



After Action Report

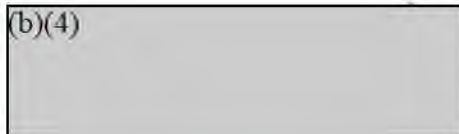
**ENERGY FUTURES IN ASIA
SEMINAR**



**Director, Net Assessment,
Office of the Secretary of Defense**

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(b)(4)



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OVERVIEW

The 26 March 2007 *Energy Futures in Asia* seminar was part of a broader effort conducted by Booz Allen Hamilton for the Director, Office of Net Assessment, Office of the Secretary of Defense (OSD/NA) to understand drivers and trends shaping the future energy strategies of China and India and the foreign policy implications of these strategies. The seminar brought together government participants and outside experts on energy issues pertaining to China and India, the energy market and industry, and strategic futures to examine the energy strategies of China and India and how they could precipitate cooperation or competition between these two countries over the next two decades. (b)(6)

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The seminar began with scene-setting presentations that characterized China's and India's energy strategies and examined how these two countries might be thinking about future energy security requirements. (The scene-setting presentations are included as Appendices B and C.) Participants then identified the key drivers of two alternative worlds for Sino-Indian energy relations: competition and cooperation. The report that follows provides a brief summation of the key insights and findings of the seminar.

CHARACTERIZING THE ENERGY STRATEGIES OF CHINA AND INDIA

CHINA

The primary objective driving China's energy policy is to secure adequate energy supplies at reasonable prices to meet its growing domestic needs. China is currently more than 90 percent self-sufficient due largely to its considerable coal resources and a coal-based economy but is developing a growing dependence on imported energy, particularly oil. China's energy policy is also driven by the secondary interest of expanding China's global influence. To achieve these objectives, China is pursuing a multi-tiered strategy of diversifying its energy imports, acquiring energy assets abroad, and leveraging energy diplomacy to meet its interests.

Diversification. The Chinese Government views diversification of energy imports as essential to its supply security. In particular, Beijing is seeking to diversify its energy imports away from the Persian Gulf and to decrease its reliance on sea lines of communications (SLOC) through which roughly 90 percent of the country's crude oil imports currently pass. Chinese energy companies are pursuing oil pipeline projects, most notably in Kazakhstan and Russia, to help fulfill both goals. The government also has expanded its efforts to other continents, as demonstrated by the doubling of crude oil imports from Africa between 1995 and 2005.

Acquiring Assets Abroad. China's commitment to acquiring energy assets from regions such as Central Asia, West Africa, and Latin America dovetails with both national and corporate objectives. In addition to seeking profits, China's national oil companies (NOC) aim to replenish and grow their reserves through the addition of overseas assets. Currently,

of China's three major NOCs¹, China National Petroleum Company (CNPC) holds the large majority of overseas equity assets. Each Chinese NOC pursues an independent overseas investment strategy, as there is little incentive for coordination among them. For the government's part, the Chinese Communist Party (CCP) believes that the acquisition of assets abroad is a prerequisite for Chinese companies to be recognized as world-class firms with international prestige.

Energy Diplomacy. The final key component of China's energy strategy is the use of energy diplomacy to facilitate good relations, trade, and investment with energy exporters. This is consistent with China's broader goal of fostering a global environment open to China's rise to great-power status. Beijing works toward this end by providing both political and financial support to its diplomatic endeavors. On the political side, China attends summit meetings with leaders of oil-exporting states, in part to convey the importance of those relationships to Beijing, and uses its membership in international organizations to protect its NOCs. Financially, China provides concessionary loans to NOCs for specific acquisitions, grants low- and no-interest loans to host governments, and even invests in non-oil infrastructure projects within target host countries.

Shifting Policy Trends. Beijing continues to utilize its political and financial resources to assist its energy firms in gaining investment and trade opportunities. However, China's growing energy demand has signaled a shift in power away from the central government into the hands of the NOCs, who are increasingly making their own decisions about where to invest. Participants believed that the interplay between the CCP and the NOCs would increasingly evince friction at home and cooperation abroad as China continues to seek access to energy resources around the world.

INDIA

The Indian Government's energy priorities are three-fold: to ensure energy affordability, sufficient supply, and supply diversity. India recognizes that it needs to acquire supplies at affordable prices and protect itself from price fluctuations while also securing a sufficient quantity of supplies to sustain its growing economy. By seeking to diversify its fuel consumption and supply, India hopes to limit its dependence on any one region and reduce the risk of disruption.

External and Internal Dimensions of India's Energy Policies. The Indian Government pursues these three key priorities through both external and internal means. Internally, India uses competition and new policies to attract foreign investment and reform energy production, distribution, and consumption at home. Externally, India uses a range of diplomatic and commercial approaches to engage in commercial energy deals overseas and build a portfolio of equity oil investments around the world. Participants noted that the Indian Government largely controls the internal dimensions of energy policy but remains on the margins with respect to direction or regulation of external energy policy.

¹ China's three major national oil companies are Chinese National Petroleum Company (CNPC), China National Offshore Oil Corporation (CNOOC), and China Petroleum & Chemical Corporation (Sinopec).

Internal Policies. India's government under Prime Minister Manmohan Singh is focused on implementing a wide array of domestic reforms, including price reforms and liberalization policies, efficiency standards to improve demand-side management, and the establishment of a strategic petroleum reserve. In addition, the government is investing in a range of alternative energy sources, with an emphasis on nuclear power and renewable sources such as hydropower and wind.

External Policies. India established international subsidiaries to enhance the reputations and capabilities of its state-owned energy companies. For example, the Oil and Natural Gas Corporation (ONGC) is using its subsidiary, ONGC Videsh, Ltd. (OVL), to build an international presence and to serve as the primary vehicle for acquiring energy assets abroad. OVL and other Indian companies, including commercial firms like Reliance, are forging business alliances with other national or private oil companies to gain presence in new markets. Indian energy companies are also leveraging the commercial and political relationships of international Indian companies in other sectors. For example, OVL and an Indian international steel conglomerate, Mittal, coordinated strategies in Nigeria, Kazakhstan, and Angola. In addition, the Ministry of External Affairs and Ministry of Petroleum and Natural Gas play a small role in supporting energy companies by providing information on political risk factors associated with energy investments and assisting with negotiations of terms for projects such as regional gas pipelines.

Lack of Integrated Energy Policy. Despite these efforts, India's energy policies have not been integrated into or operationalized as a coherent energy strategy, nor have they been integrated into its broader national security strategy. Even so, ad hoc pursuit of energy opportunities has facilitated achievement of other strategic priorities. For instance, many Indians credit the civilian nuclear energy deal between India and the United States with facilitating a deeper strategic partnership with the United States and transforming India's status in the international community. Likewise, pipeline negotiations with Iran can serve as a political maneuver to demonstrate Delhi's political independence from the United States without committing to future actions.

"STRATEGY" IS A MISNOMER

Participants agreed that using the term "strategy" to describe the approaches of China and India to energy security is a misnomer. Instead, each state's energy-related activities should be characterized as collections of ideas, goals, and policies rather than as one grand vision on which all domestic stakeholders have reached consensus and are operating with a common purpose. However, leaders in both countries associate energy security with national security; thus, both countries are seeking to formulate some sort of integrated energy policy. For example, India's Planning Commission published a comprehensive report in August 2006 at the direction of the prime minister entitled, *Integrated Energy Policy: Report by the Expert Committee*, which outlined an integrated vision for India's energy policies. However, the Planning Commission has no authority over the eight ministries with stakes in energy policymaking, let alone India's 28 state governments. Without advocates at the ministerial level to lobby for implementation of the report's recommendations, the transition of "vision" into policy is unlikely.

MOTIVATIONS OF CHINESE AND INDIAN ENERGY COMPANIES

Investment decisions of Chinese and Indian energy companies seek to fulfill three goals:

- To make sound commercial investments that yield profit
- To diversify energy suppliers
- To establish/increase status as international competitors.

Commercial Incentives. NOCs in both countries are driven primarily by commercial incentives in their investment decisions rather than by government direction. Participants noted, however, that the communist structure of China's government implicitly requires decisionmakers in these companies to balance party, state, and commercial interests if they hope to advance in their positions. Still, seminar participants pointed to cases in which Chinese companies have lobbied the government or even operated counter to its guidance to pursue what they believed to be the most commercially viable opportunities. Likewise, OVL executives have claimed that their overseas investments are based on sound economic analysis, not directives from the Indian Government.

