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***Will Iranian Oil Still Fuel China? An Analysis of Beijing's Stance on  
International Sanctions Against Iran***

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**A minor-dissertation submitted in partial fulfilment of the requirements for the award  
of the degree of**

**Masters of Social Science: International Relations**

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## Dedication

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This thesis is dedicated to my parents, Deevak and Shamina Bagwandeem, who have been a constant pillar of strength in my life. Without your love, endless support and encouragement this thesis would not have been possible. I am extremely blessed to have you both as my parents.

## Abstract

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Due to China's growing energy needs that stem from its unrelenting drive for economic development, Beijing stresses the importance of maintaining a continuous supply of energy, particularly oil, to maintain its impressive economic growth. However, seeing as China's domestic resources are unable to satisfy its projected future oil demands, the Chinese realise that, barring significant domestic oil discoveries, their dependency on oil imports, particularly from the Middle East, will continue to increase. Since the international oil scene is dominated by Western energy companies, China's fuel procurement strategy reflects a mercantilist approach to improving its position vis-à-vis established energy consuming nations. Beijing's mercantilist stance in securing energy resources is particularly demonstrated in its oil diplomacy, which makes use of various political and economic incentives that can only be employed by the state. China's energy-centric form of diplomacy has been inevitably extended to the globe's most hydrocarbon affluent regions. Of significant importance to the Chinese is the Middle East, particularly the Persian Gulf as it contains a large stake of the world's proven oil reserves. China has thus sought to improve its relations with Persian Gulf nations such as Iran. However, Iran's relentless pursuit to obtain nuclear capabilities has implicated China in Iranian-American tensions. Although China has sought to steer clear of becoming embroiled in the Iranian nuclear situation due to its improved standing in the Gulf, Beijing has unavoidably become a significant actor in the diplomatic brinkmanship over Iran's nuclear situation. The scenario surrounding Iran's nuclear ambitions essentially pits China's national interests of energy security against its desire to maintain favourable relations with the United States. In light of this, the following thesis – by means of a literature survey – attempts to address how Beijing manages to maintain Iranian oil imports and uphold stable relations with Washington in the face of American-led international sanctions against Iran.

## List of Acronyms

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<b>CCP:</b>	Chinese Communist Party
<b>CISADA:</b>	Comprehensive Iran Sanctions, Accountability, and Divestments Act
<b>CNOOC:</b>	China National Offshore Oil Corporation
<b>CNPC:</b>	China National Petroleum Corporation
<b>EU:</b>	European Union
<b>FDI:</b>	Foreign Direct Investment
<b>GCC:</b>	Gulf Cooperation Council
<b>GDP:</b>	Gross Domestic Product
<b>IAEA:</b>	International Atomic Energy Agency
<b>IEA:</b>	International Energy Agency
<b>IPE:</b>	International Political Economy
<b>ISA:</b>	Iran Sanctions Act
<b>LNG:</b>	Liquefied natural gas
<b>MOCs:</b>	Multinational Oil Companies
<b>NEC:</b>	National Energy Company
<b>NOC:</b>	National Oil Company
<b>NPT:</b>	Nuclear Proliferation Treaty
<b>NYMEX:</b>	New York Mercantile Exchange
<b>OPEC:</b>	Oil Producing Export Countries
<b>PRC:</b>	People's Republic of China
<b>SASAC:</b>	State Assets Supervision and Administration Commission
<b>Sinopec:</b>	China Petroleum and Chemical Corporation
<b>SOE:</b>	State-Owned Enterprises
<b>UN:</b>	United Nations
<b>US:</b>	United States
<b>USSR:</b>	Union of Soviet Socialist Republics

**WTO:** World Trade Organisation

# Table of Contents

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<b>Compulsory Declaration .....</b>	<b>i</b>
<b>Acknowledgements .....</b>	<b>ii</b>
<b>Dedication .....</b>	<b>iii</b>
<b>Abstract.....</b>	<b>iv</b>
<b>List of Acronyms.....</b>	<b>v</b>
<b>Table of Contents .....</b>	<b>vii</b>
<b>Chapter 1: Introduction .....</b>	<b>1</b>
1.1. Research Question .....	5
1.2. Main Argument.....	5
1.3. Objectives .....	5
1.4. Methodology.....	6
1.5. Theoretical Background.....	6
1.6. Chapter Outline.....	10
<b>Chapter 2: China’s Mercantilist Oil Strategy .....</b>	<b>12</b>
2.1. Energy Mercantilism: Bypassing the Market through State Intervention.....	13
2.1.1. The Mercantilist Advocacy for State Intervention.....	13
2.1.2. State Intervention in the Contemporary World.....	16
2.1.3. Energy Mercantilism: Bypassing the Market.....	17
2.1.4. The Mercantilist Structure of China’s Energy Sector .....	19
2.2. China’s Oil Diplomacy .....	21
2.2.1. Pursuit of the Pariah.....	29
<b>Chapter 3: The Sino-Iranian Relationship .....</b>	<b>33</b>
3.1. Background: Sino-Iranian Ties .....	34
3.2. Economic .....	37
3.2.1. Trade .....	37
3.2.2. Energy .....	39
3.3. Geostrategic: Countering US Hegemony in the Middle East .....	44
<b>Chapter 4: China’s Persian Gulf Diplomacy.....</b>	<b>48</b>
4.1. China’s Energy Quest and the Persian Gulf.....	50
4.2. China’s Persian Gulf-Dilemma: Beijing’s Balancing Act Between Iran and the US .....	57
4.2.1. China’s Stance on Sanctions against Iran .....	60
<b>Chapter 5: Conclusion.....</b>	<b>70</b>
<b>Bibliography .....</b>	<b>76</b>

# CHAPTER 1

## Introduction

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The adoption of market reforms and an open-door policy in the 1970s under Deng Xiaoping propelled China to achieve astounding economic growth rates and expansive industrialisation. Relentless economic growth averaging at approximately ten percent per annum coupled with continuous development efforts led the People's Republic of China (PRC) to become the world's second largest economy.<sup>1</sup> China's drive to become an economic superpower placed a huge amount of strain on domestic resources, especially oil, to advance its economic development. As a result, Beijing's rapid consumption of oil in the 1990s outpaced the development of its domestic resources.<sup>2</sup> In order to sustain its blistering economic growth rate, China was forced to become a net-oil importer in 1993. Since then, Chinese foreign oil purchases have vastly increased and subsequently positioned China as the world's second largest oil importer behind the United States (US). However, it has been predicted that by 2020 China will require approximately 12 million barrels per day (b/d), tripling its current import levels, and consequently surpassing the US as the world's top oil importer.<sup>3</sup> Barring potentially significant domestic oil discoveries, China is unavoidably expected to increase its reliance on oil imports to meet its ever-growing energy demands.

Approximately three decades of relentless fast-paced economic growth has produced an oil deficit that is forcing China to become increasingly dependent on oil imports. Current domestic consumption is estimated to be at 9.2 million barrels per day (b/d) and domestic production at 4.5 million b/d,<sup>4</sup> thus, as a result of this supply and demand gap, the PRC imports more than half of its oil to meet the country's energy needs. Since most of China's oil fields have reached production plateaus or are in decline, its dependency on foreign oil is not expected to lessen. Instead, foreign oil is projected to make up 60 to 80 percent of the Asian

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<sup>1</sup> Christopher Howe and Tatsu Kambara, *China and the Global Energy Crisis: Development and Prospects for China's Oil and Natural Gas* (Cheltenham: Edward Elgar Publishing, 2007), p. xi.

<sup>2</sup> Jim Cooney, *Chinese Oil Dependence: Opportunities and Challenges*, Pennsylvania: U.S. Army War College (2005): p. 1. Accessed: 08 June 2012, URL: <http://www.dtic.mil/cgi-bin/GetTRDoc?AD=ADA432502>

<sup>3</sup> Abdulaziz Sager, "GCC-China Relations: Looking Beyond Oil-Risks and Rewards," in *China's Growing Role in the Middle East: Implications for the Region and Beyond* (Washington: The Nixon Centre, 2010), p. 6. Accessed: 05 February 2013, URL: <http://cftni.org/full-monograph-chinas-growing-role-in-me.pdf>

<sup>4</sup> Amar Causevic, "A Thirsty Dragon: Rising Chinese Crude Oil Demand and Prospects for Multilateral Energy Security Cooperation," *Peace Research Institute Frankfurt*, Report No.116 (2012): pp. 2-3. Accessed: 04 July 2012, URL: <http://www.jhubc.it/ADMISSIONSBLOGDOCUMENTS/a%20thirsty%20dragon.pdf>

Giant's oil consumption by 2020.<sup>5</sup> The PRC's increasing dependence on oil imports has generated a strong sense of energy insecurity amongst its leadership, prompting Beijing to look to alternate fuel options and promote energy reducing initiatives to decrease consumption. However, Daojing asserts that, "no matter how China carries out its energy policies, dependence on imported oil will have to continue."<sup>6</sup> Beijing's heavy reliance on oil imports has generated insecurity and concerns that an interruption in oil supply or unforeseeable price hikes could hinder the country's growth and, in turn, spawn social unrest that will have the potential to undermine the Chinese Communist Party's (CCP) hold over the country.<sup>7</sup> Since energy security is closely linked to political and economic stability, Beijing places access to reliable and adequate energy supplies at the top of its national security agenda.<sup>8</sup>

In an effort to improve energy security, the PRC has encouraged its national oil companies (NOCs) to set their sights beyond China and acquire foreign energy assets in the form of equity agreements that, unlike the global market, can provide consumers with a greater supply of oil at cheaper prices.<sup>9</sup> In 2008, the total oil production of China's top three NOCs (CNPC, Sinopec and CNOOC) amounted to 45 million tonnes.<sup>10</sup> The notion that equity oil is a better option than total reliance on the market stems from Chinese concerns that supply bottlenecks in parts of the world, and the unpredictable nature of the international market, may jeopardise China's access to oil supplies which are vital for sustaining its economic growth.<sup>11</sup> As such, China prefers equity agreements as they somewhat insulate the Chinese economy from oil price hikes and garner Beijing greater control over its foreign oil supplies.<sup>12</sup> In line with this view, the Chinese leadership has assisted and continues to aid Chinese NOCs in their foreign investment endeavours. By employing diplomatic efforts as well as the use of political and economic incentives, China has lured numerous energy rich

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<sup>5</sup> Erica Downs, "China," *The Brookings Foreign Policy Studies Energy Security Series* (2006), p. 10. Accessed: 16 July 2012, URL: <http://www.brookings.edu/~media/research/files/reports/2006/12/china/12china.pdf>

<sup>6</sup> Zha Daojiong, "China's Energy Security and its International Relations," *The China and Eurasia Forum Quarterly*, vol.3, no.3 (2005): p. 42.

<sup>7</sup> Heinrich Kreft, "China's Quest for Energy," *Policy Review*, Issue 139 (2006): p. 65.

<sup>8</sup> Ibid.

<sup>9</sup> Downs, "China," p. 37.

<sup>10</sup> Philip Andrews-Speed and Roland Dannreuther, *China Oil and Global Politics* (London: Routledge, 2011), p. 76.

<sup>11</sup> Kreft, "China's Quest for Energy," p. 65.

<sup>12</sup> Erica Downs, *China's Quest for Energy Security* (Santa Monica: Rand Corporation, 2000), p. 18. Accessed: 16 July 2012, URL: <http://www.dtic.mil/cgi-bin/GetTRDoc?AD=ADA384039>

countries from across the globe into permitting Chinese NOCs to enter into their energy sectors. Although Western nations frown upon the state assistance that China's NOCs receive, the PRC reasons that, since the international oil market is dominated by Western companies, Chinese oil firms cannot gain a competitive standing without Beijing's assistance in their foreign ventures.<sup>13</sup> As a result of China's influence over its NOC's overseas energy activities, the PRC's oil companies are considered to be proxies for advancing Beijing's international interests; hence the reason why China's NOCs are characterised as arms of the Chinese government and perceived as a threat by the West who consider them to be a destabilising force in global energy markets.<sup>14</sup> Nevertheless, in spite of the West's outcry against China's unwillingness to distance itself from its NOCs, Chinese oil corporations, together with Beijing's aid, continue to press forward in their relentless mission to 'lock up' international energy supplies. It has been outlined that, unlike Beijing's Western counterparts who undertake a liberal market-oriented approach towards securing energy supplies, China, in perceiving the accumulation of oil as a zero-sum game, has opted for a mercantilist stance to characterise its energy strategy. Due to the heavy influence of the state in China's NOC's business dealings and Beijing's unilateral stance towards fuel resource procurement, mercantilism is a term that has become synonymous with China's energy drive.

In its oil diversification efforts, China has spread its economic and diplomatic interests to wherever there are excess hydrocarbon resources.<sup>15</sup> Beijing has inevitably sought to secure oil imports from the world's richest oil regions, most notably the Persian Gulf.<sup>16</sup> Noting the Persian Gulf's rich endowment in 'black gold', Chinese foreign policy has prioritised improving relations with Gulf States as, "officials regard the region to be of long-lasting geo-economic and geopolitical significance."<sup>17</sup> Moreover, in the interest of ensuring energy security, Beijing is especially attracted to Gulf producers because of their, "large proven oil reserves, idle surplus capacity and relatively low development and production costs."<sup>18</sup> As a result, China's NOCs, with assistance from government, have endeavoured to gain a stronger

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<sup>13</sup> Downs, "China," p. 41.

<sup>14</sup> Chen Shaofeng, "Assessing the Impact of China's Foreign Energy Quest on its Energy Security," *East Asian Institute (EAI)*, Working Paper No.145 (2009): p. 1. Accessed: 23 June 2012, URL: <http://www.eai.nus.edu.sg/EWP145.pdf>

<sup>15</sup> Zha Daojiong, "China's Energy Security and its International Relations," p. 53.

<sup>16</sup> Hongyi H. Lai, "China's Oil Diplomacy: is it a global security threat?" *Third World Quarterly*, vol.28, no.3 (2007): p. 522.

<sup>17</sup> John Calabrese, "China and the Persian Gulf: Energy and Security," *Middle East Journal*, vol.52, no.3 (1998): p. 353.

<sup>18</sup> *Ibid.*, p. 356.

foothold in this region's energy sector by acquiring long-term supply contracts as well as oil exploration and development projects.<sup>19</sup> By fostering closer economic relations with oil-producing Gulf States, China hopes to gain its fair share of oil from a region that is dominated by the US. Via the establishment of economic interdependence, Beijing aims to lock into the Gulf's fuel reserves as energy experts predict that the Persian Gulf will remain an important source of crude oil for China over the next 25 years.<sup>20</sup>

Although the marked expansion of Chinese diplomatic, energy and economic interests in the Gulf represents one of the most important geopolitical trends of the 21<sup>st</sup> century, China, aware of the United States' dominant role in the Middle East,<sup>21</sup> has treaded carefully in the region in order to avoid being perceived by Washington as a threat to its hegemonic position in the area. Yet, as a result of its markedly improved presence in the Persian Gulf, Beijing has been thrust into the mix of diplomacy and tensions surrounding the dispute over Iran's nuclear ambitions. As a result, the Sino-Iranian relationship has been placed under intense scrutiny as a US-led international coalition calls upon China to support efforts to dismantle Iran's nuclear programme. Sino-Iranian economic ties have evolved to become highly robust despite the international community's attempts to increase the diplomatic and economic isolation of Iran vis-à-vis intensified sanctions.<sup>22</sup> Moreover, since China's relations with Iran are primarily shaped by its growing energy needs, Beijing has been reluctant to throw its weight behind international efforts to isolate Tehran. Given that Beijing's growth is largely driven by its strong relationship with the West, particularly the US, China's association with Iran has the, "potential to become too great a liability to maintain."<sup>23</sup> However, unlike other nations which have minimised their interactions with the Islamic Republic, Beijing has intensified its economic investments in the country despite international sanctions. Due to the pull out of Western energy companies from Iran, China is presented with increased access to Iran's oil and gas reserves.<sup>24</sup> Caught between maintaining comity with the US and its energy interests in Iran, China has chosen a balanced and pragmatic response to its 'Persian Gulf

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<sup>19</sup> Calabrese, "China and the Persian Gulf: Energy and Security," p. 356.

<sup>20</sup> Downs, "China," p. 2.

<sup>21</sup> The Middle East is traditionally comprised of Armenia, Azerbaijan, Bahrain, Gaza Strip, Georgia, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Syria, Turkey, UAE, West Bank and Yemen.

<sup>22</sup> Aaron Morris, "From Silk to Sanctions and Back Again: Contemporary Sino-Iranian Economic Relations," *Al Nakhlah: Online Journal on Southwest Asian and Islamic Civilization*, (2012):p. 1. Accessed: 26 February 2013, URL:

[http://fletcher.tufts.edu/~media/Fletcher/Microsites/al%20Nakhlah/archives/Winter2012/Morris\\_Final.pdf](http://fletcher.tufts.edu/~media/Fletcher/Microsites/al%20Nakhlah/archives/Winter2012/Morris_Final.pdf)

<sup>23</sup> Ibid.

<sup>24</sup> Ibid.

Dilemma'. Beijing has sought to appease both sides by condemning Iran's nuclear proliferation ambitions whilst simultaneously voicing that Tehran has a right to utilise nuclear energy for peaceful purposes.

Based on various assessments of China's stance on sanctions against Iran it has been noted that, although Beijing condemns the use of sanctions to coerce Iran into giving up its nuclear aspirations, China has nonetheless played a role in the issuing of United Nations (UN) sanctions against the Islamic Republic. Despite this, the PRC has shielded Iran from the imposition of aggressive UN sanctions as Beijing has delayed the passage of, and diluted each, Security Council Resolution aimed at Iran, thus providing Tehran with diplomatic cover and extended time to advance its nuclear plans.<sup>25</sup> Furthermore, by 'softening' UN sanctions against Tehran, China has ensured the protection of Chinese investments in Iran and the production and export of Iranian fuel to its shores.<sup>26</sup> In light of China's soft handling of the Iranian nuclear issue, the PRC's determination towards preventing the possibility of a nuclear Iran is being questioned. Although Chinese officials have on numerous occasions reassured the West that they condemn Tehran's nuclear proliferation aspirations,<sup>27</sup> numerous analysts such as Berman highlight that China's energy interests are preventing Beijing from assuming a more aggressive stance against the Islamic Republic.

### **1.1. Research Question**

How does Beijing maintain Iranian oil imports and at the same time uphold stable relations with Washington in the face of an American-led international campaign for sanctions against Tehran?

### **1.2. Main Argument**

In light of recent sanctions against Iran, China's continued economic engagement with the Islamic Republic is motivated by its energy interests.

### **1.3. Objectives**

- The first research objective is to prove that China's improved position and keen interest in the Persian Gulf is motivated by its energy interests.

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<sup>25</sup> John W. Garver, "Is China Playing a Dual Game in Iran?" *The Washington Quarterly*, vol.34, no.1 (2011): p. 76.

<sup>26</sup> Ibid.

<sup>27</sup> Ilan Berman, "Beijing's Iranian Gamble," *Far Eastern Economic Review*, vol.172, no.3 (2009): p. 55.

- The second aim of this thesis is to outline that energy mercantilism underpins China's accumulation of hydrocarbon resources, especially oil.
- Thirdly, this thesis demonstrates that, stemming from China's energy security concerns, Beijing will continue to import Iranian oil whilst simultaneously attempting to maintain stable relations with the US.

#### **1.4. Methodology**

The methodology adopted for this thesis is that of a literature survey. The consulted literature, as reflected in this thesis, can be separated into three categories, namely China's energy security/strategy, China's Gulf strategy and Sino-Iranian Relations. When collectively viewed, these three categories provide a holistic view from which one can assess China's capacity to maintain its energy interests in Iran in the face of sanctions against the Islamic Republic. The expanding literature on China's oil diplomacy and energy security covers an array of issues yet, although the collection of articles reviewed has been informative, they also have their limitations. Firstly, in some cases the data relating China's oil consumption and imports is outdated, only accounting for the 1990s to early 2000s. Secondly, the varying estimates of the PRC's future oil consumption and production make it difficult to substantially grasp the magnitude of China's projected oil deficit and subsequent energy demands. Moreover, most of the literature pertaining to Sino-Iranian relations predominantly situates Iran-China ties within the PRC's foreign policy. There are a very few articles and studies that have taken into consideration factors (aside from alleviating the effects of sanctions) that influence Iran's approach towards Beijing. In addition, Sino-Iranian relations and China's expanding influence in the Gulf are mainly analysed from a Western perspective. As a result, Beijing-Tehran ties have been generally assessed to determine the potential effects that this relationship will have on the West, especially the US – a nation that has a long record of being at odds with Iran.

#### **1.5. Theoretical Background**

This thesis is informed by mercantilism, particularly energy mercantilism. However, it is not concerned with the economic intricacies of mercantilism but rather with its appeal for the dominance of the state in economic co-ordination and how this is reflected in China's pursuit of fuel resources. Mercantilism is one of the oldest approaches, and arguably the most important one, to the study of the international political economy (IPE). Although

mercantilism dates back to the sixteenth and seventeenth centuries, its tenets are still influencing economic practises and policies around the globe. Mercantilism is not a systematic theory but a coupling of policy prescriptions and ideas that were often noted on pamphlets. This school of thought aligns closely with realism as mercantilists assert that the, “nation state and the interplay of national interests (as opposed to corporate interests),” are the main determinants of the world economy.<sup>28</sup> Mercantilism is essentially typified by government’s attempts to manipulate the market in order to maximise their own interests, irrespective of whether this is at the expense of others. In short, Gilpin argues that, “each nation will pursue economic policies that reflect domestic needs and external political ambition without much concern for the effects of these policies on other countries or on the international economic system as a whole.”<sup>29</sup>

Although mercantilism contains various ideas and doctrines there are three core tenets that typify this school of thought. Firstly, mercantilists are concerned with the dominance of national interest in economic policy. Secondly, they stress the role of the state in dictating economic activity; and lastly, mercantilism emphasises the importance of creating a favourable trade balance to establish a wealthy nation. Although the classical mercantilist thinkers stressed different elements of mercantilist thought, there was a general recognition that national security, state building and the creation of economic wealth were interconnected. Thus, mercantilists advocated that economics and politics were inseparable, with the state assuming the oversight of political-economic dealings.<sup>30</sup> This position is strongly opposed by liberal economic theory (as in those theories proposed by Smith, Ricardo and Hayek) which stresses that individual enterprise devoid of state interference is the most rational plan for advancing a nation’s economy.

Early mercantilists’ contribution to the study of IPE lies in their acknowledgement and rationalisation of the state’s role in regulating the domestic economy to obtain wealth, security and the fulfilment of national interests. Mercantilism’s emphasis on state

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<sup>28</sup> Harry Stephan and Michael Power, *The Scramble for Africa in the 21<sup>st</sup> Century: From the Old World to the New* (Cape Town: Renaissance Press, 2012), p. 16.

<sup>29</sup> *Ibid.*, p. 17.

<sup>30</sup> Using the example of England’s Corn Laws, the establishment of the iron industry, and navigation acts, Lipson depicts the interaction between economic and political spheres and highlights that economic issues must be subordinate to national interest. – Ephraim Lipson, *Planned Economy or Free Enterprise* (London: Adam and Charles Black, 1946), pp. 62-63.

For background on the conception of political economy see: Robert Gilpin, *The Political Economy of International Relations* (New Jersey: Princeton University Press, 1987), pp. 10-11.

intervention was particularly prevalent in the 18<sup>th</sup> and early 19<sup>th</sup> centuries. Whereas classical mercantilism was primarily concerned with gaining wealth and power, economic nationalism (a form of mercantilism in the late 18<sup>th</sup> and 19<sup>th</sup> centuries) focused on the internal development of the national economy effectively arguing for a planned economy. During this era, mercantilist thinkers, particularly the German historical economists (who proposed inherently mercantilist measures to develop their country into a major power) deemed state intervention necessary for promoting the economic growth of developing nations, essentially advocating that the, “state should be the main determinant of organised political, economic, and social activity.”<sup>31</sup> This contradicted Adam Smith’s *Wealth of Nations*, which argued that competitive markets and rational human nature should be relied on to generate economic prosperity.

