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Transcript

CHINA IN THE WORLD PODCAST

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Guest: **Wang Tao**

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Haenle: You're listening to the Carnegie–Tsinghua China in the World podcast, a series of conversations with Chinese and international experts on China's foreign policy, international role and China's relations with the world brought to you by the Carnegie–Tsinghua Center here in Beijing. I'm Paul Haenle, the director of the Carnegie–Tsinghua Center, and I'll be your host.

Today, we are delighted to welcome back to the Carnegie–Tsinghua podcast one of Carnegie–Tsinghua's resident scholars, Dr. Wang Tao. Wang just recently became a father. Congratulations.

Wang: Thank you, Paul.

Haenle: Wang Tao is a resident scholar in the Energy and Climate Program based here at Carnegie–Tsinghua. He links the work of Carnegie's programs in Beijing with Carnegie's global centers in Washington, Moscow, Beirut, and Brussels. His research focuses on China's climate and energy policies, with particular attention to unconventional oil and natural gas transportation, electric vehicles, and international climate negotiations. Today we are going to discuss the topic of one of Wang Tao's recent articles on China's New Silk Road. Tao, to begin with, let's talk about the New Silk Road, which Xi Jinping announced in the Fall of 2013 on a trip to Central Asia in Astana. He announced this New Silk Road project and the main objectives of what is called today "One Belt, One Road Strategy". Can you give us a sense for what the objectives are for this? What's the background?

Wang: Sure, Paul. First of all, the One Belt, One Road Initiative is the first ever comprehensive and systematic overseas investment and development initiative made by China. It aims to strengthen the connectivity and economic cooperation with the countries along the road and also the belt. Investment, trade, infrastructure construction, and also personal and cultural exchanges deepen China's economic integrations with those countries and also enhance China's presence and influence in this instance and, potentially in the future, China's power in those regions, and make China more influential in those critical regions as well as diplomatic relations.

But also this is a way to comfort the neighboring countries for their concerns over China's rise. There are a lot of concerns over what China will be and, if China becomes a superpower in the future, what would be the implications. So this is really to bring them the economic benefits and to share with them the spillover effect of China's integration, to enjoy some of the benefits of economic growth. Also, the exchange helps them to benefit from this program. But if you look at the big picture of this, there is a significant feature of this map which is energy. The energy investment and also the infrastructure related to energy is playing a very key role in China's overseas development, especially along the One Belt, One Road route. It includes, for example, most of the important oil and gas exporters to China and also covers the most important, critical energy trade routes that China has, for example, the ones through Central Asia to import gas and oil and also the one through South East Asia in the Malacca Strait which covers almost 80 percent of China's oil imports. This initiative also has a very strong flavor to China's energy supply security.

Haenle: So, part of an effort to convince countries on China's periphery that not only will its rise not threaten them, they will in fact benefit from it. Part of a charm offensive of sorts. But you also focus in on the energy objectives here. They are also important and, as you say, will play a dominate role in the One Belt, One Road Strategy. Can you give us a sense of what kind of energy

and infrastructure project investments do you think are being planned or are already underway along the maritime silk road and the 21st Century Silk Road? The Maritime Silk Road is obviously the sea based portion of this. The 21st Century Silk Road, which starts out through Central Asia and beyond is the land component of this. What kind of projects are being planned and will be the kind of impact on China's energy security?

Wang: In fact, China already made a huge investment along both of the routes. For example, if you look at the land roads which they called the Silk Road Belt all the way from China towards Central Asia and towards the Middle East and, finally, towards Europe—there are a lot of countries where China has already made investment, particularly, for example, the Central Asia investment in Turkmenistan, Kazakhstan, in terms of oil and gas investment. But also, there are a lot of investments China has already made along the Maritime Silk Road in South East Asia and all the way towards India and Africa. There are different types of investment that China has made. For example, some of them are direct investment made by the Chinese state owned oil companies in Sudan, in Libya, in the Middle East, and in other places. There are lots of them. But, also there are government-backed agreements which are called "loan for oil." That type of agreement will give China access to oil and in return, China will offer favorable loans to the country—for example, like what we have in certain countries like in Africa and in Russia in terms of oil deals. Also, there are some favorable loans for related energy investment and infrastructure in those countries offered by Chinese-owned banks.

Haenle: This is tough business; this is not easy business. The conditions in these countries vary. Some countries are at a higher level of governance and security. I assume there are a number of risks associated with this when it comes to Chinese SOEs and other companies going into these regions of the world pursuing energy projects and investments along these Silk Road routes. Can you talk about some of the successes and failures that Chinese SOE's can learn from in terms of their own previous experiences in investing overseas, especially in developing regions and complicated regions of the world?