Supplier Diversification. Chinese and Indian companies are wary of the volatile political environment in the Middle East and are seeking to diversify their energy sources away from this region. To this end, these companies are pursuing energy investments all across the globe in areas such as Russia, Central Asia, Africa, and even Latin America. Diversification of energy sources helps reduce dependence on one particular region and hedge against the risk of supply disruption in the Middle East. However, participants also noted that investments in production in Latin America and Africa are equally or even more vulnerable to transportation disruptions on the high seas. Moreover, these investments, unless they include an exclusive supply agreement, do little to insulate China or India from price spikes in the international market.

Increased International Competitiveness. Chinese and Indian energy companies have faced criticism or skepticism because of their decisions to invest in certain "pariah" states, such as Sudan or Burma, who generally have been isolated from the international community. China and India, however, are latecomers to the international energy game; thus, they are compelled to look for investment opportunities where they do not have to compete directly with the Western international oil companies (IOCs). These opportunities have tended to exist in states such as Sudan, Burma, and Iran, where IOCs are not active due to sanctions or public pressure. However, Chinese and Indian companies are increasingly leveraging the experience they have developed in these states to take more active and competitive positions in mainstream energy supplier states such as Kazakhstan, Venezuela, Angola, and Nigeria.

EVALUATING THE STRATEGY OF OVERSEAS EQUITY

China and India have both identified the purchase of equity energy stakes overseas as one of the key components of their energy policies for the foreseeable future. Participants openly criticized this approach because physical ownership of energy assets does not guarantee security of these supplies: resources from abroad must be transported back to both countries, which requires shipping them via key sealanes or pipelines.

Security of overseas oil is currently assured by the presence of the U.S. Navy, with the Indian, Indonesian, Malaysian, and Japanese navies playing lesser roles in the Indian Ocean, along the Strait of Malacca, and in the East China Sea, respectively. Nevertheless, strategic positioning of these powers in the future is a key uncertainty. Consequently, China and India cannot assume that the searoutes will always remain secure transit routes. Indian and Chinese experts, however, assured participants that both countries are aware of these transport vulnerabilities. India seems to be covering its bases through the use of swap deals to avoid these routes, while China is pursuing efforts to build overland pipelines from Kazakhstan and Russia and discussing the prospect of a pipeline with Burma.

Pipelines are generally considered to be a more secure method for transporting energy than shipping. They are also more cost-effective and commercially viable as long as there is enough oil or natural gas to fill them. However, participants observed that China's current pipeline projects would not provide sufficient supplies to substantially reduce China's dependence on seaborne energy supplies from Africa and the Middle East. India seeks to diversify its energy supplies by building natural gas pipelines from Iran, Burma/Bangladesh, and possibly Central Asia, but participants remained unconvinced that any of these pipelines will ever be built.

ENERGY INTERESTS OF INDIA AND CHINA: COMPLEMENTARY OR CONFLICTING?

Participants identified several ways that the energy interests of China and India could converge or diverge. In general, they anticipated that interests on the demand side would offer greater opportunities for cooperation than those on the supply side, which they believed would be more likely to create a pretext for competition. However, participants recognized that several shared interests could, under the right circumstances, lead both countries to cooperate on the supply side.

Complementary Interests. On the demand side, China and India have common interests in increasing efficiency and developing and boosting the use of alternative fuel sources. Both countries realize that their dependence on energy imports presents a vulnerability that could disrupt their energy supplies, thereby impeding the sustainability of their high economic growth rates. They also share an interest in reducing the adverse environmental impact of this economic growth and of their burgeoning populations, both of which add to energy demand. Participants believed that China and India could cooperate to share clean energy technologies, jointly develop alternative fuels, set efficiency goals, and implement international environmental recommendations.

On the supply side, China and India realize that their competitive bidding for overseas benefits supplier country by driving up prices. Thus, China and India are establishing joint ventures to bid collectively on these assets in places such as Syria. Both countries also share an interest in acquiring assets in places where they face little competition from other energy companies. However, these assets tend to be located in states that are under sanctions or isolated by Western governments. In such cases, China and India could provide mutual political coverage as they pursue investments in "pariah" states.

Conflicting Interests. Indian and Chinese energy interests could become divergent if these countries view the world's available resources as insufficient to meet world demand. Under these circumstances, China and India would perceive energy acquisitions as a zero-sum game in which China's gain is India's loss and vice versa. These divergent interests reflect in the companies' continued competition for resources in Kazakhstan and Burma. While they may be willing to partner in Syria or Colombia where they need each other to turn up business and deflect criticism from the United States, they have no interest in partnering in Kazakhstan or Burma where both compete for finite stores of influence and resources.

PERCEPTIONS AND DRIVERS OF SINO-INDIAN COOPERATION OR COMPETITION

Participants discussed at length how cooperative or competitive environments could emerge for China and India with respect to energy. They identified political and economic drivers of both environments and then described pathways to two alternative worlds: one characterized by cooperation and the other by competition. Participants agreed that energy by itself would not be a key driver of these alternative futures. Instead, the overarching drivers of both scenarios would be 1) how countries, particularly China and India, perceive themselves and each other, and 2) the actions, role, and presence of the United States in the future. Participants concluded that opportunities for conflict are greater than those for cooperation in terms of supply but that cooperation could be achieved on the demand side by pursuing mutual interests.

PERCEPTIONS AS AN OVERARCHING DRIVER OF ALTERNATIVE WORLDS

Participants concluded that Chinese and Indian perceptions of themselves and each other in regional and international systems would play a primary role in determining whether these countries would cooperate on or compete for energy in the future. Perceptions shape how China and India view their own strengths and vulnerabilities and how they might respond to developments in the energy markets and the strategic environment writ large.

Chinese Perceptions. China's winning bids against India for key assets in Angola, Russia, and Kazakhstan have strengthened China's perception that India does not have a competitive advantage in the international energy market. As a result, China is not concerned that India will become a threat to China's plans for acquiring equity energy abroad. However, China views energy as a strategic resource that is vulnerable to outside manipulation, particularly by the United States, in a potential conflict scenario. Participants surmised that China does yet not feel militarily prepared to assert its strategic interests in a way that would counter the United States. Over the next 10-15 years, however, as China builds a robust military and out-of-area capability and gains confidence in its status as a great power, participants anticipated that China would adopt a more visible posture along the SLOCs and develop the ability to defend their energy supplies. In this context, increasing Indo-U.S. energy and military cooperation causes China to view India as a strategic competitor.

Indian Perceptions. India recognizes China's competitive advantage in the energy sector and pays particular attention to Chinese energy and infrastructure investment activities around the world, particularly in the Indian Ocean region. Indians perceive increasing Chinese economic and diplomatic efforts in the Indian Ocean littoral states as encroachment into their strategic neighborhood. Participants noted that Burma, with its recent announcements that the Burmese Government might support the construction of a gas pipeline to China, is a new source of concern about growing Chinese influence in the Indian Ocean region. Moreover, recent Chinese incursions into the East China Sea could play into Indian fears that China is seeking to gain not only energy assets but also regional preeminence.

THE UNITED STATES AS A KEY DRIVER OF THE FUTURE SECURITY ENVIRONMENT

Participants agreed that the United States plays a key role in determining what type of environment will emerge between China and India, and in the international energy market more broadly. The supremacy of U.S. economic and naval power currently provides a hedge against many of the risks associated with securing access to energy through the international market. Participants speculated that a diminished presence or role for the United States might lead to increased volatility in energy markets and increased instability, or the perception of instability, in Asia. Without the U.S. naval presence in East Asia, Japan and India would likely perceive that a Chinese invasion of Taiwan were imminent. If successful, such an invasion would significantly enhance China's positioning along the South China Sea. For its part, China could become more wary that a resurgent Japan would interfere with China's own ambitions of regional dominance.

DRIVERS OF COOPERATION

Seminar participants posited that China, India, and other Asian actors could find opportunities to cooperate in areas associated with the demand side of the market. They suggested the following ways in which countries could work together to achieve mutual interests in reducing the demand for hydrocarbons:

- **Hydrocarbon Demand Reduction.** China and India share mutual interests in reducing energy demand to achieve greater economic growth, lessen dependence on sources from volatile regions, and comply with international environmental standards.
- **Increased Efficiency.** China and India could form a coalition to collectively identify an acceptable goal for energy efficiency and identify methods to reach this goal.
- **Alternative Fuels Development/Usage.** Opportunities exist for China and India to share information and technology, using joint resources to develop alternative energy sources such as biofuels and exploring the benefits of processes such as cellulosis.

Participants believed that cooperation between China and India would occur only under certain conditions. First, both countries would have to feel that they were operating on their own terms, rather than bowing to unilateral or multilateral pressure. For example, China would not accept any offer in which it perceived that India was colluding with the United States to contain its behavior. Second, each must perceive that they are seeing equal benefits as a result of cooperation. Finally, cooperation would need to be based on a long-term, equitable arrangement rather than a short-lived marriage of convenience.

