

China in the Indian Ocean: Impacts, Prospects, Opportunities

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Prepared for
U.S. government's Office of South Asia Policy

Workshop in International Public Affairs
Spring 2011



**ROBERT M. LA FOLLETTE
SCHOOL OF PUBLIC AFFAIRS
University of Wisconsin-Madison**

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Foreword

Students in the Master of International Public Affairs (MIPA) program in the Robert M. La Follette School of Public Affairs at the University of Wisconsin–Madison produced this report for the U.S. government’s Office of South Asia Policy. The students are enrolled in the Workshop in International Public Affairs, the capstone course in their graduate program. The workshop provides MIPA students the opportunity to improve their analytical skills by applying them to an issue with a substantial international component and to contribute useful knowledge and recommendations to their client.

The La Follette School offers a two-year graduate program leading to a Master of Public Affairs or a Master of International Public Affairs degree. In both programs, students develop analytic tools with which to assess policy responses to issues, evaluate implications of policies for efficiency and equity, and interpret and present data relevant to policy considerations.

The workshop provides practical experience applying the tools of analysis acquired during three semesters of prior coursework to actual problems clients face in the public, non-governmental, and private sectors. Students work in teams to produce carefully crafted policy reports that meet high professional standards. The reports are research-based, analytical, evaluative, and (where relevant) prescriptive responses to real-world clients. This culminating experience is the ideal equivalent of the thesis for the La Follette School degrees in public affairs. While the acquisition of a set of analytical skills is important, it is no substitute for learning by doing.

The opinions and judgments presented in the report do not represent the views, official or unofficial, of the La Follette School or of the client for which the report was prepared.

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May 2011

Acknowledgments

We could not have completed this project without the invaluable assistance of a few key individuals. The planning and critique of our analysis would not have been possible without the support of our advisor, Dr. Melanie Manion. We would also like to thank Karen Faster, Publications Director at the La Follette School of Public Affairs, for her expertise in editing our report. Our peers at the La Follette School also deserve thanks for their willingness to provide constructive feedback on our work. Finally, we would like to recognize Keith and the U.S. government's Office of South Asia Policy for providing us with the opportunity to conduct this research project.

Executive Summary

Mainland China has increased its activities in the Indian Ocean region by investing in local states, building ports and infrastructure, and acquiring energy resources. We analyze the *impact* of these activities on overall regional stability and security, as well as the impact on relevant regional players, especially India. We also assess *trends* and *prospects* for the region's future. Evaluation of prospects occurs under two diametric assumptions: an expansionist China and a non-expansionist China. Finally, we discuss *opportunities* created for U.S. government action in the South Asia.

We analyze the impact of Chinese activities on 14 matters in three broad issue areas: regional security, non-energy economic relations, and energy security. We find that smaller relevant regional players win across all 14 issues, but that India and China rarely experience wins simultaneously. In fact, in most matters, China wins at India's expense.

We view the assumptions of China as expansionist or non-expansionist as equally plausible. For this reason, our analysis of prospects presents predictions in four categories: the short term and the long term for both expansionist and non-expansionist China. For example, in the regional security issue area, we predict that stronger China-India security partnerships are very unlikely assuming an expansionist China, but much more likely if we assume a non-expansionist China. Our predictions range in probability from very unlikely to very likely.

Regardless of Chinese government intentions, the current and future situation in the Indian Ocean region presents opportunities for U.S. government action to further its strategic interests. In order of importance, we propose five policy tools: strengthening relations with India, expanding relations with Chinese-courted states, maintaining naval superiority in the area, ensuring energy security for smaller South Asian states, and pursuing closer diplomatic relations and a less unequal trade balance with China.

I. Context

To put the analysis of China's involvement in the Indian Ocean region and its consequences into context, we introduce in this section three key aspects of regional issues: (1) regional security, including military expansions and piracy, (2) non-energy economic relations, and (3) energy security, including the pursuit of equity oil stakes, supply via pipeline, investment in pariah states, and strategic petroleum reserves. We find few mutual gains for China and India in these issue areas, although many smaller regional states benefit from the increased competition between the two powers.

Regional Security

In this section we examine the regional security situation in the Indian Ocean region, including Indian and Chinese military expansion, and piracy.

Indian Military Expansion

Over the last two decades, India has spread its naval forces across the Indian Ocean. Its strategic location allows access to vital sea lanes of communication in the Persian Gulf, Suez Canal, and Strait of Malacca, and its defense spending has increased significantly. According to recent reports, India plans to increase its fleet to include three aircraft carriers, which will operate in the Bay of Bengal, the Indian Ocean, and the Arabian Sea. It has a stronger naval presence on the Indian Ocean than does China, and it has strengthened its port infrastructure with new southern ports, which allow greater projection into the ocean and better challenge China's sea lanes of communication.¹ While India's efforts have focused on the northern Indian Ocean region, India has developed security partnerships with states in the south and east, including the Maldives, Madagascar, Mauritius, and the Andaman Islands.² Furthermore, its strategic relationships with Singapore³ and Indonesia reflect its desire to take a more direct role in the security of the Strait of Malacca.⁴

India has also expanded its land-based military capabilities. It strengthened its infrastructure along its border with China and continues to remain strong in Nepal. India has increased its presence in and communication with Afghanistan, and it has a military presence in Tajikistan. It also made overtures to Mongolia, with which it has conducted bilateral exercises, most recently in 2007.⁵

Chinese Military Expansion

China has increased its military presence in Tibet, including the expansion of railroads and highways to the mainland. Although the Himalayas separate China and India, they do not pose a viable obstacle (especially to modern missile

technology) to the Chinese military should it choose to threaten India from the north. Chinese power projection into Tibet directly threatens India and makes India more vulnerable to Chinese pressure.⁶ China's power also extends southward into Pakistan, strengthened by a longstanding friendship. In addition to assistance in constructing and maintaining the Karakorum Highway, China has developed and funded a deep-water port with the cooperation of the Pakistani government at Gwadar, where China enjoys "sovereign guarantees" to the facilities, which raises questions about possible military purposes of the port.⁷ This port gives China access to its oil imports more quickly than traditional trade routes and provides western China easier access to sea routes, which will help develop shipping, energy, and manufacture infrastructure in the region. The Pakistani military plans to use this port for naval purposes,⁸ and Pakistani and Chinese forces conducted their first joint naval exercise in 2005.⁹ China and Pakistan are considering an oil pipeline between Gwadar and Kashi that would allow Chinese oil imports to bypass transport on the Indian Ocean and specifically through the Strait of Malacca, where the Chinese fear a lack of control of sea lanes. By pursuing land-based transport options throughout South and Southeast Asia, China hopes to create trade routes secure from outside influence. The proposed pipeline from Pakistan would reduce oil shipments by more than 4,000 nautical miles.¹⁰

