The Party, the Oil Companies, and Energy Security: Who Determines Chinese Policy?

Yuanyuan Ding

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ABSTRACT

China is today the third largest importer of crude oil in the world. Since 1993 when the country’s consumption of oil first exceeded the capacity of its domestic production, China has become a net importer and has witnessed a growing appetite for oil during the past decade. Energy security has been given enormous emphasis in the country’s foreign policy making, and is believed to be one of the most important components of China’s foreign policy in the 21st century. While enough ink has been spilled on the assessment of what China’s energy security policy looks like, few scholarly inquiries have been made into the domestic sources of China’s energy security policy. The purpose of this article is to reevaluate such a policy by identifying the different domestic stakeholders and analyzing how the potential divergence between the state and the oil companies influences the final policy outcome.

INDEX WORDS: China, Energy Security, Oil Companies, CCP
THE PARTY, THE OIL COMPANIES, AND ENERGY SECURITY: WHO DETERMINES
CHINESE POLICY?

by

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THE PARTY, THE OIL COMPANIES, AND ENERGY SECURITY: WHO DETERMINES CHINESE POLICY?

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Chapter 1: Introduction

China is today the third largest importer of crude oil in the world\(^1\). Since 1993 when the country’s consumption of oil first exceeded the capacity of its domestic production, China has become a net importer and has witnessed a growing appetite for oil. In 2006, China consumed 348.8 million tonnes of crude oil, 42% of which was imported, and is 2.4 times greater than the amount of 1993. As a regime whose stability relies largely on economic growth, the dependence of China’s economy on foreign oil has triggered great concerns in the policy making community. Energy security has been given enormous emphasis in the making of the country’s foreign policy, and it is believed to be one of the most important components of China’s foreign policy in the 21\(^{st}\) century (Downs 2000; Downs 2004; Jeffe and Steven 2002; Ross 1999; Ziegler 2007, in Guo and Hua 2007).

While enough ink has been spilled on the assessment of what China’s energy security policy looks like, as well as what regional and international implications the policy might have, few scholarly inquiries have been made into the domestic sources of China’s energy security policy. Due to the authoritarian nature of the Communist regime, it is widely assumed that energy security in China is made by the CCP leadership, and implemented through the state-owned agencies, such as national oil companies and their overseas branches. As a result, scholarly attention has been focused almost exclusively on the general outcome of China’s energy security policy, instead of its domestic sources (Andrew-Speed et. al. 2002; Downs 2000 and 2004; Zweig and Bi 2005). Even in the

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occasional chapters where the authors do mention the domestic debates about energy security policy, they do not seem to believe that such debates have an important impact on the policy outcome, since many of them take place only within the institutional structure of the CCP, and the CCP decision makers are always capable of reconciling the diverse opinions and forming a unified policy at the state level. As a consequence, not much effort has been made to analyze the origins of these debates, which players are involved, what role each plays, and why.

The purpose of this thesis is to fill this gap in the existing literature, by offering a new approach to looking at energy security policy making in China. Questions to be asked in this analysis include: How is energy security policy made in China? Is there a unified, state-made and rigidly implemented policy, or are there other sources of policy input? Who are the stakeholders in the making of this policy? What are their interests and initiatives? And what implications do the relationships between the players have for China’s energy security?

In answering these questions, I seek to identify and separately analyze the different players in the policy making game. This new approach rejects the assumption that the CCP is in complete control of its agents when it comes to energy security policy. Instead, I argue that the CCP has political objectives and ideological preferences that sometimes differ from those of the companies, whose behavior is more market-oriented and who are to some extent autonomous, especially in overseas markets. Chinese energy security policy, as we perceive it today, is a mixed outcome shaped by both the preferences of the political sector and the strategies of the oil companies. Ignoring this fact will lead scholars and politicians to a false estimation of the international
implications of China’s energy security policy, and therefore result in policy misjudgments and overreactions. I will discuss later how the state-company divergence could negatively influence the overall security of China’s energy supply, and what policy adjustments are needed to better achieve the state’s strategic goals. Prospectively, the theory presented in this paper should be beneficial, as a point of departure for policy prescriptions, to both policymakers in China and their counterparts in the West, and I will discuss in brief in the concluding chapters why I so argue. A quick sketch can be offered here. First, the CCP decision makers would infer from my approach that since oil companies are the agents that carry out energy security policy, persisting in directing the policy along ideological and political lines is unnecessary and counterproductive. For the West, my approach would imply that before deciding a response to China’s energy security policy, policymakers should first identify if the specific policy is a result of CCP’s political arrangement that deserves a response on the political level or merely represents the business interests of Chinese oil companies, which should better be left for the international market to deal with.
Chapter 2: China’s Energy Security Policy: A Review of Literature

Writings in both the academic and policy communities have frequently expressed concerns over China’s energy security since the mid-1990s, when China became a net importer of oil (Calder 1996; Calder and Fesharaki 1996; Downs 2000; Manning 2000). While their approaches and perspectives differ, scholars have exhibited little disagreement when it comes to the making of Chinese energy security policy and the implications of such policy on the political security of the Asian Pacific. Erica Downs, among the first analysts who systemically examined Chinese energy security, noted in 2000 that China’s transition from an exporter to importer of oil “is a matter of great concern to the Chinese leadership, who regard oil imports as a strategic vulnerability that could be exploited by foreign powers” (Downs 2000, 53). Indeed, China becoming heavily reliant on foreign resources is an unprecedented situation facing most members within the new generation of Chinese leadership, whose predecessors were guided by the Maoist “zìlì gèngshèng” (self-reliance) doctrine. Although Beijing long ago realized the inevitability of oil dependence, the hope for self-reliance, realistic or not, is still firmly rooted in China’s philosophy and logic of energy policy making. As Downs appropriately points out, China’s energy security policies “can be explained in terms of China’s long-lasting fear of dependency on foreign energy” (Downs 2000, xi). It is true that Beijing’s worries about its vulnerability results partially from the Maoist heritage. Nonetheless, besides ideology, there are also realistic concerns about the negative impact China’s dependence on foreign oil might have on the country’s national security. As noted by Andrews-Speed, Liao and Dannreuther, “China is vulnerable to a blockade of sea-lanes either in the Malacca Straits or in the South and East China Seas” (Andrews-Speed, Liao
and Dannreuther 2002, 25), a potential danger confirmed by David Zweig and Bi Jianhai in their 2005 article “China’s Global Hunt for Energy”, which documented President Hu Jintao’s concern that “certain powers [read ‘the United States’] have all along encroached on and tried to control the navigation through the strait” (Zweig and Bi 2005, 34).

