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Abstract

How China will satisfy its rising energy demand will have impact on the availability and market price of energy resources such as oil and gas, but also on foreign policy. Of special interest is the role of rising neighboring countries and region – Russia and Central Asia countries – who can supply China by way of pipelines.

In this paper important factors influencing Chinese energy decision-making are discussed, with a particular focus on energy investments abroad. The state capitalism framework is used to explain the long-term policies of Chinese energy investments as well as discuss the importance of State-Owned Enterprises and National Oil Companies to the Chinese economy.

On this background the energy relations between Russia, China and other Central Asia states is discussed. The main focus is on the influence Chinese Energy Based Loan (EBL) agreements have on the Chinese presence both economically and politically in the region. The objective is to present the current situation and outlook for Sino-Russian-Central Asian energy relations as well as the economic implications a closer Chinese presence could have for the region. China's EBLs with Central Asian countries illustrate the preferred Chinese approach in expanding trade relations and should be considered as important examples for future bilateral agreements.

Key Words

China, Russia, Central Asia, Energy dilemma, China Development Bank, Energy Based Loans, Oil, Gas

Contents

1 Introduction

According to China's Vice Premier, Wang Qishan, and Russia's then Deputy Prime Minister, Igor Sechin, the Sino-Russian energy cooperation is all-around, long-term and strategic, and is an important component of the Sino-Russian strategic partnership of cooperation. Since 2005, the Sino-Russian relationship has been characterized by an unprecedented financial involvement by Chinese policy banks, contributing to new partnerships between Chinese and Russian National Oil Companies (NOCs) such as the 2005 Rosneft – China National Petroleum Corporation/China Development Bank/Export import bank's $6 billion financial deal and the 2009 Rosneft/Transneft - CNPC/CDB's $20 billion trade finance deal.

These deals reflect the new long-term strategic energy cooperation (collaboration between the states, NOCs and financial institutions) that has developed between China and some of its energy trade partners since the mid-2000s. Energy-backed loans (EBLs) are an exchange of resources for loans, in which the loan is paid back by the revenue earned from exporting oil or gas to China's NOCs. Most EBL agreements have conditions that secure Chinese NOCs and infrastructure companies' access to development contracts in the state. This facilitates a close economic integration between the two countries. Still, the conditions attached to each EBL are often different and could influence China's future investments.

This paper aims at analyzing the development of Russian-Chinese energy cooperation by assessing various EBL agreements as well as other energy cooperation frameworks that China has pursued with Russian state-owned enterprises (SOEs). The emphasis will be on determining the factors that have caused the current development, what type of short-term and long-term benefits/objectives related to the current energy-related agreements between Russia and China exist and how future cooperation will develop. Moreover, the implications for energy relations with the Central Asian states are discussed, and to provide a comparative assessment to the Sino-Russia EBLs, China's agreements with other Central Asian states will be presented.

To explain these issues, this paper will first present a short introduction to the Chinese institutional framework of state capitalism. Second, provide a short empirical overview over the Sino-Russian-Central Asian energy cooperation, and discuss the relevance of international developments in this regard, with two cases as examples.

2 State Capitalism

The Chinese state capitalist model applies a combination of command and control, market-based and non-regulatory instruments to develop competitive industries or national champions within sectors regarded as essential for the long-term growth of the national economy. The state capitalist principles summarize the roles of the financial system, state-owned enterprises (SOEs) and the state. Although, this state capitalist framework complies with the mainstream view on the Chinese economic model, there are still clear distinctions between this framework and the mainstream view. While the mainstream view characterizes the Chinese economic model as a vaguely defined combination of authoritarian politics and state-driven capitalism, the state capitalist framework has more direct explanatory power. The framework stipulates that China's economic system is divided between strategic and private industries and that the strategic industries are selected based on the economic development stage the country is in.[1] The strategic industries are actively promoted by the state and financial institutions if in return SOEs take the role of responsible stakeholders in implementing state policy. This state capitalist framework also emphasizes that Chinese investments overseas cannot be characterized as a "lock up" neo-mercantilist policy any longer, but that they rather aim to promote the establishment and growth of Chinese enterprises in foreign markets.

Based on the state capitalist framework China's national energy policy is developed and executed by three types of institutions: 1) the state bureaucracy's regulatory agencies (the National Development and Reform Commission and the National Energy Commission), 2) China's NOCs and 3) The Chinese policy banks (China Development Bank CDB, China Export import bank Eximbank and China Investment Corporation CIC). The final decision on any investment is done in conjunction between the three types of institutions and the China Communist Party (CCP). The basic assumption of the state capitalist idea is that if the state, financial institutions and the SOEs coordinate their long-term policies/interests, they could create internationally competitive industries that spur domestic innovation as well as provide natural resources needed to the continuous long-term growth of the national economy.

2.1 State Capitalist Principles

The goal of state capitalism is to bring the various institutions together to pursue coordinated long-term objectives that are beneficial to the economy as a whole. These objectives are achieved through the coordination of the three Chinese state capitalist principles and can be formulated as follows:

[1] The selection of a strategic industry is based on its importance as growth catalysts to push the economy from one development stage to the next. As a result, strategic industries evolve in accordance with China's stage of economic development.

1 Financial System: A functional financial system must be in place to guide the material self-interest of individuals and corporations in pursuing long-term profit goals through regulation, and not only increase the short-term profits.[2] Overseas investments should not only contribute to the growth of the company, but also to the long-term growth of the domestic economy through foreign market access, resource imports and facilitation of technological or competitive development opportunities.[3]

2 State-Owned Enterprises: Sustaining manufacturing is vital for supporting the continued development of high-tech industries. Here, the state's role is to promote large state-supported companies (within the sectors relevant for national security), which help to develop productivity growth in the economy as a whole and an industrial niche for the promotion of international trade and further innovative thinking. An important task is these institutions' role to provide the necessary preconditions for private sector development such as foreign market access and securing the rights and other conditions necessary for private enterprises to thrive and develop internationally.