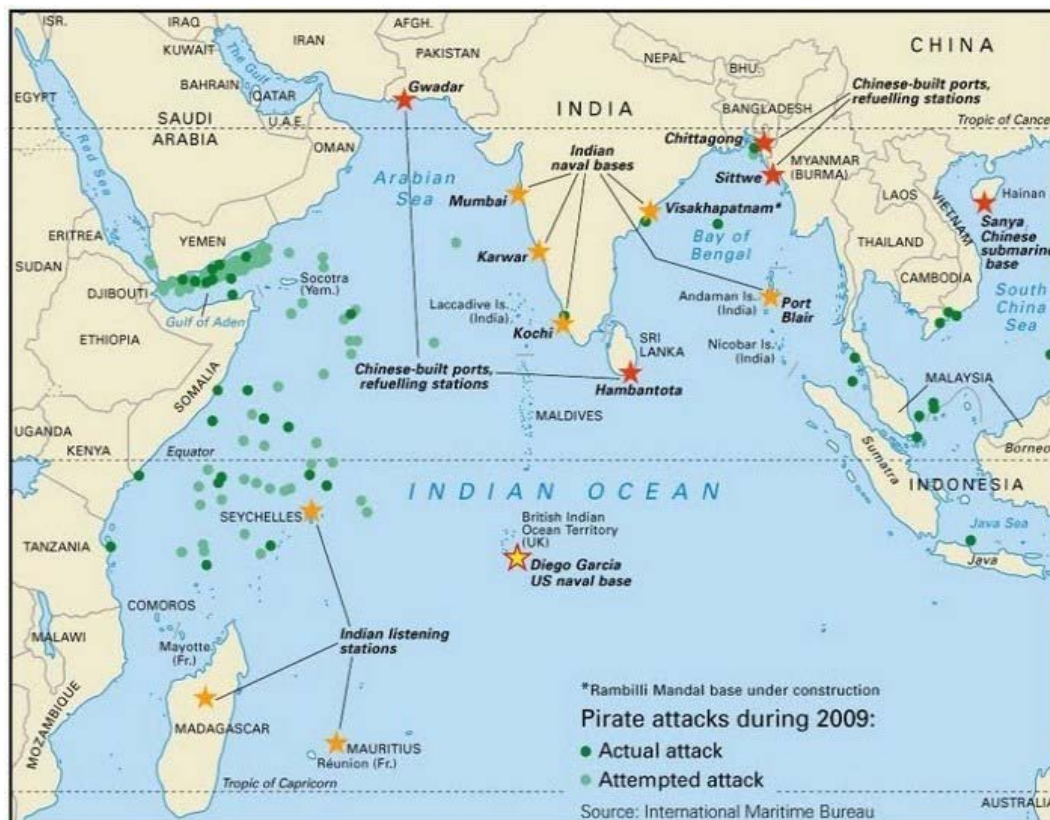
In Sri Lanka, China has provided financial and technical aid in the development of the Hambantota port and bunker facility, which is six nautical miles from a major Indian Ocean shipping route.¹¹ China has increasingly encouraged bilateral trade and military cooperation with Sri Lanka and has explored the island for oil resources.¹²

Reports that China attempted to lease the island of Marao in the late 1990s to develop a submarine base are not conclusive, and although there have been more recent reports of Chinese hydrographic survey around the island, it is unlikely that any Chinese military presence remains today.¹³ India retains a strong relationship with the Maldives, which suggests that the establishment of a Chinese base at Marao is unlikely.

Although India has asserted itself as guardian of the Strait of Malacca, China has moved to establish its presence in the eastern Indian Ocean. China and Thailand are discussing a canal at Kra that would directly link the Bay of Bengal and the South China Sea and allow the Chinese to avoid the Strait of Malacca.¹⁴ China has constructed a deep-water port at Chittagong, Bangladesh, and is seeking increased naval and commercial access, according to a 2005 report for the U.S. Secretary of Defense.¹⁵ The Chinese and Bangladeshis entered into a defense cooperation agreement in 2002, which allows the Chinese navy to use the harbors of Chittagong and gives China access to refueling stations for its aircraft.¹⁶ In Burma, China assisted in the construction of several military

and commercial facilities, most notably a naval jetty on Great Coco Island and a commercial shipping facility at Sittwe.¹⁷ There has been significant discussion by military and academic experts regarding the intentions of the Chinese at these facilities and even reports of a Chinese military presence, although these visits likely are periodic and the presence is not permanent.¹⁸ However, given the close relationship between China and the military régime in Burma, it is a legitimate concern whether these facilities will be maintained and retained for Chinese naval use. China and Burma have planned a pipeline from Sittwe to Kunming that will account for a 10 percent reduction in the oil destined for China that travels through the Strait of Malacca.¹⁹ Map 1 shows the location of Chinese and Indian ports, as well as piracy incidents, which are examined in the next section.

Map 1. Indian Ocean Regional Security Situation



Source: International Maritime Bureau, republished by *Africa-Asia Confidential*, "The battle for the Indian Ocean," May 2009.

Piracy

Piracy originating in Somalia harms security and trade across the Indian Ocean. Although pirates have long threatened the waters immediately off the coast of Somalia, they have now successfully attacked ships more than 1,000 miles away.²⁰

The severity of the piracy problem stands in sharp contrast to another area of the Indian Ocean that was, until recently, notorious for pirate attacks: the Strait of Malacca. Since 2008, however, piracy there has been all but eradicated. The navies of Singapore, Malaysia, and Indonesia worked together to defend ships and to deter pirates. Tactics include regular sea and air patrols and, perhaps most importantly, shared intelligence on pirate activities.²¹ However, it may not have been the increased naval presence alone that resolved the issue. Most pirates were believed to be of Indonesian origin; as coordinated military action in the strait increased, a long-standing political crisis between the Indonesian military and a separatist group ended. The country's increased stability allowed for more legitimate employment options, which in turn may have lessened the allure of piracy.²²

The ongoing civil war in Somalia will keep pushing otherwise unemployable people to piracy. Somalia's lack of a legitimate naval presence further complicates the matter, as the pirates' home state is unable to share intelligence on pirate activities, an essential component in eradicating Indonesian piracy in Malacca.

Non-Energy Economic Relations

In this section we discuss non-energy economic relations, including Sino-Indian bilateral relations and relations between China, India, and third states.

Chinese and Indian Non-Energy Economic Ties

In 2009 the Chinese economy absorbed less than 6 percent of all Indian exports, making China the third largest importer of Indian goods. That same year India imported more goods from China than from any other country, roughly 11 percent of total imports. India's trade balance with China is 75 percent of its total trade deficit, showing the imbalance in the size of each country's trade.²³

Chinese and Indian Non-Energy Economic Ties with Third Nations

Aid and trade from China have been vital to Pakistan. As of 2007, Chinese laborers had worked on 120 projects in Pakistan,²⁴ and China dedicated \$250 million in humanitarian aid for flood relief in 2010 alone.²⁵ China is Pakistan's leading source of imports²⁶ and has become a significant arms exporter to Pakistan during the last decade. As India and Pakistan are historic enemies, it is not surprising that their trade is relatively small: \$2 billion in 2008.²⁷ Table 1 summarizes the trade relationships between China, India, and third nations.

As of 2009, Bangladesh received 16 percent of its total imports from China and 13 percent from India.²⁸ China is Bangladesh's largest single source of imports,

and a large trade imbalance tips in China's favor.²⁹ Of concern for India is an agreement between China and Bangladesh to further Chinese development of and access to the port at Chittagong,³⁰ as this handles roughly 92 percent of all Bangladeshi trade.³¹

China is the largest exporter to Burma,³² and it is poised to benefit greatly from agreements like that allowing China to develop port facilities at Kyauk Phyu in exchange for its use.³³ India has sought to counter Chinese influence in Burma.³⁴ It is the second largest consumer of Burmese exports, and it has been developing the port at Sittwe in exchange for its use and overland access to it.³⁵

India is the leading exporter to Sri Lanka and a significant importer of Sri Lankan goods.³⁶ However, its involvement in Sri Lanka's civil war and subsequent refusal to supply its government with arms left an opening that China has filled.³⁷ China is now the second leading exporter to Sri Lanka, and it has secured important rights to develop the port at Hambantota, near a vital shipping route.³⁸ China is building a second international airport at Hambantota and an expressway connecting Colombo with the airport at Katunayake, among other projects.³⁹

Table 1. Selected States' Total Imports from and Exports to China and India

Percentage of Imports from China and India		
	China	India
Pakistan	15.4	4
Bangladesh	16.2	12.6
Burma	33.1	N/A
Sri Lanka	13.5	20.7
China	--	11
India	10.9	--
Percentage of Exports to China and India		
	China	India
Pakistan	4.4	N/A
Bangladesh	1.7	4
Burma	9	12.9
Sri Lanka	N/A	4.5
China	--	N/A
India	5.6	--

Sources: Figures on Bangladeshi exports to China and India are from the World Trade Organization. All other figures are from the CIA World Factbook.

Energy Security

In this section we introduce the four major issue areas in energy security: pursuing equity oil stakes, ensuring supply via pipeline, investing in pariah states, and establishing a strategic petroleum reserve.

