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In a Fortnight

By Joseph E. Lin

FILLING OF CHINA'S STRATEGIC OIL RESERVES APPARENTLY DELAYED

According to unidentified officials from Chinese oil majors, China's remaining two of four strategic oil reserve bases will begin to be filled with oil sometime within the next year. One based in Huangdao, Shandong province will start to be filled by the end of 2007, while the other in the port city of Dalian, Liaoning province, will commence during the first half of 2008 (*China Daily*, June 28). According to a report from AFP, however, these time periods reflect a delay in the original schedule, most likely due to the high prices of oil in international markets. AFP noted that Sinopec had previously declared that filling its Huangdao base would be completed by mid-2007, but with oil prices currently at \$70 per barrel, it has become too expensive to fill the reserves (AFP, June 28). China's strategic oil reserve, with a current total capacity for 16 million tons of crude oil, is meant to protect the Chinese economy from sudden supply disruptions or spikes in international oil prices. Yet, energy analysts contend that, given China's enormous demand for crude oil, the size of the reserves must be at least doubled in order to be effective. The National Development and Reform Commission has announced that China intends to expand its strategic oil reserves to 28 million tons, though no such timeline has been established (*China Daily*, June 28).

AUSTRALIAN DEFENSE MINISTER ATTEMPTS TO SOOTHE CHINA'S CONCERNS

Seeking to assure his Chinese hosts that Australia's increasing military cooperation with the United States and Japan was not aimed at containing China, Australian

Defense Minister Brendan Nelson stated that “Australia stands ready to work more closely with China” (*China Daily*, July 10). In a speech at China’s National Defense University, Nelson reiterated that Australia’s support for U.S. and Japanese development of a ballistic missile defense system was motivated only by concerns regarding North Korea, which “remains a key threat to regional and international stability” (AFP, July 9). Following talks with his Chinese counterpart Cao Gangchuan, Nelson proposed the increase of bilateral military exchanges and announced that Australia, China and New Zealand would hold their first-ever joint maritime exercise in September. The drill, held off the Australian coast, will involve search-and-rescue exercises with the explicit goal of building confidence between the three militaries. Conspicuously absent from Nelson’s public discussions with the Chinese, however, was Australia’s recently released defense policy paper, *Australia’s National Security: A Defence Update 2007, in which China’s military modernization*, “particularly the development of new and disruptive capabilities such as the anti-satellite missile,” was noted with much concern. When first published on July 5, the paper’s claims were tactfully dismissed by Chinese Foreign Ministry spokesman Qin Gang as “unfounded” (Xinhua, July 6). Since then, there has been little discussion in the Chinese media of Australia’s defense paper, perhaps reflecting a conscious decision by Beijing to gingerly avoid issues of potential bilateral contention.

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Healthcare Reform in China: Design by Committee

By Drew Thompson

Since the disassembly of its comprehensive pre-1979 healthcare system, China has sought to shape and reshape the national healthcare system in an attempt to keep pace with rapid social and economic reforms. While reforms have been ongoing for over 10 years, an overhaul of the healthcare system appears to be in the works with vibrant public debate regarding which international healthcare models to emulate. The government has formed several ad hoc government coordinating committees to review options and offer informed recommendations to senior leaders on different aspects of the healthcare system. Despite senior leaders stating their concerns and setting lofty targets in a “five-year health plan,” reforms have been slow in coming. Commentators have indicated that up to

18 different government departments and offices have responsibility and investments in the healthcare system, causing protracted negotiations and heated debates behind closed doors over an outcome that will undoubtedly favor certain stakeholders at the expense of others.

A key healthcare reform “small group” was created in 2006 to establish the direction for healthcare reform strategy and coordinate research and deliberation about various healthcare reform options [1]. Under the leadership of co-chairs Minister Ma Kai of the National Development and Reform Commission (NDRC) and Minister Gao Qiang of the Ministry of Health (MOH), the group formally received seven healthcare reform proposals in late May during the latest stage of China’s quest to develop a functioning and equitable healthcare system [2]. While neither the content of the proposals nor membership of the group tasked to review them has been made public, various media sources have reported broad details of the proposals and mentioned key members of the small group. The complete membership of the group is not officially confirmed (with some media sources placing membership at 11 and others at 14 departments), though it is instructive to review which agencies are reportedly members and the implications their membership might have for the composition and character of China’s future healthcare system (*People’s Daily*, September 19, 2006).

A “SMALL GROUP” IS FORMED

The formation of the government group to review healthcare reforms constitutes the most recent development in a reform process that has been evolving since the early 1990s. In 1994, the State Council piloted a pooled urban medical insurance system in Jiangsu and Jiangxi provinces, ultimately scaling up the “basic medical insurance system” for urban employees in 1998. The outbreak of Severe Acute Respiratory Syndrome (SARS) in 2003, however, revealed major vulnerabilities in the public health and medical system. In response, the State Council Development Research Center, an office under the State Council, collaborated with the World Health Organization to compile a report on the progress of China’s medical and health system reforms, ultimately concluding in 2005 that China’s medical reforms were “basically, unsuccessful.” Recognizing that the cost of care was skyrocketing and the majority of the population was not able to access the system, Minister of Health Gao Qiang publicly apologized for the failures of the system, admitting that “getting healthcare is hard, seeing a doctor is expensive” (*kan bing nan, kan bing gui*) (*Zhongguo Qingnian Bao*, February 19, 2006).

In September 2006, various newspapers reported that the State Council had formed a “Health Care System Reform Coordinating Small Group” (*yiliao tizhi gaige xietiao xiaozu*) under the leadership of the MOH and the National Development and Reform Commission (NDRC) [3]. While this is not the first small group that has been formed to address various aspects of healthcare reform, this group appears to possess the broadest mandate to establish the “guiding principles” that would define the shape and direction of China’s future healthcare reforms.

Interviews with multiple sources in Beijing suggest that as of June 2007 there are at least 16 members of the small group [4]. It is important to bear in mind that an official list of members has not been published and that various sources have reported slightly different membership rosters. Media reports initially stated that 11 departments were involved, but later reports place the number at 14, indicating that several organizations had likely joined the group after its inception, undoubtedly hoping to influence the outcome of the healthcare debate.

KEY DEPARTMENTS REPORTEDLY MEMBERS OF THE HEALTHCARE REFORM SMALL GROUP

1. National Development and Reform Commission (co-chair)

The NDRC is the “super ministry” that determines economic and social policies and generates the guiding five-year plan and associated budgets. In the healthcare reform development process, it functions as an “honest broker,” able to make difficult decisions (including the most contentious choices about where to allocate resources and where to reduce funding and authority). It is not an implementing agency nor does it depend upon other organs of the State Council for its authority. For these reasons, it can pursue the project’s goals without concern for its own status and budget. Having no “turf” to protect, it can ride herd on agencies that are more interested in protecting their own interests than establishing a functioning healthcare system.