In retaliation against liberal prescriptions of laissez-faire economic progress, mercantilists advocated that mercantilism should underpin the development of nations. In line with its concerns regarding accumulation and protectionism, the mercantile system focused on establishing, “the best policies for promoting the wealth and power of the nation.”<sup>32</sup> In opposing the prescriptions of liberal economic development, mercantilists argued that instead of the state distancing itself from the economy it should assume a central position in guiding economic activity.<sup>33</sup> Ultimately, almost every branch of industry was (to some extent) brought under the control of the state. It must, however, be noted that mercantilists did not argue for a totalitarian state, rather they emphasised that the state should serve as a guide and not a dictator of economic activity.<sup>34</sup> Fundamentally, mercantilists purported that government’s effective and efficient organisation of private capital and handling of market forces would ensure the development of the national economy. Based on the evolution of mercantilist thought over the centuries, Moffat suggests that mercantilism can be categorised into two prescriptions. Firstly, it may be described as a system that strives for the protection and direction of industry by the state, or secondly, mercantilism can be considered as the state’s control and exploitation of economic opportunities for solely national ends.<sup>35</sup> According to Moffat, the second outlook is a better interpretation as he deems that,

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<sup>31</sup> W. Raymond Duncan, Barbra Jancar-Webster and Bob Switky, *World Politics In The 21<sup>st</sup> Century: Student Choice Edition* (Boston: Houghton Mifflin Harcourt Publishing Company, 2009), p. 414.

<sup>32</sup> David Colander and Harry Landreth, *History of Economic Thought* (Boston: Houghton Mifflin, 2002), p. 44.

<sup>33</sup> Duncan, Jancar-Webster and Switky, *World Politics In The 21<sup>st</sup> Century: Student Choice Edition*, p. 414.

<sup>34</sup> Ibid.

<sup>35</sup> James E. Moffat, “Nationalism and Economic Theory,” *Journal of Political Economy*, vol.36, no.4 (1928): p. 423.

“mercantilism means not so much the protection of industry as the control and direction of industry in the interests of achieving national strength.”<sup>36</sup>

Although liberal economic practises have been adopted as the global norm, mercantilist influences are nevertheless still prevalent. This is especially reflected in China’s energy strategy. Beijing’s pursuit of energy supplies displays an adherence to mercantilist prescriptions of governmental interference in the market to realise its strategy of obtaining secure and reliable fuel supplies and additionally underlines the notion that the state should maintain a central role in the development of a strong economy. The postulations that Beijing has chosen a politically motivated and state-oriented approach to energy security lies in the government’s entrenched influence in China’s energy sector and Beijing’s hand in its NOCs international procurement of fuel resources. The state-centred structure of China’s economy (particularly its energy sector) means that the PRC depends greatly on state-owned enterprises (SOEs) to fulfil its fuel needs.<sup>37</sup> Due to this state-centric approach, business decisions take place within a structure that entrenches the dominance of China’s NOCs and the CCP’s influence within these companies. An advantage of this mercantilist approach to energy policy is that the role of the market in determining supply, pricing and distribution of energy resources is limited.<sup>38</sup>

On the international front, Beijing is pursuing an energy mercantilist strategy. Although China pragmatically participates in global energy markets, it has simultaneously taken precautions to guard against supply and price disruptions. Since China distrusts the markets to fulfil present and projected energy needs, Beijing, via its NOCs, has taken subsequent measures in the form of equity agreements to hedge against sub-optimal occurrences in the global oil market.<sup>39</sup> Due to this mercantilist approach to energy security, China, in search of securing offshore oil assets, has extended extensive diplomatic, political and economic assistance to those NOCs who aim to procure favourable overseas energy deals. This approach to securing energy supplies has come to be known as energy mercantilism, an emerging resource accumulation strategy that basically circumvents the market in favour of inter-governmental dealings to secure fuel resources. This strategy, as will be highlighted in chapter two, is particularly evident in China’s oil diplomacy. Even though the Chinese deny

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<sup>36</sup> Moffat, “Nationalism and Economic Theory,” p. 423.

<sup>37</sup> John Lee, “China’s Geostrategic Search for Oil,” *The Washington Quarterly*, vol.35, no.3 (2012): p. 75.

<sup>38</sup> Ibid.

<sup>39</sup> Ibid.

subscribing to mercantilist influences because of the international opprobrium that would stem from such claims, it is nevertheless undeniably evident that Beijing's energy strategy is influenced by the mercantilist argument for state intervention.

## **1.6. Chapter Outline**

Chapter two highlights that Beijing's oil accumulation strategy displays mercantilist undertones. By shedding light on mercantilism's advocacy for state intervention and outlining energy mercantilism (a resource accumulation strategy that mainly bypasses international commodity markets in favour of inter-governmental dealings), this chapter conveys that, due to the state-centred structure of China's energy sector and the heavy involvement of the Chinese government in their national energy companies' (NECs) foreign ventures, Beijing's oil strategy does indeed have mercantilist characteristics. Secondly, by touching on China's belief that international markets favour Western nations, this chapter outlines that in seeking an advantage in the global oil accumulation game, Beijing's mercantilist oil diplomacy has also been extended to pariah states.

Chapter three demonstrates that, in light of calls from the West for the PRC to distance itself from Iran, China, due to Beijing's longstanding relations with Tehran and the geo-economic and strategic factors that rationalise relations with the Islamic Republic, has thus far been unwilling to sacrifice its ties with Tehran for international collective security interests. However, since the PRC is not heavily dependent on the Islamic Republic for its economic development and national security, this chapter hints at the possibility that, if Washington-Tehran tension were to heighten, there is a high chance that China would forsake its relations with Iran to remain in favour with the West, especially the US.

Chapter four emphasises the importance of the Persian Gulf for China's energy security and aims to demonstrate that Beijing has sought to improve relations with Gulf countries in an attempt to secure and guarantee energy supplies for China. However, aware of America's possessiveness over this region, this chapter stresses that Chinese foreign policy also attempts to delicately balance the maintenance of stable relations with Washington against China's interests in developing multi-dimensional relations with energy rich Gulf nations. This is most aptly depicted by China's handling of its 'Persian Gulf Dilemma' – a dilemma characterised by Beijing's reluctance to side with either the West (particularly the US) or Iran over the latter's nuclear issue as the costs of siding with either party are too great for any nation, let alone a rising 'superpower'. Instead, in an effort to protect its interests with both

parties, Beijing has chosen a balanced, middle-of-the-road approach which essentially colours China's response to sanctions against Iran.

Lastly, chapter five provides a summary of the thesis and discusses the possibility of Beijing scaling down its energy commitments in Iran in order to uphold Sino-American relations.

## CHAPTER 2

### China's Mercantilist Oil Strategy

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Since Beijing joined the oil-importing club in 1993, the question of how China fuels itself has generated a substantial amount of literature. Throughout this body of literature there seems to be one shared view in particular that, unlike industrialised Western nations that opt for a liberal-democratic approach towards global energy markets, China has adopted a zero-sum mercantilist outlook. In line with this view, this chapter aims to demonstrate that Beijing pursues energy resources in a mercantilist fashion. However, it must be noted that this chapter does not intend to delve into the intricacies of mercantilism, instead by emphasising this theory's advocacy of state intervention which is particularly evident in energy mercantilism; this chapter demonstrates that, through the state-dominated structure of its energy sector, China takes a state-centric approach towards securing energy supplies.

Due to China's demand-induced energy scarcity situation,<sup>40</sup> the Chinese have acknowledged that a majority of their energy needs, especially their oil requirements, will have to be met with imports. This becomes starkly evident when analysing the PRC's flat oil production and projected output decline. The annual deficit in China's oil supplies is expected to rise to 197 million tonnes in 2015 and leap to 250 million tonnes in 2020.<sup>41</sup> In the face of rising energy demands, the CCP realises that oil is the only energy fuel that could pose a threat to its survival, as it needs to be imported in large quantities to satisfy societal and economic dependency. This places immense pressure on China to engage actively in the international energy market and vigorously pursue overseas oil supplies to ensure its energy security. Thus, Chinese NOCs, with the support of their government, have stepped into the international oil scene with the aim of internationalising China's oil industry. Although Chinese government officials have never clearly outlined their objectives for substantially influencing their NOCs, China's intentions of considerably increasing the number of countries that supply oil to the PRC and gaining direct ownership over vital foreign reserves became particularly transparent when its energy companies went on a global shopping spree in the aftermath of the global financial meltdown. In 2009 China spent an estimated US\$ 18

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<sup>40</sup> Demand induced scarcity, "results from population growth within a region or increased per capita consumption of a resource, either of which heightens the demand for the resource." – Val Percival and Thomas Homer Dixon, "Environmental Scarcity and Violent Conflict: The Case of South Africa," *Journal of Peace Research*, vol.35, no.3 (1998): p. 280.

<sup>41</sup> Pak Lee, "China's Quest for Oil Security: Oil (Wars) in the Pipeline?" *The Pacific Review*, vol.18, no.2 (2005): p. 267.

billion on merger and acquisition deals in upstream oil and gas and, in 2010, this figure increased to US\$ 29.39 billion.<sup>42</sup> China's aggressive pursuit of 'locking up' oil supplies has raised anxiety levels, particularly those of Washington. According to former US Deputy Secretary of State, Robert Zoellick, China's 'locking up' of fuel supplies in the form of equity agreements has raised Washington's anxiety over its energy security.<sup>43</sup> Furthermore, aside from the PRC's equity agreements which "remove millions of barrels of oil from the supply pool,"<sup>44</sup> the international community is also concerned with Beijing's willingness to engage with pariah states to secure energy resources.<sup>45</sup>

## **2.1. Energy Mercantilism: Bypassing the Market through State Intervention**

### **2.1.1. The Mercantilist Advocacy for State Intervention**

Before broaching energy mercantilism, a brief overview of mercantilism's advocacy for state intervention is required, since government involvement underpins this energy strategy. It is essential to keep in mind when attempting to interpret mercantilist thought that, despite its primacy in IPE, it does not have a universal definition. This is due to the various interpretations of mercantilism and the consequent varieties of mercantilist thought that prevailed in Britain, France and Germany from the 16<sup>th</sup> to the 18<sup>th</sup> century.<sup>46</sup> Despite the numerous variations of mercantilism that were produced with the progress of history, the emphasis placed on the state to assume control of the nation's economic life has remained the core thesis of this school of thought.<sup>47</sup> By emphasising the necessity of governmental interference in market principles or the economic order, mercantilism advises that governments should maintain a central role in the development of a strong national economy in order to ensure the security of the state. Thus, in taking this political-economy approach, Gilpin defines mercantilism as the, "attempts of governments to manipulate economic arrangements in order to maximise their own interests, whether or not this is at the expense of

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<sup>42</sup> Roland Dannreuther, "China and Global Oil: Vulnerability and Opportunity," *International Affairs*, vol.87, no.6 (2011): p. 1346.

<sup>43</sup> *Ibid.*, p. 1349.

Michael T. Klare, "Fuelling the Dragon: China's Strategic Energy Dilemma," *Current History*, vol.105, no.690 (2006): p. 182.

<sup>44</sup> Cherie Canning, "Pursuit of the Pariah: Iran, Sudan and Myanmar in China's Energy Security Strategy," *Security Challenges*, vol.3, no.1 (2007): p. 51.

<sup>45</sup> Linda Jakobson and Zha Daojiong, "China and the Worldwide Search for Oil Security," *Asia-Pacific Review*, vol.13, no.2 (2006): p. 65.

<sup>46</sup> *Ibid.*

<sup>47</sup> Philip W. Buck, *The Politics of Mercantilism* (New York: Octagon Books, 1974), p. 21.

others. These interests may be related to domestic concerns (such as full employment and price stability) or to foreign policy (such as security and independence).”<sup>48</sup>

This notion of the state’s primacy in a nation’s economic endeavours is clearly demonstrated by the classical mercantilist period (1500-1800). By emphasising domestic production and the control of export markets, classical mercantilism was essentially an economic policy that shaped the relationship between Western European powers and their overseas territories.<sup>49</sup> Fundamentally, mercantilism promoted policies of political and economic self-reliance and the creation of wealth through the means of a favourable balance of trade (exporting more and importing less).<sup>50</sup> Since gold and silver were the currency of trade at the time, bullionism (which proposes that the state and national economy can be measured by the amount of gold and silver it possesses) was used to measure a state’s national economy.<sup>51</sup> Thus, mercantilists advocated that the strength of a country could be determined or measured by its accumulation of gold.<sup>52</sup> Mercantilists reasoned that, in an effort to strengthen the nation, a successful trade policy would ‘swell government coffers’ and thus lead to the development of a strong nation.<sup>53</sup> Bullionism required that a nation always maintained a favourable balance of trade. This essentially meant that, in order to increase the amount of gold in the national treasury, the value of the state’s exports would have to be greater than its imports.<sup>54</sup> Mercantilists argued that this could only be achieved by government intervention in the form of state subsidies for exporting industries and the discouragement of imported manufactured goods through the imposition of high tariffs, duties or quotas. Thus, in an attempt to secure power and the nation’s welfare, “the state was always entitled, frequently obligated and generally invited to exercise control over most of the economic activities of the nation.”<sup>55</sup> In this context, mercantilists were essentially lobbying for an economic system that was in the, “strictest sense of the words, a political economy.”<sup>56</sup> This prescription of extensive state regulation in a nation’s economy is what chiefly divides the mercantilists from their laissez-

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<sup>48</sup> Robert Gilpin, “Three Models of the Future,” *International Organisation*, vol.29, no.1 (1975): p. 45.

<sup>49</sup> Audra Diptee, “Mercantilism,” in *Colonialism: An International, Social, Cultural and Political Encyclopaedia*, ed. Melvin E. (California: ABC-CLIO, 2003). p. 384.

<sup>50</sup> Alexander Hamilton, “Excerpts From Report on Manufactures,” in *International Political Economy: State Market Relations in the Changing Global Order*, eds. C. Roe Goddard, John T. Passé-Smith and John G. Conklin (Colorado: Lynne Rienner Publishers, 1996), p. 75.

<sup>51</sup> Diptee, “Mercantilism,” p. 384.

<sup>52</sup> Ibid.

<sup>53</sup> Ibid.

<sup>54</sup> Ibid.

<sup>55</sup> Buck, *The Politics of Mercantilism*, p. 72.

<sup>56</sup> Ibid., p. 74.

faire counterparts.<sup>57</sup> Mercantilists did, however, differ on the extent of state involvement in the economy. This is particularly demonstrated by Germany's historical school's theorists Friedrich List (1789-1846) and Gustav von Schmoller (1838-1917).

In the early stages of development, List argued that the state should (via protectionist policies) be heavily involved in developing national industry. However, once mercantilist economic policies had assisted the nation in achieving a thriving national industry, List advocated that the state needed to adopt laissez-faire means to maintain economic development. List reasoned that, once a state achieved manufacturing supremacy, it needed to orientate itself towards the competition spawned from free trade to, "protect its own manufacturers and merchants against retrogression and indolence."<sup>58</sup> Thus, in this context List sided with some liberal economic conclusions and rejected a few mercantilist ideas.

Unlike List's developmental model, which is a progression from protectionism to free trade, Schmoller emphasised that even if a state achieved industrial supremacy, it should not prescribe to laissez-faire means to maintain economic development. Instead, Schmoller stressed that the state and national economy should remain intertwined as, "economic forces, while living for themselves, should yet entirely serve the state, and that the state, pursuing its own ends, should at the same time place all its might and all its members in the true service of the national economy."<sup>59</sup> The core of mercantilism for Schmoller was not just simply modern state making, but, "state making and national economy making at the same time."<sup>60</sup> This insistence on the dual makeup of mercantilism is strongly juxtaposed against List's eventual separation of the state and economy. Although List and Schmoller differ on the extent of state interference in national economic advances, both scholars convey a nationalistic sense of development. List advocated that a national economy's development would be hindered if it did not, "constitute factors of national scale and national policy."<sup>61</sup> Meanwhile, Schmoller suggested that the essence of mercantilism lay, "in the total transformation of society and its organisation, as well as of the state and its institutions, in the replacing of a local and territorial economic policy by that of the national state."<sup>62</sup>

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<sup>57</sup> Buck, *The Politics of Mercantilism*, p. 78.

<sup>58</sup> Friedrich List, *National System of Political Economy Volume 2: The Theory* (New York: Cosmo, Inc., 2006), p. 87.

<sup>59</sup> Gustav von Schmoller, *The Mercantile System and its Historical Significance* (New York: The McMillan Company, 1897), pp. 90-91.

<sup>60</sup> *Ibid.*, p. 50.

<sup>61</sup> *Ibid.*, p. 12.

<sup>62</sup> *Ibid.*, p. 51.

Essentially, mercantilism was seen not so much in terms of the protection of national industry, but as a representation of the state's control and manipulation of economic activities for purely national interests.<sup>63</sup>

### 2.1.2. State Intervention in the Contemporary World

In light of the contemporary world largely adhering to liberal economic prescriptions, mercantilism is considered to be an archaic description of economic functioning. However, mercantilism is still prevalent, albeit under various *modi operandi*.<sup>64</sup> By providing mercantilism with the alias of state-capitalism, Schneider outlines that, aside from traditional mercantilist undertakings such as protectionist policies, subsidies, national industries and state-backed national champions, mercantilist entities have also emerged in the form of state-owned enterprises, public-private partnerships, and the state as a minority shareholder.<sup>65</sup> Thus, state intervention in economic life is still prevalent as contemporary mercantilism draws on the classic mercantilist strategy of state intervention for promoting and protecting domestic industry and ensuring SOE's competitiveness. State intervention, in the form of financial incentives (protectionist measures, trade remedies or state subsidies) are therefore still utilised in order to achieve a semi-free market.<sup>66</sup> By primarily adhering to its classical roots, contemporary mercantilism (or state-capitalism), "is favoured not because it is the most efficient way of producing and distributing goods, but because it serves political aims."<sup>67</sup> Instead of relying on markets, which by operating in the moment are unable to foresee the results of market engagement, mercantilism opts for, "foreseeable, clear-cut outcomes that can be planned or influenced by the state."<sup>68</sup> Hence, mercantilism prioritises, "economic and political objectives over considerations of global efficiency."<sup>69</sup> This is particularly evident in energy mercantilism.

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<sup>63</sup> Moffat, "Nationalism and Economic Theory," p. 422.

<sup>64</sup> Gilpin, "Three Models of the Future," pp. 45-46.

<sup>65</sup> Henrique Schneider, "State-capitalism and Globalisation – a Challenge to Whom?" *Iliria International Review*, Issue 2 (2012): p. 122.

<sup>66</sup> *Ibid.*, p. 126.

<sup>67</sup> *Ibid.*, p. 123.

<sup>68</sup> *Ibid.*, pp. 123-124.

<sup>69</sup> Gilpin, "Three Models of the Future," p. 45.

### 2.1.3. Energy Mercantilism: Bypassing the Market

Although the world relies mainly on the open marketplace to determine the distribution and price of fuel resources, the emergence of energy mercantilism (an energy security strategy) has led to the questioning of the market's credibility as an effective mechanism for ensuring energy supply security. As a result, numerous nations (especially Asian states) are bypassing the global energy market with equity agreements to secure fuel resources – particularly oil.

Energy mercantilism has gained significance in the international hydrocarbon scene due to a renewed focus on energy security, especially amongst countries that are highly dependent on energy supplies to drive their economic development. Heightened energy insecurity fears stem from several factors, namely, an increasingly tight oil market and rising oil prices, unstable energy exporting countries, the threat of terrorism, nationalist fervour over indigenous resources, suspicions of a scramble for resources, geopolitical tensions and a country's inherent need to feed its economic growth.<sup>70</sup> In addition to these factors, there is a worldwide anxiety over whether there will be a sufficient amount of resources to meet the world's future energy demands. Stemming from these concerns, energy is now placed at the top of many national agendas.<sup>71</sup> Numerous countries (particularly industrialising Asian nations) are responding to their energy insecurity fears with an array of strategies that endeavour to guarantee supply and price stability. Efforts directed towards improving energy security range from traditional dependence on cooperative market approaches to a more hard-line competitive, mercantilist stance.<sup>72</sup> The latter approach has drastically changed the way that oil is bought as markets are undermined by countries such as China and India who circumvent the market by 'locking up' fuel supplies directly with energy producing nations.<sup>73</sup> Since energy mercantilism is typified by governments' use of NECs to advance strategic national interests, Leverett aptly defines resource or energy mercantilism as:

*The use of economic and foreign policy instruments by national governments to help their state-owned national energy companies (NECs) secure access to overseas*

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<sup>70</sup> Daniel Yergin, "Ensuring Energy Security," *Foreign Affairs*, vol.85, no. 2 (2006): p. 69.

<sup>71</sup> *Ibid.*, p. 70.

<sup>72</sup> Mikkal E. Herberg, *Asia's Energy Insecurity: Cooperation or Conflict*, p. 340. Accessed: 18 April 2013, URL: <http://www.scribd.com/doc/131589490/ASIA%E2%80%99S-ENERGY-INSECURITY-COOPERATION-OR-CONFLICT>

<sup>73</sup> Donald Miller, *Energy Mercantilism: Is Private Oil Threatening the NYMEX?* Accessed: 15 March 2013, URL: <http://www.investmentu.com/2007/%E2%80%A6/20070125.html>

*hydrocarbon resources on a more privileged basis than simple supply contracts based on market prices.*<sup>74</sup>

Energy mercantilism seems to be a popular strategy amongst industrialising countries for securing hydrocarbon resources, as the purchase of equity barrels eliminates market price risk and it is comparatively low-priced when compared to oil sold on the international markets.<sup>75</sup> However, the equity route directly counters the market in terms of pricing and distribution. When oil is traded globally on the New York Mercantile Exchange (NYMEX) and other bourses, customers pay approximately the same price for their oil. However, long-term bilateral supply contracts avoid market dictations, as energy producers, when dealing directly with a potential customer, can pursue various pricing strategies that entail political agreements and thereby utilising alternative methods of payment (such as development of infrastructure, aid and trade agreements) to secure oil supplies.<sup>76</sup>

Pursuing hydrocarbon resources in this manner essentially undermines and distorts the functioning of the market as the energy mercantilist approach sets oil prices at a fixed price, irrespective of future market fluctuations. Thus, all states will not pay the same price for their oil. As a result, energy mercantilism ultimately counters market pricing and destabilises the supply and distribution networks that determine oil prices.<sup>77</sup> This is a concern for Western countries that mainly rely on the market for their oil supplies. From the West's perspective, "bilateral deals lock up too much of the world's oil supplies and harm the liquidity of the open market."<sup>78</sup> Moreover, off-market supply contracts make Western nations susceptible to price shocks and volatility as off-the-market deals result in global markets struggling to "manage tight markets, shortages, and disruptions to supply."<sup>79</sup> However, despite the aforementioned concerns over energy mercantilism, countries such as China remain bent on pursuing oil assets in an energy mercantilist manner.

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<sup>74</sup> Flynt Leverett, "Resource Mercantilism and the Militarization of Resource Management," in *Energy Security and Global Politics: The Militarisation of Resource Management*, eds. Daniel Moran and James A Russell (New York: Routledge, 2009), p. 211.

<sup>75</sup> Erica Downs, "The Chinese Energy Security Debate," *The China Quarterly*, vol.177 (2004): p. 35.

<sup>76</sup> Simon Wilson, "Russia, Iran and a dangerous Axis of Oil." Accessed: 15 March 2013, URL: <http://www.moneyweek.com/investments/commodities/russia-iran-and-a-dangerous-axis-of-oil>

<sup>77</sup> Miller, *Energy Mercantilism: Is Private Oil Threatening the NYMEX?*

<sup>78</sup> Wilson, "Russia, Iran and a dangerous Axis of Oil".

<sup>79</sup> Ibid.

#### 2.1.4. The Mercantilist Structure of China's Energy Sector

Beijing's fast-paced economic development is inevitably accompanied by a demand for natural resources, especially oil. Since energy resources are the main ingredient for any economy to function optimally, nations around the globe view, "energy security as an inherent component of their national interests."<sup>80</sup> Aside from a reliable and uninterrupted energy supply, Beijing also considers a cheap supply of energy to be essential to its national and domestic interests.<sup>81</sup> Although the pursuit of a relatively cheap and secure access to overseas oil is vital for decreasing economic risk in all oil-importing nations, in China's case securing favourable access to energy resources is deemed necessary for mitigating threats to the survival of the CCP.<sup>82</sup>

Since China is not a democratic country, the CCP stakes its legitimacy on bettering the lives of the country's citizens by delivering continuous economic growth. In order to achieve this, large amounts of energy supplies are considered to be a prerequisite for maintaining relentless development.<sup>83</sup> Thus, a potential disruption to oil supply and unforeseeable price increases may lead to a stagnating Chinese economy. This could fuel mass discontent which may destabilise the CCP's hold over the country.<sup>84</sup> In an effort to avoid such a scenario, Chinese leaders consider an annual gross domestic product (GDP) growth of eight percent with minimum inflation as the key to maintaining social stability and regime security.<sup>85</sup> Given that industrial development requires large amounts of oil imports, the CCP has, in order to mitigate risks to its regime survival, avoided solely relying on international markets to meet its energy needs. Instead, since the Chinese economy evolved from being predominantly private-sector orientated (prior to 1989) to state-sector run (since the mid-1990s), the accumulation of energy supplies has fallen mostly under state oversight.<sup>86</sup> Essentially, China's state-centred political economy considers energy policy, regime security

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<sup>80</sup> Lee, "China's Geostrategic Search for Oil," p. 77.