3 State: Government interventions should encourage economic dynamism and stability through subsidization or general trade remedies benefitting its key economic sectors (armaments, electric power and distribution, oil and chemicals, telecommunications, coal, aviation and shipping). Through Research and Development (R&D) investment, worker training and risk sharing in projects low on private- but high on social returns, as well as the protection and promotion of "infant" industries in secured foreign markets, the state can increase its industries' competitive level on the international market together with pursuing high-end products and technological expertise.[4]

2.2 The State Capitalist Framework's Relevance to Energy Cooperation with Russia and Central Asia

In order to understand the Chinese energy policy decision-making processes relevant to Russia and Central Asia, one must take into account the specific position that SOEs/NOCs have for the long-term growth of the Chinese economy (underscored in the state capitalist principles), as well as their central position in the energy decision-making processes.

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[2] Ha-Joon Chang, *23 Things They Don't Tell You About Capitalism,* London: Allen Lane. An imprint of Penguin Books, 2010. 255-256. To promote this principle, state capitalism takes advantage of both neo-mercantilist and neo-Keynesian theories and tools.

[3] James K. Galbraith, *The Predator State: How Conservatives Abandoned the Free Market and Why Liberals Should To.* New York: Free Press, 2008, and James K. Galbraith, *Created Unequal: The Crisis in American Pay*. Chicago: The University of Chicago Press, 1998.

[4] Especially in regard to developing countries, governmental protectionism should be present in order to regulate foreign investment and protect and develop a competitive domestic industry: Chang, *23 Things They Don't Tell You About Capitalism*. 261. It is appropriate to trace this principle to the theory of Keynesian, neo-Keynesianism and neo-mercantilist thinking.

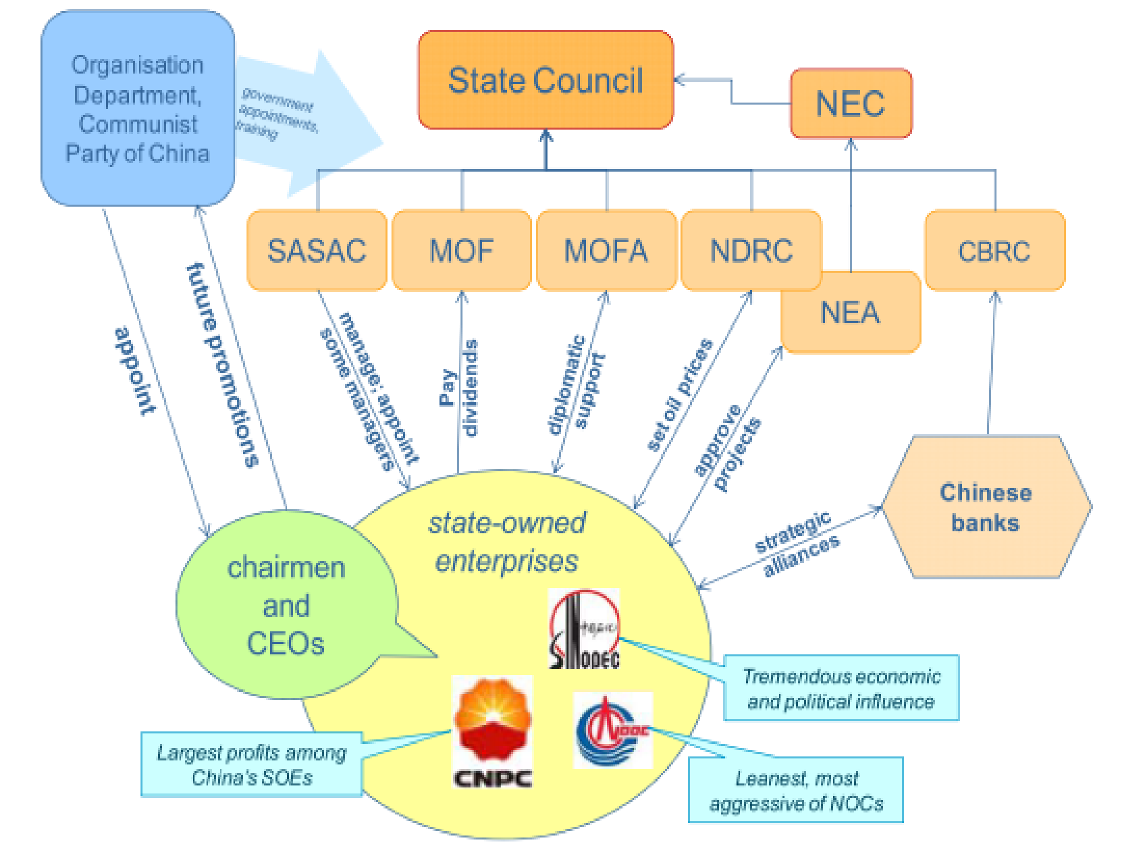
2.2.1 China's energy policy and decision-making process

Due to administrative limitations in China's energy bureaucracy, the development and implementation of China energy policy resides within the Chinese financial sector, the CCP and the SOEs.

Since 1949, the Chinese state bureaucracy's organization of the energy sector's short- and long-term strategies has experienced a consistent transition between centralization and decentralization, thus creating a "bureaucratic mess" of overlapping jurisdictions. As presented in Figure 1 below, the decision-making process is headed by the National Energy Commission (NEC) and the State Council with a number of sub-institutions in charge of executing the policy decisions.

Figure 1

Relations between state-owned enterprises and government in China



Notes: NEC = National Energy Commission; SASAC = State Assets Supervision and Administration Commission; MOF = Ministry of Finance; MOFA = Ministry of Foreign Affairs; NDRC = National Development and Reform Commission; NEA = National Energy Administration; CBRC = China Banking Regulatory Commission; SOE = state-owned enterprise.

(Source: Jiang, Julie and Sinton, Jonathan, "Overseas Investments By Chinese National Oil Companies." International Energy Agency, Information Paper, February, 2011.)

However, Figure 1 fails to illustrate the weaknesses of the state institutions. In reality the State Council and the NEC are mere approval mechanism of policies initiated by the NOCs and policy banks. Although the NEC has the sufficient power-clout in pushing through policy in the energy sector it does not have the necessary time, manpower or resources to take part in the strategic development of energy policy. This task is left to an understaffed NEA, which is subordinate in rank to most of the SOEs' leaders with Vice Minister rank at the State Council.

