

Roadmap of China's Energy Security Strategy in Context of New Silk Road Initiative: Legal and Policy Implication from ECT and NAFTA

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ABSTRACT

Given that China is the second largest oil consumer in the world and its oil demand is set to rise rapidly in the coming decades, it raised great concern regarding its national energy security. Chinese President Xi Jinping's foreign policy agenda proposed the New Silk Road Economic Belt and 21st Century Maritime Silk Road (New Silk Road Initiative) in 2013, one of which drivers focus on energy area. For the sake of national energy security, like its counterpart EU and US in their regional practice through the Energy Charter Treaty (ECT) and the North American Free Trade Agreement (NAFTA) respectively, China will move into Europe and other Asia countries' energy sector for opportunities of trade and investment by means of "New Silk Road Initiative". This article attempts to review China's energy sector situation and exam how the European Union and its counterpart the United State design their pillar of policy and legal instruments to achieve regional or trans-border energy trade and investment, by which some implications is proposed to China to design its roadmap of external energy strategy from the perspective of policy and legal framework.

Keywords: China, Energy Security, New Silk Road Initiative, ECT, NAFTA

1. Introduction

China's rapid economic growth has led to a substantial increase in fossil fuel imports, which has raised great concern regarding its national energy security and economic sustainability. Because China depends on limited international energy suppliers, this situation urges China's policy makers to focus more on internal and external energy policy reform regarding the critical issue of energy security. Given that China is already the second largest oil consumer and its oil use is set to rise rapidly, China needs to continue to diversify its deployment of energy sources from regional and international energy supplies as it has aggressively pursued during the period of current financial crisis. The New Silk Road Initiatives unveiled by Xi Jinping in 2013 were regarded as international economic and diplomatic policy of Beijing's emerging effort to deepen institutional reform, improve and stimulate internal economic growth and development along its geographic periphery. These initiatives were also seen as part of an overall Chinese attempt to "leverage China's growing political and economic power and influence (along its periphery) in order to strengthen and expand energy cooperative interactions, create an integrated energy market of mutually beneficially economic and industrial connection, and ultimately lower price volatility and enhance a sense of common security in energy area. In the field of regional energy market, China and other neighboring countries had made various efforts to strengthen regional energy trade and investment links through different political or economic forum, not in the sense of international law however.

The EU and U.S. is increasingly considered to be emerging successor as a very powerful player in international energy market over the past decade, such a rising prospect depends, among other variables, on their future energy security in the context of policy framework and legal constitution sustained with regime of the ECT and NAFTA respectively. There is no denying that their bilateral and multilateral efforts have been going on at both regional and sub-regional levels to develop energy co-operation. The question that is critically posed to China is whether the ECT and the NAFTA could provide a good model for a prospective policy and legal regime for its new policy of "the New Silk Road Economic Belt and 21st Century Maritime Silk Road" in context of the Asian region as a whole. It is surprising that, although there are lots of scholarly writings on the legal and policy aspects of regional energy co-operation from the European and U.S. perspective, it still seems to be a marked absence of literature on the question of the suitability of transplantation of lessons to China from the ECT and NAFTA in the context of energy co-operation in the Asia region. This article will first review China's energy market circumstances internally and externally; and secondly analyze the NAFTA and the ECT comparatively from the perspective of international law and

regional policy. The article will be concluded with some legal and policy implications for China for achieving national energy securities in context of New Silk Road Initiative.

2. Energy Situation in China: emerging security issue

Although China's efforts to seek development and production of fossil energy will be insufficient to backfill and satisfy internal demand due to the dwindling resource base, the degree to which efforts at energy savings and the development of alternative energy will meaningfully contribute to satisfying demand, additionally, primary energy will depend largely upon private sector innovation and government policy choices. However all those efforts can not change the situation that China's demand for conventional oil and gas is projected to grow together with the sustainable growth of its economy. China's energy security increasingly relies on imported oil and gas, and consequently China must develop and expand its capability to protect its national energy security interests beyond its national borders. Therefore, energy security may be meaningfully analyzed within a global, value chain informed perspective that links energy, economic growth, and political power at the national and the international level in the context of New Silk Road Initiative.