Wang: You are absolutely right on this point. Most of the nations along this route are actually developing countries, and, as often is the case, they are experiencing social and political instabilities during investment or during the time of the project. Sometimes the lack of a transparent legal system is a lack of protections when something happens to China's investment. There has been a lot of successes in some of the investments. For example, China's early investment in Africa and Angola has given China a large quantity of the oil equity, and now Angola is China's number two oil exporter after Saudi Arabia. But there are many cases where we have heard of different kinds of risks affecting China's investment. There are different types. For example, the basic ones are like asymmetric information of the destination countries will impose huge risks in the financial terms of China's investment. In some of the investments they made, after they went to the country, they realized the situation was much more difficult so the cost became much higher than they bid for. In one case, in Saudi Arabia, China was bidding for a high speed railway and in the end they realized the cost was twice the price they had been offered and they still managed to do it because they think this is important to maintain the relationship, particularly because this railway was somehow related to religious regions or has religious factors to it. But there is also the case where China's investment was affected by the local issues or political risks. For example, we have heard the case in Libya when the civil war broke out when

China had to evacuate over 36,000 people over two weeks because of the risks it imposed. And also there are oppositions in, for example, Myanmar, in certain investment China made this time in hydro power because of the environment issues so it all has to be taken into account. But, there are new types of political risks that China has to start to realize and face in their investment. For example, the investment China made in Russia and the deal that was signed with Russia for natural gas is already being affected by the intensified fight between Russia and Europe and America. The sanctions on the technology of oil and gas already affects the prospects of Russia delivering the gas to China. So, there are a lot of risks they have to consider, and it's the lesson they are going to learn over time.

Haenle: Given these risks that Chinese SOEs and Chinese companies face when investing in these countries, which as you point out many have weak government systems, high levels of instability, political and other instability, will China be looking to play an enhanced role in looking to the future to enhance the security in these regions and potentially building government capacity in these countries, especially where China has strong commercial and energy interests and those interests that we see are growing?

Wang: It's certainly in China's national interests to protect the safety of its personnel and also its investment and commercial interests. But we have seen that in the cases, for example, Sudan and Libya, China has already carried out a huge or massive campaign to rescue people and also its assets as much as it can when emergencies break out in those countries. Most of the cases we have seen so far post crisis management or emergency plan or damage fixing, China still feels like it's not in the position to proactively act in some of the countries, probably also because of the non-interference principle China has in its diplomatic strategy. So it has made China very, very reluctant to exercise their power and also their influence in certain countries. But, I think in the future, with more of the investments coming from China and China's companies—especially now this year and last year in 2014 we have seen China with over $60 billion in investment, for the first time ever exceeded the investment China received from the foreign countries—so there would be more and more investment overseas with all sorts of people doing all sorts of projects. So, there will be huge pressure for China to take measures to prevent certain risks from breaking out and taking a more proactive road in the future to maintain security and enhance the government in the destination countries where they have a very high stake.

Haenle: We've talked about projects and investments in Central Asia along the land component of this strategy. We've talked about South East Asia as well. But I've seen a Tsinghua map of this New Silk Road Strategy, and this goes beyond these regions and it in fact goes through the Middle East and beyond, connecting I believe in Venice, Italy. Let's talk about the Middle East. How does the Middle East fit into this strategy and this New Silk Road strategy?

Wang: Well, the Middle East for sure is very important for China's energy security. If you look at the data at moment, last year Saudi Arabia alone accounted for one fifth of China's oil import, and if you look at the whole region, the Middle East as well as North Africa accounts for more than half of oil imports and 30 percent of China's total oil consumption. So, it's absolutely crucial for China to continue to be able to import oil from these areas. Even for natural gas, Qatar is the first and the largest liquefied natural gas supplier to China. Iran as the world's third largest natural gas producer could also potentially become a very important supplier to China in terms of natural gas.

And given the huge demand, the growth of the oil and gas demand in China and particularly because of the pressure to tackle air pollution, China will continue to consume more and more gas and oil. This is crucial for China to maintain a supply from these regions. So, we will see that the Middle East is very crucial for China's energy security and is going to be even more so in the future. Even with today's development in unconventional oil, the Middle East oil is still among the cheapest and with the close proximity to China, this makes the Middle East oil the first priority or favorable choice for China's oil companies to import. With the recent fall of the oil price, this is actually going to make the Middle East oil even more attractive to China because of the certain type of oil in the Middle East is very suitable for China's refinery capacity. China already built a large fleet of refineries that is designated for Middle East oil. So, with the fall of the price, China is going to see a large profit in those refinery sectors which makes them very attractive to them.