Further, the Chairman and CEOs of the SOEs are above SASAC, MOF, MOFA,NDRC and NEA[5] in the Chinese hieratical power structure. As a result, most cases where SOEs are confronted with unfavorable policies made by SASAC,MOF, MOFA,NDRC or the NEA, the decision of whether or not the SOEs must follow the policy is based on the discussions between the top leadership in the CCP and the SOEs leadership. In these cases the State Council is only a mere shell agreeing on the outcome of the CCP and SOEs discussion. [6]An example of this is the CNPCs' increased investment in its Sudan project, even though the NDRC, in 2007, discouraged further investments in the country[7]. The NOCs have also had a tendency to complete overseas acquisitions and inform the NDRC and State Council afterwards. These actions lend support to the unofficial agreements made between the SOEs and CCP leadership. In short, the decision-making power resides within the Chinese financial sector, the CCP and the SOEs.[8] Compared to the CCP, the Chinese NOCs and policy banks exhibit more experience and expertise in operating in the international market. It is therefore reasonable to assume that Chinese NOCs and policy banks have relative freedom in executing its short- and medium-term policies.

Still, there are certain agreements between the NOCs and the Chinese leadership, framed by the state capitalist principles, on how to pursue energy cooperation with foreign countries to provide import security for China as well as secure the long term growth for the Chinese national economy.

Since the CCP gained power in 1949, energy security (particularly the availability of secure oil resources) has been regarded as a matter of national security. This view was strengthened with the breakdown in relations with the USSR in the 1960s, hitherto the most important oil supplier. Undoubtedly, the vulnerability that became evident gave rise within the CCP to what could be referred to as neo-mercantilist policies of securing self-sufficiency of oil through foreign reserves, or "locking up" foreign oil reserves. This strategy still stands strong within parts of

[5] See Figure 1 for full name.
[6] For examples on NOCs disregard of sub-institutions policy decisions see Henrik Bergsager, "China's National Oil Policy; State capitalism an explanatory framework". University of Oslo, November 2011.
[7] Erica S. Downs, "China's "New" Energy Administration". Washington D.C.: Brookings institutional Press, 2008. Page 42-43.
[8] Ibid.

the CCP leadership and underscores the national security factor in the increased cooperation with Central Asian states and Russia.[9]

In exchange for the NOCs and policy bank's freedom to develop and implement short- and medium-term policies, their expansion into the international market must serve the long-term growth of the Chinese economy as well as its import security and diversification of natural resources. In short, diversifying China's sources of oil and gas imports, facilitate foreign market access for Chinese infant industries, and support and improve China's national status in countries of diplomatic importance to China's foreign policy.[10]

Thus, a valuable part of energy-related agreements in Central Asia/Russia is the combination of private and state interests. Further Russian/Central Asian/Chinese energy cooperation, will be determined by three factors: 1. The objectives outlined in the state capitalist principles, 2. The NOCs' own agenda of expanding their foreign operations to improve the position in the international market: 3. The state's national security policy of diversifying the sources of oil and gas imports.

3 Russia-China Energy Cooperation

Although Russian-Chinese energy cooperation is promising, there is also a growing mutual distrust between the two that limits future cooperation.

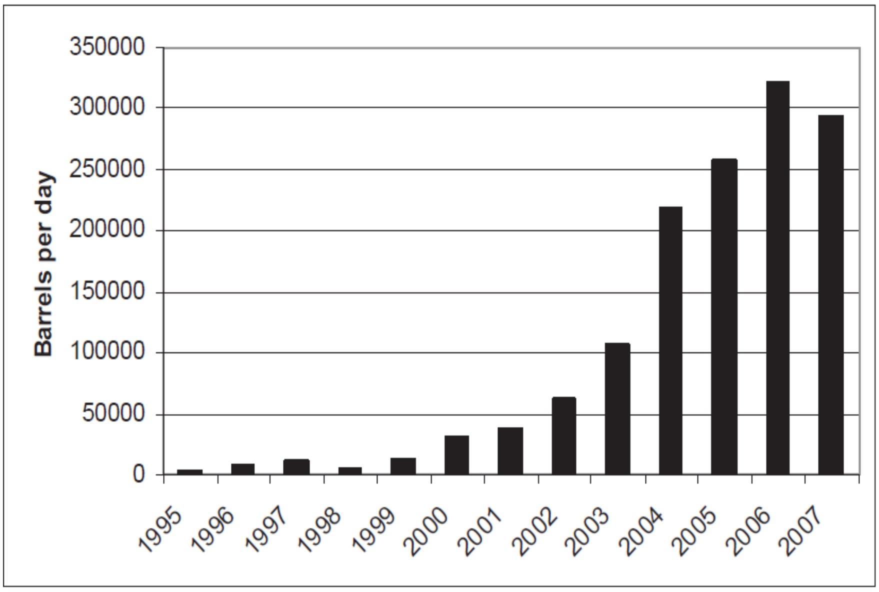
Russian energy SOEs are still undercapitalized and lack muscles for development of major projects in new regions. In addition, Russia's primary export market, Europe, is currently proceeding with long-term plans for increasing energy efficiency in accordance with environmental objectives and diversification of imports, thereby reducing the potential for import growth from Russian oil and gas producers. East Asia has emerged as the most promising expanding market for oil and gas exports in the longer-term. However, the pipeline infrastructure necessary to shift the focus towards East Asia is currently underdeveloped. As a result, eastward looking energy exports have been dominated by rail, and in the process nurturing powerful Russian rail actors lobbying for a delay of further pipeline developments to East Asia.[11]

With Russia wanting to diversify its energy exports away from Europe, and China wanting to counterbalance its imports through the Strait of Malacca, it seems that the match of the two is perfect. As presented in Figure 2, China's crude oil imports from Russia has soared. However, as illustrated in Chart 1, there is great potential for more cooperation as China's imports are still dominated by marine transport:

[9] Interview with Chinese NOC's official, August 2011.
[10] Ibid.
[11] One example on such a prolonged process is the ESPO pipeline from Taishet to Daqing, which was finished in 2010 after being discussed since the mid-1990s. This prolonged process underlines the difficulties attached to this seemingly beneficial energy cooperation.

