

Chinese Energy Cooperation in “One Belt One Road” Initiative

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Key Question

OBOR involves huge investments and plenty projects in which Chinese authorities prioritise infrastructure.

Project based energy cooperation, such as transnational pipelines, transnational grids, energy hubs, is an important mean for China to promote the OBOR.

Energy expansion in OBOR will define the future of Eurasian energy geopolitics.

OBOR foresees turning China's bilateral relations into more of a regional and multilateral engagement strategy that is underpinned and bolstered by multiple strategic initiatives.

•**Key Question:** Will the OBOR initiative enhance the multilateral engagement in Chinese energy cooperation, through existing multilateral platform or a new mechanism contributing to global energy governance?



Issues to be addressed

- Background, objectives and means of OBOR
- Energy dimensions in OBOR
- Is OBOR happening?
- Case Study: Central Asia and Energy Charter Treaty
- Multilateralism or not?
- Future Scenarios

Background, objective and means

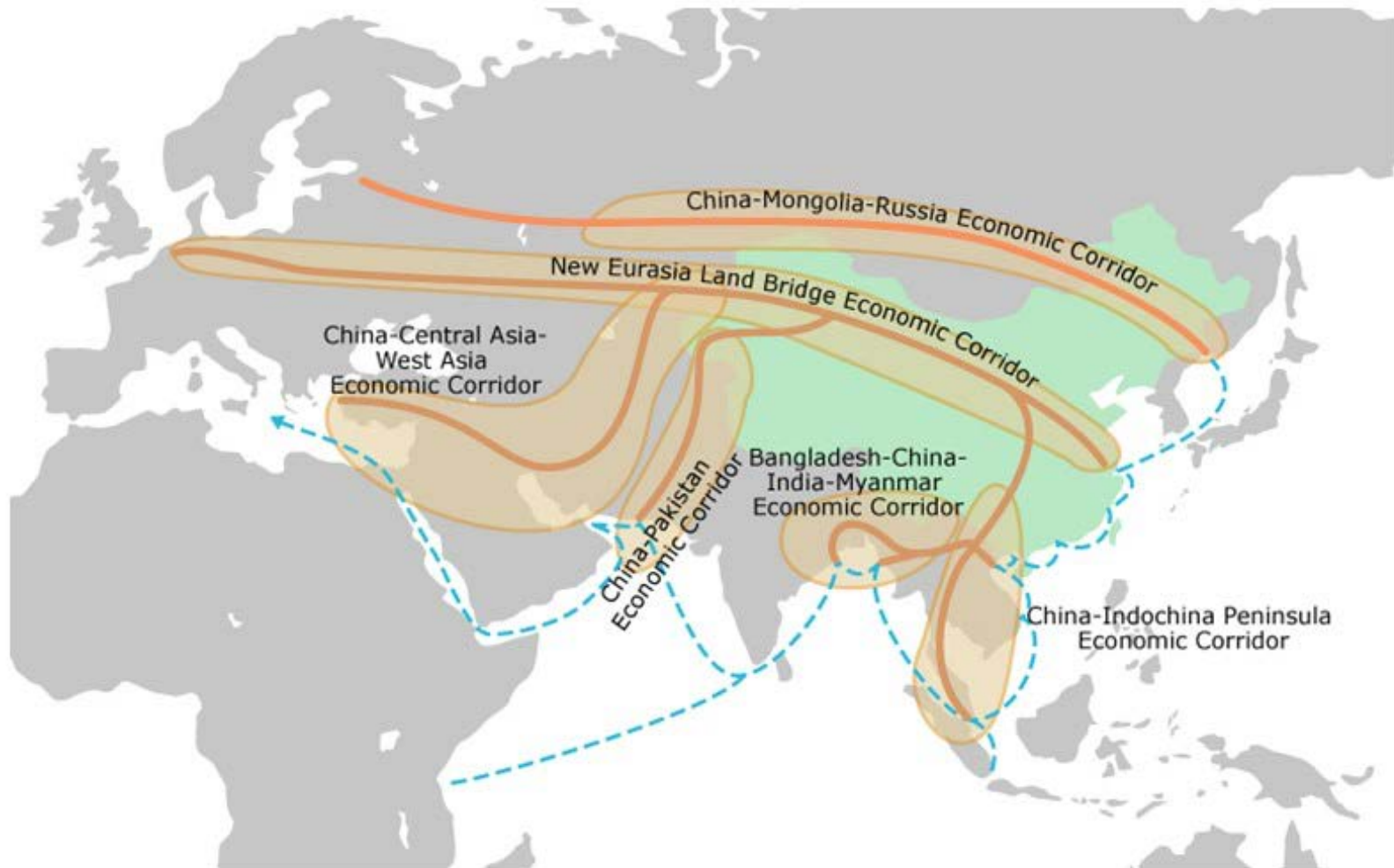
- On Mar 28 2015, NDRC, MFA, and MOCOM issued *the Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road*
- China has developed a new foreign policy concept with strong geo-economic dimensions as a response to global economy slowdown
 - places its neighbourhood at the “top strategic priority.”
- Essentially a Chinese vision of the future regional integration of Eurasia
 - aims to achieve mutual benefit and prosperity of the region.
 - China’s economic, foreign, and security policy interests through a series of smaller initiatives and projects.
- Countries along OBOR need to strengthen interconnection/cooperation
- Interconnectivity in 5 areas: Policy, Infrastructure, Finance, Trade, People



