

The Politics of Oil Behind Sino-Japanese Energy Security Strategies

Janet Xuanli Liao

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Executive Summary

China and Japan have experienced an escalation of competition over sources of energy supply during the past decade. With China's growing economic capability and the increase in Japan's international influence, the interdependence between the two powers has weakened and both countries have become more concerned with defending their status. An important role in the processes of Sino-Japanese energy cooperation – as well as competition – has also been played by Russia. Not only have Sino-Japanese rivalries over access to Russian oil pipelines, as well as their dispute over gas exploration in the East China Sea, offered an unprecedented picture of the two neighbors fighting for energy security, but so has China's and Japan's heavy reliance on oil supply from the Middle East.

Since the mid-1990s, energy security has been one of the top issues in Sino-Japanese relations and the post-war experiences have shown that energy security is not purely an economic matter to China and Japan. However, despite the obvious linkage between petroleum resources and Sino-Japanese rivalries, it is insufficient to illustrate the tensions in the bilateral relationship through energy alone.

The paper argues that to China and Japan, political concerns have always been in command over energy security strategies. Three case-studies are conducted to demonstrate the role that political considerations have played in the Sino-Japanese energy relationship over the past four decades. The first one examines how the political factors made it possible for China and Japan to cooperate on energy related issues during the Cold War era, using the Tyumen oil project as an example. In contrast to many people's belief that the essence of energy security is to ensure sufficient energy supply at a stable energy price, the Sino-Japanese energy relationship has presented a more complicated case, fraught

with a great deal of politics. The proposal to build an oil pipeline from Siberia to the Pacific coast forty years ago is one example of this. That time China succeeded in persuading Japan to abandon the Tyumen oil pipeline project and to join its “united front” against the Soviet threat by providing a stable oil supply to Tokyo and by working together with Japanese companies on oil exploration. What enabled China’s success, then, was not that it could supply Japan with more oil than the USSR, but that its strategic interests converged with those of Japan and the United States.

The second case concerns the Sino-Japanese competition over access to Russian oil pipelines that escalated in 2003. What happened was closely linked to the Tyumen oil project. However, during the 1970s, China’s weaker economic potential and Japan’s similarly weak political influence had worked favourably for their cooperation. This time, though, the competition between the two, when it came to deciding the routes of Russian oil pipelines, was a fact. In both cases political considerations had ended up playing an important role, but with very different outcomes.

The last case concerns the recent Sino-Japanese dispute over gas exploration in the East China Sea, which had been triggered by legal causes, but stalemated largely due to mutual political distrust between the two nations. In this case, the reasons behind the dispute partially had to do with the vagueness of the International Law of the Sea, and partially with the Sino-Japanese political mistrust. Given the current circumstances facing China and Japan, it seems unlikely that the two countries will be able to rely on the International Law of the Sea to settle their disputes over the EEZ demarcation in the East China Sea and over the sovereignty of the Diaoyu/Senkaku Islands. The most reasonable option for the two countries would thus be to form a practical plan for joint development and to leave aside the more difficult issues. However, it is far from adequate to rely entirely on the top leaders to ensure a stable development of the bilateral ties; it is crucial for China and Japan to build up mutual trust on many levels. In addition, the two countries need time to settle this dispute peacefully and, more importantly, the governments have to show political courage and be wise, in order to reach a compromise solution that both sides can agree on.

The paper concludes by looking at possible prospects of the Sino-Japanese energy and political relationship and its implications for the power structure and regional stability of East Asia. The three cases covered serve as an ample reminder of the need for sensitivity and mutual respect when these two neighbours engage each another; as long as China and Japan remain distrustful towards each another and continue with their rivalry, it will not be possible to for the two powers to work together when it comes to energy security.

I. Introduction

Being the second and third largest oil importers in the world, China and Japan have experienced an escalation of competition over sources of energy supply during the past decade. In addition to their heavy reliance on oil supply from the Middle East, Sino-Japanese rivalries over access to Russian oil pipelines and the dispute over gas exploration in the East China Sea have offered an unprecedented picture of the two neighbours fighting for energy security. Undeniably, energy security has become one of the top issues in Sino-Japanese relations, especially since China became a net oil importer in the mid-1990s. However, despite the obvious linkage between petroleum resources and Sino-Japanese rivalries, it is insufficient to illustrate the tensions in the bilateral relationship by taking energy security as the sole concern. This is not only due to the fact that similar resentment has not been seen between other major oil consumers; moreover, the post-war experiences have shown that energy security is not purely an economic matter to China and Japan.

Indeed, energy security has often been viewed by China and Japan as an issue that transcends economic considerations. The past half-century has witnessed a major change in the Sino-Japanese energy relationship: from close partners in oil trade and exploration after the first oil crisis to tough competitors for energy supplies at the turn of the century. The factors associated with this change can certainly be attributed to China's shift to becoming a net oil importer, but the underpinning factor has been geopolitics and the balance of power in East Asia. During the Cold War era, the confrontation of the two camps in East Asian international politics, led by the United States and the former Soviet Union (FSU), played a dominant role in facilitating Sino-Japanese energy cooperation, because such cooperation was largely based on national security concerns and was aimed at confronting the military threats from the FSU. In the wake of the Cold War, China and Japan have encountered a more direct competition, not

only for energy security, but also for a leadership role in the region, due to the changed balance of their economic and political potentials. In other words, China and Japan needed each other more *before* the end of the Cold War to stand against Soviet military threats which, combined with China's weak economic potential and Japan's similarly weak political influence at the time, served to work in favour of cooperation. With China's growing economic capability and the enhancement of Japan's international influence from the 1990s, the interdependence between the two powers has weakened and both countries became more concerned about defending their respective statuses. Interestingly, in the processes of Sino-Japanese energy cooperation and competition, the Russian factor has played an important role for various, but inter-related, reasons at different periods of time, relating to energy and the national security of China and Japan, as well as to geopolitics and the balance of power in East Asia.

Against this background, the paper argues that to China and Japan, political concerns have always been in command over energy security strategies. The paper conducts three case-studies to demonstrate the role played by political considerations in the Sino-Japanese energy relationship over the past four decades. The first case examines how political factors made it possible for China and Japan to cooperate over energy related issues during the Cold War era, taking the Tyumen oil project as an example. The second case concerns Sino-Japanese competition over the access to Russian oil pipelines that escalated in 2003. This was closely linked to the Tyumen oil project, but due to the changed circumstances, the political factors involved have varied greatly from those that existed three decades before. The last deals with the recent Sino-Japanese dispute over gas exploration in the East China Sea; triggered by legal causes, it has stalemated for a solution largely due to mutual political distrust between the two nations. The paper will conclude by looking at possible prospects of the Sino-Japanese energy and political relationship, and its implications for the power structure and regional stability in East Asia.

2. The Politics of Oil and the Tyumen Oil Pipeline

In contrast to many people's belief that the essence of energy security is to ensure sufficient energy supply at a stable energy price, the Sino-Japanese energy relationship has presented a more complicated instance fraught with a great deal of politics. The proposal of building an oil pipeline from Siberia to the Pacific coast forty years ago was one such example. The proposal was raised and discussed by Japan and the former Soviet Union (1917–1991, also referred to as USSR below) from the late 1960s, following the political *détente* between the United States and the Soviet Union. Resource-scarce Japan made a similar rapprochement with the Soviet Union and turned its attention to the abundant energy resources in Siberia. The proposed energy cooperation may have served to help Tokyo's interest in energy security, but in return, Moscow wanted Japan to support its collective security system in Asia, aimed at containing the People's Republic of China (PRC).

Soon afterwards, however, Japan normalized diplomatic relations with the PRC in 1972, one year after the Sino-American *détente*. Tokyo then found itself at the centre of contention between the two biggest, and conflicting, communist countries. The choice facing Tokyo was to ally itself with either Beijing or Moscow in conjunction with its energy security concerns, although its energy situation was not particularly alarming at the time. In the end, Japan decided to abandon the Tyumen oil project, largely due to Chinese objections deriving from its national security concerns, though US resistance and the Japan-Soviet territorial disputes also worked as obstacles in the process.

Japan's Energy Situation Prior to the Tyumen Oil Project

Japan is a nation well-known for its scarcity of natural resources, and thus energy security has often been among the issues at the top of its policy agenda. Due to its rapid industrial development in the post-war era, Japan became the

largest oil importer in the world by the early 1970s, with its oil imports skyrocketing from 32 million tons (mts) in 1960 to 202mts in 1970; and the figures were predicted to rise further to 600mts by 1980.¹ On the other hand, Japan had only a small strategic oil stockpile during this period and therefore had to rely heavily on the international oil majors for its oil supply. Among Japan's total oil imports, the "Seven Sisters" (Exxon, Texaco, Chevron, Mobil, Gulf Oil, BP, and Shell) controlled nearly 60 percent of the supply; 12 percent came from independent American oil companies and only 10 percent was supplied by Japanese oil companies.²

Against this backdrop, the Japanese government established a few principles to ensure its energy supply prior to the first oil crisis: (1) to diversify sources of supply, (2) to maintain stable supply in volume, (3) to reduce costs to the lowest possible level, (4) to maintain autonomy from the international oil majors, and (5) to strengthen international cooperation.³

A number of Japanese oil companies were established between 1969 and 1972 to facilitate the accomplishment of the government objectives, including the Mitsui Oil Development Co., the Mitsubishi Oil Development Co., and the Overseas Petroleum Development Co. In 1973, four other companies joined the line to fortify the capacity of Japan's overseas oil exploration: Toyo Oil Development Co. Ltd., Fuyo Oil Development Co. Ltd., Sumitomo Oil Development Co. Ltd., and the World Energy Development Co. These companies were strongly encouraged by the Japanese government and received financial support from major Japanese banks as well. An important factor that facilitated Japan's expansion in overseas energy investment was the dramatic improvement in Japan's balance of payments at the time. By the end of 1972, Japan had become a major capital exporting country with a capital reserve of

¹ Gene T. Hsiao, "Prospects for a new Sino-Japanese relationship", *China Quarterly*, No. 60, December 1974, p. 742.

² Raymond J. Albright, *Siberian Energy for Japan and the United States* ([Washington, DC], Department of State, 1972-73), p. 45, Table 2, and pp. 3-4.

³ Ken Koyama, *Japan's Energy Strategies Towards the Middle East*, PhD Dissertation, The Centre for Energy, Petroleum and Mineral Law and Policy (CEPMLP), University of Dundee, 2000, pp. 44-45; Albright, *Siberian Energy for Japan and the United States*, p. 3.

US\$18.3 billion. In order to ensure the implementation of the plans on overseas energy investment, Japan's Export-Import Bank adopted a new policy which encouraged investment in overseas resource development, but the terms for financing exports in general were tightened.⁴

Prior to the Tyumen oil proposal, the Soviets had already in 1958 started to export oil to Japan, after the two countries had restored their diplomatic relationship in 1956 and concluded a treaty of commerce the following year. However, due partly to the US-Soviet confrontation and partly because of the undeveloped state of infrastructure in Siberia, the oil supply from the Soviet Union to Japan remained only in the range of 3mths annually, as most of the oil cargo had to be shipped from Black Sea ports. Interestingly, transportation costs were not responsible for this limited volume, as the price charged by Moscow for crude oil was only half of what it charged China. Instead, the shortage of tankers and the constraints caused by having to pass the Suez Canal seemed to cause greater difficulties.⁵

Initiation of the Tyumen Oil Project

The Tyumen oil project was initiated in 1966 in Tokyo at the first meeting of the Japan-Soviet Economic Committee. The original plan was to build a 7,800 kilometre (km) oil pipeline from Tyumen in West Siberia to the Pacific port of Nakhodka, supposedly to supply Japan with 40mths of oil annually for a period of 20 years, with Japan providing US\$1-1.5 billion in bank loans for the building work and the necessary equipment.⁶ The Tyumen pipeline proposal was obviously designed to serve Japan's interest of diversifying sources of oil supply, and also help to enhance economic cooperation between Japan and the USSR in general. However, little progress was made initially due to the Japanese

⁴ Albright, *Siberian Energy for Japan and the United States*, pp. 4-5.

⁵ The high oil price imposed to China was partly due to the overpricing of goods by both sides in an essentially barter trade, and partly involving exploitation as a result of Soviet's largely captive markets in other communist states. See Arthur Jay Klinghoffer, "Sino-Soviet relations and the politics of oil", *Asian Survey*, Vol. 16 (No. 6), June 1976, pp. 541, 548; Hsiao, "Prospects for a new Sino-Japanese relationship", p. 741.

⁶ Jeremy Russell, *Energy as A Factor in Soviet Foreign Policy* (London: Saxon House, 1976), p. 157.

adherence to its demand for the return of the Northern Territories – the four islands (Etorofu, Kunashiri, Shikotan, and Habomai) that had been seized after World War II (WWII) by the USSR, which referred to the islands as the Southern Kurile Islands.⁷ In fact, as early as in 1956, a Japan-Soviet Joint Declaration was signed when the two countries normalized their relations, during which the Soviets agreed to return two of the four islands (Habomai and Shikotan) after a peace treaty was signed with Japan. Prior to that, in 1951, the then Japanese Prime Minister Shigeru Yoshida also “conceded before the Diet that the Kuriles given up did include Etorofu and Kunashiri”. Nevertheless, the Japanese government later insisted that Japan’s sovereignty over all the four islands be recognized *before* a peace treaty be signed – which has prevented the two from signing one ever since.⁸

Between 1968 and 1971, the Japanese companies further proposed several natural resource-related projects to the Soviets, in addition to the Tyumen proposal. These included: (1) to develop an LNG project in Yakutia, for a 20-year period with an investment of US\$3 billion, to supply Japan with 10 billion cubic meters of LNG annually, (2) to export heavy coking coal from South Yakutia to Japan, involving a US\$585 million investment for 500mts of annual supply starting from 1982, and (3) an offshore petroleum development on Sakhalin Island, requiring US\$200 million in Japanese loans.⁹ Nevertheless, according to Hsiao, the Tyumen oil project was “the most significant one, in both economic and strategic terms”.¹⁰

In April 1971 the Japanese government indicated that it was interested in resuming substantive talks on Tyumen and asked the Soviet side to present a concrete proposal at the fifth session of the Japan-Soviet Economic Committee, originally scheduled for 1970, but then rescheduled for February 1972. After a series of visits between high ranking officials of the two countries, the fifth joint

⁷ Albright, *Siberian Energy for Japan and the United States*, pp. 1, 15.