DOMESTIC CHANGE IN CHINA: PATHWAY TO COOPERATION

Some participants advised against "straightlining" China, or extrapolating China's future domestic environment according to current trends. These participants offered an optimistic scenario for energy cooperation, even on the supply side, in which a China with different national objectives and a strong relationship with the United States assumes a responsible stake in the international energy market. Under these circumstances, the United States and China would share similar economic interests; moreover, China would not be operating under the constant assumption that the United States was pursuing a strategy of containment. Participants who described this scenario admitted, though, that achieving it would require "massive internal change in China."

DRIVERS OF COMPETITION

Participants identified two categories of drivers that would precipitate energy competition between China and India: geostrategic or geopolitical drivers, and market-based drivers. Energy security factors into Chinese strategic thinking, and to a lesser extent in Indian thinking, both as a lever of influence and as a vulnerability that can be exploited. Moreover, any overlap of these drivers—for example, political rivalries or instability in the context of a tight, volatile market—could lead to fierce competition among all actors.

Geostrategic/Geopolitical Drivers. Changes in the global geopolitical or economic regime could create a context that magnifies one or both country's vulnerabilities, heightens existing bilateral tensions, or revives dormant ones. Participants suggested the following examples:

- *Deteriorating Sino-U.S. relations.* A serious breakdown in Sino-U.S. relations in the next 10-15 years has important consequences for how China responds to its perceived vulnerabilities. Moreover, it provides India and other countries with opportunities to exploit these vulnerabilities to their advantage.
- *Contingencies in Asia that involve only one country but have serious implications for both.* Conflict in the Taiwan Strait or between China and Japan would have consequences for both China and India. Chinese actions to tighten its economy, integrate with East Asia to form a co-prosperity sphere, or pursue a Sino-Arab alliance driven by mutual interests could seriously alarm India and increase its perception of Chinese aims for regional dominance.
- *Contingencies in Asia involving neither China nor India but having implications for one or both countries.* Civil unrest or political change in Russia could affect Russia's decisions about which potential investors (e.g., India or China) it allows to access its energy resources. Instability in Indonesia could threaten safe passage of oil and gas tankers through the Straits of Malacca, Sunda, and Lombok.
- *Bilateral Sino-Indian contingencies.* China and India have several unresolved border disputes, are directly competing in Burma for energy, and have disagreed about larger geopolitical issues such as China's relations with Pakistan.
- *Cataclysmic event in either country.* Wildcards in this category could include the bursting of the Chinese economic bubble or irredentism precipitated by success of separatist movements (e.g., the "Tamil Tigers").

- *General instability.* Participants believed that an event that upsets global stability could create the context for competition between China and India or among other actors. Some participants considered instability an unlikely driver of competition, with the exception of instability centered in the Middle East, which would have the maximum impact on energy markets. Participants cited unfavorable developments in the Middle East caused by regime changes, terrorism, or bungled policies of Western governments as general sources of instability.

Market-based Drivers. Participants speculated that competition could also arise if countries' access to future energy supplies came into question or if countries perceived that this would occur. The following drivers would contribute to this set of circumstances:

- *High prices.* High prices shift the advantage to producers, allowing them to demand more "side deals" as conditions for gaining access to supplies and play investor countries against each other. This kind of environment gives China a competitive advantage by enabling it to expand its diplomatic footprint because it has more resources available to meet increasing supplier demands. This context exacerbates tensions between China and other investor countries such as India when the two countries vie for the same resources. India and the IOCs cannot match China's ability to offer bundled investment and financial packages and incentives for supplier states.
- *Real or perceived market instability.* If Asian consumers and producers believe that the market no longer functions effectively, they could seek to form their own arrangements, which would further erode the effectiveness of the market and exacerbate this cycle. For example, China's offers of lucrative investment packages tied to bids for energy access distort the market's normal ability to match a commodity with the price that consumers are willing to pay. Moreover, participants speculated that proliferation of these kinds of activities could enable China to add or remove oil from the market. If market confidence is lost, countries would be scrambling to make deals with producers in a perceived zero-sum game characterized by nationalist energy policies, leading to competitive mercantilism. Due to the growing scarcity of attractive investment options, some participants argued that signs of competitive mercantilism are already visible.

ALTERNATIVE WORLDS OF COOPERATION OR COMPETITION

Participants identified several scenarios that could lead to cooperation or competition between China and India, and among China, India, and other actors in the region. The cooperation scenario posited dramatic changes in the oil market precipitated by a Shi'a resurgence in key supplier countries in the Middle East. The competition scenario depicted a world in which the oil market becomes "balkanized" for a variety of geopolitical reasons.

COOPERATION SCENARIO: SHI'A RESURGENCE

A resurgent Shi'a movement characterized by political unification across the Middle East under Iranian leadership could reshape the oil market by creating a huge bloc that controls resources in key supplier countries and shift the focus of energy security from transit to the source of supply. In this case, the world could see a "Nasser-like" scenario in which the Shi'a regime uses its control of the oil market to achieve ideological ends and play preferential politics. For example, Iran could cut off oil supplies or increase the prices for

any consumer that has a bilateral relationship with Israel. Participants believed that this scenario might provide the impetus for international cooperation because all actors outside the Shi'a regime would have converging interests in reestablishing a functioning international market.

Participants cautioned, however, that a collective dilemma would not necessarily yield a cooperative strategy. Power calculations or other domestic drivers could motivate China or some other country to seek preferential relationships with the Iranian regime. Higher oil prices might embolden Russia. Some participants believed that China could take advantage of this development to win favorable deals, particularly because its investment decisions are not guided by considerations about the nature of a country's governance or the character of its regime.

However, most participants agreed that China's long-term interests are more compatible with the United States. Astronomical oil prices and a severe downturn in the U.S. economy would have a doubly negative impact on the Chinese economy. Consequently, participants generally concluded that China would seek to be cooperative in this scenario but adopt a low profile and try to dissociate itself from the United States and India to avoid being perceived as anti-Muslim. Participants agreed that the most likely factor that would drive China to compete instead of cooperate would be a severe downturn in Sino-U.S. relations.

**GROWING INTERDEPENDENCIES DO
NOT NECESSARILY PRECLUDE
COMPETITION**

Some participants posited a scenario in which growing Sino-Indian trade drives bilateral energy cooperation. In their view, interdependencies raise the costs of conflict and give other countries stakes in the success of their economic partners. Other participants noted that thriving economic relations do not necessarily translate into cooperation in other sectors, explaining that trade "increases the cost of conflict but does not eliminate the prospect for conflict." For example, the United States and Japan maintain prosperous trade ties with China but continue to experience tensions in other areas of their relationships. Moreover, most participants believed that the current complementary nature of the Indian and Chinese economies in the context of the international market, could change in the future as these countries increasingly produce goods and services that overlap.

COMPETITION SCENARIO: BALKANIZATION OF THE OIL MARKET

Participants envisaged several economic or political events that might render the international energy market incapable of functioning, thereby precipitating a "balkanization" of the market in which actors would seek private arrangements between producers and consumers. Balkanization of the oil market would create an environment characterized by competition among China, India, and other key energy actors. Participants identified three pathways to this scenario:

- The first is U.S. withdrawal from its role as guarantor of Asian sealane security, whether by choice or because China has developed more formidable capabilities and has driven it out. In the absence of security guarantees, countries would scramble to make private arrangements in this "Hobbesian, self-help" world.

- The second pathway to competition is Chinese “hypermercantilism”—that is, China’s making spectacular long-term, strategic deals with energy producers in such a way as to discredit the market function; increase anxiety among other consumer countries, particularly India and Japan; or some combination of the two. This “psychological” market failure leads to a general loss of confidence in the market.
- The third pathway to balkanization is an economic collapse in China, which would also drive a loss of confidence in the demand side of the market: Persian Gulf countries need to have guaranteed markets, too. In any of these cases, countries would pursue their own independent policies to secure markets, further intensifying the failure of the market.

Participants did not envisage these pathways leading to any sort of tactical Sino-Indian cooperation; moreover, they predicted that India would begin to view Chinese deals on India’s periphery (e.g., with Burma) as more threatening than currently perceived. Figure 1 depicts the progression of these various drivers to an endstate of competition.

