A Dragon in the Andes? China, Venezuela, and U.S. Energy Security

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IN AUGUST 2005, the Venezuelan daily *El Universal* published an interview with Ambassador Ju Yijie, the Chinese envoy to Caracas. When asked if China's demand for Venezuelan oil could push the United States out of Venezuela's market, the ambassador asserted that "China has the potential to do it." He then quickly added, "Though I don't see the necessity for any of the countries involved."[1] The exchange highlighted the growing tension between China, the United States, and Venezuela over the fate of Venezuela's oil reserves as China's influence in the Western Hemisphere continues to expand.

Does China's increasing role in South America's energy sector represent a threat to U.S. interests? In recent years, this question has provoked unease among U.S. policymakers who see a dangerous convergence of three worrisome trends. The first is the rise of China as a global economic power that may seek to challenge U.S. dominance over the next quarter-century. Second, U.S. influence in Latin America appears to be in flux as a number of the region's leaders, led by Venezuela's left-leaning President Hugo Chávez, have embraced populist politics and adopted anti-American stances. Third, ensuring access to energy sources has become a central U.S. security concern because a tight global oil market has caused crude oil prices to soar to more than $70 per barrel. Against this backdrop, China's increased efforts to tap into energy reserves in the Western Hemisphere have reverberated throughout the region, with potentially profound consequences for U.S. energy security.

The Global Oil Squeeze

China's need for oil has surged dramatically since the country first became a net oil importer in 1993. By 2003, China had overtaken Japan to become the second largest oil importer in the world (after the United States). According to the U.S. Energy Department, China now accounts for 40 percent of the global growth of oil demand since 2001. In fact, China's oil consumption is increasing 7 times more quickly than that of the United States, at a rate of 7.5 percent annually.[2] The Paris-based International Energy Agency predicts that, by 2030, Chinese oil imports will equal imports by the United States today.

Meanwhile, the United States, which consumes 25 percent of the world's oil despite accounting for only 3 percent of world production, continues to rely on global oil markets, a fact that has created an enduring source of vulnerability.[3] Today, for the first time since the 1980s, the balance of economic bargaining

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power has swung toward oil-producing countries, thanks mainly to increased demand as developing states such as China and India replicate the United States' dependence on imports. How long this situation will last is anyone's guess, but it appears likely to continue for the foreseeable future.

While China continues to import a majority of its oil from the Middle East—and that percentage is due to rise in the coming decades—it has increasingly focused on finding other suppliers, especially in the Western Hemisphere. One result has been the consummation of numerous oil and gas deals with Canada and countries in South America, including Argentina, Brazil, Ecuador, Peru, and Venezuela. Consequently, some in Washington are becoming apprehensive about China's attempts to tap into the hemisphere's energy sources, and bilateral tensions threaten to grow over time if competition for oil becomes more acute.


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Chinese President Jiang Zemin, left, and Venezuelan President Hugo Chavez exchange signed agreements in Caracas, Venezuela, 17 April 2001. Jiang and Chavez signed accords on agriculture, taxation, and energy.

Beijing's Southern Thrust

In an effort to reduce Venezuela's dependence on the United States, Hugo Chávez has aggravated U.S. concerns by declaring his desire to seek major alternative markets for his country's crude. China has responded to his overtures by sending mixed signals about its eagerness to serve as an alternative market. On the one hand, China is seeking to portray itself as a rising power with significant interests in the hemisphere, but on the other, its officials continue to suggest that the United States has nothing to worry about.

Despite China's ambiguous public posture, it is clear that its relationship with Latin America generally, and Venezuela specifically, is rapidly expanding. Just a decade ago, China was viewed as a peripheral actor in the region; today, though far from being a dominant player (China only accounts for 1 percent of current overall foreign investment in Latin America), it has nevertheless become a relevant influence in hemispheric affairs.

This growing influence results from China's effective economic penetration of Latin America over the past 10 years, a phenomenon that has intensified since 2001. In that year, Chinese President Jiang Zemin's landmark visit to the region was followed by a wave of exchanges by Chinese and Latin American senior officials and business leaders to discuss political, economic, and military concerns. Jiang's successor, Hu Jintao, traveled to Argentina, Brazil, Chile, and Cuba in 2004 and visited Mexico in 2005. The presidents of all of these countries (and several others) have subsequently paid reciprocal visits to China.