⁸ Lawrence M. Njoroge, “The Japan-Soviet Union territorial dispute: an appraisal”, *Asian Survey*, Vol. 25 (No. 5), May 1985, pp. 499–511.

⁹ Sheldon W. Simon, “The Japan-China-USSR triangle”, *Pacific Affairs*, Vol. 47 (No. 2), Summer 1974, p. 127.

¹⁰ Hsiao, “Prospects for a new Sino-Japanese relationship”, p. 742.

committee was held in Tokyo as planned. By that time, the Soviets had already completed the building of a 3400 km pipeline between Tyumen and Irkutsk, and thus asked Japan to help with the construction of the remaining 4178 km of the pipeline, from Irkutsk to Nakhodka. Japan was expected to provide a bank loan of US\$1 billion for the purchase of a large diameter pipeline, and other equipment and materials necessary for the construction. Japan was not to participate in any of the construction itself, but would obtain 25-40mts of oil supply annually for a period of 20 years.¹¹

In a letter to the Soviet President Leonid Brezhnev in March 1973, Japanese Prime Minister Kakuei Tanaka called for negotiations for a peace treaty, and said that his government was prepared to provide support to the Tyumen project once an agreement had been reached between the Soviet authorities and the participating Japanese companies. The Export-Import Bank was later required to supply up to 80 percent of the project cost that would be required, contrasting to the previous policy that the government would assume not more than 70 percent of the financing.¹² Since the Soviets viewed the financial commitment made by the Japanese government to support its oil companies' activities in Siberia as a test of its sincerity, the change in the government policy of the Tanaka Cabinet indicated a better chance for the projects to proceed. Consequently, a Japanese technical delegation was sent to Moscow in April 1973 to prepare a draft general agreement. The Japanese representative in charge of the Tyumen project and president of Nippon Steel, Hiroki Imazato, also held hopes of leading a senior team to visit Moscow in mid-1973 for more comprehensive negotiations with their Soviet counterparts.¹³

However, the summit meeting between Prime Minister Tanaka and President Brezhnev, in October 1973, failed to make much progress. At the meeting, the Soviets unilaterally raised the amount of loans requested for the Yakutia LNG project, from US\$150 to \$300 million, and reduced the amount of Tyumen oil that would be supplied to Japan, from 40mts to 25mts annually. The Soviets also indicated that the realization of the Tyumen project was to some degree

¹¹ Russell, *Energy as A Factor in Soviet Foreign Policy*, pp. 156-57.

¹² *Ibid.*, pp. 158-59.

¹³ Albright, *Siberian Energy for Japan and the United States*, pp. 12-15.

contingent upon Japan's willingness to support Brezhnev's collective security system in Asia. Tanaka, on the other hand, refused to discuss the security plan with the Soviets without first resolving the territorial problem. In the end, the summit reached no agreement on any major issues.¹⁴

In spring 1974, the Soviet government proposed the new plan to Japan of building a second Siberian railway which would run 3200 km from Irkutsk to Sovetskaya Gavan and which would substitute the Tyumen pipeline as a means of delivering oil to Japan. Japan would need to contribute to the building of the railway in order to obtain Tyumen oil, but the price for building the railway had gone up to US\$3.3 billion from the original US\$1 billion. The Tyumen oil to be supplied to Japan was reported as 5mths in 1981, 10mths in 1982, 15mths in 1983, 20mths in 1984, and 25mths annually from 1985 to 2000.¹⁵ At the sixth meeting of the Japan-Soviet Economic Committee in 1974 in Moscow, the Japanese declined to agree on the new Soviet proposal over the Tyumen oilfield development, "because of their concern over the proposed Siberian railway and its strategic and political implications". Despite the USSR's willingness to continue the negotiation, the Japanese announced in mid-June 1975 that the Tyumen project had been abandoned.¹⁶

Reasons behind Japan's Abandonment of the Tyumen Oil Project

A number of factors seem to have contributed to Japan's final decision over the Tyumen oil pipeline. First, the strategic implications associated with the Tyumen oil project were seen to affect Japanese interests. When the pipeline proposal was first raised its sensitive location was already an issue of concern. According to Hsiao, "In some parts of the route both the proposed pipeline and highway (to be built together with the pipeline) would run very close to the Chinese border where a giant Soviet military complex is already located."¹⁷ The

¹⁴ Simon, "The Japan-China-USSR triangle", pp. 125, 128; Hsiao, "Prospects for a new Sino-Japanese relationship", p. 743.

¹⁵ Hsiao, "Prospects for a new Sino-Japanese relationship", p. 743; Russell, *Energy as A Factor in Soviet Foreign Policy*, p. 159.

¹⁶ Russell, *Energy as A Factor in Soviet Foreign Policy*, p. 160.

¹⁷ Hsiao, "Prospects for a new Sino-Japanese relationship", pp. 742, 743.

revised plan presented by the Soviets later further intensified Japan's concern over the political and military implications, since a second Siberian railway would not only considerably enhance the supply position of the Soviet Far Eastern Fleet, but also that of the Soviet military forces on the Far Eastern border with China. Japan then began to worry that "the Soviet plan might pose a security threat not only to China but to the United States and Japan as well".¹⁸

The second matter was related to the financial arrangements of the project and the oil that was to be supplied to Japan. In the negotiations between Japan and the USSR, the two sides had different perspectives on how to deal with the proposed credit that Japan was asked to provide to finance drilling and exploration equipment. The Soviets had suggested that the repayment be made through the oil reserves found; if no oil was discovered, all or part of the repayment would be waived. The Japanese, however, were more interested in oil supply. They thus pressed for an agreement over how much oil would be supplied and at what price; in the case that no oil was discovered, they wanted the assurance of supply from other Soviet sources. The two sides also differed on other commercial matters, such as the price and the credit terms, as well as supply and purchase assurances.¹⁹

In order to increase the financial and political stability of the arrangements, the Japanese government requested US participation in the project and had discussions with two American companies, Gulf Oil and Exxon, about possible forms of participation. The agreement reached stipulated that the Japanese would play a leading role in the project, and that US participation would not exceed 20 percent in terms of both credit provision and oil delivery. Japan also hoped that US participation would make China less concerned about likely Soviet-Japanese collusion. Interestingly, the Soviets also wanted to involve US companies in the project, but its purpose was to "obtain better conditions" in the contract and also offering the Soviets an opportunity to play Japan and the US off each other in competitive terms.²⁰

¹⁸ Russell, *Energy as A Factor in Soviet Foreign Policy*, p. 159.

¹⁹ Albright, *Siberian Energy for Japan and the United States*, pp. 12, 16-18.

²⁰ *Ibid.*, pp. 11-16, 26.

The US attitude, however, seemed to vary greatly from that of the Japanese. According to Albright, due to the concerns of national security and balance of payments, the US authority preferred to give priority to developing domestic resources and thus suggested “going slow on Siberian energy”. In the meantime, the Americans were worried about the possibility of a last minute block of the project due to the Japanese-USSR impasse over their territorial dispute. Moreover, the US did not wish to see the proposed pipeline running along the Chinese-Soviet border if there was an increased hostility between China and the USSR. In the end, against such circumstances, Washington declined to officially commit itself to the arrangements related to the Tyumen oil project.²¹

The final, and the most significant, reason was the strong objection from China, due to the strategic implications associated with the Tyumen project. After splitting with the Soviets for political reasons in 1960 and the Amur-Ussuri border clashes in 1969, China viewed the USSR as representing a significant threat on its northern boundary. Beijing believed that the proposed Tyumen oil project might impair Chinese strategic interests by enabling a closer Soviet-Japanese relationship on the one hand, and by strengthening “the Soviet military and economic position in the Far East” with improved infrastructure for transportation and communications.²²

Officially, China remained silent on the grounds that the Tyumen oil project was an internal matter for Japan and the USSR to decide. Privately, however, Beijing expressed its serious concern to Tokyo about the likely implications. In January 1973, Chinese Premier Zhou Enlai raised the issue at the meeting with the Japanese Minister of International Trade and Industry, Yasuhiro Nakasone, saying that the capacity of the Tyumen oil pipeline was far more than what Japan intended to import from the USSR.²³ Soon after, the Chairman of the Sino-Japanese Friendship Society, Liao Chengzhi, was sent to Tokyo to warn the Japanese to minimize the military significance of the project; otherwise, China would be forced to take “appropriate measures”. On the other hand,

²¹ *Ibid.*, pp. 19, 21; Hsiao, “Prospects for a new Sino-Japanese relationship”, p. 743.

²² Klinghoffer, “Sino-Soviet relations and the politics of oil”, p. 549.

²³ *Ibid.*, pp. 549–50.

China showed its understanding of Japan's energy needs. As a first step, China supplied Japan with one million tons of crude oil in 1973. China's oil supply to Japan increased gradually to 4mts in 1974 and 8mts in 1975, and Beijing also offered to jointly develop oil resources in the Bohai Bay with Japanese companies.²⁴ What helped China to make the offer to Japan were its sizeable increments in oil production due to the discoveries of three giant fields: Daqing in 1959, Shengli in 1962, and Dagang in 1964. These discoveries not only enabled China to achieve self-sufficiency of oil supply by 1965, but also made oil the third largest category in China's export products by the mid-1970s, following light industrial products and foodstuffs. China's oil and fuel exports accounted for 28 percent of total exports in 1975, and in 1985 the figure peaked at more than 54 percent.²⁵

In reality, Chinese oil supply to Japan was not very significant in terms of amount, ranging only between 11–13mts annually between 1975 and 1987, compared with Japan's total oil imports of 250–200mts per year (in a declining trend) during the same period. However, the bilateral energy cooperation, based on the shared political interest of the two countries, had ensured a smooth development of the overall relations between the two regional powers. Oil exports played a crucial role in helping China to obtain foreign exchanges to introduce advanced technology from Japan, and keep Tokyo in a "united front" to counter the Soviet military threat. From the Japanese perspective, energy cooperation with Beijing not only diversified its energy supply, but also enabled Japanese companies to gain advantaged access to the Chinese market; which was something that Western companies were not able to do until some years later.²⁶

²⁴ Choon-ho Park and Jerome Alan Cohen, "The politics of China's oil weapon", *Foreign Policy*, No. 20, Fall 1975, p. 39.

²⁵ Larry Chuen-ho Chow, "The changing role of oil in Chinese exports, 1974-89", *The China Quarterly*, No. 131, September 1992, pp. 751, 754.

²⁶ See Xuanli Liao, "The petroleum factor in Sino-Japanese relations: beyond energy cooperation", *International Relations of the Asia-Pacific*, Vol. 7, No. 1, January 2007, pp. 27–30.

3. The Sino-Japanese Disputes over the Oil Pipelines: Angarsk-Daqing & Angarsk-Nakhodka

Whilst the politics of oil associated with the Tyumen oil project had promoted energy cooperation between China and Japan in the 1970s, the turn of the century witnessed a competition between the two countries over the different routes of Russian oil pipelines, again with political considerations playing a significant role.

The oil pipelines under dispute concerned two different routes proposed by China and Japan, respectively (refer to Map 1). The Chinese plan was to build a 2240 km oil pipeline between Angarsk in Russia's East Siberia and China's northeast oil city, Daqing. A bilateral agreement to jointly build a pipeline was reached in 2001 by Russia's private oil company Yukos and the China National Petroleum Corporation (CNPC), involving an estimated cost of US\$1.7 billion. The pipeline was supposed to be completed by 2005 and to provide 20mts of oil annually to China by 2010. The other project concerned building a 3800 km pipeline from Russia's East Siberia to its Pacific port Nakhodka. It was initially proposed by Russia's state-owned pipeline monopoly Transneft in 2001 but gained support from the Japanese government in 2003. The project was estimated to involve an investment of US\$5 billion, with a capacity of 50mts of oil annually.²⁷

Many cited the case as a rivalry between China and Japan for the sake of energy security,²⁸ whereas few have realized that, similar to the Tyumen oil project,

²⁷ *FSU Oil & Gas Monitor*, 12 June 2001, p. 15.

²⁸ For examples, Shoichi Itoh, "The Pacific pipeline at a crossroads: dream project or pipe dream?" *ERINA Report*, Vol. 73, January 2007, pp. 42-62; Bernard A. Gelb, *Russian Oil and Gas Challenges*, 3 January 2006, CRS Report for Congress; Goichi Komori, Sanae Kurita and Keishi Nakashima, "The Russian oil policies and its oil industry trends", December 2005, available at: <www.nautilus.org/aesnet/2006/FEB0106/IEEJ_Russia.pdf> (Last accessed 25 September 2006); Li Xing, "Lun Eluosi de nengyuan waijiao yu Zhong-E

Sino-Japanese competition over Russian pipeline routes is again an interaction between politics and security concerns; but due to the post-Cold War international circumstances and the changed energy situations in China and Japan, it was Russia that played off China and Japan, using oil as a means of leverage.

Map 1 Proposed Russian Oil Pipelines



□ Angarsk-Daqing pipeline: Length - 2400 km; Estimated cost - US\$1.9 billion; Capacity - 0.6 million barrels per day by 2010

□ Angarsk-Nakhodka pipeline: Length - 3800 km; Estimated cost - US\$5.2 billion; Capacity - 1 million barrels per day by 2010

Source: BBC²⁹

guanxi zhongde youqi yinsu” [On Russia’s energy diplomacy and the petroleum factor in Sino-Russian relations], *Russia, Central Asia and East European Market*, No. 2, 2005, pp. 2-5; Gilbert Rozman, “Sino-Japanese competition over the Russian Far East: is the oil pipeline only the starting point?” available at: <http://src-h.slav.hokudai.ac.jp/coe21/publish/no6_1_ses/chapter1_rozman.pdf> (Last accessed 17 September 2006).

