Shifting Energy Geopolitics

ZhongXiang Zhang 张中祥
Distinguished Professor and Chairman
School of Economics, Fudan University, Shanghai, China
Tel: +86 21 65642734; Fax: +86 21 65647719
Email: ZXZ@fudan.edu.cn

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Outlines

• Energy security in the context of China
• Factors China considers in evaluating its energy security risks
• China’s increasing concerns about the Strait of Malacca and its responses at both demand and supply sides
• Putting China’s global search for energy security into perspective
  – China’s global quest for oil and natural gas has received unprecedented worldwide attention and scrutiny
  – A U.S.-led oil blockade against China
  – The operations of Chinese policy banks
  – Loan-for-oil and -gas deals
  – Chinese national oil companies’ equity oil shares
• Concluding remarks
For China Energy Security ≈ Oil Security

• Main reliance on domestic energy resources
  – Domestic supply provided about 91% of the total energy consumption in China in 2010, meaning that the overall energy dependence is about 9%.

• Heavy reliance on coal as a major source of energy
  – China replaced Japan as the world’s top coal importer in 2011
  – Japan had held the No.1 position since at least 1975

• Imports of natural gas set to rise, but much less concerning than the oil situation
  – Its dependence rate is much less than that of oil
  – A number of alternatives to natural gas for chemical feedstock and power generation
  – China’s unconventional gas reserves suggest that gas use can expand faster than expected, without creating huge new import dependency.

  • China is believed to have the world’s third-largest coalseam gas reserves, and the world’s largest recoverable reserves of shale gas (1275 trillion cubic feet estimated by the U.S. EIA in April 2011), although Chinese companies have struggled to master the hydraulic fracturing and horizontal drilling techniques used to exploit these resources

• Oil poses a unique challenge for China
China’s Growing Thirst for Oil

• China’s appetite for oil is soaring
  – 2.3 mb/d in 1990; 4.4 mb/d in 2000 (IEA, 2000)
  – By 2009, 8.1 mb/d (IEA, 2010)
  – By 2035, 14.9 mb/d, overtaking the U.S. (14.5 mb/d) as the largest oil consumer in the world (IEA, 2011).

• China’s economic boom and its stagnating domestic oil production have produced a growing hunger for foreign oil – China soon depending on more foreign oil than U.S.
  – In 2009, China imported 4.3 mb/d, 53.1% of its demand (IEA2010).
  – By 2011, China’s oil dependence rate further increased to 56.5%, (China’s National Energy Administration, 2012).
  – During 2011, China’s oil imports cost the country US$ 196.7 bn, accounting for 11.3% of its total import expenditures (China’s General Administration of Customs, 2012; Ma, 2012).
  – By 2035, China will import nearly 12.6 mb/d (IEA, 2011), more than the U.S. imports today, or 84.6% of its supply.
China’s future oil supply: domestic versus imported (mb/d) (IEA, 2010)
Factors China Considers in Evaluating its Energy Security Risks

• Oil dependence rate: already high AND increasing, but this needs not be viewed in a solely negative way
  – As a high trade intensity (imports + exports)/GDP suggests: the higher ratio means more integrated with the global economy
  – Many large economies have even higher oil dependence rates, although China naturally stands out in terms of the sheer quantity of its requirements
  – In the 1950s, oil was almost completely imported in China
  – This factor alone is insufficient to determine the true level of energy security/insecurity of a country

• Sources and routes of oil supply
  – Whether concentrate on a few countries—unless no choice, don’t place all eggs in the one basket
  – Whether the main oil-exporting countries are political stable
  – Whether routes of oil imports considered vulnerable to disruption

• Pricing power: to what extent to influence world oil prices
• Availability of oil on the market/access to that market at an affordable price
Sources and Routes of China’s Oil Imports

• In 1995, China relied mainly on the Middle East and the Southeast Asia.