Growing political engagement accompanied the skyrocketing volume of trade between China and the region. In the past 6 years, Chinese imports from Latin America have grown more than sixfold, at a pace of some 60 percent a year, to an estimated $50 billion in 2005. China has become a principal consumer of food, minerals, and other primary products from Latin America, benefiting principally the region's commodity-producing countries (particularly Argentina, Brazil, Peru, and Chile). China has also become a strong competitor with the

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Argentina's President Nestor Kirchner and China's Hu Jintao drink a toast 28 June 2004 during a welcoming ceremony at the Great Hall of the People in Beijing. Hu and Kirchner agreed to step up economic and trade ties.

United States in manufactured goods, making deep inroads into markets in Mexico and Central America and, more recently, in Brazil and Argentina.

To provide perspective, it is important to note that although half of China's overseas investments in 2004 were made in Latin America, the total only reached a relatively modest $6.5 billion. However, China has promised to increase its investments in Latin America to $100 billion by 2014. (With several investment pledges already showing signs of falling short in Brazil, Argentina, and elsewhere, the Chinese have begun to suggest that this figure was taken out of context.) Overall, China's economic engagement in Latin America dovetails well with the trade requirements of a booming economy that has been growing at nearly 10 percent a year for the past 25 years.

Rising Chinese influence in Latin America has prompted some U.S. officials and members of Congress to view China as the most serious challenge to U.S. economic and security interests in the region since the end of the cold war. U.S. policymakers cite concerns about continued allied access to the Panama Canal, the deployment of Chinese peacekeepers in Haiti, China's support for Cuba's Fidel Castro, and Beijing's growing claims to Venezuelan oil.

Although these concerns may be overly alarmist, Chinese competition for Latin America's energy resources has clearly created a new and uncertain dynamic for U.S. policymakers. Even the most benign interpretations of Chinese penetration into Latin American markets—that China is growing and needs resources, while the region is searching for new customers—implies a potential loss for U.S. business interests. The more ominous view, however, posits the eventual emergence of an anti-American alliance led by China and Venezuela that might include other energy-exporting nations in Latin America and elsewhere. Such an alliance could potentially isolate and undermine the U.S. economy. Some analysts worry that if emboldened or threatened, this new alliance might seek to engage in a form of asymmetric warfare against the United States by cutting off vital oil supplies. Given current constraints, however, such drastic action would be difficult to carry out and would inflict greater harm on the perpetrating countries than on the United States itself.

U.S.-Venezuela Tensions

Setting aside the security concerns raised by China's larger regional role, Venezuela has independently evolved to become a major preoccupation of the United States. Elected in 1998 with overwhelming popular support, Hugo Chávez has since been re-elected under a new constitution in 2000, survived a short-lived coup in 2002, withstood a strike by employees of the state-owned oil company PDVSA in 2003, and triumphed in a referendum on his rule in 2004. He seems well-positioned to retain power in a presidential election scheduled for later this year. Since 1998, Chávez has consolidated his control over most major institutions of government, and domestic opposition to his regime has withered.

The United States is particularly concerned about Chávez's openly stated policy to use Venezuela's resources and influence to undermine the U.S. both regionally and globally. In support of such policy objectives, Chávez has gradually embarked upon a program of outreach to such avowed U.S. enemies as Cuba and, more recently, the Islamic Republic of Iran. Venezuela has also adopted a hawkish position in OPEC and has backed policies to maintain high oil prices.

Chávez has been particularly active in the Americas. Working with Cuba, Venezuela has spearheaded a regional social and investment pact known as the Bolivarian Alternative for Latin America, or ALBA, a rejoinder to the U.S.-sponsored Free Trade Area of the Americas. Bolivia has now joined ALBA, led by its president, Evo Morales, who was elected overwhelmingly last December following a campaign critical of U.S. influence in the region. Morales's recent decision to nationalize Bolivia's vast gas reserves is thought to have been mentored by Chávez.

Venezuela's ties to Iran have provoked even greater unease among U.S. policymakers. Former Iranian president Mohammad Khatami has visited Caracas three times, signing a range of economic cooperation agreements. Venezuela's support of Iran has extended to publicly defending Iran's nuclear energy program with an expressed interest in collaborating on nuclear technology. The possibility of Venezuela claiming a seat on the U.N. Security Council at a time of increasing confrontation over Iran's nuclear program is now keeping U.S. diplomats awake at night.

U.S.-Venezuelan relations were already tense when the U.S. Department of State appeared to endorse the overthrow of Chávez in 2002. Since then, relations have deteriorated to a historic low with Chávez now regularly launching public criticism, personal insults, and barbs against the Bush administration and its members. U.S. officials have found it hard to resist responding. During her Senate confirmation hearing in 2005, Secretary of State Condoleezza Rice characterized Venezuela as a "negative force" in the region. More recently, Secretary of Defense Donald Rumsfeld likened Chávez to Hitler.

