Fuelling China's Growth
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The Chinese Quest for Energy Ressources

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In 2004, China National Petroleum Corporation closed a deal that secured it an 11% stake in a proven oil field in Sudan. Shortly thereafter, the UN Security Council stopped short of imposing sanctions on Sudan in punishment of human-rights abuses in Darfur. Incidentally, China is one of the veto powers in the UN Security Council.

In 2005, China National Offshore Oil Corporation extended an offer of USD 19.6 billion in cash to acquire the ninth-biggest US oil firm, Californian Unocal, which has large production operations in Asia. Eventually, the White House vetoed the bid through the treasury-chaired Committee on Foreign Investment in the United States (CFIUS) as "against national interests".

As in many fields, Chinese actions do not go unnoticed. And when it comes to energy, quite frankly, China seems to be at the source of actions that are sometimes perceived by the West as out of the ordinary, and often as menacing.

Why is that so? The following proposes to adopt the Chinese point-of-view for a change, to clear facts from fiction and to enable us all to better understand, and be better able to assess and put into context, how China is fuelling its growth through her quest for energy resources.

In the early 80ies, China was just emerging from a decade of the "Cultural Revolution", a period marked by turmoil and agony for all Chinese but a select few. China displayed virtually no economic activity to speak of, let alone any social prospects guaranteeing a better live for the Chinese people. With Mao Zedong dead and his official wife Jiang Qing and her "Gang of Four" imprisoned awaiting trial, Deng Xiaoping was now firmly in power and had gathered his most trusted comrades around him. Together, they finally set-out to implement what they had already devised in 1962 when they convened the "Conference of 7'000 Experts" in Beijing. This meeting was to devise a way to develop China economically and socially. Sure enough, its recommendations were brushed under the table as "the first step back to capitalism" in one single outburst of anger by then paramount leader Mao Zedong. At that conference, however, it was agreed that China should first and foremost need to develop its economy to feed the hungry masses. Social development should have to wait until a middle class had emerged that was ready and mature to assume political responsibility as well. The magic tool was the cleverly and ideologically concealed "Household Responsibility System". It gave Chinese farmers back their previously collectivised farmland and encouraged and empowered them to do what they were best at: To grow the foodstuff needed to feed a growing Chinese population.

This priority prevails to this day, and will so for the foreseeable future: China has made the conscientious decision to put economic before social development until her development would have reached that of a medium European country. And all social, and therefore also political or democratic, development would have to wait until later. It thus becomes evident that this deliberate choice of "economy first, democracy later" is at the heart of many a Western misunderstanding of Chinese actions and positions. One may not want to agree with this Chinese paradigm easily, but neither can anyone have an interest in seeing China falling to pieces as the Soviet Empire did in the late 90ies. Today's Chinese leadership has observed that unwanted development very attentively indeed, and is deeply marked by what they perceived as a horror vision for China.

Since the early 80ies, China set out on an unprecedented path of economic development. A compounded GDP growth rate of 7% over more than two decades has turned the country into the third largest trading nation after the USA and Germany. One out of every eight cargo ships that sail from China to the USA is carrying goods for American supermarket giant Wal-Mart. And were Wal-Mart a country instead of a company, it would be China's eighth largest trading partner, outranking Russia, Australia and Canada. This successful interconnection with global trade has also made China the first country with foreign exchange reserves in excess of USD 1'000 billion. Today, more people are using the internet in China than in the USA. And in 2005, 220 billion mobile text messages were sent around China. Such forced growth often reminds us of the development Europe experienced after the 2nd World War. And the same mistakes are made, too, leading to environmental problems at a magnitude that is more than worrying. The Chinese government itself has recently stated that 90% of all rivers in China are so polluted that their water can not be safely used.

Looking forward, where does a 7% compounded GDP growth rate take China over let's say the next 25 years, provided it can successfully tackle all the problems that tag along with her development? Over the next 20 years, her share in global trade would grow from four to ten percent. In other words, by 2025 China would be the second largest trading nation behind only the USA, rather than the tenth largest today. China's economy would likely overtake Germany in absolute size of GDP by around 2010, its archrival Japan by 2015, and very long term the USA by 2040.

All of this takes tremendous energy. Certainly, the industriousness of China's population, now enabled by Deng Xiaoping's famous quote "getting rich is glorious", means plentiful of energy. But beyond human inspiration and zest, it also takes physical energy to drive what is probably the largest industrialisation the planet has ever seen. Where would that energy come from?

