

Untangling China's Quest for Oil through State-backed Financial Deals

Dr. Peter C. Evans

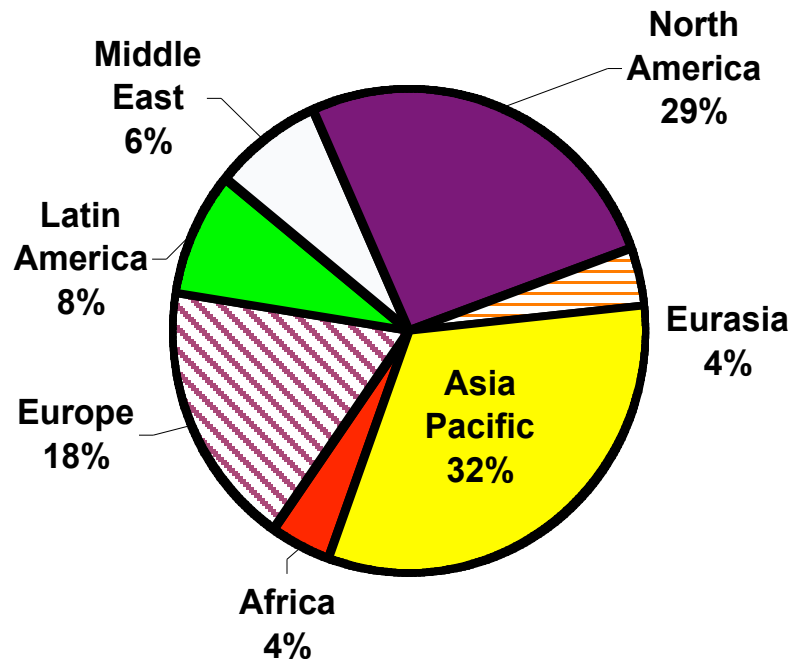
Sponsored by Asia Strategy
Toranomon, Tokyo
March 29, 2006

Overview

- Oil Market Conditions in Asia
- China's Oil Strategy
- Role of Government Finance in China's Quest for Oil
- Options and Limits of International Rules and Institutions to Regulate China's Government Backed Financing Strategy

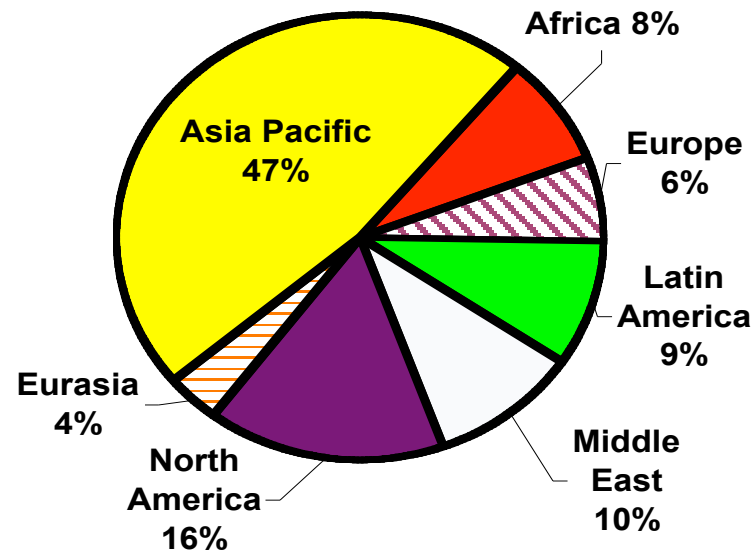
Led by China, Asia Pacific Will Drive Half of Global Demand Growth From 2005-2015