Jansuz Bielecki, "Energy security: is the wolf at the door?" *The Quarterly Review of Economics and Finance*, vol.42, no.2 (2002): p. 236.

<sup>81</sup> Ibid.

<sup>82</sup> Lee, "China's Geostrategic Search for Oil," pp. 77-78.

<sup>83</sup> Chen Shaofeng, "Motivations Behind China's Foreign Oil Quest: A Perspective from the Chinese Government and the Oil Companies," *Journal of Chinese Political Science Studies*, vol.13, no.1 (2008): p. 81.

<sup>84</sup> Lee, "China's Geostrategic Search for Oil," p. 78.

Kreft, "China's Quest for Energy," p. 64.

<sup>85</sup> Lee, "China's Geostrategic Search for Oil," p. 78.

<sup>86</sup> Ibid., pp. 78-79.

and national interest to be interdependent entities.<sup>87</sup> Due to the heavy handedness of the state in China's economy, particularly in the energy sector, commercial decision-making is situated within a structure that ingrains the dominance of SOEs which are influenced by the CCP.<sup>88</sup> Thus, in such a politicised economic system the PRC, especially with regards to hydrocarbon resources, does not rely entirely on the markets to determine supply, pricing and distribution.<sup>89</sup>

Following the establishment of China as a net-oil importer in 1993, Beijing reorganised its oil and gas assets into three state-owned firms, namely the China National Petroleum Corporation (CNPC), the China Petroleum and Chemical Corporation (Sinopec) and China National Offshore Oil Corporation (CNOOC). These SOEs dominate onshore and offshore oil activity in the country's oil sector.<sup>90</sup> Their domination of China's energy sector is not only ensured through the, exclusive access to oil assets, and the development and distribution of fuel resources, but also through financing arrangements with state-owned banks that provide cheap and plentiful credit to SOEs.<sup>91</sup> Although Beijing's national energy companies (NECs) are encouraged to behave as profit-seeking entities, China's energy firms are essentially considered to be extended arms of the government as their assets are held by the State Assets Supervision and Administration Commission (SASAC) which is controlled by, and answerable to, the upper echelons of China's administrative and legislative body – the State Council of the National People's Congress.<sup>92</sup> Thus, the higher strategic objectives of the country's SOEs are determined by CCP leaders.<sup>93</sup> The CCP's ability to influence, "shape, and execute energy policy," is further strengthened when one notes that senior managers or executives of China's NECs are all present or past members of the CCP.<sup>94</sup> Furthermore, the

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<sup>87</sup> Lee, "China's Geostrategic Search for Oil," p. 79.

<sup>88</sup> Ibid.

<sup>89</sup> Ibid.

<sup>90</sup> Ibid., p. 81.

This becomes evident when one takes into consideration that these three SOEs are amongst the 10 largest corporations in China with a collective market capitalisation of approximately \$500 billion. - Lee, "China's Geostrategic Search for Oil," p. 81.

<sup>91</sup> Lee, "China's Geostrategic Search for Oil," p. 81.

<sup>92</sup> Ibid.

<sup>93</sup> Ibid.

<sup>94</sup> Ibid., p. 82.

"The president and party secretary of CNPC is Jiang Jiemin, a former deputy governor of Qinghai Province. The president and party secretary of CNOOC is Fu Chengyu, a member of the CCP's Central Discipline Committee. Fu's predecessor at CNOOC was Wei Liucheng, who was subsequently appointed as the committee secretary of Hainan, the province's highest political post. The president of Sinopec, Su Shulin, was previously the vice minister of Liaoning Province." – Lee, "China's Geostrategic Search for Oil," p. 82.

maintenance of such influence is ensured by restricting private sector enterprises from assuming major roles in the energy sector. As a result, business decisions remain largely subject to political interests.

Essentially, unlike Western nations who subscribe to a liberal economic perspective that prescribes that, economic life should be influenced by the markets as it results in better outcomes, namely market based pricing and a more efficient supply and distribution of resources.<sup>95</sup> China's state-centric approach towards energy security, "hedges against strictly market-based outcomes" by emphasising a, "CCP first mindset in the domestic market and a China-first mindset," in the global oil markets.<sup>96</sup> Simply put, efficient pricing and distribution takes a back seat as the PRC's energy policy prioritises the CCP and state interests.

## **2.2. China's Oil Diplomacy**

Prior to 1993, due to China's oil wealth, Beijing did not deem it necessary to prioritise energy security. However, since the dawning of the 21<sup>st</sup> century, the Chinese have come to place an immense emphasis on energy security as a matter of national concern. By acting on the view that energy security is too important to be assigned to market forces, China opted in 2003, under Hu Jintao's government, to pursue a mercantilist strategy variously termed 'going global', 'going out' or 'going abroad'. In line with energy mercantilism, this strategy is typified by an energy-centred form of diplomacy that is carried out by Beijing's officials, as well as a campaign by China's 'big three' energy giants to acquire overseas oil assets. Thus, Holslag aptly states that Beijing is pursuing a, "pragmatic mercantilist policy that combines a wide array of diplomatic and economic devices"<sup>97</sup> hence the term 'oil diplomacy'.

The definition of oil diplomacy is essentially similar to that of energy mercantilism. According to Shaofeng, oil diplomacy is defined as, "foreign activities with explicit involvement of the central government aiming to secure foreign oil and gas resources to promote interstate oil and gas business cooperation."<sup>98</sup> Oil diplomacy differs from oil and gas trade, "in terms of the major players involved in business cooperation, the principal

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<sup>95</sup> Lee, "China's Geostrategic Search for Oil," p. 82.

<sup>96</sup> Ibid., pp. 82-83.

<sup>97</sup> Jonathan Holslag, "China's New Mercantilism in Central Africa," *African and Asian Studies*, vol.5, no.2 (2006): p. 133.

<sup>98</sup> Shaofeng, "Motivations Behind China's Foreign Oil Quest: A Perspective from the Chinese Government and the Oil Companies," p. 80.

objectives, and the specific transaction methods.”<sup>99</sup> Oil and gas trade, in purely economic terms, is profit-orientated and business deals are negotiated on a firm-to-firm basis with a cost-benefit analysis.<sup>100</sup> The direct involvement of government is mostly unheard of. However, oil diplomacy is typified by governmental interference and thus, aside from purely commercial interests, oil diplomacy takes into consideration other economic concerns, for example: ensuring oil supply security, expanding a state’s scope of influence and the improvement of inter-state relations.<sup>101</sup> Thus, although oil and gas trade is one of the primary goals of oil diplomacy, it may be utilised to serve other purposes, hence its mercantilist nature.

China’s oil diplomacy consists of three stages:<sup>102</sup> firstly, the Chinese government seeks to build ties with various energy rich countries to ‘open the doors’ for their NOCs to negotiate energy arrangements. Secondly, Beijing’s NOCs take advantage of the inroads created for them by accumulating upstream (crude oil exploration and extraction/production) and downstream (refinement and distribution of crude oil) deals. Thirdly, as state-owned energy firms seize opportunities created for them by the government, China continues to politically and financially support its NOCs. Financially, this is usually in the form of special loans (i.e. loans at below market rates or without interest are issued by state-owned banks) that are granted to energy companies for overseas energy acquisitions.<sup>103</sup> In addition, Beijing indirectly supports its NECs by providing an array of incentives to nations in an effort to encourage that energy investing opportunities be given to Chinese NOCs. These incentives are usually in the form of foreign aid, infrastructural development, and trade and arms agreements. Politically, Beijing assists its NOCs by arranging official meetings between Chinese leaders and heads from energy-producing nations to negotiate over specific energy deals and the utilisation of the PRC’s various memberships in international organisations to promote the interests of energy producers.<sup>104</sup> With considerable variation across regions, China has employed most of these tactics to aid its NECs in their global energy acquisition efforts.<sup>105</sup>

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<sup>99</sup> Shaofeng, “Motivations Behind China’s Foreign Oil Quest: A Perspective from the Chinese Government and the Oil Companies,” p. 80.

<sup>100</sup> Ibid.

<sup>101</sup> Ibid.

<sup>102</sup> Leverett, “Resource Mercantilism and the Militarization of Resource Management,” pp. 218-221.

<sup>103</sup> Ibid., p. 221.

<sup>104</sup> Ibid.

<sup>105</sup> Ibid.

In order to improve China's oil security, Beijing's bilateral oil diplomacy has prioritised the gain of a more secure control over foreign oil supplies and the geographical diversification of imports. Although the Middle East is the PRC's main oil source, due to the region's instability and the Iraq War China believes that becoming too dependent on this part of the world to fulfil its oil needs could jeopardise Beijing's oil security. Therefore, Beijing has sought to aggressively diversify its import sources. This has resulted in China's oil diplomacy targeting countries all over the globe, including those shunned by Western oil companies.<sup>106</sup> Beijing has defined three strategic areas for oil exploration and production, namely Russia/Central Asia, Middle East/North Africa and South America.<sup>107</sup>

With assistance from China's state-owned banks in 2011, Chinese NOCs had stakes in more than 200 energy projects across 50 countries with an approximate value of \$80 billion.<sup>108</sup> The expansion of China's international energy ventures has provided it with noteworthy strategic opportunities. In a relatively short period of time, China has, by providing an alternative to the dominant external influences of the West, emerged as a significant economic and political actor in Latin America and Africa.<sup>109</sup> In the Middle East, Beijing is not seen to be a risk-averse investor in the cases of Iraq and Iran. Moreover, China has improved its relationship with traditionally pro-American states such as Saudi Arabia.<sup>110</sup> With regards to Russia and Central Asia, the oil and gas infrastructure and proposed pipeline projects that link the PRC to its energy rich neighbours has inevitably led China to regionally extend its geopolitical interests and influence.<sup>111</sup>

Like many other energy dependent nations, Beijing holds the view that availability, reliability and affordability are essential for ensuring energy security.<sup>112</sup> However, unlike other states that rely on the markets for energy supplies, the PRC, due to several factors, remains distrustful of the markets to meet its energy requirements. The popular perception amongst the Chinese is that, owing to the dominance of Western states in international oil markets, Beijing's NOCs are presented with limited opportunities. Moreover, as a result of the West's

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<sup>106</sup> Shaofeng, "Motivations Behind China's Foreign Oil Quest: A Perspective from the Chinese Government and the Oil Companies," p. 81.

<sup>107</sup> Ibid.

<sup>108</sup> Dannreuther, "China and Global Oil: Vulnerability and Opportunity," pp. 1345-1346.

<sup>109</sup> Ibid., p. 1346.

<sup>110</sup> Ibid.

<sup>111</sup> Ibid., p. 1347.

<sup>112</sup> Shaofeng, "Motivations Behind China's Foreign Oil Quest: A Perspective from the Chinese Government and the Oil Companies," p. 85.

longstanding history in the oil-importing industry, Western nations are more experienced than China in international energy dealings and, therefore, a majority of the world's most viable oil reserves are under the control of Western multinational oil companies (MOCs).<sup>113</sup> The PRC views its relatively disadvantaged position in the international oil industry as an obstacle to ensuring its oil security. Moreover, influenced by its perceptions of an unfair international energy market, China believes that international oil prices are determined by market mechanisms that are, "manipulated by the West, speculated by hedge funds and agitated by price volatility."<sup>114</sup> As such, Beijing has avoided relying entirely on the global oil market to ensure its oil supply. Aside from deeming the markets to be in favour of Western nations, China also reasons that, due to a potential decline in oil supply, price instability or supply disruptions, its unilateral energy procurement initiatives are considered to be legitimately substantiated.

Since Beijing's 'going out' strategy involves efforts from both its NOCs and national government, the PRC's plan for securing oil supplies is essentially a mercantilist strategy that reinforces the nexus between China's government and its business sector.<sup>115</sup> As a result, Beijing's energy strategy creates some confusion as it is not entirely clear whether an energy investment by one of China's three NOCs is purely based on commercial reasoning or the PRC's foreign policy interests, or both.<sup>116</sup> Thus, China's NOCs are considered to be an,

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<sup>113</sup> Shaofeng, "Motivations Behind China's Foreign Oil Quest: A Perspective from the Chinese Government and the Oil Companies," p. 85.

<sup>114</sup> Ibid.

For a more grounding outlook on the unfairness of the international energy market, see:

Xu Qinhua, "Global Energy Security: China's Energy Diplomacy and its Implications for Global Energy Security," *Friedrich Ebert Stiftung (FES): Dialogue on Globalisation*, Briefing Paper 13 (2007): p. 6. Accessed: 03 April 2013, URL: <http://library.fes.de/pdf-files/iez/global/04763.pdf>

Chinese perceptions of the international oil market being dominated by the West were strengthened when the US Congress blocked CNOOC from buying Union Oil Company of California (UNCOAL) due to fears that China's purchase of UNCOAL would threaten national security. This left Chinese analysts questioning if the US was really committed to upholding market principles in the international energy arena. Stemming from the UNCOAL debacle, Chinese analysts assert that Washington confirmed that, "its policies are driven by mercantilist principles that it regularly [denounces] China for pursuing." – Andrews-Speed and Dannreuther, *China Oil and Global Politics*, p. 107.

<sup>115</sup> David Zweig and Bi Jianhai, "China's Global Hunt for Energy," *Foreign Affairs*, vol.84, no.5 (2005): p. 27.

<sup>116</sup> Canning, "Pursuit of the Pariah: Iran, Sudan and Myanmar in China's Energy Security Strategy," p. 49.

Zha Daojiong, "China's Energy Security: Domestic and International Issues," *Survival*, vol.48, no.1 (2006): p. 182.

China is securing deals with offerings that only the state can provide, i.e. the dispensation of soft loans and credit lines, development assistance, military aid, diplomatic support and access to the PRC's expanding markets. For more examples of "sweeteners" that China is using to gain access to foreign energy assets see: Canning, "Pursuit of the Pariah: Iran, Sudan and Myanmar in China's Energy Security Strategy," p. 49.

“unusual agglomeration of modern entrepreneurial talent striving for earnings growth and ever-greater profitability, whilst at the same time remaining arms of government, increasingly focused on shaping energy policy to meet national strategic economic goals.”<sup>117</sup>

Unlike private firms which prioritise commercial interests over domestic factors, Chinese NOCs, whilst minimising potential risks, try to synergise all potential benefits.<sup>118</sup> Due to the state’s involvement in its NOCs’ oil dealings, political considerations sometimes outweigh commercial viability. When a potential deal is commercially unfeasible but could produce substantial political benefits, Beijing’s NOCs, propped up by government, may advance with the deal irrespective of the economic costs.<sup>119</sup> This is exemplified by CNPC’s decision in 1997 to outbid various oil firms for a 60 percent stake in Kazakhstan’s state-owned Aktyubinsk Oil Company and the right to develop the Uzen oil field, the second largest oil field in Kazakhstan.<sup>120</sup> Motivated by the stability that these energy arrangements could bring to China’s Xinjian Province,<sup>121</sup> the CCP urged the CNPC to agree to build a pipeline from Kazakhstan to China. Despite doubts about the feasibility of this pipeline, the CNPC proceeded with drafting up China-Kazakhstan oil pipeline plans. Apparently, the CNPC overpaid by as much as 30 percent for the Aktyubinsk Oil Company and Uzen field.<sup>122</sup>

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Zweig and Jianhai, “China’s Global Hunt for Energy,” p. 27.

Denis M. Tull, “China’s Engagement in Africa: Scope, Significance and Consequences,” *The Journal of Modern African Studies*, vol.44, no.3 (2006): p. 469.

<sup>117</sup> Henry Lee and David Shalmon, “Searching for Oil: China’s Oil Initiatives in the Middle East,” Belfer Centre for Science and International Affairs, (John F. Kennedy School of Government: Harvard University, 2007), p. 5. Accessed: 16 July 2012, URL: <http://belfercenter.ksg.harvard.edu/files/china%20oil%20h%20lee%202007.pdf>

<sup>118</sup>Shaofeng, “Motivations Behind China’s Foreign Oil Quest: A Perspective from the Chinese Government and the Oil Companies,” p. 81.

<sup>119</sup> Ibid.

<sup>120</sup> Ibid.

<sup>121</sup> Uighur Muslim separatists in Xinjiang desire to re-establish their own independent state of East Turkestan, which existed briefly in 1933 and from 1944 until 1950. However, Beijing is opposed to this, not only because Xinjiang is endowed with natural resources but because if Uighur separatists were to succeed in achieving independence it could foster similar movements in Tibet and Taiwan. Aware, of the political instability in Xijiang, the government has attempted, through investments in energy-development projects, to promote the economic enfranchisement of Uighurs and other minorities. The CCP anticipated that the potential construction of the pipeline would create jobs for the Uighur population and thus minimise discontent. Furthermore, Beijing hoped that the construction of the pipeline would persuade the Khazak government to curb the actions of Uighur separatist groups in Khazakstan.’ – Downs, *China’s Quest for Energy Security*, pp. 26-27.

<sup>122</sup> Shaofeng, “Motivations Behind China’s Foreign Oil Quest: A Perspective from the Chinese Government and the Oil Companies,” p. 82.

Although numerous Chinese foreign policy advisors assert that the creation of stronger economic ties between China and oil abundant states can assist in ensuring their country's access to energy resources, oil diplomacy may not guarantee Beijing protection from oil price hikes.<sup>123</sup> By drawing on the 1970s, Downs points out that oil-importing countries learnt that 'special relationships' with oil exporters are rendered useless during a crisis as each nation becomes primarily concerned with securing their oil supplies.<sup>124</sup> Nevertheless, as noted by Shaofeng<sup>125</sup>, some supporters of oil diplomacy believe that producing oil abroad (under the control of Chinese NOCs) and then exporting it directly to China has the merits of cost efficiency and risk reduction. Contrary to this line of reasoning, based on, "strong anecdotal evidence from 2008-2010," Lee highlights that under benign conditions, instead of shipping private oil supplies directly to China, Chinese NOCs sold a significant amount of their equity oil on domestic and global markets.<sup>126</sup> This is considered to be a rational move as, when the shipment costs of equity oil and third party refiners (China's refineries cannot handle large amounts of oil) are taken into consideration, purchasing oil on the international markets is a lot cheaper.<sup>127</sup>

In this context siding with the international market makes more sense than choosing the equity route. Yet, when taking into consideration potential disruptions that could affect global commodity markets, offshore equity oil provides China with the flexibility of hedging or circumventing international markets.<sup>128</sup> Seeming to align with this view, the Chinese posit that gaining more control over foreign oil sources is a better option than relying on the market as it provides China with a greater capacity to insulate itself from oil price hikes.<sup>129</sup> Having learnt from the oil shortages that were incurred after the Sino-Soviet break up in the 1960s, Beijing is aware that depending on others to ensure its oil supply will expose the PRC to, "external vulnerabilities and risks brought about by rival interruptions, regional turmoil, terrorist attacks and so forth."<sup>130</sup> Due to this reasoning, China is persevering in fortifying its

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<sup>123</sup> Downs, "The Chinese Energy Security Debate," p. 38.

<sup>124</sup> Ibid.

<sup>125</sup> Shaofeng, "Motivations Behind China's Foreign Oil Quest: A Perspective from the Chinese Government and the Oil Companies," p. 88.

Downs, "China," p. 37.

<sup>126</sup> Lee, "China's Geostrategic Search for Oil," p. 84.

<sup>127</sup> Ibid., p. 84.

<sup>128</sup> Ibid., pp. 84-85.

<sup>129</sup> Shaofeng, "Motivations Behind China's Foreign Oil Quest: A Perspective from the Chinese Government and the Oil Companies," p. 90.

<sup>130</sup> Ibid.

control over foreign oil sources. However, Beijing is realising that its strategy of ‘controlling’ foreign oil is of limited feasibility as, instead of allowing overseas firms to own ‘their’ oil, present day oil markets, “prefer to contract with foreign oil companies for expertise, technical services and investments.”<sup>131</sup> With regards to any potential instability that may arise in Sino-US relations, ‘locking up’ overseas oil supplies is not an effective hedge. Due to the maritime transport of oil and the dominance of the American navy on trade routes, equity oil that is shipped to China could be cut off by the US during a war. As a result, the Chinese are keen to develop land routes via pipelines for oil transport. For example, Beijing was especially eager to develop the China-Russia oil pipeline.<sup>132</sup>

When Beijing became a member of the World Trade Organisation (WTO) in 2001, many Western nations expected the CCP to limit its role in China’s commercial activity.<sup>133</sup> However, especially in the energy sector, the government seems more entrenched than ever. This does not rest well with Western countries as the CCP’s oversight of Chinese NOC’s commercial activities has produced fears that China is using its oil companies as proxies to further Beijing’s international interests.<sup>134</sup> The US considers Chinese state involvement in business arrangements to be ‘patently unfair’ as Washington has voiced that the use of SOEs reflects a, “centrally coordinated ‘mercantilist’ approach to international business at odds with global norms of free trade.”<sup>135</sup> Additionally, Beijing’s NOCs’ relentless pursuit to own below-ground assets has spawned fears that China, to the detriment of other economies, will lock up supplies and distort global markets.<sup>136</sup> Such fears are compounded by China’s political strategy of ‘cosying up’ with energy-producing countries to gain their NOCs’ favoured access to energy deals. Although the Chinese have sold quite an amount of their offshore equity oil on local and international markets, this has done little to allay suspicions

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<sup>131</sup> Lee and Shalmon, “Searching for Oil: China’s Oil Initiatives in the Middle East,” p. 8.

<sup>132</sup> The 1,000 km pipeline originates in western Siberia and ends in Daqing. Since its first transportation of oil from Russia to China on the 1 January 2011, the pipeline has transported 30 million tons of crude oil in the last two years. Based on an agreement between the two countries the pipeline, “will transport 15 million tons of crude oil from Russia to China annually between 2011 and 2030.” The China-Russia pipeline has been applauded for reducing oil import costs and improving efficiency. – China.org.cn. *China-Russia Oil Pipeline Records 30m Tons in Delivery*. Accessed: 17 April 2013, URL: [http://www.china.org.cn/business/2013-01/02/content\\_27565666.htm](http://www.china.org.cn/business/2013-01/02/content_27565666.htm)

<sup>133</sup> Lee, “China’s Geostrategic Search for Oil,” p. 85.

<sup>134</sup> Ibid.

<sup>135</sup> David Zweig, “Resource Diplomacy” Under Hegemony: The Sources of Sino-American Cooperation in the 21<sup>st</sup> Century,” *Centre of China’s Transnational Relations*, Working Paper No.18 (2006): p. 8. Accessed: 05 February 2012, URL: [http://www.cctr.ust.hk/materials/working\\_papers/WorkingPaper18\\_DavidZweig.pdf](http://www.cctr.ust.hk/materials/working_papers/WorkingPaper18_DavidZweig.pdf)

<sup>136</sup> Lee, “China’s Geostrategic Search for Oil,” p. 85.

that China could secure massive amounts of equity oil which may potentially disrupt future market supplies.<sup>137</sup> However, Beijing's ability to achieve this is, "far less significant than some alarmists' views imply."<sup>138</sup> For China's 'locking-up' strategy to substantially impact international markets, Chinese NOCs would have to dominate, "the largest Middle-Eastern players by controlling oil assets in countries such as Saudi Arabia."<sup>139</sup> As a result of the geopolitical ramifications and economic turmoil that would result from allowing one importer to accumulate significant quantities of oil, Middle-Eastern countries are wary of granting China equity arrangements.<sup>140</sup> Nevertheless, the fear that China's aggressive energy accumulation efforts will increase other nations' energy insecurity still persists. In an attempt to influence Beijing to pursue energy resources in a cooperative manner instead of a 'winner takes all' or zero-sum stance, an invitation to join the International Energy Agency (IEA) was extended to China. However, it has been speculated that by viewing multilateral cooperation as a cover for advancing Western interests and since Beijing would have to be more transparent about its energy dealings, China declined to become a member of the IEA.

