China’s trade strategies: Searching for critical resources

Minxin Pei


In response to China’s growing demands for resources and its inefficient consumption of those resources, the government has adopted a two-prong strategy to conserve existing supplies and develop new sources of energy and water, said Minxin Pei in his address to the Global Executive Forum.

“One is what I call internal response and the other revolves around external strategies,” said Pei.

Internal strategies

The internal response encompasses limited policy reforms to increase efficiency. “China is going to impose one of the world’s most enlightened energy efficiency measures which will set relatively high standards for vehicles,” said Pei. “Toyota is going to manufacture its Prius in China on a very large scale, and the use of hybrids will be encouraged.”

To boost energy production, China plans to expand the number of nuclear plants in the country, said Pei. Right now nuclear plants generate only 2.3 percent of all energy production. The government hopes to increase that to 6 percent by 2020. Meeting this goal is an expensive undertaking, “involving building something like two nuclear plants a year for the next 15 years” at an estimated cost of US$48.3 billion.

“If the massive inefficiencies in the system can be corrected, the results are going to be very, very impressive,” said Pei, pointing out that China can achieve 10-20 percent savings in electricity usage if good standards are introduced and enforced.

Inefficiencies are only half the problem; consumption is the other half. Market mechanisms would help control consumption of key resources based on established principles of supply and demand, but the country is reluctant to employ these, Pei said.

“For example, gasoline prices in China are lower than gasoline prices in the US. Today in California we paid $2.40 a gallon; in China the price is $1.70 a gallon. Why? Because there’s no tax on gasoline. And industrial use of water is ridiculously priced at the lower end.

“China is a believer in administrative solutions so introducing efficiency improvements is viewed as much more important than using market methods to cut down on usage.”

Administrative solutions are evident in some large infrastructure activities the government has initiated: power plants, pipelines to pump natural gas from central Asia to China’s east coast, a water transfer project to move water from the south to the north. Pei calls these undertakings a “brute force approach that is risky and fails to deal with the source of the problem, the lack of a market mechanism to curb demand and consumption.”
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External strategies

Resource constraints will determine the pace of China’s growth, which is why the country has extended its global reach and scope in securing supplies of critical resources.

“China appears to have a very high level of tolerance for risk, both political and financial,” said Pei. “They have used very aggressive tactics to try to buy equity in companies all over the world, placing more importance on direct control of assets than on potential financial returns.

Another tactic that China favors is entering into long-term contracts that establish fixed pricing “because the government is loathe to subject itself to the miseries of fluctuations in market prices.”

Political risks involve some of the countries China does business with, such as the “pariah states of Sudan, Iran and Venezuela. China imports 70,000 barrels per day of oil from Sudan. China also has multi-billion dollar supply contracts from Canada and Australia, which are far more stable.

“The Chinese government has given the quest for external resources its highest attention,” said Pei. “President HU Jintao has turned himself into China’s chief acquisition officer. On his first trip abroad he visited Gabon to secure contracts and supplies.”

Demand for resources outpacing supply

“China is short on all kinds of resources -- oil, water, minerals,” said Minxin Pei. And demand is outpacing the country’s ability to supply the needed resources in an efficient, timely manner.

“One of the reasons China is now bumping up against resource constraints is because it has chosen a manufacturing-led growth model. The industry & construction sector accounts for 52.9 percent of the country’s GDP. (This sector is 28.4 % in India, 19.7% in US.) And of course manufacturing is enormously energy intensive.

“China is one of the least efficient users of energy. Its energy consumption per unit of GDP is eight times greater than Japan, six times greater than the US and three times greater than India. “The country’s steelmaking production capacity is 216 billion tons — more than the US, Japan and Germany combined. To support that production you need a lot of power plants.

“Oil production has peaked at little more than 3 million barrels per day, but demand is going to continue to grow.

“China has the largest coal reserve in the world, but its production capacity is already at 1.9 billion tons a year and there are limits to additional production. Furthermore, the coal mines are in the north while the bulk of demand is in the industrialized parts of the south. So the coal has to be transported from north to south. And because there’s no water in the north to wash the coal, it has to be transported dirty. It’s not a very economical way of getting energy.”