Shares of World Refined Product Demand by Region in 2005



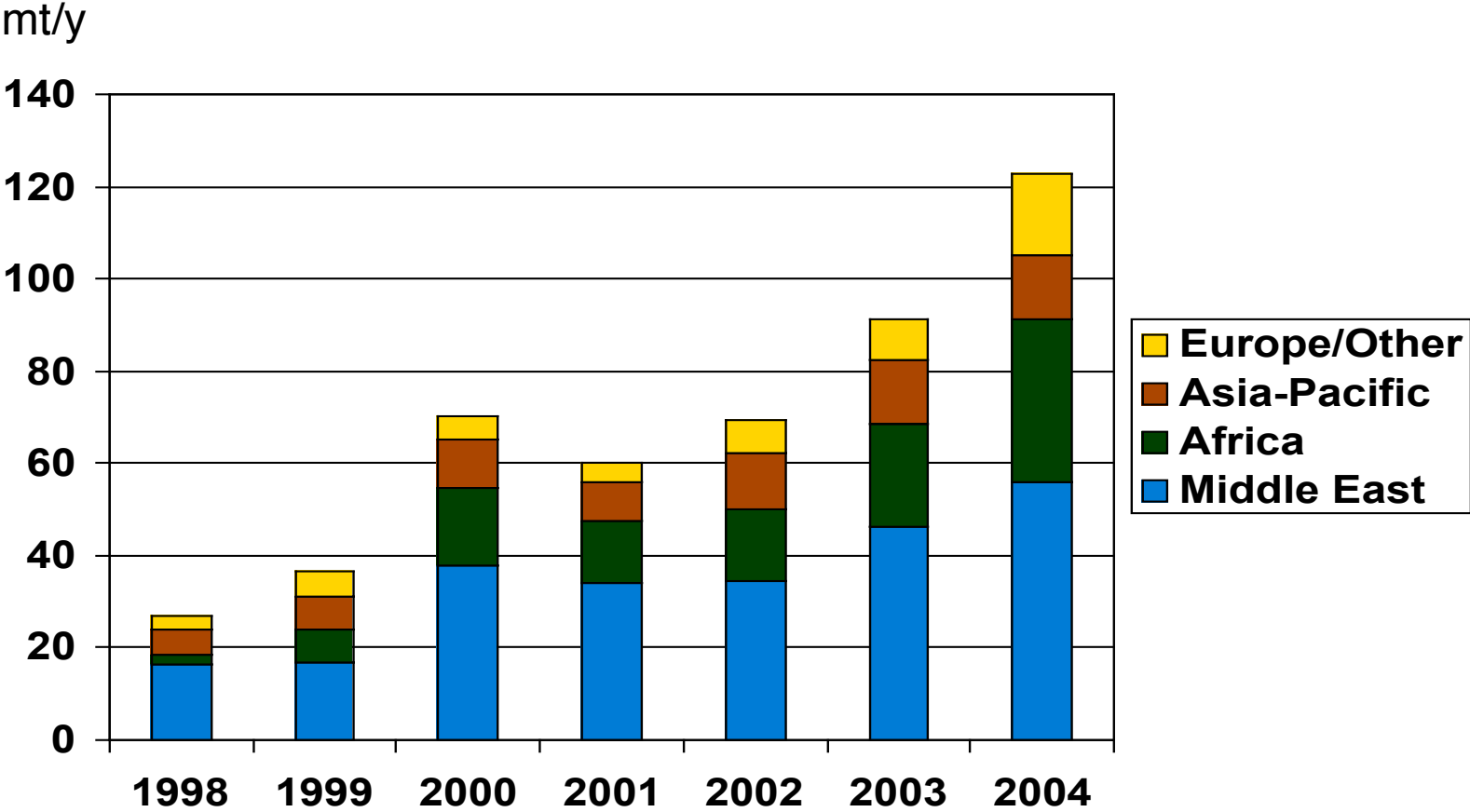
Demand in 2005 = 83.4 mbd

Shares of World Refined Product Demand Growth by Region from 2005 to 2015



Change in Demand from 2005 to 2015 = 18.3 mbd

China's Oil Imports Have Quadrupled



Source: China Petroleum and PetroChemical Industry Economics (2003) and China OGP, Xinhua News Agency (2005)