In spite of the West's disapproval of China's oil diplomacy it appears that, due to Beijing's unwillingness to leave its energy security in the hands of the international market, the Chinese will continue to bypass the market and pursue bilateral energy arrangements. China is essentially pursuing the same strategy that the US, Britain, France and Japan utilised in the 1970s and 1980s. Thus, protests from Washington that Beijing is attempting to amass future global oil supplies are hypocritical, "since this is exactly what British and US companies attempted to do in the past."<sup>141</sup> Moreover, due to the inequality of the global energy market and China's relative inexperience in international energy dealings, Beijing seems to be justified in guiding and assisting its NOCs in expanding their international outreach.<sup>142</sup>

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<sup>137</sup> Lee, "China's Geostrategic Search for Oil," p. 85.

<sup>138</sup> Ibid., p. 86.

<sup>139</sup> Ibid.

<sup>140</sup> Ibid.

<sup>141</sup> Lee and Shalmon, "Searching for Oil: China's Oil Initiatives in the Middle East," p. 8.

<sup>142</sup> Hui-Chi Yeh and Chi-Wei Yu, "China's Energy Diplomacy: SOE Relations in the Context of Global Distribution and Investment Pattern," *Advances in Applied Sociology*, vol.2, no.4 (2012): p. 341.

### 2.2.1. Pursuit of the Pariah

Due to its delayed development in the international energy market, and seeing as most of the main oil markets are dominated by Western companies, China's oil firms have found it challenging to assert themselves amongst intense competition from Western MOCs.<sup>143</sup> With the odds stacked against them, Chinese NOCs struggle to secure oil deals in favourable areas. As a result, Beijing's international oil accumulation drive has targeted countries where Western MOCs cannot intensely challenge the PRC's oil companies. In line with the notion of comparative advantage, China pursues countries that Washington highly condemns and which are, in many cases, placed under unilateral oil sanctions. Due to Western firms withdrawing from countries that are placed under sanctions, it makes it easier for China to pursue oil supplies in such states, as Beijing is not legally obligated to adhere to unilateral sanctions. As a result, the Chinese have struck oil agreements and various other energy resource deals with countries such as Sudan, Myanmar, Iran, Libya, Uzbekistan and Venezuela – all states that have dubious domestic policies and foreign outlooks that contradict the Western perspective.<sup>144</sup>

Beijing's interactions with politically isolated states (that are eager to seize the opportunities that the Chinese markets present) have raised Western, especially American, suspicions.<sup>145</sup> Since most of Washington's isolation efforts target states that have questionable domestic policies, a lack of respect for human rights, poor international law adherence and intentions for nuclear proliferation, Beijing's moral compass is under scrutiny as, in pursuit of energy assets, China counters the West's attempts to isolate dubious states. By providing internationally condemned countries with political cover and an economic lifeline that is free of governance or reform conditions, Beijing essentially undermines the reformative efforts that are directed at rogue states.<sup>146</sup> Due to the comparative advantage that pariah states offer China, it is unlikely that Beijing would relinquish such a benefit as, "whenever and wherever there are significant energy assets for sale, there are few political, diplomatic, commercial or ethical issues preventing Chinese NOCs from bidding."<sup>147</sup> Beijing's continued engagement

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<sup>143</sup> Qinhua, "Global Energy Security: China's Energy Diplomacy and its Implications for Global Energy Security," p. 6.

<sup>144</sup> Daojiong, "China's Energy Security: Domestic and International Issues," p. 182.

<sup>145</sup> Canning, "Pursuit of the Pariah: Iran, Sudan and Myanmar in China's Energy Security Strategy," p. 51.

<sup>146</sup> Zweig and Jianhai, "China's Global Hunt for Energy," p. 32.

Lee, "China's Geostrategic Search for Oil," p. 88.

<sup>147</sup> Ibid.

with rogue states strains the PRC's efforts to be viewed as a responsible global power. Aware of this, former US Deputy Secretary of State, Robert Zoellick, in September 2005 played the 'responsible stakeholder' card in an attempt to persuade China to cooperate in formulating policies towards pariah states in return for America's recognition of its rise.<sup>148</sup> However, as a result of China's piecemeal actions against pariah states, it appears that Beijing is not desperate for Washington's acknowledgement of its ascendancy. Instead, China has chosen to stick to the middle road, so as to avoid endangering its energy interests in US condemned states.<sup>149</sup> Furthermore, hard-liners that are opposed to the US's global dominance reason that maintaining support of pariah regimes serves to counter Washington's power.<sup>150</sup> In order to avoid undermining its vital economic interests with America, Beijing has been circumspect in its dealings with pariah states. Thus, although China will continue to set its own international agenda, Washington and other concerned parties can play a vital role in influencing Beijing's interactions with internationally condemned states.<sup>151</sup>

If the West wants China to 'toe the line' and help modify the behaviour of pariah states, countries will have to establish a realistic outlook of when and how the PRC is likely to assist in cajoling rogue states to embrace international norms.<sup>152</sup> According to Kleine-Ahlbrandt and Small this means that states, particularly Western nations, will have to develop a clear sense of how their objectives are in line with, or deviate from, China's interests.<sup>153</sup> Thus, in part, the international community will have to accept that cooperation with Beijing over pariah states will sometimes come at a cost. For example, states may have to consent to allowing dubious regimes an extended lease on life by limiting or minimising coercive measures against them.<sup>154</sup> As such, "China's ability to assume a greater role as a broker between pariah states and the international community means that it can define the bottom line in negotiations."<sup>155</sup> However, drawing on Beijing's past interactions with pariah countries, it seems that China will resort to the bare minimum in order to steer clear of, "acute instability or sustained international opprobrium."<sup>156</sup> Although the inadequate

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<sup>148</sup> Stephanie Kleine-Ahlbrandt and Andrew Small, "China's New Dictatorship Diplomacy: Is Beijing Parting with Pariahs?" *Foreign Affairs*, vol.87, no.1 (2008): p. 43.

<sup>149</sup> *Ibid.*, p. 51.

<sup>150</sup> *Ibid.*

<sup>151</sup> *Ibid.*, p. 52.

<sup>152</sup> *Ibid.*, p. 53.

<sup>153</sup> *Ibid.*

<sup>154</sup> *Ibid.*

<sup>155</sup> *Ibid.*

<sup>156</sup> *Ibid.*

economic and political reform that Beijing encourages amongst pariah states may be frustrating for Western nations – due to the West’s limited diplomatic influence and economic leverage over internationally shunned nations – Western nations realise that owing to China’s unique influence over and insight into the intentions of rogue state leaders, Beijing’s privileged ties with pariah countries may be (if China wishes to do so) manipulated to compel rogue states to align themselves with international norms.<sup>157</sup>

In conclusion, it has become increasingly clear that Beijing favours a mercantilist *modus operandi* for obtaining energy resources. The PRC’s preference for securing equity agreements, as opposed to relying extensively on global energy markets for fuel resources, points out that China subscribes to an energy mercantilist strategy for accumulating hydrocarbon, particularly oil supplies. This notion is further supported by the state-centred structure of China’s energy sector and the heavy influence that the CCP has over the country’s NOCs. Furthermore, by relying heavily on incentives that can only be utilised by the state, China’s ‘going-out’ strategy depicts the major role that the Chinese government plays in assisting its NOCs with obtaining lucrative oil deals.

Although China’s mercantilist oil strategy deviates from liberal norms of free trade and thus impinges on the market’s ability to serve as an effective pricing mechanism and distributor of energy supplies, Chinese motivation behind their pursuit of energy-equity through mercantilist means is coloured by their worldview. This view posits that the international energy markets work in favour of developed (especially Western) nations; therefore Chinese equity initiatives (which hedge against market disruptions and price hikes) provide the CCP with the best opportunity for securing and safeguarding a continuous supply of oil to its shores. In addition, stemming from its mercantilist outlook on energy procurement (which is considered to be a zero-sum game), China has not hesitated to engage with well-endowed energy pariah states, especially since such states offer Chinese NECs little competition from Western energy companies. Beijing’s interaction with politically isolated nations has led the international community to question China’s moral standing as, unlike the US, it has done very little to encourage pariah states to embrace international political and economic norms. It seems that in its relentless pursuit of energy resources, Western-voiced disapproval of Beijing’s maintenance of ties with pariah states has largely been an exercise in futility. However, aware that its drive for continued economic prosperity depends to a large extent on

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<sup>157</sup> Kleine-Ahlbrandt and Small, “China’s New Dictatorship Diplomacy: Is Beijing Parting with Pariahs?” p. 53.

remaining in favour with the US, Beijing has, in sticking to its middle-of-the-road approach, treaded cautiously with pariah states such as Iran.

## CHAPTER 3

### The Sino-Iranian Relationship

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Due to the multi-dimensional and ever-changing nature of Sino-Iranian relations it would be impossible to cover every facet of Beijing-Tehran ties in this chapter. Therefore, this chapter will focus on what are considered to be the more prominent aspects of the relationship that ties Beijing and Tehran together despite the international pressure placed on China to implement measures to further isolate Iran for its defiant nuclear activities. This chapter will analyse the Sino-Iranian relationship from three points of view, namely trade, energy and geostrategic reasoning. These three factors have been chosen as, based on the literature reviewed, they appear to be the 'glue' that binds these two countries together.

In spite of periods when relations were strained, Sino-Iranian ties have gradually evolved into a sturdy relationship. This relationship is strengthened by the historical commonalities between the two nations, namely that both consider themselves to be heirs of once great civilisations that were victimised by Western imperialists. However, aside from historical similarities binding China and Iran, "circumstances have conspired to make China and Iran well suited energy partners."<sup>158</sup> Chinese efforts to enhance their relations with Iran have mainly stemmed from China's search for energy resources, an opportunity to create a diverse portfolio of overseas market shares and the desire to exert political influence in the Middle East. Yet, not all credit can be given to Beijing for establishing links with Tehran as Iranian officials have taken, "determined, consistent and effective initiatives," to entice China to build a relationship with Iran.<sup>159</sup> By advertising itself as a reliable energy source and key strategic partner in the Middle East, Iran has managed to gain the PRC's attention and advance Sino-Iranian relations. Additionally, aside from acknowledging Tehran's crucial role in the energy market, Beijing also recognises Iran's vital geostrategic location and its potential to be an energy transport base between the Middle East, Central Asia, and Europe.<sup>160</sup>

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<sup>158</sup> James B. Gentry, "The Dragon and The Magi: Burgeoning Sino-Iranian Relations in The 21<sup>st</sup> Century," *The China and Eurasia Forum Quarterly*, vol.3, no.3 (2005): p. 115.

<sup>159</sup> John Calabrese, "China and Iran: Mismatched Partners," *Occasional Paper: The Jamestown Foundation* (2006), p. 5. Accessed: 04 July 2012, URL: <http://www.jamestown.org/docs/Jamestown-ChinaIranMismatch.pdf>

<sup>160</sup> Peter Mackenzie, "A Closer Look at China-Iran Relations," *CNA Roundtable Discussion: China's Relations with Iran* (2010), p. i. Accessed: 05 March 2012, URL:

Since the 1980s, Sino-Iranian relations have evolved from a focus on arm sales to one that encompasses commercial, energy and diplomatic dealings. This shift in relations is partly attributed to the international sanctions imposed on Iran, as increasing isolation has forced Tehran to search for alternate markets to export its energy resources. Moreover, Iranian leaders are aware that the geopolitics of oil has shifted from West to East, as incremental growth is creating a demand for oil from the three non-Western territories of China, India and the Middle-Eastern region. As a result, there has been a steady increase in the energy interdependence between Asian and Gulf States.<sup>161</sup> Essentially, Sino-Iranian relations are considered to be mutually complementary or naturally symbiotic as the Chinese have a ballooning economy that requires hydrocarbon resources which, in turn, provides a market for Iran's surplus of energy commodities.<sup>162</sup>

### **3.1. Background: Sino-Iranian Ties**

The development of Sino-Iranian relations stems from a gradual expansion of ties between China and the Middle East. The birth of this relationship has been traced back to the second century BCE when the Han Dynasty of China opened up the Silk Road and established trade with the Parthian Empire.<sup>163</sup> Although official diplomatic relations were established in 1971, Iran kept China at a distance as the US pressured Tehran to limit its interaction with communist Beijing. However, before his overthrow in 1979, the Shah sought to improve relations with China as mutual concern over Soviet actions in Asia edged the PRC and Iran to achieve greater cooperation. Yet, relations with China were again strained when revolutionary leader Ayatollah Ruhollah Khomeini (successor to the Shah), in rebellion against the Union of Soviet Socialist Republics (USSR) and US, supported a foreign policy that was, "neither West nor East." However, Khomeini's suspicions of China had to be revised as Iran's isolation and war with Iraq forced Tehran to cooperate a little more with Beijing. The Islamic Republic had come to perceive that China could be used as a counterbalancing mechanism against the USSR and US, thus providing Iran with much

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<http://www.cna.org/sites/default/files/research/d0023622%20a%20closer%20look%20at%20china-iran%20relations.pdf>

<sup>161</sup> Mackenzie, "A Closer Look at China-Iran Relations," p. 4.

<sup>162</sup> Ibid., p. 3.

Liu Jun and Wu Lei. "Key Issues in China-Iran Relations," *Journal of Middle Eastern and Islamic Studies (in Asia)*, vol.4, no.1 (2010): p. 44.

<sup>163</sup> Gentry, "The Dragon and The Magi: Burgeoning Sino-Iranian Relations in The 21<sup>st</sup> Century," p. 111.

needed leverage on the international stage.<sup>164</sup> Tehran's new outlook towards China suited Beijing's global political agenda as it provided the Chinese with a gateway to pursue their territorial ambitions in Iran and, more importantly, the greater Middle East.<sup>165</sup>

The endurance of the Sino-Iranian relationship is attributed to shared interests and similar political outlooks.<sup>166</sup> The survival of these ties illustrates that both these nations value political pragmatism, strategic thinking, and economic dealings above differences in ideology and religion.<sup>167</sup> However, past grievances against Western domination have also played a part in shaping both nations' contemporary outlooks on global politics. With memories of 'victimisation' and 'vulnerability' at the hands of Western imperialists etched deep into their psyche, Beijing and Tehran continue to protest against Western imperialism and hegemonic behaviour.<sup>168</sup> As a result, both countries distrust the US and frequently criticise Washington's policy of liberal interventionism as 'imperialist' and 'hegemonic'.<sup>169</sup> By acknowledging their historical lineage of having once been 'great civilisations', Beijing and Tehran draw inspiration from this narrative to reassert their great power status.<sup>170</sup> This essentially fuels China's, "foreign policy goals of a multi-polar world, free of US hegemony, where regional powers play the dominant role within their respective spheres of influence."<sup>171</sup> In this regard, Beijing and Tehran's ambitions have remained quite similar.

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<sup>164</sup> Manoj Dorraj and Carrie L. Currier. "Lubricated with Oil: Iran-China Relations in a Changing World," *Middle East Policy*, vol.15, no.2 (2008): p. 68.

<sup>165</sup> Scott Harold and Alireza Nader, *China and Iran: Economic, Political and Military Relations* (Santa Monica: Rand Corporation, 2012), p. 3. Accessed: 15 June 2012, URL: [http://www.rand.org/content/dam/rand/pubs/occasional\\_papers/2012/RAND\\_OP351.pdf](http://www.rand.org/content/dam/rand/pubs/occasional_papers/2012/RAND_OP351.pdf)

<sup>166</sup> Melinda Baker, *Beyond Oil? Chinese National Interests and the Sino-Iranian Relationship*, MA thesis, Graduate School of Arts and Sciences: Georgetown University, (2010), p. 21. Accessed: 25 June 2012, URL: <http://repository.library.georgetown.edu/bitstream/handle/10822/553441/bakermelinda.pdf?sequence=1>

<sup>167</sup> John Douglas, Matthew Nelson and Kevin Schwartz, *Fuelling the Dragon's Flame: How China's Energy Demand Affects its Relationships in the Middle East* (2006), p. 6. Accessed: 16 July 2012, URL: <http://origin.www.uscc.gov/sites/default/files/Research/fueling%20the%20dragons%20flame.pdf>

<sup>168</sup> Baker, *Beyond Oil? Chinese National Interests and the Sino-Iranian Relationship*, p. 22. Calabrese, "China and Iran: Mismatched Partners," p. 5.

Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 3.

Dorraj and Currier, "Lubricated with Oil: Iran-China Relations in a Changing World," p. 67.

<sup>169</sup> Brandon Fite, *U.S. and Iranian Strategic Competition: The Impact of China and Russia* (Centre for Strategic and International Studies, 2012), p. 7. Accessed: 15 June 2012, URL: [http://csis.org/files/publication/REPORT\\_Iran\\_Chapter\\_X\\_China\\_and\\_Russia\\_Final\\_Revision2212.pdf](http://csis.org/files/publication/REPORT_Iran_Chapter_X_China_and_Russia_Final_Revision2212.pdf)

<sup>170</sup> The shared Silk Road heritage links China, Iran and the post-Soviet states of Central Asia, and serves as a historical basis for present day cooperation. – Gentry, "The Dragon and The Magi: Burgeoning Sino-Iranian Relations in The 21<sup>st</sup> Century," p. 111.

<sup>171</sup> Baker, *Beyond Oil? Chinese National Interests and the Sino-Iranian Relationship*, p. 22.

Even though the commonalities between China and Iran portray a grounded relationship, ‘when push comes to shove’, Beijing has, on various occasions, demonstrated that it is willing to sideline Iran in favour of remaining in comity with the US. This was particularly demonstrated when China acknowledged calls from Washington to abandon nuclear cooperation with Iran in 1997. Although Iran felt betrayed by China’s actions, the Ayatollahs realised that it was still in Tehran’s best interests to continue working with the Chinese on economic and political issues. Thus, it is by means of such flexibility that the Chinese and Iranians have created a durable, albeit limited, relationship that continues to persist under straining conditions.<sup>172</sup>

Contrary to framing Sino-Iranian relations in terms of mutual cooperation, Harold and Nader emphasise that this relationship is characterised by a lopsided or asymmetrical dependence.<sup>173</sup> China has subtly conveyed that, instead of viewing Tehran as a vital strategic energy ally, Iran is considered to be one of several countries that it interacts with on a mercantilist basis.<sup>174</sup> Although the PRC views Iran as a potential partner for limiting US advancements in the Middle East, Beijing is not overly reliant on Tehran for its energy needs, economic development or national security. This is demonstrated by China’s globally dispersed sources of oil and its substantial oil imports from other Middle-Eastern nations, most notably Saudi Arabia. On the other hand, because of Iran’s small number of allies and shunning of the US, Tehran has come to rely heavily on Beijing for vital diplomacy, economic, military and technological assistance. Although China’s dependency on Iran is minimal, Sino-Iranian relations have nonetheless enhanced Beijing’s capacity to become a vital player in Middle-Eastern issues. Aware of how sanctions have heightened the Islamic Republic’s vulnerability, Beijing is exploiting Iran by utilising its increasing isolation from the international community to demand Iranian oil at discounted prices. Despite such exploitive demands, Tehran is not willing to dismiss the PRC, as China provides the Islamic Republic with vital

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<sup>172</sup> Baker, *Beyond Oil? Chinese National Interests and the Sino-Iranian Relationship*, p. 33.

<sup>173</sup> Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 13.

Marybeth Davis *et al.*, “China-Iran: A Limited Partnership,” *U.S.-China Economic and Security Review Commission*, p. 4. Accessed: 12 March 2013, URL: [http://missilethreat.wpengine.netdna-cdn.com/wp-content/uploads/2012/12/USCC\\_China-Iran-Report-Nov-28.pdf](http://missilethreat.wpengine.netdna-cdn.com/wp-content/uploads/2012/12/USCC_China-Iran-Report-Nov-28.pdf)

Afshin Molavi, “The New Silk Road, “Chindia,” and The Geo-Economic Ties that Bind the Middle East and Asia,” in *China and the Persian Gulf*, eds. Bryce Wakefield and Susan L. Levenstein (Washington: Woodrow Wilson International Centre for Scholars, 2010), p. 51. Accessed: 16 July 2012, URL: [http://www.wilsoncenter.org/sites/default/files/ASIA%20Program\\_China%20and%20the%20PG.pdf](http://www.wilsoncenter.org/sites/default/files/ASIA%20Program_China%20and%20the%20PG.pdf)

Morris, “From Silk to Sanctions and Back Again: Contemporary Sino-Iranian Economic Relations,” p2.

<sup>174</sup> Molavi, “The New Silk Road, “Chindia,” and The Geo-Economic Ties that Bind the Middle East and Asia,” p. 50.

diplomatic cover in the international arena. Although Beijing acknowledges that its relationship with Tehran (a pariah state) may tarnish its image as a ‘responsible stakeholder’ and threaten Sino-US relations, China has nonetheless demonstrated an unusual support for Iran.<sup>175</sup>

## **3.2. Economic**

### **3.2.1. Trade**

In 1979 both nations undertook drastic reforms that laid the building blocks for their intricate present day economic and political relationship.<sup>176</sup> For Iran, the Islamic Revolution and subsequent hostage debacle led to the deterioration of Tehran’s relationship with the West as it was faced with economic sanctions and diplomatic isolation. Whilst Beijing, under Deng Xiaoping, implemented market-based reforms that were followed by a rise in GDP growth which subsequently led to the ascendance of China as an international force.

Sino-Iranian economic relations have grown at an annual average of 40% over the past few years.<sup>177</sup> This is demonstrated by the level of trade between the two nations increasing from \$400 million in 1994 to \$29 billion in 2008.<sup>178</sup> Although economic exchanges were first limited to military purchases by Iran, trade exchanges between Beijing and Tehran have primarily advanced through general trade and oil-gas dealings. Both nations have hosted various conferences that promote bilateral trade and economic cooperation. However, energy is, without question, the main pillar of Sino-Iranian economic ties. Due to China’s energy demands, bilateral trade in fuel resources rose. In addition to rising energy trade, bilateral trade in other goods also increased – with total bilateral interaction rising from \$700 million in 1993 to \$5.6 billion in 2003.<sup>179</sup> Aware of Iran’s vast energy resource endowments, Beijing and Tehran have signed various energy deals worth millions of dollars. However, unlike China who mainly views Iran as an energy source and another market for Chinese goods, the Iranians highly value Chinese patronage. The PRC has come to be indispensable to the

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<sup>175</sup> Douglas, Nelson and Schwartz, *Fuelling the Dragon’s Flame: How China’s Energy Demand Affects its Relationships in the Middle East*, p. 2.

<sup>176</sup> Morris, “From Silk to Sanctions and Back Again: Contemporary Sino-Iranian Economic Relations,” p. 2.

<sup>177</sup> Jun and Lei, “Key Issues in China-Iran Relations,” p. 43.

<sup>178</sup> Ibid.

<sup>179</sup> Gentry, “The Dragon and The Magi: Burgeoning Sino-Iranian Relations in The 21<sup>st</sup> Century,” pp. 114-115. Morris, “From Silk to Sanctions and Back Again: Contemporary Sino-Iranian Economic Relations,” p. 2.

Iranian economy as it is considered to be an important energy customer, a source of technological knowledge, and a major investor in a variety of Iranian sectors.<sup>180</sup>

Though energy trade dominates Sino-Iranian relations, it has become evident that both nations are interested in expanding economic dealings to incorporate various other sectors. In efforts to expand the Sino-Iranian relationship beyond energy, the two nations established the Chinese-Iranian Joint Commission on Economic, Trade, Scientific, and Technical Cooperation in 1993.<sup>181</sup> This keen interest in diversifying relations became particularly evident in 2005 when Beijing expressed interest in strengthening labour ties between the two nations and the possibility of initiating cooperation with regards to aerospace ventures.<sup>182</sup> However, it was a signed aluminium deal worth \$1 billion that significantly demonstrated China's interests in diversifying its relations with Iran.<sup>183</sup> Additionally, China's desire to dabble in different Iranian sectors was again demonstrated at the 2009 Iran-China Economic Cooperation Conference, where many Chinese companies finalised negotiations and signed agreements to improve Iranian infrastructure and the country's mining and construction industries.<sup>184</sup> More recently, in the wake of sanctions issued against the Islamic Republic, China displayed its keenness to expand its interests in the country when Beijing signed a \$20 billion agreement in May 2011 to boost bilateral cooperation in Iran's industrial and mining sectors.<sup>185</sup>

The Iranian market is considered to be extremely profitable for China as, "the abundant natural resources, big market, geographic location and educated workforce," are advantageous factors that have enticed Beijing to engage with Tehran.<sup>186</sup> This is echoed by the estimated 250 Chinese companies involved in a variety of projects or retailing in low-cost consumer products in Iran.<sup>187</sup> Moreover, due to the positives of trading with Iran, the two countries have announced that they plan to more than double their annual bilateral trade from \$30-\$40 billion to \$100 billion by 2016.<sup>188</sup> China's growing economic influence and the effects of sanctions have altered Iran's trading patterns – Tehran has become increasingly

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<sup>180</sup> Gentry, "The Dragon and The Magi: Burgeoning Sino-Iranian Relations in The 21<sup>st</sup> Century," p. 115.