Today, 80% of the energy needs of China are covered by using coal, of which China sits on the world's largest reserves. Burning coal, with often less than space age technology employed, of course produces massive emissions, CO2 and others. Another 16% of China's energy is derived from water, clean, abundant and renewable from the Himalayas. But hydro-electric power comes a long way from the scarcely populated, underdeveloped Himalayan foothills in the Southwest to reach the densely populated and industrious coastal regions in the East. And large projects such as the "Three Gorges Dam" are contested by many inside and outside of China. The remaining 4% of China's energy needs are covered by nuclear power plants. But, for the time being China depends on foreign technology to build and operate them in a responsible and efficient way.

So, if China can cover its energy needs with its own resources, why then has China become the second largest consumer of oil and gas, ahead of Japan and just behind the USA? It is China's industrial base, the "Factory Floor of the World", that is gobbling up vast amounts of petrochemicals. It is needed to make everything from fertilisers to Barbie-dolls. And much of it goes into exports to Western consumer markets. It is therefore all of us who participate in driving China's thirst for petrochemicals. This should prevent us from blaming China as the single culprit for raising prices at our gas stations. But, it is true that Chinese have fallen in love with cars, just as Westerners have done some decades ago. There are now about 30 million automobiles on Chinese streets already. And GM expects the Chinese car market to surpass the US market by 2025. Though there are only 6 million privately owned cars blowing their horns in the congested streets of China's urban areas today, some 74 million Chinese families could actually afford to buy cars. Add to this the robust appetite for diesel in agriculture and construction, and the jet fuel needed to transport people and cargo across Chinese skies, and you will understand why China became a net oil importer ever since 1996.

China has oil deposits, known and suspected, tapped and untapped ones. The largest tapped reserves are the "Daqing Oil Fields" in Northeastern Manchuria discovered in 1959, and the offshore fields in the Bohai Gulf exploited since 1979. Today, however, productivity and output are in decline, and these reserves will probably to be depleted within ten years. There are untapped petroleum pools yet in China: Those in the "Tarim Basin" in the Western "Taklamakan Desert" are proven, but uneconomic to drill even at today's high oil prizes. The "Spratly Islands" in the South China Sea have oil, too. But the sovereignty over the islands being disputed by China, Malaysia, the Philippines, Taiwan and Vietnam, commencement of large-scale exploitation is no immediate option either.

This leaves China no other alternative than to look for oil and gas outside its own borders. A first choice might be buying oil on the open market. But, China does not want to become hostage of sharp price raises as are Korea and Japan. China fears the negative impact on her still lesser developed economy. Instead of buying in the open market, long term supply contracts could be closed directly with supply countries. However, the largest oil producing countries are in the Middle East, but their oil supply is firmly in the hands of European, Japanese and American companies. What's more, the USA has clearly slammed the door on China accessing US oil in the Unocal deal. Russian oil and gas could be funnelled to neighbouring China through pipelines. But China, just as Europe, has grown a bit more sceptical as to pipeline deals with Russia ever since the heavy handed politics of Russia in cutting off the Ukraine's gas supply. Russia in turn seems in no hurry either to close a pipeline deal with China. The two neighbouring countries have been negotiating such a deal for many years now.

Where else should China turn to secure reliable oil and gas supply at stable prices to fuel its industrial development? One way to do this is for China to invest in exploration and development in countries that have oil fields but lack the technology or capital to exploit them. This directs Chinese oil executives and high officials to countries such as Burma, Uzbekistan and Indonesia in Asia, to Gabon, Nigeria and Sudan in Africa, and to Venezuela, Ecuador and Colombia in Latin America. With all the ensuing problems of "dealing boldly where no western oil company is dealing anymore". And playing it very, very long term.

Lastly, China may sit on dwindling oil reserves. But its cash treasury is swelling. So for the time being, China buys her way into the oil supply of the world. Thus she satisfies her thirst for oil, although at a hefty price both financially and non-financially.

About the author:
Dr. Daniel V. Christen is Vice-Chairman of the "Swiss-Chinese Chamber of Commerce" and a frequent speaker on China. He began his 15 years of experience with China by representing Credit Suisse in China out of Beijing. He then joined the Swiss trade diplomacy with responsibility for supporting Swiss companies entering emerging Asian markets, and where he negotiated several bilateral agreements. He was also member of the Swiss delegation negotiating China's accession to the WTO. Subsequently he became Vice-President of SGS, the Geneva based and the world's largest quality assurance firm, where he assumed responsibility for marketing and business development in Asia. In 2005, he started his own company "Assetis Ltd.", specialising in raising, analysing and documenting soft factors on behalf of important decision makers such as banks, investors and consultants. For more information see www.assetis.ch

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