Oil Demand Trends

- China and U.S. remain keys to demand growth in near term
- China's rapid growth results in Asia Pacific accounting for nearly 50% of global demand increase between 2005 and 2015
- Demand growth to remain concentrated in middle of the barrel – diesel and jet fuel – in virtually all regions
- Rate of development of end-use (mainly transportation) technologies a key to long term oil demand growth
- Current tightness in global refining capacity will ease gradually as investment picks up; significant capacity needed over longer term in Asia Pacific

Consequences: A New Oil Era

- We have entered an era marked by heightened anxiety about security of oil and gas supply.
- Key catalysts of supply anxiety: Demographic, economic, and social trends.
- Growing concentration of oil production capacity will tend to foster a high price environment compared with the \$21 world of 1986–2003.
- Supply anxiety creates potential for efforts to emerge to restrain demand growth
- The challenges to oil supply growth are largely above ground, not below ground.

China's Oil Strategy

Domestic Measures

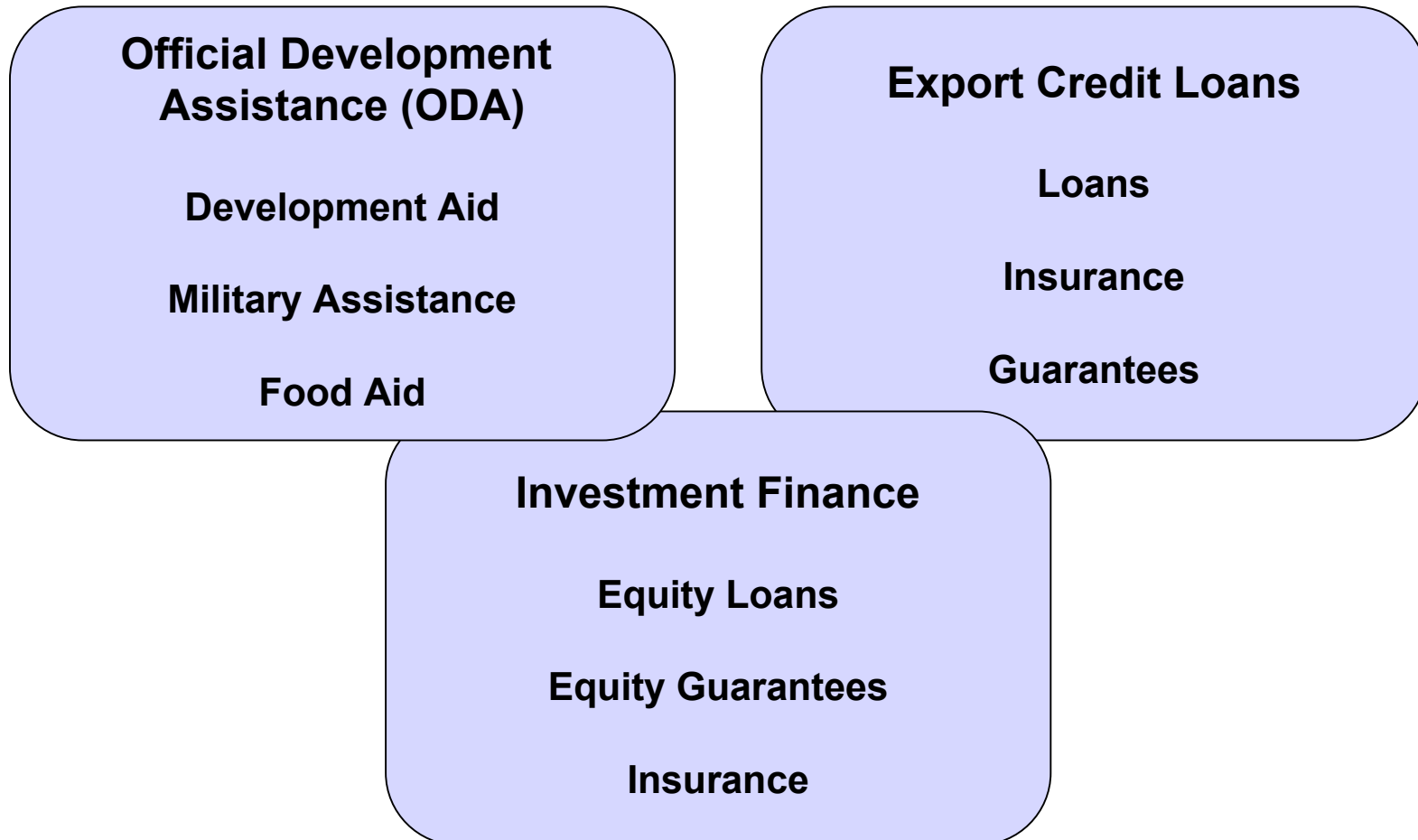
- Maximize domestic production of oil & gas
- Expand domestic refinery capacity
- Construct some emergency oil storage
- Reduce oil use in power generation
- Invest in coal-to-liquids