Pursuing Equity Oil Stakes

A central component of Indian and Chinese energy security strategies in the past decade has been the pursuit of upstream oil investments. Policymakers in India and China hope that oil reserves owned by domestic companies will help their countries hedge against high price volatility, supply shocks, and global crises.⁴⁰ India and China signed a memorandum of understanding in 2006 on upstream oil exploration, but competition over stakes in global reserves has not eased. China outbid India for \$12.5 billion in energy investments in 2009;⁴¹ China's success is due in large part to its willingness to commit significantly more resources. India intends to emulate China's overseas energy security strategy, but its finances are more limited than China's. Dim prospects for domestic oil recovery motivate China and India to search abroad for equity oil stakes.

India has, however, secured a substantial portfolio of upstream reserves. Its public sector oil companies have launched successful bids in Central Asia and several countries, including Australia, Egypt, Sudan, Libya, Iraq, Ivory Coast, Burma, Syria, and Russia.⁴² India also established a "strategic energy partnership" with Saudi Arabia, wherein the oil producer will double oil flows to India in the next several years. Even though India increased annual equity oil purchases by 700 percent from 2002 to 2008, its overseas oil investments still pale in comparison with China's accomplishments. From mid-2009 to mid-2010, China's national oil companies increased their international reserves by 40 percent; during the first decade of this century, China increased overseas oil production by more than 540 percent.⁴³

Despite strong competition, Indian and Chinese oil companies have entered into a limited number of agreements to jointly purchase overseas equity stakes. For instance, in 2006, subsidiary Indian and Chinese oil companies purchased shares in a 50:50 joint venture covering 36 oil fields in Syria.⁴⁴ The companies also worked together on the Greater Nile Oil project in Sudan.

Ensuring Supply Via Pipeline

India does not possess a pipeline that could reliably carry a substantial portion of gas or oil into the country.⁴⁵ Solutions such as the proposed Iran-Pakistan-India or the Turkmenistan-Afghanistan-Pakistan-India pipelines have failed, due to

ongoing tensions with Islamabad. Additionally, India's fossil-based energy resources are scarce.

In contrast, China has negotiated several pipeline projects in the past decades. Among the most significant are the Kazakhstan-China oil pipeline, which broke ground in 2004,⁴⁶ and a pipeline to eastern Russia that will be completed in 2013.⁴⁷ China has 50,000 kilometers of oil and gas pipelines, an amount that Beijing plans to almost double by 2015.⁴⁸ Furthermore, as China has realized it would be difficult to completely replace its seaborne oil imports and end its dependence on transport bottlenecks such as the Strait of Malacca, it is constructing a pipeline through Burma, offering an overland bypass route.

Investing in Pariah States

Both China and India have pursued overseas oil investments in nations subject to international censure.⁴⁹ They have courted the who's who of energy-rich pariah states, including Iran, Burma, and Sudan. Chinese investments in these nations help finance and strengthen the regimes, undermining UN- or U.S.-led sanctions. For instance, a Burma-China pipeline is projected to generate transit payments of at least \$14 million per year, assisting the Burmese junta's repressive rule.⁵⁰ China and India purchase more than 10 percent of their oil from Iran, despite U.S. sanctions and pressure on Tehran to abandon its reputed nuclear weapons program.

Establishing a Strategic Petroleum Reserve

Growing demand for crude oil motivated Beijing to establish a government-administered strategic petroleum reserve (SPR) in 2001. The reserve guards against oil supply disruptions and will be completed by 2016. Beijing has thus far tactically filled the reserve based on global prices and internal projects.⁵¹ Because Beijing plans to purchase oil at low prices, the fill rate will depend on global crude oil price movements. In addition to the SPR, China has roughly 300 million barrels of commercial crude oil storage. At China's 2011 estimated import rate of 4.2 million barrels per day, the SPR will replace 119 days of oil imports.

With no strategic crude oil stocks at this time, India trails China's level of preparedness. India's first SPR facility at Visakhapatnam will hold 9.8 million barrels when completed at the end of 2011.⁵² Two facilities to be completed at the end of 2012 will increase its storage capacity by an additional 29 million barrels. Given India's 2009 daily oil imports of 2.1 million barrels per day, the completed 39 million barrel storage facilities will provide 19 days of import replacement capacity by the end of 2012.

II. Impact Analysis of Chinese Involvement in the Indian Ocean Region

The impact analysis in this section focuses on three security-related issue areas in the Indian Ocean region: (1) regional security in the form of diplomatic and military relations, (2) non-energy economic relations, and (3) energy security. In analyzing the impacts of recent events and international relationships within each issue area, we assign outcomes to one of three categories: (1) pure competition, (2) mixed competition and wins, (3) pure wins and losses. These outcome categories apply to the distribution of benefits for individual countries. We examine 12 specific topics in the three issue areas. We find that smaller regional players achieve wins in all areas, but that there are very few win-win situations in the Indian-Chinese relationship. In fact, on most issues, China wins at India's expense.

Regional Security

In this section, we examine the impact of Chinese and Indian actions on the security situation.

Diplomatic Alliances

New and strengthened diplomatic ties between China and states in the Indian Ocean region are a consequence of Chinese activity. A similar trend is apparent in Africa: as China donated infrastructure and increased economic activity with African states, many chose to support China in international bodies, where, despite being small, they retain a vote. As a Security Council member, China has a strong presence in the United Nations and could see its increased economic activity in the Indian Ocean region as a hedge to ensure support on what could otherwise be unpopular international moves. For India, these increased ties may be of concern: as China moves to be the central player, India will want to collect and retain loyalties from the same states that China currently courts. It is through international bodies that these small states have the most power—not individually but as a group. Both China and India will need to sway as much support to their own sides as possible.

India has moved to increase its diplomatic ties in China's immediate area. India has pursued increased economic relations with Uzbekistan, Tajikistan, and Kazakhstan, and plans to continue courting partners in Central Asia. India has attempted to increase its influence in Southeast Asia, particularly with Singapore, Vietnam, and Indonesia, as a way to balance the Chinese presence in that region.⁵³ In the larger context, India has strengthened its relations with the United States, Australia, and Japan since 2005.⁵⁴

The pursuit of increased diplomatic ties put India and China in direct competition. Any state that assigns diplomatic allegiance to China or India is a complete loss to the other, unless the topic of contention in the international body is one on which China and India agree. It is likely, however, that there will be few times that a smaller regional state supporting China or India could be an international diplomatic “win” for both India and China. The smaller states of the Indian Ocean region, now courted by wealthy China and India, will benefit from the new relationships.

Military Expansion and Port Creation

The development of the deep-water port at Gwadar, Pakistan, is of concern to India in the near term and in the far term for two different but related reasons. First, the construction of the pipeline from Pakistan to eastern China will allow Chinese oil imports to avoid the Strait of Malacca, which India controls. India thus loses a significant point of contact with China and its ability to exert pressure on China vis-à-vis shipping lanes. The port also allows China another point of naval entry into the Indian Ocean, closer to Indian coastal waters. In the long term, should military conflict ever break out between India and China, the port at Gwadar would provide a convenient land base for Chinese military forces. Land bases are invaluable in armed conflict as they do not require the mobile supply load of a naval aircraft carrier, and planes that have easy access to fuel at a nearby air base are able to fly lighter with less fuel for sorties. The development of the base at Gwadar reflects a strictly competitive relationship for India and China, and a mutually beneficial relationship for Pakistan and China.

Chinese military funding and economic development throughout the rest of the Indian Ocean region are mutually beneficial for the states that receive Chinese attention but are a loss for India. The Chinese-funded Hambantota port in Sri Lanka is a clear security loss for India as India and Sri Lanka are historically close allies and the port’s proximity to the southern tip of India is strategically significant should armed conflict ever break out. The friendly relationship between Sri Lanka and China is mutually beneficial. Sri Lanka benefits from the aid from China, and China retains a presence on the island. China’s apparent failure to obtain a presence in Marao is a loss for China but a win for India and, arguably, a win for the Maldives as its long-standing relationship with India remains strong and reinforced. In the east, China’s success in constructing a deep-water port at Chittagong, Bangladesh, and in securing a defense cooperation agreement is a win-win for those two nations and, like the port at Gwadar, a major loss for India as the port could be used for an air base. Finally, China’s close partnership with Burma is a win-win for those countries and a loss for India, as China is able to utilize the naval jetty at Sittwe as a launch point in the far eastern Indian Ocean. The Burmese government, long isolated from the international

community, relies on its relationship with China for some semblance of legitimacy and aid. The pipeline from Burma to China further allows Chinese oil imports to avoid the Strait of Malacca and thereby skirt Indian control. Table 2 assesses the outcomes of these relationships as competition and absolute zero-sum (win-loss).