Asked if the buildup of the military is for a secondary purpose of obtaining supplies, Pei said, “No. It’s to make sure that Taiwan will not be able to declare its independence and get away with it.”

In building up its military, China has turned to Russia, which has been its political rival for the last 150 years. “China is now the biggest purchaser of Russian weapons and its appetite for Russian raw
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materials is voracious. Short term there’s a perfect match between China’s needs and Russia’s capacity to serve those needs,” said Pei.

“But longer term the Russians are worried about China’s strength and ascendancy and do not want to be totally dependent on the Chinese market. Consequently, they are not going to give China everything, either in military weapons or resources.”

Limits of China’s strategy

Internationally, competition for resources is fierce and as a latecomer to the game, China often finds itself outmaneuvered. "Wherever China wants to make a serious effort to gain access or control of a desirable asset, it gets squeezed out by established players and multinational corporations," said Pei.

“China wanted to buy a piece of a really nice oil field and BP and other petroleum firms said no. China will always bid much lower for developmental rights, thus squeezing the profit margins of companies with which they contract.”

There are foreign policy implications to China’s strategy; China’s interests are impinging on America’s interests; the US doesn’t like the fact that China is investing in Iranian oil fields and getting on friendly terms with countries that are antagonistic to the US. “China has been very careful not to provoke a foreign policy response in the US Congress," said Pei.

“Because of its aggressive tactics, China is arousing fear, resentment and resistance in developed countries and setting itself up for a backlash in developing countries.”

Despite the problems, Pei sees a brighter side to China’s future, provided it introduces more market mechanisms, improves energy efficiency and shifts the economic base from manufacturing to a strong services sector which is far less reliant on resources. Pei believes that this shift will occur in the next five to 10 years.

If these adjustments are made, “China is going to do better than I think my fears would first lead me to believe.”

Investment-led growth to continue

China will continue to have investment-led growth for the foreseeable future, said Minxin Pei, citing infrastructure needs -- housing, energy, roads, etc. -- that will drive demand and consumption.

- Enormous needs for infrastructure in the inland areas as the government tries to stimulate growth in these previously overlooked sections of the country. The government is now allocating capital and granting more favorable policies to inland areas in order to attract investment.
- Rapid and massive migration of rural residents into towns and major cities. In the next 20 years 200-300 million people will move out of the countryside into urban cities, which will generate enormous demands for infrastructure that will sustain the demand side.
- Although China is moving up quite rapidly, its income level is low compared to developed countries and its level of consumption, while growing within the borders, is also low when compared to the developed world. So there’s a lot of ground to be made up and a lot of opportunity for investors.
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<th>China’s resources</th>
<th>India’s resources</th>
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<tbody>
<tr>
<td>Population: 1.3 billion</td>
<td>Population: 1.1 billion</td>
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<tr>
<td>• Industrial production growth rate: 17.1% (04 est)</td>
<td>• Industrial production growth rate: 7.4% (04 est)</td>
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<tr>
<td>Electricity</td>
<td>Electricity</td>
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<tr>
<td>• Production: 1.91 trillion k Wh (03)</td>
<td>• Production: 547.2 billion k Wh (02)</td>
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<tr>
<td></td>
<td>• Consumption: 1.63 trillion k Wh (03)</td>
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<tr>
<td>Oil</td>
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<tr>
<td>• Production: 3.392 million bbl/day (03 est)</td>
<td>• Production: 780,000 bbl/day (04 est)</td>
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<tr>
<td></td>
<td>• Consumption: 4.956 million bbl/day (02)</td>
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<tr>
<td></td>
<td>• Proved reserves: 17.74 billion bbl (04 est)</td>
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<tr>
<td>Natural gas</td>
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<tr>
<td>• Production: 3.5 billion cu m (03 est)</td>
<td>• Production: 22.75 billion cu m (01 est)</td>
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<td></td>
<td>• Consumption: 29.18 billion cu m (03 est)</td>
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<td></td>
<td>• Proved reserves: 2.23 trillion cu m (04)</td>
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Source: CIA World Factbook 2005

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