<sup>181</sup> Ibid., p. 114.

<sup>182</sup> Ibid., p. 117.

<sup>183</sup> Ibid.

<sup>184</sup> Ariel Farrar-Wellman and Robert Frasco, *China-Iran Foreign Relations*. Accessed: 06 December 2012, URL: <http://www.irantracker.org/foreign-relations/china-iran-foreign-relations>

<sup>185</sup> Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 10.

<sup>186</sup> Sanam Vakil, "Iran: Balancing East against West," *The Washington Quarterly*, vol.29, no.4 (2006): p. 54.

<sup>187</sup> Calabrese, "China and Iran: Mismatched Partners," p. 6.

<sup>188</sup> Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 10.

dependent on China both as a market and as a source of consumer and industrial goods.<sup>189</sup> This plays to Beijing's advantage in terms of foreign direct investment (FDI). Due to the Islamic Republic's strained relations with the West, Iran, in terms of FDI, offers China little competition. Additionally, there has been an increase in China's exports to Iran which, since 2001, have increased nearly sixteenfold to \$12.2 billion.<sup>190</sup> Such improvements in Chinese-Iranian commercial dealings led China to surpass the European Union (EU) in 2009 to become Iran's largest trading partner, with a bilateral trade volume estimated at more than \$21 billion.<sup>191</sup>

Although the Sino-Iranian economic relationship has evolved to become highly robust, China and Iran have, "yet to fully exploit their economic potential in various [other] spheres" as the regulatory framework underpinning this relationship requires substantial improvements.<sup>192</sup> It has been suggested that the Sino-Iranian economic relationship could be enhanced with the signing of a customs agreement and the co-ordination of import and export regulations between the two nations.<sup>193</sup> In addition, due to financial and banking obstacles hindering deals from moving forward, China and Iran need to establish a legal arbitration board for bilateral disagreements.<sup>194</sup> Owing to the, "unpredictable pricing and contractual terms that often come with political strings attached," observers have speculated that Iran's strenuous business climate could possibly influence China to rely more on Saudi Arabia to meet its energy demands.<sup>195</sup> Nevertheless, for now Iran continues to be a key piece in China's foreign economic-energy puzzle.

### 3.2.2. Energy

As OPEC's (Oil Producing Export Countries) second largest oil exporter, Iran produces 3.7 million barrels of crude oil per day and is ranked as the world's fourth-largest oil producer.<sup>196</sup>

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<sup>189</sup> Barbara Salvin, "Iran turns to China, Barter to Survive Sanctions," *Atlantic Council: Iran Task Force*, (2011): p. 1. Accessed: 15 June 2012, URL:

[http://www.acus.org/files/publication\\_pdfs/403/111011\\_ACUS\\_IranChina.PDF](http://www.acus.org/files/publication_pdfs/403/111011_ACUS_IranChina.PDF)

<sup>190</sup> Salvin, "Iran turns to China, Barter to Survive Sanctions," p. 4.

<sup>191</sup> Mackenzie, "A Closer Look at China-Iran Relations," p. 6.

<sup>192</sup> Jun and Lei, "Key Issues in China-Iran Relations," p. 43.

Morris, "From Silk to Sanctions and Back Again: Contemporary Sino-Iranian Economic Relations," p. 3.

<sup>193</sup> Ibid.

Jun and Lei, "Key Issues in China-Iran Relations," p. 43.

<sup>194</sup> Ibid.

<sup>195</sup> Morris, "From Silk to Sanctions and Back Again: Contemporary Sino-Iranian Economic Relations," p. 2.

<sup>196</sup> Fite, *U.S. and Iranian Strategic Competition: The Impact of China and Russia*, p. 10.

Furthermore, the country has oil reserves collectively estimated at 155 billion barrels and gas reserves at 33 trillion cubic metres.<sup>197</sup> Thus, it is not surprising that energy driven China has developed a keen interest in Tehran's energy sector.

Although energy in the form of liquefied natural gas (LNG) has provided a second energy link with Iran, Iranian crude is still the main attraction. Ever since China's first purchase of Iranian oil in 1974 under the Shah's regime, the PRC's oil imports from Iran have grown substantially.<sup>198</sup> Within a space of two years, oil imports from Iran increased from seven million tons in 2000 to eleven million tons in 2002.<sup>199</sup> As a result of this marked increase in Iranian oil imports, Iran was positioned in 2003 as the second largest oil exporter to China, after Saudi Arabia.<sup>200</sup> In addition, the oil connection between the two nations was further reiterated in 2009 when the PRC surpassed Japan to become Iran's top oil customer.<sup>201</sup> Iranian crude oil accounts for approximately 10-15 percent of China's total oil imports.<sup>202</sup>

Although this percentage is miniscule when compared to Saudi Arabia and Angola, the Chinese have calculated reasons for importing Iranian oil. Crude oil from Iran not only assists in meeting rapidly increasing Chinese consumption demands, it also helps contain rising import expenses as the sour crude oil (sulphur-rich) found in Iran is comparatively cheaper than sweet crude (carbon-rich).<sup>203</sup> Moreover, access to Iranian oil is gaining importance as Iran provides China with an opportunity to access its oil reserves without competition from Western oil companies.<sup>204</sup> Iran is also one of the few Middle-Eastern states that permit China to carry out business in upstream sectors.<sup>205</sup> This demonstrates how, by being amongst a few Middle East countries that allow Chinese NOCs to carry out upstream ventures, Tehran is using its energy reserves to strengthen its partnership with Beijing and fortify its position as

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Mahnaz Zahirinejad, "Implication of New World Order on China's Energy Policy Towards Iran," *Asia-Pacific Journal of Social Sciences*, no.1 (2010): p. 114.

<sup>197</sup> Fite, *U.S. and Iranian Strategic Competition: The Impact of China and Russia*, p. 10.

<sup>198</sup> Although China began importing oil from Iran in 1974, Davis *et al.*, point out that Beijing's earnest involvement in Tehran's oil and gas sector began with a 1997 agreement for cooperation in oil and gas exploration. – Davis *et al.*, "China-Iran: A Limited Partnership," p. 16.

<sup>199</sup> Lai, "China's Oil Diplomacy: is it a global security threat?" p. 525.

<sup>200</sup> Ibid.

<sup>201</sup> Mackenzie, "A Closer Look at China-Iran Relations," p. 5.

<sup>202</sup> Michael D. Swaine, "Beijing's Tightrope Walk on Iran," *China Leadership Monitor*, no.33 (2010): p. 4. Accessed: 02 August 2012, URL: <http://media.hoover.org/sites/default/files/documents/CLM33MS2.pdf>

<sup>203</sup> Calabrese, "China and Iran: Mismatched Partners," p. 7.

<sup>204</sup> Bezen B. Coskun, "Global Energy Geopolitics and Iran," *Uluslararası İlişkiler*, vol.5, no.20 (2009): p. 184.

<sup>205</sup> Zhao Hongtu, "China's Energy Interest and Security in the Middle East," in *China's Growing Role in the Middle East: Implications for the Region and Beyond* (Washington: The Nixon Centre, 2010), p. 50. Accessed: 05 February 2013, URL: <http://cftni.org/full-monograph-chinas-growing-role-in-me.pdf>

an important regional player.<sup>206</sup> Aside from upstream developments, Chinese NOCs have also shown a strong interest in downstream developments. This has resulted in more than one hundred Chinese companies operating in Iran to develop the metro, ports, airports, and oil and natural gas facilities.<sup>207</sup> Essentially, in efforts to improve the future of China's energy security, upstream and downstream projects are a part of Beijing's plan to internationalise its NOCs and gain equity stakes in production.<sup>208</sup>

Despite Iran barring foreign oil companies from concession agreements and restricting them to 'buy back' contracts, Chinese NOCs, unlike many other international oil companies, are not deterred by Tehran's approach to dealing with overseas energy firms.<sup>209</sup> China's increasing focus on the Iranian energy sector is demonstrated by the 166 Chinese companies that attended the Iranian Oil Show in 2011, as opposed to the one hundred firms that attended in 2010.<sup>210</sup> Moreover, aside from signing numerous energy agreements, Iran has also formed a joint oil and gas committee with China to advance energy cooperation. Apart from purchasing Iranian crude oil and gas, Beijing (after Japan's withdrawal from deals due to US pressure) has, by securing the massive Azadegan and Yadvaran oil and gas fields, become a formidable player in Iranian upstream operations.<sup>211</sup>

Although China has acquired numerous Iranian fuel agreements, Iran's energy sector has presented Beijing with various challenges. Tehran traditionally restricts foreign ownership of its hydrocarbon resources and, due to this, China has been provided with limited opportunities to acquire equity in Iranian oil.<sup>212</sup> Like its Western and Japanese counterparts, Chinese investors are prone to becoming frustrated with Iran's approach to drafting contracts and business dealings, as possible ventures usually involve continuous rounds of back and forth negotiations and unimplemented business deals.<sup>213</sup> Nevertheless, such irritations have not hindered China from filling the void that sanctions have created in Tehran's energy

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<sup>206</sup> Gentry, "The Dragon and The Magi: Burgeoning Sino-Iranian Relations in The 21<sup>st</sup> Century," pp. 115-116.

<sup>207</sup> Shahram Chubin, "Iran and China: Political Partners or Strategic Allies," in *China's Growing Role in the Middle East: Implications for the Region and Beyond* (Washington: The Nixon Centre, 2010), p. 65. Accessed: 05 February 2012, URL: <http://cftni.org/full-monograph-chinas-growing-role-in-me.pdf>

<sup>208</sup> Calabrese, "China and Iran: Mismatched Partners," p. 7.

<sup>209</sup> *Ibid.*, p. 14.

'Buy back' contracts, are contracts that ensure the repayment of development costs that oil companies incur and provide an agreed rate of return from initial production.

<sup>210</sup> Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 10.

<sup>211</sup> *Ibid.*, p. 11.

<sup>212</sup> *Ibid.*, p. 22.

<sup>213</sup> *Ibid.*

sector. Due to being wary of fines under the Iran Sanctions Act (ISA), various companies have withdrawn from the Islamic Republic as numerous businesses believe that the, “political and public relation problems more than outweigh business rewards.”<sup>214</sup> By viewing the pull out of Western companies as an opportunity to gain a stronger foothold in the Iranian energy sector, the Chinese have seized this opening by signing various energy deals, particularly during 2005 to 2010.<sup>215</sup> Energy related agreements signed during this period are estimated to be worth \$120 billion.<sup>216</sup> Investments of note include a \$40 billion deal to update the Iranian petroleum refining industry, a \$2 billion Sinopec Group agreement to develop the Yadavaran oil field and an additional \$70 billion in assistance directed towards the development of the Yadavaran oil field in exchange for 10 million tons of LNG from Iran.<sup>217</sup>

Despite fortifying Sino-Iranian relations with economic-energy agreements, in light of Iran’s outdated energy infrastructure analysts are still left with technical difficulties in terms of deciphering how successfully energy agreements are being implemented towards meeting China’s energy needs.<sup>218</sup> As a result of the numerous energy contracts that have been initiated between the two nations, the Islamic Republic has subsequently been provided with cover to weather sanctions that target its energy sector.<sup>219</sup> However, the ‘life jacket’ that Beijing provides Tehran’s energy sector can easily be revoked. Due to, “the challenges and potential political backlash” linked with conducting business in Iran, most Sino-Iranian agreements are in the, “form of non-binding memoranda of understanding which are easily revocable in the event of political, economic, or internal instability”.<sup>220</sup>

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<sup>214</sup> Jurgen C.U. Budike, *Securing China’s Oil Supply from the Persian Gulf: The Case of Iran and Saudi Arabia*, MA thesis, International School for Humanities and Social Studies (ISHSS): University of Amsterdam, (2010), p. 82. Accessed: 17 July 2012, URL:

[http://epa.ias.asia/files/Jurgen%20Budike\\_Securing%20China's%20Oil%20Supply%20From%20the%20Persian%20Gulf.pdf](http://epa.ias.asia/files/Jurgen%20Budike_Securing%20China's%20Oil%20Supply%20From%20the%20Persian%20Gulf.pdf)

<sup>215</sup> Morris, “From Silk to Sanctions and Back Again: Contemporary Sino-Iranian Economic Relations,” p. 3.

<sup>216</sup> Ibid.

For more information on the various energy deals/projects between Iran and China see:

Budike, *Securing China’s Oil Supply from the Persian Gulf: The Case of Iran and Saudi Arabia*, p. 84.

Zahirinejad. “Implication of New World Order on China’s Energy Policy Towards Iran,” p. 118.

Davis *et al.*, “China-Iran: A Limited Partnership,” pp. 15-17.

Jun and Lei, “Key Issues in China-Iran Relations,” p. 45.

<sup>217</sup> Morris, “From Silk to Sanctions and Back Again: Contemporary Sino-Iranian Economic Relations,” p. 3.

<sup>218</sup> Budike, *Securing China’s Oil Supply from the Persian Gulf: The Case of Iran and Saudi Arabia*, p. 86.

<sup>219</sup> For example, the US’s Iran-Libya Sanction Act which bans any company from investing more than \$20 million per annum in Iran’s petroleum sector. – Gentry, “The Dragon and the Magi: Burgeoning Sino-Iranian Relations in the 21<sup>st</sup> Century,” p. 116.

<sup>220</sup> Morris, “From Silk to Sanctions and Back Again: Contemporary Sino-Iranian Economic Relations,” p. 3.

Taking into consideration the damage that UN sanctions and unilateral measures have inflicted on Iran's economy, Tehran views Beijing as a lifeline now more than ever. China is considered to be a strong economic partner that is capable of providing the crucial investment and technology that is need for Iran's economic development. On the energy front, Beijing's vested interests in Tehran's energy sector are vital as Iran lacks the necessary expertise and capital to modernise its declining energy industry, especially its oil refining capabilities.<sup>221</sup> Until recently, Tehran did not possess the refining capabilities to meet domestic oil needs, thus Iran had to import approximately 40 percent of its refined oil to meet demands.<sup>222</sup> However, with sanctions limiting refined oil exports to the country, Iran was forced to expand its oil refining capacity. Despite needing more than \$100 billion in investments to maintain and modernise its oil production capacity, Iranian officials are wary of granting foreign firms overly generous access to their energy resources.<sup>223</sup> Thus, Downs states that the, "Iranians themselves have been more effective in deterring investment in their oil sector than US sanctions."<sup>224</sup> However, by appealing to its dominant energy beneficiary, China increased fuel shipments to the Islamic Republic and is aiding Iran with its refining expansion efforts.<sup>225</sup> Assisting Iran has provided the Chinese with an opportunity to expand their foreign investment and a chance to enter Tehran's 'good books' for securing future oil supplies.<sup>226</sup> Since the Chinese are essentially keeping the Iranian energy sector afloat, Molavi suggests that the Sino-Iranian relationship seems to be more vital for Tehran than Beijing.<sup>227</sup> By playing on this asymmetrical dependence, Chinese firms have asserted that if there are hindrances that prevent China's Iranian projects from obtaining attractive profits, they will revert to a peripheral position in the country's energy sector.<sup>228</sup>

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<sup>221</sup> However, although China has the necessary capital to assist Iran, it currently lacks the technological expertise and equipment (which are mainly in Western hands) to substantially upgrade and modernise Iranian oil infrastructure. – Dorraj and Currier, "Lubricated with Oil: Iran-China Relations in a Changing World," p. 72.

<sup>222</sup> Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 11.

<sup>223</sup> Erica Downs, "China-Gulf Energy Relations," in *China and the Persian Gulf*, eds. Bryce Wakefield and Susan L. Levenstein (Washington: Woodrow Wilson International Centre for Scholars, 2010), pp. 71-72.

Accessed: 16 July 2012, URL:

[http://www.wilsoncenter.org/sites/default/files/ASIA%20Program\\_China%20and%20the%20PG.pdf](http://www.wilsoncenter.org/sites/default/files/ASIA%20Program_China%20and%20the%20PG.pdf)

<sup>224</sup> *Ibid.*, p. 72.

<sup>225</sup> Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 11.

Chinese companies have agreed to build a refinery in Hormuz and assist in expanding the capacity of the existing refinery in Abadan. – Mackenzie, "A Closer Look at China-Iran Relations," p. 5.

<sup>226</sup> Baker, *Beyond Oil? Chinese National Interests and the Sino-Iranian Relationship*, p. 19.

<sup>227</sup> Molavi, "The New Silk Road, "Chindia," and The Geo-Economic Ties that Bind the Middle East and Asia," p. 51.

<sup>228</sup> Lee and Shalmon, "Searching for Oil: China's Oil Initiatives in the Middle East," p. 21.

Despite the seemingly anchored Sino-Iranian economic-energy relationship, major Chinese NECs have been stalling the implementation of agreements in Iran in the face of sanctions against Tehran. However, there has been no clear indication if the decision to delay the implementation of energy deals is a directive from the Chinese government or based on Chinese NECs' wariness of proceeding with energy plans in a high-risk environment. Harold and Nader suggest that firms are individually weighing up the risks to avoid a Libyan scenario, where analysts forecasted that a democratic Libya would potentially cost China \$18.8 billion in investments.<sup>229</sup> While awaiting the outcome of the Obama Administration's deliberation regarding the possibility of sanctioning Chinese firms under the Comprehensive Iran Sanctions, Accountability, and Divestments Act of 2010 (CISADA), China delayed the implementation of an estimated \$40 billion in 2010 investments to revamp Iran's petroleum industry.<sup>230</sup> Thus, of the \$40 billion, China, in 2011, had so far only provided less than \$3 billion.<sup>231</sup> If a high risk business environment is behind Chinese NECs reluctance to implement decisions it can be assumed that, once Tehran gains a more favourable international status, China is likely to advance the implementation of agreements in order to avoid competition from other countries who may want to re-engage with Iran.<sup>232</sup>

### **3.3. Geostrategic: Countering US Hegemony in the Middle East**

In terms of geostrategic reasoning the Islamic Republic is of major importance to China. Iran stands out mainly because it is the largest and most populous Islamic country in the oil abundant Middle East.<sup>233</sup> Moreover, due to its strategic location, geographical land mass and human resources, Iran is considered to be a regional power in the Middle East. The Islamic Republic is deemed to be geostrategically imperative because:<sup>234</sup> firstly, Iran has a stretching coastline on the North Arabian Sea which dominates the entire eastern side of the Persian Gulf. Secondly, the Islamic Republic has lengthy borders with Iraq, Turkey, Afghanistan and Pakistan. Furthermore, Iran also borders on some of the remaining republics of the former Soviet Union, namely Armenia, Azerbaijan and Turkmenistan. Lastly, towards the North of Iran, the country also has a coastline on the Caspian Sea and shares borders with states in the Central Asian region.

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<sup>229</sup> Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 12.

<sup>230</sup> Salvin, "Iran turns to China, Barter to Survive Sanctions," p. 3.

<sup>231</sup> Ibid., p. 4.

<sup>232</sup> Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 12.

<sup>233</sup> Jun and Lei, "Key Issues in China-Iran Relations," p. 50.

<sup>234</sup> Ibid.

Taking these geostrategic factors into account and the country's potential as a regional power, in the 1970s Washington considered Iran to be a 'strategic pillar' in America's grand strategy for Western Asia.<sup>235</sup> However, with the ousting of the Shah in 1979 and the Iranian hostage crisis, the US revised its views of Iran and deduced that the country was to be considered a 'strategic threat'.<sup>236</sup> Over the years, Washington's aversion towards Tehran has been demonstrated by the numerous unilateral sanctions against the country and speeches by American officials that deem the country to be a 'pariah' state and part of the 'axis of evil'. As such, the Americans have strategically established an expansive military and naval presence in the Middle East in order to protect their oil investments, to insure regional stability and, most importantly, to serve as a warning to Iran.<sup>237</sup> However, "the military implementation of the Bush administration's unilateralist foreign policy" has produced significant changes in geostrategic alliances.<sup>238</sup> This is particularly demonstrated by the strengthened Sino-Iranian relationship.

China perceives that America's policy towards the Middle East and its established military presence serves to bolster the US's dominance in the region.<sup>239</sup> Stemming from Beijing's desire for a multi-polar world and its opposition to the US's hegemonic influence in the Arab world, a part of China's foreign policy towards the Middle East is, from a realist-mercantilist perspective, based on opposing American hegemony in the area.<sup>240</sup> Beijing strongly favours multi-polarity because the PRC, "believes that a regional and international environment in which the US is obliged to accept the diversity of political and social systems best serves China's interests."<sup>241</sup> Such thinking could possibly stem from Beijing's anxiety over Washington's ability to control strategic global areas and its potential to cut off energy

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<sup>235</sup> Jun and Lei, "Key Issues in China-Iran Relations," p. 50.

<sup>236</sup> Ibid.

<sup>237</sup> The US has military bases in Bahrain, Saudi Arabia, Kuwait and Qatar, a bold military presence in Afghanistan and Iraq, and a strong naval setup in the Persian Gulf.

<sup>238</sup> Jun and Lei, "Key Issues in China-Iran Relations," p. 51.

<sup>239</sup> Cooney, *Chinese Oil Dependence: Opportunities and Challenges*, p. 6.

<sup>240</sup> Since the early 1970s, the PRC has consistently called for the creation of a multi-polar world system. Throughout the Cold War era, China disapproved of American hegemonic uni-polarity and pushed for the international community to embrace the virtues of multi-polarity. As a result, Beijing's desire for a multi-polar world has moulded Chinese views of American hegemony in the Middle East and other places where the PRC has vested interests. – John Garver, Flynt Leverett and Hillary M. Leverett, "Moving (Slightly) Closer to Iran: China's Shifting Calculus for Managing its "Persian Gulf Dilemma"," *Asia Pacific Policy Papers Series* (2012), p. 16. Accessed: 24 June 2012, URL: [http://www.reischauercenter.org/en/wp-content/uploads/2012/05/moving\\_slightly\\_closer.pdf](http://www.reischauercenter.org/en/wp-content/uploads/2012/05/moving_slightly_closer.pdf)

<sup>241</sup> Garver, Leverett and Leverett, "Moving (Slightly) Closer to Iran: China's Shifting Calculus for Managing its "Persian Gulf Dilemma," p. 18.

supplies to China in the event of a military conflict, possibly over Taiwan.<sup>242</sup> Additionally, Chinese analysts are concerned with Washington's potential to utilise its hegemonic status to assert control over oil resources that could be used as leverage to coerce major oil consumers, since, "once you control the gulf, you control Europe, Japan and China, like holding the tap in your hands."<sup>243</sup> Thus, oil is more than just a fuel resource, it is a power tool.

However, without any strong historical ties or a longstanding strategic interest in the region, China's mission to 'chip away' at American dominance in the Middle East is hampered. Thus Beijing has avoided directly challenging the US's hegemonic position. Instead, the PRC is indirectly working towards minimising America's strong influence in the area by supporting or building relationships with regimes that have an aversion towards the US's presence in the Middle East.<sup>244</sup> In this regard, Iran is considered to be an ideal partner for China. Aware of the Islamic Republic's emergence as a regional power, geostrategic location, distaste of America's influence in the region and, most importantly, Iran's shared view of a multi-polar world, Beijing has sought to forge sturdy economic, diplomatic and military ties with Tehran to counterbalance US power in the Middle East.

Since American-Gulf alliances have established a security regime that is in line with the US's interests in the Middle East,<sup>245</sup> China has been prompted to pursue substantial military and defence relations with Iran. The Chinese strategically reason that assisting Iran with military improvements indirectly counterbalances US dominance in the Persian Gulf.<sup>246</sup> Furthermore, there have been suggestions that Beijing may eventually propose to enter into a formal defence relationship with Iran<sup>247</sup> but, due to the negative implications that such an agreement would have on China's relations with the US, the Arab world and Israel, a Sino-Iranian defence relationship seems improbable. Nevertheless, this does not mean that geopolitical cooperation between China and Iran is stunted. On the contrary, geostrategic collaboration between these two nations can continue to advance, despite the absence of a formal defence

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<sup>242</sup> Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 2.

<sup>243</sup> Cited by: Zhang Jianxin, "Oil Security Reshapes China's Foreign Policy," *Centre on China's Transnational Relations: The Hong Kong University of Science and Technology*, Working Paper no.9 (2005): p. 5. Accessed: 04 August 2012, URL: <http://www.marshallfoundation.org/documents/ChinaForeignPolicyEnergy.pdf>  
Garver, "Is China Playing a Dual Game in Iran?" pp. 77-78.

<sup>244</sup> Cooney, *Chinese Oil Dependence: Opportunities and Challenges*, p. 7.