China's Oil Strategy

International Measures

- Diversify source of oil imports
- Build infrastructure to support imports
- Develop closer political relations with key suppliers
- Provide government financing to directly and indirectly support China's national oil champion

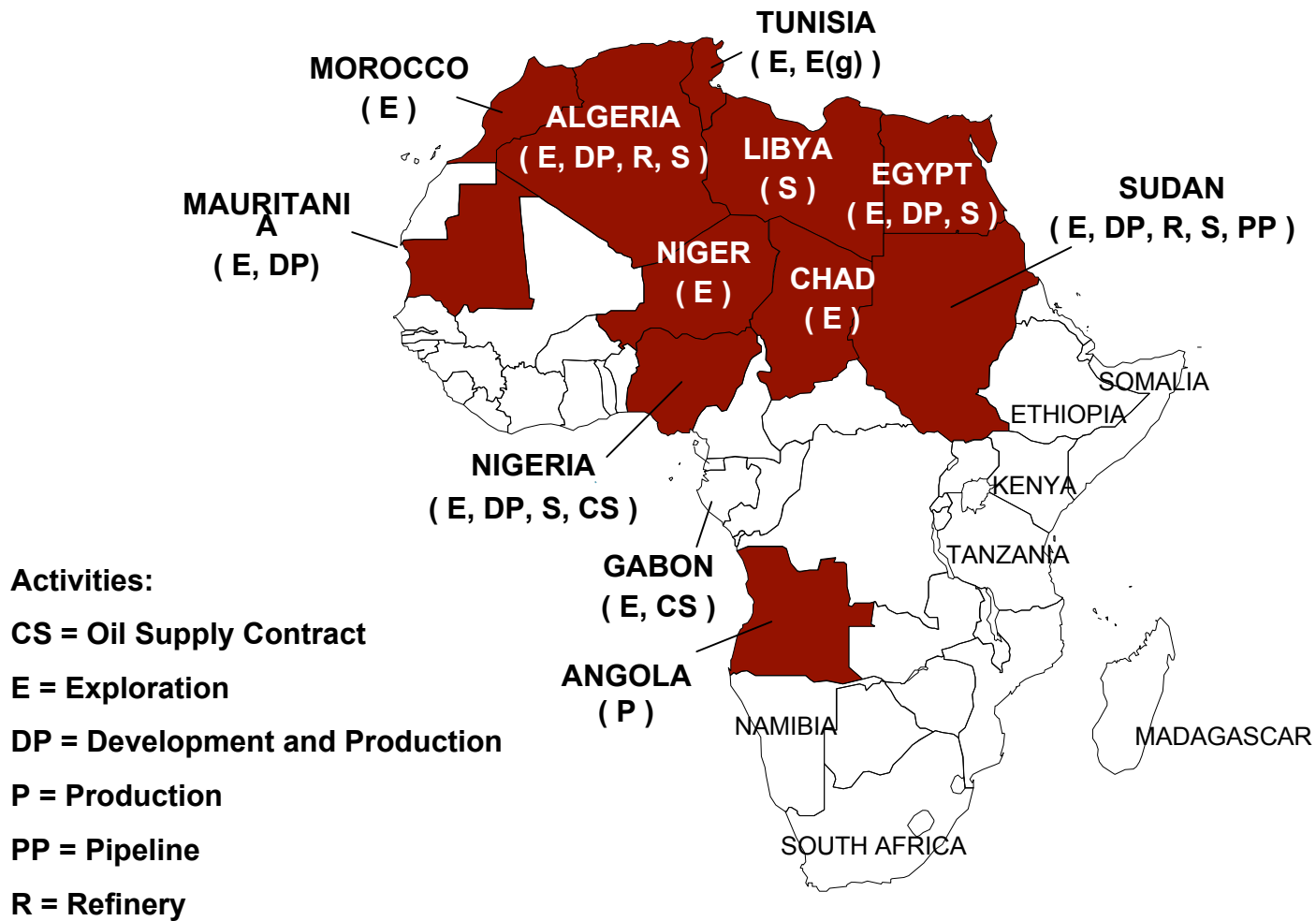
Financial Tools Used to Secure National Interests, Including Energy Interests