It is not difficult to capture the overall picture of China’s energy security policy after recognizing the ideological and strategic dimensions of policy making highlighted above. However, these two dimensions alone still cannot fully explain and predict Chinese energy security policy making. Equal attention should be allocated to the examination of the uniqueness of China’s domestic political structure. Governed by the Chinese Communist Party (CCP) since 1949, China is a country in which foreign policies are made through a rather opaque and sometimes mysterious process. Regarding the making of energy security policy, any scholar exposed to Chinese politics would suspect that the final policy outcome might very well result the interactions among different domestic actors.

Unfortunately, not enough emphasis has been given to such interaction in the scholarly writings concerning China’s energy security policy. As Downs admits in her 2004 article, “despite the interest among the international community in China’s approach to energy security, the debate over this topic outside China has paid little attention to the similar debate unfolding inside the country” (Downs 2004, 22). Among the few attempts to do so, Andrews-Speed, Liao and Dannreuther first noticed the importance of recognizing the influence of different domestic actors in the process of Chinese energy security policy making. The authors identify four key actors: the top leadership of the party and government; the military; the relevant government
departments; the state petroleum companies, and two subsidiary actors: provincial
Andrews-Speed, Liao and Dannreuther thoroughly explained the priorities of these
diverse actors in the making of Chinese energy security policy, but they do not further
determine if a pattern of decision making can be discovered, after admitting that “Seeking
to uncover how policies are formed and decisions are made within this structure is
inherently difficult” (Andrews-Speed, Liao and Dannreuther 2002, 46). This unanswered
question is discussed in Downs’s 2004 article, where she categorizes the actors into five
“powerful stake holders”: the Chinese oil companies, the State Development Planning
Commission (now the National Development and Reform Commission), the defunct
State Economic and Trade Commission (now integrated into the Ministry of Commerce),
the Ministry of Foreign Affairs, and the military (Downs 2004, 24). After surveying the
functions these stakeholders perform in the decision making process, Downs argues that
China’s energy security policy making can be generally explained by the fragmented
authoritarianism model (see below), and further describes, through examples, how such
policies are made (Downs 2004, 30-1). Downs’s approach is of great value to our
understanding of the sources of Chinese energy security policy making. In particular, the
question Downs raises at the end of her article opens the door to a largely uncultivated
field of scholarship: when conflicts of interests are observed among the actors in China,
who prevails, why, and what are the international implications? These questions will be
explored later in this paper, after the following review of literature regarding another
aspect this analysis seeks to address: the international implications of Chinese energy
security policy.
While most experts of international relations and Chinese foreign policy agree that China’s energy security policy has clear goals and is implemented by various but understandable means, the scholarly opinion on the effects that China’s hunger and quest for oil might have on regional and international stability seems bifurcated. The lack of consensus over the international implications of Chinese energy security policy largely mirrors the Liberal-Realist debate. The Liberals would argue that the growing interdependence might motivate China’s decision makers to favor a foreign policy that relies on the international oil market as well as transnational organizations in order to secure the nation’s energy supply. As Charles Ziegler (2006) argues, “China’s foreign policy on energy security is accurately described by the liberal perspective on international relations. China, at least at this point in time, has pursued a cooperative path in the energy field” (Ziegler, in Guo and Hua 2007, 197). Ziegler’s argument is based on his observation of China’s cooperative strategies around the globe, but one might wonder why doing so is advantageous for China’s energy security. Andrews-Speed, Liao and Dannreuther answered this question in their report by suggesting that China should feel safe because “energy resources are not the key geopolitical concern”, and that “the actual military and security threat to oil supplies tends to be exaggerated” (Andrews-Speed, Liao and Dannreuther 2002, 81). If the Liberal arguments correctly reflect the energy security policy of China, then the policy should eventually lead to broadened regional and global cooperation, rather than conflict.

However, voices from the Realist school may sound otherwise. Indeed, the Realists have reason to argue that China’s increasing dependence on imported oil might very well become the driving force behind the country’s military expansion. Such an
argument dates back to the mid-1990s, when Kent Calder and Fereidun Fesharaki worried that “The effect of energy rivalries and tensions could easily have destabilizing international consequences, given the underlying geopolitical uncertainties and tensions in the Northeast Asian Arc of Crisis” (Calder and Fesharaki 1996, 11). Calder and Fesharaki’s argument is supported by the looming rivalries over energy among major powers in East Asia in the mid 1990s and such rivalries are, in the 21st century, already an undeniable fact. Beijing’s energy security policy has driven the Chinese oil companies to compete with Japan in almost all major oil exporting countries. Such a wide spread competition would, according to the Realists, cause regional instability, and the oil diplomacy conducted by Beijing is said to have a negative impact on the nation’s long term energy security (Andrews-Speed, Liao and Dannreuther 2002, Jaffe and Lewis 2002). A better way to secure China’s energy supply, according to most Western scholars, is for Beijing to use international institutions and market-oriented multilateral approaches. Why, then, is China still actively engaged in cultivating its relationship with oil exporters, besides the security concerns elaborated above? As Andrews-Speed and his coauthors point out, “the current policy-making framework favors actors and interest groups who promote a more strategic than market approach to energy security” (Andrews-Speed, Liao and Dannreuther 2002, 100). Thus it is vitally important for us to analyze process inside the policy making framework.
Chapter 3: The Decision Making Process in China