India is increasingly isolated from its immediate neighbors as China successfully creates these partnerships. Although India's size allows it to retain a strong naval presence, it will meet a formidable challenge from China should the two nations clash and China utilize its many ports for swift and decisive military action.

Table 2. Regional Security Impact Analysis Outcome

Issue Area	China	India	Relevant Regional Player(s)
Diplomatic Alliances	Competition	Competition	Win
Port at Gwadar, Pakistan	Win	Loss	Win
Chinese-funded port at Hambantota	Win	Loss	Win
Failure by Chinese to obtain a presence in Marao	Loss	Win	Win
Chinese deep-water port at Chittagong	Win	Loss	Win
Close Chinese relations with Burma	Win	Loss	Win

Source: Authors

Non-Energy Economic Relations

In the last 10 years China has become a major economic player in the Indian Ocean region. In most countries nearest to India, China has supplanted India as the leading trade partner. Chinese commercial expansion produces opportunities for economic benefits all around and risks to stability in the region.

Bilateral Economic Ties: India and China

China's trade has a major impact on its bilateral economic ties with India. Despite the recent worldwide economic downturn, China and India have maintained growth rates that outstrip that of any developed country.⁵⁵ However, in the last several years, China has exported approximately twice as much to India as India has exported to China. This negative trade balance for India accounts for three-fourths of India's overall trade deficit.

Chinese and Indian Trade

China has increased economic relationships in the Indian Ocean region during the last decade. Many of these moves have been into countries India has

considered in its sphere of influence.⁵⁶ This shift has left India in a reactive position, competing for economic supremacy where it had been dominant.

The last decade saw strong Indian trade in the region. However, India's trade has not grown as fast as has China's. Chinese trading growth and investment in countries in the region creates competition with India that some South Asian countries have been able to exploit. For these countries, increasing trade with China and India and increasing foreign direct investment have led to increased growth of gross domestic product (GDP) and, for some, the opportunity to begin to counter historical Indian dominance.⁵⁷

Although increasing Chinese and Indian trade in the region has benefited everyone through overall increased GDP, it has also led to an increased sense of encirclement and loss of regional influence for India. This change in economic relations opens up opportunities for increased growth and economic cooperation, and it creates stability risks, such as increased pressure on China and India to curry favor in some Indian Ocean countries in the form of arms sales.⁵⁸

Opportunities from Expanding Sino-Indian Trade

The growth of trade between China and India stabilizes the region by creating mutual dependency between the economies of the two countries. Trade between India and China and with the other countries in the region increases overall wealth.

Risks Created by Expanding Sino-Indian Trade

At the same time, the trade imbalance between China and India destabilizes the region. India's trade deficit with China indirectly increases India's budget deficit, which hinders it from making strategic investments abroad, places where China might be India's main competitor. This fact makes many in India hold China responsible for India's lost access to vital resources and declining influence in the region, which it has long considered its backyard.⁵⁹ Table 3 assesses the outcomes of economic change in the Indian Ocean region.

Table 3. Regional Economic Impact Analysis Outcome

Issue Area	China	India	Relevant Regional Player(s)
Increased Sino-Indian trade	Win	Competition and win	Win
Increased trade between China and other Indian Ocean nations	Win	Loss	Win

Source: Authors

Energy Security

Energy security requires that resources are available in sufficient quantities to facilitate economic growth, energy supplies are uninterrupted, and prices are affordable.⁶⁰ By this standard, China and India face similar risks to the security of their energy supply and infrastructure. Among major economies, China and India exhibited the fastest rates of real GDP growth in 2010 at 10 percent and 8 percent respectively.⁶¹ Perpetuating this economic growth requires increasing energy consumption, even as both nations face the specter of depleting domestic reserves of oil and natural gas. In the past decade, China and India have taken increasingly assertive steps to shore up the diversity, reliability, and price negotiability of their energy supplies. Arguably the most critical issue at stake for both nations has been finding ways to address the rising share of imports as proportion of their total oil consumption.

Under the status quo, China and India ride free on the security blanket the U.S. navy provides in the Indian Ocean region. Neither country possesses the naval capacity to act as a maritime hegemon. In cooperation with regional powers, the U.S. navy helps ensure safe passage through four key energy transit chokepoints: the Suez Canal, Bab-el Mandeb, the Strait of Hormuz, and the Strait of Malacca. Oil and natural gas reserves are predominantly located in the west of the Indian Ocean region. Abundant energy resources in Northeast Africa, the Persian Gulf, and Central Asia must be transported to voracious demand centers in South and East Asian countries. Located to the east of the critical Malacca Strait, China seems to view reliance on U.S. naval supremacy skeptically, even though it is obviously necessary for the immediate future. Both China and India have sought to address the inherent risks of energy imports and transport bottlenecks via four interrelated strategies: (1) pursuing equity stakes in overseas upstream energy projects, (2) building overland or underwater pipelines, (3) investing in pariah states with oppressive regimes, and (4) establishing SPRs. The pursuit of similar energy security strategies has frequently brought the two nations into vigorous competition for the same limited resources, and China has typically gained the upper hand. Nevertheless, Sino-Indian relations resist one-dimensional characterization. The nations have cooperated on a subset of initiatives to collectively improve their energy security. While the majority of critical issues at stake in the realm of energy security are purely competitive, a limited number of universally beneficial scenarios for China, India, and smaller regional players are also apparent.

The Pursuit of Equity Oil Stakes

As India, China, and other states have pursued direct equity stakes in upstream oil assets, the Chinese have often outbid the competition. Once China outbids another nation for an equity oil interest, the oil is essentially off the market for

all other national competitors, assuming that Chinese oil companies will supply oil to their domestic market even if higher prices are offered elsewhere in the world. This move establishes the purely adversarial nature of the equity oil acquisition game. The effectiveness of the Chinese strategy hinges on the crucial assumption that the nominally private Chinese oil companies will be capable and disposed to produce crude oil, ship it to China, and sell it domestically for significantly less than the global market price during a supply crisis. This assumption is not necessarily guaranteed, as the firms could be giving up the opportunity for windfall profits or even selling at a net loss.

Assuming the upstream investment strategy does work for China or any other nation-state equity investor, it could pose an energy security risk for other countries, because oil might be removed from the freely functioning global commodity market. The price signal and oil distribution mechanism could be distorted, such that resources do not flow to where they are most highly demanded, as indicated by where the offered price is highest. The effect of China retaining oil for domestic consumption would be likely felt most acutely during an international supply shock. It could affect any net importer, including the United States, India, or any other nation in the Indian Ocean region.

China's ability to out-compete all comers has largely been a result of its willingness to commit significantly more resources. Overall, Chinese companies spent roughly \$32 billion acquiring natural resource assets abroad in 2009. India intends to emulate China's overseas energy security strategy but has more limited finances.⁶² In 2009 India spent just more than \$2 billion on overseas projects. Emboldened to compete head to head with China on upstream acquisitions, India's Oil and Natural Gas Corporation asked officials in Delhi for more cash to deploy, hoping to get direct access to India's \$280 billion of foreign currency reserves.⁶³ However, it will be difficult for India to compete with China's world-leading \$2.6 trillion in foreign reserves. Despite setbacks in the race with China, India has secured a substantial portfolio of upstream reserves. India's public sector oil companies have launched successful bids in several countries.⁶⁴ These bids inject some much-needed security and diversity into India's import sourcing geography, which has been dominated by countries in the Persian Gulf.