• By 2005, China had significantly diversified its import mix.
  – Africa accounted for 30% of China’s oil imports
  – Russia supplied 10% of total imports

• China remained just as reliant on the Middle East in 2005 as it had been 10 years ago.

• Because China was now heavily reliant on Africa as well as the Middle East, it now depends more on a single chokepoint - the Strait of Malacca - than it had been 15 years ago, with nearly 78% of its oil imports flowing through the Strait in 2010 (BP, 2011).
China’s crude oil imports by region, in 1995 (left) and 2005 (right)

- **1995:**
  - Middle East, 43.3%
  - SE Asia, 38.8%
  - South America, 0.0%
  - Russia & Central Asia, 0.2%
  - Others, 10.5%

- **2005:**
  - Middle East, 47.2%
  - SE Asia, 7.4%
  - Africa, 30.2%
  - Russia & Central Asia, 11.1%
  - Others, 4.0%
  - South America, 3.4%
  - Others, 4.0%
China’s Malacca Dilemma [1]

• The Strait of Malacca is of the strategic and economic importance to China’s economic and energy security.
• This Strait directly affects China’s sea lane of communications, but China has little direct influence over it. Therefore, China has every reason to be concerned about the safe and smooth passage of its shipments.
• Beijing feels susceptible to this strategic weakness considering that any unexpected event could disrupt its trade flows and particularly oil imports.
China’s Malacca Dilemma [2]

• Top Chinese leaders have come to view the Strait of Malacca as a strategic vulnerability (Blumenthal, 2008; Holmes, 2007).

• In November 2003, the Chinese President Hu Jintao declared that “certain major powers” were bent on controlling the strait, and called for the adoption of new strategies to mitigate the perceived vulnerability.

• The Chinese press thereafter devoted considerable attention to the country’s “Malacca dilemma” (Lanteigne, 2008; Storey, 2006).
  – “It is no exaggeration to say that whoever controls the Strait of Malacca will also have a stranglehold on the energy route of China”
    *China Youth Daily*, 15 June 2004
China’s Responses to Energy Security Concerns – Demand Side

• Set energy and carbon intensity targets to control the growth of energy/oil demand
  – Requiring that energy use per unit of GDP be cut by 20% from 2006 to 2010
  – Just prior to the Copenhagen climate summit, China further pledged to cut its carbon intensity by 40-45% by 2020 relative to its 2005 levels.
  • China should aim for a 46-50% cut in its carbon intensity over the period 2006-2020. That will lead to China’s emissions reductions of 15-21% compared with its baseline levels in 2020, and thus will put China’s absolute emissions reductions very much within the IPCC’s recommended level of 15-30% below baselines (Environmental Economics and Policy Studies, Zhang, 2011).
  • Carbon embodies in China trade and implications for who should pay for the cost (Mineral Economics, Zhang, 2012).
  – Requiring that energy intensity be cut by 16% (10-18% across provinces) and carbon intensity by 17% (10-19.5% across provinces) from 2011 to 2015

• Put policies and measures in place to achieve these targets
China’s Responses to Energy Security Concerns – Supply Side [1]

- Considerable efforts to maintain domestic production close to the current level of 4.1 mb/d to 2025 (IEA, 2011)
- Chinese national oil companies (NOCs) establish strategic partnerships with other NOCs and IOCs to gain technical know-how in areas where Chinese NOCs lack technical expertise. The recent flurry of Chinese NOCs’ deal-making is more about gaining access to technology than the commodity itself so that Chinese NOCs will better position them to explore and develop similar resources within China (deep-water reserves, coalbed methane, shale gas)
  - PetroChina bought in February 2012 a 20% stake in Shell’s Groundbirch natural gas development in northeastern British Columbia, hoping to gain shale gas experience from Shell (WSJ, 3 Feb 2012).
- China has the largest recoverable reserves of shale gas in the world (U.S. EIA, 2011), but its companies have struggled to master the hydraulic fracturing and horizontal drilling techniques used to exploit these resources.
  - In January 2012, Sinopec signed a deal with Devon Corporation to invest US$2.2 bn for a one-third stake in five U.S. shale and oil-and-gas fields controlled by Devon.
  - CNOOC with TOTAL in Nigeria’s Akpo and Egina deep-water fields
  - PetroChina with Shell in March 2010 to acquire a 100% stake of Australian coalbed methane producer Arrow Energy.

