The Chinese don't think oil is fungible

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Topic: Supply/Production

Ah, me! I see that the Guardian has a column by Mark Tran that could equally well have been written by Econbrowser. In essence he is saying that oil remains fungible and that profit is the driver.

> But concerns about China's energy deals are overblown. It is immaterial who owns oil reserves as sooner or later the oil ends up on the world market. If China decides to hoard oil from one of its foreign reserves, say in Kazakhstan or Sudan, it frees up a barrel of Saudi oil for the world market.
> Owning reserves does not change the price either. If the price of oil goes to $100 a barrel, and China owns a field in Sudan, the price for that barrel from Sudan is still $100. If China hoards that oil from Sudan for its own use, it would miss the chance to sell it at the higher price. That oil from Sudan would effectively cost the Chinese the same as if they bought oil on the open market.

This only works when there is more oil available than there is a need for. And until we see more demand destruction than we have so far one must conclude that this historical situation is coming to an end. As depletion continues to carve away at the oil available from existing fields, and as new development fails to match both this depletion and the growth in demand, then oil will stop being fungible.

At that point China may well get what it needs, only if it has the rights to the oil through the companies that it controls. And that may become an issue. Countries such as Indonesia are already having problems because "their" oil is leaving, and they can't afford to buy it back. This may lead to different national policies. After all, in the past, a number of countries took over the oil from foreign operators, and there is nothing to say that existing arrangements cannot be changed, by state fiat in many cases.

The article goes on to state:

> There are other reasons why China may be on to a hiding for nothing. First, China's oil concessions abroad will not yield anything like enough for its energy needs in the next two decades. Second, most of the oil produced in China's foreign concessions will not physically enter China because of transport and logistical costs.
> The oil will most likely be sold on the international market or swapped for oil that will enter China

I wonder how they reach that conclusion? China seems bent on a very determined program of oil acquisition around the world - the purchase of the PetroKazakhstan reserves are only a step in

that process. Unocal was obviously another such attempt, and though that failed, remember that Unocal has large Asian reserves. In looking at China's five year plans (from Asia Times

> The tenth plan, which runs from 2001 from 2005, continued the previous efficiency goals but also called on enterprises to seek international sources of oil and gas. CNPC responded to this goal energetically, and now has projects in over 11 countries, including Indonesia, Sudan, Azerbaijan, Syria, Algeria, Ecuador, Peru, Niger, Chad, Russia, and Kazakhstan. The latter two have been the main focus of China's international oil hunt in recent years.

The Guardian would suggest that China does not see its demand growing, which is obvious nonsense. Likely what China sees is that if it does not tie up reserves, then down the road as the pie gets smaller it may lose its share. As the Asia Times notes:

> For China, this deal is about resources. It's material. But it's not a solution to China's growing oil demand. PetroKazakhstan represents maybe 30% of one year's demand growth in China if it keeps growing [at its current rate]. So the Chinese would need one PetroKazakhstan every four months to satisfy demand [growth]. Still, it's a good and a fairly large purchase for them."
>
> Magee specifies, "They have a very good refinery - it's pretty modern - as well as production and reserves. They produce high quality oil, too. It's light sweet crude. So taken as a whole - the reserves, the production facilities, the refinery, and pipelines - it's a nice package. And it's strategically located near the Chinese border, close to its ultimate markets."

The bid, however, is not yet a done deal. And Business Week would seem to agree.

> With its economy booming, China is striving to meet its enormous energy needs by intensifying its ties to major energy producing countries and seeking to buy a wide array of foreign oil and natural gas assets.?

Though that article goes on to note that their purchases will not be enough to keep up with demand, and that, like the rest of us, Chinese needs can only be met by Saudi Arabia.

> It is an unarguable fact that China's dependence on Middle East oil is increasing," said a recent report from the government-sponsored Chinese Academy of Social Sciences. "And this reliance will continue. Henceforth the Middle East will be the most important supply source of international oil for China."
> Out of China's total oil consumption last year of 6.7 million barrels a day, almost half came from imports, according to BP PLC statistics. Chinese customs figures show Saudi Arabia provided 16 percent of China's import needs, with Oman and Iran contributing another 24 percent between them.
> Less than 10 percent of its imports -- about 300,000 barrels a day -- came from foreign oil properties controlled by Chinese firms, said Wu Kang, a fellow at the University of Hawaii's East-West Center in Honolulu, citing Chinese statistics. And as China's economy expands, Wu estimates that its import demands will swell to 5 million barrels a day by 2010.

> Saudi Arabia is probably the only country that can meet those demands, Wu says -- at least for the next several years. "But in the long term, there is a big problem," he said Adrian Loh, an analyst with Merrill Lynch in Singapore, believes the situation will deteriorate even sooner. He predicts China's oil import needs in 2010 will grow to at least 10 million barrels a day -- twice Wu's projection and an amount that would leave it struggling to find Persian Gulf suppliers.

Technorati Tags: peak oil, oil

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