# Strategic Change in China's Oil Policies to Further Strengthen Energy Security

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China is now the world's second largest oil consumer following the United States, and the growth in its crude imports is considerably higher than the world's major economies. In 2009, the import volume of crude exceeded domestic production for the first time, resulting in an import dependency of more than 50%. Until the first half of the 1990s, China was a net crude oil exporter; the recent surge in import dependency has led to a strategic change in its oil policies towards strengthening energy security.

## 60% dependence on crude imports expected by 2012

Even during the financial crisis, which affected economic growth during 2009, China's crude imports increased by more than 14%, higher than the average of 13% witnessed over the past five years, and exceeded 200 million tons for the first time. Sluggish domestic crude oil production since the 1990s contributed to this trend as did the strong economic growth that prompted a surge in petroleum chemical demand caused by the rush to build social infrastructure, and an increase in demand for transportation fuels following the full-fledged motorization of the economy.

In 2010, against the background of a faster recovery in global economic growth than expected, China's gross domestic product (GDP) growth rate is expected to be strong - in the first quarter growth reached 11.9%. Over the next three years, an average annual GDP growth rate of 10% is expected despite some pessimism linked to fears of a bubble effect, inflation, and revaluation of the yuan. Therefore, the increase in oil demand seems to be essential to support such strong economic growth. In addition to their immediate needs, increasing stocks accumulated as part of the 2nd phase of strategic petroleum reserves (SPR) and commercial oil reserves promoted actively by oil companies will contribute to an expected increase in China's crude oil imports. Imports are forecast to grow at an annual average rate of 10% over the next three years and may exceed 300 million tons by 2012[1]. In this case, oil import dependence will be close to 60%. In the international oil market, China's increasing presence as a huge and rapidly growing buyer is assured.

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[1] Author's estimation

## Actively expanding relations with oil-producing countries

With the increase in oil demand and imports, in 2009, China overtook Japan and became the world's second largest oil importer after the US for the first time. Based on the certainty of further economic growth, oil security has become a serious policy issue for China, driving it to actively build strategic bilateral relations with oil-producing countries. For instance, in return for the huge loans provided to oil-producing countries such as Russia, Brazil and Kazakhstan, China secured a substantial volume of long-term oil supplies from these countries in 2009. In April 2010, China provided Venezuela with a US$20 billion loan in addition to the existing line of credit to support new power plant and infrastructure construction and has secured long-term oil supply from Venezuela in return. Moreover, it is also actively investing in oil-producing countries such as Iran and Sudan where developed Western countries have difficulty investing.

Besides developing businesses in oil-producing countries, China is also attracting oil-producing countries into its downstream market at home. At present, oil-producing countries including Saudi Arabia, Kuwait, Qatar, Russia and Venezuela are all in the process of establishing joint venture businesses with Chinese national oil companies (NOCs) in the refining and petroleum chemical areas. Through these measures, China has helped oil-producing countries recognize the attractiveness of its stable and expanding domestic market, while its steadily built-up relations with oil-producing countries have helped their businesses achieve huge profits.

As a result, from the viewpoint of oil-producing countries' exporting businesses, China has become one of their most important counterparts. Especially, in 2009, judging from Saudi Arabia, the leader of Middle East oil exports, China surpassed the US and became its largest oil exporting counterpart. Given that China's oil imports are expected to continue to increase sharply, in 2010, Saudi Arabia plans to expand its crude exports to China by 30%, Kuwait by 60%, and Iraq by 2.4 times[2].

## Chinese NOCs aiming for overseas oil equities

Besides building strategic relationships with oil-producing countries as a way to ensure oil security, China is actively taking part in the upstream business that is dominated by international oil companies (IOCs). Chinese NOCs began to acquire overseas oil assets when China turned to a net importer in the early 1990s. Recently, Chinese NOCs have increased their interest in mergers and acquisitions (M&A) with their foreign counterparts in

[2] Nikkei News, January 18th, 2010

addition to bidding for exploration and production (E&P) works of oil blocks at an early stage. In 2009, Chinese NOCs successfully acquired 11 foreign assets, worth around US$30 billion, with the background that China holds the world's largest foreign currency reserves and could maintain economic growth of more than 8% despite the global financial crisis. As a result, China's foreign equity crude reached 50 million tons in 2009, which represented 25% of its imported crude.

During the first quarter of 2010, Chinese NOCs invested US$7 billion in the acquisition of overseas properties, accounting for almost 25% of the total world oil sector's M&A activity over this period[3]. The Chinese government was concerned about the intensifying competition among its domestic NOCs in their rush to acquire foreign assets, issuing a notice to five major NOCs[4] to cooperate in advance and decide their stakes before bidding.

## Attempts to reduce dependence on the Malacca Straits

In addition to ensuring quantitative safety, the Chinese government has been promoting many initiatives to increase the diversification of its crude import sources and routes following an increase in the Middle Eastern and African crude ratio in recent years. Especially, as about 80% of imported crude oil passes through the Straits of Malacca, China has been making attempts to lower its reliance on the strait.

Specifically, it has been trying to increase imports of crude oil from Venezuela, which do not need to pass through the strait, while also promoting overland pipelines from Kazakhstan and the China branch of the Eastern Siberia - Pacific Ocean (ESPO) oil pipeline from the northwest. Construction of the overland pipeline from Myanmar through the Bay of Bengal in the southwest has started and is scheduled to be completed by 2012. Moreover, it is reported that China is considering participating in the pipeline across Peninsular Malaysia which the Malaysian government has been trying to resume recently.

China's GDP will soon become the world's second largest. Its response to rising energy security issues stemming from rapidly increasing oil demand and dependence on imported crude will need to be watched.

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[3] HIS report, April 2010
[4] PetroChina, Sinopec, CNOOC, Sinochem, CITIC