Inside China, Inc: China Development Bank's Cross-Border Energy Deals

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Outline

1. Who is China Development Bank (CDB)?
2. How are CDB’s energy-backed loans (EBLs) structured?
3. What do these deals tell us about how the Chinese government and companies interact to execute cross-border deals?
4. What are the implications for the United States?

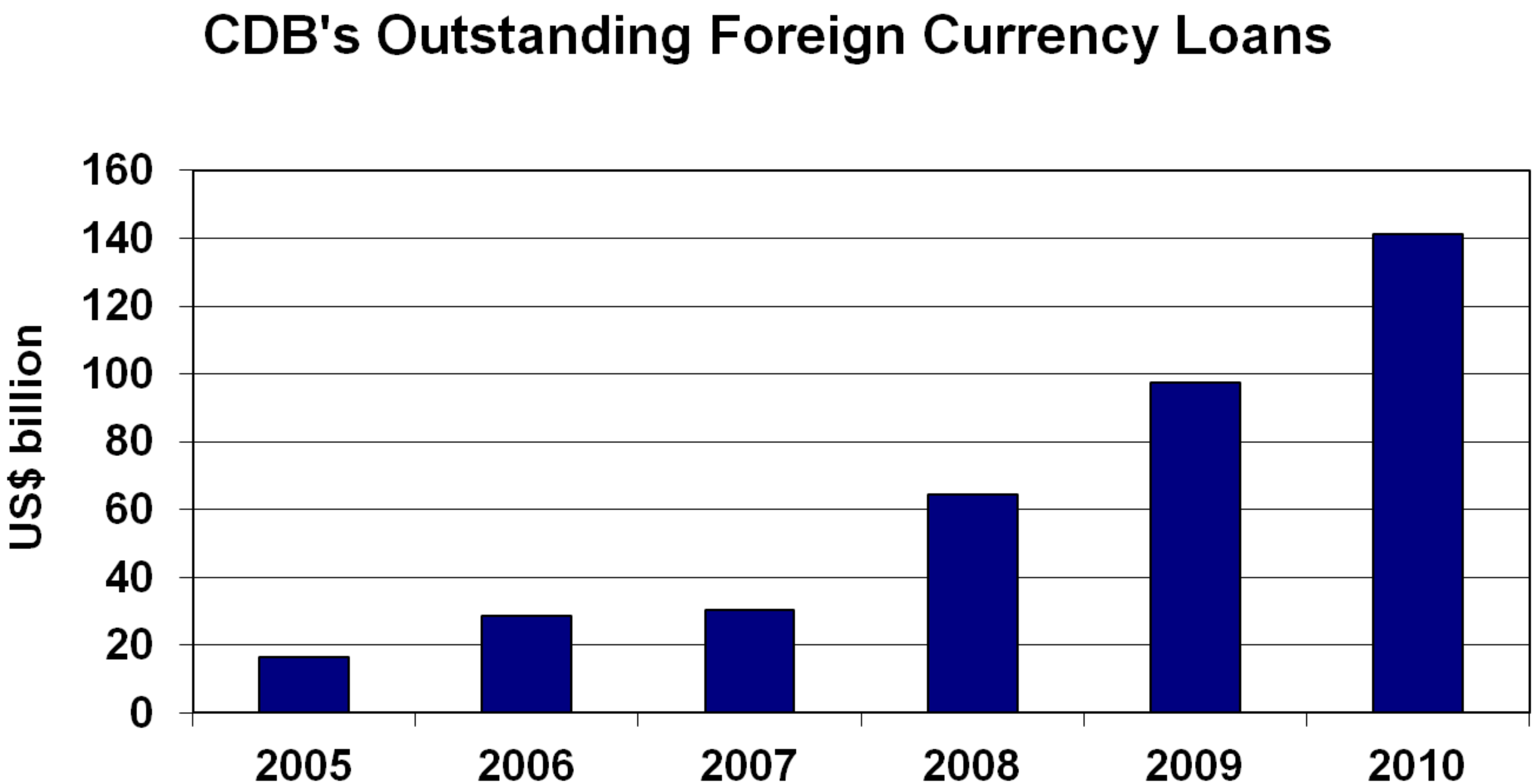
1. Who is China Development Bank (CDB)?

CDB is a state-owned bank which aims to profitably advance China’s national interests

- These interests include:
  - supporting the global expansion of Chinese firms
  - securing access to energy and natural resources

- CDB is one of the most commercial and global financial institutions in China
  - CDB has the lowest nonperforming loan ratio of China’s major banks
  - CDB has the largest portfolio of outstanding foreign currency loans

Since the global financial crisis (GFC), CDB has substantially increased its int’l lending