2.1 Sector Situation: market perspective

Within the last twenty years, China has become dependent on import of coal, oil and natural gas. China will remain dependent upon imports from lower-cost conventional oil and gas reserves in North Africa, the Middle East and the former Soviet Union in coming decades as well. Especially oil is now regarded as an economic and a security concern by the Chinese regime and key international stakeholders. Until 2035, China will account for one fourth of the global net growth in global gas consumption and more than half of the net growth in oil consumption. The future demand cannot be covered by China's own conventional and unconventional energy sources. As China's economy moves from dependence on energy intensive industrial manufacturing to services, the transportation sector becomes the most significant source of growth in liquid fuels use, and China's liquid fuels consumption more than doubles from its 2010 level. In the reference case, China will replace the United States as the world's largest consumer of liquid fuels by 2035 (International Energy Outlook 2014, World Petroleum and Other Liquid Fuels, U.S. Energy Information Administration). On the other hand, China's proven reserves of natural gas are estimated to cover consumption for 26 years based on consumption level in 2010. What is worse, the domestic oil resources are even more strained, the national proven reserves are only expected to cover China's consumption for five years. To solve the energy shortage situation, considerable infrastructure investments in the form of drilling equipment, pipelines, and refineries are needed to extract and process these resources. Although China had expanded the national infrastructure for extraction of oil and gas constantly over past decades, the reality is that the nation became a net importer of oil already in 1993 and of natural gas in 2007. By 2035, China will account for nearly 20 percent of the world net trade of natural gas (Liquefied Natural Gas and pipeline), which is a sharp increase from only 4 percent in 2011. China's share of the global net trade of oil will increase significantly, from 14 percent in 2011 to 24 percent in 2035 (IEA, 2013).

2.2 Trans-border practice: Maritime Silk Road

In China's internal policy and legislative context, the quest for energy has translated into a diversification strategy based on a wide mix of traditional and renewable energy types, ranging from coal, oil and gas, to nuclear, hydro-electric, and renewables. Given its growing reliance on oil and gas imports, Chinese national oil companies (NOCs), with the encouragement and support of the government, have also taken to securing multiple transportation modes and routes, and sources of oil and gas supplies. The importance of the sea lines of communication (SLOCs) for China has greatly increased as it opened up to the world economy since the open-door policy of the late 1970s. As an export-oriented economy with increasing energy demands, which can only be met substantially through imports, China's survival and prosperity is closely tied to the seaborne trade. Today, Chinese NOCs have assets across the world in the Middle East, Africa, North America, Latin America and Asia, and China relies on seaborne deliveries for much of its oil and increasingly, natural gas, as well as coal. As the majority of China's seaborne energy imports transit through the Indian Ocean region and the South China Sea, Beijing is aware of the strategic importance of these western SLOCs to its energy security.

3. EU's Energy Security Approach: the ECT

In today's volatile fuel market, the issue of energy security is increasingly proving to be of great concern for both developed and developing countries. Energy security is best understood as the continuous assurance of an adequate, reliable supply of energy at a reasonable cost at any given moment of time in the short and long run. Because EU energy demand increases every year along with import dependency on fossil fuels, to relieve such emerging situation, the ECT needs to be seen today as one of the best available instruments for improving regional energy security. There is much at stake for EU as far as energy cooperation in the neighborhood is concerned. EU's efforts have been going on over energy issues in recent years at both regional and intra-regional levels.

3.1 Strategic Philosophy of ECT

The ECT (1994) is the first multilateral treaty for liberalization of trade and investment in the field of energy sector. One observer has expressed the view that it is "the latest and most ambitious multilateral treaty to date." As a regional effort, the ECT has established a legal regime for such energy cooperation between States at the intra-regional level. Furthermore, the ECT as a sectoral treaty, the first of its kind has added a new dimension to international economic law by regulating in the same document both the liberalization of foreign investment and international trade in energy. As of September 2002, the ECT comprises fifty-one European and non-European Member States which have now signed or acceded to the Treaty. The countries include Western and Central Europe, Russia and the Commonwealth of Independent States countries, Japan, Mongolia and Australia. The ECT is internationally unique in that it covers states at various levels of economic development and from different regions, such as Europe, the former Soviet Union and the Asia-Pacific, and it also covers a wide range of issues that concern liberalization of trade and investment in the energy sector. The main purpose behind the ECT was to ensure energy security in the constituency and thereby economic growth, prosperity and development in the countries concerned.