- Significant efforts to support the expansion of its own national oil companies (NOCs)
  - These NOCs now have equity production in 20 countries.
  - By the first quarter of 2010, these NOCs’ overseas equity shares had reached 1.36 mb/d, nearly one-third of China’s net imports in 2009 (Jiang and Sinton, 2011).
China’s Responses to Energy Security Concerns – Supply Side [3]

Diversify both sources and routes of its oil supply

- Has been keen to invest in Central Asian and Russian oil and natural gas field development projects and in the construction of pipelines
- Has also turned the eyes on the emerging oil and gas fields in Africa. Its high-profile, goodwill-based energy diplomacy has helped China to make remarkable inroads in striking energy deals with oil-rich African countries.
- China’s search for oil has recently taken to Central and South America, America’s backyard.
- A string of refineries set up in China through joint ventures with partners from energy-rich countries that often come with supply agreements
  - Jan 2012: CNPC with Qatar Petroleum International and Shell PLC to build a refining facility (20 mt/y) in Taizhou, Zhejiang

• Recognizing its limited potential to further diversify its oil imports from its main suppliers, China has sought to diversify the routes that its oil shipments take towards China from the Middle East and Africa
  – CNPC started in June 2010 within Myanmar to construct parallel oil and gas pipelines that would connect the Chinese province of Yunnan with the Bay of Bengal, scheduled for completion in 2013
  – Involved in developing rail and road infrastructure that will connect Pakistani ports on the Arabian Sea with western China. Yet this connection will be even more constrained than the pipeline through Myanmar (Erickson, 2010).

• Develop its own strategic petroleum reserves since 2007
  – First phase (4) completed: 14 mt, about 12 days of China’s oil use
  – Second phase (8 sites) planned to complete by 2012: additional 23 mt
  – Third phase under planning, and completed by 2020: by 2020: 85 mt, about 78 days of China’s oil imports (8 mb/d in 2020) projected by IEA

• Strengthen its naval capabilities to protect supply lines
International Pricing Power and Domestic Institutional Arrangements

• Despite the large quantities of imported crude oil per year, China’s influence in the international market is very limited, and has less choice but to face the ups and downs of the international oil prices. In recent years, there have been calls for establishing a crude oil futures market in China.
  – In Jan 2012, the Chairman of China Security Regulatory Commission Guo Shouqing called for stepping up the construction of crude oil and other commodity futures to gradually increase China’s influence in international commodity futures markets.
  – China’s National Energy Administration said that the relevant government departments are currently undertaking feasibility studies on crude oil futures and market research.

• Voice to re-establish Ministry of Energy???
  – Diffuse governance
  – The absence of a single voice for the energy sector has also stymied China's efforts to improve energy security
    • NDRC: approves non-natural resource investments of up to US$100 mn or natural resource investments of up to US$300 mn;
    • Ministry of Commerce: must also approve projects of more than US$100 mn, as well as for investments spanning multiple countries; and
    • The State Council, whose approval is needed for certain strategic sectors.
China’s Global Quest for Energy Security: Why Are the Stakes So High?