Few experts of Chinese politics would disagree that the decision-making structure in China in the post-Mao era is no longer an absolute hierarchy. Instead, it is a complicated process in which political elites, factions, and provincial bureaucrats negotiate their interests and ideological preferences (Harding 1981; Pye 1981; Lieberthal and Lampton 1992). A good example in this literature is Lieberthal’s fragmented authoritarianism model. According to Lieberthal, “the fragmented authoritarianism model argues that authority below the very peak of the Chinese political system is fragmented and disjointed. The fragmentation is structurally based and has been enhanced by reform policies regarding procedures” (Lieberthal, in Lieberthal and Lampton 1992, 10). This model echoes, as Lieberthal admits, Graham Allison’s model of bureaucratic politics. In Allison and Zelikow’s updated book *Essence of Decision* (1999), the authors present three models of decision making: the rational actor model, the organizational process model, and the governmental politics model (Allison and Zelikow, 1999). Although mainly derived from the US experience during the Cuban Missile Crisis, Allison’s models are to some extent applicable to China, especially after Mao’s death in 1976. Although most of the information regarding decision making inside the Political Bureau remains classified, enough evidence has been provided by the memoirs of former political elites, observers and the shifting policy outcomes to suggest that Allison’s model does indeed hold in contemporary China.

The aforementioned models adequately capture the dynamics of Chinese politics and are important to this analysis because they provide the basic assumptions for the arguments to be made. Nonetheless, when it comes to China’s energy security policy,
several important factors have not received enough attention and can be explained by neither Lieberthal’s nor Allison’s models. First, the role of state-owned oil companies has been overlooked. Both Lieberthal and Allison’s models focus almost exclusively on the political sphere, and they can only capture the dynamics within the CCP’s institutional structure. However, with the initiation of Deng Xiaoping’s Reform and Open policy and the decentralization of the economic sector that followed, many new actors and stakeholders have been introduced to the bargaining process of decision making, in this case the three major oil companies: China Petroleum & Chemical Corporation (Sinopec), China National Petroleum Corporation (CNPC), and China National Offshore Oil Corporation (CNOOC). These three companies are agents of the state that help carry out various policies, from purchasing Middle Eastern oil to the exploitation of natural gas in the East China Sea. This undeniable fact has therefore made the principal-agent model a necessary, and perhaps the ideal, theoretical framework for this analysis.

The principal-agent theory was developed in the first place by scholars interested in the behavior and structure of economic organizations, in other words firms (Jensen and Meckling 1976; Simon 1957; Spence and Zeckhauser 1971)2. Since the theory emphasizes on the relationships between two groups of actors in a hierarchical relationship (i.e. stockholders vis-à-vis managers) who do not always enjoy shared interests and preferences, it has been extensively applied in political science, especially in the study of bureaucratic politics and public policy in democracies (Bendor 1988; Evans 1980; Kiewiet and McCubbins 1991; Mitnick 1992; Moe 1984; Waterman and Meier 1998; Wood and Waterman 1991). As Moe points out, “the problem of political control is

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2 For a closer review of the early development of principal-agent theory, see Moe 1984.
analogous in many respects to the economic problem of the separation of ownership and control, with politicians attempting to control bureaucrats rather than stockholders trying to control managers” (Moe 1984, 766).

In its actual application in political science, the principal-agent theory generally has two core assumptions: first, conflict in goals and preferences exist between principals and agents who are in a contractual relationship, and second, the fact that the agents have more information regarding specific issues than the principal, which results in an information asymmetry between them (Waterman and Meier 1998). To illustrate these two assumptions, the patient-physician analogy is frequently used by scholars (Evans 1980, Waterman and Meier 1998). As rational, utility maximizing actors, the patient (principal) and the physician (agent) are indeed in a conflict of interests, with the patient’s demand being health and the physician’s demand being maximum income through treatments. Also, since the patient is not equipped with advanced medical knowledge, he/she cannot evaluate and control the behavior of the physician, thus resulting in an information asymmetry between the two.

Given the above two assumptions, one might find many instances in politics that could be potentially explained by the principal-agent model. Frequently in the study of American politics, scholars have discovered that nonelective public bureaucracies tend to pursue their own organizational interests if not closely monitored and controlled by the Congress and/or the president (Wood and Waterman 1991). While enough has been written on the analyses of the relationship between politicians and bureaucrats in the United States, I now seek to apply the model to China’s energy security policy making, which satisfies the assumptions and logic of the principal-agent theory. The first task is to
identify who should be included as principals and who as agents. The identification of the principal should not be a difficult question, since as an authoritarian regime the top leadership of the CCP is unequivocally in control of China’s energy security policy. With regards to the agents, however, there exists a wide variety of possible candidates: the State-Owned Assets Supervision and Administration Commission of the State Council, which is the immediate supervisor of all three oil companies; the National Development and Reform Commission, which is responsible for providing both long term and short term plans for China’s energy security; the three state-owned oil companies; the Foreign Ministry; and other related central or provincial bureaucracies. As Table 1 illustrates, these actors, together with the military, think tanks and the media, are often included by other authors as players in the making of China’s energy security policy. At first glance, it would appear fitting to include all these actors as important players, a closer analysis based on the principal-agent model suggests otherwise.

Table 1: Stakeholders in the Making of Chinese Energy Security Policy

<table>
<thead>
<tr>
<th>Andrew-Speed, et al.</th>
<th>Downs</th>
<th>Ding</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Top leadership of the party and government</td>
<td>1. Chinese oil companies</td>
<td>1. The Chinese Communist Party (principal)</td>
</tr>
<tr>
<td>2. The military</td>
<td>2. State Development Planning Commission</td>
<td>2. The three oil companies (agents)</td>
</tr>
<tr>
<td>3. The relevant government departments</td>
<td>3. State Economic and Trade Commission</td>
<td></td>
</tr>
<tr>
<td>4. The state petroleum companies</td>
<td>4. Ministry of Foreign Affairs</td>
<td></td>
</tr>
<tr>
<td>5. Provincial governments</td>
<td>5. Military</td>
<td></td>
</tr>
<tr>
<td>Think-tanks</td>
<td>6. Research institutes, academics, media</td>
<td></td>
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</tbody>
</table>

Unlike Andrew-Speed et al. and Downs, who include the various government departments in their articles, I do not incorporate them into this analysis because in the
principal-agent model, they do not qualify as agents who pursue their own interests. More specifically, none of the government agencies meets the requirement of the first assumption mentioned above, which suggests an existing conflict in the goals and preferences between the principal and the agent. For instance, although the Ministry of Foreign Affairs and the National Development and Reform Commission do actively participate in the policymaking process and may provide their own professional opinions in terms of policy orientation, when it comes to energy security, they tend to abide by the decisions made by the central government and do not constitute autonomous agents. The relationship between these ministries and the CCP leadership is by no means contractual, especially in energy security policy, because the organizational interests of the bureaucracies are guaranteed as long as they perform their own assigned administrative duties. In other words, there is little incentive for the bureaucracies to pursue their own goals in the making and implementation of energy security policy.