Most of CDB’s post-GFC lending involves energy and natural resources

Source: CDB Annual Reports

2. How are CDB's energy-backed loans structured?

CDB’s EBLs total about $85 billion

Date	Country	Borrower	$ Bln	Term (yrs.)
2005	Russia	Rosneft*	6	6
2008	Venezuela	BANDES	4	3
2009	Russia	Rosneft	15	20
2009	Russia	Transneft	10	20
2009	Brazil	Petrobras	10	10
2009	Venezuela	BANDES	4	3
2009	Turkmenistan	Turkmengaz	4	NA
2010	Venezuela	BANDES	21	10
2010	Ecuador	Ministry of Finance	1	4
2010	Ghana	Gov’t of Ghana	1.5 1.5	15 10
2011	Turkmenistan	Turkmengaz	4.1	NA
2011	Venezuela	BANDES	4	NA
2011	Ecuador	Ministry of Finance	2	8

*This amount includes funds provided by the Export-Import Bank of China

All of the EBLs have similar structures

- The loans are secured with revenue earned from oil and natural gas deliveries to China's national oil companies (NOCs)

- China's NOCs deposit payment for the deliveries into accounts at CDB held by the companies making the deliveries

- CDB withdraws the money it is owed from the accounts

3. What do these deals tell us about how the Chinese government and companies interact to execute cross-border deals?

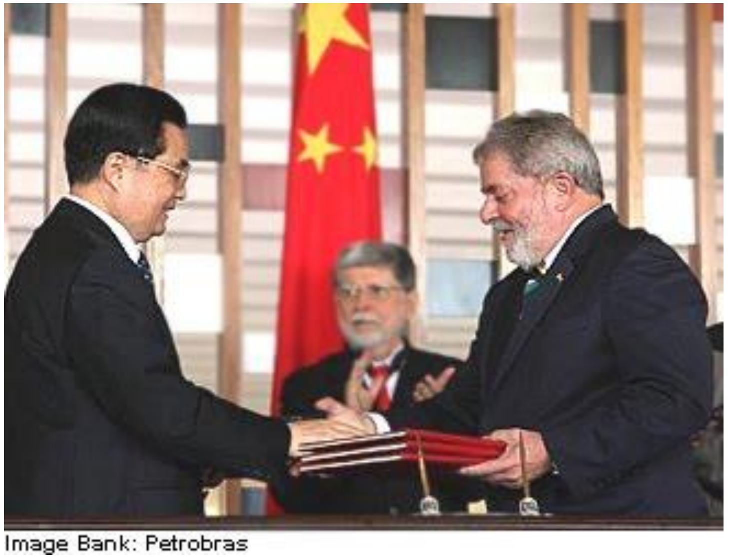


Image Bank: Petrobras

CDB’s EBLs involved government-company coordination with two import caveats:

- Each of the actors involved had its own interests to pursue
- Coordination is not synonymous with “top-down” decision-making

Caveat 1: each of the actors involved had its own interests to pursue (1)

- China Development Bank’s interests:
  - Profitability
  - Expansion of global business portfolio
  - Maintaining policy bank status

Caveat 1: each of the actors involved had its own interests to pursue (2)

- The Chinese government's interests:
- Energy supply security
  - Loans to Russia were contingent upon construction of a spur from Russia's ESPO pipeline to China
- Export Diversification
  - Half of $20.6 billion loan to Caracas is in RMB, which locks Caracas into buying and hiring from China
  - $3 billion of $10 billion loan to Petrobras earmarked for purchase of oil equipment from China
  - At least 60% of $3 billion loan to Accra is required to be spent on hiring Chinese contractors

Caveat 1: each of the actors involved had its own interests to pursue (3)

- The NOCs’ interest: upstream assets
- The recipients of CDB’s EBLs control some of the most important sources of future growth in oil and natural gas supplies
- The opportunity to play a role in developing these resources is very attractive to China’s NOCs
- The only EBL directly linked to an upstream role for a Chinese NOC is the loan to Turkmenistan

Caveat 2: Coordination is not synonymous with “top-down” decision-making

- CDB drove the deal with Petrobras
  - Loan is the product of the bank’s efforts to get business in Brazil since mid-2000s
  - Once China’s leaders learned about the deal and decided it would make a good “diplomatic deliverable” the Chinese government lent support

- CDB’s first EBL to Rosneft probably originated with CNPC and Rosneft

- CDB’s other EBLs appear to have originated in government-to-government frameworks
  - In the case of Venezuela, CDB was probably happy to have Beijing involved for risk management purposes

4. What are the implications for the United States?

CDB’s loans support some US interests in Central Asia

- Bringing incremental energy supplies to the world market
- Providing Central Asian states with multiple energy export routes
- Enhancing the autonomy of Central Asian states

CDB is concerned about good economic policymaking in recipient countries

- Chinese lending practices typically differ from those of more established multilateral and bilateral donors
- However, CDB’s loans to Venezuela indicate that the bank shares their goal of promoting good economic decision making by recipients
- A Chinese government/business delegation drafted 10 plans for Venezuela to reform and grow its economy
  - Included plans for achieving price stability, currency reform, and creating a climate more conducive to foreign investment
- Bottom line: CDB wants its loans repaid