• China’s global quest for oil and natural gas has received unprecedented worldwide attention and scrutiny.
• Partly because of China’s high-profile energy diplomacy and some debatable issues about the management and operation of Chinese NOCs.
• Mainly because of misconceptions and misunderstandings of China’s quest for energy security both inside and outside China.
• Inside China, relate to
  – The hypothesized U.S.-led oil blockade against China
  – The role of Chinese investments in oil fields overseas (Chinese NOCs’ equity oil shares)
• Outside China, relate to
  – The operations of Chinese policy banks
  – Loan-for-oil and -gas deals
Misperceptions or misunderstandings: A U.S.-led oil blockade against China [1]

- Misguidance: The threat of a U.S.-led oil blockade against China
  - Largely a chimera
- If the threat of a U.S.-led blockade is the concern, then sending Chinese NOCs’ equity oil shares back home faces the same blockade problem.
- The U.S. is certainly reluctant to see and accept the rise of China and is wary of any prospective challenge to its hegemony.
- Geopolitically, the U.S. has attempted to contain China’s increasing world’s influence.
Misperceptions or misunderstandings: A U.S.-led oil blockade against China [2]

• But auctioning a policy that would inhibit the Chinese economy is highly unlikely, because the world’s two largest economies are too integrated and interdependent for one to fail. It would be a self-immolating policy.
  – The U.S. attempt to influence, but not intervene, in the recent Taiwan presidential election to avoid instability in the Taiwan Strait clearly supports this view.
  – Take the U.S.-dominated Transpacific Trade Partnership as a counterargument?
    • The U.S. wants to use the TPP to press China to observe the rules of the road on trade and intellectual property.
    • The U.S. also wants to use the TPP to achieve the major goal of leveling the playing field in which private and state-owned enterprises compete. This goal reflects the serious U.S. frustration with what it sees as unfair advantages that Chinese SOEs have in world trade (Bussey, 2012; Davis, 2011).
Misperceptions or misunderstandings: A U.S.-led oil blockade against China [3]

- Even if U.S. were to attempt a blockade, it would probably not be very successful (Collins and Murray, 2008), and would be extremely difficult to operate in practice (Kennedy, 2011).
- If this blockade is unlikely to happen, and even if attempted has a low chance of success, then this raises the issue of the basis on which China’s energy security risks are evaluated and the responses are formulated.
- In my view, Chinese NOCs exacerbate the extent of potential disruption of oil supply, and in the name of energy security, Chinese NOCs are complicating China’s foreign relations in sensitive regions of the world. This could potentially hijack Chinese government’s going-out policies, as the NOCs prioritize their own profits but at the potential expense of China’s overall national interests.
Misperceptions or misunderstandings: The operations of Chinese policy banks [1]

- During the 1994 reforms of the financial sector, the Chinese government created the China Development Bank (CDB) and the Export-Import Bank of China as policy banks.
- The two policy banks provide lines of credit to Chinese NOCs and foreign entities, mainly NOC counterparts, to support international expansion and secure oil or natural gas deals.
  - Since 2009, CDB has extended lines of credit totaling almost US$85 bn to national energy companies and government entities in Brazil, Ecuador, Russia, Turkmenistan and Venezuela (Downs, 2011).
- Misperception: CDB is the mere puppet of the Chinese government.
  - That is wrong. It is wholly state owned, but is not state run.
  - Yes, CDB has a mission to advance the Chinese government’s policy objectives at home and abroad, including securing oil and natural gas supplies, but that mission to serve the interests of the Chinese government does not prevent it from pursuing its own agenda to expand its business at home and abroad and pursue profits.
Misperceptions or misunderstandings: 
The operations of Chinese policy banks [2]

• In fact, CDB is successful in balancing commercial and policy priorities
  – Its non-performing loans ratio has stood below 1% since 2005, lower than that of all other major Chinese banks.
  – It lends at the market-based interest rates. The interest rates on the lines of credit totaling US$45.6 bn extended to Petrobras, Rosneft and Transneft in 2009 and to Venezuela’s Bank of Economic and Social Development in 2010 are all based on the London Interbank Offered Rate (although the spread over LIBOR may be thinner than what a Western bank would require) (Downs, 2011).