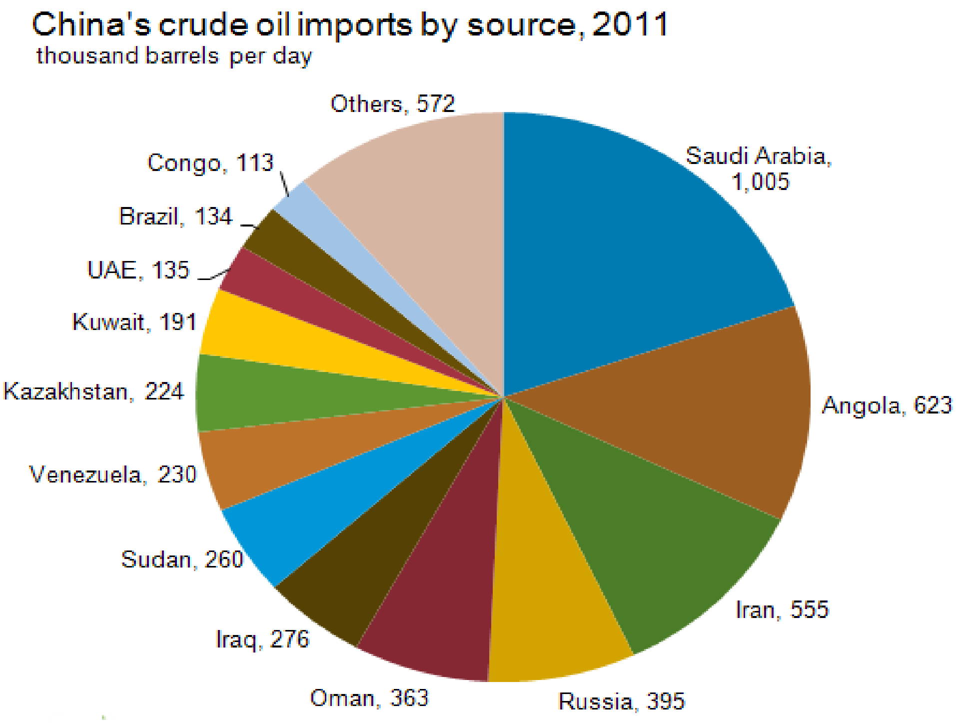
Figure 2

China's Crude Oil Imports from Russia, 1995-2007



Source Figure 2: Erica S. Downs, "Sino – Russian Energy Relations: An Uncertain Courtship". Chapter from *The Future of China –Russian Relations*. Kentucky: University of Kentucky Press, 2010.)

Chart 1



Source Chart 1: EIA.gov, http://www.eia.gov/countries/cab.cfm?fips=CH [Accessed 24.09.2012].

But there are some obstacles that must be removed if any cooperation is to increase.

3.1 Obstacles to the Russian-Chinese energy partnership

There are three issues which discourage a close relationship between Russia and China. First, the Russian energy industry has become highly politicized; all large scale energy-related industry development must be under the supervision of a Russian SOE or at least sanctioned by the authorities. China's energy industry is also highly politicized, as the import of energy is regarded as a matter of national security. With the impression that Russia uses oil/gas exports as a political tool, Chinese leaders have concerns with relying on Russian energy exports.[12]

Second, there is an underlying mutual distrust. Seeing China's economic, military and political power growing rapidly over the past two decades, Russia has come to fear a shift in the power balance between the two. Since Russia has realized that it cannot compete with Chinese economic growth, Russia is afraid of becoming China's sidekick by supporting its continuous rise through securing its energy needs, while the Russian domestic economy is stalled. For this reason, Russia has chosen to pursue multipronged oil and gas pipelines to East Asia (the ESPO pipeline) instead of a purely Russian-Chinese pipeline (the idea of a Yukos-CNPC/Angarsk-Daqing oil pipeline has not been further pursued by Russian SOEs). The thought here has been to avoid what has taken place with the Blue Stream pipeline to Turkey (because of its single buying status, Turkey renegotiated the price formula after the pipeline was built).[13] Hence, since Russia sees China as becoming a potential national security threat, Russia has kept the upper hand in controlling the flow of oil and gas to East Asia through its ability to easily shift the final destination of its pipeline exports. But this strategy of course highlights China's concerns about Russian exports. Reflecting on Russia's actions toward Ukraine in terms of cutting exports to help force a better price formula, the Chinese are concerned about the dependability of Russia as an energy exporter.[14]

The third issue is the price formula in long term agreements. China wants to buy Russian natural resources based on a price formula based on its domestic coal prices, while Russia wants to sell its energy resources at a price equal to its export price to Europe. Hence, although the energy cooperation between China and Russia has great potential, there are some crucial differences that are currently stalling the negotiations.

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[12] Erica S. Downs, "Sino – Russian Energy Relations: An Uncertain Courtship". Chapter from *The Future of China –Russian Relations*. Kentucky: University of Kentucky Press, 2010. 153-154.

[13] Marc-Antoine Eyl-Mazegga and Olgu Okumus, "Turkey and Europe`s quest for gas: The equilibrium of a bargaining position and its possible consequences for new gas transport routes". INGAS, 2009.

[14] Downs, "Sino – Russian Energy Relations: An Uncertain Courtship". 160-161.

4 Russian involvement in Central Asia

As noted above, Russia possesses some of the world's largest undeveloped oil and gas resources. Russia imports some hydrocarbons from Central Asia, but a major interest behind its involvement in the region is to preserve Russia's status as the main transit route for energy exports from Central Asia to Europe, in addition to limiting foreign influence (mainly US and China) in its own back yard. Russia has used a multi-pronged approach of "soft power" diplomacy towards Central Asia through its state dominated energy companies, headed by Gazprom and Transneft.