FIGURE 1. PATHWAYS TO COMPETITION



Increased prices and volatile markets can lead states to start “worst-casing;” subsequently, they will try to buy political strategies for preferential treatment that are inherently

**COROLLARY: “ASIA FOR ASIANS”
COOPERATION SCENARIO**

Some participants believed that a balkanization of the oil market could lead to the emergence of an internal Asian trading bloc—an “Asia for Asians”—that effectively freezes out other consumers such as the United States and Europe. In fact, this arrangement is more detrimental to U.S. interests than competition with China and India. The direction of China’s patterns of trade would have to change. An Asian energy trading bloc would see Russia become the supplier of choice and China as a market unto itself. Participants remained uncertain about the status of China’s relations with other Asians, questioning whether China would have to appear weak enough for the other countries to have a role or strong enough for them to realize that the game is over.

competitive, resulting in serious consequences for the security of the global oil market. All states have a stake in the continued functioning of the oil market, and whether it survives depends on the behavior of the biggest consumers. But as states begin to use private agreements as competitive strategies, they serve the insecurities of others, thus creating an “oil security dilemma.” China, Russia, and the Persian Gulf countries are most equipped to operate in this kind of environment. Participants observed that these countries also have converging interests in a more managed, state-controlled oil market and might even attempt to form an Eastern alternative to the International Energy Agency.

POTENTIAL MILITARY CONTINGENCIES

Participants considered the possibility that military contingencies could emerge between China and India as a result of increasing competition for energy. They generally believed that the reactive nature of governments in both countries with respect to policy decisions and military responses would make such military contingencies unlikely; however, they identified several circumstances that might precipitate the use of force. Participants also supposed that competition would focus on naval contingencies and would likely occur in the Indian Ocean rather than in searoutes closer to China, such as the South China Sea.

China's Options. Participants believed that no one event would trigger China to respond with military force; rather, they hypothesized that Chinese military action would arise more ambiguously as a result of a gradual Chinese strategy to adopt a more aggressive posture in response to increases in perceived threats from other countries. For example, China's objective to ensure the safety and transport of its overseas energy investments would drive increasing efforts to modernize the People's Liberation Army Navy (PLAN). China already views the growing Indo-U.S. partnership as threatening and is likely to perceive the developing trilateral India-U.S.-Japan military cooperation as "three powers acting in concert to deny access to supply lines." Such increases in the breadth and depth of cooperation would heighten the Chinese perception that other powers are trying to contain it, even despite best efforts to frame the strategy as something different (e.g., keeping the searoutes open). Participants offered the following options that China might pursue as part of this posture:

- *Threaten others.* China could use capabilities such as smart minefields and long-range autonomous undersea vehicles to threaten adversaries. It could also actively exploit the "seam" that exists in the United States among the Department of Defense, Department of Homeland Security, and the Department of Commerce. For example, the Department of Defense does not spend money on homeland security; thus, the U.S. Navy does not have many capabilities for protecting the United States at home. One participant intimated that China could probably threaten the Long Beach, California area with its mining capabilities or with nuclear submarines. China could pursue a similar strategy toward Japan.²
- *Protect energy shipments and coastlines.* China could aggressively focus on developing its anti-submarine warfare (ASW) program to counter potential threats to its overseas energy shipments. Part of this strategy would include tracking how much money the United States, India, and Japan are spending on submarine and ASW capabilities.
- *Increase political engagement with countries who partner with the United States and India.* Participants suggested that China could court current U.S. or Indian partners such as Singapore, Indonesia, or Australia to increase the costs to these countries of partnering with the United States or India in the future. They believed that this could be achieved at a relatively low cost, possibly even by using tactics such as information operations (IO) campaigns. China could also establish forward operating bases on its "String of Pearls" states in the Indian Ocean. India already perceives Chinese presence in these states as a threat. Thus, the expansion of this presence accompanied by overt

² In fact, a Chinese nuclear submarine encroached upon Japanese waters in November 2006, causing heightened bilateral tension and prompting Japan to adopt an "alert" status. China apologized for the incident; however, Japan remains suspicious of China's true motives with respect to this encroachment.

Chinese military objectives would raise Indian anxiety regarding China's intentions for the region. It would also impede India's ability to form the alliances and partnerships necessary to counter Chinese incursions into its immediate strategic neighborhood.

- *Exploit India's internal vulnerabilities.* A continued Chinese buildup in Tibet could distract India from pursuing other military postures and drain resources that would otherwise have funded development of naval capabilities. Similarly, China could tacitly support Maoist insurgencies—which, according to participants, are active in seven Indian states—and smaller insurgencies in India's northeast.
- *Increase defense and security ties with Pakistan.* Seminar participants emphasized that China's relationship with Pakistan would play an important role if China wanted to threaten India. China could "look the other way" in response to Pakistan's Inter-Services Intelligence (ISI) actions aimed at destabilizing India or even increase its weapons sales, technology transfers, and cooperative maneuvers to prey on Indian insecurities.

Redlines for India. Participants attempted to assess how India might respond to a more aggressive Chinese posture as outlined above. They identified the following "redlines"—that is, Chinese actions that would be perceived as aggressive enough to trigger an Indian military response:

- *Chinese naval presence in the Indian Ocean.* Participants considered Chinese incursions into the Indian Ocean to be the most likely trigger of an Indian military response. Indeed, India expressed great concern about Chinese involvement in a multilateral exercise held in the Indian Ocean during March of 2007 even though China was invited to participate by other countries (that one of these countries was Pakistan likely did not help alleviate Indian anxiety). Clearly, Chinese encroachment upon India's sphere of influence represents a potential source of future conflict.
- *Acquisition of bases on the island states in the Indian Ocean.* Indians would see increasing Chinese military investments in the "String of Pearls" as particularly threatening, especially if China began to deploy forces to these installments, even if on a rotational basis.
- *Chinese buildup of naval capabilities.* Participants stated that the Indian Navy is already keeping a close watch on China's intentions to acquire more aircraft carriers in the future as India seeks to retain a competitive advantage in aircraft carriers vis-à-vis China. India is also concerned about the possibility of Chinese ASW capabilities making their way into the Indian Ocean.
- *Existing bilateral tensions.* India would likely react to serious border incursions or overt Chinese support of internal insurgencies in India with military force. Participants believed, however, that India feels confident that Chinese land forces are not sufficient to threaten the Indian periphery.

ISSUES FOR FURTHER EXAMINATION

Participants identified several key issues that focus on future characteristics and developments in key producer or consumer countries. These issues highlight how the strengths and vulnerabilities of these actors could change during the next several decades and what these changes could imply for the future strategic and geopolitical environment.

CHINA

Participants characterized China's far-flung energy investments as "potential hostages," noting that these overseas assets could offer targets of opportunity for the United States, India, and Japan to shape Chinese behavior. They continued to question the strategic logic of investment but acknowledged that not enough information is available about Chinese decisionmaking to confidently assess the reasoning behind these investments. Participants also cautioned against making "straightline projections" for China, citing China's plethora of internal vulnerabilities—any one of which could trigger dramatic changes in China's domestic political or economic environment.

Key Questions:

- How will economic or political developments in China shape the types of alliances and partnerships it pursues?
- Under what conditions does China's current energy investment strategy become a liability or vulnerability? How can it be exploited?
- What are the implications of China's vulnerabilities for U.S. strategic advantage?
- How do Chinese leaders make decisions on energy policy? Which stakeholders have the most influence?

RUSSIA

Participants observed that Russia would be the clear winner in any sort of competition scenario. Asian countries would look to Russia as the major source of supply because of its proximity to the centers of Asian demand in China, Japan, and South Korea, and also because of its ample reserves. In a balkanized market driven by exclusive supply arrangements, increased demand for Russian energy would enable Russia to charge higher prices, thereby increasing income that could reinvigorate the economy and provide the catalyst for a Russian resurgence. As one participant stated, "Russia could stop pretending to be a great power and actually become a great power."

Key Questions

- How would a resurgent Russia compete or cooperate with other actors, particularly China, India, and the United States?
- How does a Russian resurgence and U.S. decline reshape the strategic environment?

IRAN

Some participants were struck by China's and India's close relationships with Iran in both scenarios despite the U.S. objective to isolate the Iranian regime. China seeks broader engagement with Iran to meet energy needs and other strategic objectives. Likewise, although it does not support the development of Iran's nuclear program, India has a

longstanding relationship with Iran that provides strategic advantages beyond energy. Iran is India's gateway to Central Asia, a counter to Pakistan, and a Shi'ite partner, which gives the Indian government credibility with its own Shi'ite minority. India is also concerned about China's growing influence in Iran and the Middle East writ large. A strong energy relationship with Iran could provide India leverage to address this issue and achieve its objectives in this part of the world. For India (and the United States), a nightmare scenario would be the emergence of a China-Pakistan-Iraq-Iran axis along its border.