• CDB has been vocal in mobilizing China’s massive foreign reserves to support cross-border energy and natural resource deals.
  A good way to hedge against a declining dollar and rising commodity prices, and thus serves as a medium for shifting China’s foreign exchange reserves away from low-yielding financial instruments -- Chen Yuan, CDB Governor
Misperceptions or misunderstandings: The operations of Chinese policy banks [3]

• China’s loan commitments of US$37 bn in 2010 to Latin America were more than the World Bank, Inter-American Development Bank, and the United States Export-Import Bank combined for that year.

• The common claims: Chinese loans to Latin America
  – have more favorable terms
  – impose no policy conditions, and
  – have less stringent environmental guidelines than the loans of international financial institutions and Western governments.
Misperceptions or misunderstandings: The operations of Chinese policy banks [4]

But Gallagher et al. (2012) finds that

- The CDB loans carry more stringent terms than the World Bank loans, e.g.,
  - Loan to Argentina in 2010: CDB’s US$10 bn at LIBOR+600 vs World Bank’s US$30 mn at LIBOR+85;
  - Loan to Brazil: CDB’s US$10 billion loan in 2009 at 280 basis points vs IBRD’s US$43.4 million loan in 2000 at a variable spread of 30–55 basis points.
- China’s Ex-Im Bank, by contrast, generally offers lower interest rates than the U.S. Ex-Im Bank.
- Chinese banks impose no policy conditions but to mitigate loan risks, do require equipment purchases and sometimes oil sale agreements with borrowers as a sort of collateral in kind.
Misperceptions or misunderstandings: The operations of Chinese policy banks [5]

• This method allows China to loan to less creditworthy borrowers.
  – Backing loans with oil shipments “effectively keeps risks to a minimum level” -- CDB founder Chen Yuan

• The risk mitigation of loans for oil seems to explain why CDB was able to offer the US$20 billion loan to Venezuela at LIBOR+(50-285), only a fraction of its 935 basis point cost in sovereign debt markets (Gallagher et al., 2012).

• To date, this kind of lending seems to work well for borrowing countries in which they need less costly Chinese inputs and equipment to develop their own energy, mining, infrastructure, transportation and housing sectors.
Diversifying China’s oil import mix via loan-for-oil deals [1]

• Using loan-for-oil and -gas deals to secure long-term supplies is not a Chinese invention.
  – Japan gave China loans for its oil as early as the 1970s.

• This type of deal is not new for China and has been used by Chinese NOCs for some time, but not at this scale and in such quantity.
Diversifying China’s oil import mix via loan-for-oil deals [2]

• Loan-for-oil deals involve risks
  – Contracts could be voided in case of a change of government.
  – Resource-rich countries may fail to supply the promised quantity.
  – Because the oil is not collateral for the loan, if the borrowers threaten to cut off the supply of oil, lenders cannot seize extra oil or oil revenue to compensate for potential losses.

• Loan-for-oil and-gas deals are not the preferred method of the NOCs to gain foreign supplies, but they serve as a second-best strategy to diversify oil supply.
  – Good quality assets are rarely for sale these days
  – Even if they were, Chinese NOCs might not be able to fairly win the bids.
Diversifying China’s oil import mix via loan-for-oil deals [3]

- Chinese state-owned banks made 12 loans worth US$77 bn to nine different countries in 2009 and 2010, all outside the Middle East (Jiang and Sinton, 2011).