2. Ministry of Health (co-chair)

At the center of China’s healthcare system since it was founded in 1949, the MOH is tasked with managing a healthcare system that can provide universal access to basic health services and ensure that public health is maintained through preventative health programs and anti-epidemic networks. Focusing on health management and service operations, the MOH oversees hospitals and clinics that form the core of any system. The ministry, however, is lightly staffed and has faced challenges in establishing effective

oversight of a freewheeling market system plagued by corruption and counterfeit products. The ministry has also had an uneasy relationship with other government bureaus that have overlapping jurisdiction in regulatory areas, such as with the State Food and Drug Administration (SFDA). One of the ministry’s main objectives is to ensure that hospitals and clinics are adequately funded, either from user-fees or government grants.

3. The Ministry of Finance (*caiwubu*)

The Ministry of Finance (MOF) is responsible for producing annual budgets and monitoring financial management performance in accordance with the five-year plan. The MOF determines the budgets of government departments and controls the finances of state-owned enterprises.

4. The Ministry of Labor and Social Security (*laodong baozhang bu*)

The Ministry of Labor and Social Security (MOLSS) is responsible for the management of state medical insurance systems. The MOLSS would play an important role in public insurance schemes that serve the unemployed and laborers who are not covered by private or other insurance programs. MOLSS also establishes a list of “essential drugs” and prices that qualify for insurance reimbursement. MOLSS will undoubtedly seek to contain costs and minimize “profits” earned by service providers.

5. State Commission Office for Public Sector Reform (*zhongyang jigou bianzhi weiyuanhui bangongshi*)

This office is responsible for overseeing the administrative management system and supervising institutional reforms at national and provincial levels [5]. It has oversight responsibilities for government departments at national and local levels and establishes the division of labor between state council-level ministries and provincial bureaus. It performs audits of other government departments and, most importantly, sets staff-limits for government offices, making it a very influential actor in any reform process.

6. The Ministry of Education (*jiaoyubu*)

The Ministry of Education has oversight for medical schools, many of which play an important policy-advisory role as well as provide medical services in university-run hospitals and regulate the licensing of medical professionals.

7. Ministry of Civil Affairs (*minzhengbu*)

The Ministry of Civil Affairs is responsible for maintaining a social safety net for the poor, which includes ensuring

access to healthcare in rural areas. Though social security funding is inconsistent outside of urban areas, any attempt to increase healthcare access for peasants, the unemployed and the poor through a Chinese-style Medicaid program would be the purview of the Ministry of Civil Affairs. It is currently unclear how rural medical financing programs run by Civil Affairs bureaus might be integrated with other systems or what role the Ministry of Civil Affairs might play in any expansion or reform of the Rural Cooperative Medical Scheme currently implemented by the Ministry of Health.

8. The Ministry of Personnel (*renshibu*)

The Ministry of Personnel manages the recruitment and careers of civil servants and workers with advanced educational degrees, including those in the healthcare sector. The Ministry of Personnel plays a leading role in reform exercises in all sectors, particularly where downsizing or reorganization of the bureaucracy results in significant shifts in personnel.

9. The State Population and Family Planning Commission (*renkoujishengwei*)

The State Population and Family Planning Commission (SPFPC) is responsible for the reproductive health of women, including the oversight of birth control medication. The commission also oversees local clinics within its system. Due to its robust network of service providers, reaching all the way to the village level, SPFPC advocates for a greater role in the health system, particularly as a provider of preventative health services at the community level.

10. Legislative Affairs Office of the State Council (*guowuyuan fazhi bangongshi*)

The Legislative Affairs Office will be responsible for drafting the rules established by the small group. The office is primarily responsible for coordinating between the various ministries and departments and “narrowing discrepancies and disputes” [6]. Senior officials in this office also take stands on certain policy issues, such as voicing expectations about limiting foreign ownership in healthcare facilities and ensuring that hospitals remain under state control.

11. State Council Development Research Center (*guowuyuan fazhan yanjiu zhongxin*)

The State Council Development Research Center authored the seminal 2005 report that declared healthcare reform to be “basically, unsuccessful.” The “DRC” is the government’s top policy “think tank” that studies strategic

and long-term issues concerning economic and social development and makes recommendations to the Premier and the State Council.

12. China Insurance Regulatory Commission (*baoxian jiandu guanli weiyuanhui*)

Established in 1998, the China Insurance Regulatory Commission is a ministerial-level body that operates directly under the State Council, supervising and managing the insurance market. Private health insurance is a relatively recent phenomenon in China; the first pilot policies were introduced in 2004. To date, private health insurance coverage is very limited and has reportedly met with serious challenges, with claims often outstripping premiums. The commission is tasked with promoting and integrating private insurance with government-led medical insurance programs currently being developed (*China Daily*, March 16).

13. State Food and Drug Administration (*shipin yaopin jianguan ju*)

Recently rocked by scandal with the conviction and subsequent execution of its founding director, the State Food and Drug Administration (SFDA) has struggled to define its role in the health care sector, particularly in the shadow of more powerful bureaus, such as the Ministry of Health, which has overlapping jurisdiction over many issues. Clarifying its roles, responsibilities and jurisdiction in a reformed system is critical.

14. The State Traditional Chinese Medicine Administration (*zhongyiyao ju*)

With over 2,500 Traditional Chinese Medicine (TCM) hospitals, any reforms will have to incorporate this extensive branch of the medical system. The administration is tasked with overseeing TCM practitioners, research and development activities and promoting this facet of Chinese heritage. The administration’s role in the small group is undoubtedly to ensure that TCM continues to be an integral part of any reformed health system and that TCM compounds and practices are recognized on insurance reimbursement lists. The administration is under the authority of the Ministry of Health, but it operates independently. Traditionally, the director of the Traditional Chinese Medicine Administration concurrently holds the post of vice-minister of the Ministry of Health.

15. State-owned Assets Supervision and Administration Commission of the State Council (*guowuyuan guoyou zichan jiandu guanli weiyuanhui*)

The State-owned Assets Supervision and Administration Commission of the State Council (SASAC) is the “owner” of public companies in China, tasked with overseeing and strengthening the management, reform and value of state-owned enterprises. Ostensibly, the SASAC will seek to ensure that the interests of state-owned hospitals, pharmaceutical, insurance and equipment manufacturing companies are in a position to benefit in any future system. SASAC can be presumed to weigh in heavily on any decisions regarding privatization or public-private partnerships, and they are also likely to play a role in strengthening corporate management practices, including transparency and accountability of the government-owned companies involved in the healthcare system.

16. All-China Federation of Trade Unions (*zhonghua quanguo zonggong hui*)

The All-China Federation of Trade Unions plays a key role in the healthcare reform debate, representing the overall work force, including workers and their employers, who contribute to health insurance schemes. The federation also represents the interests of healthcare workers and suppliers to the industry who will undoubtedly be affected by reforms.

