

# Feeding The Dragon

**IS CHINA TRYING TO SWALLOW THE  
WORLD'S NATURAL RESOURCES?**

**BY THEODORE H. MORAN**

**H**as China embarked on a long-term strategy of controlling access to natural resources from around the world? There are, after all, precedents for such a strategy – and in China's own backyard. Resource-poor imperial Japan rationalized its military adventures in East Asia in the 1930s as an attempt to become self-sufficient in raw materials critical to military and economic survival. Indeed, the nominal trigger for going to war with the United States in 1941 was Franklin D. Roosevelt's export embargo on iron, steel and aviation fuel.

DAVID G. KLEIN (AU)



## FEEDING THE DRAGON

China is hardly imperial Japan, but there is a plausible case to be made that, as Asia's new superpower, it is anxious to reduce its dependence on the commercial goodwill of foreigners. Rapid, sustained economic growth would be far more difficult without large and growing imports of oil, metal ores, timber and organic chemicals. And while nobody is threatening to isolate China from world markets for

### **O**n the supply side, Chinese efforts to procure raw materials might smooth the bumps along the road as global markets respond to resource scarcity.

these resources, it is worth noting that Beijing has chosen to risk its relationships with Vietnam, Indonesia and the Philippines in claiming rights to exploit oil in disputed territory in the South China Sea. What's more, one need not be paranoid to imagine circumstances in which China's access to foreign resources could be at risk. China might, for example, reasonably fear some sort of resource-linked retaliation down the road in response to its reluctance to join in efforts to contain climate-changing carbon emissions.

Plausibility is not evidence, though. Whatever China's motives may be, what counts are the consequences of its actions. And here, there is more than one way to interpret the impact of China's resource strategy. When Chinese companies take equity stakes in African oil fields, extend loans to mining and petroleum investors in Latin America or write

---

**THEODORE H. MORAN** is the Marcus Wallenberg professor of international business and finance at Georgetown University and a senior fellow at the Peterson Institute for International Economics.

long-term procurement contracts for minerals and liquid natural gas from Australia, do these steps reduce other buyers' access to world supplies? Or, might these tactics actually serve the interests of non-Chinese buyers by multiplying suppliers and opening up fresh sources of raw materials for global markets?

To be sure, China's vast appetite for energy and minerals has the potential to put tremendous strain on the international natural-resource sector. (And, as I discuss later, Beijing's investments often undermine international efforts to link governance reforms with economic integration in some of the shadier corners of the globe.) But on the supply side, Chinese efforts

to procure raw materials might smooth the bumps along the road as global markets respond to resource scarcity. The only way to tell is to look at the evidence.

#### TESTING THE LOCK-UP HYPOTHESIS

I've divided recent Chinese natural-resources procurement deals into four categories:

- Equity stakes in large, established producers.
- Equity stakes in start-ups and small producers aiming for expansion.
- Loans to established producers in which the debt is linked to a purchase.
- Loans to back the expansion of small, developing firms.

If an arrangement simply gives a Chinese company a legal claim on the output of an established producer – the first and third categories – it has zero-sum implications. That is, China's greater access comes at the expense of other importing nations. However, if the procurement arrangement expands and/or diversifies sources of output – the second and fourth categories – all resource users stand to gain.

I then examined China's 16 largest resource-



## **FEEDING THE DRAGON**

procurement deals from 1996 through 2009. The resources acquired ranged from oil to natural gas to bauxite (aluminum ore) to copper, establishing a Chinese presence in places ranging from Iran to Australia and Brazil to Sudan.

The scorecard for China's largest procurement arrangements does reveal a handful of cases (3 of 16) in which Chinese natural-resource companies took an equity stake to create a "special relationship" with a large established producer, suggesting that the trans-

**It appears that China is attempting to exercise global control over the mining of "rare earths" – minerals that have a variety of critical industrial uses.**

actions were problematic in the sense described above. But the typical pattern (13 of 16 cases) was for Chinese enterprises to take equity stakes or to write long-term procurement contracts with producers that operate at the competitive fringe and need Chinese capital and expertise to expand. In these cases, China's gain is likely to be everyone else's gain, too.