²⁹ “China Pressures Putin on Pipeline”, *BBC News*, 15 October 2004 <<http://news.bbc.co.uk/1/hi/world/asia-pacific/3746444.stm>> (Last accessed 15 January 2008)

Chinese Proposals on the Angarsk-Daqing Oil Pipeline

Since China became a net oil importer in the mid-1990s, energy security has become one of the top concerns for the Chinese government. Driven by its strong economic growth during the past 20 years, China's oil consumption has increased constantly, at an annual rate of five percent since 1996, overtaking Japan in 2003 to become the second largest oil consumer in the world. On the other hand, the growth of China's domestic oil production has shown a much lower rate – on average at 1.2 percent annually since 1996 – due to the high cost of capacity expansion in oil production. According to a report by the Research Institute of Macroeconomics under the Chinese Planning and Development Commission in 1998, it would cost more than US\$300/tonne for the Chinese oil companies to expand capacity of oil production, which is much higher than that of the OPEC average (US\$250/tonne) and almost double that of the OPEC countries in the Middle East (US\$153/tonne).³⁰

Accordingly, the Chinese leadership decided to move away from the Maoist self-reliance principle in the late 1990s and instead pursue a policy of exploiting domestic and overseas petroleum resources simultaneously. Among the resource-rich countries, Central Asia and Russia were the primary targets suggested by Chinese specialists, due to their adjacent position that could help reduce China's concerns over sea-lanes communication;³¹ this is of particular importance as the country has not yet established a “blue water navy” to safeguard its oil transportation routes. However, as argued by some scholars, “The salience of Sino-Russian energy connections has only increased as the political relationship has assumed greater significance and substantive content.”³² Indeed, the post-Cold War era has witnessed a dramatic rapprochement between China and Russia. Faced with a world under the dominance of the only superpower, the United States, China and Russia felt

³⁰ Zhou Fengqi and Zhou Dadi et al, *Zhongguo zhongchangqi nengyuan zhanlue* [A study on long-term energy development strategies of China] (Beijing: Zhongguo jihua chubanshe, 1999), pp. 50–51.

³¹ *Ibid.*, p. 51.

³² Philip Andrews-Speed, Xuanli Liao, and Roland Dannreuther, *The Strategic Implications of China's Energy Needs*, Adelphi Paper 346 (London: The International Institute for Strategic Studies, 2002), p. 62.

marginalised in the post-Cold War world and perceived a shared strategic interest in confronting US hegemony. Against this background, China and Russia established their “constructive partnership” in 1994 which became a “strategic partnership” two years later.³³

Despite the seemingly smooth development of the Sino-Russian political relationship, there lacked a strong economic foundation to secure the endurance of such a partnership. In contrast to China’s trade with Japan and the United States, which reached US\$89.2 billion and US\$122 billion in 2001 respectively, trade between China and Russia amounted to only US\$10 billion in the same year. According to experts from the Chinese Ministry of Foreign Trade and Economic Cooperation, China was Russia’s sixth largest trading partner and Russia was China’s eighth largest by the end of 2002.³⁴ In spite of the relatively low level of trade, Russia’s arms sales to China remained a significant part, accounting for US\$1 billion per year, which triggered increasing anxiety, especially from the United States, “about emerging PRC power”. Therefore, building an oil pipeline between Russia and China would enable the two countries to reinforce their political relationship through energy cooperation, as well as help the Russian Far East region promote economic development, since its economic and social regeneration is essentially dependent on the region’s integration into the dynamic East Asian markets.³⁵

Against this background, China and Russia signed an agreement, in July 2001, on building a 2240 km oil pipeline from Angarsk in Russia to China’s northeast oil town Daqing. As mentioned above, the pipeline was supposed to be completed by 2005 and provide 20mts of oil to China by 2010. Angarsk is located

³³ Ibid.

³⁴ “Japan-China trade hits record \$89.2 bil. in 2001”, *Asian Economic News*, 18 Feb 2001; Wayne M. Morrison, *China-U.S. Trade Issues*, Congressional Research Service, The Library of Congress, 14 March 2002, available at: <<http://fpc.state.gov/documents/organization/9061.pdf>> (Last accessed 5 July 2007), p. 3; “China, Russia sign trade agreement”, *Xinhua News Agency (Xinhua)*, 23 May 2002; “Sino-Russian trade expected to be better than ever”, *People’s Daily*, 2 Dec 2002.

³⁵ Richard D. Fisher, Jr, “New Pentagon report: a change in U.S. attitude”, *China Brief*, Vol. 2, Issue 16, 1 Aug 2002, available at: <http://jamestown.org/publications_details.php?volume_id=18&issue_id=656&article_id=4661> (Last accessed 5 Jul 2007); Andrews-Speed et al., *The Strategic Implications of China’s Energy Needs*, p. 62.

60 km north of Irkutsk in Siberia and is over 2000 km away from the Tyumen oil field. The city does not produce oil but has pipeline connections with the Tyumen oil field, and is also well-known as the home of the Angarsk Petrochemical Co., Russia's fifth-largest petrochemical company.³⁶

The agreement was signed during Chinese President Jiang Zemin's visit to Moscow by China's State Development and Planning Commission (SDPC) and CNPC on the one side, and by Russia's Energy Minister, the CEO of Yukos, and the president of Transneft on the other. The two sides then also concluded the Good Neighbourly Treaty of Friendship and Co-operation. As a result, the Angarsk-Daqing pipeline deal was viewed as not simply a commercial contract, but an "inter-state agreement" and "part of a broader bid to boost trade between the two huge neighbours".³⁷ Two months later, Chinese Premier Zhu Rongji further substantiated the agreement on his visit to Russia, where he and his Russian counterpart Mikhail Kasyanov agreed to soon thereafter start a feasibility study for the project.³⁸

In addition, the Sino-Russian oil pipeline deal seemed a part of their "energy partnership" agreed by the two leaderships. As Russian Energy Minister Kaluzhny told the *Far Eastern Economic Review* in March 2000: "We would like to peg development of the eastern areas of Russia, especially Siberia, with the development of China, including China's western regions."³⁹ This had enabled Gazprom to become a part of the Shell consortium in 2001, in the building of China's West-East gas pipeline.⁴⁰ Even after 9/11, when the strategic relationship between China and Russia was weakened by the US anti-terrorism campaign with the US changing strategy towards the two countries, the

³⁶ Shao Da, "Daqing pipeline still most feasible", 11 March 2004, available at: <www.china.org.cn/english/2004/Mar/89979.htm> (Last accessed 8 July 2007)

³⁷ *FSU Oil & Gas Monitor*, 24 July 2001: 12-13; *Alexander's Gas & Oil Connections*, 9 Oct 2001, available at: <www.gasandoil.com/goc.news/nts14113.htm> (Last accessed 12 May 2002).

³⁸ *FSU Oil & Gas Monitor*, 24 July 2001: 12-13; *Alexander's Gas & Oil Connections*, 9 October 2001.

³⁹ *Far Eastern Economic Review (FEER)* 6 April 2000, p.32.

⁴⁰ *FSU Oil & Gas Monitor*, 3 July 2001: 3 and *Gas Matters Today*, 8 January 2002: 2.

Chinese and Russian leaders still remain committed to their “high level” relationship and to their energy cooperation.⁴¹

The oil pipeline deal was also relevant to Sino-Russian military cooperation. It was reported that the Russian government supported the Yukos scheme, despite competition from the state-owned Transneft, because part of the deal was made on China’s agreement to increase weapon purchases from Russia; China signed a contract with Russia in July 2001, worth an estimated US\$2 billion, to buy Russian Su-30 MKK fighter jets.⁴² Before that, China had signed another major arms deal with Russia in 1999 to buy a range of Russian fighter jets costing US\$2 billion. Furthermore, the People’s Liberation Army (PLA) navy bought two Sovremenny-class destroyers and Kilo-class diesel-electric attack submarines from Russia in 2002.⁴³

In general, the agreement on the Russia-China oil pipeline was formed under the pre- 9/11 international scenario with the strong support of the Sino-Russian strategic partnership. The concern over energy security only played one part behind the oil pipeline deal, while the shared interests between China and Russia in world affairs and their concerns over regional stability were underpinning factors in the process. The improvement in Russo-US and Russo-Japanese relations in the aftermath of 9/11, however, added more complexity to the Sino-Russian relationship, as illustrated by Japan’s involvement in the pipeline deal.

Japanese Proposal on the Angarsk-Nakhodka Pipeline

The proposal to build a pipeline from Angarsk to Nakhodka was initiated by Russia’s pipeline monopoly Transneft in June 2001, as a means “to enter Asian markets”. The plan was to build a 3800 km pipeline between Angarsk and Russia’s Pacific port Nakhodka, with an investment of US\$5 billion and a capacity of 80mts oil supply annually.⁴⁴ Yet, no progress was made on the proposal until Japan showed its interest in it. In late 2002, the Japanese Foreign

⁴¹ *Asia Times Online*, 26 June 2002; *China Daily*, 28 May 2003, 26 Sept 2003.

⁴² *Nefte Compass*, 27 Nov 2002; and *South China Morning Post (SCMP)*, 19 July 2001.

⁴³ SCMP, 19 July 2001 & 18 Sept 2002.

⁴⁴ *FSU Oil & Gas Monitor*, 12 June 2001, p. 15.

Minister Yoriko Kawaguchi and the Head of Ministry of Economy, Trade, and Industry (METI), Takeo Hiranuma, reportedly wrote a letter to Moscow “in a bid to persuade Russia, which is committed to laying an oil pipeline to China, to build a pipeline closer to Japan”, offering that Japan was ready to issue up to US\$5 billion in untied credits to Russia to implement the Pacific oil pipeline.⁴⁵ Japan’s intention was confirmed by Prime Minister Junichiro Koizumi in January 2003 on his first official visit to Russia, when a six-point “action plan” was signed, calling for cooperation in economics, energy, and international diplomacy.⁴⁶

Japan’s decision to support the Pacific route project can be analysed from three main angles. First of all, it indicated that the Japanese government still viewed oil as a “strategic commodity” and was willing to rely on strategic means to secure its oil supply. Due to the efforts made by the Japanese government since the first oil crisis in 1973, Japan had become one of the most energy efficient nations in the world and had managed to reduce its reliance on oil from 77.4 percent in 1973 to 50 percent in 2003, in its total energy consumption.⁴⁷ Japan also established the biggest strategic oil stockpiles among the OECD countries, which amounted to 171 days by 2006.⁴⁸ Nevertheless, given the fact that 88 percent of Japan’s oil was still imported from the Middle East in 2002, METI has viewed finding alternative oil supplies to the Middle East region as “a top government priority”. The sense of Japan’s insecurity in its oil supply was so severe that it was “reflected in its unusually aggressive diplomatic offensive to win the Siberia pipeline, despite China’s head start”, as commented by a Western analyst.⁴⁹

⁴⁵ *The Japan Times*, 10 Jan 2003; *FSU Oil & Gas Monitor*, 15 Jan 2003, p. 12.

⁴⁶ *The Japan Times*, 13 Jan 2003; *Financial Times*, 10 Jan 2003, p. 9.

⁴⁷ Yoshihiro Sakamoto, “Changing Environments Surrounding the Energy Industry and Japan’s Choice”, 12 Feb 2003, available at: <<http://eneken.iej.or.jp/en/forum/spec2003/030303e03.pdf>> (Last accessed 5 Mar 2007).

⁴⁸ “The Oil Situation After the Attack on Iraq”, Agency for Natural Resources and Energy, Japan <www.enecho.meti.go.jp/english/energy/japan/qa.htm> (Last accessed 12 May 2007)

⁴⁹ David Murphy, “Asia’s pipeline politics”, *FEER*, 24 July 2003, p. 13.

In addition, after the failure of the Tyumen oil project, which was largely associated with political concerns, it was not surprising to see Japan as “very determined” this time to realise its long time dream of building a trans-Siberia oil pipeline to the Pacific coast. Tokyo thus, on the one hand, ignored the feasibility study by Transneft that the oil reserves in the Angarsk region were insufficient to justify the pipeline project, but offered the Russians a new financial package worth US\$7 billion, with US\$5 billion for the construction of the pipeline and US\$2 billion in loans for the development of Siberian oilfields.⁵⁰ On the other hand, Japan lobbied hard to convince Moscow that it should avoid allowing a “monopoly power [China] to get the Siberia oil”, as claimed by Yoshi Murase from METI, and that Japan “would prefer the oil to be available to the wider Asia-Pacific market”.⁵¹ What might also have fortified Japan’s anxiety over China’s contract with Yukos were the discouraging developments in the Middle East, where Japan had lost its rights to Saudi Arabian oil exploitation in 2000. In June 2003, Japan again failed to reach a deal with Iran on the Azadegan oilfield, due to US pressure, whilst Chinese companies were active in striving for the right to develop Iranian oilfields.⁵²

Secondly, the proposed oil pipeline was a breakthrough in Russian-Japanese economic relations. Due to the outstanding territorial disputes and political distrust, Japan had lagged behind other major powers, such as the US, Europe, China, and even South Korea, in terms of investment and trade with Russia. According to the Russian ambassador to Japan, Alexander Panov, “The Russian market remains untapped by the Japanese.”⁵³ If the pipeline deal was to be concluded between Russia and Japan, it would be the largest economic project so far between the two countries, which could not only serve their needs of energy security, but could also constitute a “pillar for Japan-Russia economic cooperation”, as was said by Japan’s Chief Cabinet Secretary Yasuo Fukuda.⁵⁴

⁵⁰*The Japan Times*, 17 Sept 2003; *Financial Times*, 14 Oct 2003, p. 9.