PARTIES UNREPRESENTED IN THE SMALL GROUP

Several organizations have a stake in the healthcare system and are reportedly not associated with the small group responsible for reviewing healthcare reform proposals. Their apparent lack of representation on this committee is not necessarily surprising and potentially points to efforts to streamline debate and focus on government-led service delivery over other concerns. It does not mean, however, that they do not play a role in the healthcare system. Nor, does it suggest that they will not have other means to ensure that their interests are considered. For example, the Ministry of Commerce (MOC) is not consistently mentioned as a key participant. This might indicate that foreign companies should not expect to have a meaningful role in healthcare financing or service provision, since the MOC is largely concerned with foreign commerce, including the international trade of equipment and pharmaceuticals. The Ministry of Science and Technology is responsible for state laboratories and funding new pharmaceutical product development, so it is unclear why they are not featured more prominently in the debate. The Chinese Centers for Disease Control operate clinics throughout the country and provide preventative medical and anti-epidemic services, though it is likely that their role is represented in the small group by the Ministry of Health.

While the government has stated its expectation that “the market” and private sector funding will play an important role in a reformed healthcare sector, its representatives do not have a formal place in the “small group” (*China Daily*, March 22). Key domestic industry associations, such as the China OTC Association, China Insurance Association, China Pharmaceutical Commerce Association, Chinese Hospital Association and others only play a consultative role in the process.

The General Logistics Department of the People’s Liberation Army is not openly involved in the healthcare debate, indicating that the military hospital system will likely continue to operate outside of the oversight of civilian authorities, despite the fact that military hospitals are highly commercialized and serve civilian patients. In addition, many government bureaus operate hospitals for their direct employees and dependents, including public security, railway, power, land reclamation and mining bureaus. These hospitals, like most military hospitals, also provide services to civilian customers and will be affected by a restructured healthcare system.

CONCLUSIONS

Healthcare reform in China has been a work in progress for years, and the recent effort to establish a new framework that improves access, affordability and quality has yet to produce meaningful results. The issue is as complex as the stakes are high, necessitating the involvement of many government departments in the process. There are challenges, however, that will need to be overcome if the process is to ultimately produce an implementable proposal that can become a functioning and affordable healthcare system. The current system has inefficiencies and biases (such as over-investment in urban rather than rural systems and over reliance on drug sales to generate revenue) that cannot be carried into a new system if it is to succeed. Corruption is a continual, systemic issue that must be more effectively addressed in order for the government to enjoy a return on the promised increased investment in healthcare.

Transparency is lacking in both the healthcare system and the reform process and will have to be improved. For instance, many hospitals lack computerized information systems that facilitate auditing and compliance, and hospitals further protect their information as “commercial secrets,” enabling them to avoid oversight. While there is significant public debate regarding healthcare reform and many public events featuring government speakers presenting their organization’s views, the policymaking process is neither inclusive nor transparent. The membership of the “Health Care System Reform Coordinating Small Group” is not

officially acknowledged (even as it receives “proposals” from Chinese as well as foreign organizations), nor is the deliberative process transparent, despite significant public interest and private sector resources that would inform the debate. Chinese experts have argued that the healthcare reform model should include private financing and an active role for the private sector, even though the process is committed to producing a “government-led” model. If the government determines that the private sector will play a significant role in a future healthcare system—a likely possibility—then greater involvement of private stakeholders, such as insurance companies, pharmaceutical companies and civil society, will be necessary to generate effective outcomes.

If the senior leadership is truly committed to reforming the system and creating an equitable and affordable medical system that can deliver appropriate-quality care to its citizens, a strong and sustained senior-level political leadership and greater transparency is needed. The most senior leaders will have to make challenging decisions (and maybe break a rice bowl or two) if the reforms are to be effective. Too frequently, a “design by committee” process protects vested interests and produces compromises that maintain bureaucratic harmony, rather than affecting sweeping transformations that will create a new system out of the current “basically, unsuccessful” one.

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NOTES

1. “Small groups”, also referred to as “leading small groups,” are ad hoc coordinating committees formed to build consensus on issues where there are multiple stakeholders affected by the particular issue and often when there is no clear division of responsibility or authority. “Small groups” normally perform a coordinating role and provide a structured forum for members to interact, particularly when issues are contentious and a consensus cannot be reached by the bureaucracy on its own. Small groups do not actually make policy, but provide recommendations and “guiding principles” that the bureaucracy should follow.

2. *Beijing Business News*, “11 Departments set up a healthcare reform coordinating small group to balance interests of various groups” [*shiyi buweizu jian yigai xietiaoxiaozu tongchou yiliao gaige gefang liyi*], September 18, 2006. Available online at: [http://news.tom.com/2006-](http://news.tom.com/2006-09-18/000N/09021689.html)

[09-18/000N/09021689.html](http://news.tom.com/2006-09-18/000N/09021689.html). See also: *Southern Weekend*, “Medical Reform: Seven medical reform proposals put before the government to compete for consideration” [*yigai: qitao yigai fangan guotang zhengfu shichang zhizheng jixu*] June 6, 2007. Available online at: <http://health.sohu.com/20070608/n250447644.shtml>.

3. Note: The Ministry of Health spokesperson has publicly referred to the small group as a “working small group” though media reports have not used this term.

4. Requests were sent to government officials, academics and technical experts in Beijing to provide the complete small group roster. Three lists purporting to be the membership roster were provided to the author, with slight variations between them. Exhaustive search of the NRDC, MOH and State Council web site did not reveal an official document listing the membership of this small group. Media articles listed only 8 out of 11 members.

5. “Brief introduction to the State Commission Office for Public Sector Reform” [*zhongyang bianban jianjie*]. Available online at: http://www.chinaorg.cn/idx/top/2007-06/06/content_5026988.htm.

6. “The Legislative Affairs Office of the State Council, The People’s Republic of China” accessed at: <http://www.chinalaw.gov.cn/jsp/contentpub/browser/contentproe.jsp?contentid=co1865792191>.

Cold War Redux: China Responds to the Russo-American BMD Dispute

By Joseph E. Lin and Christopher Griffin

As Chinese commentators criticize U.S. defense officials for their “Cold War mentality,” one need merely read the headlines to feel trapped in a bad rerun of the 1960s. Washington’s attempts to meet asymmetric challenges at both ends of the conflict spectrum have kept its hands full. At the “low intensity” end, the U.S. military is enmeshed in a long, bloody insurgency in Iraq. Meanwhile, Washington and Moscow are engaged in a heated row over U.S. attempts to deploy a ballistic missile defense (BMD) system in Europe as each side demonstrates its prowess at “high intensity” warfare. China’s growing fears that such a feat, if successfully accomplished in Europe, might be replicated in the Asia-Pacific, have resulted in a crescendo of criticism from Beijing. While certainly not the first time that China has condemned the deployment of a U.S. BMD system—as seen during the dispute prior to Washington’s withdrawal from the Anti-Ballistic Missile (ABM) Treaty in 2002—China is now backing its words with deeds. Indeed, the January anti-satellite (ASAT) test and the expected deployment of the DF-31 road-mobile intercontinental ballistic missile (ICBM) are indicative of a Chinese strategy

to develop capabilities that would permit it to negate any military advantage the U.S. might obtain by deploying a similar BMD system in the Asia-Pacific.