But, if we are looking at the investment alone, then you will see a very interesting divergence between the pictures between the Silk Road and the role the Middle East is going to play in China's future and its security and China's investment in this region. If we compare the figure of China in the previous research done at the Carnegie-Tsinghua Center, the "China's Oil Future," we compared the accumulated loans and investment in the oil sectors made by Chinese oil companies between 2008 and 2013. Russia and Eurasia came first, which accounts for about $150 billion in the last 5 years. But, the Middle East is only about a tenth of that size, much smaller, compared to Russia and Eurasia. And also much smaller compared to Latin America and other areas. So this reflects a reluctance or hesitation in China's oil companies to step into these areas to play a kind of role that they already played in South America and Africa, as they did in those areas to have much deeper engagement and to give huge investments and loans in those countries. And I think that is particular because, in China's view, the Middle East is probably one of the most complicated geo-political regions in the world and also been intertwined with very complicated culture and religious reasons. China feels very reluctant or, if you like, unconfident, to step into this area and to be an active investor and engage in the internal politics in these areas. But also, there are very strong and long standing interests being led by the United States in this certain area.

I think this is not the right time, China feels, to play a very active role in this region. Instead, China is trying to play under these frameworks that have already been established by the United States and the Western world in the Middle East, trying to focus mostly on the commodity trade. So this explains why China imports so much oil from the Middle East but is not doing the comparable size of investment and loan to those countries. But certainly, this does not mean that the Middle East is not important to China. Instead, it is so important that China doesn't want to step in too early and mess that up.

Haenle: You mentioned in other regions of the world that you anticipate over time China beginning to play a more enhanced role, maintaining stability and building capacity for governance. How do you see China's contributions to the Middle East playing out over time? If it's not the right time now, how will this evolve?

Wang: I think over time, that's true that China will also feel it's necessary to play its own part in securing or improving the governance and stability in this particular region because of the high stakes China has. But, it's still unclear exactly what road and which way China could play in this region and on the very complicated issues. But I think there is also a huge opportunity for China to work together with the United States to enhance the security and stability of this region. And

China is already facing that pressure. If you look at Iraq, China is now the largest investor in Iraq after the Iraqi War and now their own interests have been threatened by the sudden rise of ISIS. Now, there is a huge stake there for China, and China has very strong incentives to make sure that it's not going to be affected.

Haenle: Thank you. For my final question, I want to shift slightly to something you mentioned, falling oil prices. At the OPEC meeting in December, Saudi Arabia decided not to make cuts in its oil production. In Saudi's calculus, this policy puts pressure on Russia over the Ukraine. It puts pressure on the Iranians, Saudi Arabia's foe. It discourages investment potentially in the U.S. tight oil and shale-gas oil industry. And, it also helps to preserve Saudi's market share. Can you give our listeners a sense of what you believe are the implications of falling oil prices for China: the costs and the benefits, the winners and the losers?

Wang: Certainly. The impact of the falling oil prices on China are very mixed. Of course, as a big oil importer, China could benefit significantly from falling oil prices, and this means huge profits for the oil refiners in China. But, there are also some heavy industries that will be saved by the falling prices and will be able to sustain longer. That is not good news for China, especially now that we are trying to limit pollution. On the other hand, there is also encouragement for people to drive more because now you look around and the oil price is back to almost 3 or 4 years ago, and people feel like they can afford to drive more. This also means more emissions, more congestion, and more pollution in the big cities like Beijing. So that also is a big contribution the air pollution. So we have to understand why this next impact is very difficult to evaluate and understand why Chinese government actually decides to raise the tax on the oil when the oil price is falling, because we don't really want to encourage people to drive more, to use more oil, and also to save some of inefficient, outdated, dirty industries. Whenever the oil price return back to normal or back to the higher prices, we find that again the difficulty to find enough oil to supply.

But there is also another unintended result that we actually got caught in-between. China has actually made lots of investment as we mentioned before in oil and gas field overseas. Many of them are based on certain assumptions of oil prices. Many of them are actually very high, for example, over $80, over $100 per barrel. Now, because the oil price suddenly falls so much, many of these investments became economically unfeasible. So now we have to again review all the investments we made, and some decision has to be made whether to delay construction and development or to resell them and have the cost cover the loss. But this, again, illustrates the kind of risk that we faced when we made the huge investment in oil and gas overseas, particularly because Chinese oil companies are very interested in investing in overseas areas like in North America and South America and also Africa. Those are the high-priced assets, and when the oil price suddenly falls or the demand is not growing as many people expected, like the case in China, their investment becomes a problem. So we have to be very cautious in the future on that.

Haenle: Well, thank you very much, Wang Tao, for sharing your insights today with our podcast, and thank you as well for all the important research contributions you have made to CTC. It seems now wherever I go, whether it's to visit Carnegie Centers overseas in Europe and the United States and other places, I'm always being asked how I can help them arrange to get Doctor Wang Tao to come talk to their audience. So your profile has certainly gone up, and your work is being read by increasingly larger numbers of people around the world, so thank you for that.

That's it for this edition of the Carnegie–Tsinghua China in the World Podcast. If you would like to read Wang Tao's article on China's New Silk Road and other recent publications by Doctor Wang Tao, you can find those on the Carnegie–Tsinghua website at www.carnegietsinghua.org. I encourage you to go to our site and view the work of all our scholars at the Carnegie–Tsinghua Center. Thank you for listening, and be sure to tune in next time.