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## **Mixed Motivations and Mixed Blessings: Chinese Investments in Southeast Asian Energy and Mineral Resources**

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### **EXECUTIVE SUMMARY**

- Multi-national energy and mining companies used to play a significant role in exploring and exploiting Southeast Asia's energy and mineral resources. Their involvement has steadily declined as larger deposits have become available for exploitation elsewhere in the world, and under more attractive fiscal and regulatory conditions. Their place is progressively being taken over by state-owned and state-backed enterprises from different Asian countries, especially China.
- Energy and mineral companies play an important part in China's economic engagement with Southeast Asia. Although Southeast Asia is not a preferred region for Chinese overseas resource investments, it offers distinct locational advantages to China's energy and mineral companies and to the government.
- Most Chinese companies undertaking the projects are wholly or partly owned by the government at either central or local levels, though private companies do engage in smaller projects. Corporate objectives include securing energy or resource supply chains, increasing or diversifying their asset base, and enhancing their profits or market share. The motivations of the government range from straightforward support of the companies for the purpose of industrial strategy and security of resource supply, to development assistance, diplomacy and regional strategic positioning.

- Chinese investment in the oil and gas sector in Southeast Asia is part of the national oil companies' strategies to build themselves into international corporations. CNPC/PetroChina has also been active in the downstream oil industry, buying into the Singapore Petroleum Corporation and building pipelines across Myanmar to bring oil and gas directly to China.
- Chinese companies have two main objectives in Southeast Asia's hydropower sector: to win construction contracts and thus sustain their businesses, given the slowing down of dam construction in China; and, in some cases, to transmit the electricity back to China. The Chinese government supports these initiatives, sometimes with financing through the state policy banks, for a mix of economic and diplomatic reasons. The highest level of activity is in Myanmar and in the Mekong River Basin (Laos and Cambodia), where hydropower resources are abundant.
- China has a large import requirement for certain categories of minerals, which determines the pattern of overseas direct investment by the nation's mining companies, including in Southeast Asia which holds significant deposits of nickel, bauxite, copper and coal.
- The rapid surge of Chinese companies to extract the resources of its neighbours in Southeast Asia has not met with unalloyed success on account of a combination of the limited international experience of Chinese enterprise and poor standards of governance on the part of the host nations. Some cases have led to disputes, project delays, financial losses and occasional violence, leading to a growing level of distrust and reputation loss for China. Such cases can also undermine trust between communities and their own governments.

*\* This article is based on a presentation made at an ISEAS Writers' Workshop on "Chinese Natural Resource Extraction in Southeast Asia: Cooperation or Conflict" held on 25-26 May 2015. **Philip Andrews-Speed** is Principal Fellow at the Energy Studies Institute of the National University of Singapore.*

## INTRODUCTION

Energy and mineral companies play an important role in China's economic engagement with Southeast Asia.<sup>1</sup> Although not a preferred region for Chinese overseas resource investments, Southeast Asia offers distinct locational advantages to these companies and to the Chinese government. Countries in the region are close to or even immediately adjacent to China and, in some cases, have political, economic and ethnic ties that date back centuries. The region as a whole has significant reserves of different forms of energy and mineral resource which Chinese companies can exploit and, in some case ship back to China, or earn revenues by providing construction and other services. In recognition of these advantages, the Catalogue guiding outward investment issued by the Chinese government in 2004 listed a number of energy and mineral resources in Southeast Asian countries.

Most of the companies are wholly or partly owned by the Chinese government at either central or local levels, though private companies do engage in smaller projects. As a result, the motivations for these activities reflect a mix of corporate and state objectives. Corporate objectives include securing energy or resource supply chains, increasing or diversifying their asset base, and enhancing their profits or market share. The motivations of the government range from straightforward support of the companies for the purpose of industrial strategy and security of resource supply, to development assistance, diplomacy and regional strategic positioning. Companies from Japan, South Korea and Russia, also with strong state connections, are following a similar path, but at a lower level of activity.

There is however a real risk that these strong strategic motivations may undermine Southeast Asia's development by failing to deliver sufficient benefits for the host nations and their peoples.

## OIL AND GAS

Chinese investment in the oil and gas sector in Southeast Asia date back to 1993, the year that China first became a net importer of oil. Between 1993 and 1995 China National Offshore Oil Corporation (CNOOC) gained a share of the Malacca oilfield in Indonesia and the China National Petroleum Corporation (CNPC), through its subsidiary PetroChina, winning blocks in Thailand and Papua New Guinea. The next phase of new acquisitions in exploration and production by China began in 2001 and continued for about ten years as CNOOC and CNPC built modest portfolios across the region, mainly in Indonesia and Myanmar. The China Petrochemical Corporation (Sinopec), Sinochem and the CITIC Group have also built up small positions. These investments are part of a strategy to build themselves into international corporations. Information on the companies' oil and gas reserves and production in Southeast Asia is not readily available. In the case of Indonesia, CNPC had by 2010 accumulated a total output of 5.8 million tonnes of oil and gas equivalent<sup>2</sup> and CNOOC had more than 15 million

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<sup>1</sup> Zhao Hong, *China's FDI into Southeast Asia*, ISEAS Perspective #08, 2013.