The three state-owned oil companies, on the other hand, perfectly qualify as agents who are designed to carry out policies made by the CCP. They should be treated as agents because, first of all, as companies they do not incorporate political factors as part of their goals, which fundamentally differs from the CCP’s preference. The potential interest conflict would give the companies incentives to pursue their own strategies that are not completely in accord with the Party’s preferences. Second, there exists a potential information asymmetry between the companies and the Party, particularly in overseas markets. The companies are staffed with oil technicians, market analysts, and field managers whose priority is to maximize profit for the company, while the CCP’s political sector focuses more on the country’s overall energy strategy and its impact at the
international level. Since there is no coordinating mechanism to channel and communicate the expertise each party possesses, such an asymmetry in information might very well facilitate the divergence between the companies and the Party. I will discuss how the information asymmetry and the state-company divergence play out later in the case study chapters of this paper.

In this chapter, I have briefly introduced the essence of the principal-agent theory and have demonstrated why it is the most appropriate framework for the analysis of China’s energy security policy. The next step is to respectively analyze the specific interests and preferences of the CCP as well as those of the oil companies. I argue that although the oil companies are financially owned by the state, the companies are in fact autonomous, especially when it comes to foreign markets because of the variance between their goals and preferences.

Policy Preference of the CCP: Survival and the Doctrine of Self-Reliance

When it comes to the goals that the Chinese Communist Party (CCP) pursues, few doubts exist in the academic community. Clearly, as the ruling party of China since 1949, staying in power has always been one of the highest priorities of the CCP. With the initiation of Deng Xiaoping’s Reform and Open policy and especially after the 1989 Tiananmen Square protests, the political elites of the CCP have reached a consensus that the party’s very survival must not be taken for granted. Rather, it is heavily dependent on the country’s rapid economic growth and the stability of Chinese society. Thus, in terms of energy security, the CCP would never prefer a policy that would potentially jeopardize its power. There seems to be no direct relationship between the CCP’s goal of survival
and energy security; nevertheless, it is precisely the goal of survival that provided the political green light for state-owned companies, including the three oil companies, to invest extensively in foreign markets. In the late 1990s, two decades after the implementation of the Reform and Open policy, Chinese state-owned companies were being greatly challenged by foreign investments and burgeoning private enterprises. The CCP realized that if it did not strengthen the power of the state-owned assets, the party’s control over the market resources could have been severely diminished. Thus, a policy recommendation called “going out” (zouchuqu) was given by the Party to the state-owned companies, and a series of organizational reforms was conducted among the companies. I will discuss the “going out” policy in detail later in this paper. At this point, we should simply note that this policy was made possible by the CCP’s desire to survive. In the next paragraph, I shall discuss the CCP’s self-reliance doctrine, which also has a significant impact on the Party’s policy preference.

Self-reliance (zili gengsheng) is an important aspect of Mao Zedong’s thought. This notion dates back to the 1940s, when Mao stressed the importance of economic independence in the revolutionary base areas. China’s economic and trade policies were largely guided by this doctrine throughout Mao’s years until Deng Xiaoping initiated the Reform and Open policy, which promoted broader international cooperation and allowed greater economic interdependence. Nevertheless, it is dangerous to assume that today’s Chinese political elites have completely abandoned the self-reliance doctrine and are willing to be more dependent on the international market. Although no longer a guide for state policy, Mao’s self-reliance doctrine has been valued and is deeply rooted in the logic of Chinese decision makers. Indeed, China’s energy security policy vividly reflects
the existence of this logic: why does the Chinese government prefer cultivating its relationships with individual oil exporters, knowing that in the long term such an approach may be more dangerous than relying on the international oil market? Where does the sense of insecurity first come from?

As Downs (2004) points out, the major advocates of greater integration are those analysts who have the best understandings of global energy markets (Downs 2004, 41). It is therefore reasonable to argue that if China were a purely rational actor, it should pursue an energy security policy that differs from the one we see today. Instead of cutting bilateral deals with oil exporters, China’s energy supply might be in fact more secure if it relied on the global oil market. It is the intervening effect of the CCP’s belief in self-reliance that shaped China’s policy choice, and the sense of insecurity resulting from the self-reliance doctrine has been the driving force behind the energy security policy made by the CCP.

Readers may be interested in the role, if any, that the Chinese military plays in the making of energy security policy, and a quick sketch of the military’s influence might seem necessary at this point. As Table 1 suggests, scholars do include the military as a player, but the exact role of the People’s Liberation Army (PLA) in the policymaking process has been largely a mystery for both scholars and policy analysts in the West. Until very recently, the PLA has been believed to be under the absolute control of the Central Military Commission, a core component of the CCP central committee, whose chair is usually the CCP’s general secretary. This was true in the eras of Mao Zedong and Deng Xiaoping, both of whom were commanders of the PLA during its wartime history, and also that of Jiang Zemin, who, although lacking a military background, was able to
establish his status in the PLA, thanks to a series of arrangements Deng made when he decided to pass power to Jiang in the early 1990s.

However, the recent power transition in China, namely Hu Jintao’s succession, was not as smooth as it was when Jiang took the position in November 1989. Hu Jintao, during his first 2 years in office, had a very hard time establishing his prestige among the PLA generals, most of whom at that time were still loyal to Jiang. Since 2004 when Hu was finally appointed as the chairman of the Central Military Commission, many military generals have expressed their advocacy and loyalty to the new leadership. With the ongoing power struggle on the CCP elite level, however, it is still unsafe to assume that the military would support all decisions made by Hu’s office, and it may very well pursue its own objectives.