WATCHING FROM THE SIDELINES

Since January, the United States and Russia have engaged in a verbal tit-for-tat over plans to expand the U.S. ballistic missile defense system into Europe by constructing a radar base in the Czech Republic and stationing mid-course interceptor missiles in Poland. This plan was always likely to earn Russian ire, as Moscow had long viewed the incorporation of former Warsaw Pact members into NATO as a direct affront to its dignity and security and only relented in the 1990s when it was implicitly guaranteed that U.S. and NATO troops would not be stationed on former Pact countries.

At a February conference on international security in Munich, Russian President Vladimir Putin condemned the missile defense plan, stating that it would lead to an “inevitable arms race.” Since then, Russia has suspended its participation in the treaty on Conventional Forces in Europe and threatened to abrogate the Intermediate-range Nuclear Forces Treaty that helped prevent a nuclear arms race in Europe at the height of the Cold War in the 1980s.

Chinese media have followed the Russo-American spat over the missile defense system closely, focusing on Washington’s supposedly anti-Russian strategy and the destabilizing effects of missile defense. While the Chinese Foreign Ministry initially refrained, for the most part, from taking an explicit position on the Russo-American disagreement on missile defense, Beijing expressed its views by proxy; Chinese academics and state-owned media have adopted positions generally favorable to Moscow, thereby allowing Beijing to express its views without becoming directly involved.

Indeed, when discussing the missile defense program in isolation, Chinese media reports in this earlier period tended to be matter-of-fact. For example, Ren Xiangqun, a researcher at the Chinese Military Science Academy, noted in a *People’s Daily* editorial in late May that if “the United States can smoothly set up interception bases and radar bases in Poland and the Czech Republic, its missile defense system will basically create a global deployment structure with the U.S. homeland at the center and East Asia and Europe as its two flanks” (*People’s Daily*, May 23).

When discussing the missile defense shield in light of Russia’s interests, however, Chinese media have championed the Russian position and criticized American justifications for the program. One characteristic report in this vein is an early

May *People’s Daily* article that claims U.S. policy toward Russia is to “contain the nation to prevent it from rising again.” The article continues to observe that “Washington is no doubt targeting Russia” with the deployment of the missile defense system in Poland and the Czech Republic, and that the “world is perhaps on the brink of a new Cold War” (*People’s Daily*, May 11).

An earlier *People’s Daily* piece attempts to place the broader set of Russo-American disputes over such issues as human rights, the rule of law and nuclear proliferation in Iran in context by summarizing the two sides’ respective strategies: “The paramount objective of the Putin administration is a Russian renaissance, which is the last thing Washington wants to see and will tolerate, since U.S. hegemony cannot be challenged. To prevent such a scenario, the U.S. has been trying every means possible to weaken and contain Russia since the end of the Cold War” (*People’s Daily*, May 3).

Another article that attempted to explain Washington’s strategic logic toward Russia likewise points to the overall pattern of U.S. efforts on NATO expansion, democracy promotion in the Commonwealth of Independent States, and missile defense efforts as proof of Washington’s vindictive goals. The article concludes that the United States is “punishing the loser” of the Cold War by attempting to impose upon it “the reality that the U.S. will expand in a range as large as possible in a hope to build a permanent U.S.-led international pattern.” (*People’s Daily*, March 24).

Such a supporting role was easy (and not costly) for China to play, expressing concerns about U.S. missile defense capabilities by criticizing developments in Europe without having to directly lead the charge in public. This approach was only possible, however, so long as Moscow kept up the pressure on Washington.

LEADING THE CHEERING SECTION

At the early June Group of 8 meeting in Germany, Putin changed tack, offering to cooperate with the United States on missile defense by changing the location of the planned radar site to Azerbaijan, where a Soviet-era X-band radar facility is already established. When President George W. Bush and Putin met at the Bush family compound in Maine a month later, Putin expanded upon his earlier offer, stating that the Russians would be willing to either update the existing radar facility in Azerbaijan or replace it completely, provided that the Polish and Czech facilities were disbanded.

As Putin cast aside the standard of opposition to missile defense at the G8 summit, Beijing—concerned that

Russia might once again capitulate to Washington's will as it did regarding the ABM Treaty—has taken a more assertive course in the debate by releasing a series of press commentaries and public statements criticizing the U.S. missile defense effort. The first official Chinese Foreign Ministry statement on the issue of missile defense in Europe was released at the dawn of the summit, when Foreign Ministry spokesman Jiang Yu told the media that the U.S. plan for Europe has attracted “some concern” and that “missile defense systems negatively impact strategic balance and stability and are detrimental to mutual trust among major powers and regional security [and] will also probably trigger new proliferation issues” (Xinhua, June 5). A pair of articles since the G8 summit indicates the degree to which the Chinese media position has swung in support of the government's openly critical line.

First, on June 18, the *People's Liberation Army Daily* published a scathing critique of the proposed U.S. system, stating that “vigorous U.S. development of antimissile defense systems is aimed at changing the ‘mutually assured destruction’ nuclear deterrent concept left over from the Cold War...by weakening the enemy's nuclear missile deterrent, thus achieving ‘attack through defense.’” The article concludes that because U.S. efforts are pushing Russia to develop new offensive missile capabilities “that can pierce through any antimissile defense system,” U.S. efforts will ultimately be frustrated and “Europeans will become ‘hostages’ to the U.S. antimissile system.” The article concludes by predicting that the “summer breezes” at the then-upcoming Kennebunkport summit “will probably still be mixed with some whiffs of the Cold War” (*Jiefangjun Bao*, June 18).

The source of China's increasingly critical pronouncements on the missile defense system in Europe is the perceived threat from U.S. missile defense ambitions in the Asia-Pacific and the risk that Russia will no longer lead the international campaign against the BMD system if the Azerbaijan plan happens to go through.

On June 21, the *People's Daily* clearly laid out these concerns with an editorial headlined as “The Untimely Anti-Ballistic Missile System.” Observing that Washington's plan in Europe has been matched by similar efforts in cooperation with Japan and Australia in Asia, the article observes that the ballistic missile defense also has “offensive” uses such as “accurately intercepting high-speed missiles attacking aircraft in flight and satellites in orbit.” The article argues that U.S. and allied efforts to build a missile defense system “simply reflects the U.S. mindset of intensifying the Cold War mentality” and “can neither help maintain regional security and stability nor enhance the mutual trust and cooperation between Asian-Pacific countries.” The article

concludes on an ominous note, stating that missile defense “will intensify the distrust and feelings of alienation among countries and even pose a new issue of proliferation” (*People's Daily*, June 21).

PLAYING BALL

The fairly sudden intensification in China's rhetoric toward missile defense is explained in part by the understated decision that Beijing will be committed to space warfare and developing missile capabilities to leverage against U.S. and Taiwanese forces in the region for the foreseeable future.

The decision to commit itself to bolstering its missile forces is implicit in China's official statements and media commentaries on missile defense, where the warning that U.S. efforts will result in instability and proliferation may be read as a threat. Indeed, in the one instance where proliferation has arguably been tied to missile defense, Chinese commentators have been exuberant over the challenge posed to U.S. missile defense capabilities. After Russia test-fired the RS-24 intercontinental ballistic missile (ICBM) in June—a weapon capable of carrying up to ten independently targetable warheads and was designed to replace a missile that Cold War planners code-named “Satan”—the *People's Daily* reported that the most dangerous nuclear missile had “destroyed the myth” of U.S. missile defense and restored “strategic balance” between the two powers (*People's Daily*, June 12).