Energy diplomacy has also been coordinated with other diplomatic approaches to sustain Russian influence in the region. The Shanghai Cooperation Organization (SCO), which was established in 1996 in an effort to resolve border disputes between Russia, the Central Asian states and China, represents on paper an important multilateral organization in Central Asia from a military, environmental, economic and political perspective.

However, there have been few developments indicating that China and Russia plan to coordinate development and exportation of Central Asian energy resources. This is not unexpected as Beijing will persist in being a gas importer in the decades to come and is interested in bilaterally negotiating low prices, whereas Russia as the biggest gas exporter has other interests.

4.1 Russian Energy Investments in the Region

Since 2000, the involvement of Russian SOEs in Central Asia has included several high level projects: Uzbekistan - $2.5 billion in investments by Gazprom and Lukoil[15]; Kazakhstan - joint exploration with KazMunay Gas of Kurmangazy (Rosneft), Tsentralnoye (Gazprom) and Khvalinskoye (Lukoil).[16] In addition, an agreement was made in 2007 that underscored the Russian policy of securing its geopolitical position as a transit route between Europe and East Asia. Together with President Nursultan Nazarbayev of Kazakhstan and President Gurbanguly Berdymykhammedov of Turkmenistan, Putin signed an agreement for the construction of a new pipeline that would link Kazakh and Turkmen gas production with the Russian pipeline network. This project is now stalled.

Although these agreements highlight Russia's involvement, the amounts invested are relatively small compared to the investment necessary to develop the Central Asian gas and oil fields and fulfilling its export potential. In short, there have been more political promises of cooperation than actual investments. The question then is how does this affect the relations between Central Asian countries and China?

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[15] Gazprom International, "Making up for what was lost". 2010. http://www.zargaz.ru/364-making-up-for-what-was-lost.html [Accessed 14.05.2012].

[16] Marlène Laruelle, "Russia's Central Asia Policy and the Role of Russian Nationalism". Central Asia – Caucasus Institute: Silk Road Paper, April 2008. 22.

5 China's Energy Cooperation with Russia and Central Asia

Due to stalled negotiations with Russia, China is shifting its energy investments to Central Asia. China has pursued increased energy cooperation with the Central Asian states, represented by NOCs investments. As listed in table 1 below, Chinese NOCs have signed several energy contracts with Uzbekistan, Kazakhstan and Turkmenistan. The most significant of these are the joint venture between KazMunay Gas and CNPC on the construction of the Atasu-Xinjiang oil pipeline, the CNPC acquisition of Canada's PetroKazakhstan in 2005, the CITIC Group acquisition of the Kazakh oil assets of the Canadian Nation's Energy Company, the $152 million gas exploration deal between CNPC and Turkmenistan in November 2006, the CNOOC cooperative exploration deal with Uzbekistan in 2006 and the CNPC/China Development Bank's $4 billion loan to Turkmengaz for the development of the South Yolotan basin in 2009.[17]

In addition, after a state visit to Beijing on November 23, 2009 Turkmen President Gurbanguly Berdymykhammedov indicated that an initial agreement had been made with President Hu Jintao that Turkmenistan would increase its gas exports to a volume of 65 billion cubic meters a year[18]. If realized this volume would cover over half of China's 2010 gas consumption. All of the aforementioned investments were funded by the CDB's EBLs, which further underscores the connection between the NOC, the state and financial institutions in developing closer energy cooperation with Central Asia.

Chinese energy investments in Central Asia, particularly in petroleum transport infrastructure, have proceeded in spite of Russia's determination to control the transport system to East Asia. As discussed above, Russia and China are unable to establish additional long-term gas pipeline contracts. To compensate, China has proceeded to increase its presence in Central Asia to further its own security agenda of energy diversity, highlighted by the Kazakhstani pipeline and the two Turkmenistan pipelines. If further access to Central Asian energy resources is obtained, the Chinese might be able to use such deals to put pressure on Gazprom in order to have them offer competitive prices.

Moreover, besides the oil and gas import contracts, China has increased its industrial investments in Central Asia in an effort to develop and tie Central Asia to Chinese economic development. More precisely, by increasing the economic integration within the region, the stability of the western Chinese borders will also improve, in line with China's national security policies.[19] Energy Backed Loans are a very important instrument in this respect.

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[17] Charles E. Ziegler, "Russia and China in Central Asia," Chapter 8 in the book; James Bellacqua, *The Future of China-Russia Relations*, Kentucky: The University Press of Kentucky, 2010. 249-250.
[18] Tom Balmforth, "Turkmenistan: China Export Deal Undercuts Gazprom's Leverage". Eurasianet.org. http://www.eurasianet.org/node/64609 [Accessed 30.01.2012].
[19] Ziegler, "Russia and China in Central Asia".

Table 1

Chinese Overseas Oil Acquisitons and Mergers		
Time	**Country**	**Company**
May. 5, 1994	Indonesia	CNOOC
Jan. 18, 2002	Indonesia	CNOOC/CNOOC Limited
Aug. 23, 2002	Australia	CNOOC/CNOOC Limited
Oct. 24, 2003	Australia	CNOOC/CNOOC Limited
Apr, 2005	Canada	CNOOC/CNOOC Belgium
Nov, 2005	Australia and Myanmar	CNOOC/COSL
Oct, 2005	South China Sea	CNOOC
Jan, 2006	Nigeria	CNOOC/CNOOC Limited
Feb, 2006	Equatorial Guinea	CNOOC/CNOOC Africa Limited
Apr, 2006	Australia	CNOOC/CNOOC Limited
Feb. 02. 2007	Norway	CNOOC/COSL
Apr. 10, 2008	Qatar	CNOOC
Sep. 22, 2008	Norway	CNOOC/COSL
Des. 26, 2008	Taiwan	CNOOC
May. 12, 2009	Australia	CNOOC
May. 10, 2010	Argentina	CNOOC
May. 17, 2010	Iraq	CNOOC/CNOOC Limited
Nov. 16, 2010	US	CNOOC/CNOOC Limited

(Source: Bergsager, Henrik. "China's National Oil Policy; State capitalism an explanatory framework". Master Thesis, University of Oslo, 2011.)