<sup>245</sup> *Ibid.*, p. 18.

<sup>246</sup> Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 18.

<sup>247</sup> *Ibid.*, p. 19.

agreement.<sup>248</sup> Chinese analysts advocate that Beijing's efforts to strengthen ties with Iran could serve as a hedge to prevent Iran from succumbing to American influences in the future, especially if the Islamic Republic's current regime is overthrown and replaced with a more pro-American government.<sup>249</sup> However, China and Iran's diverging interests regarding the US limits the extent of their opposition towards Washington. Unlike Tehran who is almost entirely cut off from the US's economy and has to deal with numerous American-led international sanctions, Beijing depends greatly on Washington for its economic growth and the protection of its oil shipments along East Asian sea routes. Thus, China's desire to counter America's dominance in the Middle East is limited by its dependence on favourable trade and investment relations with Washington.<sup>250</sup>

In sum, in spite of the imposition of international sanctions against Iran, Sino-Iranian relations have grown considerably. This is particularly demonstrated by the increase in trade between the two countries, as well as their shared interest in expanding relations to encompass non-energy related cooperation and investment. Nevertheless, energy (particularly the export of large amounts of oil to China) remains the cornerstone of this relationship – it is a significant factor that rationalises Beijing's maintenance of ties with the internationally condemned Tehran. However, as a result of a risky Iranian business climate, Chinese NECs have been stalling the implementation of energy agreements with Iranian suppliers. This has led to increased doubts over China's commitment to Iran in the face of Western calls for Beijing to distance itself from a nuclear-aspirant Tehran. Aside from Iran's alluring hydrocarbon assets, the Chinese also acknowledge the significant role that Tehran can play in keeping a check on US influence in the Middle East. Aware of the country's geostrategic position and its regional power status, Beijing has been motivated to forge sturdy ties with Tehran in order to counterbalance US power in the Middle East. However, unlike Iran, Beijing's economic dependence on Washington limits it from significantly minimising the US's dominance in the Middle East. Although Sino-Iranian relations have grown and strengthened over the years, diplomatic pressure placed on China to contribute to isolating Tehran may have influenced the Chinese to reassess their economic-energy interests in Iran. Nevertheless, even though the Islamic Republic is regarded as just another market and energy source for China, Beijing cannot be easily swayed in its decision to engage with Iran as it has come to play a vital role in shaping Chinese interest in the Middle East.

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<sup>248</sup> Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 19.

<sup>249</sup> *Ibid.*, p20.

<sup>250</sup> *Ibid.*, p21.

## CHAPTER 4

### China's Persian Gulf Diplomacy

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Since the Middle East, and particularly the Persian Gulf, assumes a vital position in Beijing's energy security, this thesis would not be complete without an analysis of China's Persian Gulf diplomacy. This chapter, firstly, demonstrates why the Gulf is important to Beijing's energy accumulation drive and how the PRC, by fostering economic interdependence between China and Gulf countries, hopes to lock into the area's energy resources. Secondly, by analysing Beijing's US-Iran balancing act and its response to international sanctions against Tehran, this chapter illustrates that China has carefully calculated its actions in this region so as to avoid straining its relationship with Washington.

Although Gulf countries do not border the PRC, the region has become, "a natural and certain extension of China's neighbouring areas."<sup>251</sup> The Gulf is strategically related to Beijing's various interests because of its geopolitical location, economic opportunities, security issues and, most importantly, its abundant oil supplies. However, the PRC lacks the historically forged links and deep connections that Western powers have established with Arab states. Thus, the challenge for China is to strengthen its economic standing in the Middle East, especially with Gulf countries. Aside from being a radical and revolutionary influence during the Cold War, Beijing has rarely assumed a central or influential role in the region.

This does not mean that China has been inactive in this part of the world; on the contrary, it has utilised numerous strategic advantages to improve its political and economic position in the Gulf. In doing so, China has managed to increase its energy security whilst simultaneously establishing foundations to enhance its political position in the Middle East. This could, in the face of the US's hegemonic control of the region, embolden Beijing to pursue a more active role in the area. However, such an endeavour would likely interfere with Washington's Middle East interests.<sup>252</sup> Aware of China's increasing dependence on oil imports, and Beijing's willingness to interact with pariah states to extract oil and gas resources, the West, particularly the US, believes that Beijing will use all available means to satisfy its voracious oil appetite. As a result, Washington is concerned with China's growing

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<sup>251</sup> Luo Yuan, "China's Strategic Interests in the Gulf and Trilateral Relations among China, The US and Arab Countries," in *China's Growing Role in the Middle East: Implications for the Region and Beyond* (Washington: The Nixon Centre, 2010), p. 23. Accessed: 05 February 2013, URL: <http://cftni.org/full-monograph-chinas-growing-role-in-me.pdf>

<sup>252</sup> Andrews-Speed and Dannreuther, *China Oil and Global Politics*, pp. 135 & 139.

presence in the Middle East as the Americans speculate that Beijing's increasing involvement in the region could destabilise the regional order, and undermine the US's access to oil and efforts to stabilise the region. However, contrary to negative accusations and predictions, Lai outlines that Beijing has been mindful of the US and its interests in this region, as China attempts to pursue its Middle-Eastern goals through a constructive and cooperative approach.<sup>253</sup> Chinese and American interests regarding the Gulf diverge and have the potential to create serious tensions between the two states. This is clearly depicted by the different strategies that the US and China have taken in dealing with the Iranian nuclear issue.

Historically, China's 'Persian Gulf Dilemma' first emerged with the Iranian Revolution in 1979 and the consequent divergent American and Chinese policy towards Iran. The Clinton Administration's policy of 'dual containment' vis-à-vis Iran and Iraq was in stark contrast to Beijing's advances in establishing cooperative, multi-faceted relationships with Washington's Gulf rivals.<sup>254</sup> Given the intense focus that China places on increasing economic growth, Beijing has tried to avoid endangering its energy supplies and economic investments in Iran, whilst simultaneously steering clear of antagonising its relations with the West, particularly the US.<sup>255</sup> However, with Western pressure increasing against Iran, Iranian officials are aware of the balancing role that China could play against the West. As such, Tehran has sought to use its energy assets as a political lifeline in an attempt to draw China closer.<sup>256</sup> The Iranians are aware that Beijing could utilise its position as a permanent member of the UN Security Council to provide Tehran with leverage in the international arena.<sup>257</sup> However, although Beijing highly values its Sino-Iranian energy relationship and acknowledges that Iran's status as the second largest oil exporter in OPEC affords China a powerful position within the Middle East and amongst other oil-producing states, Iranian officials may underestimate the importance Beijing places on its relationship with the US and, as a result, overestimate how far China will stretch to support Iran.<sup>258</sup>

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<sup>253</sup> Lai, "China's Oil Diplomacy: is it a global security threat?" p. 530.

<sup>254</sup> Garver, Leverett and Leverett, "Moving (Slightly) Closer to Iran: China's Shifting Calculus for Managing its Persian Gulf Dilemma," p. 7.

<sup>255</sup> Baker, *Beyond Oil? Chinese National Interests and the Sino-Iranian Relationship*, p. 30.

Budike, *Securing China's Oil Supply from the Persian Gulf: The Case of Iran and Saudi Arabia*, p. 71.

<sup>256</sup> Calabrese, "China and Iran: Mismatched Partners," p. 12.

<sup>257</sup> *Ibid.*, p. 8.

<sup>258</sup> Baker, *Beyond Oil? Chinese National Interests and the Sino-Iranian Relationship*, p. 20.

#### 4.1. China's Energy Quest and the Persian Gulf

With China's rise being viewed as one of the most outstanding developments of the early 21<sup>st</sup> century, Beijing adopted a 'look beyond China' strategy to procure reliable sources of energy to fuel its expanding economy. This has resulted in the Asian Giant intensifying its relations with Persian Gulf states that are heavily endowed with energy resources. Although Beijing has in the past viewed events in the Middle East through a revolutionary, Maoist ideology, China's policy towards the region has evolved over the last three decades from an ideological focus to a more rational, pragmatic approach.<sup>259</sup> China's growing involvement in this part of the globe stems from its aspirations to assume a more proactive role in maintaining a stable Middle East, as the PRC perceives that the Arab world provides Beijing with a platform to demonstrate that, as a rising power, it is a 'responsible stakeholder'.<sup>260</sup> China's objectives for Sino-Arab relations are best expressed by former president Hu Jintao, who stresses four points that China and Arab states should focus on to strengthen relations. According to Hu, China and Arab states should strive:

*to promote political relations on the basis of mutual respect, to forge closer trade and economic links so as to achieve common development, to expand cultural exchanges through drawing upon each other's experience, and to strengthen cooperation in international affairs with the aim of safeguarding world peace and promoting common development.*<sup>261</sup>

Despite massive oil discoveries in other regions, Lee and Shalmon highlight that the Middle East will continue to have the largest oil reserves and lowest production costs.<sup>262</sup> Thus, with an expected increase in oil import levels, Beijing is pushing to gain a larger share of Gulf oil markets as 51% of proven oil reserves are located in the Middle East, of which 33% is

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<sup>259</sup> Bryce Wakefield, "Introduction," in *China and the Persian Gulf*, eds. Bryce Wakefield and Susan L. Levenstein (Washington: Woodrow Wilson International Centre for Scholars, 2010), p. 2. Accessed: 16 July 2012, URL:

[http://www.wilsoncenter.org/sites/default/files/ASIA%20Program\\_China%20and%20the%20PG.pdf](http://www.wilsoncenter.org/sites/default/files/ASIA%20Program_China%20and%20the%20PG.pdf)

Wu Bingbing, "Strategy and Politics in the Gulf as seen from China," in *China and the Persian Gulf*, eds. Bryce Wakefield and Susan L. Levenstein (Washington: Woodrow Wilson International Centre for Scholars, 2010), p. 10. Accessed: 16 July 2012, URL:

[http://www.wilsoncenter.org/sites/default/files/ASIA%20Program\\_China%20and%20the%20PG.pdf](http://www.wilsoncenter.org/sites/default/files/ASIA%20Program_China%20and%20the%20PG.pdf)

<sup>260</sup> Pan Zhenqiang, "China and the Middle East," in *China's Growing Role in the Middle East: Implications for the Region and Beyond* (Washington: The Nixon Centre, 2010), p. 87. Accessed 05 February 2013, URL:

<http://cftni.org/full-monograph-chinas-growing-role-in-me.pdf>

<sup>261</sup> Cited by: Zhenqiang, "China and the Middle East," p. 87.

<sup>262</sup> Lee and Shalmon, "Searching for Oil: China's Oil Initiatives in the Middle East," p. 14.

situated in Gulf Cooperation Council (GCC) countries.<sup>263</sup> China is especially attracted to Saudi Arabia, Iran and Iraq as 68% of the region's oil is located within these three states.<sup>264</sup> According to Budike, China's dependency on Gulf oil is predicted to increase from an estimated 42% to 70% between 2015 and 2030.<sup>265</sup> This means that, *ceteris paribus*, at least 9.3 million barrels per day (mb/d) would have to be imported from this region.<sup>266</sup> With energy undeniably the primary driver of Sino-Gulf relations, it is imperative that China's energy security strategy recognises the importance of Gulf oil in maintaining the continued advancement of Beijing's economy.<sup>267</sup> Thus, China's oil security in the Gulf depends on relentless efforts to establish economic, political and security measures to protect and ensure a reliable and sufficient supply of oil at convenient prices.<sup>268</sup>

Like China, whose energy interests motivate its pursuit of Gulf countries, oil is also a driving factor for the Gulf's interactions with Asia, especially the PRC. The Asian Giant is viewed by Gulf States as a massive market for their oil exports. In light of oil demand having plummeted in the wake of the global economic crisis, most GCC states are focusing on securing access to the Chinese domestic market which, according to Sager, is ranked as the fastest growing energy market in the world.<sup>269</sup> Furthermore, Sager posits that, in light of the global trend amongst developed nations towards greener energy resources, Gulf oil producers seek new markets to lessen their dependency on traditional and established oil consuming nations.<sup>270</sup> However, due to the Gulf's comparatively steep oil prices and China's limited capabilities to refine high sulphur crude oil from this region, Chinese foreign energy policy seeks to strengthen political relations with Gulf oil-producing states, whilst simultaneously courting additional suppliers whose oil can be purchased at cheaper prices.<sup>271</sup>

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<sup>263</sup> CIA World Factbook, *Estimated Proven Oil Reserves as of 2011*. Accessed: 10 June 2013, URL: <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2178rank.html>.

<sup>264</sup> Ibid.

<sup>265</sup> Budike, *Securing China's Oil Supply from the Persian Gulf: The Case of Iran and Saudi Arabia*, p. 92.

<sup>266</sup> Ibid.

<sup>267</sup> Emile Hokayem, "Looking East: A Gulf Vision or Reality?" in *China and the Persian Gulf*, eds. Bryce Wakefield and Susan L. Levenstein (Washington: Woodrow Wilson International Centre for Scholars, 2010), p. 39. Accessed: 16 July 2012, URL:

[http://www.wilsoncenter.org/sites/default/files/ASIA%20Program\\_China%20and%20the%20PG.pdf](http://www.wilsoncenter.org/sites/default/files/ASIA%20Program_China%20and%20the%20PG.pdf)

<sup>268</sup> Budike, *Securing China's Oil Supply from the Persian Gulf: The Case of Iran and Saudi Arabia*, p. 92.

<sup>269</sup> Sager, "GCC-China Relations: Looking Beyond Oil-Risks and Rewards," p. 2.

<sup>270</sup> Ibid.

<sup>271</sup> Charles Ziegler, "The Energy Factor in China's Foreign Policy," *Journal of Chinese Political Sciences*, vol.11, no.1 (2006): p. 9. Accessed: 16 July 2012, URL:

[http://jcps.sfsu.edu/past%20issues/JCPS2006a/2%20Energy%20Factor%20in%20China\\_Ziegler.pdf](http://jcps.sfsu.edu/past%20issues/JCPS2006a/2%20Energy%20Factor%20in%20China_Ziegler.pdf)

Taking into consideration US interests in the Middle East and historical ties between Western energy companies and Gulf oil-producing states, China, in the 1990s, adopted a foreign policy towards the region of, “being detached generally and involved appropriately.”<sup>272</sup> Essentially, this meant that with such a pragmatic orientation, the PRC had to compromise between its core national interests and the dominant role of the US in the Middle East. China’s pragmatism is essentially divided into two categories: firstly, by focusing on trade, economic and energy interests, Beijing downplays its ideological differences with pro-US Gulf States (such as Saudi Arabia).<sup>273</sup> On the other hand, China, under the precondition of not challenging US interests, aims to improve relations with anti-American governments (such as Iran) that provide little competition for Chinese NOCs.<sup>274</sup> However, the main evaluation of Beijing’s Gulf policy pertains to China’s ability to manoeuvre around pro- and anti-American regimes<sup>275</sup> as there is, “something inherently unstable in a Middle Eastern (*sic*) order that relies on the West for its security and on the East for its prosperity.”<sup>276</sup> Alterman contends that there is little doubt that the Middle East can create contention between China and the US as they seek to address their differing interests in the region.

Chinese overseas energy acquisitions in the Middle East have been considered with distrust as Washington fears that China’s growing presence, combined with its thirst for energy, will make it a destabilising force in the region.<sup>277</sup> Yet, both countries have vested interests in the stability of the region for the pursuit of energy goals – the need to ensure a stable and reliable oil supply at a fair price. Aside from this shared concern over the Gulf’s energy security, both nations have an aversion towards nuclear development and the consequential possibility of an arms race that could severely impede Gulf oil supplies. Since energy is the common denominator between these two nations, cooperative, instead of competitive and conflicting, relations between Washington and China over the Middle East is a possibility. However, given their diverging interests in the region, such an assertion may be considered as too optimistic. Nevertheless, with common strategic, regional and energy interests shared by both sides, the possibility of improved bilateral Chinese-American cooperation in the Middle East

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<sup>272</sup> Bingbing, “Strategy and Politics in the Gulf as seen from China,” p. 19.

<sup>273</sup> Ibid.

<sup>274</sup> Ibid.

<sup>275</sup> Ibid.

<sup>276</sup> John Alterman, “The Vital Triangle,” in *China and the Persian Gulf*, eds. Bryce Wakefield and Susan L. Levenstein (Washington: Woodrow Wilson International Centre for Scholars, 2010), p. 35. Accessed: 16 July 2012, URL:

[http://www.wilsoncenter.org/sites/default/files/ASIA%20Program\\_China%20and%20the%20PG.pdf](http://www.wilsoncenter.org/sites/default/files/ASIA%20Program_China%20and%20the%20PG.pdf)

<sup>277</sup> Cited by: Hongtu, “China’s Energy Interest and Security in the Middle East,” p. 54.

should not be denied, but embraced as it offers a foundation for collaboration that could not only improve security in the Middle East, but also enhance Sino-American relations.<sup>278</sup>

Bajpae cautions that, although Washington and Beijing are not engaged in explicit competition in the Middle East, it is not difficult to envision that the region could emerge as a source of contention between these two states as, in conjunction with their energy competition in this part of the world, China and the US present opposing models of international conduct.<sup>279</sup> Whilst Washington has carried out humanitarian intervention, pre-emptive action and regime change campaigns in the Middle East, Beijing has sought to refrain from such activities by adhering to its preference of non-intervention, state-sovereignty and territorial integrity – a traditional Westphalian method of engaging in international affairs that has become particularly appealing to Arab states in the face of US attempts to spread democratic principles across the region.<sup>280</sup> By considering the relationships between China, the US and the Middle East to be triangular, Alterman contends that interactions between any two sides can affect the other party.<sup>281</sup> However, since a triangle connotes relatively equal partners where actions taken by one party can affect the other two sides, Yuan denies that there is a US-China-Middle East triangle as the Americans outweigh the Chinese and Middle-Easterners in terms of power.<sup>282</sup> In addition, since relations between the three parties have only recently emerged, all sides have to overcome numerous barriers to reach a stage of interconnectedness (triangle relations).<sup>283</sup>

Although Sinologists doubt Beijing's strategic wisdom and operational effectiveness in the Middle East, China believes that it can strengthen its position in the region, especially with Gulf States that are interested in balancing their historical overreliance on the US. Furthermore, given the lack of substantial improvement in the Israeli-Palestine conflict and the US invasion of Iraq, Gulf States have realised that China, "brings a paucity of political baggage to the negotiation table," and a massive market for Middle-Eastern goods and services.<sup>284</sup> Thus, China is considered to be an attractive alternative to the US. Furthermore,

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<sup>278</sup> Alterman, "The Vital Triangle," p. 29.

<sup>279</sup> Chietigj Bajpae, *China's Growing Middle East Role and the Potential for China-US Conflict*. Accessed: 16 May 2013, URL: <http://www.japanfocus.org/-Chietigj-Bajpae/1677>

<sup>280</sup> Ibid.

<sup>281</sup> Alterman, "The Vital Triangle," p. 28.

<sup>282</sup> Yuan, "China's Strategic Interests in the Gulf and Trilateral Relations among China, The US and Arab Countries," p. 28.

<sup>283</sup> Ibid.

<sup>284</sup> Calabrese, "China and the Persian Gulf: Energy and Security," p. 356.

by adhering to the principles of sovereignty and non-interference, China has become more appealing to Middle East states as politically, unlike the US, China does not press Gulf States about their domestic political environments – especially the need for democracy and respect for human rights. Consequently, this makes dealings with China less challenging.<sup>285</sup>

Beijing is not the only beneficiary in the Gulf-China relationship as the strengthening of ties with China fits well into the GCC states' strategy to diversify their international relationships in an attempt to lessen their dependence on the US. China's shift from an exporter to a consumer market is viewed as an opportunity for GCC countries to improve their competitive standing and enlarge their share in the world's largest market.<sup>286</sup> In this context, China's open-door policy is complemented by non-politicised relationships, which have led Beijing and Middle-Eastern countries to make investments worth billions of dollars.<sup>287</sup>

Although a picture of favourable circumstances for Chinese advancement in the Middle East has been painted, there are barriers to China's mission of improving ties in the Persian Gulf. International sanctions and the US war in Iraq have hindered China from pushing its agenda forward in Baghdad, whilst complicated geology and a strenuous business climate have strained investment plans in Iran. Furthermore, Saudi Arabia, China's largest oil exporter, is reluctant to privatise oil fields, although the Saudi government has offered to consider foreign investment in integrated domestic natural-gas projects. Chinese NOCs have not favoured this option as they consider it to be a costly investment which does not provide a shareholding in oil supplies to ship back to China.<sup>288</sup>

Unlike the US, Japan and Europe – which have a lengthy history of importing oil from the Middle East, Beijing is at a disadvantage due to its late arrival in this oil rich region and because, in contrast to its counterparts, China is still attempting to foster secure relations with Middle-Eastern states that can assure the shipment of oil to the PRC.<sup>289</sup> By deliberately avoiding a singular focus on oil supplies, Beijing has attempted to expand the scope of economic exchanges between GCC countries and itself. China's strategy aims to build a level of economic interdependence between Beijing and Arab states that will result in increased trade (especially with regards to the purchasing of oil and gas). Through establishing

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<sup>285</sup> Sager, "GCC-China Relations: Looking Beyond Oil-Risks and Rewards," p. 16.

<sup>286</sup> Ibid., p. 12.

<sup>287</sup> For more information on the numerous investments China has made in the Middle East see:

Sager, "GCC-China Relations: Looking Beyond Oil-Risks and Rewards," pp. 12-14.

<sup>288</sup> Amy M. Jaffe and Steven W. Lewis, "Beijing's Oil Diplomacy," *Survival*, vol.44, no.1 (2002): p. 124.

<sup>289</sup> Downs, *China's Quest for Energy Security*, p. 48.

economic interdependence, Beijing realises that it would be difficult and economically straining for Gulf countries to disrupt oil supplies to China.<sup>290</sup> Economically, China is pursuing a ‘two imports and one export’ strategy to advance its energy relationship with Arab oil-producing states.<sup>291</sup> The ‘two imports’ refers to oil imports and the necessary capital needed to develop China’s oil industry, whilst the ‘one export’ refers to Beijing’s investments in oil exploration and development projects in the Middle East.<sup>292</sup>

With the aim of establishing a mutually beneficial trade relationship, GCC-China trade increased from \$12 billion in 2003 to \$68 billion in 2009.<sup>293</sup> Moreover, Beijing has allowed Chinese oil firms to gain a strategic foothold in the region’s energy sector by allowing NOCs to negotiate long-term supply contracts and production sharing arrangements directly with Persian Gulf governments instead of international oil firms.<sup>294</sup> On the political front, China is expanding its diplomacy in the region, albeit carefully under the watchful eye of the US, as Beijing is aware of Washington’s potential to thwart oil supplies to China. Although Downs highlights that the 1970s’ oil crisis demonstrated that bilateral relationships are, “virtually useless during a crisis,” the PRC seems to bely historical evidence as it persists with the establishment of strong bilateral ties to ensure the security of oil supply from the Gulf.<sup>295</sup> Several Chinese state leaders have undertaken state visits to the Middle East in an effort to strengthen ties in the region, especially with countries that have an aversion towards the US. In terms of utilising its military capabilities for its energy drive, Downs suggests that China could use its arms sales to develop closer ties with heavily oil endowed Middle-Eastern countries, as Beijing is considered to be an attractive option for states seeking ballistic-weapons technology that the US is reluctant to provide.<sup>296</sup>

In spite of its strategic approach towards the Gulf, China has had to rethink its strong dependence on Persian Gulf oil. Taking into consideration the volatility of the Middle East, the dominance of the US in the region, and having to ship oil through the Strait of Malacca – one of the most dangerous shipping lanes in the world – China has sought to aggressively

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<sup>290</sup> Lee and Shalmon, “Searching for Oil: China’s Oil Initiatives in the Middle East,” p. 15.

Downs, *China’s Quest for Energy Security*, p. 33.

<sup>291</sup> Downs, *China’s Quest for Energy Security*, p. 48.

<sup>292</sup> Ibid.

<sup>293</sup> Sager, “GCC-China Relations: Looking Beyond Oil-Risks and Rewards,” p. 7.

<sup>294</sup> Calabrese, “China and the Persian Gulf: Energy and Security,” p. 356.

<sup>295</sup> Downs, “The Chinese Energy Security Debate,” p. 38.

<sup>296</sup> Downs, *China’s Quest for Energy Security*, p. 49.

