportation and equipment—in China's exports to the six GCC countries rising from 49.4% in 2000 to 71.3% in 2008 (Lin, G., 2011).

Services are also an important part of China's trade with West-Asian major oil and gas producing countries, with the main form being China's export of construction contracting services. Since the beginning of the new century, China has already become a competitive force in the construction contracting market in West-Asian countries. From 2008 to 2011, the turnover of China's contracted construction projects in the above-mentioned six West-Asian countries grew at an average annual rate of 32% and amounted to \$11 billion in 2011 (National Bureau of Statistics of PRC, 2012). Export of contracting construction services alone brought electrical machinery and plant equipment, making themselves an additional driving force for exports of electrical machinery.

While trade relations are coming closer, China and the GCC launched free trade agreement negotiations in July 2004. Establishment of a free trade area would undoubtedly further eliminate the barriers for Chinese goods and services to enter the GCC market.

Petrodollars that China pays to West-Asian countries can be retrieved from both current account and capital account. West-Asian countries are an important source of international investment. According to statistics, GCC countries' sovereign wealth funds managed \$1.586 trillion in assets before the global financial crisis broke out in 2008, accounting for 36% of the \$4.4 trillion assets under the management of all sovereign wealth funds worldwide (Lin, G.,

2011). Although the GCC sovereign wealth funds prefer financial investments and cannot provide technologies and markets, they have still invested in several major projects in China's oil refining and petrochemical industries. Since 2007, Saudi Arabia and Qatar have directly invested in a series of projects in the downstream of oil industry in China, including the refining project in Fujian Province, the gas station project in Fujian, the petrochemical project in Tianjin, and refining projects in Zhanjiang of Guangdong Province and Taizhou of Zhejiang Province. These projects are often joint ventures with two or three partners and mainly target the Chinese domestic market. We should see that GCC countries' investments in the downstream of China's oil industry are of strategic importance to both sides. To China, the investments provide a solution to the capital demand in expanding refining capacity for the higher sulfur West-Asian crude oil and ensure stable oil supply from West-Asian countries. To West-Asian oil and gas exporting countries, investing in the downstream sector of the oil industry in a major market like China is an important part of the international integration strategy of their oil industry, which aims at ensuring potential exporting markets of their crude oil. Therefore, the mutually beneficial strategic investment is sustainable.

III. Conclusion

Changes in the international energy markets have offered a new perspective for studying China-West Asia relations. Regionalization of the international oil market and de-regionalization of the international gas market proposed in this paper are the two major trends in the

international energy markets that would have a far-reaching influence on the relations between China and West-Asian countries. The two trends, although seemingly developing in opposite directions, converge in essence in building closer ties between the West-Asian oil and gas exporting countries and China on their core interests of energy security. The strategic interdependence contributes to laying down a solid foundation for broader cooperation and would open up brighter prospects for their mutual relations.

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