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Policy Note

China's foreign oil policy: genesis, deployment and selected effects

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Abstract

China is a rising global power with a growing role and impact on the world's energy markets as well as on the Earth's climate system. China pursues its development in an essentially non-confrontational manner, a vision encapsulated by the notion of peaceful rise which is viewed positively in the world's major capitals. Nevertheless, China's rapid growth represents a genuine global challenge and raises many questions. How is China dealing with its growing need for imported crude oil? What is the impact of China's rise on the global oil market, notably in terms of oil price developments? Are Chinese actions on oil markets different from those of other major importers? What opportunities and risks arise as a result of china's growing role on the global oil market from the viewpoint of other global players? In this report we seek to offer some answers to those questions with a review of China's developing energy policy, of the actions and revealed preferences of its national oil companies, and of broader economic and geopolitical analyses of the impact of China's growing oil consumption on other global players.

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Policy Brief

China's Foreign Oil Policy

Genesis, Deployment and Selected Effects

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China is a rising global power with a growing role and impact on the world's energy markets as well as on the Earth's climate system. China pursues its development in an essentially non-confrontational manner, a vision encapsulated by the notion of *peaceful rise* which is viewed positively in the world's major capitals. Nevertheless, China's rapid growth represents a genuine global challenge and raises many questions. How is China dealing with its growing need for imported crude oil? What is the impact of China's rise on the global oil market, notably in terms of oil price developments? Are Chinese actions on oil markets different from those of other major importers? What opportunities and risks arise as a result of China's growing role on the global oil market from the viewpoint of other global players? In the report we offer some answers to those questions, as well as concrete policy suggestions so as to prevent possible future tensions between large oil consumers. (1/)

1/ E. Christie (Ed.), J. Francois, W. Urban, F. Wirl (2009), 'China's Foreign Oil Policy: Genesis, Deployment and Selected Effects'. A study commissioned by the Austrian Federal Ministry of Economy, Family and Youth (BMWFJ) within the scope of the Research Centre International Economics (FIW) and funded out of the Internationalisation Program "go international," wiiw: Vienna.

1. Core Facts and Figures

1.1 China was self-sufficient in oil until 1993. Since then its consumption has by far outstripped its production. According to IEA (2009) (World Energy Outlook 2009), China's net oil imports were 3.9 mb/d (million barrels per day) in 2008, compared to 13.5 mb/d for the USA (World's No. 1) and 9.1 mb/d for OECD Europe.

1.2 China will overtake the United States as the world's largest net importer of oil by 2030. The Reference Scenario of IEA (2009) projects net imports for 2030 as: China: 13.1 mb/d; USA: 12.7 mb/d; OECD Europe: 10.5 mb/d.

1.3 As a result, the world will have three major oil importers (China, USA, EU) in 2030 as opposed to two (USA, EU) today.

1.4 Each of these three giant net importers will be vulnerable to oil market developments. The net import dependence in 2030, based on IEA (2009), will be: China: 80%; USA: 74%; OECD Europe: 88%.

1.5 Key drivers for China are: massive economic growth; increased urbanisation; expansion of transportation in general and of private vehicle fleets in particular.

2. Key Actors, Key Goals

2.1 China's foreign oil activities are carried out by large state-owned National Oil Companies (NOCs). The main ones are: CNPC, CNOOC, Sinopec.

2.2 China's government agencies are not well organised for dealing with foreign oil. Experts refer to that situation as: *strong firms, weak institutions*.

2.3 Up to 2003, China's foreign oil policy was reactive and poorly coordinated. The 2003 US invasion of Iraq changed the Chinese perception. The Chinese leadership grew concerned both about instability in the Middle East and about excessive strategic leverage of the United States.

2.4 The Chinese government encourages and supports its NOCs in foreign activities all over the world, particularly to the extent that they contribute to one or more of the following: diversification (of suppliers, of routes), acquisition of new technologies, swapping financial reserves for resource reserves, shifting towards a larger share of long-term contracts.

2.5 The Chinese government supports its NOCs abroad, particularly in Africa, and to some extent in Latin America, by putting forward 'package deals' that may include, e.g., financial loans, development aid, technical assistance. Dealings in Central Asia are indirectly supported politically and diplomatically through China's key role in the SCO.

2.6 China is awash with cash in 2009 and has accelerated its search for upstream equity and participations all over the world. The crisis is a strategic boon for China's foreign oil policy.

3. Economic and Oil Market Simulations

3.1 Within a global economy model simulation, it is found that the growth of China over 2008-2020 has a very strong impact on the world economy. China boosts the average annual GDP growth rate of the EU and of Austria by about 0.5%. However China's growth alone explains almost 90% of the rise in the oil price over the simulation period.

3.2 Partial equilibrium oil market simulations using similar assumptions as IEA (2009) find higher results than IEA (2009) for Chinese oil demand: 19 mb/d instead of 16.3 mb/d in 2030.

3.3 Oil security. Partial equilibrium simulations of an oil supply cut of 5 mb/d find a short-term price jump from 73 \$/bl to 220 \$/bl.

4. Specificities of Chinese Oil Market Interventions

4.1 China's interest in upstream investments made us wonder: could this trend distort the oil market? Actual ownership rights are seldom obtained, and when they are the volumes are small. The largest reserves remain in the hands of NOCs of oil-rich countries. We found no strong evidence that distortions could arise.

4.2 The other question for us was the increased reliance on long-term contracts. Could this fragment the oil market? Reliable information is hard to find. But we believe that if global arbitrage holds, fragmentation can be prevented.

4.3 Our key finding is that it is not how China gets oil, but how much which will change the world. Policy-makers should be aware of the size of the challenge and of its potential impacts.

5. Oil Security Assessment: Is China Different?

5.1 In the report we develop a framework for oil security assessment for net importers of oil. Oil intensity, import dependence and diversification of suppliers, routes and fuels are common components. Core variables, risks and threats are similar for China, the US or EU member states.

5.2 There is one major exception. One oil security concern is a blockade by the US Navy and Japan in case of conflict over Taiwan. Obviously nobody really wants that kind of development. The issue of Taiwan is however not within the scope of the project and we deliberately refrain from making suggestions.

6. Policy Suggestions

6.1 China, the US and the EU will have similar levels of dependence and vulnerability with respect to oil by 2030. They will also share many of the same risks and threats to oil security.

6.2 As a result, we recommend the creation of a new trilateral body so as to organise regular discussions and consultations on energy policy and energy security, with particular reference to foreign oil policy and oil security.

6.3 This trilateral body would bring together China, the EU and the USA, with the specific goal of improving understanding and cooperation between the world's largest importers of oil. The goal of the trilateral body is not to oppose producer interests, but to ensure mutual understanding on common goals (see below).

6.4 In particular, it should be the policy of all three parties:

First, to avoid negative-sum or zero-sum competition for resources;

Second, to uphold a transparent global market with functioning arbitrage;

Third, to work constructively and with reference to the interests of oil producers towards a new transportation system that will no longer be based on petroleum products.

6.5 Austria could suggest the creation of the trilateral body both in bilateral discussions and multilaterally at energy-related meetings of the Council of the European Union (Consilium).