Note, moreover, that the 16 projects chosen do not offer a distorted picture of Chinese behavior. A review of diverse smaller Chinese procurement arrangements suggests that these second-tier procurement efforts predominantly support competitive fringe development.

Thus the actual impact of Chinese procurement arrangements appears to be benign. This conclusion should not be surprising.

During the 1970s, for example, the Japanese government entertained the idea of creating "national champion" enterprises to pursue procurement arrangements that secured "special relationships" with major foreign resource producers. However, the Japanese quickly shifted to other sorts of procurement deals. Japanese direct investment and loans became a major force in building efficient global markets for extractive industries and diversifying the geography of production.

### **RARE EARTHS AND LITHIUM: EXCEPTIONS TO THE RULE?**

There is one category, however, in which China's resource initiatives do seem more problematic. It appears that China is attempting to exercise global control over the mining of "rare earths" – minerals, derived from 17 elements on the periodic table, that have a variety of critical industrial uses. Note, however, contrary to their name, most rare earths are far from rare. And the fact that more than 90 percent of rare earths used in the United States now come from China is driven by relative cost, not material scarcity. Indeed, the rare-earth mining industry has historically been characterized by excess capacity and oversupply.

Looking to the future, however, that picture could change. Rare-earth elements will be key inputs for a large and growing array of civilian and military products. High-strength magnets made with rare-earth elements allow miniaturization of components used in computers, communications systems and military gear. (Such magnets, for example, are used to control the guidance vanes on the sides of missiles.) Liquid crystal displays and color cathode-ray tubes employ europium as the red phosphor. New energy-efficient fluorescent lamps that will play a large part in reducing the demand for electricity (thereby slowing containing carbon emissions) use rare-

## **China's Strategic Resource Investments: a Sampling**

### **China National Petroleum Corp. investment in Sudan (1996)**

Chevron withdrew from Sudan in 1991 in reaction to the civil war in Darfur. Its production rights were acquired by Canadian State Petroleum, which was later bought out by another Canadian company, Arakis Energy. Arakis failed to meet its contractual obligations to invest \$200 million in exploration and \$1.2 billion in a pipeline, and the Greater Nile Petroleum Operating Company was formed to take its place. Greater Nile is jointly owned by the China National Petroleum Corporation (40 percent), Petronas of Malaysia (30 percent), Talisman of Canada (25 percent) and Sudapet of Sudan (5 percent). Greater Nile's production reached some 328,000 barrels per day by 2005. Since these fields would probably not have otherwise been developed – investors in Sudan face sanctions from the United States – China's investment has increased the total global supply of oil and diversified its sources.

### **China Development Bank loan to Rosneft and Transneft of Russia (2009)**

The China Development Bank, the state-owned bank with primary responsibility for large domestic infrastructure projects, is lending \$15 billion to Russia's Rosneft oil company and \$10 billion to that country's Transneft pipeline monopoly. It will be paid back in kind from Rosneft's Siberian oil fields (300,000 barrels a day for 20 years). This arrangement fits the category of a loan to a major producer to secure its output, and thus tends to reduce supplies available to other countries.

### **Sinopec investment in Iran's Yadavaran oil field (2007)**

In December 2007, Sinopec (the state-controlled China Petroleum & Chemical Corporation) agreed to invest \$2 billion in the Yadavaran oil field in Iran's Khuzestan Province. Sinopec, with a 51 percent stake, will develop and manage the field, while the National Iranian Oil Company will hold 49 percent of the equity. The first phase aims to create 85,000 barrels a day of new capacity over four years, rising to a capacity of 180,000 barrels a day over the subsequent three years. Ultimately, the development could yield 300,000 barrels a day. At first look, this seems to be a project that reduces others' access to oil since the project is within an established OPEC member. But in light of the international sanctions imposed on Iran and the inability of most Western oil companies to invest there, it really constitutes an addition to production from an exporter that is struggling to lift as much oil as it can.

earth elements. Several of those elements are essential constituents of chemical catalysts needed to "crack" crude oil into light fuels and to convert auto tailpipe emissions into less-toxic gases.