⁵¹ *Financial Times*, 5 March 2003, p. 9.

⁵² *People’s Daily*, 25 July 2003; *FEER*, 24 July 2003, p. 13.

⁵³ “Departing Panov has high hopes for Japan-Russia relations”, *The Japan Times*, 5 Aug 2003.

⁵⁴ *The Japan Times*, 10 Jan 2003.

Finally, Japan obviously wished to promote political relations with Russia through energy cooperation, namely to create a favourable environment to settle their territorial disputes. Since the end of WWII, the issue of the Kurile Islands has remained a central concern for Japan and Russia, preventing the two countries from concluding a peace treaty. However, during the process of negotiations, “Japan was showing signs of being willing to sideline the issue of the islands for the sake of better relations”, and Tokyo also reportedly planned to resume financial assistance to Sakhalin, where the four islands of dispute are located.⁵⁵ Additionally, the deteriorating mutual trust between China and Japan in the last decade might also have a role to play in the process, as China was increasingly regarded as a threat by Japan, because of its growing economic potential. In this context, Japan would prefer to get closer to Russia politically in order to confront China’s rising political and economic potential. As *The Washington Post* commented, “the contest displays the historic rivalry between East Asia’s two biggest countries for influence in the region.”⁵⁶

Overall, Japan’s competition with China over the oil pipelines has not been based purely on the concerns of energy security; rather it has been characterized by an “unusually aggressive diplomatic offensive”,⁵⁷ driven by non-energy concerns, which could not only serve its interest of energy security, but also create a more favourable environment for Japan in building up a closer relationship with Russia to offset China’s influence in East Asia. The case indicated clearly the lack of intention from China and Japan to cooperate on their energy security, largely due to their political distrust. On the other hand, as argued by Shoichi Itoh, “when Japan expressed its readiness to participate in the ESPO [East Siberian–Pacific Ocean] pipeline project that emerged from the Russian sides, Russia began to weigh up Japan and China, both in name and reality.”⁵⁸

⁵⁵ *Financial Times*, 10 Jan 2003, p. 9 & 14 Oct 2003, p. 9.

⁵⁶ Quoted from *People’s Daily*, 14 July 2003.

⁵⁷ *FEER*, 24 July 2003, p. 13.

⁵⁸ Itoh, “The Pacific pipelines at a crossroads: dream project or pipe dream?” p. 43.

Politics of Oil behind Russia's Decisions

The competition between China and Japan over the oil pipeline routes has given the Russian government an opportunity to serve its own national interests. The decision about which pipeline to build first seemed not to be an easy one, because the real question about which route to choose was actually “a political one”, as argued by Catrina Stewart. Choosing China, she argued, Russia would potentially lose “Japan’s offers of state aid to promote East Siberian development and guaranteed loans for the construction costs”; in choosing Japan, “China could prove more difficult to enter in the future.”⁵⁹ Given such a delicate situation, it took Moscow nearly two years before announcing its final decision.

Russia’s first policy change took place two months after the Japanese Prime Minister Koizumi’s visit to Moscow. On 15 March 2001, Prime Minister Mikhail Kasyanov announced that the Russian government intended to endorse the Angarsk-Nakhodka oil pipeline, though the final route would not be decided until May. To offset the negative impact of the changing plan on Russia-China relations, Moscow offered that a branch oil pipeline be built to northeast China, in connection with the Pacific pipeline.⁶⁰ Beijing seemed not too concerned about the likely impact initially, probably as it believed that the bilateral political partnership would help ensure the pipeline deal. According to Zhu Xingshan, a Chinese oil analyst with the State Development and Planning Commission (SPDC), the oil link would be finalized sooner or later; “It’s just a matter of time”, he said.⁶¹

The logic behind Russia’s change of decision seemed to partially lie in its desire to develop the economy through exploiting its petroleum resources, especially in its backward Siberia region, and to better ensure its energy security for demand purposes. In contrast to the Angarsk-Daqing pipeline that would only serve the Chinese market, a pipeline to the Pacific coast, according to *South China Morning Post*, “will facilitate Russia’s oil exports to multiple markets” in Northeast Asia

⁵⁹ *Oil & Gas Monitor*, Feb 2004 *Pipelines Special Report*, p. 3.

⁶⁰ “Siberian oil pipeline link to supply Daqing”, *SCMP*, 17 March 2003; *FSU Oil & Gas Monitor*, 19 March 2003, p. 7.

⁶¹ *China Daily, Business Weekly*, No. 100, 21 Dec 2002/6 Jan 2003, pp. 1, 24.

and in North America, and to ensure Russia's control, as it is to be built on Russian soil.⁶² Since the United States showed its preference for the Pacific route, Russia's new decision could be helpful in mending its political relationship with Western countries as well.⁶³

Legal and financial problems were believed to be another part of the reason. The proposed Angarsk-Daqing oil pipeline, with an investment of US\$2 billion, was to be financed by Yukos (paying US\$700 million) and CNPC jointly.⁶⁴ However, when the Russian government in January 2003 declared that pipelines would remain under state ownership, Yukos ran the risk of losing out to state-owned Transneft.⁶⁵ In the meantime, it seems likely that when Transneft proposed the Pacific route project, the company was unable to undertake the US\$5 billion investment required; but the Japanese offer to cover the total investment had made it possible for Russia to change its position, despite the remaining suspicions over the unclear new market and the untapped oil reserves in East Siberia.⁶⁶

In April 2003, however, Transneft suddenly changed its supportive position toward the Pacific pipeline. Its CEO Semyon Vainshtock told Reuters that he now believed that the route would be "unprofitable" as Eastern Siberian reserves were insufficiently developed to feed the Pacific route.⁶⁷ This was a big blow to Tokyo because the Angarsk-Nakhodka pipeline project was viewed by Japan as "the last chance to reduce its dependence on Middle East oil".⁶⁸ To prevent Transneft from abandoning the Pacific project, the Japanese began heavily lobbying the Kremlin. Iwao Okamoto, the head of Japan's Agency for Natural Resources and Energy, flew to Moscow in mid-April and put forward a proposal to Russian officials, including Deputy Prime Minister Viktor Christenko, which asserted that "Japan will not impose an upper limit on the size of the loan

⁶² SCMP, 7 March 2003.

⁶³ Ibid.; *Financial Times*, 10 Jan 2003, p. 1.

⁶⁴ Sergei Blagov "Russia, China eye pan-Asian oil bridge", *Asia Times*, 26 June 2002.

⁶⁵ *FSU Oil & Gas Monitor*, 16 April 2003, p. 6.

⁶⁶ *China Daily*, 3 March 2003; *Business Weekly*, No. 100, p. 24.

⁶⁷ *FSU Oil & Gas Monitor*, 16 April 2003, p. 6.

⁶⁸ *Kyodo News International (Kyodo)*, 16 April 2006.

it will extend to finance the construction cost.”⁶⁹ However, the Japanese proposal was reportedly “rejected” by Moscow for two main reasons. One was that Tokyo demanded “a repayment guarantee” from the Russian government in exchange for abandoning the “prerequisite from Russia to purchase equipment from Japanese suppliers”, but the Russians declared that “making the repayment guarantee is not part of Russia’s government policy”. The other was Transneft’s remaining concern about insufficient oil reserves in East Siberia to support both pipelines.⁷⁰

Consequently, an agreement was signed by CNPC and Yukos, in May 2003, during Chinese President Hu Jintao’s state visit to Moscow. It stipulated that Yukos was to supply US\$150 billion worth of crude oil to China for a period of 25 years and also set up other “key aspects, such as the quality of oil to be supplied, contractual terms and the pricing formulas” for the Angarsk-Daqing pipeline. The Chinese media embraced the agreement by calling it a “landmark deal that could carry rippling geopolitical ramifications”, since China’s dependence on Middle East oil imports would be reduced by half, “from the current 52 percent to 26 percent by 2006”. Hu’s visit was also said to have bolstered the Sino-Russian “strategic cooperative partnership that has advanced well in recent years”.⁷¹

Japan, however, refused to give up and escalated its lobbying by withdrawing from its earlier insistence that Moscow provide guarantees for any loans.⁷² Tokyo’s strategy seemed to have an effect this time. Only a few days after the CNPC/Yukos agreement had been signed, Valery Yazev, a member of the Russian Duma’s energy committee, said at a news conference in Tokyo that Moscow had not reached a final decision over the two pipelines, and a final decision “might depend on the successful lobbying from either the Chinese or Japanese sides”.⁷³ His statement was further confirmed by President Vladimir

⁶⁹ Ibid.

⁷⁰ *Kyodo News*, 16 & 18 April 2003; *FSU Oil & Gas Monitor*, 30 April 2003, p. 8.

⁷¹ “China and Russia ink oil pipeline agreement”, *China Daily*, 29 May 2003; *SCMP*, 29 May 2003.

⁷² *FSU Oil & Gas Monitor*, 16 June 2003, p. 5.

⁷³ *FSU Oil & Gas Monitor*, 11 June 2003, p. 6.

Putin, who at a press conference on 20 June 2003 claimed that no “final” decision over the pipelines had been made yet, since “both appear to be commercially viable ... the projects will have to be studied further”.⁷⁴ Later that day, the Russian government spokeswoman, Tatyana Razbash, said that a decision would be made by September, the due date for Yukos to finalise its supply contract with CNPC.⁷⁵

Encouraged by Putin’s speech, Japanese Foreign Minister Yoriko Kawaguchi paid a two-day visit to Russia in June 2003, where she reiterated Japanese readiness to finance development of the Pacific pipeline and offered that if the pipeline was to be built first, Japan would help pay to develop the eastern Siberian fields, “to recover what may be 10 billion barrels of oil beneath the tundra and permafrost.” Kawaguchi further stated that “If an oil pipeline is laid ... mutual trust between Japan and Russia will grow”.⁷⁶ In mid-August, Russia’s Primorsky region’s governor, Sergei Darkin, told the press after his visit to Tokyo that Japan had increased its offer to US\$14 billion in order to promote the Pacific pipeline (with US\$5 billion for the construction, US\$7 billion for oil exploration in East Siberia, and a further US\$2 billion for social projects in Russia’s Far East).⁷⁷

Tokyo’s highly attractive offer made Moscow again lean towards the Pacific pipeline. In September 2003, the Russian Ministry of Natural Resources raised “environmental concerns” over the Angarsk-Daqing route, because the proposed route would go through the Tunkinsky National Park and was also too close to Lake Baikal. Two months later, Moscow formally announced its disapproval of the Angarsk-Daqing pipeline.⁷⁸ In light of this situation, Transneft announced a new pipeline route in February 2004, starting from Tayshet, about 130 km northwest of Angarsk (see Map 2 below), bypassing north of Lake Baikal, running parallel with the Baikal-Amur Mainline (BAM) railway to

⁷⁴ *FSU Oil & Gas Monitor*, 25 June 2003, p. 4

⁷⁵ *Ibid.*

⁷⁶ “Oil pipeline to improve Japanese-Russian ties: Japanese FM”, *People’s Daily*, 30 June 2003; *FEER*, 10 July 2003, p. 11.

⁷⁷ *FSU Oil & Gas Monitor*, 13 Aug 2003, p. 9.

⁷⁸ *FSU Oil & Gas Monitor*, 3 Sept 2003, p. 9 & 19, Nov 2003, p. 7.

Skovorodino, and terminating in Perevoznaya, with a total distance of 4130 km.⁷⁹

Map 2 Russian Far East Oil and Gas Pipelines



Source: Energy Information Administration - Russia⁸⁰

Around the same time, on 25 October 2003, the former CEO of Yukos, Mikhail Khodorkovsky, was arrested on charges of fraud and tax evasion. Since Yukos was the biggest supporter of the Daqing oil pipeline and the only Russian oil supplier to China, this event triggered serious concerns in Beijing about the “underlying reason” behind the Russian action. Despite Moscow’s assurance to Beijing that the event was mainly a power struggle between the hard-liners and liberals within Russia and that it would not affect Russian-Chinese oil cooperation,⁸¹ the Chinese began to claim that the logic behind Russia’s behaviour “may lie with scepticism on the part of certain Russian factions toward China’s future growth and behaviour”.⁸² A Russian specialist, Peter

⁷⁹ Itoh, “The Pacific pipelines at a crossroads: dream project or pipe dream?” p. 44.

⁸⁰ Energy Information Administration – Russia (April 2007) <www.eia.doe.gov/emeu/cabs/Russia/Full.html> (Last accessed 15 Jan 2008)

⁸¹ *Financial Times*, 28 Oct 2003, p. 9; *FSU Oil & Gas Monitor*, 12 Nov 2003, p. 12.

⁸² Zhu Qiwen, “A pipeline for prosperity”, *China Daily*, 26 Sept 2003.

Rutland, also believed that the Yukos affair was “a deliberate reflection of a strategic decision by Moscow to balance the growing power of China”.⁸³

Beijing’s concern over the likely impact of the Yukos affair was soon proved correct: on 19 September 2004, Yukos informed CNPC that it would cut its oil exports to China by 1m bbl between 28 September and the end of the year, as a result of its inability to pay for duties and transportation fees. Since the announcement came just ahead of a China-Russia summit that was due to begin in Moscow on 22 September, some analysts believed that the move was “designed to embarrass Vladimir Putin”, given Russia’s repeated assurance that the Yukos affair would have no effect on its oil cooperation with China.⁸⁴ CNPC’s subsidiary PetroChina had once threatened to demand compensation from Yukos for all the losses incurred – an estimated US\$45 million – as a result of the Russian oil company’s failure to ensure the renewal of rail deliveries. In order to restore Chinese confidence in Russia’s energy reliability, Gazprom signed an agreement on a strategic partnership with CNPC in October 2004, during Putin’s visit to China. A month later, Transneft was reported to have agreed to deliver Yukos’ oil to China.⁸⁵ Whilst the Kremlin tried to comfort its Chinese partner, it had, in fact, already made a decision on the pipeline to Nakhodka, as posited by Russia’s ambassador to Japan on September 24.⁸⁶

When President Putin visited China in October 2004, he met with several key Chinese leaders, including President Hu Jintao, Parliament Chief Wu Bangguo and Premier Wen Jiabao, and the two sides also signed 13 documents on anti-terrorism, border agreement, and on promoting bilateral trade. However, Putin avoided giving a definite answer regarding the Angarsk-Daqing pipeline, but added, “I hope you will understand me when I say it sincerely and frankly: first of all we need to meet our own national interests. We should develop Russia’s Far Eastern territories.”⁸⁷ According to Peter Lavelle, “Putin’s current trip to China should be interpreted as part of Russia’s new role in the world – as an

⁸³ *FSU Oil & Gas Monitor*, 21 July 2004, p. 6.