Key Questions

- Under what circumstances might China and India compete directly in or for Iran?
- If the United States withdraws from the Middle East, would the Iranian Navy seek to increase its presence in the Indian Ocean and, if so, how would India respond to this move into its perceived purview?
- How would U.S.-Iranian détente affect China's strategic goals in Iran and the Middle East? How could similar U.S. reengagements affect China's strategic goals?

CENTRAL ASIA

Participants acknowledged that China has established itself as a major actor in Central Asia, particularly with respect to energy. India, on the other hand, remains uncompetitive in Central Asia. Participants wondered whether any sets of circumstances existed that could trigger an Indian reaction to seek greater involvement in Central Asia—for example, a Chinese move to protect the substantial gas and oil interests it might have in the future.

Key Questions

- How would India view a military partnership or alliance between China and one or more of the Central Asian states?
- How does India seek to expand its presence and influence in Central Asia? To what end?
- What circumstances might prompt China and India to cooperate in Central Asia?

BURMA

Participants identified Burma as a focal point of energy competition between India and China. India is in negotiations with Burma to build a pipeline from Burma through India to transport gas to India's northeast, while China is pursuing discussions with Burma to build an alternative pipeline leading eastward. This competition also has a strategic dimension: China views a closer relationship with Burma as a vehicle to gain access to the Indian Ocean, but India sees Chinese influence in Burma as encroachment into India's strategic neighborhood. China continued to provide assistance and support to Burma when other states, including India, isolated Burma in response to the 1980s military coup, thus granting China strategic leverage here. India has been working to mend its relationship with Burma over the last several years as it pursues its energy and strategic interests vis-à-vis China.

Key Questions:

- How can India cooperate with or assist Burma to shift the strategic advantage away from China?
- How might a thaw in U.S.-Burmese relations offer opportunities for India and the United States to work together to achieve shared interests?

(b)(6)



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APPENDIX B: CHINA'S ENERGY STRATEGY

Presented by (b)(6) The Brookings Institution

B



China's Global Search for Energy: Drivers, Actors, and Policies

(b)(6)

Energy Futures in Asia Seminar
Washington, DC
26 March 2007

The Brookings Institution, Washington, D.C.

www.brookings.edu



Outline

- **Drivers**
- **Actors**
- **Policies**
 - **Diversification**
 - **Acquisition of assets abroad**
 - **Energy diplomacy**

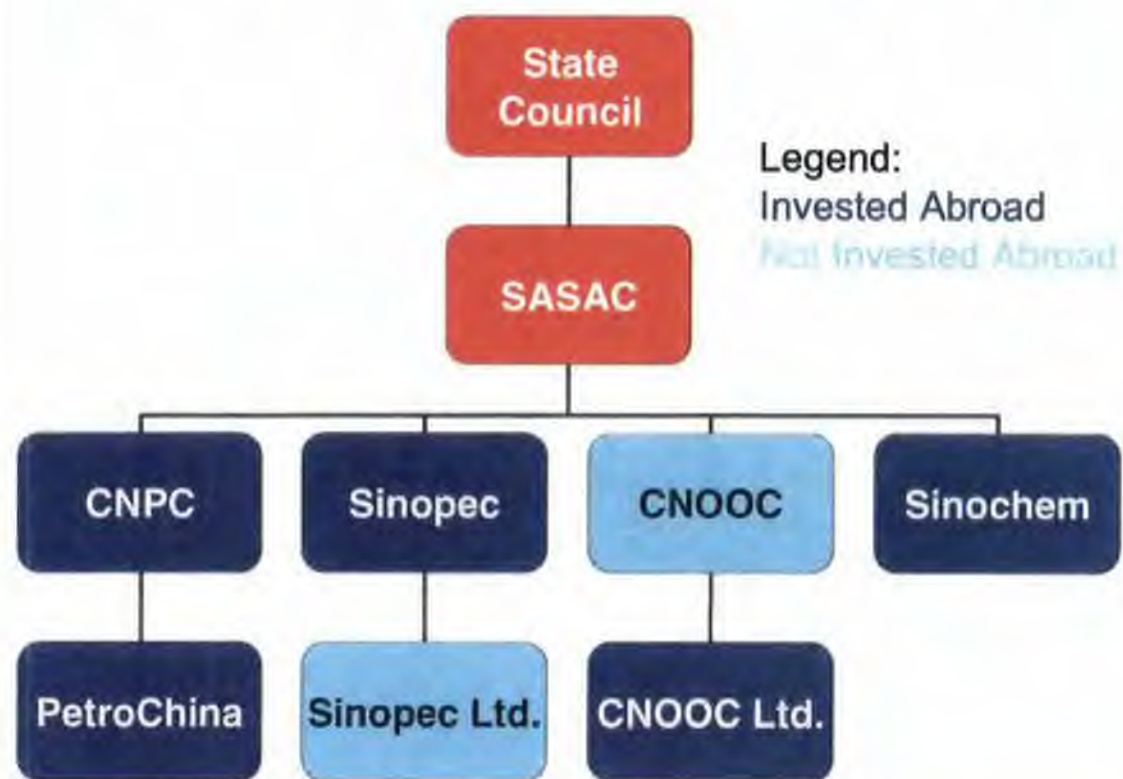
Drivers of Foreign Energy Policies

- **Primary Objective: Secure energy supplies**
 - Modest but growing dependence on imported energy
 - 90%+ self-sufficient
 - Only oil imported in large quantities
 - 2006: almost 50% reliant on imports
 - 2020: projected 60-80% reliant on imports
 - Small imports of LNG and coal
 - Less than 2% of natural gas and coal consumption
- **Secondary Objectives**
 - Expand China's global influence
 - Create world class companies

Actors in Foreign Energy Policies

Actor	Role
Nat'l oil cos. (NOCs)	Secure oil and gas assets
CITIC	Secure oil and gas assets
Ministry of Foreign Affairs	Support NOCs; keep them from harming other diplomatic goals
Ministry of Commerce	Distribute foreign aid
Policy Banks China Export Import Bank State Development Bank	Support NOCs with loans to NOCs and host countries; make money
Nat'l Development & Reform Commission	Approve investments; prevent direct competition between NOCs
Senior Leaders	Energy diplomacy
International Banks	Sell assets to China's NOCs
Host Governments	Seek FDI from Chinese firms

China's National Oil Companies



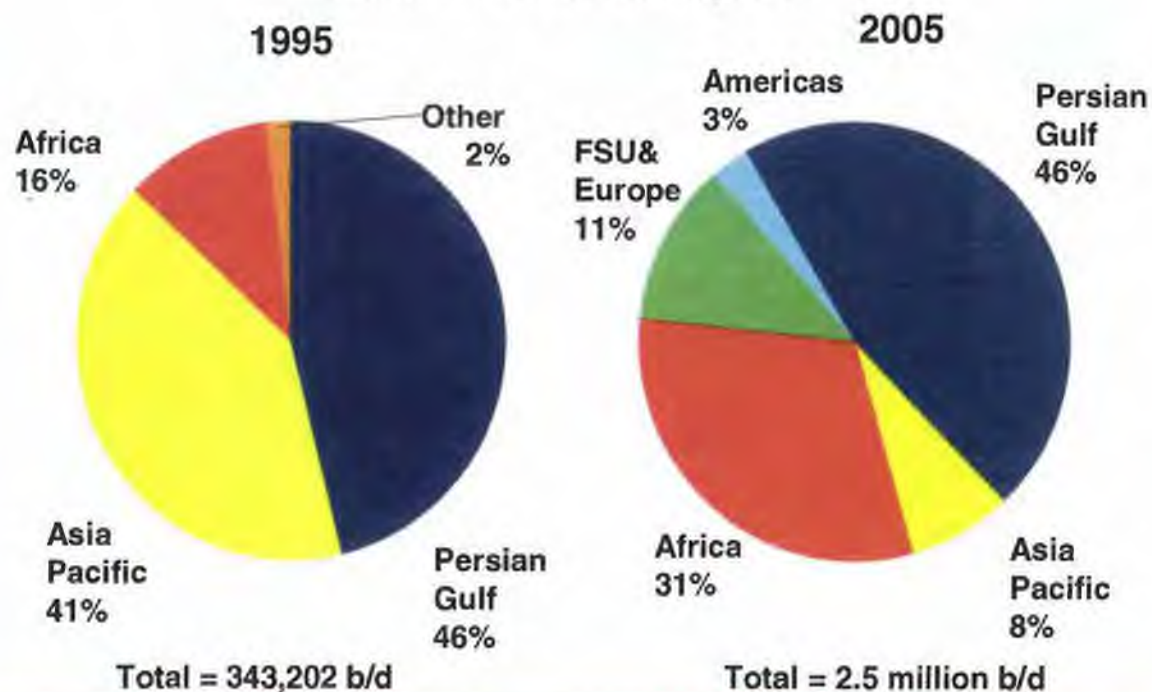


Diversification (1): The Big Picture

- **Key to supply security**
- **China wants to diversify energy imports away from:**
 - Persian Gulf
 - Sea-lines of communication
- **Oil pipelines from Kazakhstan (under construction) and Russia (proposed) help fulfill both goals**
 - Combined design capacity of 1 million b/d
 - 10-20% of 6-11 million b/d of projected imports for 2020