3.2 Pillar Arrangement: transit flows of energy

To secure the stable and predictable energy trade within treaty members, the ECT's Article 7 is provided to deal with the issue of transit and aims at establishing a multilateral framework of rules governing transit flows of energy. Based on the principles of 'freedom of transit' and 'non-discrimination' enshrined in General Agreement on Tariffs and Trade (GATT) 1947. The objective of the Article 7 was to establish an effective regime for the secure flow of energy via existing and future cross-border transit infrastructures. The Article 7 has a number of provisions that deal with the security of transit flows. For instance, the interruption or reduction of existing transit flows in view of a dispute over transit is prohibited. The primary responsibility of the transit contracting party is to facilitate the energy transit. Other provisions deal with the upgrading of infrastructure or the creation of new one. Transit is understood as through-transit, meaning the carriage of energy materials and products across the area (territory) of a contracting party. The ECT constituency felt that general principles of free movement of transit needed further elaboration. Therefore, the idea of a specific protocol to develop the Article 7 appeared shortly after the negotiations of the 1994 ECT. There was a shared view that common rules on energy transit need to respect a balance of interest between gas producers, consumers and transit countries. By 2003, the drafting and negotiation process was effectively concluded and all delegations agreed on almost all provisions of the Draft Transit Protocol.

4. US's Energy Security Approach: regionalism

As energy sector is one of the most sensitive sectors to any nation, original NAFTA negotiations saw few realizations of the ambitious expectations about energy trade among US, Canada and Mexico. Especially, in the Free Trade Agreement (FTA) energy negotiation, there was relatively little effort to achieve harmonization of domestic energy laws into one trilateral arrangement in the region, partly because of Canadian sensitivities but mostly because of the formidable presence of both energy economic regulation and energy monopoly power, and the tremendous variation of that combination in each country as well.

4.1 Rules of Harmonization of Energy Trade and Investment

Notably, in terms of regulatory laws varieties in each country's energy market, it was true of the antitrust/competition rules. In the energy area in the FTA, there was only some very minor tinkering with three quite discrete areas of domestic policies that directly affected cross-border trade. Generally, however, each country holds the opinion that their current regulatory framework were consistent with the FTA if implemented properly, and all counterparts were very conscious that most of the challenge would lie in effective implementation. Moreover, the exercise in the FTA to ensure that domestic laws did not directly undermine the energy trade rules which was limited to the local government of each state. For instance, there was no systematic effort even to identify specific problem concerning regulatory laws or industry policies in the fifty United States and ten Canadian provinces, a task that possibly would have been a great barrier to the energy negotiators. The question of consistency of these laws with the FTA was left to the implementation stage. The basic approach of the FTA thus was to let each nation work out its own relationship between competition, regulation, and state ownership, and then to attempt to superimpose upon this differentiated regime overarching general rules for trading goods, mostly based on the General Agreement on Tariffs and Trade ("GATT") rules.

4.2 The principles governing the Energy Chapter in NAFTA

The principles governing the Energy Chapter are set forth in Article 601 of NAFTA. The first of these requires the parties to "confirm their full respect for their constitutions." This pays homage to the Mexican insistence at the outset of the negotiations that NAFTA should not impinge upon basic energy principles in the Mexican Constitution, such as the right of the Mexican State to reserve certain activities to itself. This does not, however, legitimize the monopoly status of its domestic energy monopolists including PEMEX and CFE as such. This was conceded in principle early in the negotiations. There is considerable room for interpretation, however, as to the actual scope of the monopoly required by the Mexican Constitution and as to what activities it may engage in, evident from the relative flexibility with which the Mexicans had already adjusted the parameters of those monopolies. Regarding the U.S., whatever its views on the issue, US urged all the parties to recognize the importance of having "viable and internationally competitive energy and petrochemical sectors." This would seem to suggest going far beyond normal trade rules. A commitment to enhance international competitiveness of a country's sector might require a good deal more than free trade rules and could have very little to do with free trade. U.S. negotiators have characterized this language as a horatory statement of the obvious. In essence, the Energy Chapter of NAFTA follows the FTA quite closely with respect to the basic trade rules.

5. Implication to China

The New Silk Road Initiatives will be beneficial for enduring supply of domestic energy sources, and also for transferring energy sectors in overcapacity from the eastern China to the central and western regions and to countries on China's periphery, and more importantly, it will effectively promote the diversification of the energy sources and further promote China's external energy cooperation through energy regionalism and rule harmonization.

5.1 Asian Regionalism: the first footstep for national energy security

An individual country is quite unable to face such an energy challenge on its own, which is why EU and U.S. should act concertedly in the present interdependent world to respond to their common problems in their own region. Co-operation among regional countries on the matters of energy security appears to be of great significance in common interest. Globally, efforts have been going on in recent years at both regional and intra-regional levels. To achieve Chinese energy strategy goals in context of New Silk Road Initiative, China's first step is to adopt Asian regionalism in energy sector. In area of energy trade, APEC or other form of regional co-operation seems to have become a laboratory where different tests of regionalism have been carried out, yet its energy regionalism still remains at a rudimentary stage in many respects. Regionalism in the Asia region does not, in fact, fit in with the traditional concept as may be found in the ETC and the NAFTA. Despite the lack of commonality in culture, religion, historical experience, political and economic