⁸⁴ “Yukos challenges Putin with China export threat”, *Financial Times*, 21 Sept 2004, p. 31.

⁸⁵ *FSU Oil & Gas Monitor*, 3 Nov 2004, p. 10 & 15, Dec 2004, p. 10.

⁸⁶ *FSU Oil & Gas Monitor*, 29 Sept 2004, p. 8.

⁸⁷ “Russia’s Putin hears energy-thirsty China’s needs”, *New York Times*, 15 Oct 2004.

international energy broker. This is the role that Putin's Kremlin has been waiting for after a year-long assault on Russia's private oil sector."⁸⁸

On 31 December 2004, Moscow finally made an official announcement that it had chosen the Taishet-Perevoznaya route for the building of the oil pipeline, with an annual capacity of 80mts.⁸⁹ The statement did not mention the cost of the project, but according to earlier reports, the estimated cost for the pipeline had risen from the original US\$5 billion to US\$16 billion by late 2004, due to the rise of price in steel and environmental concerns. Given the East Siberian tapped oil reserves of 20 billion barrels, Koichi Iwama, Japan's parliamentary advisor on energy issues, began to claim that "the pipeline is economically useless".⁹⁰ Nevertheless, the Japanese government did not seem to care much about the cost; the state-run Japan Bank for International Cooperation contended that it was ready to issue a low-interest long-term credit to Russia, covering 80 percent of the project cost in both pipeline construction and oil exploration in East Siberia.⁹¹

The Chinese were largely disappointed by the Russian decision. Beijing soon resumed its attention to Central Asia to secure alternative oil supplies from Kazakhstan. In January 2005, it was reported by CNPC and Kazakhstan's state oil transport company KazTransOil that the building of the third section of the Kazakh-Chinese oil pipeline, between Atasu and Alashankou, was to start in March. The pipeline is 980 km long and was planned to be completed by 2006, carrying 10mts of crude oil to China initially and the capacity was to double in a later stage.⁹²

Probably worried about the likely negative impact on the Sino-Russian relationship and on its role in the burgeoning Chinese market, Russia soon indicated that it had second thoughts about the project. According to Russian Transport Minister Igor Levitin, there was no need to build the eastern pipeline quickly, because it would not be profitable until the pipeline could transport

⁸⁸ "Analysis: Putin's energy bazaar", *Space Daily*, 14 Oct 2004.

⁸⁹ "Russia orders oil pipeline to Pacific", *China Daily*, 1 Jan 2005.

⁹⁰ *FSU Oil & Gas Monitor*, Dec 2004, p. 14.

⁹¹ *FSU Oil & Gas Monitor*, 8 Dec 2004, p. 14.

⁹² *FSU Oil & Gas Monitor*, 26 Jan 2005, p. 10.

55mnts of crude oil per year. Therefore, oil exports to Asia should continue to be delivered through railways for another 12–15 years. Russia also told Beijing that it was possible to eventually build a branch of the Taishet-Perevoznaya pipeline to Daqing.⁹³ In late April 2005, Russia's energy minister Viktor Khristenko signed an order calling for the first phase of the Pacific pipeline to be laid from Taishet to Skovorodino by late 2008. From there, oil would be transferred by rail to the Pacific coast. Since Skovorodino was only 70 km from the Chinese border, Beijing was told that a branch pipeline could be built from there to enable China to receive oil supplies, in the short term, of 20–30mnts annually. Christenko also informed Japanese officials on his trip to Tokyo on 21 April that the construction of the branch line to China would begin first.⁹⁴

Tokyo was apparently furious with Russia's new change of decision. The METI minister Shoichi Nakagawa was quoted as saying that "If the pipeline stops half-way, then there's a big risk that the oil will never reach Japan." He threatened to withdraw the US\$11.5 billion offer to finance the pipeline construction if the branch to China was to be built first, stating that "we would not be able to provide taxpayers' money for such a risky project". The Russians, however, did not seem worried about the threat; as Sergei Grigoriyev, vice-president of Transneft, stated, "We are building a pipeline across our own territory. No one will decide for us who gets oil through it first."⁹⁵

The change in Russia's position seemed to lie partly in the fact that Russia was not so dependent on Japan's financial support compared to two years earlier. According to Grigoriyev, "Transneft does not need Japanese loans. Lots of other creditors are offering us money. ... Transneft's size, state ownership and strategic role in the Russian economy combine to make it an attractive counterpart." Some even speculated that Chinese capital had been involved in the process, as a US\$6 billion transfer had been made from China – supposedly to help Rosneft's acquisition of Yukos' Yuganskneftegaz in December 2004, but

⁹³ *FSU Oil & Gas Monitor*, 30 March 2005, p. 7.

⁹⁴ "Issues of Russian oil supplies to China resolved, says Putin aide", *BBC Monitoring – Energy (BBC Monitoring)*, 5 April 2005; *FSU Oil & Gas Monitor*, 27 April 2005, p. 10.

⁹⁵ "Tokyo in threat to withdraw from \$11bn oil pipeline", *Financial Times*, 30 April 2005, p. 8.

both China and Russia denied that the Chinese loan to Rosneft was related to its purchase of the Yukos unit.⁹⁶

The unsolved territorial dispute between Russia and Japan was also believed to have played a negative role in the bilateral relationship. As mentioned earlier, Japan and Russia both hoped that their energy cooperation could help create a favourable atmosphere for the settlement of their territorial dispute. However, they both insisted on their own positions and showed little flexibility in compromising. Russian President Putin insisted on the USSR's 1956 position that only two of the islands would be returned when the two countries conclude a peace treaty; whilst Japan, on the other hand, believed that the Tokyo Declaration signed by the two in 1993 had "committed them to tackle the issue of sovereignty over all four islands".⁹⁷ Consequently, the expected visit to Japan by President Putin in early 2005 was delayed indefinitely.

Despite the fraught problems with the oil pipeline, such as environment-related issues,⁹⁸ and ongoing struggles between China and Japan, the Pacific pipeline has not shared the same destiny of the Tyumen project, but has instead started to become a reality. According to Russia's then Prime Minister Mikhail Fradkov, the first section of the Pacific pipeline – which is about 1000 km long – has already been built and the transfer of 30mths of oil should begin by the end of 2008. An agreement on building a branch of the Pacific pipeline was also signed in June 2007 between Transneft and CNPC, after Transneft's feasibility report received approval from the Russian authorities. The cost of the branch construction was estimated at more than US\$400 million, with the Chinese providing funding for the construction.⁹⁹ Nevertheless, following the soaring international oil prices during the second half of 2007, the Russian Deputy

⁹⁶ *Financial Times*, 30 April 2005, p. 8; "China denies lending Russian oil company money to buy Yukos unit", *SCMP*, 4 Feb 2005; "Russian oil: King Solomon's pipes", *The Economist*, 7 May 2005, p. 72.

⁹⁷ "Planned Putin visit eludes amid isle row", *The Japan Times*, 12 March 2005.

⁹⁸ According to the *BBC Monitoring*, 6 June 2007, the Republic of Buryatia's Supreme Court ruled, on 6 June, "invalid the favourable conclusion made by the state environmental study on the route of an oil pipeline passing 800 m. away from [Lake] Baykal", which may imply that Transneft needs to revise its route again for the pipeline.

⁹⁹ *BBC Monitoring*, 19 July 2007.

Prime Minister Alexander Zhukov was reported as saying that the Russian State Oil Company Rosneft was dissatisfied with the current price for exporting oil to China, as it could export oil to the West at a higher price. In the future, it would not export oil to China at the price agreed upon.¹⁰⁰

¹⁰⁰ “Variables in construction of China-Russia oil pipeline”, *Zhongguo Tongxun She (ZTS) (HK)*, 16 Dec 2007.

4. Sino-Japanese Dispute over the East China Sea Gas Exploration

The bilateral dispute over East China Sea gas exploration, which surfaced in mid-2004, is another example that illustrates the interaction of politics and energy security between China and Japan. The dispute has attracted great attention from scholars and observers,¹⁰¹ but has not been settled yet, despite more than three years of governmental negotiations.

Origin of the Sino-Japanese Dispute over the East China Sea Gas

The Sino-Japanese dispute over gas exploration in the East China Sea concerned eight gas fields located in the “Xihu Trough”: Pinghu, Chunxiao, Canxue, Duanqiao, Tianwaitian, Baoyunting, Wuyunting, and Kongqueting. The gas reserves were discovered by Chinese oil companies in the 1990s, following geological investigations from the late 1970s. In November 1998, the Pinghu field was among the first under development, by a joint venture run by the Shanghai Municipal government, the Xinxing Oil Corporation, and the China National Offshore Oil Corporation (CNOOC) – China’s leading offshore oil company.¹⁰²

In June 2001, the rights to development of the Xihu Trough gas were transferred to CNOOC and the China Petroleum & Chemical Corporation (Sinopec). On

¹⁰¹ Daojiong Zha, *Zhongguo shiyou anquan de guoji zhengzhi jingjixue fenxi* [China’s oil security: An analysis based on international political economy] (Beijing: Dangdai shijie chubanshe, 2005); Susumu Yarita, “Toward cooperation in the East China Sea”, available at: <www.wilsoncenter.org/topics/docs/Susumu_Yarita.pdf> (Last accessed 8 June 2006); Kosuke Takahashi, “Gas and oil rivalry in the East China Sea”, *Asia Times*, 27 July 2004, available at: <www.atimes.com/atimes/japan/fg27dho3.html> (Last accessed 25 Nov 2005); Su Bin, “China’s ‘bargaining power’ on East China Sea gas field: very strong”, <<http://sun-bin.blogspot.com/2005/11/chinas-bargaining-power-on-east-china.html>> (Last accessed 15 Feb 2006).

¹⁰² Zha, *Zhongguo shiyou anquan de guoji zhengzhi jingjixue fenxi*, p. 173.

19 August 2003, CNOOC and Sinopec (each holding 30 percent stakes) signed five contracts with the Royal Dutch Shell and the Unocal Corp (each holding 20 percent stakes), to explore three blocks and develop two offshore gas fields in the Xihu Trough. The blocks located 400 km southeast of Shanghai cover an area of 22,200 square kilometres, and the initial investment involved was US\$85 million.¹⁰³ In fact, starting from 1985, the CNOOC (standing for the Chinese part) and the Uruma Resources Exploration Co. Ltd. and the Teikoku Oil (representing the Japanese part) had conducted a series of negotiations regarding likely joint development. However, due to the unsettled boundary demarcation in the East China Sea, as well as the sovereignty dispute over the Diaoyu/Senkaku Islands, both sides had to give up their efforts in 2001 for joint development.¹⁰⁴

Nine months later, in May 2004, Japan's *Tokyo Shimbun* reported Chinese offshore gas exploration efforts in the East China Sea and claimed that it might harm Japanese maritime interests, because the closest gas field was only 5 nautical miles west of the median line.¹⁰⁵ Beijing refuted the claim saying that the gas fields under development were within the indisputable waters of the Chinese Exclusive Economic Zone (EEZ) (see Map 3), but invited Tokyo to jointly develop the resources. The Japanese, however, were concerned about the likely estrangement of gas resources across the "median line", and thus insisted that China provide geological data before considering any proposal on joint development. Shoichi Nakagawa, the then head of the METI, made an aerial inspection to confirm the existence of the Chinese gas project, and on 7 July, Japan initiated an intensive seismic survey (by chartering a Norwegian ship) of the area east of the "median line" opposite Chunxiao, to prevent possible Chinese "infringement on its resources".¹⁰⁶

¹⁰³ *China Daily*, 30 September 2004.

¹⁰⁴ Yarita, "Toward cooperation in the East China Sea", pp. 2-6.

¹⁰⁵ Takahashi, "Gas and oil rivalry in the East China Sea"; *Lianhe Zaobao (Zaobao)*, 27 Aug 2004.

¹⁰⁶ *SCMP*, 25 June 2004; *People's Daily*, 29 June 2004; *Washington Times*, 30 June 2004.

Map 3 The Chunxiao Gas Field in the East China Sea



Source: Kosuke Takahashi, “Gas and oil rivalry in the East China Sea”, *Asia Times*, 27 July 2004.

As the bilateral dispute over the EEZ boundary dragged on, Shell and Unocal announced on 29 September 2004 that they would withdraw from the Xihu Project for “commercial reasons”, under the clause that the final decision on the project could be made “within 12 months pending a further assessment”.¹⁰⁷ However, a report by Japan’s *Mainichi Shimbun* believed that the oil majors’ withdrawal was political. The report alleged that the companies were told by Japan via Washington that, “their investment would be risky as the planned gas field was located in an area disputed”.¹⁰⁸ Neither the US nor Japanese authorities offered confirmation of the report’s finding, but it was logical to assume that the ongoing territorial dispute between China and Japan formed at least part of the reason for their withdrawal.

The unexpected change seemed to have little impact on China and Japan. The METI Minister Nakagawa held that “Japan would not be affected by their decision and the survey within our EEZ will continue”. The CNOOC chairman and CEO, Fu Chenyou, also told the press that, “We are confident

¹⁰⁷ *International Herald Tribune (IHT)*, 30 Sept 2004; *People’s Daily*, 30 Sept 2004.