Diversification (2): More crude from Africa and Russia, less from Asia

China's Crude Oil Imports



Diversification (3): Kazakhstan-China oil pipeline being built in stages

Source: DI Cartography/US EIA



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Source: BBC

Diversification (4): Fate of Pipeline Oil Imports from Russia in Moscow's Hands

Proposed East Siberia Pacific Ocean Pipeline:

- Taishet-Skovorodino leg under construction
- No final decision about spur to China



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Acquisition of Assets Abroad (1): National and Corporate Objectives

- **Reserve replacement**
- **Profits**
- **Competition between China's national oil companies (NOCs)**
- **Creation of globally competitive firms**
- **Energy security**

Acquisition of Assets Abroad (2): NOCs invested around in oil the globe

Signed contracts for equity participation: Selected countries

Algeria	Eq. Guinea	Mauritania	Sudan
Angola	Gabon	Morocco	Syria
Azerbaijan	Indonesia	Myanmar	Thailand
Canada	Iraq	Niger	Tunisia
Colombia	Iran	Nigeria	Turkmenistan
Cote D'Ivoire	Kazakhstan	Oman	UAE
Cuba	Kenya	Peru	Venezuela
Ecuador	Libya	Russia	Yemen

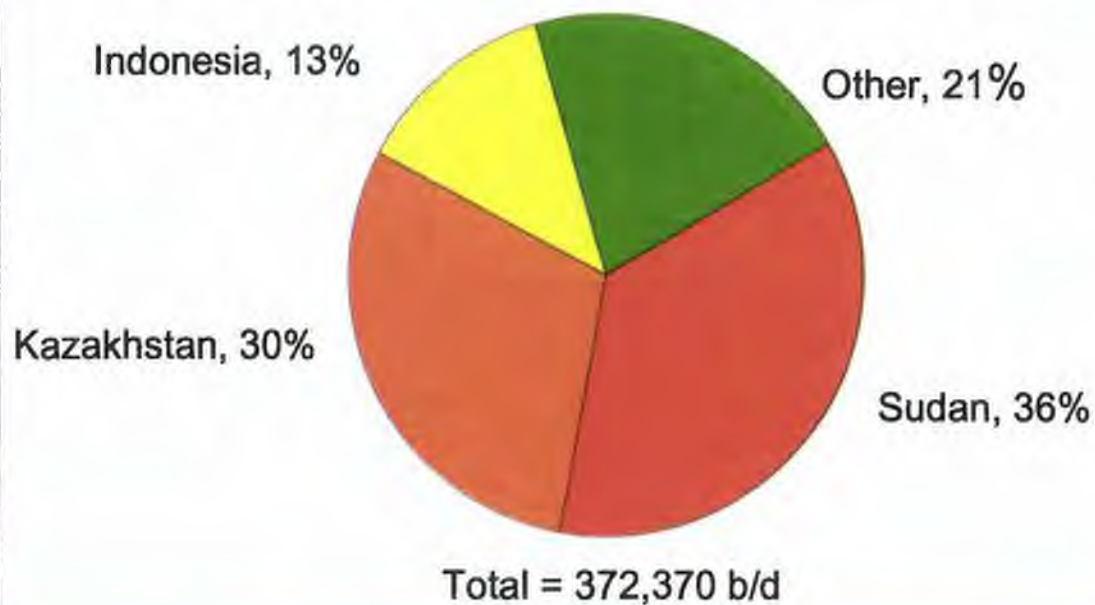
Includes buyback and extended service contracts



Source: company and press reports

Acquisition of Assets Abroad (3): Output concentrated in a few countries

Equity Oil Production by Country, 2004

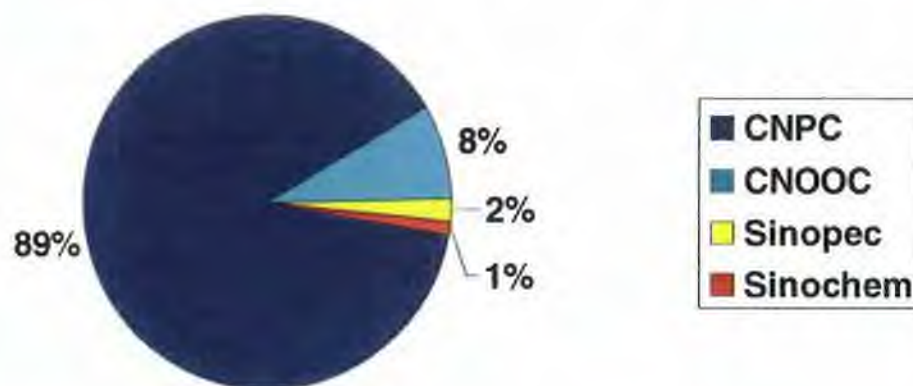


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Acquisition of Assets Abroad (4): Output concentrated in CNPC

Equity Production by NOC, 2004



Total = 372,370 b/d

Energy Diplomacy (1): Motivations

- **Good relations with governments of energy exporters facilitate trade and investment**
- **Consistent with broader goal of creating a global environment hospitable to China's rise**

Energy Diplomacy (2): Political Support

- **Ministry of Foreign Affairs: broad mandate to support firms abroad**
- **Summit meetings with leaders of of oil exporting states**
- **Use of membership in int'l orgs. to protect oil producers**

Energy Diplomacy (3): Financial Support

- **Direct Support**
 - Concessionary loans to NOCs for specific acquisitions
- **Indirect Support**
 - Grants and low- and no-interest loans to host governments
 - Investment in non-oil infrastructure in host country
 - Often at request of host government
- **Murky issue: how concessionary are the loans Chinese policy banks provide to Chinese firms and host countries?**

APPENDIX C: INDIA'S ENERGY STRATEGY

Presented by (b)(6) Booz Allen Hamilton

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PRESENTATION

Energy Futures in Asia Seminar Baseline Presentation

Sponsored by Director, Net Assessment, Office of the
Secretary of Defense

Herndon, Va.
March 26, 2007

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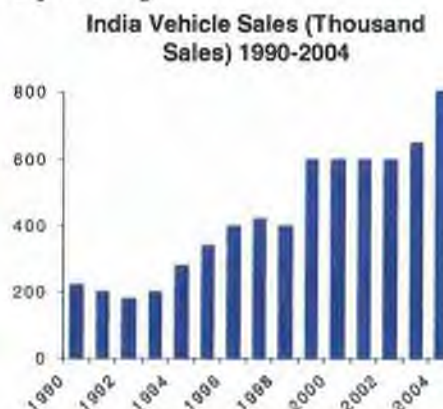
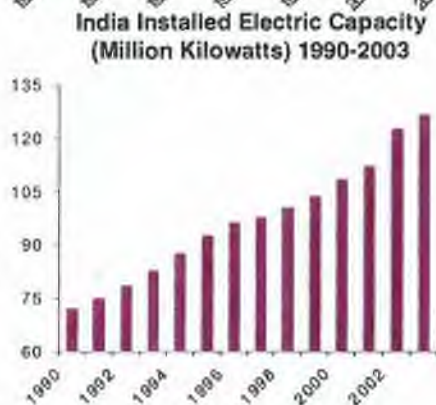
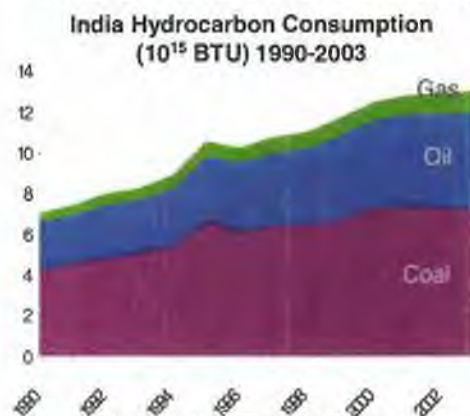


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Baseline Presentation

- ▶ India's Energy Situation
- ▶ India's Energy Priorities
- ▶ India's Energy Strategy
- ▶ India's Foreign Policy Priorities (Energy's Role in Context)

Demand for hydrocarbons increase as the Indian economy modernizes and adds capacity.