- A noticeable deal with Russia
  - China and Russia had been discussing a cross-border pipeline for crude oil since early 1990s, but weren’t able to finalize a deal. Leveraging its relative financial strength at the financial crisis, China eventually struck this largest, long-awaited mega loan-for-oil deal with Russia on February 17, 2009.
  - Under this long-term deal, China lends US$25 bn to Rosneft and Transneft. In exchange, Russia will provide China with an additional 15 million tons of crude oil a year between 2011 and 2030, about 300 kb/d for 20 years, or nearly 7% of China’s volume of oil imports in 2009.
Misperceptions or misunderstandings: Loan-for-oil and -gas deals

• Misperception: these deals grant Chinese NOCs a discount
  – That is wrong: Chinese NOCs have no bargaining on prices.
  – All the deals are linked to market prices, not quantities of oil.
• But Chinese NOCs, with the support from the Chinese government and backed with Chinese policy banks, did take advantage of stricken foreign companies in the global financial crisis
  – Reach these otherwise unlikely deals
  – Receive long-term oil and gas supplies
  – Require the borrowers to buy and hire from China to mitigate loan risks, despite no policy conditions imposed (Gallagher et al., 2012).
  • China’s US$10 billion loan to Argentina in 2010 is to buy Chinese trains. Thus, this loan is actually a credit line for Chinese railway companies to invest in 10 separate rail projects in Argentina, with the money effectively staying in China (Hall, 2010).
  • US$10.6 bn of the US$20.6 billion loan CDB granted to the Bank of Economic and Social Development is denominated in Chinese Renminbi, which locks Venezuela into buying Chinese equipment and hiring Chinese firms (De Córdoba, 2011; Downs, 2011).
Misperceptions or misunderstandings: Chinese NOCs’ equity oil shares [1]

- Going-out policies help Chinese NOCs to achieve their ambition to grow and build global business.
- Arguably the government also sees supporting Chinese NOCs to make oil and natural gas mergers and acquisitions overseas as a way to diversify its foreign exchange reserves to higher-yielding assets away from low-yielding financial instruments such as U.S. Treasury Bonds.
- But with oil as an internationally traded commodity, whether this strategy is superior to simply buying oil in open markets?
  - Overbidding???
  - China’s “big three” oil firms (CNPC, Sinopec, CNOOC) had invested in some 144 overseas projects totaling US$70 bn by 2010, with two thirds of such overseas investments suffering losses (China University of Petroleum, 2010).
Chinese NOCs overpaying for acquisitions of oil and gas fields overseas? [1]

- The Chinese oil companies have a history of overpaying for equity positions, because China has viewed paying a higher price than competitors to secure energy resources to be more of a national security issue than the absolute price itself.
- Prior to the credit crisis, China had grabbed these deals by overbidding at least 10% more than its competitor India had offered.
  - In January 2006, CNOOC bought a 45% stake in the Akpo offshore oil and gas field in Nigeria for US$2.27 bn by outbidding the competitor, the ONGC that submitted a bid of US$  bn but withdrew after India’s Cabinet raised concerns about the risks involved.
  - In August 2005, CNPC paid US$4.18 bn to acquire Canadian oil company PetroKazakhstan. Originally, CNPC offered US$3.6 bn. With the Indian consortium’s (ONGC-Mittal) bid of US$3.8 bn, CNPC hiked its offer to US$4.18 bn to grab this deal.
Chinese NOCs overpaying for acquisitions of oil and gas fields overseas? [2]

• In the buyer’s market, however temporarily, after the financial and credit crisis, do the Chinese oil majors grab better M&A deals than those prior to the credit crisis?
  – In Addax deal, KNOC also bided for US$6.9 bn. On 24 June 2009, Sinopec offered US$7.2 bn to grab this deal. So, Sinopec only overbided 4.6% than its competitor, far less than the overbidding of at least 10% more to grab those aforementioned deals prior to the credit crisis.
  – Measured in other indicator, however, the story differs. Sinopec’s offer is equivalent to US$34 a barrel of proved reserves and US$14 a barrel of proved and probable reserves. The African transaction average in 2007, when the average crude price was similar to current prices, was $14.40 a barrel for proved reserves and $9.90 for proved and probable reserves, respectively. On a proved basis, the 2007 average suggests US$3.1 bn total value for the deal. Therefore, US$7.2 bn implies a 135% premium (WSJ, 2009).
Chinese NOCs overpaying for acquisitions of oil and gas fields overseas? [3]

• In December 2008, Sinopec paid C$2.1 bn to acquire Tanganyika Oil, a Canadian company that owned oil fields in Syria.
  – The 95 percent takeover marked the first time a Chinese company had almost complete ownership of a formerly North American oil and gas firm.
  – The C$2.1 billion deal had been initiated when the price of oil was at US$90 a barrel. When the price fell to US$40 a barrel by December 2008, the offer was generally seen as overpriced. The company still went ahead with the purchase (Vaidyanathan, 2012).