In terms of energy security, the military has long suggested the need to build a stronger Chinese navy in order to patrol the Malacca strait, through which Middle Eastern oil flows to China. Due to a lack of data, it is difficult to measure precisely the role the military plays in the making of energy security policy, and in the case studies conducted below one might notice that the PLA is not included as an independent player and consequently, I do not intend to speculate further on the role military plays. However, one should note that with the declining influence of the party central leadership over the PLA as a result of internal power struggles and transitions, as discussed above, the military has evolved from a subsidiary group that follow unconditionally the CCP’s leadership to an actor that has its own strategic preferences and policy pursuits, and such preferences are often reflected in the ideological shift in recent Chinese foreign and energy security policy.
Oil Companies: Independent Players?

The three major state-owned oil companies in China—Sinopec, CNPC, and CNOOC—were created by the Chinese government in 1983, 1982, and 1988, respectively. During the first years of their development, each company was assigned specific responsibilities: Sinopec was responsible for refining and marketing; the CNPC, formerly the Chinese Ministry of Petroleum Industry, dominated the exploration of domestic oil fields and the production of petroleum; and the CNOOC operated and oversaw most off-shore businesses. The three oil companies did not start to become individual interest groups, or agents by the definition of the principal-agent theory, until the March 1998 reforms, when the government adjusted its role from actually running the companies to providing general regulation and supervision. The 1998 reforms have allowed oil companies great leeway to pursue their own interests either independently or through political channels. All three have gone beyond their initial responsibilities, and the expansion of the scope of their business has led them to compete with each other in foreign markets, a result that followed the CCP’s policy of encouraging the state-owned companies to “go out”.

The CCP introduced the idea of “going out” or “going global” for Chinese companies during the 9th National People’s Congress in 2001. The idea of “going out” has strongly encouraged Chinese companies to invest extensively in overseas markets and is the political basis of the oil companies’ expanding strategies. While this notion significantly helped globalizing Chinese firms, in energy security it has caused problems. In the first place, since all three oil companies are essentially dedicated in the same

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3 For a detailed introduction of the three oil companies, see Andrew-Speed et al. 2004. pp. 51-52.
business, and in some cases they operate in the same region of the world, competition
between or among them would be inevitable in the absence of a governmental
coordinating mechanism. Such competition, although not harmful in purely economic
terms, may negative affect China’s energy supply, since not all results of international
competitions are positive-sum. The case study conducted later on CNPC and Sinopec’s
competition in Sudan will illustrate this point in further detail.

In the second place, due to their organizational nature, the oil companies do not
always have to consider political impact when making decisions on overseas investment
or expansion. And since they are not closely monitored by the CCP’s bureaucracies that
are responsible for evaluating political consequences (e.g., the Ministry of Foreign
Affairs), their behavior can sometimes be fundamentally different from the Party’s
preferences and thus create embarrassing international situations that the state must
address. The second case study, which focuses on CNOOC’s bid for Unocal in 2005,
provides a vivid example of this scenario.
Chapter 4: The Research Design

As discussed above, the aim of this paper is to offer an alternative approach to analyzing China’s energy security making. Thus, it is beyond the scope of my analysis, and perhaps empirically very difficult at this stage, to test the theory with reliable data and survey/interview results. Nevertheless, these difficulties should by no means obfuscate the validity of my approach, since if the conventional assumption of China having a unified, state-made energy security policy does not hold, the arguments made in this paper should be logically sound inferences from the alternative assumption, which identifies a state-company divergence. The main task of this research is therefore to demonstrate that there are observable and verifiable cases in which the state and the companies act as autonomous players pursuing their own ends. This mission has inevitably led this paper to the use of case studies as an avenue of theory building.

Alexander George and Andrew Bennett (2005) have conducted research on the value of case studies in theory development. They seek to “raise the standards for case studies and explicate procedures for improving their value” (George and Bennett 2005, xiii). The authors define a case study as “the detailed examination of an aspect of historical episode to develop or test historical explanations that may be generalizable to other events” (2005, 5). In particular, they highlight the importance of “process-tracing”, which “focuses on sequential process within a particular historical case, not the correlation of data across cases” (George and Bennett 2005, 13).

The case studies conducted in this analysis will generally follow the guidelines provided by George and Bennett. Specifically, I choose to use the heuristic case studies, as termed by the authors, as the main method in this study. Heuristic case studies,
according to the George and Bennett, are studies that “inductively identify new variables, hypotheses, causal mechanisms, and causal paths” (George and Bennett 2005, 75). Cases whose outcomes contradict the prediction of conventional theories should be used in this type of case study because they may help demonstrate new hypotheses or causal mechanisms. That being said, to build a theory on a heuristic case study would first require the identification of these unconventional cases. Among the universe of all possible cases, which should be included and which should not? Which time period(s) needs be covered? To answer these questions, I offer the following criteria for the selection of cases:

1. Only events after 1993, when China became a net importer of oil. Before then, energy security did not receive much attention from the CCP leadership;
2. Only events after the formal establishment of the three national oil companies in 1988;
3. Only events that took place overseas or involved foreign countries. No state-company divergence is expected in domestic energy policy, where the companies enjoy less autonomy.

Among all the instances that might meet the above criteria, the two particular cases introduced later in this paper were chosen mainly for two reasons. First, these two cases are relatively well documented in both the Chinese and Western media, therefore making them more reliable than other potential candidates. Second, in these two cases there is little room for ambiguity. Case studies are vulnerable to alternative
interpretations. In other words, there is always a different side of the story. In the cases chosen for this study, however, one might find it difficult to argue that the Party and the companies were indeed convergent in their interests or that the companies were merely carrying out policies made by the Party.