Despite all the bitter public rhetoric, the U.S. and Venezuela remain locked in a mutually beneficial relationship based on oil. Venezuela continues to sell 1.5 million barrels per day to the United States, making it the U.S.'s fourth largest oil supplier and accounting for about 14 percent of total U.S. imports. More than half of Venezuela's oil exports go to the United States, with much of it processed through the PDVSA-owned company CITGO, which has 6 oil and asphalt refineries in the U.S. able to refine 860,000 barrels per day, a storage capacity of 24 million barrels, and a network of 13,800 service stations across the U.S.[4]

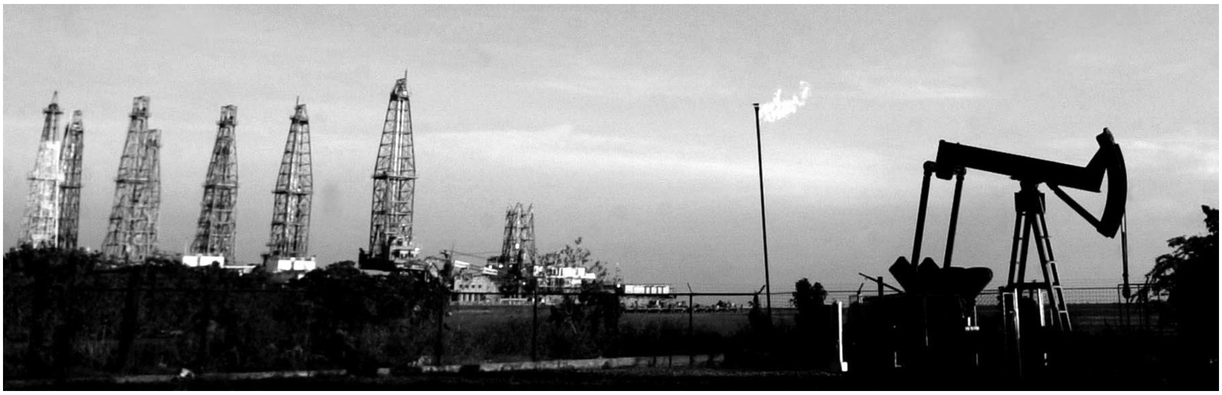
Given existing technological constraints, it would be extremely difficult for Venezuela to replace its sales to the U.S. market. Venezuela's crude oil has a typical sulfur content of 4 to 5 percent, which is much higher than the sour crude from the Middle East/Gulf region. The light, sweet crude of the Middle East yields 95 percent finished fuel products such as gasoline and aviation fuel.[5] By comparison, Venezuelan heavy crude yields 65-percent-finished fuel products, and only after a complex refining process. (Otherwise, the crude is used as asphalt.) Therefore, perhaps the most crucial factor sustaining the U.S.-Venezuelan oil relationship is that U.S.-based CITGO refineries have an unmatched capacity to refine heavy Venezuelan crude.

Technological factors notwithstanding, the U.S.-Venezuela oil relationship is driven by strong market logic based on supply and demand and low transportation costs due to geographic proximity. Oil sales to China, on the other hand, translate into much greater shipping costs and narrower profit margins for the Venezuelan suppliers. In other words, market factors and the U.S.'s unique ability to refine large amounts of Venezuelan oil guarantee, at least in the foreseeable future, a stable energy relationship no matter how high the political tensions.

Venezuela-China: Increasing Links

Venezuela is now the largest single recipient of China's overall investment in Latin America. This investment is mainly concentrated in two oil fields under development by the China National Petroleum Corporation (Sinopec). By 2000, trade between China and Venezuela had already hit $351 million, which represented an 86 percent increase over the previous year, while Chinese investment in Venezuela totaled $530 million.[6]

When Jiang Zemin visited Venezuela during his six-country swing through Latin America in



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The sun sets behind an oil field of Venezuelan state oil company Petroleos de Venezuela S.A. (PDVSA) in Cabimas, Venezuela, 500 km (300 miles) west of Caracas, Venezuela.

April 2001, he found a willing ally in Chávez, who proclaimed his admiration for Mao, backed China's effort to host the 2008 Olympics, and most importantly, pledged to oppose a U.N. resolution to censure China for its human rights record. Chávez declared that "we don't believe any country in the world has the right to condemn another…. We are going to vote against the resolution."[7] He also announced that he would write a letter of condolence to the family of a Chinese fighter pilot killed in a collision with a U.S. spy plane earlier that month. The agreements signed during Jiang's trip included a $60 million investment in a tractor factory and a number of accords on energy, mining, agriculture, and taxation. Chávez also said that the two countries discussed the joint manufacturing of Chinese K-8 and Y-12 military training and cargo planes in Venezuela.