<sup>2</sup> CNPC. (2010). *CNPC in Indonesia*. p.13. Retrieved from:  
<http://www.cnpc.com.cn/en/cnpcworldwide/indonesia/PageAssets/Images/CNPC%20in%20Indonesia.pdf>

tonnes of oil reserves.<sup>3</sup> These numbers are nevertheless small in proportion to the total output and reserves of the companies.

Since 2009, the largest share of overseas investment by China's NOCs has been directed to North and South America, the Middle East, and Australia where the remaining reserves of oil and gas are much larger than in Southeast Asia.<sup>4</sup> Instead, the NOCs have been directing their attention at the mid-stream and downstream in this region. In 2009, PetroChina purchased a 96% share of the Singapore Petroleum Corporation (SPC). In addition to a small number of upstream assets in Indonesia, Cambodia and Vietnam, SPC has interests in oil refining, pipelines, oil storage and bunkering, and service stations. The acquisition of SPC gave PetroChina a number of advantages—it can gain access to Southeast Asian markets, learn advanced refining technology, and escape the highly regulated downstream market at home.

Of much greater significance is the involvement of CNPC in two pipelines running the length of Myanmar. In 2009, China and Myanmar agreed that the company would construct one gas and one oil pipeline from Myanmar's deep-water port of Kyauk Phyu to Kunming in China's Yunnan Province. The gas pipeline was commissioned in 2013 and carries the output from the offshore Shwe gas field, operated by Korea's Daewoo Corporation. Under the current arrangement, Myanmar can offtake 20% of the throughput which will ramp up gradually to a maximum of 20 billion cubic metres per year. The balance will flow to Yunnan. The oil pipeline was commissioned in January 2015 with an annual capacity of 20 million tonnes, and is fed with oil unloaded from tankers at Kyauk Phyu. Myanmar may tap up to 2 million tonnes per year, with the rest going to China.<sup>5</sup>

China's motivations for these two pipelines are largely strategic in nature. The gas pipeline adds to the existing routes for importing natural gas which is a key source of relatively clean energy to substitute for coal. The oil pipeline provides a marginal reduction in China's dependence on sea lanes for its oil imports and CNPC will receive feedstock for its refineries which are under construction in south-west China. Despite these gains, the pipeline projects have run into a number of controversies on social and environmental grounds. In addition, a strong feeling exists in Myanmar that the country should receive a larger share of the pipelines' throughput.<sup>6</sup>

## HYDROPOWER

Chinese companies have two main objectives in Southeast Asia's hydropower sector: to win construction contracts and thus sustain their businesses, given the slowing down of dam construction in China; and, in some cases, to gain access to the resource in order to transmit

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<sup>3</sup> CNOOC. (2010). *Key Operating Areas – Indonesia*. Retrieved from:

<http://www.cnoc.com/encnooltd/AboutUs/zygzq/Overseas/1639.shtml>

<sup>4</sup> Julie Jiang and Chen Ding, *Update on Overseas Investments by China's National Oil Companies. Achievements and Challenges since 2011*, OECD/IEA, 2014.

<sup>5</sup> Zhao Hong, *The China-Myanmar energy pipelines: risks and benefits*, ISEAS Perspective, #30 2013.

<sup>6</sup> 'China Starts Importing Natural Gas from Myanmar', *Financial Times*, 30 July 2013.

<http://www.ft.com/intl/cms/s/0/870f632c-f83e-11e2-92f0-00144feabdc0.html#axzz2uIw1LuZE>

the electricity back to China. The Chinese government is happy to support these initiatives, sometimes with financing through the state policy banks, for a mix of economic and diplomatic reasons. The highest level of activity is in continental Southeast Asia, where hydropower resources are abundant in Myanmar and in the Mekong River Basin (Laos and Cambodia). These rivers provide excellent opportunities for Chinese companies to win construction contracts, for the Chinese government to build influence in its immediate neighbourhood, and, in a few cases, for the electricity to be transmitted to China.

Myanmar has the largest number of dams with Chinese involvement. The six plants built between 1996 and 2006 played an important role in boosting national power generating capacity.<sup>7</sup> We have documented 49 dam projects with Chinese involvement, including those completed (probably 10-15 in total), under construction, planned and suspended. More than twenty of these have a scale of 500 MW or above. The largest completed dam with Chinese involvement is the Yeywa dam at 790 MW which was commissioned in 2011. In many cases, Chinese involvement is limited to construction services provided by companies such as SinoHydro. In other cases, the financing also comes from China, normally through the China EximBank or the China Development Bank. If the power is flowing back to China, enterprises in south-west China such as power generating companies provide a significant share of the funding. An example is the 600 MW Shewli-1 dam completed in 2008 that sells most of its power to China.<sup>8</sup>

As well as projects under construction with a capacity of 1,000-1,600 GW, there are a small number of very large projects with a scale of several 1,000 MW. Most of these have been suspended due to protests from local communities and wider civil society. The most notorious of these is the 6,000 MW Myitsone dam where construction work was suspended by Myanmar's government in 2011. In addition to concerns over social and environmental impact, there was rightful indignation that the previous government had agreed that 90% of the electricity generated by the dam flow to China.<sup>9</sup>

The dams built and planned in Laos and Cambodia tend to be on a smaller scale, with a few exceptions such as the Sambor dam in Cambodia and the Pay Lak dam in Laos. Both of these proposed dams have encountered opposition on social and environmental grounds and, as a result, construction had not started as of early 2015.