Also, one should note that among the potential cases, some will indeed strongly confirm the conventional arguments, so this research would be biased if they were completely left out. Consequently, I will briefly introduce a couple of these cases later in this analysis, and suggest that although they support the conventional wisdom, it is the state-company divergence identified by my cases that needs to receive more scholarly attention.
Chapter 5: Case Study I

Introduction to the Case

In 2004, the Sudanese government opened a 1380 kilometers pipeline project in Block 3/7, also known as Melut Basin Oil Development Project to bids. The project was partially contracted to Sinopec, because it offered the Sudanese government $190 million, a price $64 million lower than CNPC’s original bid of $254 million. Sinopec winning the Sudanese bid was not beneficial to either CNPC or itself. For CNPC, the loss is obvious: having entered the Sudanese market in the mid 1990s, CNPC had invested heavily in the country in order to build a positive image and a close relationship with the government. In the 5 years from 1999 to 2003 alone, CNPC spent 10 million US dollars on building hospitals, schools, and drinking water facilities. In 2004, the company donated another $10 million to the Sudanese government to help build the Marowe Bridge, a project completed in early 2008. In the 3/7 Block project however, CNPC’s cultivation of the Sudanese government and its careful planning was interrupted by the uninvited participation of Sinopec. On the Sinopec side, since it held only a 6% share and was in coalition with the Malaysian company Petronas, which held a 40% percent share, offering a low price neither helped it enter the Sudanese market on a desirable scale, nor did it bring the company considerable profit. The end result of such competition was therefore a zero-sum game for both parties.\footnote{For a more detailed introduction to the case, see Jingji Cankao Bao (Economic Reference News), June 28, 2004. Available at <http://www.southcn.com/news/china/china04/petroleum/latest/200406280680.htm>
Where was the CCP?

For private companies, this case may seem unremarkable, since both CNPC and Sinopec are owned by the Chinese government however, a few interesting questions arise: Where was the government? Why was it absent in such a competition which at the aggregate level was harmful to China’s energy supply? Indeed, although the CCP owns the companies, it did very little in this particular case. When CNPC and Sinopec were in competition, the Chinese embassy in Sudan realized the severity of the situation and referred the case to the Ministry of Foreign Affairs, its immediate boss. The Ministry of Foreign Affairs found itself incapable of exerting direct influence on the behavior of the companies; so it passed the case to the Ministry of Commerce, which was deemed proper according to China’s bureaucratic structure. However, since there is no hierarchical relationship between the Ministry of Commerce and the companies, the only solution the Ministry came up with was to forward the case once more to the China International Contractors Association, a semi-governmental association. As one would expect, this semi-governmental association had no actual political power, and after more than one month of meetings, it eventually failed to carry out the mission of coordinating the two companies.

This case clearly illustrates that due to the “going out” strategy, the Chinese oil companies are bumping into each other in overseas markets, and since each company now has gone beyond the original assignments and developed its own business and strategic interests, their behavior in foreign markets can no longer be fully controlled and monitored by the government. In other words, the state-owned companies can sometimes be independent and autonomous. This finding is extremely important, because it clearly
contradicts the conventional argument which assumes that the companies are controlled by the state, and it provides the theoretical foundation for case study II, which will further develop the state-company divergence in China’s energy security policy. I do admit that in the Sudan case, although CNPC and Sinopec ran into an undesired competition, their behavior did not contradict the goal of the CCP, which was access to Sudanese oil. But this case does establish the independent status of the oil companies and the inability of the Chinese government to effectively regulate and police their behavior in foreign markets.
Chapter 6: Case Study II

I next examine China National Offshore Oil Corporation’s unsuccessful bid for the California based oil company Unocal in 2005 and show that there was a state-company divergence, where the oil companies were pursuing their own ends, instead of being controlled or directed strategically by the Chinese Communist Party. The CNOOC’s bid for Unocal in 2005 was, due to the attention it received on the international level, relatively well documented and has been repeatedly mentioned by journalists and academics who are interested in Chinese foreign policy (Ben 2005, Goodman 2005, Lohr 2005, Samuelson 2005, Wayne and Barboza 2005). Thus a careful study of this case is not only a legitimate approach in terms of methodology, but also it is an important inquiry for our better understanding of Chinese energy security policy.

Introduction to the Case

Created in 1982, China National Offshore Oil Corporation (CNOOC) is one of the three major oil companies in China, with a specific responsibility for oil and gas exploitation in China’s offshore areas. On June 23, 2005, CNOOC Ltd., the Hong Kong based subsidiary of CNOOC, made an unsolicited bid of $18.5 billion for an American company, Union Oil Company of California (Unocal), after the latter’s agreement to be acquired by Chevron for 16.5 billion dollars in cash-and-stock. CNOOC’s bid triggered deep worries on the part of Chevron, which initiated heavy lobbying in the Congress. On June 30, 2005, the U.S. House of Representatives passed H.RES. 344, which called for a review of CNOOC’s bid by the Committee on Foreign Investment in the United States (CFIUS). On the same day, the House passed another bill to forbid the use of Treasury
funds to approve the sale of Unocal to CNOOC (CRS 2006). On July 16, the chief executive of Unocal, Charles R. Williamson, told Fu Chengyu, CEO of CNOOC, that it was possible for Unocal to reject Chevron’s bid, if CNOOC was willing to raise the $67-a-share bid (White 2005). On July 20, Chevron raised its offer for Unocal to approximately 17 billion dollars, which eventually led to CNOOC’s withdrawal of its bid on August 2, 2005 (CRS 2006).

Where was the CCP?

The above introduction has briefly laid out the timeline of the CNOOC’s bid for Unocal. While most analysts have focused on the tension this bid created in the Congress and the reasons behind CNOOC’s failure, in this paper I shall take a step back by asking whether CNOOC’s bid was part of China’s energy security policy, or whether it was separate from, or even contrary to the Communist Party’s policy preferences. If my hypotheses hold, the United States was in fact overreacting to CNOOC’s offer of acquiring Unocal, by mistakenly assuming that the bid indicated the aggressiveness of China’s energy policy.

