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Growing demand, limited supply?

As China gets more dependent on oil imports, doubts arise about Saudi Arabia's ability to meet orders.

By Peter Enav

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China's growing thirst for oil will place a greater strain on the world's top supplier, Saudi Arabia, at the very time that doubts are being raised about the kingdom's ability to increase production substantially.

Should output falter in Saudi Arabia and other Middle East nations, some analysts warn of growing tension - or even conflicts - over access to diminishing resources between China and the world's biggest oil importers, the United States and Japan, unless alternative sources of energy are found.

With its economy booming, China is striving to meet its enormous energy needs by intensifying ties to major energy-producing countries and seeking to buy a wide array of foreign oil and natural-gas assets.

A unit of China's biggest state-owned oil firm, China National Petroleum Corp., announced Monday that it has reached an agreement to buy a major oil producer in neighboring Kazakhstan for $4.2 billion. Beijing's strategy was dealt a blow earlier this month, however, when state-controlled CNOOC Ltd. abandoned its $18.5 billion bid to acquire California-based Unocal Corp., citing enormous opposition to the deal in Washington.

But even if China were to double in the next five years the foreign energy reserves it acquires for its domestic use, it would meet only a fraction of its expanding oil appetite, experts who follow China's oil industry say.

"China will never be able to satisfy its oil demand through foreign acquisitions," says Gavin Thompson of the Beijing office of British oil consultants Wood Mackenzie. "They are now getting 55-60 percent of their oil imports from the Middle East. In the future, that proportion will only increase, because the Middle East is where the oil is."

Almost half of China's total oil consumption of 6.7 million barrels a day last year came from imports, according to BP P.L.C. statistics. Chinese customs figures show Saudi Arabia provided 16 percent of China's import needs, with Oman and Iran contributing 24 percent between them.

Less than 10 percent of its imports - about 300,000 barrels a day - came from foreign oil properties controlled by Chinese firms, said Wu Kang, a fellow at the University of Hawaii's East-West Center in Honolulu, citing Chinese statistics. And as China's economy expands, Wu estimates that its import demands will swell to 5 million barrels a day by 2010.

Saudi Arabia is probably the only country that can meet those demands, Wu says - at least for the next several years. "But in the long term, there is a big problem," he said.

Adrian Loh, an analyst with Merrill Lynch & Co. Inc. in Singapore, says he believes the situation will deteriorate even sooner. He predicts that China's oil import needs will grow to at least 10 million barrels a day in 2010 - twice Wu's projection and an amount that would leave it struggling to find Persian Gulf suppliers.

"We believe that more than 50 percent of China's oil imports in five years will have to come from Saudi Arabia," Loh said. "The problem is, I'm not sure they'll be able to deliver them."

In recent months, influential oil analysts have begun to question Saudi Arabia's petroleum potential. They cite the refusal of state-run oil company Saudi Aramco to provide reliable data about the performance of its fields and the methodology underlying its doubling of the kingdom's estimated oil reserves in 1988.

Houston investment banker Matthew Simmons, author of the recently published *Twilight in the Desert: The Coming Saudi Oil Shock and the World Economy*, has emerged as a leading critic of the Saudi oil claims. He argues that Saudi Arabia's best oil fields are aging rapidly, and warns that the giant Ghawar field, which produces half the kingdom's output, could collapse in coming years because of increasing structural problems - with devastating consequences for global energy markets.

Questions about Saudi oil output, China's growing demand, plus the wild card of terrorism are the recipe for "a perfect storm" that could spark future conflicts over access to oil, says Gal Luft, executive director of Washington's Institute for Analysis of Global Security, a conservative think tank that advocates reducing America's demand on foreign oil sources.

Recent tensions between China and the United States over trade, oil acquisitions, and China's military buildup, as well as friction between China and Japan over conflicting claims to energy resources in the East China Sea and historical memories about World War II, have already created a delicate atmosphere, Luft says.

"In an environment of tension like this, small incidents can spin out of control and lead to military confrontation," Luft says. "It doesn't necessarily mean war, but in all of this, energy will be the main sticking point. It's far more important than any other issue."

Analysts say state-owned CNPC International's acquisition of PetroKazakhstan was partly influenced by China's desire to cement ties with Central Asia, reflecting its unease at the presence of U.S. forces in the former Soviet region that borders Afghanistan.

Chinese leaders "want to stick their flag in the ground and become a more important player in different countries," says Paul Sampson, senior correspondent for London-based Energy Intelligence Group.

Cambridge Energy Research Associates, a Massachusetts-based consultancy, paints a much more optimistic scenario on oil supplies.

In a June report, CERA says it believes that between now and 2010, there will be a substantial increase in worldwide oil production capacity, providing a supply cushion of 6 million to 7.5 million barrels per day that could cause oil prices to "slip well below $40 a barrel as 2007-08 nears."

The current supply cushion is about 1.5 million barrels per day - less than 2 percent of daily demand - and concerns about output disruptions are a key reason behind the recent surge in oil prices.

For their part, the Saudis say they have enough oil to meet global demand for now and would raise production if prices rose too high.