Table 2

Chinese Overseas Oil Acquisitons and Mergers		
Time	**Country**	**Company**
2004	Kazakstan	Sinopec
2005	Canada	Sinopec
2005	Canada	Sinopec
2006	Russia	Sinopec
2006	Ecuador	Sinopec and CNPC
2008	Australia	Sinopec
2008	Syria	Sinopec
2009	Angola	Sinopec and CNOOC
Jun, 2009	Canada	Sinopec
Apr, 2010	Canada	Sinopec
Oct, 2010	Brazil	Sinopec
Dec, 2010	Indonesia	Sinopec

(Source: Bergsager, "China's National Oil Policy; State capitalism an explanatory framework".)

Table 3

Chinese Overseas Oil Acquisitons and Mergers		
Time	***Country***	***Company***
Oct. 23, 1993	Peru	CNPC
Sept. 26, 1995	Sudan	CNPC
Mar, 1997	Sudan	CNPC
Jun, 1997	Venezuela	CNPC
Jan, 2002	Turkmenistan	CNPC
Apr. 18, 2002	Indonesia	CNPC/PetroChina CO. Ltd.
May. 12, 2003	Algeria	CNPC
Jul. 31, 2003	Sudan	CNPC
Oct. 14, 2003	Kazakhstan	CNPC
Nov. 10, 2003	Niger	CNPC
Nov. 29, 2003	Algeria	CNPC
Feb. 04, 2004	Mongolia	CNPC
Sept. 06, 2004	Mauritania	CNPC
2005	Kazakhstan	CNPC
Aug. 30, 2005	Sudan	CNPC
Dec. 07, 2005	Libya	CNPC
Nov, 2006	Turkmenistan	CNPC
May. 09, 2008	Venezuela	CNPC
June. 02, 2008	Niger	CNPC
Oct. 15, 2008	Uzbekistan	CNPC
Oct. 28, 2008	Russia	CNPC
Oct. 31, 2008	Kazakhstan	CNPC
Nov. 10, 2008	Iraq	CNPC
Apr. 16.2009	Kazakhstan	CNPC
Jun. 30, 2009	Iraq	CNPC
Jul. 01, 2009	Chad	CNPC
Dec. 11, 2009	Iraq	CNPC
Dec. 29, 2009	Canada	CNPC
May. 10, 2010	Argentina	CNOOC
May. 17, 2010	Iraq	CNOOC/CNOOC Limited
Nov. 16, 2010	US	CNOOC/CNOOC Limited

(Source: Bergsager, "China's National Oil Policy; State capitalism an explanatory framework".)

As listed in table 1, 2 and 3, the Chinese investments in Central Asia are part of a larger effort by the NOCs to expand their global operations. From 1993 to 2010 Chinese NOCs established their presence in 29 states. These investments were either based on the NOCs own agenda, the Chinese national security agenda or coordinated through an EBL agreement. In short, most of the investments above have the long-term objective of increasing the market competitiveness of the NOCs, the NOCs international resource portfolio and the NOCs technological capabilities vis-à-vis International Oil Companies. The national security agenda is pursued in specific states (in close proximity to the Chinese mainland) to diversify China's energy imports, while some agreements are pursued on the conditions of an EBL agreement. The EBL agreements are interesting as they coordinate the long-term goals of all three institutions as well as include all three of the state capitalist principles.

5.1 Energy-Backed Loans Agreements and the Conditions Attached to those Agreements

In short, these Chinese agreements are characterized by collaboration between financial, energy and state institutions in providing loans in exchange for the security of energy imports, in addition to promoting Chinese corporations abroad. To evaluate the impact the agreements have on energy relations it is necessary to study also the *conditions* of the EBLs not directly related to energy. This will also indicate the financial viability of these agreements in the long-term.

From 2005-2010, the CDB and the Eximbank have invested in just a few countries, as seen in Table 4 showing ratified EBL agreements.

Table 4

	China's Energy-Backed Loans 2005-2010					
Date	**Country**	**Lender**	**Borrower**	**Amount ($ billion)**	**Return**	**Term (Years)**
2005	Russia	CDB	Rosneft	6		6
2008	Venezuela	CDB	BANDES	4	Up to 200.000 bpd of oil	4
2009	Russia	CDB	Rosneft	15	300.000 bpd of oil per year	20
2009	Russia	CDB	Transeft	10	Pipeline from Russia to China	
2009	Brazil	CDB	Petrobras	10	150.000 bpd in 2009,	1
					2010-2019: 200.000 bpd	9
2009	Venezuela	CDB	Bandes	4		3
2009	Turkmenistan	CDB	Turkmengaz	4	40 bcm/y of gas	3
2009	Kazakhstan	CEIB/CNPC	KazMunaiGaz	10	Right to buy 50% of	
					Mangistaumunaigas	
2010	Venezuela	CDB	BANDES	20,6		10
2010	Equador	CDB	Ministry of Finance	1		4
2010	Kazakhstan	CDB		1,498	Mining project in Aktogay	15

Source: Authors own research in addition to Downs, "Inside China, Inc.: China Development Bank's Cross-Border Energy Deals". And Global Oil Insight, "China's search for energy security".

As emphasized by Erica S. Downs, the choice of countries reflects the influence of financial petroleum and political institutions.[20]

All the EBLs provided to states in close proximity to China mainland, notably Russia and Turkmenistan, should be considered as politically initiated EBLs that support diversification of China's energy supply and contribute to national security. Moreover, to relieve China's heavy reliance on the maritime transportation of oil and gas, China's effort over

[20] Downs, "Inside China, Inc.: China Development Bank's Cross-Border Energy Deals". 39.

the last decade has been to look for opportunities for long-term overland energy imports, preferably by expanding its pipeline network to neighboring states. The politically initiated EBLs reflect the national and strategic aspects. Energy security is the first priority and profit-making has secondary importance. However, Central Asian states also offering economic cooperation with China are prioritized. The economic incentives often reflect the different conditions attached to the EBLs and their importance to the Chinese decision-making process should not be disregarded. One way to study their significance is by looking at the differences between the EBLs provided to Russia and the ones to Turkmenistan.