India "Golden Quadrilateral" Interstate Highway (Scheduled 2007)



Share of Manufacturing in Total Economic Output 2005



Source: Consumption & Electric Capacity—EIA International Energy Annual 2003; Vehicle Sales—Government of India Ministry of Roads and Transport; Industrial Production Index—India Info Online (www.indiaonline.com)

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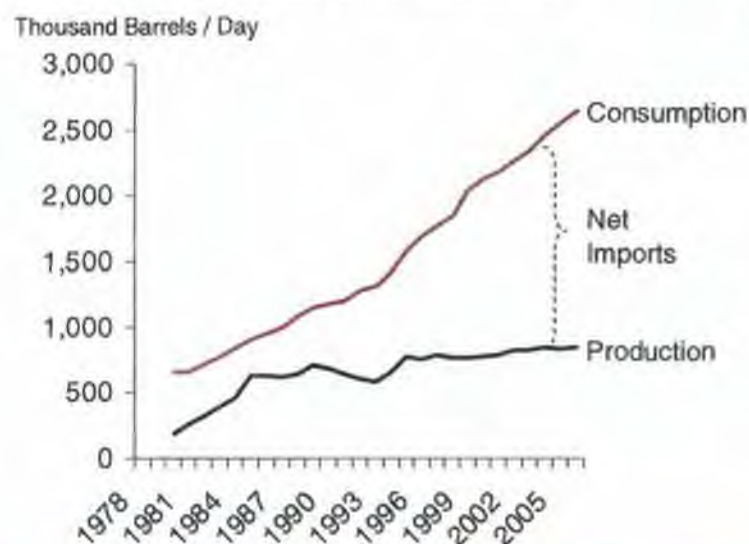
India's energy priorities are three-fold: affordability, sufficient supply, and diversity of supply.

- ▶ **Affordability:** India seeks affordable supplies and protection against fluctuations in global energy prices.
- ▶ **Sufficient Supply:** India seeks sufficient energy supplies to sustain its economic growth.
- ▶ **Diversity:** India seeks to limit risks of disruption and reduce its dependence on single regions.

The country is energy secure when we can supply energy to meet our citizens effective demand at affordable costs at all times considering shocks and disruptions. *India's Planning Commission*

India seeks affordable supplies and protection against fluctuations in global energy prices.

India's Oil Consumption & Production



Global Crude Oil Prices



World oil prices have fluctuated substantially over the years. While we may be able to pay for imports, the high oil price can cause inflation, slow down the economy and impose hardship on our people. *India's Planning Commission*

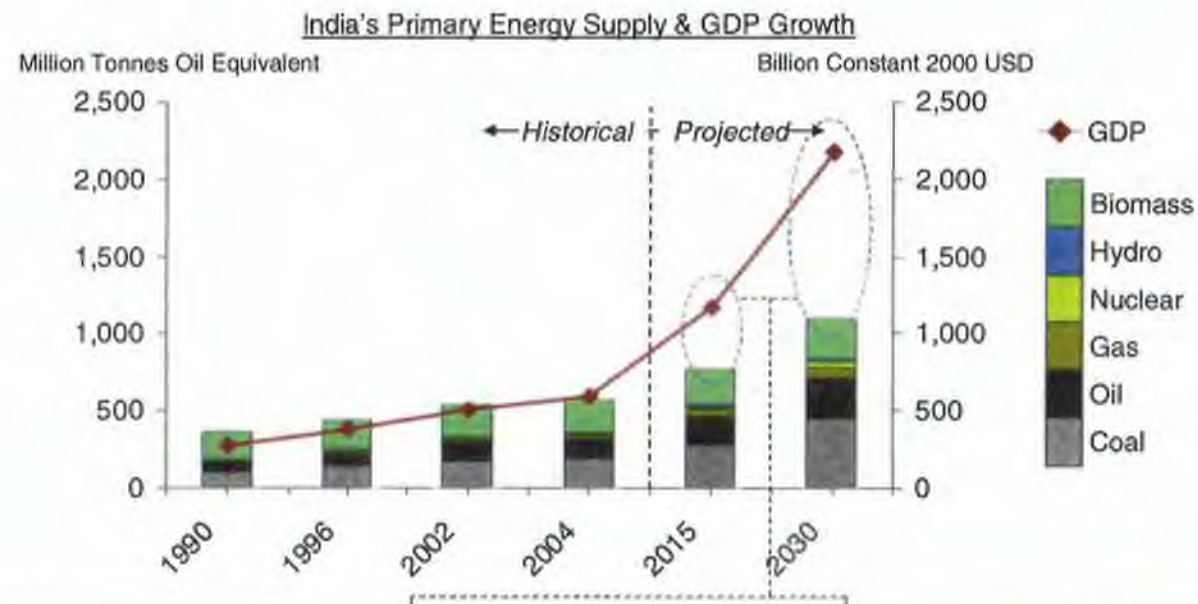
Source: Energy Information Administration

Note: Global Crude Oil Prices measured as Refiner Acquisition Costs in U.S.

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India seeks sufficient energy supplies to sustain its economic growth.



Energy Intensity: If energy intensity improves less than projected here India's energy demand would have to increase more than shown here to sustain growth.

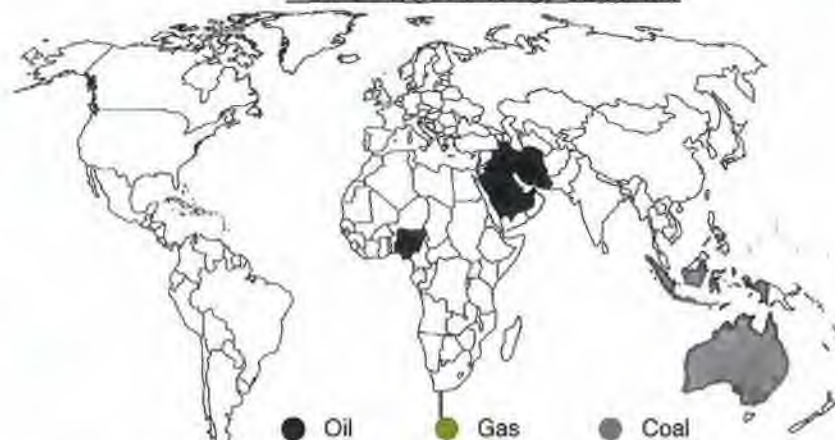
Energy Infrastructure: Improved infrastructure could reduce the share of Biomass fuels projected here and further increase demand for hydrocarbons.

Source: International Energy Agency; & World Development Indicators Database

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India seeks to limit risks of disruption and reduce its dependence on single regions.

India's Largest Energy Suppliers



India's Oil Imports (2005)



96 Million Metric Tonnes

India's Gas Imports (2005)



5 MMT of Oil Equivalent

India's Coal Imports (2003)



14 MMT of Oil Equivalent

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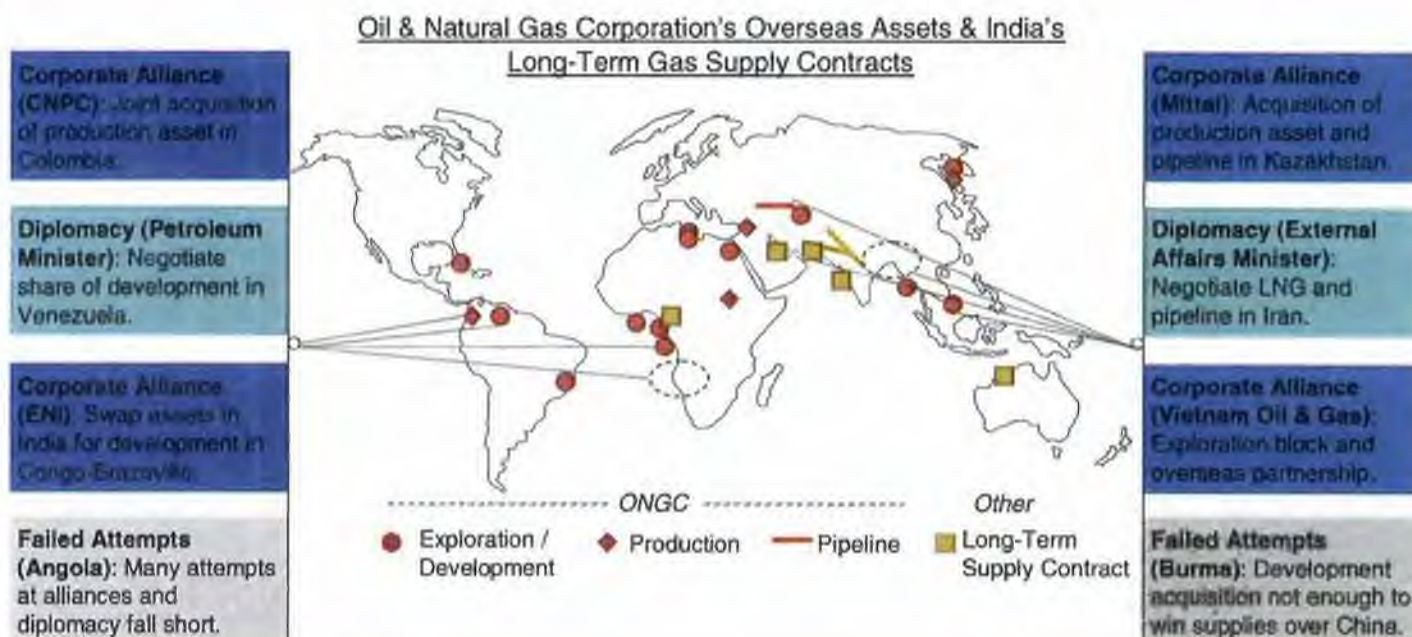
Source: Ministry of Petroleum and Natural Gas; Energy Information Administration; & UN COMTRADE

India's energy strategy is to engage in commercial energy deals overseas and reform systems of production, distribution and consumption at home.