Although India most often plays second fiddle to China because of limited financial resources, bureaucratic shortcomings also play a role. Chinese oil companies have far greater carte blanche from Beijing to quickly sign large energy deals. Indian national oil companies must seek approval from officials in Delhi before inking deals more than \$1.1 billion. Tying company officials' hands in this manner contributed to India losing out to China when it tried to buy PetroKazakhstan in 2005 and when it attempted to secure equity stakes in Uganda's Lake Albert region in 2010. Lumbering Indian firms, kept on a tighter

leash, lack the deft touch enjoyed by their more nimble Chinese counterparts. This deficiency is imperiling Indian energy security.⁶⁵ Although the race for upstream direct equity stakes is purely competitive, when focusing on oil importers like India and China, beneficial scenarios emerge within bilateral relations between exporting and importing nations. For instance, when China invests in Sudanese oil reserves, often developing large swaths of infrastructure in the process, both actors derive substantial benefits that neither could achieve independently. As mentioned, energy security improves for oil importers when its companies hold legal titles to overseas oil deposits. On the other side of the bargain, resource-rich but capacity-poor states like Sudan lack the ability, resources, and demand centers to independently explore, develop, and exploit their oil reserves. When skilled, financially flush players like Indian, Chinese, or Western oil companies enter producing countries, the companies offer not only their checkbooks, but also a very helpful skill set. Producing countries gain a partner who may not share their immediate interests but does share in their burgeoning prosperity.

Ensuring Supply via Pipeline

All else being equal, delivering oil by sea is cheaper than any other delivery method by nearly an order of magnitude, including rail or pipeline transport.⁶⁶ The motivation for countries to increase transport diversity comes not from price concern, but rather from concern for the risks inherent to maritime transport, such as piracy and naval blockades.

The acquisition of pipeline routes is a highly competitive game for importing countries. Although oil-exporting nations could choose to construct multiple pipelines to multiple destinations, the huge fixed costs of such projects makes duplication of infrastructure infeasible. Nations where China has completed projects are generally hesitant to invest in infrastructure and build separate pipelines to supply India. For instance, the Sino-Kazakhstan oil pipeline has established a firm Chinese foothold in Central Asia, which may resist encroachment by other Asian powers.

Chinese strategists hope that other pipeline projects, namely the Burma overland path, will offer a backdoor supply line, reducing reliance on the Strait of Malacca and helping to secure Chinese oil inflows.⁶⁷ The Burma-China pipeline ranks as a large boon to the Beijing regime, as it could help draw Burma away from its historically strong ties to India. In fact, Chinese oil and gas pipeline agreements with the Burmese junta came as a huge surprise to Delhi, which had attempted for several years to negotiate a Burma-Bangladesh-India natural gas pipeline.⁶⁸ With improved diplomatic cachet from the oil pipeline and other projects, China has also won titles to purchase Burmese natural gas.

The Burma-China pipeline could in principle reduce the credibility of any future U.S. or Japanese threat to blockade Chinese oil imports, especially if the China pipeline is expanded to 400,000 barrels per day, as ultimately planned.⁶⁹ That stated, the Burma pipeline itself would be subject to attack, and even now oil tankers can avoid the Strait of Malacca by taking Lombok Strait, Makassar Strait, Sibutu Passage, or Mindoro Strait, albeit at markedly higher transportation time and cost. In the near future, China-bound shipments may have a not quite competitively priced, alternative overland route.

Although the game between oil-importing nations for pipeline routes is highly competitive, the bilateral relations between the winning import nation and countries hosting pipelines are very beneficial. When China builds pipelines through Burma or Kazakhstan, China improves its energy security and the pipeline host enjoys transport payments or a new resource customer.

Investing in Pariah States

China and India's gamesmanship, brazenly courting relations with Iran, Burma, and Sudan, the Indian Ocean region's pariah states, sets up a scenario that mixes competition and mutual gains. On the one hand, both China and India would like to forge the closest, most exclusive relations with any pariah states up the supply chain. They are engaging in a winner-take-all battle for limited resources. On the other hand, while China's or India's pursuit of relations with pariah states could easily draw criticism from the rest of the world, there is some safety in courting the pariah states together. When India and China simultaneously pursue investments and relations with pariah states, they may decrease potential diplomatic fallout. It is easier to criticize one player not abiding by the rules, than to criticize two powerful offenders.

There are two key effects on global energy security from Chinese and Indian dealings with pariah states. From one perspective, their investments embolden these repressive regimes, helping them flaunt nefarious behavior despite international sanctions and condemnation. Such action impinges upon UN influence and endangers security across the Indian Ocean region in general. Looking at the issue in another light, India and China open up significantly more oil and natural gas to the global market through their investments in pariah states. If neither country pursued upstream investments in Iran, Burma, or Sudan, they would have to purchase more oil on the open market, which would mean higher prices and even more constricted supply, to the detriment of all importing nations. Chinese and Indian willingness to extract oil from places other energy players avoid means that the global market is better supplied, thereby reducing energy prices and benefiting consumers in North America, Europe, and Japan.⁷⁰

Establishment of a Strategic Petroleum Reserve

Both China and India have executed plans to stockpile crude oil in their SPRs. While this strategy could increase both countries' demand for imported oil, it also bolsters their energy security and may moderate their actions in the Indian Ocean region. A well-managed SPR helps ensure regular supply and enhances the government's capacity to stabilize the oil market.⁷¹ For an oil importer facing a supply shortage, a larger SPR lengthens the time frame the government has to seek solutions before lack of imports severely damages the domestic economy.

Viewed through one lens, India and China are competing to build the best SPR facilities and to increase oil imports as they fill the reserves. At the same time, prudently managed SPRs may set up universal gains. If both nations establish more trust in the international oil market, it may alleviate some of their security concerns that incite highly competitive actions, such as equity oil pursuit, pipeline projects, investments in pariah states, or even naval arms races. Establishing SPR facilities is a critical first step to set up a scenario of greater trust. Table 4 summarizes the impacts of possible actions by China and India on overall energy security.

Table 4. Energy Security Impact Analysis Outcome

Issue Area	China	India	Relevant Regional Player(s)
Upstream Equity Oil Pursuit	Win	Loss	Win
Pipeline Projects	Win	Loss	Win
Investing in Pariah States	Win	Win	Win
Building up SPR	Win	Win	Competition and win

Source: Authors

III. Trends and Prospects for the Indian Ocean Region

This section summarizes the outlook for the Indian Ocean region based on the impact analysis above. We summarize patterns of change related to the role of sea lanes of communication and energy security. In the section on prospects, we imagine the region's future in light of piracy off the coast of Somalia and then under two scenarios: an expansionist China and a non-expansionist China.

Trends

In this section, we evaluate important trends in the Indian Ocean region.

Sea Lanes

Much of China's reported String of Pearls strategy has been centered around reported fears of an oil blockade of one or more key choke points for shipping at the straits of Hormuz, Malacca, Luzon and Taiwan.⁷² This scenario usually envisions the U.S. navy, as the only deep water navy capable of such an action, blockading a specific choke point (usually Hormuz or Malacca) and preventing oil tankers from reaching China.⁷³

The feasibility of such a blockade, however, is doubtful. For instance, an average of 52 tankers pass through the Strait of Malacca daily, roughly a third of which are bound for China.⁷⁴ Of the oil ultimately bound for China, only 10 percent actually travels on Chinese tankers. Furthermore, due to the fungible nature of the product, tankers often carry oil destined for one of several countries, as it is being traded on spot markets while the tankers are en route.⁷⁵ Thus, the oil in the tanker might trade ownership multiple times before it actually reaches its destination. As oil could be traded to China after it passed the Strait of Malacca and as manifests could be forged in the event of boarding, an effective blockade would require having all tanker owners agree to cooperate with an embargo, banning any tankers from the Strait of Malacca or the Lombok Strait to the south, or traveling around Australia.⁷⁶ Such a blockade would cut off oil shipments to Japan, Korea, the Philippines, and other countries. A blockade of the Strait of Hormuz would cause similar difficulties for even more countries. The level of agreement among governments and private parties that would be necessary to create an effective blockade is usually only seen during events like a world war.