Moreover, as Beijing has become vehemently critical of U.S. attempts to erect a missile defense system in Europe, it seems that China has also begun to make secondary, hardware preparations, should the United States either remain unconvinced about halting the deployment of the BMD system or decide to replicate a similar system in the Asia-Pacific. Western observers have noted that the technical parameters of China's January 11 ASAT missile test—the use of a phased array radar to guide a kinetic-kill vehicle toward a target traveling faster than an ICBM warhead during reentry—are similar to those of a ballistic missile intercept [1]. While surprising, China's attainment of such a sophisticated technological capability was first hinted at in November 2006 by the China Aerospace Science and Industry Corp.'s display of a conceptual ballistic missile defense system at the Zhuhai Air Show (*Wen Wei Po*, November 10, 2006).

Ashley Tellis, a scholar at the Carnegie Endowment for International Peace, notes that Beijing has determined that a robust missile and anti-satellite capability is essential to “counter the overall military capability of the United States” and to disable the “complex, exposed network of

command, control, communications, and computer-based systems that provide intelligence [and] reconnaissance” to U.S. forces [2]. Tellis writes that because Chinese defense planners see the networked nature of American forces as their principle vulnerability, they are not likely to surrender their efforts to build stronger missile forces no matter what offers Washington makes to halt the weaponization of space. This logic has a corollary in the area of missile defense, where the ability to intercept Chinese missiles and protect critical U.S. and allied satellites and nodes is one of the greatest threats to China’s emerging military strategy.

Having recently dissected a series of doctrinal textbooks on campaign strategy published by China’s National Defense University and distributed to its military academies and war colleges, defense analyst and former U.S. defense attaché in Beijing Larry Wortzel finds that, much like Russia, China is taking steps to overwhelm any U.S. missile defense system. Wortzel cites a group of Chinese military officers from the Second Artillery Command Academy who recently wrote that “guided missile forces are the trump card (*sa shou jian*) in achieving victory in limited high technology war” [3]. Another Chinese officer argues that in order for a guided missile attack to successfully destroy U.S. military capabilities, it is necessary to “neutralize enemy anti-missile systems and missile sensor systems,” leaving such critical assets as naval vessels and airfields vulnerable to attack [4].

CONCLUSION

While the Russo-American spat over missile defense has attracted the most attention in recent months, China has played a critical role in observing and attempting to undermine U.S. efforts in this field. Beijing’s effort to rapidly develop a broad range of theater missile strike capabilities that it will likely employ in a potential conflict—unlike Russia’s RS-24 Armageddon missile—certainly carries a tremendous risk of unintentionally escalating a Sino-American armed conflict to the level of nuclear war. As China develops its capabilities to blind U.S. surveillance, reconnaissance and intelligence assets with missile attacks, the temptation for the United States to respond in kind will increase, raising a new specter of conflict that is indeed reminiscent of the Cold War.

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NOTES

1. For an additional discussion of the technical aspects of the ASAT test and its similarities with a BMD system, see Ashley Tellis, “Punching the U.S. Military’s ‘Soft Ribs’: China’s Antisatellite Weapon Test in Strategic Perspective,” *Carnegie Endowment for International Peace Policy Brief* 51 (June 2007), 2-3 or Richard Fisher, Jr., “Two Cheers for the 2007 PLA Report,” *International Assessment and Strategy Center*, June 20, 2007.
2. Tellis, “Punching the U.S. Military’s ‘Soft Ribs’” 2-3.
3. Ge Xinliu, Mao Guanghong, and Yu Bo, “Problems Faced by Guided Missile Forces in Information Warfare Conditions and Their Countermeasures,” (Xinxi zhan zhong daodan budui mianlin de wenti yu duici), in Military Science Editorial Group, *Wo Jun Xixi Zhan Wenti Yanjiu*, pp. 188-189 in Larry Wortzel, “China’s Nuclear Forces: Operations, Training Doctrine, Command, Control, and Campaign Planning,” Strategic Studies Institute (May 2007), 13.
4. Nie Yubao, “Combat Methods for Electronic Warfare Attacks on Heavily Fortified Enemy Naval Formations” (Daji haishang di da jian jianting biandui de dianzi zhan zhanfa), in Military Science Editorial Group, *Research on Questions about Information Warfare in the PLA (Wo Jun Xixi Zhan Wenti Yanjiu)*, Beijing: National Defense University Press, 1999, pp. 183-187 in *Ibid.*, 12.

Malaysia’s Hedging Strategy with China

By Ian Storey

The relationship between Malaysia and the People’s Republic of China (PRC) is, by mutual consent, the best it has ever been. On the economic front, two-way trade is expanding by 20-25 percent per year, and Malaysia looks set to cash in on China’s growing appetite for natural gas. Politically, the two sides have established a high level of trust based on regular meetings and shared perspectives across a range of international issues. Malaysia’s current Prime Minister, Abdullah Badawi, has repeatedly said that his government does not view China as a strategic threat. Naturally, however, the relationship is not problem-free. Malaysia has a large and growing trade deficit with China, and the two countries still have overlapping sovereignty claims in the South China Sea. Moreover, despite Malaysian rhetoric concerning China’s peaceful rise, Kuala Lumpur continues to pursue a hedging strategy that puts a premium on the continued U.S. military presence in the Asia-Pacific region—a presence Malaysia quietly facilitates.

In October 2003, Abdullah succeeded Mahathir Mohamad as prime minister. Since Abdullah took office, the fundamentals of Malaysian foreign policy have remained essentially the same, though the tone has changed, leading to improved atmospherics with the United States, Australia and Singapore—all favorite targets of Mahathir's acerbic criticism. Under Abdullah, Malaysia's ties with China have strengthened across the board. Economics remains the bedrock of the relationship. The volume of two-way trade has expanded from \$14.2 billion in 2003 to \$22.5 billion in 2005 [1]. According to IMF figures, in 2005, China was Malaysia's fourth largest trade partner behind the United States, Singapore and Japan. Since 2000, however, Malaysia's trade with China has been in deficit, and the gap is growing (by 2005, it stood at \$3.9 billion). The cause is not difficult to identify: Malaysian businesses have found it very challenging, if not impossible, to compete with Chinese manufactured goods in terms of price and quality. In response, Kuala Lumpur has encouraged its businessmen to exploit niche markets, especially high-technology areas where Malaysia still enjoys a comparative advantage over China. A related concern for Malaysia has been the loss of foreign direct investment (FDI) to China, an issue the prime minister has admitted to be a "very important challenge" (*People's Daily*, December 12, 2005). Malaysia has been particularly concerned about the loss of Japanese investment. As a result, the government has tried to take advantage of Japan's "China plus one" strategy—whereby Japanese businesses are encouraged to not place all of their investment eggs in China's basket—by positioning itself as the "plus one," though Malaysia recognizes that it faces stiff competition from other Association of Southeast Asian Nations (ASEAN) members, especially Vietnam.