- ▶ India uses a range of commercial and diplomatic approaches to engage in commercial energy deals overseas
 - Indian energy companies form alliances with other foreign energy companies (e.g., IOCs, consumer NOCs, or supplier NOCs)
 - Indian energy companies form alliances with Indian companies in other sectors (e.g., Mittal)
 - Oil diplomacy led by Ministry of External Affairs/Ministry of Petroleum and Natural Gas (bilateral and multi-lateral approaches)
- ▶ India uses competition and policy to reform energy production, distribution and consumption at home

[Energy Security] measures are reducing need for energy and imports, diversification of supply sources, maintenance of strategic reserve and obtaining equity oil or gas abroad that helps in reducing the consequences of risks. India's Planning Commission

India uses diplomacy and corporate alliances to engage in commercial energy deals overseas.



"It is very necessary to mobilise all diplomatic experience to synchronise with our investments abroad." *Mani Shankar Aiyar, Former Petroleum Minister*

Source: Press Clippings & ONGC's Annual Report. Aiyar quote from India Express November 17, 2004

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Overseas assets and long-term supply arrangements provide a hedge against price volatility and some protection against disruption.

Overseas Assets	Long-Term Supply
<ul style="list-style-type: none">▶ Equity oil seen as hedge against price volatility▶ Equity oil encourages diversification of supply▶ Protection against disruption is minimal (e.g., nationalizations, transport disruptions)	<ul style="list-style-type: none">▶ Gas pipelines create long-term commitments to delivery to India's market; pursuing several options:<ul style="list-style-type: none">– Iran-Pakistan-India (IPI)– Turkmenistan-Afghanistan-Pakistan-India (TAPI)– Myanmar-India or Bangladesh-India▶ Long-term LNG contracts as alternative to pipelines (e.g., Qatar, Australia)▶ Long-term oil contracts are desirable but difficult to negotiate with suppliers

India uses competition and new policies to reform energy production, distribution and consumption at home.

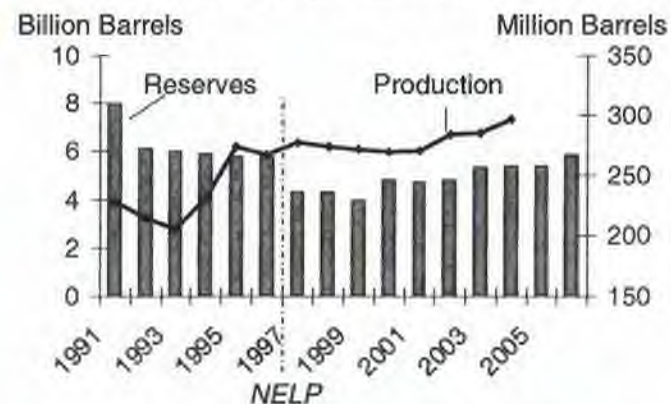
Competition

- ▶ New Exploration Licensing Policy (NELP)
 - Enhanced Oil Recovery
 - Exploration
- ▶ Alternative Fuels Industries

Policies

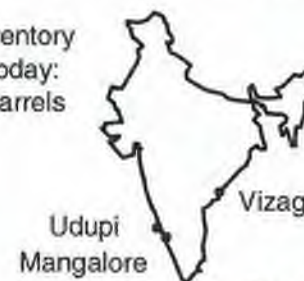
- ▶ Price reforms / Liberalization
- ▶ Efficiency Standards / Demand Side Management
- ▶ Strategic Petroleum Reserve

India's Domestic Oil Reserves & Annual Production



Planned Sites of India's Strategic Petroleum Reserve

Refiners' Inventory
Capacity Today:
35 Million Barrels



Planned Strategic
Reserve Capacity:
165 Million Barrels

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Source: Energy Information Administration; Dow Jones International News

India's energy strategy has not been integrated into its national security strategy. But ad hoc pursuit of energy opportunities has facilitated achieving other strategic priorities, even with China.

- ▶ Energy plays a facilitating role in many of India's most important strategic relationships.
- ▶ Operations to protect overseas energy assets are not a priority for India's military. Only the Navy has begun to examine the strategic implications of India's overseas interests.
- ▶ India's energy strategy underscores compatible and conflicting interests with China as both countries pursue a greater share of the global market.

"Energy is not a top priority in India's relationship with the United States, for example, but this nuclear energy deal offers a unique opportunity to improve relations and increase cooperation on other more important issues."

Lok Sabha Member (Booz Allen Interview)

Energy plays a facilitating role in many of India's most important strategic relationships.

Partner	Compatible Energy Interests	India's Other Priorities	Energy's Facilitating Role
United States	India needs nuclear technologies. U.S. needs want markets.	Integrate in international community. Form strategic partnership with U.S.	Energy provides a rationale for nuclear deal that delivers integration and partnership.
China	Both countries need to grow their share of the world oil market.	Keep pace with China's influence. Maintain beneficial relationship.	Energy cooperation shows China and India gain when they work together.
Saudi Arabia	India needs oil. Saudi Arabia needs markets and diversification ops.	Maintain visas for million-plus foreign workers and protect their rights.	"Criss-cross energy investments help build relationships." <i>Fmr Secretary</i>
Iran	India needs gas. Iran needs markets and international support.	Gain access to Central Asia. Contain Sunni extremists in Afghanistan and Pakistan.	Pipeline negotiations provide a framework for interaction.
Brazil	India needs offshore capability, ethanol. Brazil needs business.	Coordinate with ally for UN Security Council expansion. Promote business ops.	Pledges of energy cooperation signal productive relations.

Operations to protect overseas energy assets is not a priority for India's military. Only the Navy has begun to examine the strategic implications of India's overseas interests.

Military Thoughts on Energy Security

- ▶ Energy issues only factor into Navy's mission and thinking about future requirements
- ▶ Army and Air Force officials not focused on operations to protect overseas energy assets
- ▶ Most view protection as the province of corporate risk abatement and/or producer states

Navy Plans

- ▶ Acquisition of additional Aircraft Carriers extends out-of-area operations.
- ▶ Flag Officers Development Assistance Group now coordinates with ONGC.
- ▶ Spearheading military-to-military cooperation

Officials' Assessments of Available Protections

Asset Nationalization	Contract Guarantees; Insurance
Terrorist Attack / Asset Seizure	U.S. Navy; Insurance
Commercial Energy Vessel Hijacked	U.S. Navy (Coordination)
Overseas Personnel Kidnapped	Host Country Security Guarantees

"India's greater strategic neighborhood has expanded from Venezuela to Sakhalin. Energy security plays a role in the Navy's mission."

Admiral Shuraesh Mehta, Naval Chief of Staff

Source: Booz Allen Interviews and Conference Notes

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India's energy strategy underscores compatible and conflicting interests with China as both countries pursue a growing share of the global market.

Compatible Interests	Conflicting Interests
<ul style="list-style-type: none"> ▶ Improve companies' competitive position vis-à-vis IOCs (e.g., Shell/ExxonMobil) and NOCs (e.g., Saudi Aramco) ▶ Offer political cover in pariah states ▶ Pool and share technical expertise ▶ Ensure protection of open, secure sealanes 	<ul style="list-style-type: none"> ▶ Improve competitive position vis-à-vis each other ▶ Secure supplies in a zero-sum environment ▶ Secure influence with major suppliers in a zero-sum environment ▶ Build controversial strategic positioning along sealanes in each country's backyard <ul style="list-style-type: none"> – China in Indian Ocean (e.g., Pakistan, Myanmar) – India in South China Sea (e.g., Vietnam)