linkages across the wider Asian region, which are characteristically considered ingredients of regionalism, regional energy co-operation is being attempted as a matter of strategic need or economic pragmatism. This is what gives regionalism there its dynamism. China should recognize that regionalization has increasingly proven an effective vehicle for globalization. Looking back the past movement toward energy globalization, the liberalization of energy trade and investment is becoming more and more regionalized. In reality, regionalism is more of a strategy than the result of common cultural, historical and political ties among Asian countries. In the process of “the New Silk Road Initiatives” deployment, China will face the tremendous challenge that the Asian region as a whole, faces the growing regionalism in different forms in Europe or the North America.

5.2 Integrated Asian energy community

China will also use its growing political, diplomatic resources as a leverage when it comes to further developing the “rules of the game” to deploy its external energy strategy. To China, the need for rule leveraging to achieve an integrated energy community in Asia will be a key emerging priority. The Chinese government has more engagement closely with its Asian counterparts to adopt the best international practices, in terms of energy trans-border trade, investment and related industries’ competition issues. Currently, China is trying to secure supplies and stability in the region by stepping up its general as well as its energy diplomacy, unfortunately not in level of international law however. Therefore, China should accept the fact there is a continuous need for constitution of fair and more transparent rules to materialize the existing energy policy of “New Silk Road Initiatives” by means of achieving integrated energy community. In the field of Asian energy market integration, China should play an active role in institutionalizing the activities of energy trade and investment. It has to be recognized that there happens to be a growing sense of common interest and co-operation for regional energy trade. To achieve an integrated energy community, the cooperation priorities are sector-regulation coordination, facilities connectivity, unimpeded trade, capacity management integration. Specifically, energy regulation coordination aims to promote intergovernmental cooperation between China and its counterparts, facilities connectivity concerns the energy transmit and energy infrastructure investment. Ultimately, by creating energy community mechanisms for comparability and cooperation, both insecurity and market volatility can be reduced for the integrated energy community in Asian region.

5.3 Asian common electricity market: a pilot program for New Silk Road Initiative

It is internationally recognized that EU and U.S. experiencing energy crisis share one commonality, deregulated its national electricity market, which made interconnections with neighboring countries possible and have started a liberalization process of electricity market. There also appears to be an increasing demand for regional integration in the liberalization of electricity market, so that Asian region as a whole can compete with liberal regimes elsewhere and also can maintain its continued economic growth and prosperity. Furthermore, Electricity transit through the power grids across the boundaries of nations is vital for future energy security and economic development for all Asian countries. To achieve the goal, China needs more various feasibility studies on regional electricity transit from both industrial and legal perspective. Another important goal to construct an Asian common electricity market is that, China will be urged to reform its internal electricity utility regulation and sector policy in context of regional trade and sector competition. Recognizing resource depletion and embarking upon replacing a portion of its coal, gas and oil consumption with alternative energy sources such as solar photovoltaics, solar thermal, wind, wave power, geothermal and biofuels, and introducing new competitors in a market mechanisms, China and other countries’ domestic electricity markets and monopolists will be progressively reformed, matured and opened to their borders to a broader degree of competition regionally and internationally. As a consequence, China’s non-liberal electricity markets will slowly integrate into regional markets across the globe. The effect of liberalization and increased interconnection has not only led to an increased competition among each country, but a new reality of regional integrated electricity markets can produce benefits of its own players. In particular to China, such an integrated electricity market at the regional level of Asia can improve China’s internal efficiency and security of supply, reduce the cost of energy production and thereby accelerate reduction in electricity prices. Moreover, due to increased competition from external producers, integrated electricity markets at region could increase sector standardization and could assist to reduce carbon emissions too.

6. Conclusion

Due to energy product' limited mobility, its sensitivity at the heart of governmental policies and its power as the engine of the sustainable economy, security in energy is placed in privileged status in New Silk Road Initiative. The ECT and NAFTA could provide a good model for a prospective energy regime for China's New Silk Road Initiative in context of the Asia region as a whole. For China's sake, energy sector appears to need some supra national regulation or other harmonized instruments. It is therefore highly probable that China will continue to be a constructive player when it comes to safeguarding and developing the regional and global energy markets and their governance. Hopefully, China shall follow the roadmap experienced by EU and U.S. to deploy its external energy policy most likely by means of "the rules of the game" in regional energy markets and promote all regional counterparts with common interest to constitute and maintain the legal arrangements to fairly participate and compete in Asian energy community.

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[Author' Background](#)



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