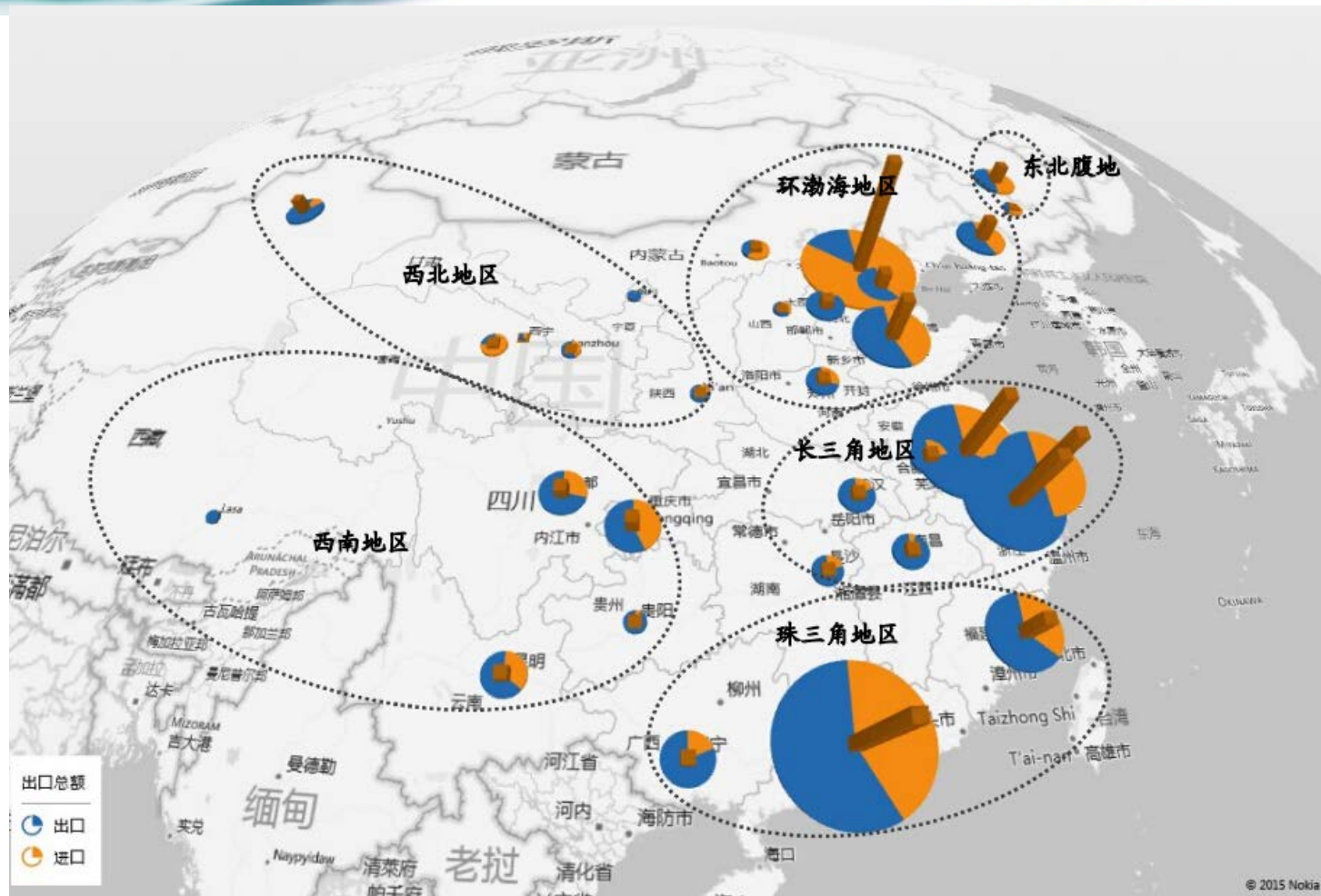
Background, objective and means

- A new round of China's opening up in response to the challenges:
 1. overproduction and overcapacity
 2. rise in labour cost
 3. backward development in western part of China,
 4. transforming to a net capital exporter
 5. regional security and political stability
- Chinese authorities traditionally considered interconnection, particularly via transport and infrastructure, as the key to boost development and economy which could help enhance regional stability
- It foresees turning bilateral relations into more of a regional engagement strategy that is underpinned and bolstered by multiple strategic initiatives.

The Belt and Road Initiative: Six Economic Corridors Spanning Asia, Europe and Africa



- Involves 65 states and around 4.4 billion people in six economic zones across Eurasia, stretched from Southeast to Africa and Europe.



- It is also linked to China's domestic economic development strategy.
- Each corridor in OBOR \leftrightarrow Domestic counterpart from province to city level
- China's provinces will play a major role with own specific interests



Background, objective and means

- China seeks to use and benefit from economic complementarities.
- Expand the overland trans-continental container trade, promoting common interests in the areas: regional production, transportation, ports, highways, fabric optic cables, airports, energy infrastructures and value chains
- Investments are also important for regional security reasons.
- Chinese authorities views poverty as one of the key reasons of political instability.
 - Economic slowdown in neighbourhood would result in regional instability
 - Harm political and social stability in regions connected to neighbors.
- For the above economic and security objectives, energy investment is a key area.
