



CIGS Seminar

"U.S.-China Politico-Economic Relations under the Treacherous Global Circumstances"

Edward Cunningham

"The X Factor: China's Energy Profile"

(Summary of speech)

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I will speak about the consolidation of power that Xi Jinping has evinced and link it to the energy sector. I will also talk about the tensions between a highly consolidated and consolidating power structure and the highly interdependent energy market and sector, and relate that to some major issues of leadership.

As some context, China's energy system is an X factor and a source of significant change and significant uncertainty to the existing global energy order, particularly as the role of the state continues to grow in this market. China is driving three of the four main shifts in the energy sector, namely global renewables growth, electrification of transportation, and the infrastructure buildout of the developing world. The fourth shift is the rise of the U.S. and the shale revolution.

China's energy demand has risen significantly in recent decades, particularly for fossil fuels. About 86% of China's primary demand is met by fossil fuels. However, recently, we are seeing a significant shift towards renewables. China is shifting majorly against vested interests, and shifting incentives and the market structure away from fossil fuels towards renewables. About 40% of global clean energy investment in 2017 is from China, double that of the U.S.

That is the supply push. On the demand side, there are significant changes happening as well. Thanks to an integrated approach of grids and car companies, electric vehicles are starting to gain traction. Almost all buses are electrified in China. In 2016, around half a million electric vehicles were sold in China, with a 50% increase year on year, which is significantly larger than Europe and the U.S. In 2017, China accounted for over half of the million electric vehicles sold worldwide.

Looking at the external aspects, the Belt and Road initiative is an odd collection of pre-existing projects with lots of different security and commercial goals that are purported to be part of a coherent vision but are not actually that coherent. The way that I look at it, there are a few very critical infrastructure projects that are absolutely security-driven and relate to foreign policy, but also a lot of commercial projects that deal with domestic pressures, such as input overcapacity. As for what is actually being built, there is an increasing tension between a greener internal China and a blacker external footprint. For example in Pakistan, one of the world's largest solar farms is

being built by China but on the other hand, 20 or more coal fired power plants are also built by China.

While China is clearly important in these main shifts in the energy sector, it is also rubbing up against two problems, namely, that its politics are becoming less transparent, while the role of the party has been growing. This is important because we are talking about the world's largest energy market and second largest economy. The way this consolidation of power is manifested through the energy sector is as a very traditional focus on security as defined by maintaining the energy supply. A simple way to measure that security is how many years of a particular energy source there are left in the ground. As China has increased its resource production this ratio has declined precipitously.

We have seen some shifts in China's energy trade policy. Early on, it shifted to becoming a net oil importer. In coal, China went from being the largest coal exporter in the world to become the largest importer. A similar change is now happening in gas. Such policy shifts have been sources of great uncertainty.

Another interesting area is industrial policy and the reshaping of the market structure of China's energy sector. There has been a merger of China's largest coal producer and its largest power producer to shift incentives away from coal. A similar intervention has occurred in solar, aimed at reducing subsidies and procurement rates. A similar shift is being discussed for wind. This is against major interests that they have been trying to keep these policies in place.

There are two key implications, one economic and one political. Economically, despite this fairly blunt and increasing role of the party in this sector and these markets on the one hand, there is also a real push to have China be a real market maker in this sector on the other. We are starting to see progress, particularly the denomination of oil futures in RMB on exchanges. The question is if this will be a challenge to international oil benchmarks and if foreigners will really buy into it, given the major market interventions that the state tends to make. The answer seems to be that it will be difficult. For example, there has not been a lot of foreign capital in well-established markets such as the bond and the equity markets.

There are also political questions. Will energy be one of the few bright spots in U.S.-China relations? In some ways it will. U.S. LNG exports were not included in the tariff list. U.S. shale gas and shale oil exports are improving, as are the trade deficits. We are also seeing significant Chinese investment in U.S. companies. In a lot of these areas where U.S. actually is very strong, there is good complementarity between the U.S. and China. In investment, the U.S. has quite strong venture capital upstream in energy technologies but U.S. energy demand is stagnant.

Finally, in terms of climate change, many people mischaracterize the situation as the retreat of the U.S. and the advance of China in this important leadership area in the public commons. However, in many ways, the U.S. is not actually retreating because it never really was there before. President Obama was a temporary outlier and the U.S. is reverting to its traditional position. Within the U.S., 17 different states, accounting for about half of the U.S. economy and about 40% of the U.S. population, have come together through the U.S. Climate Alliance and are deepening policies to continue the U.S. commitment to the Paris Agreement. For U.S.-China relations, those are the exact actors in the U.S. who are the most complementary with the Chinese national government and most open to Chinese investment. They have been arguably the stalwarts of supporting increased engagement with China.