5.2 Case 1: Chinese EBLs with Russia

The EBLs provided to the Russian energy companies mentioned above amounted to a stunning $25 billion, the largest ever trade finance deal between China and Russia. The loan agreements stipulate that Rosneft will receive $15 billion while Transneft gets $10 billion, it spans a 20-year term with a five-year grace period for interest payments. The interest rate of the $25 bill loan to Rosneft and Transneft was based on the London Interbank Offered Rate (LIBOR), which is added to a fluctuating margin independent from LIBOR. The total of $25 billion will have to be repaid by the revenues from the sale of 300,000 b/d to the CNPC, plus interest amounting to $10.9 billion, over 20 years.[21]

This agreement has the backing of both the Kremlin and Beijing, thereby helping to ensure that both parties will honor the agreement over the time span agreed on. This might seem unnecessary, but in fact a similar agreement ran into problems when the terms were altered. Rosneft was given a loan in January 2005 from both the CDB and the China Exim-bank in the amount of $6 billion, which was to be repaid through the delivery of approximately 180,000 b/d of crude oil to the China National Petroleum Company (CNPC) from February 2005 through December 2010.[22] Rosneft was in urgent need of an investment to finance its acquisition of the Yukos' subsidiary Yuganskneftegaz in 2004.[23] The agreement with the CDB and China Eximbank suggested a hastily made decision. Although the interest rate was initially set at LIBOR +3, Rosneft experienced difficulties in paying the interest since the LIBOR rates increased substantially in 2005. After some negotiations, Rosneft managed to convince the Chinese to reduce the interest to LIBOR+0.7% by first quarter 2006. Even so, as it became clear that Rosneft would be better served financially if it exported its crude to Europe rather than to the CNPC, the Russian company started to press the Chinese to revise the terms of the agreement. Although unhappy with the revision of the agreement, the Chinese had little choice but to acquiesce due to Rosneft's

[21] Rosneft Oil Company "Information on major transaction" URL: http://www.rosneft.com/attach/0/54/72/prepare10en.pdf [Accessed 10.05.2011].
[22] Rosneft Oil Company, "Management's Discussion and Analysis of Financial Position and Results of Operations for the years ended December 31, 2006, 2005 and 2004," page 7. http://rosneft.com/attach/0/58/76/MDA_Eng_2006.pdf [Accessed 10.05.2011].
[23] *The Russian Journal* "Rosneft gets Yuganskneftegaz" 22 December, 2004. http://rumer.russiajournal.com/node/18969 [Accessed 10.05.2011].

leverage. If the Chinese refused to review the terms, Rosneft threatened not to extend the supply contract after its official end in 2010. And an extension was regarded as a precondition for the development of the ESPO cross-border pipeline to China.[24] The end result was a revaluation of the oil price formula in the agreement that forced the CNPC to pay $0.675 more per barrel[25].

This story demonstrates that despite high bilateral importance, Russian-Chinese agreements have not been without risk and in specific instances have developed unfavorably for the involved Chines financial institutions and NOCs. Chinese authorities have accepted this, pursuing more important state goals, energy security. An additional problem from a Chinese point of view is that there has been less involvement of Chinese private construction companies than in other EBLs, such as the EBLs to Central Asian states. This means that the China-Russian EBL agreements do not fulfill an important objective of the state capitalist principles, market access for Chinese firms.

The Russian-Chinese EBLs must be explained by the national security factor. China's energy diversification policy trumps economic integration as well as high return on investments.

5.3 Chinese Energy Investments in Central Asia, Case 2: Turkmenistan's EBLs

To highlight the differences between the China-Russian and Central Asian states – Chinese cooperation, the EBL with Turkmenistan presented in Table 2 is a case in point.

In contrast to Russia, China has positioned itself as a state that values a non-interventionist policy, not exerting pressure on the Central Asian governments. China is seemingly pursuing a strategy of counterbalancing Russian political influence through increased *economic* cooperation with the region. In brief, China is not imposing any conditions on domestic policy in exchange for cooperation. This has undoubtedly increased China's ability to increase its presence without threatening the Central Asian states' sovereignty.

Russia has contributed to China's increased presence in the region with its diplomacy and economic policy towards some Central Asian states. The relationship between Russia and Turkmenistan has long been turbulent, much as a result of the price formula on Turkmen gas exports to Russia. Gazprom bought gas from Turkmenistan in 2006 at a price of $65 per thousand cubic meters of gas, selling it to European customers at approximately $210-230. Although, the price was increased to $100 per

[24] Downs "Inside China, Inc.: China Development Bank's Cross-Border Energy Deals". 44.

[25] It should be noted that the additional loans provided to Transneft and Rosneft in 2009 was an incentive from the Chinese to reassure that the ESPO pipeline would be completed.

thousand cubic meters in the period 2007-2009,[26] the Turkmen leadership still felt cheated by the Russians. In Europe demand for gas decreased rapidly. In response, Russia stopped its gas imports from Turkmenistan, thus breaching their agreed upon import quantity. The unexpected stoppage in imports apparently resulted in an explosion in the pipeline costing Turkmenistan some $1 billion in lost annual revenues.[27] Unsurprisingly, this incident angered Ashgabat (it publicly accused Gazprom for causing the explosion), which in conjunction with Turkmenistan's concerns about Europe's future energy import needs, as well as its political and economic suspicions towards Russia, tipped the scales in favor of China.

On June 25, 2009, China's Development Bank concluded a $4 billion loan to the Turkmen national gas company Turkmengaz. The purpose of the loan was to finance the exploration and development of one of the world's largest natural gas fields, the South Yolotan. And build a gas pipeline between Turkmenistan and China. The agreement was arranged within the framework of an EBL, where Turkmengaz would pay back the loan through the revenue from selling its gas to the CNPC. There are several interesting components in this agreement.

