

Is China trying to “lock up” natural resources around the world?

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Con

The rapid emergence of China as a major industrial power poses a complex challenge for the world's natural resources. This column argues that the Chinese government-backed investments in natural resource supplies are predominately in areas that will help expand, diversify, and improve competition in the global supplier system. But potential geopolitical consequences remain a reason for concern.

Backed by the Chinese government, Chinese companies have been acquiring equity stakes in natural resource companies, extending loans to mining and petroleum investors, and writing long-term procurement contracts for oil and minerals. These activities have aroused concern that China might be “locking up” natural resource supplies, gaining “preferential access” to available output, extending “control” over the world’s extractive industries (Silk 2006).

The empirical question

The empirical question I address here is whether Chinese equity acquisitions, loans, and long-term procurement contracts help consolidate a tightly concentrated supply base while securing preferential access for Chinese buyers? Or do these actions help multiply sources and diversify the supply base, thus making the provision of output more competitive for all buyers?

This investigative focus is deliberately narrow and precise. It assesses the impact of Chinese resource procurement on the structure of the global supply base. The broader policy discussion in the concluding section raises other separate important issues, including the effect of Chinese resource procurement on rogue states, on authoritarian leadership, on civil wars, on corrupt payments and the deterioration of governance standards, and on environmental damage. Such effects may make patterns of Chinese resource procurement objectionable, on grounds quite apart from the debate about possible “lock up”, “tie up”, and “control” of access on the part of China and Chinese companies.

Business School strategic management literature identifies four fundamental types of natural resource procurement structures for a large buyer.

1. *Take an equity stake to create a “special relationship” with a major producer.* Buyers and/or their home governments take an equity stake in a “major” producer so as to procure an equity-share of production on terms comparable to other co-owners.
2. *Take an equity stake to create a “special relationship” with the competitive fringe.* Buyers and their home governments take an equity stake in an “independent” producer so as to procure an equity-share of production on terms comparable to other co-owners.
3. *Loan capital to be repaid in output to a major producer.* Buyers (and/or their home government) make a loan to a “price maker” producer in return for a purchase agreement to service the loan.
4. *Loan capital to be repaid in output to the competitive fringe.* Buyers (and/or their home government) make a loan to a “price taker” producer in return for a purchase agreement to service the loan.

These four categories provide the basis for giving operational definition to “tying up” or gaining “preferential access” to supplies. If the buyer-seller arrangement simply solidifies legal claim to a given structure of production (categories 1 and 3), “tying up” or gaining “preferential access” to supplies has zero-sum implications for other consumers. What is noteworthy, however, is that if the buyer-seller arrangement expands and diversifies sources of output more rapidly than growth in world demand (categories 2 and 4), the zero-sum implication vanishes as other consumers have easier access to a larger and more competitive global resource base.

Figure 1 presents the scorecard of the sixteen largest of China’s procurement arrangements showing a few instances in which Chinese natural resource companies take an equity stake to create a “special relationship” with a major producer. But the predominant pattern is to take equity stakes and/or write long-term procurement contracts with the competitive fringe.

A brief review of five smaller Chinese procurement arrangements does not suggest that there is significant selection-bias in looking at these sixteen largest projects.

The rapid emergence of China as a major industrial power poses a complex challenge for global resource markets. On the demand side, Chinese appetite for vast amounts of energy and minerals puts tremendous strain on the international supply system. On the supply side, Chinese efforts to procure raw materials can exacerbate the problems of high demand, or help solve the problems of high demand. Which outcome Chinese procurement arrangements generate depends upon whether those arrangements solidify a concentrated global supplier system, or expand, diversify, and increase competition in the global supplier system. The evidence presented above shows that Chinese efforts – like Japanese deployments of capital and purchase agreements – fall predominantly into categories that help expand, diversify, and make more competitive the global supplier system.

Chinese attempts to exercise control over “rare earth elements” mining may constitute a significant exception, however. The term “rare earth”, according to the US Geological Survey, “is a historical misnomer; persistence of the term reflects unfamiliarity rather than true rarity.” The US was self-sufficient in rare earth production until the mid-1980s, now more than 90% is imported from China (\$127 million in 2008). Rare earth minerals are crucial for a growing array of civilian and military products. Historically the rare earth mining industry has been characterised by excess capacity, and oversupply. In August 2009 China’s Ministry of Industry and Information Technology issued a draft policy to set an annual export quota of 35,000 tons, a potential ban on exports of at least five types of rare earth elements, and a series of steps to control mining and improve environmental practices. These actions may be directed at securing control over international markets; at the same time, they are being deployed as a tool to compel more foreign investment and more value-added in associated industries in inland China. Concerned about access to supplies, mining companies and buyers have shown interest in developing new sites in Vietnam, Kazakhstan, Sweden, and Canada, as well as restarting production in the US. China meanwhile has pursued an aggressive policy of acquiring equity stakes in new producers, in particular in Australia.

Deng Xiaoping once noted that while the Mideast has oil, China has rare earth elements. How should national authorities react to the prospect of Chinese investment in offshore rare earth elements companies? The foreign acquisition analytics in the rare earth sector fit well within the broader framework laid out here; Chinese investment in a small independent producer whose impact can do nothing except help expand supply and make the industry more competitive should be encouraged; Chinese investment in a more major producer that perhaps puts the Chinese owners (and Chinese government) in a position to control or constrain production should be viewed with circumspection.

The impact of Chinese procurement activities on the structure of supplier industries, however, is only one dimension of the challenge posed by Chinese natural resource acquisition. The natural-resource-strategist-from-Mars might well applaud China’s vigorous support for oil production in the Sudan or Iran, and for oil transport, natural gas, and mineral production in Myanmar. But the US and other allies are rightly appalled at the consequences for regional conflict, support for terrorist groups, violation of human rights, and oppression. Finally, provision of equity capital and loans in return for natural resources form part of larger Chinese strategy toward Central Asia, the Middle East, Africa, Latin America, and the South Pacific.