¹⁰⁸ *The Mainichi shimbun*, 1 Oct 2004.

about the project's future. The change of partners has little impact on the ongoing project."¹⁰⁹

Two Causes Responsible for the Dispute

There are two main causes responsible for the Sino-Japanese dispute over marine gas exploration. One is the unsettled EEZ boundaries between the two countries, and the other is the territorial dispute over the Diaoyu/Senkaku Islands, which has long historical antecedents. At the initial stage, the EEZ division was the key factor under debate; but the territorial issue was soon brought into the process, adding more complexity to finding any solution.

According to the *UN Convention on the Law of the Sea* (UNCLOS) of 1982, the coastal states could have at least 200 nautical miles (370 km) of EEZ over which they enjoy "sovereign rights for the purpose of exploring and exploiting, conserving and managing the natural resources".¹¹⁰ But since the East China Sea has only 360 nautical miles at its widest point, how to define the border of the EEZ has been a problem for China and Japan over the past decade. Japan declared its EEZ in 1996 by suggesting a "median line" based on an "equitable solution" in Art 74(i) of the UNCLOS, and China claimed its EEZ in 1998 according to the principle of "natural prolongation of the continental shelf", stated in Art 76 of the same Law.¹¹¹

The "median line" principle favoured by the Japanese was supported by Art 6 of the *UN Convention on the Continental Shelf*, 1958, which stipulated that:

Where the same continental shelf is adjacent to the territories of two or more States whose coasts are opposite each other, the boundary of the continental shelf appertaining to such States shall be determined by

¹⁰⁹ *China News*, 1 Oct 2004; PD, 30 Sept 2004.

¹¹⁰ Articles 56 & 57, *United Nations Convention on the Law of the Sea* (UNCLOS), 10 Dec 1982, available at: <www.un.org/Depts/los/convention_agreements/texts/unclos/closindx.htm> (Last accessed 15 Nov 2005).

¹¹¹ James C. Hsiung, "Sea power, law of the sea, and China-Japan East China Sea 'resource war'", Oct 2005, available at: <www.nyu.edu/gsas/dept/politics/faculty/hsiung/sea_power.pdf> (Last accessed 4 July 2006), pp. 6-7. For more detailed analysis of China's maritime policies, see Greg Austin, *China's Ocean Frontier: International Law, Military Force and National Development* (St. Leonards, NSW, Australia: Allen & Unwin, 1998).

agreement between them. In the absence of agreement, and unless another boundary line is justified by special circumstances, the boundary is the median line, every point of which is equidistant from the nearest points of the baselines from which the breadth of the territorial sea of each State is measured.¹¹²

The 1982 UNCLOS removed the “median line” principle but suggested that an “equitable solution” be reached “between States with opposite or adjacent coasts”. Japan seems to regard the “median line” principle as an “equitable” line and has thus adhered to its position so far unilaterally, despite the Chinese objection “on the ground that it is skewed in favour of Japan”.¹¹³

The “natural prolongation” principle supported by China was based on Art 76 of the 1982 UNCLOS, which defines the “continental shelf” as

the seabed and subsoil of the submarine areas that extend beyond its territorial sea throughout the natural prolongation of its land territory to the outer edge of the continental margin, or to a distance of 200 nautical miles from the baselines from which the breadth of the territorial sea is measured where the outer edge of the continental margin does not extend up to that distance.¹¹⁴

If in case the outer edge of the continental margin “extends beyond 200 nautical miles from the baselines from which the breadth of the territorial sea is measured”, the same article stipulates that the outer limits of the continental shelf on the seabed should be drawn on the basis that “either shall not exceed 350 nautical miles from the baselines from which the breadth of the territorial sea is measured or shall not exceed 100 nautical miles from the 2500 metre isobath”.¹¹⁵ As the depth of the Ryukyu trench is 2940 metres, China has argued that it “has inviolable sovereignty over the Chinese continental shelf” that

¹¹² *Convention on the Continental Shelf*, 1958, available at: <www.un.org/law/ilc/texts/contsh.htm> (Last accessed 28 Jan 2006).

¹¹³ UNCLOS, 10 December 1982, Art 74 (1); Hsiung, “Sea power, law of the sea, and China-Japan East China Sea ‘resource war’”, p. 7.

¹¹⁴ UNCLOS, 10 December 1982.

¹¹⁵ *Ibid.*

extends to the Ryukyu trench, with a distance of 350 nautical miles from the Chinese coast.¹¹⁶

The issue of the Diaoyu/Senkaku Islands is more complicated and involves more politics as well. It concerns a group of eight uninhabited, rocky islets in the East China Sea, which belonged to China historically, but which currently are under the administrative control of the Japanese government.¹¹⁷ The root of the dispute can be traced back to the nineteenth century, when the Diaoyu Islands were under the administration of Taiwan, a part of the Chinese Qing Dynasty. After the defeat in the 1894-95 Sino-Japanese war, China was forced to cede the “Formosa (Taiwan) and Pescadores” to Japan via the Treaty of Shimonoseki. However, when the Treaty was signed in 1895, it did not specify whether the Diaoyu Islands, which were not called Senkaku by Japan until 1900, were included in the “islands appertaining to Formosa”. Japan claimed that the islands were formally incorporated into its territory in January 1895 amid the war, before the Treaty of Shimonoseki came into effect in May of 1895; whilst the Chinese argued that Japan’s seizure of the Diaoyu in the war was only “formalized” by the Treaty of Shimonoseki.¹¹⁸

Taiwan was returned to China after Japan’s surrender in WWII, as stipulated in the Cairo Declaration of 1 December 1943, signed by the United States, the Republic of China (ruled by the Nationalist regime), and the United Kingdom, that “all the territories Japan has stolen from the Chinese, such as Manchuria, Formosa, and the Pescadores, shall be restored to the Republic of China”. Based on the logic that the Diaoyu Islands were part of the “Pescadores”, the Chinese viewed the return of “Formosa and the Pescadores” as including the Diaoyu

¹¹⁶ Hsiung, “Sea power, law of the sea, and China-Japan East China Sea ‘resource war’”, p. 6.

¹¹⁷ Koji Taira, “The China-Japan clash over the Diaoyu/Senkaku Islands”, 20 Sept 2004, available at <www.japanfocus.org/157.html> (Last accessed 26 Nov 2005), pp. 1-8.

¹¹⁸ Austin, *China’s Ocean Frontier*, pp. 163-4; “The Sino-Japanese dispute over Diaoyu/Senkaku Islands: what price sovereignty?” *The Ryukyuanist*, 63 (2004), pp. 1-8; “Senkaku/Diaoyutai Islands”, available at: <www.globalsecurity.org/military/world/war/senkaku.htm> (Last accessed 28 Feb 2006).

Islands.¹¹⁹ In reality, however, those islands were under US control in the wake of WWII and were used by the US army as occasional bombing practice targets. When the US and Japan signed the Okinawa (Ryukyu) Reversion Treaty in 1969, the Diaoyu/Senkaku were further included as a part of Okinawa to be returned to Japan. The Okinawa Treaty has thus been cited by Japan as proof of its ownership of sovereignty over the Diaoyu/Senkaku Islands.¹²⁰ Nevertheless, as argued by James Hsiung, “If so, Japan would have to prove beyond reasonable doubt that the United States had sovereign title to Diaoyutai before turning it over to Japan. It is plain that Japan could not have gotten something that the United States did not have in the first place.”¹²¹

Indeed, when the United States returned Okinawa to Japan in 1972, it did not specify which country it recognized as sovereign power by stating that “what it acquired from Japan by the Peace Treaty was not sovereignty over the Diaoyu Islands, but administrative rights. Okinawa reversion did not affect claims of sovereignty with respect to these islands by any state.”¹²² In an earlier response to an inquiry from Taiwan regarding the islands, the US also made itself neutral to the issue by claiming that:

The United States believes that a return of administrative rights to Japan, from which these rights were initially acquitted, in no way damages the Republic of China’s claim of sovereignty; nor can the United States, in transferring the administrative rights over these islands, grant Japan an expansion of the legal rights that it [Japan] had prior to giving them to the United States.¹²³

¹¹⁹ Taira, “The China-Japan clash over the Diaoyu/Senkaku Islands”, p. 4. “Nansei shoto” means “Southwest Islands”.

¹²⁰ Theodore M. Critchfield, “China, Japan, and power”, 29 June 1997, available at: <<http://mcel.pacificu.edu/aspac/papers/scholars/critchfield/Critchi.html>> (Last accessed 11 March 2006); “Senkaku/Diaoyutai Islands”.

¹²¹ Hsiung, “Sea power, law of the sea, and China-Japan East China Sea ‘resource war’”, p. 10.

¹²² “Diaoyu/Senkaku: to whom do these eight isles belong?” available at: <www.geocities.com/Tokyo/Shrine/2475/diaoyu.html> (Last accessed 20 Jan 2006); Taira, “The China-Japan clash over the Diaoyu/Senkaku Islands”, p. 5.

¹²³ Taira, “The China-Japan clash over the Diaoyu/Senkaku Islands”, p. 5.

At the time, the Chinese authorities across the Taiwan Strait both responded strongly to the Okinawa Reversion Treaty. In July 1970, the Nationalist authority in Taiwan granted an exploration concession to oil companies in a large area of the East China Sea which included the islands, and in September its Foreign Minister declared before the legislative Yuan that the Diaoyu Islands belonged to China.¹²⁴ The PRC government also declared its sovereignty over the Diaoyu Islands in December 1970, claiming that China “shall not allow the US-Japanese anti-revolutionaries to rob our marine resources” or to delimit these islands “into Japanese territory”.¹²⁵

In addition to the intensified struggles over the sovereignty of the Diaoyu/Senkaku Islands, the discovery of potential undersea oil deposits around the islands by the UN Economic Commission for Asia and the Far East in 1968 might also have played a role in the dispute. It is hard to assess how much impact this discovery had on the relevant parties and their territorial claims at the time, but all the parties have reiterated their respective positions concerning the sovereignty of these islands over the past thirty years.

During the past three decades, China and Japan were unable to reach consensus regarding the issue and thus followed a principle of “shelving” (*ge zhi*) their territorial dispute for later generations, as suggested by Deng Xiaoping in 1978 in dealing with the sovereignty of the Diaoyu (Senkaku) Islands. Deng held that “since China and Japan faced with different circumstances, it is fully understandable that the two may have different views towards certain issues”, such as that of the Diaoyu (Senkaku) Islands. Deng suggested that the issue be left for the next generation, who “will be wiser than us [in solving the problem]”.¹²⁶ In February 1992, the PRC National People’s Congress passed a Law on the Territorial Sea and Contiguous Zone, stating that the sovereignty

¹²⁴ Austin, *China’s Ocean Frontier*, p. 173.

¹²⁵ *People’s Daily* commentary, “Not to allow the US-Japanese anti-revolutionaries robbing our marine resources”, 29 December 1970, in Tian Huan, ed., *Zhanhou Zhong-Ri guanxi wenxianji 1945-1970* [Collected documents on postwar Sino-Japanese relations 1945–1970] (Beijing: Zhongguo shehui kexue chubanshe, 1996), p. 936.

¹²⁶ Tian Huan, ed., *Zhanhou Zhong-Ri guanxi wenxianji 1971-1995* [Collected documents on postwar Sino-Japanese relations 1971–1995] (Beijing: Zhongguo shehui kexue chubanshe, 1997), p. 243.

over the “Diaoyu Islands” was an appurtenance to Taiwan and was thus China’s integrated territory. Japan protested promptly, but it was reaffirmed by Chinese President Jiang Zemin on his visit to Tokyo in October 1992 that China would insist on the principle of “shelving” territorial disputes,¹²⁷ Thereafter, the governments of China and Japan did not discuss the issue officially until their recent talks regarding the gas dispute in the East China Sea.

Diplomatic Dialogues between China and Japan

Soon after the withdrawal of Shell and Unocal, China and Japan started their diplomatic dialogues aimed at finding a solution to the problem. Between October 2004 and July 2007, nine rounds of talks at the Bureau-level were held in both capitals, but little progress has been made so far except for a general agreement on “joint development”.

The first three rounds of dialogues were held on 26 October 2004 and 30–31 May 2005 in Beijing, and on 30 September–1 October 2005 in Tokyo, respectively. The agenda in these talks was relatively simple and straightforward: the EEZ demarcation remained the focus of discussion and joint development of the maritime resources was suggested as an immediate solution before a general agreement had been reached between China and Japan. The Japanese delegation accepted the principle of joint development at the third meeting, but suggested that the scope should cover the gas fields under Chinese development: Chunxiao, Duanqiao, and Tianwaitian (Shirakaba, Kusunoki, and Kashi in Japanese). Encouraged by Tokyo’s acceptance of the proposal of joint development, Beijing seemed to be prepared to make certain compromises as well. As claimed by the Director-General of the Chinese Foreign Ministry’s Department of Asian Affairs and the leader of China’s negotiators, Cui Tiankai, “Under these circumstances, some kind of joint development is the only realistic solution.” Beijing even indicated that “it might be willing to discuss Tokyo’s long standing request to disclose details of China’s own oil and

¹²⁷ Taira, “The China-Japan clash over the Diaoyu/Senkaku Islands”, p. 7; Steven Wei Su, “The territorial dispute over the Tiaoyu/Senkaku Islands: an update”, *Ocean Development & International Law*, Vol. 36 No. 1 (Feb 2005), pp. 45–61, 47–48.

gas-exploration data, but only once the two nations agree to joint development".¹²⁸

For the first time, some hope could be seen for the two governments in reaching a solution, notwithstanding unpleasant episodes such as the Japanese decision in February 2005 to take over a lighthouse built by a rightist group in 1978 on the Diaoyu/Senkaku Islands. Other episodes included the worst anti-Japanese demonstration ever in China in April 2005, triggered by Japan's revision of a high school textbook.¹²⁹ The Chinese delegation agreed to consider Japan's proposal "earnestly" and reveal its stance when the two met again on 19 October, a date proposed by Japan in "an ultimatum" to China.¹³⁰

Nonetheless, two days before the meeting was to be held, on 17 October, Japanese Prime Minister Junichiro Koizumi visited the controversial Yasukuni Shrine in Tokyo again, for the fifth time since he came to power in 2001.¹³¹ Koizumi's visit to the shrine not only made the new round of talks on marine gas disputes impossible, but also led to Beijing's cancellation of a scheduled visit by Japanese Foreign Minister Nobutaka Machimura on 23 October.¹³² The deadlock remained unchanged until four months later, when Japan's new METI Minister Toshihiro Nikai visited Beijing in February 2006. Given his less hard-line position in dealing with Japan's neighbouring countries, Nikai was welcomed by the Chinese leadership, including Premier Wen Jiabao, who had not met with any senior Japanese official since November 2004.¹³³ The two

¹²⁸ J. Sean Curtin, "Stakes rise in Japan, China gas dispute" *Asia Times*, 19 Oct 2005.