 - Cover 4 key areas out of 5: **Policy Infrastructure Finance Trade**

Energy dimensions in OBOR

- China has four external energy security channels
 - namely the northwest, northeast, southeast and southwest channels.
- Neighbours are rich in energy resources
- Rely on regional influence of Russia, Central Asia, Southeast Asia etc
 - Regional markets → Free trade area, → Intl' geostrategic partnerships.
- The energy interconnection in OBOR is reflected in the following four aspects:
 1. Infrastructure Construction
 2. Industry Chain / Integration
 3. Financial System
 4. Multilateral Governance



1. Infrastructure Construction

- Infrastructure takes the priority in OBOR
 - Transfer overcapacity
 - Transfer labour force
 - Chinese company do the construction (direct payment, loan, share)
 - Chinese equipment
- Interconnection cooperation will give priority to infrastructure.
 - Oil and gas pipelines, refineries, power transmission corridors, solar panel, roads and ports connected to energy facilities
 - A energy project proposal looks more attractive if it includes ports

2. Industry Chain / Integration

- The document highlights:
 - Increase cooperation in the exploration and development of resources
 - Promote cooperation in the processing and conversion of energy and resources at or near places where they are exploited
 - Create an integrated industrial chain of energy and resource cooperation.
- With low oil price, China's companies are in a good position to merge and acquire the energy assets along OBOR.
- A way to expand and integrate energy facilities and market in the upstream, midstream and downstream areas
- Promote other energy related industry
 - Gas field > Pipeline construction, gas sale to cities, fertilizer industry;
 - Dam construction > irrigation system
- Benefit to local economic development
- Set up pilots in the important regions such as Xinjiang.