Aggressive Chinese Bidding: Pushing Up Asset Prices?

- **Recent Controversial Cases**
 - China's (CNOOC) bid for Unocal (fails but drives up cost)
 - China (Sinopec) beats out India's ONGC acquisition of Shell in Angola (\$2 billion soft aid loan in background)
 - ONGC bid in Nigeria / Chinese acquisition
 - Congo- Hydro dam in Brazzaville being repaid in oil- "Exchanging oil for Projects"- China's Ministry of Commerce.

China's Oil Interests in Africa



China Ex-Im Financing Deals in Africa

Year	Country	Project	Project Details	Developer/Sponsor	Trade Finance	Total Amount (Millions US\$)
2001	Angola	Luanda/Uige Road Restoration	10 bridges and the rehabilitation of two others, 254 aqueduct and hydraulic passages along the road	Chinese building company Roads and Bridges Corporation (CRBC)	China's Export-Import Bank	2,000
2001	Morocco	Hospital Equipment	n/a	n/a	China's Export-Import Bank	18.5
2001	Sudan	Al Jaily (gas-fired power plant)	212 MW	Harbin Power Engineering Co.	China's Export-Import Bank	130
2001	Sudan	Merowe transmission lines	Power transmission lines and equipment	Harbin Power Engineering Co.	China's Export-Import Bank	400
2002	Ethiopia	Tekeze Hydro	300 MW	China National Water Resources and Hydropower Engineering Corp.	China's Export-Import Bank	224
2002	Nigeria	Papalanto (single cycle gas)	335 MW	Shandong Power Construction Co. and China National Machinery & Equipment Import & Export Corporation (CMEC)	China's Export-Import Bank	195
2002	Nigeria	Omosho (single cycle gas)	335 MW	Shandong Power Construction Co. and China National Machinery & Equipment Import & Export Corporation (CMEC)	China's Export-Import Bank	195
2002	Sudan	Merowe Hydro	1,250 MW	China International Water & Electric/ China National Water Resources & Hydropower Engineering Corp.	China's Export-Import Bank	555