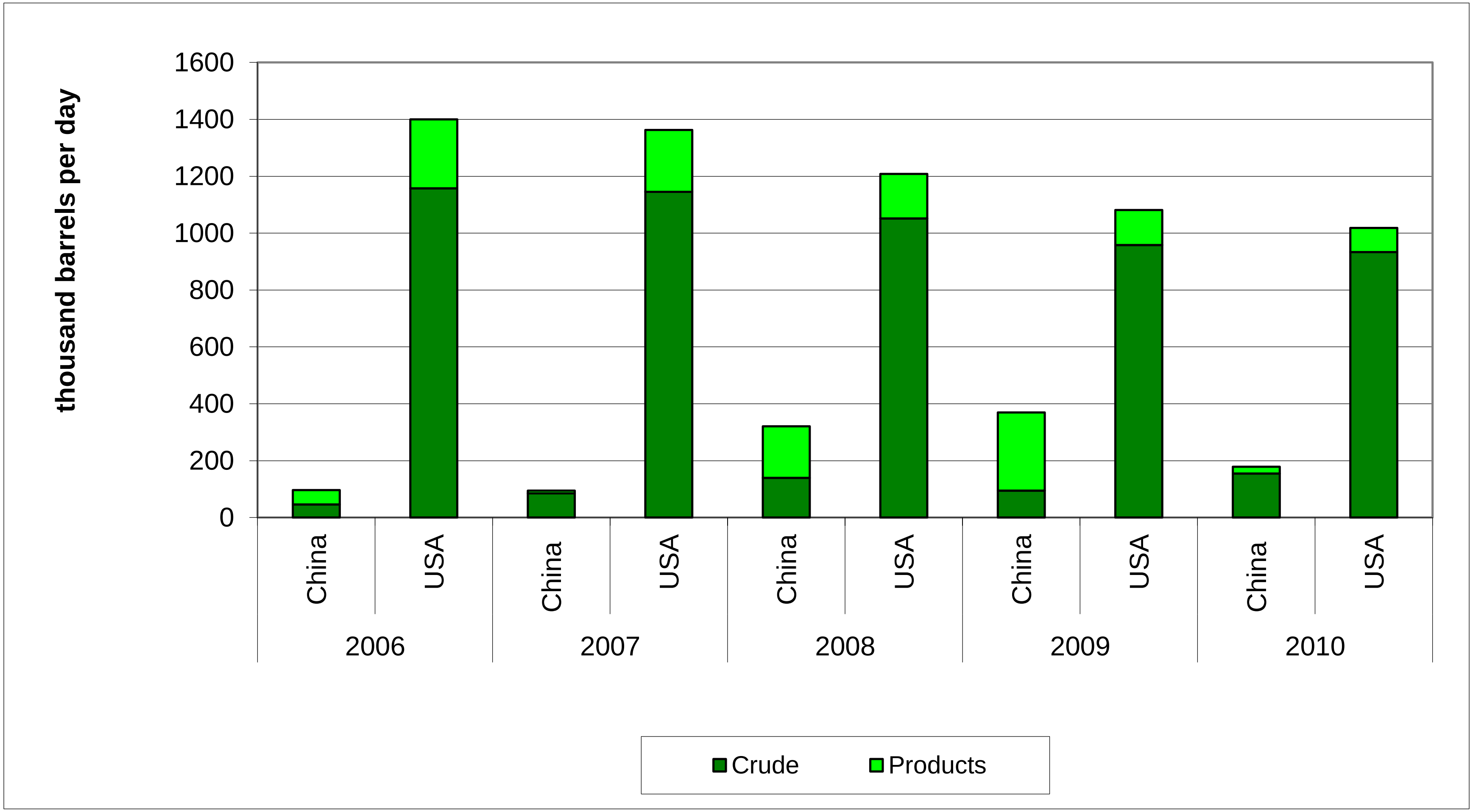
CDB’s Loans are bolstering anti-America regimes in Latin America

- Loans are supporting Hugo Chavez (Venezuela) and Rafael Correa (Ecuador)
- Empowering these regimes is not CDB’s objective
- But CDB is supporting both by serving as a “lender of last resort”
- Both administrations are using CDB’s loans to address key political vulnerabilities

Increased Venezuelan oil deliveries to China to secure CDB's loans are unlikely to undermine US oil supply security

- The oil market is global
  - If the USA imports less from Venezuela, it can import more other countries, including nearby ones like Brazil and Canada
- It is unlikely that Venezuela will quickly ramp up exports to China due to transportation and refining issues
- Chinaoil probably stores locally, sells and swaps a portion of the oil it receives from PDVSA

Venezuela's Oil Exports to China and USA*



*Continental United States

Source: PDVSA financial reports

CDB’s loans may give China’s NOCs a competitive advantage over int’l oil firms (1)

“It’s easy for Turkmenistan to make a deal with China, when China comes in and says, ‘hey, we’re going to write a check for X amount of money, we’re going to build a pipeline. That’s not a hard deal to accept, and we (the United States) can’t compete in that way.”

--Ambassador Richard Morningstar, July 2009

CDB’s loans may give Chinese oil firms a competitive advantage over int’l oil firms (2)

- Turkmenistan is one country where CDB’s EBLs have helped a Chinese oil company secure an asset attractive to int’l oil companies (IOCs)
- CDBs loans may increasingly give China’s NOCs an advantage over the IOCs because China’s NOCs are increasingly competing against IOCs

Thank You