Despite the deficit and FDI concerns, the Malaysian government remains optimistic about its economic links with China, and the two sides have set a goal of \$50 billion in bilateral trade by 2010. The export of Malaysian energy resources to China is likely to represent a larger share of future bilateral trade and, to a certain extent, may go toward offsetting the deficit. Malaysia is one of the world's leading exporters of liquefied natural gas (LNG), an energy resource much in demand in China. In November 2006, Malaysia's state-owned energy company, Petronas, won a 25-year contract to supply Shanghai with three million tones of LNG per annum in a deal worth \$25 billion—by far the largest single trade deal between the two countries (*The Straits Times*, November 1, 2006). Malaysia is obviously anxious to secure further LNG deals with China.

The tourism and education sectors have been other sources of revenue for Malaysia vis-à-vis China. Since 2000, Malaysia has relaxed visa restrictions for Chinese nationals, resulting in increasing numbers of tourist arrivals. In

2006, 439,000 Chinese citizens visited Malaysia, up from 350,000 in 2003, despite negative publicity in late 2005 over allegations that Chinese tourists had been poorly treated. In addition to the tourist trade, Malaysia has been keen to attract Chinese students to its higher-education institutions and has achieved a large measure of success; in 2003, 11,000 PRC nationals were enrolled in Malaysian courses, representing 25 percent of all foreign students and the largest single group of foreign students (Bernama, May 26, 2004). The entry of large numbers of Chinese nationals has, however, raised security concerns, as it is estimated that tens of thousands remain as illegal immigrants or move on to third countries.

As is the case elsewhere in Southeast Asia, as bilateral relations have grown closer, Malaysia has demonstrated increased deference to China over political sensitivities such as Taiwan and the Falun Gong. Malaysia has banned its government ministers from visiting Taiwan, and in July 2005, the government prevented the distribution of an allegedly pro-Falun Gong newspaper at the request of the Chinese Embassy (*Jakarta Post*, July 1, 2005). China appreciates Malaysia's support on these issues and values its overall relationship with Kuala Lumpur. China recognizes that Malaysia is a very influential player within ASEAN and the various ASEAN-driven forums such as the ASEAN Regional Forum (ARF) and the East Asian Summit process. It would be a useful diplomatic asset for Beijing to have an influential voice within these forums that is well disposed toward China. At the strategic level, China is also keen to court Malaysia, because it is a littoral state of the Strait of Malacca, through which 80 percent of China's energy imports transit. As noted elsewhere, Chinese security planners view the SOM as a strategic vulnerability, because the country's navy is incapable of protecting the sea lines of communication that pass through the Strait, resulting in the so-called "Malacca dilemma" (*China Brief*, April 12, 2006). In 2004, Malaysia angrily rejected the idea, as an infringement of its sovereignty, that the United States should help the littoral states tackle transnational security threats such as piracy and terrorism by stationing military forces in the SOM. China would not like to see a greater security role for the United States, Japan or India in the Malaccan Strait, and it quietly applauded Malaysia's stance. In a gesture of support, the PRC offered to help Malaysia enhance security in the Strait by providing intelligence and information exchange (*People's Daily*, December 16, 2005). Malaysia may also play a role in helping China mitigate its "Malacca dilemma." In April 2007, it was announced that Kuala Lumpur had given the green light to a private consortium to build an oil pipeline through Malaysia's northern states, a project that would enable oil tankers to bypass the more congested southern stretches of the Strait [2]. While China has not yet formally expressed

an interest in investing in the project, it is likely to do so in an effort to assuage its concerns over oil-supply security.

Prime Minister Abdullah has continued to affirm that Malaysia does not see China as a threat, while Najib has gone so far as to call the PRC an “ally” of ASEAN (Bernama, January 27; *The Straits Times*, July 23, 2004). In public at least, the Malaysian government has maintained a relaxed attitude toward the modernization of the Chinese military. In April 2007, for instance, Malaysia’s defense minister told parliament that China’s naval build-up should not be taken as an indication that China has expansionist designs in Asia (Bernama, April 24). Malaysian officials and analysts tend to agree with the assessment that the PRC does not have hegemonic ambitions, though it is worth noting that it has become politically incorrect in Malaysia to characterize the PRC as anything other than a benign power, and observers who harbor concerns regarding China’s long-term intentions have tended to withdraw from the debate [3]. Malaysian views on the potentially negative security implications of China’s rising power tend to focus on the possibility of domestic instability in China, the fallout from a China-Taiwan conflict (especially one involving the United States) and Great Power competition between China and the United States on the one hand, and China and Japan on the other. The issue of domestic instability in China strikes a particular chord with Malaysian security analysts because of the potential outflow of Chinese refugees into Southeast Asia, a scenario that could upset Malaysia’s delicate racial balance (roughly 30 percent of the Malaysian population is ethnically Han Chinese). On Taiwan, the consensus is that an aggressive move by China would be highly detrimental to Malaysia’s positive perceptions of China, but that if Taipei “provoked” Beijing by pushing the independence envelope too far, Malaysians would “understand.”

The one outstanding security problem Malaysia has with China is in regards to the disputed Spratly Islands. In 1980, Malaysia laid claim to 12 of the islets in the archipelago and has occupied five since then. During the 1980s, Malaysia’s defense policy prioritized the acquisition of modern air and naval assets, in part to help defend the country’s territorial claims in the Spratlys. While, at present, Malaysia remains vigilant in the South China Sea, it has ruled out the possibility of a conflict in the area. Malaysia and China have never had a major spat over the Spratlys, and it is unlikely that Beijing would directly challenge Kuala Lumpur’s claims for fear of damaging strong political ties. In any case, Malaysia’s territorial claims are geographically far removed from China, and the Malaysian Armed Forces are in a strong enough position to defend the claims (especially given that China lacks air cover in the area).

Malaysia and the PRC are working to improve defense ties. In September 2005, the two countries signed a Memorandum of Understanding on Defense Cooperation, which provides for activities such as military training, exchange of personnel and regular dialogue. A number of Malaysian military officers have attended military academies in China, and vice versa. China has offered to sell weapon systems, including naval ships, to Malaysia, but Kuala Lumpur has politely refused these offers, preferring instead to source its major arms purchases from traditional suppliers in the United States, Britain and Russia, where the quality of weapons systems is far superior to those made in China [4]. In 2004, Malaysia agreed in principle to purchase medium-range surface-to-air missiles from China, for which China in return would supply Malaysia with the technology to produce short-range shoulder-launched missiles (Bernama, July 20, 2004). As of July 2007, however, the Malaysian side has evidenced little interest in materializing the agreement due to budgetary priorities and because other producers such as Russia have offered more attractive pricing and technology transfer arrangements [5].