¹²⁹ "China: Japan's takeover of the lighthouse at Diaoyu Islands 'void'", <<http://news.creaders.net>>, 14 Feb 2005; "China, Japan eye textbook tension", *BBC News*, 11 April 2005.

¹³⁰ Curtin, "Stakes rise in Japan, China gas dispute"; "Call to jointly develop East China Sea gas and oil fields", *The Asahi shimbun*, 3 Oct 2005.

¹³¹ A Shinto temple enshrined 2.47 million Japanese war dead from mid-19th century, including 14 Class-A war criminals such as Hideki Tojo.

¹³² "Japan-China oil dispute escalates", *Washington Post*, 22 Oct 2005; "Japan, China to hold East China Sea talks in Beijing", *Bloomberg*, 1 Oct 2005; "Fighters scrambled record 30 times to intercept Chinese planes", *The Japan Times*, 10 Nov 2005;

¹³³ "Wen willing to improve Japan-China relations", *The Asahi shimbun*, 23 Feb 2006; Qiu Zhenhai, "Toshihiro Nikai's visit to China: rational settlement with the East China Sea issue?" *Zaobao*, 25 Feb 2006.

governments agreed to strengthen economic cooperation and to resume talks in early March over the maritime resources. Accordingly, Beijing ordered a delay of production in the Chunxiao gas field to allow a better atmosphere for bilateral negotiations.¹³⁴

On 6–7 March 2006, China and Japan held the fourth round of talks in Beijing. In addition to their respective positions over the EEZ demarcation, the Diaoyu/Senkaku Islands issue was brought to the table with the likely scope of joint development under discussion. Based on Japan's previous proposal, the Chinese offered to jointly explore the areas north and south to encompass four gas fields near the "median line", with Longjing (Asunaro in Japanese) added to the list, but the proposed southern area was near to the disputed Diaoyu/Senkaku Islands. Although Beijing did not clarify if these islands should be included in the plan of joint development, Tokyo swiftly rejected the offer to avoid a potential increase of "China's influence over the disputed Islands", but insisted that the joint development should only cover the "four gas fields near the median line".¹³⁵

The involvement of the Diaoyu/Senkaku Islands issue in the discussion had apparently complicated the existing negotiation. But the real concern behind China's behaviour seems to be highly relevant to the history issue, such as the textbook revision and, especially, Koizumi's repeated visits to the Yasukuni Shrine. In his talk on 9 March in Beijing, the Foreign Ministry spokesman Qin Gang, for example, refuted Japan's claim over the Diaoyu/Senkaku Islands and insisted that they are China's "innate territory"; but he also told the press that, "Should the Japanese side play up the issue (Diaoyu/Senkaku Islands) in an effort to divert attention to the Japanese leader's visit to the Yasukuni Shrine, the move would not be conducive to Sino-Japanese relations or solution to the

¹³⁴ *Interfax, China Energy Report Weekly*, May 27–June 2, 2006, pp. 5–6; "Wen willing to improve Japan-China relations", *Zaobao*, 23 Feb 2006.

¹³⁵ "East China Sea consultation between China, Japan 'constructive': FM", <www.chinaview.cn>, 7 March 2006; "China gas proposals 'include Senkaku area'", *The Yomiuri shimbun*, 9 March 2006.

East China Sea issue.”¹³⁶ Indeed, the repeated visits to the Yasukuni Shrine by Koizumi between 2001 and 2006 were a key reason for the deterioration of the Sino-Japanese relationship. Politically, Beijing refused to exchange summit visits with Japan during Koizumi’s tenure of premiership, indicating the lowest point of the bilateral political relations since the 1970s. Economically, bilateral trade relations began to show a slower pace in growth. In 2005, Sino-Japanese trade grew by only 9.9 percent, compared with a 23.6 percent growth in China-EU trade, and 180 percent in China-US trade. The Chinese side became increasingly concerned about the “politically cold yet economically hot” situation being replaced by a “politically cold and economically cool” situation, as warned by Minister of Commerce Bo Xilai.¹³⁷

Amid such unfavourable political circumstances, two more rounds of diplomatic talks were held on 18 May in Tokyo and 8–9 July 2006 in Beijing. However, no new proposals were raised at the meetings, despite the “conductive and pragmatic” talks conducted, and the meetings ended up with “great differences” remaining. The only consensus reached by the two was to set up a maritime hotline to deal with emergencies arising in the East China Sea.¹³⁸

When Shinzo Abe took over office as Japanese Prime Minister on 26 September 2006, Beijing showed a more flexible gesture in dealing with the history issue. Although Abe did not make it explicit as to whether he would visit the Yasukuni Shrine during his premiership, Beijing still invited him for a visit on 8 October, based on the “consensus” between the two governments “on overcoming the political obstacles affecting bilateral relationships and promoting a friendly and cooperative relationship”. Abe’s visit was not only the first summit visit in five years, but was also the first time a Japanese prime minister had chosen China as the destination for his first official visit abroad. It was thus viewed by both sides as a sign of Abe’s “resolve and courage” in

¹³⁶ “China in tit for tat snubs Japan gas-drilling plan”, *The Japan Times*, 10 March 2006; “China’s proposal on disputed gas ‘rational and constructive’ – spokesman”, *The Japan Times*, 9 March 2006.

¹³⁷ “Minister concerned about China-Japan trade”, *Xinhua*, 2 June 2006.

¹³⁸ “No headway in talks on gas exploration”, *The Asahi shimbun*, 18 May 2006; “China, Japan end East China Sea talks, ‘great differences’ remain”, *BBC Monitoring*, 9 July 2006.

improving the tattered relations between Tokyo and Beijing; and this was welcomed by the Chinese government warmly as well.¹³⁹ To show his refrained attitude towards the Yasukuni Shrine, Abe made a 50,000 yen offering to the Yasukuni Shrine during a Shinto festival in late April, instead of visiting in person. In thus doing, he apparently hoped to avoid harsh criticism from other Asian countries, especially China. The Chinese government also chose to downplay the issue.¹⁴⁰

In the meantime, the two governments have made great efforts in improving the bilateral relationship since Abe's tenure. During Chinese Premier Wen Jiabao's visit to Japan in mid-March, both leaderships expressed their desire to build a "strategic and mutually beneficial relationship", and they also agreed that a plan for joint development in the East China Sea should be compiled by autumn this year.¹⁴¹ Encouraged by the positive trend in the bilateral relationship, China and Japan held another three rounds of talks in Tokyo and Beijing respectively, on 29 March, 25 May, and 26 June 2007. Both sides expressed their willingness to resolve their disputes and admitted the "constructive" direction of their discussions. However, as the two sides could not reach "an agreement on the basic points", including the Diaoyu/Senkaku Islands issue, China and Japan have been unable to "define the area for the possible joint development".¹⁴²

A new round of talks, planned to be held on 21 September 2007, were postponed to 11 October, due to a leadership change in Japan following Abe's abrupt resignation from the post on 12 September. When Yasuo Fukuda became the new prime minister on 23 September, he paid great attention to Japan's

¹³⁹ "Chinese premier, Japanese PM hold talks in Beijing", "Need to keep up effort in wake of Abe's 'icebreaking' trip", *People's Daily*, 8 & 9 October 2006, "Abe off to impressive start", *The Japan Times*, 16 Oct 2006.

¹⁴⁰ "Abe made offering to Yasukuni Shrine instead of visiting", *The Japan Times*, 9 May 2007; "Jiang Yu on the questions over Abe's offering of a sacred potted plant to the Yasukuni Shrine", *Xinhua*, 8 May 2007.

¹⁴¹ "Wen's trip gives added impetus to efforts to warm Japan-China ties", *The Yomiuri shimbun*, 13 April 2007.

¹⁴² "Japan, China begin talks on East China Sea gas dispute", "Japan says no formal proposal from China in gas talks", "Japan, China 'remain apart' over gas row", *BBC Monitoring*, 29 March, 25 May, and 26 June 2007.

diplomacy with its Asian neighbours, by declaring that he would not visit the Yasukuni Shrine. He also addressed Japan's relationship with China and hoped for an early solution to the dispute over East China Sea gas exploration.¹⁴³ Fukuda's gesture did not necessarily make his life easier in Japanese domestic politics, but it was seemingly appreciated by Beijing and thus had a positive impact on the bilateral relationship.

Soon after Fukuda took over power, Chinese Premier Wen Jiabao on 27 September told a Japanese business delegation in Beijing that he hoped the new Prime Minister Yasuo Fukuda would visit China at an early date; he also confirmed President Hu Jintao's planned visit to Japan the year after.¹⁴⁴ In late September, China's new ambassador to Japan, Cui Tiankai, described the bilateral relationship as "the most important" one for both countries. At his first meeting with Japanese Foreign Minister Masahiko Komura on 11 October, Cui said China wanted to build healthy and stable relations that will prove durable. He also agreed with the latter to work on realising mutual visits by the two nations' leaders soon, and on settling the dispute over gas exploration rights in the East China Sea. Komura appreciated China's gesture and appealed for a "political decision" to reach a resolution to the dispute.¹⁴⁵ Later on, at The Second Sino-Japanese Comprehensive Forum on Energy Conservation and Environmental Protection, held in Beijing on 27 September, Chinese Vice-Premier Zeng Peiyan again urged that China and Japan further step up cooperation in the fields of energy conservation and environmental protection.¹⁴⁶ Efforts at the working level were also made to facilitate diplomatic negotiations. According to Japan's METI Minister Akira Amari, he had agreed with China's State Development and Reform Commission Chairman, Ma Kai,

¹⁴³ "Hawks expected to push Fukuda hard", *The Japan Times*, 24 September 2007; "One of the most important bilateral ties: Prime Minister Fukuda comments on [Japan's] relationship with China" *The Asahi shimbun*, 15 Oct 2007.

¹⁴⁴ "Wen hopes Fukuda makes an early visit", *The Japan Times*, 28 September 2007.

¹⁴⁵ "Japanese foreign minister, new Chinese envoy to work on visits, gas dispute", *Kyodo*, 11 Oct 2007.

¹⁴⁶ "Chinese vice-premier addresses Sino-Japanese energy conservation forum", *BBC Monitoring*, 30 Sept 2007.

to draft a specific plan for joint development of gas in the East China Sea and to report the details to the two leaderships before Fukuda's visit to China.¹⁴⁷

Nevertheless, the tenth bilateral dialogue, held in Beijing on 11 October 2007, still failed to make any breakthrough, due to the remaining "big gap between the two sides' positions on the matter", as expressed by Japanese chief negotiator Kenichiro Sasae.¹⁴⁸ With hopes growing slimmer for a settlement by autumn, Japanese Chief Cabinet Secretary Nobutaka Machimura claimed that China should take a more positive stance in the East China Sea talks. The Chinese rejected Japan's accusation by calling it "unfounded". As asserted by Foreign Ministry spokesman Liu Jianchao, "China has always taken a positive and pragmatic attitude in the talks and put forward fair and reasonable proposals."¹⁴⁹

Indeed, more commitment could be observed at the leadership level in both China and Japan towards reaching an early agreement over the dispute. At a meeting between Prime Minister Yasuo Fukuda and the Chinese ambassador to Japan, Cui Tiankai, on 5 November 2007, they agreed to strive towards an early resolution of the maritime dispute, ahead of Chinese President Hu Jintao's visit to Japan, expected in spring 2008.¹⁵⁰ The Chinese delegation also allegedly softened its long-standing position over the likely scope of "joint development". At a meeting of the Liberal Democratic Party's special committee on maritime matters on 31 October, Japan's top negotiator, Kenichiro Sasae, said that while the Chinese had insisted that "joint development" should be conducted only "on the Japanese side of the median line" in the East China Sea, they had now been told privately that it would be possible to jointly develop gas fields around the median line, "depending on how Japan deals with the issue".¹⁵¹

On 13 November, Foreign Ministry's spokesman Liu Jianchao told the press that China would be open to constructive proposals from Japan and that they would

¹⁴⁷ "Japan, China to draft joint sea gas development plan soon", *Kyodo*, 28 Sept 2007.

¹⁴⁸ "China, Japan ocean gas fields talks fail to reach deal", *Kyodo*, 11 Oct 2007.

¹⁴⁹ "China Refutes Japan's Blame on East China Sea Issue", *Xinhua*, 19 Oct 2007.

¹⁵⁰ "Japan, China agree to push for early resolution of gas dispute", *Kyodo*, 5 Nov 2007.