3. Financial system

- Energy infrastructure investment = projects with massive investment
 1. a lot of strategic capital and
 2. a mature energy financial system for operation.
- Funds are loans from CDB, AIID, SRF, etc
 - AIIB and OBOR are complementary
 - But it is not the institutional form of OBOR nor the only financing channel

Implications

- Set up more financial institute like AIIB
- Purchase Western banks to learn the financial “skills”
- Raise the scale of RMB use in oil and gas trade
- Promote RMB’s internationalization progress
- Increase decision making power in energy pricing
- Impact the financial system in Asia – initial fund is small but make a difference

4. Multilateral Governance

- Regional cooperation with neighborhood regions of China is the foundation of energy connection in Belt and Road.
- While there is a substantial increase in China's FDI, relevant trade disputes and cross-border transportation problems have also become prominent.
- Transnational infrastructure construction through investment and industrial integration will "chain" China with its neighbours
- Infrastructure investment > the need of certain mechanisms regulation for of producing, consuming and transit countries.
- China still lacks a relevant international legal framework for energy investment
- China's energy cooperation will move forward from bilateral to multilateral



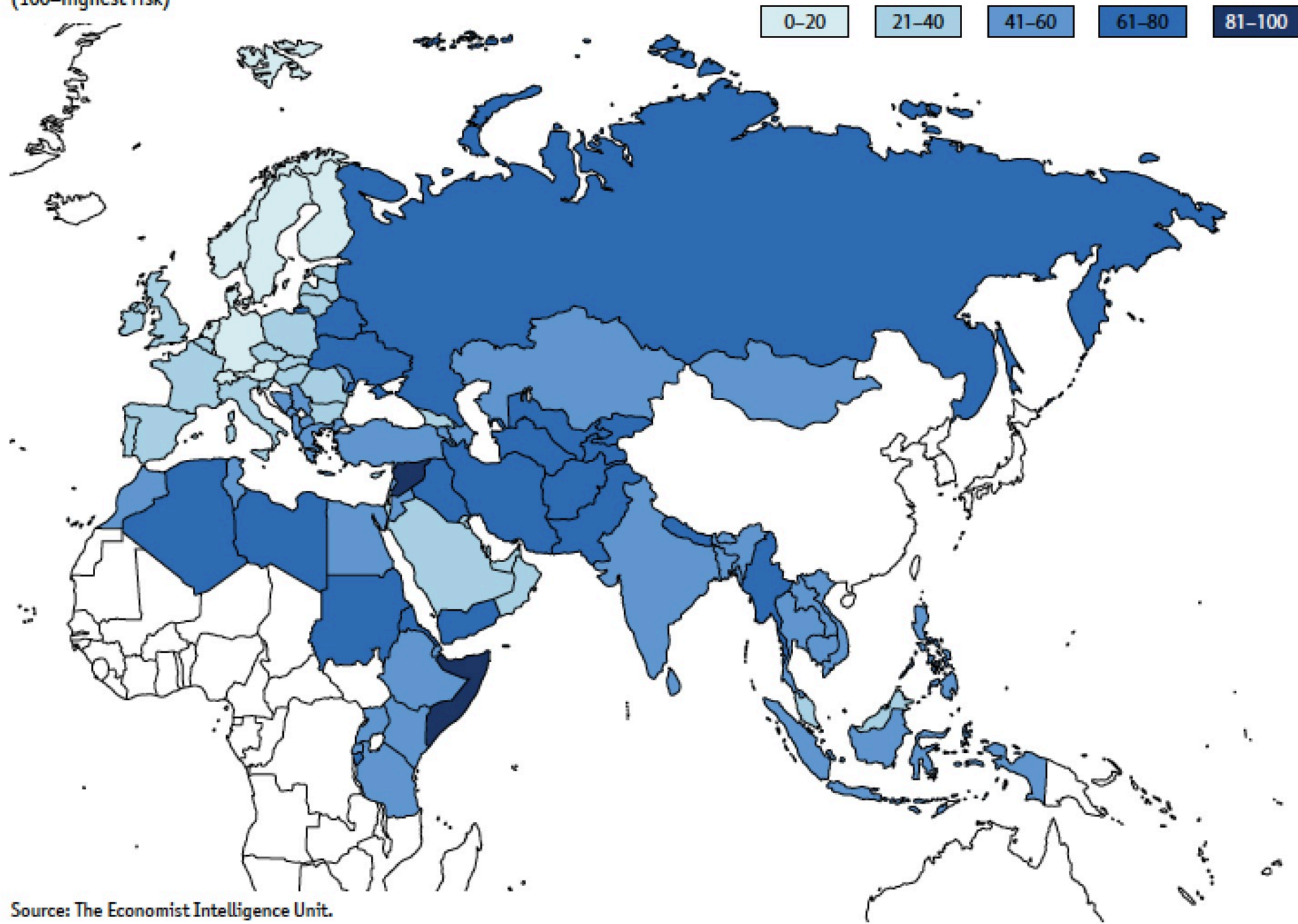
Is OBOR happening?