So what was the CCP’s position in this case? Was the Party actually behind the deal? If not, what role, if any, did it play? As discussed earlier in this paper, the CCP leadership is influenced by the self-reliance doctrine and has frequently expressed its concerns about China’s reliance on foreign oil. While cultivating bilateral relationships with oil exporters has been the main strategy applied under the doctrine, the CCP leadership is clearly aware that the coherence of this policy would be severely diminished if it posed a direct challenge to the United States on energy security issues. As suggested
by Chinese analyst Shi Yinhong, Beijing’s policy is to “feel the United States’ bottom line without giving it a strong feeling of being challenged” (Shi, cited in Wen 2005, 20). Thus, it is theoretically unlikely for the Party to start or support a bid for an American energy company, knowing that such an acquisition would almost certainly disturb Washington’s policymakers. Indeed, in summer 2005 when the bid took place, it was hard to discover any evidence that the CCP was the initiator or a supporter of the merger, beside the fact that the Chinese government controlled 75% of CNOOC’s shares. The Chinese Ministry of Foreign Affairs made only two official announcements regarding CNOOC’s bid for Unocal, both of which emphasized the commercial nature of the merger. As Foreign Ministry spokesman Liu Jianchao suggested, “CNOOC’s bid to acquire the Unocal Corp. is a commercial activity between enterprises and should not be interfered by politics”, and “[T]he relevant people should not make a fuss over this, not to mention interfering the mutual cooperation with political factors. We have consistently taken an active attitude towards China-US normal economic and trade activities, which conform to the common interest of our two countries”. The attitude such a statement implied was that the Chinese government, which “conforms to the common interest of our two countries”, did not want to be held responsible for CNOOC’s commercial behavior. One might argue that spokesman Liu’s comment was merely an official excuse for China’s policy; but, we should note that when it comes to energy security, the CCP has a perceptible pattern of policy making and implementation, which CNOOC’s bid for Unocal did not fit in. In the Middle East, for example, China’s cooperation with the oil exporters is often signaled by high-level official visits, whose function is to establish the

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political groundwork for any subsequent commercial activity conducted by oil companies. In early 2004, Chinese president Hu Jintao toured the Middle East in order to boost China’s political and economic relationships with the region and to develop a "new type of partnership" (Zweig and Bi, 2005). During and immediately after Hu’s visit, Sinopec and CNPC, the other two major Chinese oil companies, signed a series of memoranda and agreements with Egypt, Algeria, and Saudi Arabia. If the Party was involved in the case of Unocal, it should follow the past experience, which emphasized the importance of political ties rather than letting the companies explore their own markets.

The inconsistency of CNOOC’s bid for Unocal with the above pattern has revealed the fact that it was not the CCP’s idea to acquire the American company. The absence of the Chinese government during the entire process and the reluctance of the Party to support CNOOC’s bold moves have together proved that the role the CCP played was in fact that of an independent player rather than the behind-the-scene boss. Nonetheless, it remains necessary for us to further analyze to what extent CNOOC was free to make its own strategic choices and policy decisions. In other words, was CNOOC an independent player in our case?

**How Independent was the Company?**

As noted before, CNOOC is a state-owned oil company motivated by the CCP’s “going out” strategy. In comparison to Sinopec and CNPC, CNOOC is a much smaller company, which has been actively engaged in overseas investments. As far as we have seen in this analysis, it appears that CNOOC was operating on its own in the bid for

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Unocal. Such an argument could be challenged by two observations: first, over 70 percent of CNOOC’s shares are controlled by the State-Owned Assets Supervision and Administration Commission of the State Council (SASAC); second, CNOOC obtained a $4.5 billion subordinated loan and a $2.5 billion subordinated two-year bridge loan from Chinese banks at astonishingly low interest rates: 3.5% and zero respectively (Peters and Downs 2006).

Given such conditions, how was it possible for CNOOC to operate independently from the Chinese government and the CCP? Wouldn’t it not be penalized for carrying out a policy that contradicted the Party’s preferences? To answer these questions, one must understand the inherent disjunctions among branches of the Chinese government. The SASAC, while in direct control of CNOOC, was not obligated to coordinate with the energy security making community in the CCP leadership, nor was it staffed with energy security experts. Therefore CNOOC is capable of developing any company strategy as long as it follows the procedures and does not violate the domestic regulations. Since these strategies were made by a company instead of the Party, political sectors in charge of the making and implementation of energy security policy, such as the National Development and Reform Commission and the Foreign Ministry, will neither be involved nor consulted, thus creating an information asymmetry. The absence of an internal energy policy coordinating mechanism has resulted in the situation where the CNOOC, although owned by the state, can operate without being influenced by the preferences of the CCP. Regarding the low interest loans, since the SASAC is an overarching commission that regulates all state-owned enterprises, including the banks, the approval of such low interest loans does not have to be authorized by the State Council, in the event that the
SASAC confirmed their legitimacy. Western observers mistakenly assumed that the vast mobilization of funds would necessarily involve the CCP’s decision making sectors, whereas in reality, it can be done by the company and the SASAC without going to the higher levels of the bureaucracy.

So far, we have learned that when it decided to bid for Unocal, CNOOC did not have to go through all the relevant government agencies and thus enjoyed a certain degree of freedom. But after the bid was publicly announced, would not the Party and the government seek to take control of the situation? The answer is negative. The oil company remained an independent actor even after its bid for Unocal was vetoed by the Congress. Such an independent status, although allowing the company more freedom, has had a negative effect: political coordination was unavailable when needed. CNOOC’s chief executive, Fu Chengyu, suggested in October 2005 that when facing complicated international situations, the relevant domestic agencies and ministries should have had a clear, coordinated and global arrangement. He hinted that when CNOOC started the bid for Unocal, the Foreign Ministry was busy with the Six-Party Talks concerning the DPRK’s nuclear program; during the bidding process, the People’s Bank raised the exchange rate of the RMB; and immediately after the failure of the bidding, the Ministry of Commerce announced China’s purchase of airplanes made by Boeing. “It would be better if the relevant government department coordinated these three major events with CNOOC’s bid for Unocal”, said Fu (Wang 2005). It is beyond the scope of this analysis to speculate about the inherent relationships among these events (It might very well be that Fu wished the Chinese government had used them as leverage in order to pressure
the U.S. to accede to CNOOC’s bid). But Fu’s disappointment has again demonstrated that his company was indeed an independent player lacking government support.
Chapter 7: Concluding Remarks

I have noted in Chapter 4 that among all the cases that would satisfy the selection criteria, some may actually confirm the arguments made by other scholars. After conducting the above two case studies, it should be interesting to briefly look at the other cases as a comparison.