Energy Security

Already the most vital waterway for global energy security, the Indian Ocean region will become even more critical and contested. World energy demand is projected to rise 45 percent by 2030, with nearly half the growth from India and

China.⁷⁷ In 1993 China switched from being a net oil exporter to an oil importer. Projections suggest that the import production gap will continue to grow through 2020 and beyond.⁷⁸ Currently importing 48 percent of its oil, China perceives energy shortages from a constricted global market as one of its gravest threats. Assuming China's economic growth continues to fuel its increasing energy needs, it is highly likely that China will pursue upstream equity oil stakes even more doggedly in the next decade.

Despite efforts to diversify its upstream supply chain, China remains disproportionately reliant on a narrow array of crude oil providers. Fifty percent of the 4 million barrels per day imported in 2009 came from the Middle East, 30 percent from Africa, 5 percent from the Asia-Pacific Region, and 17 percent from other countries.⁷⁹ As the second largest oil importer in the world, China views dependence on the U.S. navy to protect its sea lanes of communication as an intolerable threat to its energy security. Given China's fears about dependence on the United States and lack of import diversity, China is likely to continue to pursue pipeline projects and relations with pariah states in the next decade. It is critical to note, however, that China's neighbors do not have the capacity to fully supplant seaborne oil shipments with pipeline delivery.⁸⁰ China is likely to depend on sea-based oil transport for the majority of its oil imports for the foreseeable future.

With even more meager domestic oil production capacity than China, India imported roughly 70 percent of its oil needs in 2009, making the subcontinent the sixth largest oil importer in the world. A combination of greater consumption and stagnant production levels suggest that India will be increasingly dependent on imports for the foreseeable future.⁸¹ By 2020 India will have to import 92 percent of its oil consumption.⁸² The Energy Information Administration projects that India will be the fourth largest oil importer by 2025, following the United States, China, and Japan.⁸³ These forecasts suggest that India will continue to compete for equity oil stakes over the next decade. Even the most robust economic growth projections for the subcontinent do not suggest Delhi will have enough foreign currency reserves and other financial capital to effectively outbid China at any point during the first half of this century.

Like China, India imports large volumes of oil from a restricted array of providers. Almost 70 percent of India's crude oil imports arrive from the Middle East, predominantly from Saudi Arabia and Iran. This geographic over-dependence is likely to increase in the immediate future, due to exceptionally meager prospects for new domestic production.⁸⁴ Indian energy security analysts have posited that by 2020 the only exploitable reserves of oil left in the world will be in Africa and the Middle East, not including tar sands and coal gasification.⁸⁵ As a result of perceived security risks from lack of upstream diversity, India is likely to continue to court relations with pariah states and any other oil suppliers. Fearing over-

reliance on seaborne oil shipments, India is likely to continue to consider Central Asian pipeline projects, but a combination of ongoing tensions with Pakistan and outsized competition from China will most likely derail India pipeline aspirations in the next decade.

Prospects

In this section, we discuss prospects relating to piracy in the Indian Ocean and then move on to analyze regional security, non-energy economic relations, and energy security under two assumptions. First, we assume China has expansionist intentions and we consider the scenarios we find most plausible in the near term (i.e., in the next 10 years) and far term (i.e., 10 to 20 years from now). Expansionist intentions do not necessarily imply China seeks territorial gains; instead, we define expansionist intentions as active attempts to repress another player as part of a larger effort to expand regional power. We then consider the same three issues under the assumption that China does not have expansionist intentions, again making predictions about possible outcomes in the near and far terms.*

Piracy

All states that ship goods past Somalia and, lately, on the Indian Ocean as a whole have a reason to work together to address piracy. Somali pirates are effective, numerous, and increasingly violent. Although a coordinated naval effort near Somalia by India, China, the United States, and other regional players may slow attacks, Somalia's civil war and the turmoil in which the Somali people live will keep pushing otherwise unemployable people to piracy and other illicit acts. The fact that Somalia itself has no legitimate naval presence complicates the matter, as the pirates' home state is unable to share intelligence on pirate activities, as was essential in countering Indonesian pirates in the Strait of Malacca.

These limitations, as well as the sheer size of the range of attack that the Somali pirates employ, lead to conditions in which cooperation for international partners is unlikely to succeed. Unless India, China, the United States, and other regional players are willing to put forth significant resources and can agree on shared monitoring jurisdiction, the problem of Somali piracy is most likely a loss for all. A win-win situation could arise if a massive aid and restructuring effort was aimed at Somalia as a whole, ending the extended civil war and returning the state to the bare minimum of normalcy, but this scenario is both unlikely and

* We make our predictions using the following scale and corresponding percentages: *Very unlikely* (<2%), *Unlikely* (2% - 6%), *Somewhat unlikely* (6% - 20%), *Plausible* (20% - 55%), *Somewhat likely*, (55% - 65%), *Likely* (65% - 80%), *Very likely* (80% - 100%). Table 5 summarizes our predictions.

unrealistic. For now, inaction and perhaps the deferral to private security forces are the only viable options.

Expansionist China

If we consider China's actions to reflect expansionist goals, the creation of the bases and ports detailed above as well as the economic and military aid given to South Asian states clearly point to the String of Pearls perspective. That is, China seeks to encircle India to close off its control of sea lanes and provide the Chinese military a jumping-off point for attack during a conflict. This scenario is the main fear driving the concern of Indian officials regarding China. India wishes to become a world power in its own right; an expansionist China appears to be actively working to remove India's regional support base and to threaten India's access to the shipping lanes vital to its development.

If Chinese actions are expansionist, we expect to see a continuation and acceleration of Chinese construction in the region. Also, although there is not a strong Chinese military presence at any of the ports discussed in earlier sections, an expansionist China would move to change this. We could expect a gradual buildup of military infrastructure and personnel and possibly a large Chinese population at each site, similar to the Chinese populations in Africa at locations of infrastructure creation. All of these actions would be a direct attempt to undermine India's rise in the international order while ensuring that China's own interests are propelled forward. An expansionist China would fear a rising India as a major opponent in its own rise as a regional (or eventually global) hegemon.

In the near term, military conflict between China and India is improbable, even if China does have expansionist intentions. China's navy is not strong, and many of the ports are still in development. We consider the outbreak of a major armed conflict (defined here as lasting more than one month) between the two powers in the next 10 years as *very unlikely*. In the far term, we would assume that China has successfully built up its naval forces and is secure in its control of the Indian Ocean. The probability of armed conflict in 10 to 20 years would rise to *unlikely*. We choose to keep this estimate relatively low: we predict that China would be unlikely to attack India before being quite prepared; at such a time when China was prepared, its foothold in the Indian Ocean region would be so strong that armed conflict would be unnecessary. India also would be unlikely to engage China, with the Chinese so well established in locations that completely surround India's homeland.

A proxy war between India and China (operating through Pakistan) remains possible, however. While we feel that this is *unlikely* in the near term and *somewhat unlikely* in the far term, an expansionist China would certainly consider using the animosity between India and Pakistan to its advantage. The

history of South Asia is sprinkled with this type of military engagement, and we would be remiss if we did not acknowledge this possibility.

If Chinese trade and foreign direct investment (FDI) continue to grow at present rates with countries in the Indian Ocean region, under the assumption of an expansionist China, India and the other countries in the region would face short-term and long-term challenges to existing economic relationships. In the next 10 years or so, if India wishes to maintain its influence with its closest neighbors, it would have to compete with China's direct investment in its neighbors' infrastructure. India likely would be forced to take actions such as non-prudential arms sales to neighbors. In 10 years and beyond, India would likely see China exploit the countries' widening trade gap. India would lose investment opportunities and face being cut off from key port facilities in the Indian Ocean region where it can no longer afford investment competition with China. Other countries would likely see short-term gains in the form of increased investment by China and India but face long-term instability as China and India become more belligerent. We estimate as *somewhat likely* that China will widen its trade surplus with India and as *very likely* that China will seek to expand economic influence with India's neighbors.