There are ongoing investments but lots of challenges and obstacles too:

- Lack of central coordination
- Rely on bottom-up project based approach
- Low oil price impact the SOEs
- Energy market “un”reformed
- Non-cooperative neighbours
- China’s Anti-corruption campaign

Overall country operational risk on 'One Belt, One Road'

(100-highest risk)



Source: The Economist Intelligence Unit.

Case Study of China-Central Asia Energy Cooperation

- Central Asia can be considered at the pivot hub in OBOR.
 - President Xi Jinping's first formal visit was to Central Asia in September 2013 when he announced the initial idea of OBOR
 - China–Central Asian relations are increasingly defined by a dynamic of economic and political dependency, which can be seen through their oil and gas cooperation and the importance of regional security and anti-terrorism to Xinjiang Province.
 - Follow the logic behind OBOR: Investment → regional stability
 - Ongoing Infrastructure investment: esp. transnational pipelines
 - The need of multilateral governance in the region
- Progress of multilateral cooperation in Central Asia can offer some hints showing how China will do in other regions.

Case Study of China-Central Asia Energy Cooperation

- After collaboration of over two decades, energy cooperation between China and Central Asian countries has now entered a more stable and mature phase.
 1. Extension and diversification of the value chain in energy cooperation, from traditional upstream exploitation and exploration to downstream activities
 2. More diverse cooperation in terms of ownership and contractual structures
 3. The emergence of multi-dimensional frameworks and mechanisms
 4. A growing tendency for Chinese SOE seeking Western partnership in energy investment in the region for risk-diversification
- Among them, the Central Asia-China transnational pipeline is considered one of the greatest achievements in China-Central Asia energy

CHINA-CENTRAL ASIA INFRASTRUCTURE DEVELOPMENT



- Consists of four trunk gas pipelines, almost 2000km, starting from Turkmenistan, going across Uzbekistan and Kazakhstan and ultimately reach the Chinese border and then connected to the Chinese West East Gas Pipelines. The maximum designed transportation capacity of Line A, B, C and D can be up to 90 bcm, which is equivalent to more than 50% of China's current gas annual consumption.