Jaffe and Lewis, “Beijing’s Oil Diplomacy,” p. 124.

diversify its oil imports. In doing so, China has ventured beyond the Middle East into Africa, Central Asia and the Americas. However, having taken into consideration global oil distribution, production capacity and supply potential, many scholars such as Downs still emphasise that the Middle East, and especially the Persian Gulf, will continue to be imperative to China's oil supply<sup>297</sup> as it is predicted that as much as 70-80 percent of China's future oil imports will have to be sourced from the Middle East.<sup>298</sup> Beijing's three main NOCs have thus aggressively bid against other major oil companies in an attempt to monopolise the region's vast oil reserves. This is especially evident in Iran, and specifically after a signed memorandum of understanding regarding bilateral energy cooperation agreed to the Chinese development of Iranian oil fields.<sup>299</sup>

Moreover, China is seeking to fortify its oil security by updating its age-old refining facilities to process Middle-Eastern crudes, as Chinese refiners are unable to process most of the crude oil from the region due to the high sulphur content.<sup>300</sup> Undertaking the construction of facilities that are capable of processing sour crude oil demonstrates China's growing dependence on Arab oil. Furthermore, it also highlights Beijing's view that crude imports are a better source of energy security as refined oil is more expensive to store and it deteriorates faster than crude oil.<sup>301</sup> Yet, due to its increasing dependence on Persian Gulf oil, Beijing could face new strategic vulnerabilities. Although the Chinese have militarily advanced in giant leaps, their naval build up (however impressive) is insufficient to protect the East-Asian sea lanes or guarantee protected access to Persian Gulf oil.<sup>302</sup> Thus, China acknowledges that it is unavoidably forced to depend on the US military to protect its access to the Gulf's oil. As

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<sup>297</sup> Douglas, Nelson and Schwartz, *Fuelling the Dragon's Flame: How China's Energy Demand Affects its Relationships in the Middle East*, p. 21.

Downs, "China," p. 32.

<sup>298</sup> Douglas, Nelson and Schwartz, *Fuelling the Dragon's Flame: How China's Energy Demand Affects its Relationships in the Middle East*, p. 21.

Lee and Shalmon, "Searching for Oil: China's Oil Initiatives in the Middle East," p. 13.

Yuan, "China's Strategic Interests in the Gulf and Trilateral Relations among China, The US and Arab Countries," p. 24.

Downs, "China," p. 32.

<sup>299</sup> Douglas, Nelson and Schwartz, *Fuelling the Dragon's Flame: How China's Energy Demand Affects its Relationships in the Middle East*, p. 5.

<sup>300</sup> China's refineries can refine 'sweet' (low in sulphur content) from Oman and Yemen, yet the PRC's facilities are unable to process 'sour' (high in sulphur content) crudes from countries such as Iran, Iraq and Saudi Arabia and Kuwait. – Downs, *China's Quest for Energy Security*, p. 32.

Daojiong, "China's Energy Security and its International Relations," p. 49.

<sup>301</sup> Downs, *China's Quest for Energy Security*, p. 31.

<sup>302</sup> Jaffe and Lewis, *Beijing's Oil Diplomacy*, p. 125.

a result, Beijing has to restrain its geostrategic plans for sponsoring Middle East nations that are hostile towards the US and its regional allies.

Although Middle-Eastern countries may attempt to lessen their dependency on the US, states in the Middle East are aware of China's reluctance to bring the hammer down on Iran – a potential threat to regional security. GCC members believe that, in keeping its options open, China is only willing to play a secondary role in the region.<sup>303</sup> As such, Middle-Eastern states acknowledge that, in spite of the variety of advantages that China provides, their security continues to lie in NATO's palms and therefore, by implication, in American hands.<sup>304</sup> Arab states acknowledge that, unlike the US who has invested millions of dollars in attempts to resolve regional conflicts in the Middle East, China will maintain its secondary role in the region as it waits to capitalise on situations where Washington may falter. Lee and Shalmon assert that China accepts that it is not about to replace US dominance in the region, instead Beijing is focusing on shifts at the margin by proactively seeking to enhance Sino-Arab ties. Since energy security is the backbone of China's forays into the Middle East, through attempts to secure fuel supplies Beijing is striving to extend relationships beyond energy in an attempt to create an economic interdependence that can ultimately assure the shipment of Gulf oil to China. In seeking to improve relations with Arab nations, Lee and Shalmon posit that Beijing can draw on its Gulf energy dealing experiences to equip China to handle the diplomatic and strategic complexities of oil geo-politics in the region, especially in the Persian Gulf.<sup>305</sup> However, it is essential that Beijing maintain its pragmatic stance in order to avoid disagreements with Gulf States and the possibility of souring its relations with its vital economic partner and largest export market – the US.<sup>306</sup>

#### **4.2. China's Persian Gulf Dilemma: Beijing's Balancing Act Between Iran and the US**

Since Beijing's earnest engagement with Persian Gulf countries in the early 1970s, China has been aware of the US's strong presence within the Gulf. This has challenged Chinese foreign policy to strike a fine balance between maintaining sound relations with the US against its interests in developing multi-faceted relationships with energy important Gulf countries. This

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<sup>303</sup> Sager, "GCC-China Relations: Looking Beyond Oil-Risks and Rewards," p. 20.

<sup>304</sup> Margaret Karns and Karen Mingst, *International Organizations: The Politics and Processes of Global Governance* (Boulder Colorado: Lynne Rienner Publishers Inc., 2004), pp. 156-158.

<sup>305</sup> Lee and Shalmon, "Searching for Oil: China's Oil Initiatives in the Middle East," pp. 30-31.

<sup>306</sup> Bingbing, "Strategy and Politics in the Gulf as seen from China," p. 24.

includes countries that are at odds with Washington's policies. China's 'Persian Gulf Dilemma', (often referred to as Beijing's 'balancing act', tightrope walk', and 'dual game') essentially refers to China's efforts to balance its interests in pursuing Iran's energy resources against its interests in maintaining sound relations with the US.<sup>307</sup> This has proven to be a challenging task for Beijing, as Washington has repeatedly called upon China to assist US efforts in isolating Iran for its relentless pursuit of achieving nuclear proliferation capabilities.<sup>308</sup> However, in light of China's burgeoning energy demands, Beijing has developed a strategic energy relationship with Iran that is considered to be of crucial importance to the PRC. Aware of these two aspects of the Persian Gulf Dilemma, Chinese leaders have treaded carefully in this part of the world (especially with Iran) to avoid being perceived by Washington as a direct threat to its hegemonic position in the region. Thus, it has been suggested that China's foreign policy will continue to try and balance the two aspects of its Persian Gulf Dilemma, as the costs of siding with either side are too great.<sup>309</sup>

Although China will continue to avoid directly challenging the US's hegemony in the Gulf, recent developments in the energy aspect of the Sino-Iranian relationship, according to Garver *et al.*, highlight that Beijing has calculated that it can 'get away with more', in terms of energy investments without provoking serious US scrutiny.<sup>310</sup> Such calculations likely stem from Beijing's desire to maximise the scope of its energy investments in Iran. Having invested tremendously in Iran's energy sector, Beijing is unlikely to support former Secretary of State, Hilary Clinton's ambition of implementing "crippling sanctions" against Iran.<sup>311</sup> Furthermore, it has been suggested that the Chinese perceive the US's policy of containing Iran as a unilateral initiative that has been calculated by Washington to ensure its dominance in the region and ability to dictate to others.<sup>312</sup> Nevertheless, aware of the importance that Washington places on non-proliferation, China sees very little reason to trigger American aggression by limiting the US's efforts to curb the advancement of Iran's nuclear capabilities.<sup>313</sup> This became clearly evident in 1997 when American and Chinese negotiations over China's nuclear cooperation with Iran resulted in Beijing suspending all nuclear, cruise

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<sup>307</sup> Garver, Leverett and Leverett, "Moving (Slightly) Closer to Iran: China's Shifting Calculus for Managing its "Persian Gulf Dilemma," p. 1.

<sup>308</sup> Ibid.

<sup>309</sup> Ibid., p. 2.

<sup>310</sup> Ibid.

<sup>311</sup> Ibid.

<sup>312</sup> Calabrese, "China and the Persian Gulf: Energy and Security," p. 361.

<sup>313</sup> Garver, Leverett and Leverett, "Moving (Slightly) Closer to Iran: China's Shifting Calculus for Managing its "Persian Gulf Dilemma," p. 8.

missile and nuclear capable ballistic missile cooperation with Tehran.<sup>314</sup> Yet, after Russia, Beijing remains Iran's second largest arms supplier. Although sensitive military technology to Iran has been halted, China still supplies the Islamic Republic with weapons and various types of military equipment.

Even though numerous elites in decision-making ranks have voiced that China should play a more active role in the Middle East in order to protect its oil supply, citizens and firms in various Middle-Eastern countries, Beijing remains determined to keep a low profile in this region so as to avoid overshadowing or threatening American dominance in the area.<sup>315</sup> This reflects Deng Xiaoping's foreign policy of, "observing calmly, securing our position, coping with affairs calmly" and, "never claiming leadership, maintaining a low profile, making some contributions."<sup>316</sup> In an attempt to stamp its neutrality between the US and Iran, Beijing emphasises that China seeks to, "make friends with all countries," irrespective of a country's relationship with the US.<sup>317</sup> The Chinese insist that it is not reasonable for Washington to insist that China choose between the US and its rivals. It seems that Beijing is using the notion of, "making friends with all countries" based on China's Five Principles of Peaceful Coexistence to 'butter its bread on both sides'.<sup>318</sup> Moreover, taking into consideration the rise in geostrategic stakes for both China and the US, Garver *et al.*, contend that Washington is not buying into Beijing's rhetoric, especially when 'friendly cooperation' entails Chinese ties with US deemed 'pariah' or 'rogue' states such as Iran.<sup>319</sup> Ultimately, China's relationship with Washington is bound to be jeopardised if Beijing does not alter the rules of its dual game in the Gulf as at some point the US is bound to understand Beijing's subterfuge.<sup>320</sup>

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<sup>314</sup> Garver, Leverett and Leverett, "Moving (Slightly) Closer to Iran: China's Shifting Calculus for Managing its "Persian Gulf Dilemma," p. 8.

Beijing's commitment to suspending nuclear cooperation with Iran was startling as, not only did China suspend all nuclear cooperation with Tehran, it also suspended nuclear cooperation with the Islamic Republic under the NPT (the NPT permits nuclear cooperation between states under the IAEA). Although China sided with the US it does not mean that the nature of its dual game has changed without obtaining some quid pro quo from the United States. According to Graver *et al.*, Beijing has consistently bargained hard. This has resulted in China frequently obtaining US concessions in return for Beijing's restraint or policy modifications with regards to the Middle East. – Garver, Leverett and Leverett, "Moving (Slightly) Closer to Iran: China's Shifting Calculus for Managing its "Persian Gulf Dilemma," p. 8.

<sup>315</sup> Garver, Leverett and Leverett, "Moving (Slightly) Closer to Iran: China's Shifting Calculus for Managing its "Persian Gulf Dilemma," p. 10.

<sup>316</sup> Bingbing, "Strategy and Politics in the Gulf as seen from China," p. 15.

<sup>317</sup> Garver, Leverett and Leverett, "Moving (Slightly) Closer to Iran: China's Shifting Calculus for Managing its "Persian Gulf Dilemma," pp. 32-33.

<sup>318</sup> *Ibid.*, p. 33.

<sup>319</sup> *Ibid.*

<sup>320</sup> *Ibid.*

Consequentially, this could lead the Americans to view the Chinese with increased scepticism; thus possibly leading to the demise of whatever trust and confidence Washington has placed in Beijing.<sup>321</sup> Owing to Beijing's awareness of the US's central role in its economic growth, the Chinese realise that the deterioration of Sino-American relations would endanger China's economic advancements and its diplomatic 'rise'.<sup>322</sup> As such, the PRC acknowledges that complete non-cooperation with Washington over Iran is not an option in the short term. Thus, China will continue to interact cautiously with Tehran and other Middle East states in an effort to avoid heightened confrontation with the US or a full partnership with Iran. However, Garver *et al.*, deduce that the precise balance that Beijing strikes between the two parties is shifting towards a direction that focuses on China's ability to garner a stronger foothold in Iran's energy sector whilst simultaneously averting American suspicions. Nevertheless, Beijing's sense of leeway does not mean that China will abandon caution in its dealings with Iran.

#### **4.2.1. China's Stance on Sanctions against Iran**

Since the US's first unilateral sanction against Iran in 1979, there has been an international campaign, mainly led by the Americans, against Tehran's uranium enrichment project and the subsequent possibility of nuclear weapons' development. Washington has expressed that sanctions need to be 'crippling', however, the US is not the only country to express aggressive views towards Iran.<sup>323</sup> Similar sentiments have been voiced by other states, for example the former president of France, Nicolas Sarkozy, stated that sanctions need to be, "massive," and according to Prime Minister Benjamin Netanyahu of Israel, actions against Iran have to be "biting".<sup>324</sup> With these views in mind, the US and its accomplices issued another round of sanctions against the Islamic Republic in 2010 with the aim of weakening the country so severely that Tehran would have no option but to halt its nuclear advancements. However, for sanctions to be truly effective the participation of China (Iran's largest trading partner and massive oil importer) is considered to be vital. Yet, the West is struggling to gain Chinese support over issues that concern proliferation, sanctions, arm sales, trade and energy investments.<sup>325</sup> Aware of the continued diplomatic pressure placed on China

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<sup>321</sup> Garver, "Is China Playing a Dual Game in Iran?" p. 87.

<sup>322</sup> Ibid.

<sup>323</sup> Willem van Kemenade, "China vs. the Western Campaign for Iran Sanctions," *The Washington Quarterly*, vol.33, no.3 (2010): p. 99.

<sup>324</sup> Ibid.

<sup>325</sup> Brandon Fite, *U.S. and Iranian Strategic Competition: The Impact of China and Russia*, p. 4.

to support the West's isolation efforts, Iran seeks to project itself as a secure energy supply for Beijing. By doing so, Tehran aims to deepen diplomatic relations with the PRC in an attempt to hold on to the leverage and protection that China can offer it. This makes it difficult for China to side with the West as Iran is the, "only country where the risk of energy and foreign policy interests colliding is high".<sup>326</sup>

Given the extenuating circumstances, China has thus far maintained a stable relationship with both the US and Iran. In line with its balancing strategy, Beijing has supported sanctions against Iran diplomatically, and simultaneously flouted them behind closed doors to maintain its lucrative and strategic economic and political ties with Tehran.<sup>327</sup> Essentially, China's posture towards Iranian sanctions is best viewed as, "a microcosm of the PRC's larger balancing act in pursuing economic and political leverage without upsetting Western, particularly American, sensitivities."<sup>328</sup> Thus, although China seeks to maintain its relationship with Iran – a strategic partner in the Middle East – it is essential for China to support the international campaign against the Islamic Republic in order to sustain the global non-proliferation regime and prevent the escalation of volatilities in this highly sensitive region.<sup>329</sup> Yet, in this high stakes game of 'geopolitical poker' being played between the West and Iran over the latter's nuclear plans, Berman believes that China has clearly placed its bet on Iran.<sup>330</sup> Having assessed the possible outcomes, he states that if the Chinese are right and Iran does achieve nuclear capabilities it will have massive impacts on regional politics and global energy.<sup>331</sup> However, if Beijing loses its wager, the Chinese economy could be severely affected.

A three-pronged approach has been adopted by the international community to deal with Iran's nuclear ambitions.<sup>332</sup> The most far reaching action has been the imposition of UN sanctions against Iran, with the latest being Resolution 1929 which was passed in 2010.

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<sup>326</sup> Daniel Yergin, *The Quest: Energy, Security, and the Remaking of the Modern World* (London: Penguin Group, 2012), p. 224.

<sup>327</sup> Fite, *U.S. and Iranian Strategic Competition: The Impact of China and Russia*, p. 4.

Swaine, "Beijing's Tightrope Walk on Iran," p. 1.

<sup>328</sup> John Douglas, Matthew Nelson and Kevin Schwartz, "Rising in the Gulf: How China's Energy Demands Are Transforming the Middle East," *Al Nakhlah: Online Journal on Southwest Asian and Islamic Civilisation*, (2007): p. 4. Accessed: 28 December 2012, URL: [http://ui04e.moit.tufts.edu/al\\_nakhlah/archives/spring2007/nelson-2.pdf](http://ui04e.moit.tufts.edu/al_nakhlah/archives/spring2007/nelson-2.pdf)

<sup>329</sup> Swaine, "Beijing's Tightrope Walk on Iran," p. 1.

<sup>330</sup> Berman, "Beijing's Iranian Gamble," p. 52.

<sup>331</sup> Ibid.

<sup>332</sup> Regan Thompson, "The Effectiveness of the Fourth Round Sanctions against Iran," *Stanford Journal of International Relations*, vol.8, no.7 (2011): p. 7.

Secondly, unilateral sanctions aimed at curbing international energy investment in Tehran's energy sector have been issued predominantly by the US. However, in an effort to garner support, the US has encouraged other countries to implement nation-specific regulations or sanctions to assist in isolating Iran. The EU has followed suit by prohibiting EU members' involvement in Iran's energy and financial sectors.<sup>333</sup> Furthermore, the EU's implementation of an oil embargo in 2012 against Tehran has severely affected Iranian oil exports, with a potential loss of 20 percent in oil export sales.<sup>334</sup> Thirdly, due to the risky and strenuous business climate that sanctions have created, there has been a voluntary pull out of the private sector from Iran. Consequently, this has severely impacted the Iranian economy.<sup>335</sup> Since the international community aims to slow down Iran's nuclear advancements and ultimately force the regime to abandon its nuclear aspirations, the main purpose of the three-pronged approach is to make it more expensive and complex for Tehran to obtain industrial equipment and nuclear supplies.<sup>336</sup> Nevertheless, even though sanctions are straining the Iranian economy and limiting the country's prospects for economic growth, Iran remains persistent in advancing its nuclear agenda.<sup>337</sup>

Unlike Washington and its allies who have made concerted efforts to isolate Iran, the PRC is reluctant to join the US-led mission against Tehran. In spite of participating in UN sanctions against Tehran's nuclear ambitions, China has also upheld a strong economic relationship with Iran that actively lessens the impact of sanctions against the Islamic Republic.<sup>338</sup> Aware that China is Iran's top trading partner and one of the largest remaining importers of Iranian oil, the West believes that Beijing's participation in an oil embargo is considered to be imperative if the mission to impede Iran's nuclear ambitions is to be successful. However, due to the PRC's economic, energy and geostrategic interests in Iran, China is wary of supporting an oil embargo or meaningful sanctions against Tehran. As a result, Chinese policies (especially Beijing's desire for economic growth and the emphasis that it places on sovereignty and non-interference), have hampered US and international efforts that aim to curb Iran's nuclear ambitions. Noting this, Iran has, to a considerable extent, come to regard

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<sup>333</sup> Thompson, "The Effectiveness of the Fourth Round Sanctions against Iran," p. 8.

<sup>334</sup> Chris Zambelis, "China's Persian Gulf Diplomacy Reflects Delicate Balancing Act," *China Brief*, vol.7, no.4 (2012): p. 3.

<sup>335</sup> For a background on the effects of sanctions on the Iranian economy and energy sector see: Kenneth Katzman, *Iran Sanctions*, (2012): pp. 44-54. Accessed: 16 March 2012, URL: <http://www.fas.org/spp/crs/mideast/RS20871.pdf>

<sup>336</sup> Thompson, "The Effectiveness of the Fourth Round Sanctions against Iran," p. 9.

<sup>337</sup> Davis, *et al.*, "China-Iran: A Limited Partnership," p. 47.

<sup>338</sup> Fite, *U.S. and Iranian Strategic Competition: The Impact of China and Russia*, p. 16.

China as its main diplomatic protector against external pressures.<sup>339</sup> Nevertheless, China does not want to be viewed as a willing enabler that could allow Iran to become the tenth nuclear power in the world.<sup>340</sup>

Essentially, China's nuclear diplomacy towards Iran rests on three broad principles:<sup>341</sup> (1) Non-intervention – avoid meddling in the domestic affairs of another country. (2) Non-nuclear proliferation, and (3) preventing the disruption of energy supplies from the Middle East. Since these three points underpin China's outlook towards Tehran, "Beijing has sought to balance its interests in this nuclear standoff," by stressing both Iran's rights and obligations under the Nuclear Proliferation Treaty (NPT).<sup>342</sup> Aware of Iran's vague nuclear plans, the Chinese have repeatedly voiced their disapproval towards the possibility of an Iranian nuclear arsenal. Furthermore, Beijing has underscored the importance for Tehran to honour its treaty commitments and cooperate fully with the International Atomic Energy Agency (IAEA) in order to address the concerns of the international community. Although Iran has repeatedly stated that it has no intentions of creating nuclear weaponry, Tehran has been reluctant to cooperate with the IAEA, making numerous states sceptical of its nuclear intentions.<sup>343</sup> Nevertheless, Beijing has unwaveringly maintained that diplomacy should not be written off as the Chinese have repeatedly emphasised that negotiations within an IAEA framework is still the best way to deal with Iran. Furthermore, by recognising Iran as an NPT signatory, Beijing has asserted that Tehran is entitled to nuclear energy and technology for civilian purposes.<sup>344</sup>

However, if there was telling evidence that Tehran was on the verge of nuclear weapons capability, Yuan asserts that China would not hesitate to side with the international community to dismantle Iran's nuclear programme.<sup>345</sup> Like the US, the PRC has a strong interest in preventing Tehran from acquiring nuclear weapons and undermining the global proliferation regime. Chinese leaders are aware that a nuclear-armed Iran has the potential to dramatically destabilise the Middle East and trigger a nuclear arms race that could reduce

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<sup>339</sup> Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 5.

<sup>340</sup> van Kemenade, "China vs. the Western Campaign for Iran Sanctions," p. 100.

<sup>341</sup> Calabrese, "China and Iran: Mismatched Partners," p. 10.

<sup>342</sup> Ibid.

<sup>343</sup> Jun and Lei, "Key Issues in China-Iran Relations," p. 48.

<sup>344</sup> Calabrese, "China and Iran: Mismatched Partners," p. 10.

Thompson, "The Effectiveness of the Fourth Round Sanctions against Iran," p. 7.

<sup>345</sup> Yuan, "China's Strategic Interests in the Gulf and Trilateral Relations among China, The US and Arab Countries," p. 40.

China's access to critical energy supplies.<sup>346</sup> Even though Beijing shares Middle-Eastern security concerns with the West, the PRC has not taken substantial measures such as the issuing of unilateral sanctions or the utilisation of its political leverage over Tehran to reduce Iran's potential to become a nuclear country. China's aversion towards sanctions stem from several considerations:<sup>347</sup> firstly, and most importantly, Beijing places immense importance on the protection of its expanding energy interest in Iran. Secondly, China has an aversion towards 'power politics' – the implementation of sanctions and military force to resolve conflicts. Thirdly, having had sanctions directed against it in the past, Calabrese suggests from a constructivist point of view that Beijing sympathises with Iran. Lastly, like Russia, China believes that relentlessly pressurising Iran is likely to backlash, resulting in Tehran's withdrawal from the NPT or unilateral military action from the US.

Chinese leaders also perceive Washington's endeavours to contain Iran as a unilateral initiative directed by American leaders to maintain the county's dominance in the Gulf and its ability to impose its will on others.<sup>348</sup> As a result, this line of thinking has not abated Chinese engagement with Iran. Instead, it has led some Chinese elites to believe that a nuclear-armed Iran could prove to be of value in keeping a check on the US and its influences in the Persian Gulf.<sup>349</sup> Furthermore, Beijing is keen to demonstrate to its rivals and allies that it is loyal and prepared to stand by its commitments, even in the light of US pressure.<sup>350</sup> China's maintenance of relations with Iran could also be viewed as a form of retaliation against the US's diplomatic and military support of Taiwan.<sup>351</sup> Yet, from a strategic outlook, in response to the US's heavy military presence in East Asia and its group of allies that encircle China, the Sino-Iranian relationship serves as a check against Washington. Most importantly, from a logical point of view, since Iranian oil makes up a sizeable portion of Chinese oil imports, China reasons that if it were to adhere to sanctions against Iran's energy sector, the PRC would indirectly be sanctioning itself.

Due to China's reluctance to wholeheartedly support sanctions against Iran, Beijing has avoided participating heavily in the international sanctions regime against Tehran. Instead, in an attempt to avoid jeopardising its interests with both parties, China has been reserved and

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<sup>346</sup> Swaine, "Beijing's Tightrope Walk on Iran," p. 3.

<sup>347</sup> Calabrese, "China and Iran: Mismatched Partners," p. 11.

<sup>348</sup> Calabrese, "China and the Persian Gulf: Energy and Security," p. 361.

<sup>349</sup> Garver, "Is China Playing a Dual Game in Iran?" p. 77.