In May 2001, Chávez returned to Beijing for 5 days, during which Jiang remarked that China had "a positive attitude towards formulating a 10-year plan of cooperation between the two countries."[8] Chávez presented Jiang with Venezuela's top honor, the Liberator's Medal, and a deal was struck allowing China to buy Venezuelan oil in exchange for a crucial loan to Venezuela's farming sector. The two countries also signed a Strategic Energy Plan that extends to 2011. The plan provides for Venezuela to increase oil exports to China while boosting its own agricultural production. Jiang endorsed this 10-year plan of cooperation.

A Chinese press release issued during Chávez's visit underlined the two countries' desire to work to create a "multi-polar" world order. Jiang was quoted as saying that "the process of multi-polarization will be a tortuous and long one, but it is an irreversible historical trend" and "it is important for the Chinese and Venezuelan people to carry out cooperation in the economic and trade, science and technological areas in a down-to-earth and step by step manner."[9] China has since designated Venezuela a "strategic partner," and the Chávez government has reciprocated by granting coveted "market economy" status to China.

Perhaps mindful of Washington's growing sensitivity to Chinese overtures in the Western Hemisphere, Hu Jintao chose not to visit Venezuela during his 2004 tour of Latin America. Nevertheless, Venezuela remains a central component of China's strategy to enhance its economic and political links with the region.

For its part, Venezuela sees China as a crucial market for its commodity exports, including not only oil and gas but also steel, aluminum, chocolate, and coffee. As it has with other countries in the region, China has proven willing to invest in improving infrastructure to help facilitate exports (for example, developing railway lines and selling train cars). In December 2004, Chávez made a third visit to China, signing oil and gas deals that allowed Chinese companies to invest $350 million in 15 eastern Venezuelan oil fields, as well as an additional $60 million in natural gas projects. In turn, Venezuela sought to acquire Chinese radar to improve security along its border with Colombia. This kind of security cooperation is sure to continue. Venezuela and China are already collaborating on building a Simon Bolivar satellite to be launched into space in July 2008, and Chávez vowed close cooperation, saying that "there will be no Chinese secrets from Venezuela in this project."[10]

In January 2005, Chinese Vice President Zeng Qinghong signed 19 cooperation agreements with Chávez during a visit to Caracas. Accompanying Zeng were 125 officials and businessmen. China is clearly seeking long term stakes in Venezuela's oil and gas fields. In early 2005, Venezuelan energy minister Rafael Ramirez moved to calm U.S. anxieties about Chinese interests in Venezuelan crude: "The United States should not be concerned. This expansion in no way means that we will be withdrawing from the North American market for political reasons."[11]

However, in August 2005 PDVSA opened a representative office in China, and in November Sinopec signed two contracts with PDVSA for crude and heating oil. Imports of Venezuelan oil are going up: China's customs administration has reported that the country imported 1.93 million tons of Venezuelan sour and heavy crude in 2005, nearly 6 times more than was imported in 2004. Venezuela has set a goal of selling 300,000 barrels per day of petroleum and petroleum derivatives to China. Caracas is also building up its oil shipping fleet for sales to Asian countries, in particular China. These moves have aggravated suspicions among some observers that China and Venezuela may be conspiring to cut off oil supplies to the United States, thereby dealing a body blow to an American economy already anxious about high fuel prices.

China is also moving to improve its ability to use and refine Venezuela's sour oil. The nation's refineries have begun blending sour with lighter sweet crude produced domestically to make a refinable hybrid. China has also steadily increased its ability to process straight sour oil. By 2004, capacity had climbed to 43 million tons per year, or 863,500 barrels per day, just over 12 percent of China's total refining capacity of 7 million barrels per day. China plans to add between 400,000 and 500,000 barrels per day in refining capacity annually up to 2010, with a significant portion of this targeted toward heavy and sour crude.[12] These developments suggest that China and Venezuela may be moving towards deeper systemic cooperation on energy issues. However, the case for this interpretation is by no means airtight.

Evidence to the Contrary

While Venezuela and China are clearly drawing closer, U.S. policymakers can take comfort in the fact that there is little credible evidence that China and Venezuela (perhaps with tacit support from other U.S. antagonists like Iran) are really conspiring to choke off the flow of oil to the U.S. market. The apparent threat indicators cited above are somewhat misleading. For one, the 1.93 million tons China imported in 2005 represent only 1.5% of its total crude imports.[13] Nor is China's increase in refining capacity really so ominous. The move to blend sour with light sweet crude will not result in a significantly greater ability to use Venezuelan oil because only China's coastal refineries can process sours with more than 3% sulfuric content; her inland refineries cannot process oil with greater than 1 percent sulfuric content. Thus, any blending will necessarily contain a low proportion of sour.