Investment protection mechanism with Central Asia

•Currently, China is rely on the following mechanisms to protect its energy investment in the Central Asia:

1. Bilateral investment agreements
2. MOUs and Inter-Governmental Agreements
3. Shanghai Cooperation Organization (SCO)
4. Four Countries and Seven Partners (FCSP) coordination mechanism



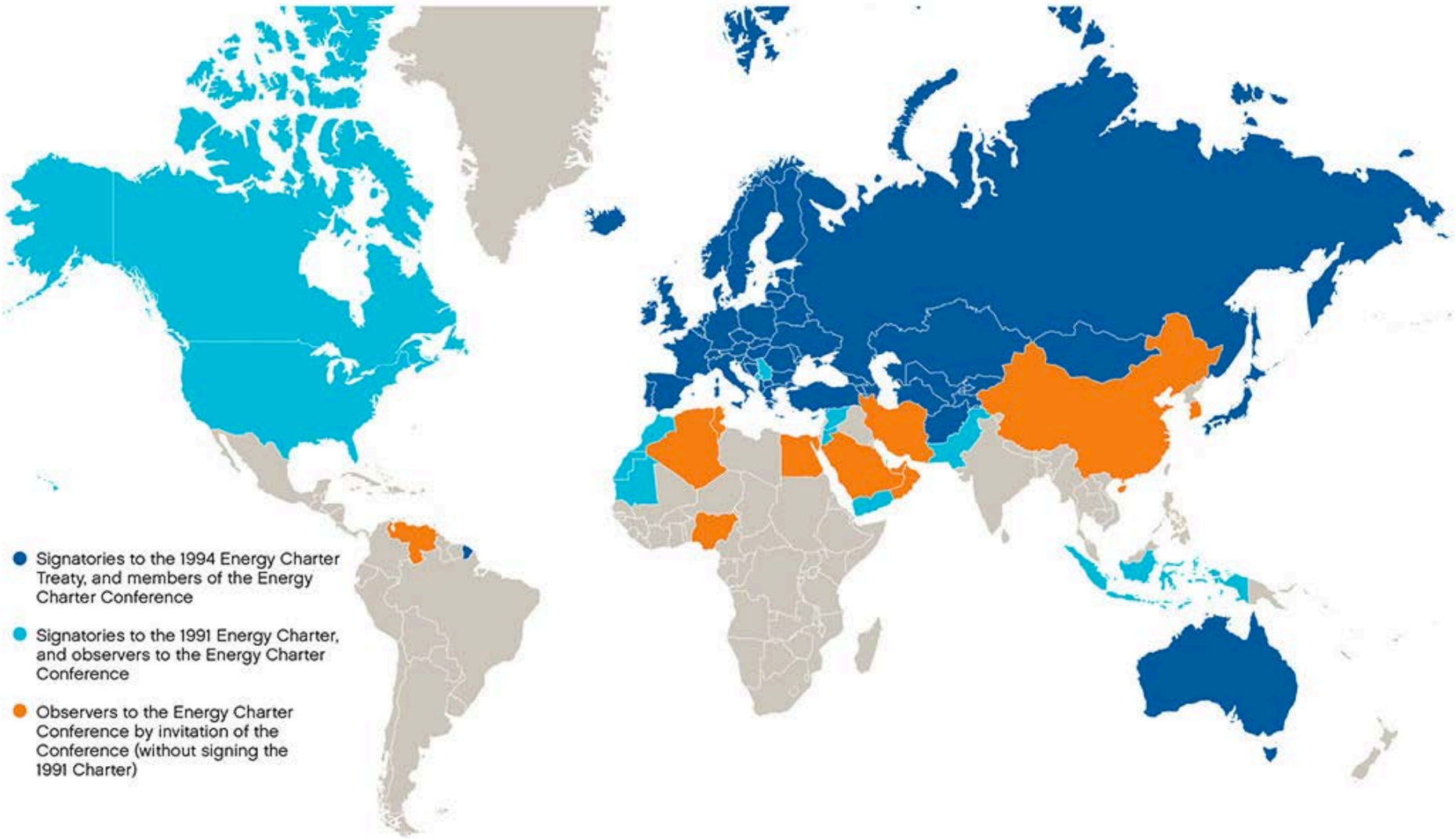
Existing mechanism is not sufficient

- Existing bilateral agreements focus more on the systematic maintenance of pipeline operation but are not legally sufficient to handle the multilateral problems such as transit issues.
- Multilateral mechanisms in SCO or FCSP are non binding and are insufficient to ensure stable energy flows in pipelines.
- A lot of energy projects within SCO are still handled in a bilateral way
- There is a need for legally binding emergency response coordination
- In the case of transit interruption owed to regional religious conflicts, commercial disputes and/or any discrepancy in the allocation of transit capacity of the pipeline based on various strategic considerations of supply and transit countries.
- The need of transnational transit management urged China to look into better energy governance from a multilateral approach.

Energy Charter Treaty

- A more efficient and comprehensive international legal framework, like the ECT, is needed to ensure the security of energy flows to China.
- ECT is a multilateral version of BITs signed in 1994 to provide comprehensive protect energy investments and reduce commercial risks in international energy cooperation.
- ECT is the WTO in energy world: Its principle cover issues such as protection of energy investment, equality in energy trade, national treatment, subjectivity to international law, compliment with obligations and dispute settlement mechanism
- Originally a treaty to overcome economic division between European countries and post-Soviet countries and currently expanding membership to Asia
- And, more importantly...

Energy Charter Treaty Ratification



- Signatories to the 1994 Energy Charter Treaty, and members of the Energy Charter Conference
- Signatories to the 1991 Energy Charter, and observers to the Energy Charter Conference
- Observers to the Energy Charter Conference by invitation of the Conference (without signing the 1991 Charter)

Source: www.encharter.org

Why Energy Charter Treaty?

- Central Asian-China pipeline is a cross-border investment, in which Central Asian countries play not the role of energy supplier but also transiting country.
- If China join the Treaty, it will enjoy Protection of FDI, Protection of Transit, Dispute Settlement which none of China's existing mechanism could provide.