Abdullah’s predecessor did not subscribe publicly to balance of power theories and feigned ambivalence over the U.S. military presence in Asia. In spite of this rhetoric, however, his government actively facilitated that presence. In 1994, Malaysia and the United States concluded a Cross Servicing and Acquisitions Agreement, which allowed U.S. Navy ships and aircraft to undergo maintenance and resupply in Malaysia. The agreement remained secret until 2005, when the Abdullah government renewed it for ten more years (ABC Radio Australia News, May 9, 2005). Overall, Malaysia’s military-to-military ties with the United States far outweigh anything it has with China: U.S. naval ships regularly visit Malaysian ports each year; the Malaysian and US navies hold annual joint exercises; U.S. Army and Navy Seals hold joint training exercises with their Malaysian counterparts; and U.S. military personnel undertake jungle warfare training in Malaysia (*The Straits Times*, May 3, 2002). Malaysia’s defense links with the United States—and also with Britain, Australia and New Zealand through the Five Power Defense Arrangements (FPDA)—strongly suggest that Kuala Lumpur wants to help preserve a balance of power in the region against the backdrop of a rising China.

Sino-Malaysian relations are at an all-time high, and the absence of major problems is likely to ensure that the relationship remains cordial for the foreseeable future. In keeping with its prudent hedging strategy, however, Malaysia will continue to facilitate a U.S. military presence in Asia and remain vigilant in the disputed Spratly Islands.

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NOTES

1. Direction of Trade Statistics Yearbook (Washington D.C.: International Monetary Fund, 2006).
2. Ian Storey, "New energy projects help China reduce its 'Malacca Dilemma'", *Opinion Asia*, May 14, 2007. Available online at: <http://www.opinionasia.org/NewEnergyProjectsHelpChinaReduceItsMalaccaDilemma>.
3. Author's interviews with Malaysian government officials and academics, Kuala Lumpur, August 2005 and September 2006.
4. Author's interview with Malaysian strategic analyst, August 2005.
5. Author's correspondence by e-mail with Malaysian defense analyst Dzirhan Mahadzir, June 18, 2007.

China's Growing Energy Relations with the Middle East

By Wenran Jiang

It is no secret that even as China is attempting to diversify its foreign sources of energy, the Middle East remains a key supplier of the oil and gas that China depends upon to sustain its continuous economic growth. Numerous energy producing states in the Middle East, few of them friends of the United States, are currently seeking new partners and markets. Washington's traditionally close ties with Saudi Arabia are eroding, its confrontation with Iran is intensifying and its war in Iraq is losing support both at home and abroad. Beijing, however, has strengthened its relations with these countries and others in the region in recent years via economic cooperation and trade, especially in the energy sector.

WARMING RELATIONS

China's economic ties with the Middle Eastern countries have been rapidly strengthened in the past few years, partly due to its overall growth in trade with the rest of the world as well as to a mutual desire to bolster relations. Since early 2000, the China-Middle East trade volume has increased at the fastest rate, outpacing China's trade growth with other regions of the world [1]. In 2002, for example, the six Gulf countries had no major investments in new company facilities in China, but by 2006, they had established 13 ventures, seven of which were financed by the United Arab Emirates (UAE). They are expecting to invest a further \$250 billion in the Asian market, including

China, over the next five years. Moreover, trade between these countries and Asia doubled between 2000 and 2005, reaching \$240 billion. When the Industrial & Commercial Bank of China launched its \$22 billion public offering last October, Gulf investors bought approximately 20 percent of the shares (AP, April 11).

Other recent major China-Middle East business deals, according to data from the Gulf Research Centre in Qatar, Diar and other sources, include the following:

- Dubai's Dragon Mart shopping mall and residential complex is now the largest trading hub for Chinese wholesalers outside mainland China;
- China's builders, engineers, labor suppliers and equipment companies won shares in the \$1 trillion projects planned or under construction in the Gulf (AP, April 11);
- Kuwaiti plans to build a \$5 billion refinery in China's Guangdong province, which would make the 300,000-350,000 barrels per day (bpd) plant China's largest petrochemical joint venture;
- Dubai-based operator, DP World, announced a \$500 million investment in a Tianjin container terminal;
- Damac Properties of the UAE invested \$3 billion in a real estate project in Tanggu district;
- State-owned Kuwait Investment Authority announced last November that it had a \$720 million stake in the Industrial and Commercial Bank of China;
- SABIC announced last November that it was planning a joint-venture in China worth up to \$5 billion;
- A Chinese firm won a contract to prepare the site for a new Doha neighborhood expected to house 200,000 people (AP, April 11).

Amid such developments, China has tried to enhance its traditionally modest portfolio in the region. As early as 2002, China has appointed a special envoy for Middle East affairs, a post that is currently filled by Ambassador Sun Bigan. Beijing hosted Palestinian foreign minister and Hamas member Mahmoud Zahar last year, but thus far it has not been effective in asserting a Chinese role in mediating the Israel-Palestine conflict or other major political affairs in the region. Beijing has also been active in UN activities, ranging from pre-war arms inspections in Iraq to participation in the UN peacekeeping mission in Lebanon in 2005. The Chinese team cleared away thousands of cluster bombs in Lebanon last year after the end of the Israeli-Hezbollah war.

As the world's third largest oil importer after the United States and Japan, China is projected to import 70 percent of its oil from the Middle East by 2015, according to the International Energy Agency's forecast. For this reason, China intends to open a dialogue with OPEC countries. Chinese Assistant Minister of Foreign Affairs Zhai Jun stated, "China wants to participate in making big decisions in the world. We want to set up a mechanism to negotiate and discuss oil market issues with the OPEC countries" (*Gulf News*, December, 6, 2006).

There appears to be an equal amount of enthusiasm from the Middle Eastern countries to take advantage of the world's fastest growing market. China's presence is largely perceived as non-ideological, economically oriented and pragmatic. Furthermore, there is little concern that China's increasing status as a world power will constitute an international threat. "Hegemony, domination, imperialism are associated with the United States and Europe. China is not seen that way," commented Sami Baroudi, a Lebanese political scientist, "Arabs appreciate its economic might, but don't see it as a political threat" (Reuters, November, 27, 2006).

THE THREE NOTABLES: SAUDI ARABIA, IRAN AND IRAQ

The most significant aspect of China's warming relations with the region is its fast growing contacts and economic interactions with Saudi Arabia, Iran and Iraq—the three countries with which Washington seems to have increasing difficulties in recent years (and with which there is little prospect of improvement in the sitting-duck period of George W. Bush's presidency).

Saudi Arabia has shown eagerness in pursuing China as a new partner. Saudi Foreign Minister Prince Saud Al-Faisal said in 2004 that Saudi Arabia would like to reduce its dependence on U.S.-dominated security arrangements. King Abdullah chose China for his first trip abroad as Saudi monarch in April and described it as a "truly friendly country" (Reuters, November, 27, 2006; AP, April 11). Shipping 60 percent of its crude to Asian markets, Saudi Arabia has been the largest oil supplier to China. Although it was overtaken by Angola last year, China has agreed to increase imports from the kingdom this year by nine percent, or 44,000 bpd, a move that might restore Saudi Arabia to its previous role as China's top supplier of oil (*Reuters*, January 9).