The new refineries coming on line are not expected to help much either. Most of the crude to be refined by the new plants will come from Saudi Arabia, which has taken a 25 percent stake in Sinopec's Fujian refinery project, while another planned expansion of the Qingdao refinery is also expected to take Saudi oil. These preexisting agreements with Saudi Arabia leave little room for processing sour Venezuelan oil in large enough quantities to displace the U.S. market.

Similarly problematic is Caracas's attempt to build up its tanker fleet to increase export to Asia. Geographic realities present the major obstacle to this ambition. Venezuela's three main transport options—shipping through the Panama Canal, building a pipeline across Colombia to the Pacific Ocean, and transporting the oil around Cape Horn at the southern tip of the Americas—are all expensive and unwieldy. For heavy crude oil, the unfavorable weight-to-value ratio means that higher transportation costs do not favor long distance shipping. Oil is a fungible commodity in the world oil market, and Chinese investors are keenly focused on the bottom line. If Venezuela seriously sought to bypass the United States and send its oil straight to China, Venezuela would have to cover the difference in transportation costs. The short-term trade disruption could mean that Chávez would have to pay an exorbitant political price as a result of the economic fallout.

Another obstacle to any Chinese-Venezuelan attempt to use oil as a weapon against the U.S. is the Chávez administration's mismanagement of the oil industry and its failure to invest adequately in infrastructure. In February 2006, Venezuela's energy minister announced plans to double oil exports to China to 300,000 barrels-per-day from 150,000 barrels-per-day, but most observers doubt that this pace of growth is sustainable.[14]

To be sure, both China's growing energy needs and Venezuela's management of its petroleum sector have important implications for U.S. energy security. But the effects are more likely to be found in the long-term supply and demand for oil on the global market, not in a sudden shock to U.S. energy supplies resulting from a cut-off of oil by conspiring parties. For one, U.S. oil consumers would have time to adjust to any sharp change in trade and could purchase oil from providers who had been displaced by China's agreement with Venezuela. In addition, even if China and Venezuela sought to spook U.S. oil markets (a highly speculative scenario), the hazardous logistics of the global oil trade would quickly extinguish any ambition to forge a sustainable oil alliance to isolate the United States.

Setting aside Hugo Chávez's far-fetched fantasies of holding American "imperialists" hostage to his oil reserves, under current conditions any disruption of oil exports to the United States would devastate the Venezuelan economy and perhaps pose a mortal threat to Chávez's regime. For its part, China is extremely sensitive to U.S. perceptions that it represents an emerging rival. It has taken great pains to avoid political provocations in the Western Hemisphere, instead focusing on purely economic objectives.

Finally, Beijing is searching for stable energy suppliers over the long term, and few high-level Chinese officials appear willing to bank heavily on a partnership with the erratic and potentially volatile Chávez. During a recent meeting with other South American presidents in April, Chávez threatened to blow up the country's oil fields in response to a possible invasion by the United States.[15] Such wild rhetoric is hardly reassuring to Chinese investors, especially when they have access to more conveniently located, better quality oil from partners in the Middle East.

A Prudent Approach

The existing relationship between China and Venezuela may not be a cause for immediate alarm, but this hardly signifies that U.S. policymakers should lapse into complacency. Indeed, China may eventually seek to establish itself as a major power and a conventional regional rival to the United States in the Western Hemisphere. Even if this does not come to pass, China is sure to continue pursuing its objective of securing the necessary commodities to sustain its economic growth and feed its large and increasingly restless population.

Competition for Latin America's energy supplies will undoubtedly intensify at a time when many nations are seeking to exercise greater control over their oil and gas reserves. Venezuela has sought and obtained a controlling stake in crucial oil ventures run by foreign companies and, as mentioned above, the Bolivian government has acted to nationalize its natural gas sector, even sending in troops with a dramatic flourish. Most recently, Ecuador cancelled the operating contracts of the U.S.-based Occidental Petroleum Corporation, triggering a trade dispute with Washington. These rifts may create opportunities for China's state-owned oil companies to play a more sweeping role in the region's energy sector. U.S. policymakers need to be vigilant and proactive. The long-term outlook for U.S. energy security will be improved if they can fashion a compelling response to the new dynamic created by China's growing economic power and Latin America's resurgent nationalism. ***MR***

NOTES

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