The prospects for energy security in the Indian Ocean region could vary dramatically, depending on China's motives. China's disposition is the key catalyst determining outcomes from a range of possibilities, because other major players like India have been defensive and responsive, rather than offensive and proactive.⁸⁶ If China pursues an expansionist policy, then it may seek true hegemony in the Indian Ocean region. China would likely minimize the volume of oil imports entrusted to global commodity markets and maximize direct control over upstream oil assets. In the process, China will likely eschew cooperative opportunities with India and other Asian powers, while aggressively pursuing purely competitive equity oil and pipeline projects. For the Indian Ocean region, political tensions would increase, as India and China race to establish control over limited natural resources, overland rights of way, and sea lanes of communication. Intentional disruption of China's oil imports by the U.S. or Japanese navies would most likely be precipitated by disputes over Taiwan or islands in the South China Sea respectively, not Indian Ocean territories.⁸⁷ Assuming an expansionist China, the potential for military conflict directly incited by natural resource access disputes will gradually increase over time as well. Even if conflict does not ensue, the price of oil and other energy resources may rise more quickly than they would if China were less aggressive, as Chinese national energy companies pull commodities off of the global market.

Given an expansionist Chinese regime, we estimate the probability that China and India will cooperate on energy security projects as *unlikely* in the next 10 years and *somewhat unlikely* in 10 to 20 years. We also estimate that it is

unlikely that India and China will entrust more of their energy security to the global market in the next 10 years, *and somewhat unlikely* that they will both do so in 10 to 20 years. In contrast, it would be *likely* that both nations will compete to maximize their equity oil and pipeline projects in the next 10 years and *somewhat likely* that they will do so in 10 to 20 years.

Non-Expansionist China

China is a rapidly rising world power and, much like the United States, it has established its presence in strategic locations around the globe and is beginning to seek out bases in its neighboring vicinity. Although these steps are not comforting to the United States or India, China's actions, as of yet, do not seem to be out of line with international norms. This situation leads to the possibility that China may be a non-expansionist power.

If China is non-expansionist, we would expect to see more economic partnerships between China and smaller South Asian players and perhaps with India itself. China also would continue to secure its shipping routes to ensure the most secure and efficient passage of its imports and exports. China's actions relating to India would not be directed at India; rather they simply would be strategic steps taken in a region that is important to Chinese shipping. Also, the presence of the Chinese military would not be explicitly aggressive or expansionist per se: it would be in line with the norms of all superpowers to retain bases throughout the globe to be utilized for a variety of reasons, including natural disaster relief, military exercises, or diplomatic relations. A non-expansionist China would be willing, perhaps even eager, to work with India to create an open and free trade climate, perhaps with security partnerships and information sharing. We assign a probability of *very unlikely* to armed conflict in both the near and far term under the assumption of non-expansionist Chinese intentions. The probability that China and India will open or expand security partnerships and information-sharing agreements is high under this assumption, at *somewhat likely* in the near term and *very likely* in the far term.

Under the assumption that China's motivations are non-expansionist, India would likely still face an increasing trade gap at least for the next 10 years. However, a non-expansionist China should be willing to negotiate trade deals, which would allow India to narrow this gap to some degree. Yet, even if China's FDI goals in other Indian Ocean countries are benign, India would need to try to match China's investment or it would still face diminished regional influence as China becomes an increasingly important trade partner for its neighbors and as increased Chinese shipping makes a larger impact on other countries' port facilities. Other countries would likely see gains from an increasing Chinese presence in the region for the next 10 years and beyond, as they reap the benefits of Chinese and Indian FDI without the instability of potential conflict between

them. We estimate it is *plausible* that China and India will cooperate to try to decrease their bilateral trade imbalance, but *somewhat unlikely* that China and India will sign a free trade agreement. It is also *somewhat unlikely* that China and India will cooperate on infrastructure development projects in India's neighbors.

Some analysts have suggested that China is most likely to adopt an expansionist stance vis-à-vis energy security, noting that although it became a net importer of oil in 1993 with the bulk of imports flowing through Indian and Pacific Ocean sea lanes of communication, Beijing refused to participate in multilateral sea security initiatives, such as anti-piracy operations, until 2008.⁸⁸ If China nonetheless adopts a non-expansionist foreign policy stance on energy security, then it is only *somewhat likely* to attempt to maximize independent control over equity oil assets and pipeline connections in the Indian Ocean region during the next decade. A non-expansionist China would be equally *likely* to pursue cooperative equity oil and pipeline projects with India as a partner. If a non-expansionist regime in Beijing continues to build up its SPR and then joins intergovernmental energy organizations, China may taper the voracious pace at which it has been gobbling up upstream oil assets and paying for uneconomical pipelines. China could entrust more of its energy import needs to the global marketplace, while maintaining an intrinsic sense of energy security. A non-expansionist China would mean a lower likelihood of military conflict over natural resources. Moreover, the price of energy resources might rise more slowly, because Indian, Chinese, and other national oil firms would take fewer commodities off of the international free market.

Given a non-expansionist Chinese regime, we estimate the probability that China and India will cooperate on energy security projects as *somewhat unlikely* in the next 10 years and *plausible* in 10 to 20 years. We also estimate that it is *plausible* that both India and China will entrust more of their energy security to the global market in the next 10 years, and *somewhat likely* that they would both do so in 10 to 20 years. At the same time, it would still be *somewhat likely* that both nations seek to maximize their equity oil and pipeline projects competitively in the next 10 years and plausible that they will do so in 10 to 20 years. Table 5 lays out some predictions.

Table 5. Summary of Near-Term and Far-Term Predictions Based on Assumptions of Expansionist and Non-Expansionist China

Prediction	Expansionist China		Non-Expansionist China	
	0-10 Years	10-20 Years	0-10 Years	10-20 Years
Security Issues				
Outbreak of a major armed conflict	Very unlikely	Unlikely	Very unlikely	Very unlikely
China and India open and/or expand security partnerships and information-sharing agreements	Very unlikely	Very unlikely	Somewhat likely	Very likely
China engages India in a proxy war via Pakistan	Unlikely	Somewhat unlikely	Very unlikely	Very unlikely
Non-Energy Economic Relations				
China widens its trade surplus with India	Somewhat likely	Somewhat likely	Somewhat likely	Plausible
China seeks to expand economic influence with India's neighbors	Very likely	Very likely	Somewhat likely	Very likely
China and India cooperate to reduce trade imbalance	Very unlikely	Very unlikely	Plausible	Plausible
China and India sign a free trade agreement	Very unlikely	Very unlikely	Somewhat unlikely	Plausible
China and India cooperate on infrastructure development projects in Indian Ocean region	Very unlikely	Very unlikely	Somewhat unlikely	Somewhat unlikely
Energy Security				
China seeks to maximize equity oil assets, pipeline connections	Likely	Somewhat likely	Somewhat likely	Plausible
India seeks to maximize equity oil assets, pipeline connections	Likely	Somewhat likely	Somewhat likely	Plausible
China entrusts energy security to global market and joins intergovernmental energy organizations	Unlikely	Somewhat unlikely	Plausible	Somewhat likely
India entrusts more energy security to global market and joins intergovernmental energy organizations	Unlikely	Somewhat unlikely	Plausible	Somewhat likely
China seeks evenhanded cooperation on energy security projects	Unlikely	Somewhat unlikely	Somewhat unlikely	Plausible
India seeks evenhanded cooperation on energy security projects	Unlikely	Somewhat unlikely	Somewhat unlikely	Plausible

Source: Authors

IV. Opportunity Analysis

We evaluate several possible opportunities for U.S. action in the Indian Ocean region.

United States' Interests in the Indian Ocean Region

Given the United States' status as a leading economic and military power and its growing presence in South Asia, it would be advantageous for it to obstruct or promote certain trends unfolding in the region. Following an examination of these trends, we discuss policy tools the United States could use.

Trends the United States Should Obstruct

The United States should act to protect its regional influence and promote its interests by discouraging several trends in recent regional activities.

First, the United States should work to slow Chinese influence derived from FDI in regional states. Small regional states benefiting from Chinese FDI have sided with China in international organizations, such as the UN. Their support hinders U.S. interests regionally and globally.

In addition to reducing Chinese influence, the United States should discourage countries from allowing Chinese-financed ports to be built in strategic locations. Ports like that at Gwadar, Pakistan, threaten the openness of key sea lanes of communication. As the dominant nation patrolling these sea lanes, the United States should retain open access for all countries. If controlled by a single nation, key choke points in the Indian Ocean, including the Strait of Malacca, the Strait of Hormuz, and Bab el Mandeb, could harm world trade. Piracy in the Strait of Malacca demonstrates what can happen when free and secure access through a choke point cannot be ensured.