Not surprisingly, then, China's Ministry of

Industry and Information Technology announcement in 2009 that it would limit exports to 35,000 tons of rare earths per year and reserve the right to block the exports of at least five rare earth elements altogether was met with disquiet outside China. China's goal



may be only to raise the financial return on rare-earth mining in order to attract more foreign investment and more value-added extractive operations in the impoverished interior of China. But the policy is open to other interpretations: Deng Xiaoping is often quoted as having said that while the Middle East has oil, China has rare-earth elements. Meanwhile, Chinese investors have been actively seeking to acquire equity stakes in new rare-earth element producers, particularly in Australia.

China's stance on rare earths is not being ignored in other industrial nations. It has sparked interest in developing new mines in Vietnam, Kazakhstan, Sweden and Canada, as well as restarting production in the United States. Meanwhile China is also actively seeking sources of rare earths in other countries.

Note, however, that, here, too, Chinese initiatives to procure rare-earth element resources could increase or decrease access for other countries. Chinese investment or loans to small independent producers that help ex-

pand supply and make the industry more competitive should be viewed with equanimity. Chinese investment in a major producer that puts the Chinese owners (and Chinese government) in a position to control production would be cause for concern.

Another mineral may (or may not) prove problematic. Lithium has a number of industrial uses, notably as a building block for high-performance batteries. And China is currently the leading lithium metal producer, followed by Argentina. But lithium is available from many regions. Nearly half of the world's known reserves are located in Bolivia. Japanese, French and Korean firms are negotiating to begin extraction. In the United States, lithium is recovered from brine pools in Nevada. Chile and Argentina have significant untapped reserves. There have also been recent discoveries in Australia, Russia and Serbia. So at this point, it is hard to predict how concentrated – and how prone to the exercise of market power – the international lithium industry will become as demand for batteries used in hybrid and electric vehicles grows exponentially.

#### **THE BIG PICTURE**

The impact of Chinese procurement arrangements on competition in natural-resource markets around the world is, of course, only one dimension of the geopolitical challenge stemming from China's resource policies. Indeed, while an observer focused solely on resource markets might view the greater diversification of supply stimulated by Chinese investments and come away satisfied that the net impact is benign, there are other factors to consider.

Much of China's resource investment is flowing to states and regions that Western investors eschew for good reasons. As noted above, China has made major commitments

in both Sudan and Iran, helping them to circumvent external pressures to curb human-rights abuses and nuclear-weapons development, respectively. China is also active in Myanmar, providing the country's military junta with capital to support oil, natural gas and mineral production.

Consider, too, that China is less than fastidious about the impact of its money on host-country governance. The Bank of China's loan of \$2 billion for infrastructure projects in Angola, granted in return for access to

**Whatever its leaders think they're doing, the consequences in terms of access to supply for other countries are largely positive.**

resources, generated such a scramble for payoffs that China's secret service had to appeal to President José Eduardo dos Santos for guidance about which palms should be greased. Similar issues are brewing in the Democratic Republic of Congo.

The bottom line, then, is that concerns about China's push to assure adequate supplies of natural resources are well-grounded, but probably misdirected. Whatever its leaders think they're doing, the consequences in terms of access to supply for other countries are largely positive. However, the primary reason that Chinese policies are making resource markets more competitive rather than less – Beijing's willingness to invest where others won't – implies that China is a problematic partner in efforts to coax outlier states into the global civil society. **M**