The loan attached to the pipeline construction helped compensate for Turkmenistan's financial losses after the halt in gas exports to Russia. The conditions for the loan were financially viable for the Turkmen economy in the long-term as they were based on the EBLs state capitalist principles. This meant that CDB would provide financial support for a range of infrastructure projects headed by Chinese and Turkmenistan personnel. The agreement also emphasized increased bilateral trade between the two economies, establishing bilateral market access for Chinese and Turkmen companies. In short, with regard to both export potential and future energy markets, China is becoming Turkmenistan's primary solution for the security of demand. China is also bringing about more general economic growth through the EBLs in comparison to the Russian energy cooperation. As a result of the Turkmen EBLs, China has invested in 37 Turkmen enterprises as well as 66 investment projects totaling $4.5 billion. Relevant sectors of Chinese Foreign Direct Investments (FDI) have been oil and gas, telecommunication and transport sectors, agriculture, textile, chemical and food industries. [28] This has presented Chinese firms with market access, providing them the opportunity to pursue competitive development in a secure foreign market. When combined with the profit earned through the export of natural resources, China has become Turkmenistan largest trade partner in a period of 3 years. The economic cooperation has been followed by numerous meeting between Chinese and Turkmen officials, emphasizing

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[26] Mert Bilgin, "New prospects in the political economy of inner-Caspian hydrocarbons and western energy corridor through Turkey". *Energy Policy, Vol. 35, (*2007): 6383-6394. 6390.
[27] Downs, "Inside China, Inc.: China Development Bank's Cross-Border Energy Deals". 54.
[28] News Europe Online, "Turkmen chief meets Chinese officials". 2011. http://www.neurope.eu/article/turkmen-head-meets-chinese-officials [Accessed 14.03.2012].

future cooperation on trade, bilateral economic integration, and technological expertise. These factors have resulted in Turkmenistan President Gurbanguly Berdymukhammedov ordering his energy officials to pursue a $4.1 billion loan agreement with CDB in August 2010 rather than agreeing to loan agreements offered by Germany's Deutsche Bank and Commerzbank. In March 2011, the Chinese Vice Premier, Wang Qishan, and the Turkmen Deputy Prime Minister, Baymyrat Hojamuhammedov, agreed to a framework for this second CDB loan to Turkmengaz. This development of economic cooperation again shows how EBL bring about the realization of the state capitalist principles' long-term objectives.

5.4 China's Economic Integration of the Central Asian's Domestic Markets

More generally, the energy-related agreements between China and Central Asian states are in accordance with the three relevant factors mentioned earlier in this paper, namely: 1. The Chinese state's support of SOEs as stressed in the first and second principle of state capitalism; 2. The NOCs' own agenda of expanding their foreign operations to develop into multinational companies, primarily with external income sources; 3. The state's national security policy of diversifying their sources of oil and gas imports.

Initially, China's investments in Central Asian states were driven through by companies such as the CNPC, the CNOOC and the China Guangdong Nuclear Power Company. However, in accordance with state capitalist principles, the Chinese presence in Central Asian states is more and more being dominated by a large number of smaller private Chinese business companies that have established themselves with the approval and support of the Chinese government. Although the government is promoting the SOE – SOEs bilateral agreements, the increased presence of smaller private businesses will most likely provide China with a higher level of economic penetration in the Central Asian economies than bilateral SOE agreements can do.[29] This increased Chinese cooperation goes well with the Central Asian states' ambition of developing high-tech industries while diversifying their oil and gas exports to counteract Russia's historic dominance in the region.

China's involvement in Central Asia directly threatens the dominance of Russian SOEs such as Gazprom. China is currently successfully expanding its presence in Central Asia through a non-interventionist state policy. More specifically, China offers financial support and market access for both energy exports and general trade. This highlights a major theme in this paper, namely how the stalled Russian-Chinese energy cooperation, as well as Russia's own actions, have resulted in an increased Chinese presence in Central Asia.

[29] Martin Sieff, "China's new investment diversification good for Central Asia, says analyst". Central Asia Newswire. 2011. http://www.universalnewswires.com/centralasia/viewstory.aspx?id=3323 [Accessed 14.04.2012].

6 How China's Energy Cooperation with Russia and Central Asia Could Develop in the Future

Russian policy towards Central Asia has benefitted the Chinese position in the region. In the case of Turkmenistan-Russia disagreement on gas prices, Russia has damaged its short-term economic presence in the region. China on the other hand has taken advantage of the situation and has concluded long-term energy cooperation agreements, diversifying its imports away from Russian energy sources. For Turkmenistan the EBL agreement should be regarded as a policy decision to play China and Russia out against each other, not a monumental shift of trade partners. It is therefore more important to see how China is sustaining its current upper hand. Through the conditions of the EBLs, China has increased the integration of the Central Asian economies with its own.

By following its state capitalist principles, China is now and will in the future continue to invest heavily in Central Asia, as an increasing share of the Chinese presence will be through private enterprises. Based on experiences from similar developments in numerous African states, the likely outlook is an increased presence of Chinese private enterprises followed by immigration of Chines workers and additional financial cooperation ultimately securing Chinese influence in the region.

Nevertheless, in the foreseeable future Russia will retain its position as the primary military power in region This is entirely compatible with China's policy of non-intervention, exemplified by its presence in Africa. It is economic expansion that will secure China's position in the region, slowly reducing Russia's importance.

China's cooperation with Russia will continue, though the issues of price as well as transportation solutions are likely to remain obstacles, thereby increasing China's willingness to move more heavily into Central Asia to diversify its energy imports. China has shown by its investments in Central Asia that its dependence on Russia is drastically reduced and that favorable commercial conditions are required if energy trade with Russia shall develop further.

Although the EBLs are focused on energy, the conditions attached emphasize their importance to China's economic and foreign policy. China's EBLs with Turkmenistan illustrate the preferred Chinese approach in expanding trade relations and should be considered as important examples for future bilateral agreements. An interesting aspect is how the US or European Union, preaching free market trade, will meet these types of long-term trade agreements.

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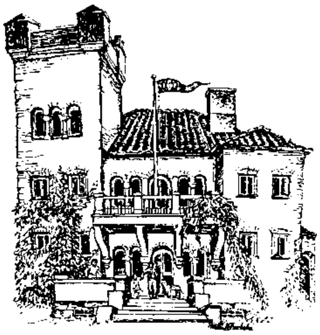

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