¹⁵¹ "China is likely to compromise in the gas fields negotiations, according to the Bureau head Sasae", *The Yomiuri shimbun*, 31 Oct 2007.

continue the negotiations with a positive, pragmatic attitude. He further said that the key to reaching a consensus would depend on the “joint efforts of China and Japan”. Japanese Foreign Minister Masahiko Komura also hoped that the upcoming discussions could reach certain agreements which could help compile “a good report” to the two leaders, to fulfil the consensus between the two leaderships on finding a solution by autumn on Wen Jiabao’s visit to Japan in mid-April 2007.¹⁵² Unfortunately, the eleventh round of the Sino-Japanese dialogues on the maritime dispute, led by Hu Zhengyue and Kenichiro Sasae and held in Tokyo on the following day, once again failed to make significant headway. At this stage, both delegations probably felt that they had exhausted existing methods in finding a breakthrough, and thus suggested “increasing political effort” to resolve the dispute, which would involve the two top leaderships and foreign and energy ministers. The Japanese Chief Cabinet Secretary Nobutaka Machimura even warned that the continuing stalemate might affect the planned visit to China by Prime Minister Yasuo Fukuda.¹⁵³

Not long thereafter, bilateral ministerial level meetings took place, on 1 December 2007, when the Chinese Foreign Minister Yang Jiechi met with his Japanese counterpart Masahiko Komura in Beijing during the China-Japan high-level economic dialogue. The two foreign ministers discussed various issues of common interest, such as the North Korean issue, the Taiwan issue, and further promotion of bilateral cultural exchanges, and made new progress in defence exchanges as well. The *Financial Times* called the bilateral talks “their most comprehensive talks in 35 years ... in a sign of the thawing relationship between Asia’s two largest economies”. Yet again, no solution was reached regarding their dispute over maritime gas exploration. The issue was brought to the attention of top Chinese leaders by Komura, who, when meeting with Chinese Premier Wen Jiabao and President Hu Jintao, urged them to adopt a

¹⁵² “Japan, China to hold gas talks in Tokyo 14 November”, *Kyodo*, 9 November 2007; “China open to Japanese proposals on East China Sea issues – spokesman”, *BBC Monitoring*, 13 November 2007.

¹⁵³ “Japan, China agree need for political effort on gas dispute”, “Lack of progress in gas talks may affect Japan PM’s China trip – official”, *Kyodo*, 14 Nov 2007.

leadership role in resolving the dispute: he received positive responses from both leaders.¹⁵⁴

Despite the remaining deadlock over the maritime dispute, the improved Sino-Japanese ties seem to have facilitated Fukuda's decision to visit China without making a settlement of the dispute a precondition. In order to play a safe card, both authorities remained cautious about reaching a solution over the dispute during Fukuda's visit as well. Before Fukuda's trip took place, a Chinese Japan specialist, Liu Jiangyong, remarked that whether or not the East China Sea dispute could be resolved should not be the only benchmark to evaluate the success of Fukuda's trip to China, because the meeting between the two leaderships could only accelerate the process, and the specific work would need to be done on the working level. The METI head Akira Amari also stated that, "the possibility [of resolving the East China Sea dispute] is extremely low" during Fukuda's China visit.¹⁵⁵

Between 27 and 30 December 2007, Prime Minister Fukuda paid his first official visit to China, three months after taking office. The Chinese attached great importance to Fukuda's visit and offered him a warm welcome. Fukuda not only met with all the top Chinese leaders, President Hu Jintao, Premier Wen Jiabao and top legislator Wu Bangguo, but also delivered a speech at Peking University with a live broadcast – an opportunity not often afforded to foreign visitors. Fukuda also reached a four-point new consensus on the East China Sea issue with Wen Jiabao on 28 December. First, the two sides will continue to adhere to the five-point consensus achieved by leaders of the two countries in April 2007 in a bid to turn the East China Sea into a sea of peace, cooperation and friendship. Second, the two sides have elevated the level of consultation, conducted earnest and substantive consultation on the concrete solution to the issue and made positive progress. Third, they agreed to conduct vice ministerial-level consultation, if necessary, while maintaining the current consultation

¹⁵⁴ "China-Japan talks a sign of warming ties", *FT*, 4 Dec 2007; "Japan FM calls on Chinese premier for leadership to resolve gas field row", *Kyodo*, 2 Dec 2007; "Hu Jintao meets Japanese Foreign Minister Masahiko Komura", *Xinhua*, 3 Dec 2007.

¹⁵⁵ "Fukuda to visit China; breakthrough still difficult to predict in East China Sea problem", *ZTS (HK)*, 22 Dec 2007.

framework. They had also made joint efforts to reach an agreement on the solution to the issue at an early date on the basis of the overall situation of China-Japan relations and international law. Fourth, the proper solution to the East China Sea issue conformed to the interests of both China and Japan. The two sides agreed to strive for an early solution in the process of developing bilateral ties.¹⁵⁶ The Chinese Foreign Ministry's spokesman Liu Jianchao held that the new consensus had fully embodied the sincerity and positive attitudes of both the Chinese and Japanese governments "in promoting the process of resolving the East China Sea issue".¹⁵⁷ Another agreement reached between Fukuda and Hu Jintao was to work towards an early settlement to the stalled dispute in the East China Sea before Hu's visit to Japan in spring 2008.¹⁵⁸

With the determination and political will of the two leaderships, progress seems to have been made over the maritime dispute since Fukuda's visit to China. In late January 2008, the *Financial Times* reported that Ambassador Cui Tiankai had told the press that a solution was likely to be found "well before Hu's visit". According to Cui, the two sides might come up with a "practical formula' that would allow the two countries to share gas reserves without ceding ground on territorial or legal questions".¹⁵⁹ What enabled progress seems to have been Beijing's concession on "implicitly acknowledging the Japanese demarcation line", which was viewed as a "huge step" by Japanese foreign ministry officials. The report claimed that China no longer insisted on including the Diaoyu/Senkaku Islands into the areas for joint development, but agreed to jointly develop gas resources around the median line. The main incentive for Beijing to do so, as stated by Jin Linbo, Senior Fellow at the China Institute of International Studies, a think tank under the Chinese Foreign Ministry, was its

¹⁵⁶ "Wen Jiabao holds talks with Japanese Prime Minister Fukuda", available at: <www.mfa.gov.cn/eng/zxxx/t395775.htm> (Last accessed 30 Jan 2008).

¹⁵⁷ "Foreign Ministry Spokesman says that the resolution of the East China Sea issue requires joint efforts of both the Chinese and Japanese sides", *Xinhua*, 29 Dec 2007.

¹⁵⁸ "Fukuda, Hu agree to seek gas rights pact / exchange programme to expand", *The Yomiuri shimbun*, 29 Dec 2007.

¹⁵⁹ "Beijing sees end to gas dispute with Japan", *Financial Times*, 19-20 Jan 2008, p. 5.

eagerness to push for a fourth formal statement on Sino-Japanese relations signed during Hu's visit to Japan.¹⁶⁰

A recent report by Agence France-Presse (AFP), quoting Japan's *Nikkei Business Daily*, also claimed that Tokyo and Beijing were considering settling their dispute by evenly splitting profits from joint development in the East China Sea. The report said a proposal under discussion had suggested that Beijing and Tokyo jointly develop the gas fields and set a formula for taking profits based on each country's investment and geographical proximity. The overall goal would be for the two countries to split the profits evenly. A Japanese trade official denied the report, but both countries have said they want a breakthrough before President Hu Jintao's visit to Japan.¹⁶¹ Nonetheless, the accuracy of the report was denied by officials from both China and Japan. On 5 February, Japan's Chief Cabinet Secretary Nobutaka Machimura pointed out that the newspaper report contained a lot of incorrect information, and the Chinese Foreign Ministry spokesman Liu Jianchao also told a regular news conference on the following day that, "Related reports are inaccurate. The Chinese side's position on the East China Sea issue has not changed".¹⁶²

¹⁶⁰ *Ibid.* There were three political documents signed between China and Japan since their diplomatic normalization in 1972, viewed by Beijing as the basis for the bilateral ties: the 1972 Joint-Communiqué, the 1978 Friendship Treaty, and the 1998 Joint Declaration for Partnership.

¹⁶¹ "Japan, China said to settle gas row by splitting profit", *AFP*, Tokyo, 4 Feb 2008.

¹⁶² *Zaobao*, 5 Feb 2008; Reuters, "China denies consensus on gas profits with Japan", Beijing, 6 Feb 2008.

5. Conclusion

The above analysis on Sino-Japanese dealings with energy security over the past four decades has revealed the fact that oil has always been perceived as a “strategic commodity” in the context of East Asia and that political considerations have always played a significant role in affecting the energy security strategies of China and Japan.

The Tyumen oil project has shown that, although the project was raised as an energy project between Japan and the USSR, the international circumstances of the Cold War had compounded the process heavily with international politics. The initiation of the Tyumen project became possible only because of the US-Soviet détente in the 1960s and the US-China rapprochement in 1971, which had allowed China to also play a role in the process. The negotiations of the arrangements were complicated by the Japanese-Soviet territorial dispute and possible strategic implications associated with the project. The strong objection from China, based on security concerns, had played a vital role in preventing the project, but the support that China received from the US and Japan was also indispensable. China successfully persuaded Japan to abandon the Tyumen oil pipeline project and to join its “united front” against the Soviet threat by providing stable oil supply to Tokyo and working together with Japanese companies in oil exploration. What enabled China’s success was not that it could supply Japan with more oil than the USSR could, but that its strategic interests converged with that of Japan and the United States. Therefore oil was in effect an instrument employed by Beijing to serve its political interests.

The end of the Cold War has diminished military confrontations between the two superpowers, with the United States remaining as the world’s only superpower; this has also helped improve the security situation in East Asia. However, one thing remaining unchanged is the role of politics associated with

the energy security strategies of China and Japan. In both of the recent cases on energy security – the access to Russian oil pipeline routes and the rights over East China Sea gas exploration – China and Japan chose to compete with each other intensively based on considerations of what they saw as energy security. This triggered great financial costs for the two countries, but did not necessarily improve the situation for their security of energy supply.

In the first case, China and Japan competed intensively over access to Russia's oil pipelines and lobbied the Russians heavily by making great financial offers. Nevertheless, they seem to have forgotten that they had no control over the final decisions, and that their competition would only offer Russia a better opportunity to play them off each other. Indeed, it is only natural for Moscow to employ oil as an effective means to serve its own national and energy security interests. Being the two biggest oil consumers and importers in East Asia, China and Japan could have been in a far better position had they worked together to negotiate with Moscow on a general deal, and so avoid the disadvantageous position they are currently facing. On the other hand, so long as China and Japan remain distrustful of each other and continue with their rivalry, it will be impossible to see the two powers working together in energy security issues, as indicated by the competition between them over maritime petroleum resources in the East China Sea.

In the case of gas exploration in the East China Sea, the causes of disagreement lie partially in the vagueness of the International Law of the Sea, and partially rooted in Sino-Japanese political mistrust. Given the current circumstances facing China and Japan, it seems unlikely that the two countries will rely on the International Law of the Sea to settle their disputes over the EEZ demarcation in the East China Sea or the sovereignty of the Diaoyu/Senkaku Islands. The most practical option for the two nations is to form a practical plan for joint development, and leave aside the more difficult issues. In fact, China and Japan had signed an agreement in 1997 regarding their fishing rights in the East China Sea, which could also be followed by the two talking “about natural resources without jeopardising each other's standpoint on the line of demarcation”, as

argued by an official from the Japanese Foreign Ministry.¹⁶³ That being said, the whole process of dispute settlement has suggested that political distrust between the two nations is of equal significance for the governments of China and Japan as the concern of energy security. Indeed, it would not have taken China and Japan more than three years to find a breakthrough in the gas dispute, if the two sides had been better prepared to reach a solution through mutual compromises.

It is encouraging to see greater hope for a settlement of the Sino-Japanese maritime gas dispute in the near future, due to political willingness and decisions made by the top leaders in both China and Japan. However, it is far from adequate to rely entirely on the top leaders to ensure a stable development of the bilateral ties. It is crucial for China and Japan to build up mutual trust at all levels to enable a better political atmosphere, and to establish more regular mechanisms in coping with contingencies. Otherwise, the political relationship between China and Japan would be too vulnerable to resist a negative impact triggered by even non-political events in both countries. As a matter of fact, the recent restraint exercised by the two governments on the issue of the China-made, pesticide-tainted, frozen dumplings is a good example of crisis management, and such conduct should be extended to cope with non-economic emergencies as well.¹⁶⁴

It is widely argued that as the two great powers in East Asia, China and Japan have inevitable responsibilities to ensure that their behaviour benefits not only their own nations, but that it also facilitates wider regional prosperity and stability. Energy security has undoubtedly become one of the top priorities for the governments of China and Japan, but such security should never be

¹⁶³ *Financial Times*, 26 Oct 2004; for details of the fishery agreement, see Zhiguo Gao and Jilu Wu, *Key Issues in the East China Sea: A Status Report and Recommended Approaches*, Asia Program, Woodrow Wilson International Center for Scholars, Washington, DC, pp. 32–36.

¹⁶⁴ On 30 January 2008, the Japanese media reported that Chinese-made dumplings had poisoned 10 people in Japan, and investigators later found insecticide on the outside of six bags containing the dumplings. The event caused a food-safety scare in Japan about Chinese food products. But the two governments have worked collaboratively ever since to find the source of the contamination. Proposals on the establishment of a joint mechanism for food-safety have also been discussed to ensure a healthy development of the bilateral economic relationship.

achieved at the risk of regional peace and stability. Time is necessary for China and Japan to settle their dispute over East China Sea gas exploration peacefully; but more importantly, political courage and wisdom from the two leaderships are required in order to reach a compromise solution that is agreeable to both sides. East Asia can only become peaceful and prosperous if China and Japan play a positive and constructive role in the region, based on mutual trust and involving less power politics in their thinking. The three cases covered here serve as an ample reminder of the need for sensitivity and mutual respect when these two neighbours engage each other.

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The Japan Times

Washington Post

Xinhua News Agency (Xinhua)

Yomiuri shimbun

Zhongguo Tongxun She (ZTS) (HK)

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