• On 8 October 2011, Sinopec bought Daylight Energy, a Canadian oil and natural gas producer, for about C$2.2 bn in cash.
  – Under the terms of the deal, Sinopec offered C$10.08 a share. That is more than double Daylight’s closing price of C$4.59 on the last trading day, and 43.9% above the 60-day weighted average trading price. China’s largest refiner paid very high premium over its share price to fully acquire Daylight Energy (De La Merced, 2011).
Chinese NOCs overpaying for acquisitions of oil and gas fields overseas? [4]

• However, the higher bid does not always win in a politically charged industry like energy.
  – CNOOC failed to acquire Unocal for US$18.5 bn, although it topped Chevron’s bid of US$16.4 bn. But, in the end, Chevron grabbed the deal.

• China’s willingness to overpay
  – Is to a large extent because these state-own oil majors are obligated to secure China’s energy security, given that the country’s demand for oil will grow faster than its domestic output.
  – Might partly reflect a need to overcome the kinds of political difficulties that hampered Chinese state-owned companies’ overseas takeover attempts in recent years.

  • The premiums were generally seen as necessary to keep shareholders happy and quell any political concerns given anti-China sentiment in certain circles.
Chinese NOCs overpaying for acquisitions of oil and gas fields overseas? [5]

• Nevertheless, the Chinese NOCs are more reluctant than in the past to overpay for assets for at least two reasons.
  – First, the Chinese NOCs have moved up technology and project management learning curves that the IOCs have dominated and have become increasingly sophisticated and capable internationally.
  – Second, they have been tightening up their premiums by examining the financial returns of their bids. CNOOC has started using a financial metric system that allows it to price its bids more accurately. Now even the larger national oil companies like PetroChina, Sinopec, have started to follow the CNOOC’s path (Vaidyanathan, 2012).

• A recent IEA study uncovered no evidence of systematic or intentional overpayment associated with recent acquisitions (Jiang and Sinton, 2011). However, there is still disagreement. Some American analysts, like Mikkal Herberg and Derek Scissors (2012), believe that Chinese NOCs continue to pay significant premiums to acquire overseas assets. The premiums were generally seen as necessary to keep shareholders happy and quell any political concerns given anti-China sentiment in certain circles.
Misperceptions or misunderstandings: Chinese NOCs’ equity oil shares [2]

- Economic rationales can take the backseat if the NOCs’ oil production outside China can help to improve China’s energy security. Question is then: Are Chinese NOCs’ equity oil shares improving China’s energy security?
  - Sending Chinese NOCs’ equity oil shares back home would face the same U.S.-led oil blockade problem if it were to emerge.
  - Available evidence does not suggest that NOCs necessarily send their equity oil production back to China. Instead, the NOCs apparently prefer to let market considerations dictate where it is sold (Jiang and Sinton, 2011; Kennedy, 2011).
  - Available evidence does not suggest that oil produced from NOCs would be cheaper or more available to China in a supply crisis. NOCs have shown little inclination to grant Chinese customers a discount when prices are high. In fact, the NOCs responded to rising crude prices prior to 2008 by reducing supplies of refined products to the Chinese market, resulting in widespread shortages at the pump, since price controls did not allow them to pass their rising costs on to customers (Downs, 2010).
Misperceptions or misunderstandings: Chinese NOCs’ equity oil shares [3]

• Chinese investments in oil fields overseas help to pump more oil out of the fields and enlarge the overall availability of oil on the world market, thus being seen as beneficial not only for Chinese consumers but also for other global consumers as well.