Third, the United States should form partnerships to prevent and eradicate the Somali pirates harassing shipping in the Strait of Malacca and the Indian Ocean. An end to piracy would ensure safer sea lanes of communication and greater security for world trade. However, piracy is likely to continue, as eradicating it will require a large international effort.

Trends the United States Should Promote

To advance its interests, the United States should encourage certain trends.

First, the United States should not prevent India and China from acquiring energy resources such as upstream equity stakes or strategic reserves. The supply of

these resources allows India and China to continue their rapid growth, which in turn helps drive the global economy. Their acquisition of energy resources from pariah states is troubling, but it brings more oil and gas onto the world market and leaves the United States to obtain resources from less problematic sources.

Second, the United States should support a return of these pariah nations to the international fold and their resources onto the global market. This diplomatic maneuver is a long-term goal; for now, inaction is the best course.

Third, the United States should encourage China and India to join intergovernmental energy organizations, such as the International Energy Agency and International Renewable Energy Agency.⁸⁹ Bolstering the case for SPRs, the International Energy Agency charter requires that members store, track, and report at least 90 days of import reserves. If China and India come to believe that they can rely on the international system and international market, then acrimony over other security concerns may be assuaged in a mutually beneficial cascade.

Fourth, the United States should use existing the Sino-Indian relationship to its advantage and promote changes that would further advance its interests. India and China appear to be wary of each other's intentions and competing influences, even as they increase trade and work as partners on several energy ventures. More trade between India and China could increase their mutual interests and lead to greater stability in their relationship and the Indian Ocean region. This stability would benefit U.S. trade and decrease the likelihood of regional conflict.

Fifth, the United States should encourage India to continue building relations with other Indian Ocean states, as well as with Southeast and Central Asian countries. As noted, China has been more successful at creating regional relationships due to its ability to spend and invest more. To maintain the balance of power and avoid Chinese domination of regional states, India needs to build up a number of strategic relationships.

Sixth, the United States has lately improved its relationship with India, and it should continue to do so. Obstacles to a strong partnership, such as Cold War politics, a stagnant commercial relationship, and disagreements over India's nuclear program, no longer exist.⁹⁰ Great progress has been made in U.S.-Indian relations since President Clinton's visit in 2000: bilateral trade has tripled, a landmark agreement on civil nuclear cooperation was reached, and security relations were strengthened.⁹¹ Continuing this progress will allow the United States to have a powerful and strategically located ally in the Indian Ocean region.

Policy Tools to Achieve U.S. Strategic Interests

The proceeding analysis allows us to discern opportunities for U.S. action in the Indian Ocean region. In order of importance, these are (1) strengthening relations with India; (2) expanding relations with Chinese-courted regional states; (3) maintaining naval superiority in the Indian Ocean region; (4) ensuring energy security for Indian Ocean nations; and (5) pursuing closer diplomatic relations and a more equal trade balance with China.

Strengthen Relations with India

The stage is set for U.S.-Indian relations to grow. Increased bilateral trade presents one opportunity to strengthen relations. Although the United States is India's largest trading partner, largely due to Indian exports, a number of trade issues remain between the two countries. For example, the United States would like greater access to India's agricultural markets and service sectors for its exports and FDI, as well as improvements in intellectual property rights protection.⁹² India would like lower barriers to agricultural and service imports, as well as expansion of the U.S. H-1B visa program.⁹³ Resolving these issues would be economically and politically beneficial to both nations. As China is a growing competitor for Indian trade, increasing U.S. trade would allow the United States to retain influence over India.

Expand Relations with Chinese-Courted Regional States

The United States should expand its relations with Indian Ocean states courted by China, such as Bangladesh and Sri Lanka. It could do so by funding port or infrastructure construction, as China has done. This financial support would increase U.S. regional influence and power. If China seeks political or military allies throughout the region, it is likely that the United States would want to court the same states to undermine Chinese efforts or at least stay on par with them. Furthermore, the United States' seat on the UN Security Council may weaken the motivation for countries to accept Chinese aid over Indian aid and investment, as long as those regional states perceive India and the United States as strong allies."

Maintain Naval Superiority in the Indian Ocean Region

The Indian Ocean region connects the land and maritime theaters of greatest concern to American strategists, such as Iraq, the greater Middle East, the Horn of Africa, and the Western Pacific.⁹⁴ U.S. maritime strategy was reoriented in 2007, from the Atlantic and Pacific oceans to the Pacific and Indian oceans. Maintaining U.S. naval superiority in the region would be beneficial to many countries by helping to combat piracy, patrol sea lanes, and maintain stability.

The United States should continue to expand the capacity of its base at Diego Garcia and create similar bases in the region. The United States could use this opportunity to strengthen its relations and influence in regional states where it would like to station U.S. forces or counter Chinese influence. Extending its own influence would be an excellent soft power policy tool to counter recent Chinese actions.

Ensure Energy Security in the Indian Ocean Region

In addition to increasing its military force generally, the United States should use its forces to ensure energy security for itself, as well as for China, India, and other regional states. Two of the fastest growing nations in the world, China and India need an assured supply of energy resources to maintain their growth. Without it, slow-growing economies might lead to civil unrest or violence. It is in the best interests of world trade and regional stability to ensure energy supplies to these countries. The United States can help do this by maintaining open sea lanes. Out at sea, there is little difference between Chinese oil and American oil. This means that perilous sea lanes and other threats to energy security in the Indian Ocean region inevitably affect all oil-consuming nations that rely on oil sources in the Middle East or Indian Ocean region.

Pursue Closer Diplomatic Relations and a Less Unequal Trade Balance with China

The United States should pursue closer diplomatic relations with China. These relationships will bring greater stability to the Indian Ocean region, even as regional powers continue to build up their military capacities. China's 2011 White Paper on Chinese Defense discusses reinforcing confidence in international military affairs through joint exercises and international missions.⁹⁵ This sentiment could represent an opportunity for greater U.S. engagement with China. Although joint U.S.-China naval exercises seem unlikely, one mission could be aiding Somalia and eradicating piracy in the Strait of Malacca. Creating opportunities for U.S. and Chinese diplomats and navies to work together could increase understanding between the two nations and enhance regional stability.

The United States should also try to equalize its trade with China. Sino-American trade has been growing rapidly in the past decade.⁹⁶ However, the magnitude of America's imports from China has caused a large trade balance in China's favor that grew from \$83.7 billion in 2000 to \$226.8 billion in 2009.⁹⁷ Increasing American exports to China will have a positive economic impact for the United States, partially fix its large trade deficit, and increase Chinese reliance on America.

Overall, the United States should create opportunities that increase diplomatic relations and equalize its trade balance with China. China remains hesitant to

start high-level strategic dialogues with the United States, and its motivations for many of its actions remain unclear.⁹⁸ For the present, the United States will have to remain vigilant for ways to strengthen diplomatic ties and work towards a less unequal trade balance.

Summary of U.S. Interests and Available Policy Tools

These policy tools will allow the United States to prevent or promote regional trends as it sees fit over the short and long term. Prioritizing and understanding the relationship between different actions and outcomes will be important. For instance, the United States would benefit from building a strong relationship with India and having a legitimate military presence in the Indian Ocean region before working more closely or negotiating with China. An Indian ally and military presence will give the United States greater leverage vis-à-vis China. Undertaking certain actions, such as ensuring energy security, could have different outcomes depending on implementation and timing. For example, the United States could ensure energy security in the region in a number of ways. It could build up an enormous military presence, which would threaten China and decrease the possibility of close cooperation with that nation. Alternatively, the United States could call for increased international patrols of sea lanes of communication or form a committee within the United Nations for dealing with piracy issues in the Indian Ocean region.

In sum, stronger relations with India and Chinese-courted regional states, naval superiority on the Indian Ocean, energy security for Indian Ocean nations, and closer diplomatic relations and a more balanced trade with China could help the United States advance its interests in the Indian Ocean region.

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