<sup>350</sup> Zambelis, "China's Persian Gulf Diplomacy Reflects Delicate Balancing Act," p. 4.

<sup>351</sup> Budike, *Securing China's Oil Supply from the Persian Gulf: The Case of Iran and Saudi Arabia*, p. 72.

balanced on the nuclear issue.<sup>352</sup> Yet, China has (mostly likely due to pressure from the US) in line with other Security Council members, voted for sanctions against the Islamic Republic. However, Beijing has tactically delayed the passage of Security Council Resolutions and watered down sanctions to ensure the protection of its energy interests.<sup>353</sup> Nevertheless, with China's stamp of approval on Resolution 1929 (the latest UN sanction against Iran), Mahmoud Ahmadinejad questioned Chinese and Russian motives by asking, "Are these countries friends and neighbours? Are they with us or looking for something else?"<sup>354</sup> Having acknowledged Tehran's scepticism of China's motives, Chinese leaders (in spite of China's hand in the implementation of Resolution 1929) re-enforced their nation's political and economic commitments to Iran and emphasised interests in expanding oil and gas ties with Tehran. This is succinctly captured by Li Keqiang, China's former vice premier, who stated that:

*China is willing to work hard with Iran, continue to push mutual political trust [sic], and maintain communication, dialogue and coordination on important international issues, to maintain regional and global peace, stability and prosperity ... The key point is to solidly push forward existing cooperative projects, to ensure they are put into effect smoothly, to deepen bilateral pragmatic cooperation and promote the continued development of bilateral ties.*<sup>355</sup>

However, despite China's affirmation of its commitment to Iran, the US may utilise various policy options and its status as China's largest economic market to coerce Beijing to limit its cooperation and commitments to Iran.<sup>356</sup> Beijing is confident though that its size and economic leverage over the US provides the PRC with the necessary weight to ignore calls

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<sup>352</sup> Douglas, Nelson and Schwartz, "Rising in the Gulf: How China's Energy Demands are Transforming the Middle East," p. 4.

Chubin, "Iran and China: Political Partners or Strategic Allies," p. 68.

<sup>353</sup> Garver, "Is China Playing a Dual Game in Iran?" p. 76.

<sup>354</sup> Cited by: Molavi, "The New Silk Road, "Chindia," and The Geo-Economic Ties that Bind the Middle East and Asia," p. 50.

<sup>355</sup> Fite, *U.S. and Iranian Strategic Competition: The Impact of China and Russia*, pp. 17-18.

<sup>356</sup> Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 23.

According to Harold and Nader, there are four options that the Washington could utilise to gain Beijing's undivided support for its campaign against Iran: firstly, Washington could offer improved cooperation between China and the US over a variety of issues that Beijing considers as important. Or the US could take a more aggressive stance and apply diplomatic pressure on China and sanction Chinese firms that invest heavily in Iran. Thirdly, Washington could encourage other oil rich nations to increase petroleum exports to the PRC, thus altering Beijing's relative dependence on Iran. Lastly, the US can create a global coalition of partners that could pressurise China not to undercut international efforts to sanction Iran. – Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 23.

from Washington to embargo Iranian oil.<sup>357</sup> China is willing to use Washington's competition with Iran as an opportunity to grow its influence and test the boundaries of a US dominated international order. Tactically, China's, "moves are calculated to reap the benefits of the US-Iranian conflict".<sup>358</sup> Due to Beijing's international standing (a permanent member of the UN Security Council, a key economic partner of both Iran and the West and an important player in internal issues), China is positioned to collect benefits in return for its support of either party. For example, when Beijing cooperated with Washington to halt its nuclear cooperation with Iran in 1997, the US in turn committed to high profile presidential visits to China and the United States in 1997 and 1998.<sup>359</sup> In return for its support on limited sanctions against Tehran, Beijing could have possibly obtained commitments of increased oil exports from Iran's neighbours, most notably Saudi Arabia.<sup>360</sup> With the pull out of Western firms creating an economic gap, Chinese companies remained in Iran and leapt into the void created by sanctions. China's state-owned firms were able to do so as Beijing only abides by UN sanctions which, unlike the US's unilateral sanctions, contain no clear limits on energy investment and trade with Tehran. As a result, Chinese NOCs stepped up on investments in Iran by grabbing opportunities to secure gargantuan oil fields that would have, in the absence of sanctions, been assigned to Western companies.<sup>361</sup> Thus, due to Beijing's increasing energy activities with the Islamic Republic, China became Iran's largest energy investor in 2010.<sup>362</sup> As such, Tehran has come to believe that, "sanctions are not useful nowadays (*sic*) because, we have many secondary options in markets like China."<sup>363</sup> Essentially, Iran has managed to hold its own in oil markets as its massive oil and gas reserves attract the foreign investment of rapidly industrialising countries such as China and India.<sup>364</sup> However, sanctions against Iran prop up China's efforts to secure discounts on Iranian crudes, as

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<sup>357</sup> Sreeram Chaulia, *China Opposes Unilateral Sanction Against Iran*. Accessed: 10 March 2012, URL: <http://theglobalrealm.com/2012/01/24/iranian-oil-poses-asian-dilemma/>

<sup>358</sup> Fite, *U.S. and Iranian Strategic Competition: The Impact of China and Russia*, p. 3.

<sup>359</sup> Swaine, "Beijing's Tightrope Walk on Iran," p. 11.

<sup>360</sup> Ibid.

<sup>361</sup> Erica Downs and Suzanne Moloney, *Getting China to Sanction Iran*. Accessed 8 March 2012, URL: <http://www.foreignaffairs.com/articles/67465/erica-downs-and-suzanne-maloney/getting-china-to-sanction-iran>

<sup>362</sup> Garver, "Is China Playing a Dual Game in Iran?" p. 76.

<sup>363</sup> Cited by: Vakil, "Iran: Balancing East against West," p. 55.

<sup>364</sup> Coskun, "Global Energy Geopolitics and Iran," p. 184.

Beijing utilises the fact that it is one of Iran's largest remaining oil customers to push for cheaper Iranian oil prices.<sup>365</sup>

In the face of sanctions, China has invested heavily in Iran's energy sector, yet Beijing's support of Tehran was questioned when, in light of setting a new oil imports record that exceeded five million b/d in April 2010, Chinese imports of Iranian crude had decreased whilst its other major suppliers saw an increase in their oil exports to the PRC.<sup>366</sup> The volume of Iranian oil imports dropped from 354,000 b/d during the first five months of 2009 to 193,000 b/d in the first quarter of 2010.<sup>367</sup> Thus, in terms of China's top oil importers Iran was placed at number eight in May 2010.<sup>368</sup> The decline of Iranian oil imports in light of increasing imports from other sources, led oil industry analysts to ask if China lowered its imports from the Islamic Republic for strategic reasons possibly relating to sanctions, or if it was a mere pricing issue. Although concrete data is required to answer this question, it does not mean that speculation cannot be taken into consideration. There are suggestions that China is supposedly partially complying with the Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISADA), a unilateral set of sanctions implemented by the US in 2010 that would most likely have sanctioned Chinese NOCs if they did not reduce their activities in Iran. As a result, and in an apparent deal with Washington, China's NECs received instructions from Beijing to slow or halt the implementation of Iranian energy deals to make it easier for the Obama administration to exempt Chinese companies from penalties.<sup>369</sup> Another postulation suggests that China's Iranian oil imports declined due to the US urging Saudi Arabia to increase its oil exports to Beijing in an effort to decrease the PRC's dependence on Iranian oil.<sup>370</sup> Yet China's Iranian oil imports rebounded in May 2012, reflecting a resolution to a commercial dispute between China United Petroleum & Chemical

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<sup>365</sup> Cited by: Indira A.R. Lakshmanan and Gopal Ratnam, *China Gets Cheaper Iran Oil as U.S. Pays Tab for Hormuz Patrols*. Accessed 10 April 2012, URL: <http://www.bloomberg.com/news/2012-01-12/china-gets-cheaper-iran-oil-as-u-s-pays-tab-for-hormuz-patrols.html>

<sup>366</sup> Molavi, "The New Silk Road, "Chindia," and The Geo-Economic Ties that Bind the Middle East and Asia," p. 50.

<sup>367</sup> Ibid.

<sup>368</sup> Ibid.

<sup>369</sup> Davis, *et al.*, "China-Iran: A Limited Partnership," p. 48.

Barbra Salvin, "Iran Sanctions Preferable to War but No Silver Bullet," *Atlantic Council: The South Asia Centre*, (2011), p. 1. Accessed: 15 June 2012, URL:

[http://www.acus.org/files/publication\\_pdfs/403/060211\\_ACUS\\_Slavin\\_SilverBullet.pdf](http://www.acus.org/files/publication_pdfs/403/060211_ACUS_Slavin_SilverBullet.pdf)

<sup>370</sup> Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 26.

Co. (Unipecc) and National Iranian Oil Co.<sup>371</sup> Nonetheless, despite a rebound in Iranian oil imports, Chinese officials have not ruled out the possibility that sanctions could still disrupt oil purchases from Iran. However, it seems highly unlikely that China would give up its Iranian oil imports and developments in Tehran's upstream because of sanctions.<sup>372</sup> This is particularly demonstrated by China's maintenance of Iranian oil imports despite the US sanctioning of Zhuhai Zhenrong – a state run enterprise that is heavily involved with Iranian oil imports.<sup>373</sup> Such is Chinese dedication to importing Iranian oil that, with international sanctions against Tehran making it difficult for China to pay Iran, Beijing has in some instances agreed to a barter system to trade Iranian oil for Chinese products and services. As a result, such agreements have assisted Tehran to bypass sanctions.<sup>374</sup>

Overall, due to the US's heightened concerns over Iran's nuclear activities, the Iranian nuclear issue has become a prominent topic on the Sino-American diplomatic agenda. It seems that Beijing does not want to be cajoled into choosing sides between Iran and the West, as China has gone to great lengths to ensure balanced cooperation with both sides. Beijing has displayed that it is a willing and responsible partner in maintaining the NPT regime; however, by diluting sanctions, China helps Iran gain time and international space to push forward its nuclear agenda. As a result, the effectiveness of the US's international campaign against Iran is severely hindered by China's balancing act. Due to Beijing's delicate handling of the Iranian nuclear issue, China has assumed a passive role as the PRC continues to press for negotiations and a peaceful resolution to the issue.<sup>375</sup> On the energy front, Beijing has emphasised that it will not endorse any measures that would seriously jeopardise its access to Iranian hydrocarbons or Chinese NOCs pursuit of Iranian upstream projects. Yet, when 'push comes to shove,' Beijing is likely to, "agree to a relatively marginal expansion of existing sanctions against Iran, to keep the nuclear issue in the Security

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<sup>371</sup> Wayne Ma, *China Oil Imports from Iran Rebound*. Accessed 16 December 2012, URL:

<http://online.wsj.com/article/SB10001424052702303610504577417803213035894.html>

BBC News, *China Iran Oil Imports Rise as Payment Dispute Resolved*. Accessed 25 August 2012, URL:

<http://www.bbc.co.uk/news/business-18545973>

<sup>372</sup> Garver, Leverett and Leverett, "Moving (Slightly) Closer to Iran: China's Shifting Calculus for Managing its "Persian Gulf Dilemma", p. 49.

Fite, *U.S. and Iranian Strategic Competition: The Impact of China and Russia*, p. 18.

<sup>373</sup> Chen Aizhu, *China's Zhenrong To Maintain Iran Oil Imports For 2013*. Accessed 15 February 2013, URL:

<http://www.reuters.com/article/2012/12/21/zhenrong-iran-oil-idUSL4N09U33Z20121221>

<sup>374</sup> Harold and Nader, *China and Iran: Economic, Political and Military Relations*, p. 12.

<sup>375</sup> Garver, Leverett and Leverett, "Moving (Slightly) Closer to Iran: China's Shifting Calculus for Managing its "Persian Gulf Dilemma", p. 47.

Council.”<sup>376</sup> However, due to Beijing’s vested geo-economic and strategic interests in Iran it can be assumed that China will not be prepared to back any measures that would be considered ‘crippling’.

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<sup>376</sup> Garver, Leverett and Leverett, “Moving (Slightly) Closer to Iran: China’s Shifting Calculus for Managing its “Persian Gulf Dilemma,” p. 53.

## CHAPTER 5

### Conclusion

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China's rapid economic ascent has made the country heavily dependent on energy resources. Of the various fuel resources that are needed to maintain its drive for economic supremacy, the Chinese are particularly concerned with their oil security as their flat line oil production and declining reserves cannot successfully satisfy Beijing's growing oil demand. Since the PRC's economic growth, social stability and national security depends – to a large extent – on Beijing's ability to fulfil its increasing energy demands, the necessity of ensuring a continuous supply of oil has forced China to rely extensively on foreign sources to compensate for its limited domestic output. By drawing on various texts this thesis has sought to address how Beijing manages to maintain Iranian oil imports (interests) and uphold stable relations with Washington in the face of American-led international sanctions against Tehran. In doing so, this thesis set out to argue that, in light of recent sanctions against Iran, China's continued economic engagement with Iran is motivated by its energy interests. Although this argument is substantiated on the grounds of Beijing's reluctance to fully support international efforts to curb Iran's nuclear aspirations, when one takes into consideration that Washington, unlike Tehran, holds a stronger influence over China's economic development, the strength of the argument weakens. In attempts to remain in favour with both Iran and the US, China has taken a pragmatic-balanced approach towards the Iranian nuclear situation. However, Beijing has demonstrated that, should Tehran-Washington tensions escalate, it is willing, in spite of the Iranian's alluring energy assets, to forgo its relations with Tehran in order to remain in comity with Washington.

In conveying the emphasis that Beijing places on energy security, chapter two outlined that China has, by means of state intervention, essentially crafted a mercantilist energy strategy for obtaining foreign oil assets. The centrality of the state in China's energy sector and foreign oil accumulation activities indicates that Beijing is pursuing fuel resources in a mercantilist manner. The mercantilist nature of Beijing's 'go-out' strategy, as succinctly stated by Lieberthal and Herberg reflects the PRC's, "sense of weakness and vulnerability regarding reliable and secure access to energy supplies."<sup>377</sup> Chinese fears of a drastic decrease in energy supply has rationalised China's state intervention and support in both

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<sup>377</sup> Kenneth Lieberthal and Mikkal Herberg, "China's Search for Energy Security: Implication for U.S. Policy," *NBR Analysis (The National Bureau of Asian Research)*, vol.17, no.1 (2006): p. 14. Accessed: 30 May 2013, URL: <http://nbr.org/publications/nbranalysis/pdf/vol17no1.pdf>

domestic and international fuel procurement activities. Beijing's 'go-out' strategy essentially reinforces the nexus between the Chinese government and its NOCs as the main elements of this plan include an active energy-oriented form of diplomacy that is extended to key fuel exporting regions, combined with efforts taken by China's three major NOCs (CNPC, Sinopec and COOC) to garner equity deals and long-term supply contracts from a wide range of exporters to meet future fuel needs.

Due to the bias of the global oil market, the PRC has deemed it necessary to assist its NOCs in gaining a competitive edge in the international oil scene by 'courting' energy rich states. Through the use of diplomatic, political and economic incentives China has paved the way for its NOCs to pursue lucrative energy investments across the globe, especially where Western interests are minimal. By utilising incentives that can only be dispensed by the state, Beijing bypasses the market in favour of gaining bilateral energy agreements that undermine the market's ability to effectively determine the price and distribution of fuel supplies. Although this mercantilist energy strategy is condemned by the West as it contravenes global norms of free trade; stemming from Beijing's scepticism of the international oil market to provide an uninterrupted fuel supply, the PRC favours a mercantilist approach as it allows China to hedge against supply disruptions and somewhat insulate itself from price hikes.

The PRC's accumulation of numerous equity agreements have resulted in Western nations becoming increasingly anxious over Beijing's ability to 'lock up' oil supplies to the detriment of international oil markets. Such fears are aggravated by China's willingness to engage with pariah states to feed to its growing energy appetite. Although Beijing's interaction with pariah nations impedes its efforts to be viewed as a 'responsible stakeholder', seeing as global oil markets are dominated by Western MOCs, China has extended its oil diplomacy to pariah states as they present Chinese NOCs with little Western competition. Thus, because of its vested geo-economic interests in various energy-endowed rogue states (states isolated by US-led Western initiatives) China has assumed a limited role in assisting the West, particularly the US, with isolating internationally condemned states. Though the West finds this frustrating due to their strained relations with such states, Western nations realise that Beijing's privileged ties with pariah countries is a key 'trump card' that may be played by China to cajole US condemned nations to comply with international norms. However, if Beijing were to manipulate its ties with rogue states, it seems that it would be on its own terms (in its national interest to do so). Although China continues to maintain relations with US deemed pariah states, Beijing has been cautious in its dealings with such nations in order

to avoid undermining its vital economic interests with Washington – a key player in the PRC’s aspirations for unbridled economic growth.

China’s attraction to Iran’s vast hydrocarbon reserves is the main factor that has held the relationship together in spite of the pressure that the West has placed on Beijing to distance itself from Tehran. Chapter three highlighted that, despite Iran’s long history of sanctions, China has continued to remain involved with the Islamic Republic on many fronts – ranging from their shared interests in counteracting the US’s dominance in the Middle East to growing bilateral trade relations. Considerations over Iran’s international pariah status is largely considered to be a moot point by China since it employs a mercantilist (realist) *modus operandi*, derived from its need to procure increasing amounts of fuel resources to sustain its mushrooming economy.

The Sino-Iranian relationship has received a growing amount of attention as analysts attempt to rationalise Chinese motivations for maintaining relations with a US condemned state that has the potential to significantly complicate Sino-American ties. Although deep historical roots, shared political views and international outlooks have been outlined as important factors that have contributed to the endurance of Sino-Iranian relations, it is their shared suspicion of the US’s dominance in the Middle East and mostly China’s growing need for energy supplies that have significantly shaped contemporary Sino-Iranian cooperation. Beijing and Tehran have expressed an interest in expanding economic collaboration to encompass non-energy related fields; however, energy remains the cornerstone of this relationship. China has been quick to move into the opening that international sanctions have created in Iran’s energy sector, as the withdrawal of Western energy companies has provided Beijing with an opportunity to obtain lucrative energy deals. The PRC’s growing portfolio of Iranian energy investments and interests has significantly contributed to Beijing’s reluctance to further economic sanctions against Iran as Western nations push for more aggressive measures to contain Tehran’s nuclear advancements. In spite of their shared aversion towards US hegemony in the Middle East, China has avoided directly confronting the US over this energy important region as, unlike Tehran who has severed ties with Washington, the Chinese are aware of America’s centrality in their drive for continuous economic development. Nevertheless, by assisting Iran with military improvements China has sought to counterbalance US dominance in the Persian Gulf. Although Sino-Iranian relations have often been framed in terms of mutual cooperation, given Iran’s global pariah status its relationship with China is increasingly viewed as asymmetrical. Since sanctions against the

Islamic Republic have distanced the West from Iran, Tehran's economic relationship with China is considered to be an existential necessity as the Iranian regime has come to view the PRC as a powerful ally which provides it with vital diplomatic and, most importantly, economic leverage to weather sanctions.

Since Iran contains a sizable portion of Persian Gulf oil, China has vested interests in maintaining ties with the Islamic Republic. As pointed out in chapter two, China has extended its mercantilist-inspired oil diplomacy to wherever abundant energy supplies are available. Thus, as would be illustrated in chapter four, the Persian Gulf is a key piece in China's energy puzzle and as such it is necessary to take into consideration Beijing's energy-driven strategy for securing Gulf fuel assets. Through efforts to secure Gulf energy resources, China has sought to improve relations with the region's most prominent oil exporters, such as Iran. Thus, as highlighted in chapter three, China's relationship with Iran is still relevant in the context of China's growing energy needs, as well as the prevailing anti-Iranian sentiments from the West. However, at the same time, in navigating through a web of sanctions to maintain its ties with Iran, and most importantly, safeguard Chinese energy interest in the country, Beijing recognises that it cannot afford to provoke American ire as international sanctions issued against Tehran stem largely from US efforts.

China is expected to become inextricably linked to the energy rich Persian Gulf as its oil consumption continues to rise. In efforts to guarantee reliable oil supplies from this part of the world, Beijing has sought to improve relations with Gulf States. China is progressively improving its standing with Arab nations as its large consumer market, demand for energy and avoidance of democratic lobbying provide Gulf countries with an attractive alternative to lessen their dependency on the US. Yet, as a result of China's precautionary role in the region and its maintenance of relations with Iran – a potential threat to regional stability, GCC states are wary of relinquishing their dependence on the US. Nevertheless, Beijing has made significant advances in the Gulf, especially with regards to energy investments. By acknowledging that Arab states desire not to simply be viewed as mere oil banks, Beijing has – under the alias of improving economic cooperation – sought to secure access to the regions' hydrocarbon resources, especially oil. Although China has expanded its presence in the Gulf, the Chinese have proceeded with caution to avoid being perceived as a threat to the Americans who have an expansive presence in the region. Yet, there is a growing sense that China is emerging as a rival of the US in the Middle East. Aware of this, some Middle-Eastern nations have sought to encourage a Sino-American rivalry in an effort to advance

their own interests. Due to the US's suspicions of China's increasing energy forays in the region, China-Gulf relations have been placed under American scrutiny. Of particular concern to the Americans are Sino-Iranian relations, since Beijing's policy of engagement contradicts Washington's efforts of containment.

Although China has been repeatedly called upon to cooperate with US efforts to isolate the Islamic Republic, Beijing is reluctant to assume an aggressive stance against Tehran due to its strategic energy relationship with Iran that is reinforced by various economic agreements. Yet, in consolidating relations with Iran, Beijing risks causing friction with the US – a country that has a vital hand in ensuring China's continued economic prosperity. Thus, the PRC's 'Persian Gulf Dilemma' essentially pits China's top national priorities of energy security and maintaining sound US relations against each other. In efforts to avoid jeopardising its interests with both parties the PRC has assumed a balancing approach that fundamentally aligns with the US in denouncing Tehran's nuclear proliferation ambitions whilst simultaneously maintaining its geo-economic interests in Iran. This bifurcated handling of US-Iran tensions is particularly evident in China's response to sanctions against Tehran. Although the PRC maintains that continued diplomacy and negotiations are a more effective way of dealing with Iran, Beijing has nevertheless, presumably for the sake of remaining in favour with Washington, had a hand in the issuing of four UN resolutions targeting the Islamic Republic. However, the PRC has played a significant role in delaying, deflecting and softening UN sanctions against Iran. Furthermore, in an attempt to avoid irking China, UN sanctions were craftily calibrated to avoid jeopardising Chinese Iranian energy interests.

By utilising its status as a permanent member of the UN Security Council, China, in effect, serves as a buffer for Iran against Western pressure. Aside from limiting the severity of UN sanctions, since Beijing is not obligated to adhere to unilateral measures, China's Iranian geo-economic investments contradict the West's aims of debilitating Tehran's energy sector (the country's main source of revenue). Beijing's maintenance of oil imports and expansion in energy investments does – to some extent – alleviate the effects of Western sanctions targeting Iran's energy industry, particularly in the oil sector. Tehran has come to depend greatly on Beijing to replace Western investment and deflect international sanctions. Although China is considered to be a crutch for Iran, Beijing's policy towards the Islamic Republic has repeatedly demonstrated its unwillingness to allow its relations with Iran to upset its ties with Washington. The PRC's disengagement from nuclear cooperation with

Iran, China's reluctance to veto the passing of UN sanctions against Tehran and the stalled implementation of Iranian energy agreements by Chinese NOCs have highlighted that the PRC is willing to adjust its cooperation with Tehran to remain in comity with Washington.

In sum, barring the increased possibility of escalating Iran-US tensions, China's energy insecurities, particularly its oil insecurity, has strongly influenced Beijing to maintain ties with Tehran in spite of Western efforts to press the Chinese into fully backing measures to curb Iran's nuclear ambitions. By continuing to maintain oil imports from the Islamic Republic, China has displayed that it is not willing to appease Western calls for a Chinese embargo on Iranian oil or support 'crippling' sanctions that would undoubtedly infringe on the PRC's geo-economic interests in this Gulf country. However, even though Iran has advertised itself as a reliable energy source for the PRC, China's fluctuating Iranian oil imports have increased speculations over recent years that, should the Tehran-Washington rift expand, it is highly likely that China would side with the US if Beijing were forced to choose sides over Iran's nuclear disposition. Such a decision would inevitably affect China's stronghold in Iran's energy sector – producing serious repercussions for China's economy, hence Beijing's determination (by means of maintaining its balancing act) to forestall this potential scenario from occurring.

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