• Taking these points together, Chinese NOCs’ efforts to secure overseas oil and gas supplies neither threaten U.S. or Western energy security, nor improve China’s energy security.
Concluding remarks [1]

• China is the world’s largest energy consumer, with an increasing dependence on imported oil. In the mean time, China is also the world’s largest energy producer. This makes it different from many other large economies.

• Yes, increasing dependence on imported oil and heavy reliance on the Strait of Malacca pose distinct security challenges for China.

• China’s responses on the demand side are well formulated and justified, but the same cannot be said on the supply side. Some (e.g., SPR) are well taken, but others might be considered misguided and not well founded (e.g., NOCs-hijacked going-out policies, exacerbation of disruption of oil supply).

• It should be made clear that Chinese NOCs’ efforts to secure overseas oil and gas supplies do not threaten U.S. or Western energy security. Nor do they improve China’s energy security. Most oil produced by Chinese NOCs abroad was sold in international markets, benefiting not only Chinese consumers but also other global consumers as well.
Concluding remarks [2]

• Yes, NOCs’ expansion is a positive development for the companies themselves, but if that is not made for improving China’s energy security *per se*, it is far from clear whether this is the case for China as a whole.
  – Many deals are not justified on economic grounds alone—economic rationales can be second to the overriding energy security if NOCs’ deals improve China’s energy security *per se*. If not, then the entire strategy is questionable.
  – China’s aggressive global expansion to acquire resources is often perceived as a threat. This perceived threat could, however, lead the Chinese NOCs to overpay in deals, and drive up the world prices of resources compared with what would otherwise have been the case --results could be different if less aggressive and keeping low-profiles
  – In the name of energy security, NOCs are complicating China’s foreign relations in sensitive regions and could hijack the Chinese government’s going-out policies.
In the context of discussions on China’s energy security, there is a tendency to exacerbate disruption of oil supply or have a little pessimistic view of the stability of energy supply.

But evidence suggests that market-based energy contracts are long lasting, prevailing over ideological differences, wars or politically motivated action.

- Under the commercial contracts the former Soviet Union exported natural gas to Western Europe virtually unimpeded even during the Cold War era.
- Brothers can be brought into conflicts if one does not follow market rules—natural gas disputes between the Russia and the Ukraine in recent years, despite that the latter was the former Soviet republic and they remain close to each other.

  - The root cause of these disputes was politics because this supply of natural gas was not based on a commercial contract but rather on a political deal.
  - OPEC-led oil embargos most unlikely to be repeated, first for the sake of the OPEC itself. Even if undertaken, they would not be as damaging as in the 1970s.
  - Using resources as a political weapon condemned internationally

    - Russia has been heavily criticized for its continued differential treatment of the former Soviet republics in terms of the price of its supplied natural gas.
    - Heavy criticism of China’s alleged embargo of rare earth exports to Japan after the disputed sovereignty of the Senkaku/Diaoyu islands in September 2010.
Concluding remarks [4]

• Both China and the Western countries need to de-politicize China’s global quest for energy security.

• The Western politicians need to recognize that their rhetoric in relation to China’s efforts to secure energy supplies overseas – which paints it as a major threat - has done nothing but intensify China’s fear that they might seek to deny China’s access to the oil it needs for development.

• China needs to reconsider its stance of distrusting global oil markets and to recognize that the reliance on aggressive acquisitions of overseas oil fields and equity oil production has been of little help in strengthening its energy security.

• Just like other oil importers, China’s energy security depends increasingly and deeply on the stability of global oil markets and reliable and growing oil supplies to the market.

• Thus, China shares with other major oil importing countries profound common interests in maintaining and strengthening the stability of global oil markets and reducing the chance of potential disruptions to oil supply and the resulting damaging oil price shocks.
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