Bilateral business deals have made headway. Prince Abdulaziz Bin Salman, assistant Saudi oil minister, said that the kingdom's 4.5 million bpd of oil exports to Asia and joint ventures in four Far Eastern countries were a "solid base" and "[t]he show is not over yet" (*Dow*

Jones International News, May 1). Giant Chinese energy companies are striving for access to Saudi's lucrative energy sector through exploration contracts and downstream investments. For example:

- March 2004: Sinopec signed a \$300 million gas exploration license for nearly 40,000 square km in the Empty Quarter deserts of Saudi Arabia's Rub al-Khali Basin;
- January 2004: China's Sinopec signed an agreement with its Saudi counterpart, Saudi Aramco, to develop natural gas resources near the Ghawar field in the country's east over 10 years. Ghawar is the world's largest conventional oil field;
- March 2007: Aramco inked an agreement with Sinopec and Exxon Mobil Corp. to upgrade a refinery at Quanzhou, in the southeastern Chinese province of Fujian to 240,000 bpd and to operate around 750 filling stations locally (*Dow Jones International News*, May 1; Reuters, November 26, 2006).
- June 2007: China Petroleum Pipeline Bureau and China Petroleum Engineering and Construction (Group) Co. Ltd signed an agreement to jointly lay a crude oil pipeline for Saudi Arabia. The 360km-long pipeline is a section of the Abu Dhabi Pipeline, and will ship oil from Saudi Arabia's Habshan Oil Field to Fujairah (Xinhua, June 5).

Iran, locked in bitter dispute with the West over its nuclear weapons program, is equally keen to develop stronger relations with China. Currently, Iran is the world's fourth largest oil exporter and the third biggest source of China's oil imports, providing 12 percent of the total in the first 10 months of 2006, behind Angola and Saudi Arabia (*The Australian*, November 29, 2006). China's crude imports from Iran are up 11 percent in the first four months of this year against the same period in 2006 (Reuters, June 10). Due to U.S.-led sanctions, Iran lacks funds to explore its energy fields and seeks to secure markets for its exports. In the past few years, the following major energy pacts have been discussed and planned between the two countries:

- Zhuhai Zhenrong, one of China's four big state oil traders, agreed in 2004 to buy more than 110 million tons of liquefied natural gas from Iran for \$20 billion, over 25 years from 2008;
- China's largest integrated oil and gas company, China National Petroleum Corp (CNPC), is reportedly holding discussions with National Iranian Oil Company (NIOC) to develop the giant Kish gas field in the Gulf;
- Sinopec signed a \$2.8 billion contract to expand the capacity of an Iranian refinery at Arak in July

- last year;
- China's largest offshore oil producer China National Offshore Oil Corp. (CNOOC) announced last December that it had signed a preliminary deal with Iran to develop Iran's offshore North Pars gas field in the Gulf, with a potential investment of \$16 billion from the Chinese side. CNOOC will finalize the deal by August this year;
- Iran is also in discussions with Beijing to assist China in filling its strategic oil reserves (Reuters, November 26, 2006; AFX International Focus, January 11; Dow Jones Energy Service, May 20; Reuters, June 10).

One particular energy package has the potential to dwarf every global deal that the Chinese have made. Sinopec, China's second largest oil company, commenced talks with Iran in 2004 for an energy agreement of up to \$100 billion. Iran does not allow foreign ownership of its natural resources, but as part of the contract, Sinopec will gain a 51 percent stake in the Yadavaran oil field near the Iraq border. It will be permitted to finance the project and recover its investment at an agreed rate from the output. If materialized, this will provide China with 150,000 bpd of oil and 250 million tons of liquefied natural gas over a 25-year period (*The Australian*, November 29, 2006).

Iraq, torn by the ongoing war, is known for its operational difficulties regarding energy extraction. Nevertheless, the country claims the world's third largest conventional oil reserve, with only 10 percent presently explored. Such resources have proved tempting for China, which has made a remarkable comeback in the country during past months. Iraqi President Jalal Talabani and his oil minister Hussein al-Shahristani visited Beijing last month to discuss cooperation and investment, and as a gesture of goodwill, Beijing cancelled a portion of Iraq's \$8 billion debt to China in a number of signed agreements.

Before the war, China had agreed to develop Iraq's Adhab oil field with a \$700 million investment under Saddam Hussein, and the new Iraqi government currently renegotiating the deal with Beijing. Thamer al-Ghadhban, who advises Iraqi Prime Minister Nouri al-Maliki on oil policy, noted that "China is very important for us—their Adhab field is in a fairly safe area, but [the contract] will be amended" (Dow Jones Emerging Markets Report, June 2). Chinese energy companies have also demonstrated, as they have in Angola, that they are willing to invest and work in very challenging conditions with extremely competitive terms. Baghdad has begun to conduct business again with China. One Iraqi official said, "It is not wise to sideline anybody. The era of signing contracts based on our mood and relations is gone. The contracts will be given to those

who are capable of doing the work" (Reuters, November 27, 2006).

STRATEGIC IMPLICATIONS

It is predictable that some observers in the United States might be alarmed by such developments. They are likely to reach the conclusion that China is making inroads in the Middle East at the expense of the United States [2]. The real situation, however, is more complex. China's gain in the region may have more to do with the troubled U.S. Middle East policies than result from a master plan by Beijing to push the United States out of the region.

There is no strong evidence that the Chinese engagement with the region is designed to undermine U.S. interests. While not being entirely compliant with Washington's wishes, Chinese officials, nevertheless, have repeatedly emphasized the commercial nature of China's relations with the Middle East [19]. In addition, Beijing remains a relatively new actor in both the region's oil fields and its politics. In spite of the speculation in the Chinese press that China is constructing an aircraft carrier and is building a blue water navy, the U.S. Navy remains in control of the sea-lane security for oil routes from the Persian Gulf to the Strait of Malacca. For reasons ranging from fundamental trade to economic and political concerns, Beijing does not seek a confrontational approach with Washington in the Middle East. Nor are there clear indications that China is willing to adopt a counter-weight role vis-à-vis the United States.

China, nevertheless, will undoubtedly come to the region to compete for energy as a major world power in the coming years. The challenges for both Washington and Beijing to ensure that they are not on a collision course in the region, require the following: China's enhanced ties with Saudi Arabia must not result in a zero-sum game in the context of Saudi-U.S. relations; China and the United States should seek coordinated policies regarding the resolution of the Iranian nuclear crisis; and with the return of Chinese companies to Iraq, China should strive to stabilize the situation in post-war Iraqi construction.

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NOTES

1. Author's calculations according to the Chinese Customs statistics.
2. For example, see the recent op-ed by Frank J. Gaffney Jr., "China's double standard," *The Washington Times*, June 26, 2007.
3. See Wu Lei, "On the Development of Sino-Middle East Energy Relations Guanyu" [*Zhonggu-Zhongdong nengyuan guanxi fazhan de ruogan sikao*], *Arab World Studies* [Alabo Xijie Yanju], No. 1, 2007; Yang Guang, "Cooperation of Mutual Benefit between China and the Mid- Eastern Countries: From the Perspective of Energy Connections" [*Cong negnyuan kan Zhongguo yu Zhongdong guojia de huli hezuo*], *West Asia and Africa* [Xiya Feizhou], No. 5, 2004.