China Ex-Im Financing Deals in Africa

Year	Country	Project	Project Details	Developer/Sponsor	Trade Finance	Total Amount (Millions US\$)
2003	Congo	Congo-B (Imboulou Hydro)	120 MW	China National Machinery & Equipment Import & Export Corporation (CMEC)	China's Export- Import Bank	280
2003	Ghana	Ghana Telecom	install 250,000 switching lines	Alcatel Shanghai Bell	China's Export- Import Bank	150
2003	Zambia	Lower Kafue Gorge	660 MW	China Water Resources & Hydropower Construction Group (Sinohydro)	China's Export- Import Bank	600
2003	Zambia	Itezhe-Tezhe Hydro	120 MW	China Water Resources & Hydropower Construction Group (Sinohydro)	China's Export- Import Bank	120
2003	Zimbabwe	Ziscosteel upgrade	n/a	China Shougang International Trade and Engineering Corporation	China's Export- Import Bank	42
2004	Namibia	Locomotives	4 diesel locomotives and 30 oil tank cars	China South Locomotive and Rolling Stock Industry Corporation	China's Export- Import Bank	6
2005	Namibia	Locomotives	15 diesel locomotives and the refurbishing of the current 30-year old locomotives	China South Locomotive and Rolling Stock Industry Corporation	China's Export- Import Bank	156.4
2005	Nigeria	Starcomms	Telcoms network	Huawei Technologies Company Limited	China's Export- Import Bank	23

5,095

Source: Compiled by Peter Evans based on various press reports, 1998-2006

Concerns Raised About Predatory Finance

The China Ex-Im Bank has become a key instrument through which China is supporting its national oil companies' overseas expansion.

- Direct Subsidies
- Indirect Subsidies
- Side Deals (aid projects linked to oil deals)

Is a Credit Race in the Making?

Indian officials recently stated India's intention to establish a US\$1 billion per year "war chest" to fund infrastructure projects in Africa as part of its quest for oil assets.

China's National Oil Champion Rises to 6th Largest Listed Oil & Gas Firm

2005 Rank	2004 Rank	Company	Market Cap (\$US billions)	Country
1	1	ExxonMobil	349.5	United States
2	2	BP	219.8	UK
3	3	Royal Dutch Shell	208.3	Netherlands
4	9	Gazprom	160.2	Russia
5	4	Total	154.2	France
6	7	Petrochina	146.6	China
7	5	Chevron	127.4	United States
8	6	Eni	111.0	Italy
9	8	BHP Billiton	100.2	Australia
10	10	ConocoPhillips	80.7	United States
43	-	INPEX	17.1	Japan

Source: PFC Energy, Ranking of the World's Largest Listed Firms in the Oil & Gas Industry, January 2006

Peter Evans, MIT Laboratory for Energy and Environment

Other Concerns Raised About China Ex-Im

- The China Exim Bank has not committed to complying with the Common Approaches on Environment.
- Until November 2004, China Ex-Im did not have any environmental guidelines.
- China Exim has not made its new environmental guideline available to the public
- China Exim Bank does not appear to have any policy governing human rights.

International Rules and Institutions

- International Energy Agency (IEA)
 - 1994 Statement of ‘Shared Goals’
- World Trade Organization (WTO)
 - Subsidies and Countervailing Measures
- OECD Export Credit Arrangement
- G7/G8 Meetings

Can International Institutions Regulate Oil Deals?

	Membership Includes China	Strong Information Sharing/Monitoring Requirments	Rules Governing Export Credits	Rules Governing Subsidized Investments
IEA	No	No	No	No
WTO	Yes	No	Yes	No
Arrangement	No	Yes	Yes	No

Note: IEA = International Energy Agency; WTO = World Trade Organization; Arrangement = Arrangement on Guidelines for Officially Supported Export Credits.

Conclusion

- Competition for Upstream Oil and Gas Resources are Likely to Intensify Further in Coming Years
- China's Oil Strategy Includes the Strategic Use of Government Finance, Specially China Export Import Bank
- International Rules Governing Government Finance in Energy Sector are Weak
- Future Trade Conflict Over Government Financing is Likely Unless China and Other Countries Adopt Common Rules Regarding Acceptable Practices- foreign aid, export credits, equity finance