- ECT, with its vast membership and relevant institutional mechanisms, could become the most appropriate and efficient institutional energy cooperation framework for securing increasing energy exports from Central Asia to China.
- ECT has sufficient legal instruments and institutions to promote regional energy cooperation and facilitate implementation of transit infrastructure projects.
- It is insightful to observe China's engagement with ECT to further examine China's attitude towards multilateralism.



China's engagement with ECT

•Because of its increasingly strong presence in international energy markets and engagement as an investor in the energy sectors of all continents, China start to pay attention to and engage with Energy Charter on

1. personnel level: exchange program
2. institute level: company involvement
3. national level: sign the International Energy Charter

China joining ECT? NO.

- Although Chinese officers are sent on exchange to ECT headquarters, but what could be brought back and delivered to the decision-making level is often limited.
- Most of the agreement between China and Energy Charter is not legally binding and this is the reason why China feels comfortable to sign it.
- Prefers to remain non-obligated and be able to “exit” freely when necessary.
- Chinese authorities were alerted by the incident that ECT was applied on the Yukos case in 2014 to charge Russia. (PS: charge released in 2016)
- ECT consider this case as an good example to show the effectiveness of the Treat and persuade China to join for protection.
- YET, Chinese authorities gave their attention to the risk of signing ECT



Four Reasons

1. Lack of urgent need for multilateralism
2. Misperceptions of multilateralism plus the Chinese own way
3. Fragmented Chinese energy governance with overlapping functions
4. Policy change as evolutionary process that requires time

Future Scenario

In the short to mid term, it is believed that China will continue to balance both approaches to maximize opportunities. As a hedge, China uses a multilateral approach as a cover for its bilateral energy diplomacy where possible, and vice versa.

1. Not joining the existing multilateral system

- Unlikely to join the current multilateral system straight the way blindly.

2. Alter the existing multilateral system

- Currently, China enjoys the upper hand in the negotiation with IO
- IO tends to modify their own agenda for China

3. Establishing a Chinese-led or Asian-led multilateral system

- Chinese elites may “copy” the useful elements from existing multilateral system and “paste” to its own system after modification.



Q&A

Thank You!

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