Generally speaking, these cases, which would support the conventional wisdom, fall into a “politics before business” pattern. For example, from January 24 to February 5, 2004, Chinese President Hu Jintao toured Egypt and Algeria, and met with delegates from the 22 members of the Arab League in Cairo to boost political and economic ties and to develop a "new type of partnership" that would further increase oil shipments to China and bilateral trade (Zweig and Bi 2005). Hu’s visit was accompanied by many high level officials of the oil companies and was followed by a series of business contracts between the Arab governments and Chinese oil companies. Another example is China’s relationship with the Persian Gulf countries. In July 2004, the finance minister of the Gulf Cooperation Council (GCC) made an important visit to China and signed a document titled “The Framework Agreement on Economic, Trade, Investment and Technological Cooperation between the People’s Republic of China and the Member States of the Cooperation Council for the Arab States of the Gulf”. This agreement significantly helped China strengthen its relations with the GCC member states.

These events, along with others which involve China’s relationship with Russia, Burma and Central Asia, are frequently cited as supporting evidence in the current

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literature concerning China’s energy security policy, or the so called “oil diplomacy”. I do admit the importance of these cases as they help demonstrate the preferences of the CCP. However, one must also look at the preferences of the oil companies, instead of merely treating China as a unitary actor with a clearly oriented policy, because as the companies grow and expand, there will be more cases where they act independently and challenge the preferences of the CCP. It is the state-company divergence that would provide scholars with a more accurate prediction of China’s energy security policy. Moreover, the case study of CNOOC’s bid for Unocal has provided abundant empirical evidence that the oil company and the CCP may very well be independent players in what is misperceived by most Western scholars, journalists, and politicians as part of China’s expansion strategy in the world energy market and a threat to US energy and national security.

The following paragraphs will discuss why a state-company divergence is harmful to China’s overall security of energy supply. I use David Deese (1980)’s definition of energy security as a point of departure and argue that the different preferences of the CCP and the oil companies may hinder China’s effort to achieve maximum security in energy supply.

Energy security, as defined by Deese, is “a condition in which a nation perceives a high probability that it will have adequate energy supplies at affordable prices” (Deese 1980, 140). The two oil shocks in the 1970s reminded the world, especially the oil importers, of the necessity of maintaining an oil price safe from external political shocks. In China’s case, if the nation were a purely rational actor, the goal of its energy security should not differ from what Deese has defined: abundant and inexpensive oil. However
the CCP’s ideological preference and its “politics before business” strategy may in the long run lead China’s energy security to be dependent on political influences, instead of free from them. For instance, the CCP wishes to reduce China’s reliance on the international oil market by building pipelines across borders and develop its bilateral relationships with its neighboring countries rich in oil and natural gas. Although these projects may in the short term slightly reduce China’s vulnerability to the fluctuation of international oil prices, are in fact heavily dependent upon China’s relationship with its neighbors. Since the long term stability of these bilateral relationships are in no ways guaranteed, building pipelines across borders may not be any safer than relying on the Malacca Strait, which is part of the international system of oil transportation.

In terms of the state-company relationship, the CCP’s efforts, which are based on political and ideological preferences, will fetter the competitiveness of oil companies because the companies have to allocate a significant amount of national wealth to projects, many of them infrastructural, that may not necessarily better guarantee a stable, relatively inexpensive, and abundant supply of energy. On the other hand, the lack of support and coordination from the Chinese government to the companies may as well hinder the successful expansion of the companies and restrict their access to the international market, thus reducing the companies’ competitiveness, which is evidently important for China’s energy security. In other words, the CCP and its ideological preferences have to some extent become obstacles in China’s path to a strengthened security of energy supply.

A state-company divergence is harmful to China’s energy security also because of the international misperceptions it might generate. Since oil companies do not take the
potential political impact into consideration when making their decisions about
investment or overseas expansion, the aftermath will sometimes embarrass the Chinese
government and thus create an undesirable international environment for the nation.
CNOOC’s bid for Unocal in 2005 has given American politicians the impression that
China is gradually becoming a threat to US energy security, while in fact it was merely a
company’s bold and, for the Chinese government, reckless move.

To conclude, while more case studies, interviews and survey are necessary in
order for us to develop a general theory of the complexity of China’s energy security
policy, this paper serves as a point of departure where I suggest that it is extremely
important for scholars and policymakers interested in China’s energy security to
distinguish company policy from Party policies. The international implication of such a
new approach could be profound: for theorists of International Relations, the
acknowledgement of the influence of oil companies would further invalidate the
Neorealist assessment of the motives and effects of Chinese energy security policy; and
for policymakers in both Beijing and Washington, identifying the preferences and goals
of different players before jumping to a political response may significantly reduce the
probability of miscalculation and overreaction from both parties. I propose that Western
policymakers concerned with China’s energy policy need to identify whether any specific
policy is a result of CCP’s political preference that deserves a response on the political
level, or it merely represents the business interests of Chinese oil companies, which may,
and should be left for the international market to deal with. In terms of policy
prescriptions for the Chinese government, it is clear first that a coordinating mechanism,
which is capable of exerting direct and powerful influence on the oil companies, is in
urgent need in order to reduce the degree of state-company divergence. Second, the CCP needs to reevaluate and perhaps discard several of its political and ideological preferences (e.g. self-reliance), which tend to prevent China from better integrating in and benefiting from the international market as well as international energy cooperation.

Since little has been written on the impact of the government-business relationship on China’s energy and foreign policy, there is much room for future research. Potential research topics might include: When can we expect a state-company divergence? Is it entirely random or are there predictable patterns? Within the existing institutional structure, what can be done for the state to better monitor and control its agents? As an important regional power, China’s foreign policy could be better understood if the above questions are appropriately analyzed. Moreover, since this thesis demonstrates that the principal-agent theory could well explain the state-company divergence in China’s energy security policy, it should provide a strong basis for future research, which might broaden the scope of the analysis by applying the principal-agent theory to the evaluation of China’s domestic politics and foreign policy.
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