## MINING

Unlike the oil and gas sector, the overseas investments in mining (both coal and metallic minerals) in Southeast Asia are carried out by both SOEs and private enterprises. The SOEs

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<sup>7</sup> Toshihiro Kudo, 'Myanmar's economic relations with China: who benefits and who pays?', in Monique Skidmore and Trevor Wilson (eds.) *Dictatorship, Disorder and Decline in Myanmar*, ANU E Press, 2008, 87-112.

<sup>8</sup> Toshihiro Kudo, *China's Policy Toward Myanmar: Challenges and Prospects*, IDE-Jetro, 2012. [www.ide.go.jp/English/Research/Region/Asia/pdf/201209\\_kudo.pdf](http://www.ide.go.jp/English/Research/Region/Asia/pdf/201209_kudo.pdf)

<sup>9</sup> "The Myitsone Dam on the Irrawaddy River: A Briefing", International Rivers, 28 September 2011, <http://www.internationalrivers.org/resources/the-myitsone-dam-on-the-irrawaddy-river-a-briefing-3931>

are further categorised into central SOEs and local SOEs. Central SOEs are directly invested, and to a certain extent managed, by the central government; whereas local SOEs are organised and invested by local, mainly provincial, governments. The most prominent central SOEs are very large enterprises such as the Aluminum Corporation of China (Chinalco), the China Minmetals Corporation, the China Nonferrous Metal Mining Corporation (CNMC), the Shenhua Corporation, and the Guohua Corporation. They are also among the main Chinese companies supplying imported minerals to the domestic market. In addition to the formally established mining enterprises with officially granted mining licenses, there exists in Myanmar a poorly documented informal mining sector which targets mainly precious and semi-precious stones.<sup>10</sup>

China has a large import requirement for certain categories of minerals, and this determines the pattern of overseas direct investment by the nation's mining companies, including in Southeast Asia. These countries have significant deposits of nickel, bauxite, copper and coal, which are the main targets for Chinese investors. The increase in investment in the region's mineral resources is in line with the increase of China's overseas mining investment globally. Compared to the oil and gas sector that is generally profitable, some of the Chinese mining companies are incurring huge losses. Chinalco, for example, declared a loss of 8.2 billion yuan in its 2012 annual report. As a result these enterprises are heavily dependent on state funding through the policy banks, the China Development Bank and the China Exim Bank. This supports the contention that the mining companies are, to a certain extent, executing central government policy through their investments in Southeast Asia, both to supply resources for the domestic market and to enhance diplomatic relations.

As has been the case with oil and gas pipelines and hydro-electric dams, Chinese mining companies have been encountering challenges in their Southeast Asian operations. In Myanmar, the Letpadaung copper mine involves an investment of about US\$ 1 billion. The Chinese company Wanbao (a subsidiary of Norinco) took over the project in 2011 after Ivanhoe of Canada withdrew. Local protests arose in 2012 from perceptions that compensation has been insufficient and that measures to protect the environment were inadequate. Production was suspended later that year. Whilst the problems probably originated with Ivanhoe, the Chinese company has had to bear the legacy. A Myanmar government commission investigated the complaints and published a report in 2013 which argued that production should restart subject to certain conditions being made. Despite Wanbao taking steps to address these conditions, the violence continues, including kidnappings and shootings.<sup>11</sup>

Vietnam has rich resources of bauxite (aluminium ore) and in 2006 Chinalco signed an agreement to construct two bauxite processing plants in the central highlands, with some of the alumina to be exported to China. Two years later, opposition to these projects started to appear. The initial grounds were two-fold. First the large influx of Chinese workers was seen

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<sup>10</sup> Su-Ann Oh and Philip Andrews-Speed, *Chinese investment in Myanmar: the shifting balance of power*, ISEAS Trends, under review.

<sup>11</sup> 'Chinese miner tries to be nice', *The Economist*, 24 May 2014, <http://www.economist.com/news/business/21602719-chinese-miner-tries-be-nice-kidnapped> ; 'Protests Continue Against Letpadaung Copper Mine', *The Irrawaddy*, 19 January 2015 <http://www.irrawaddy.org/burma/protests-continue-letpadaung-copper-mine.html>

as an unwelcome intrusion by local populations and as a security threat by individuals such as retired General Vo Nguyen Giap.<sup>12</sup> There were also strong environmental objections on account of the large quantity of toxic waste produced by the refining process. More recently it has emerged that the projects have encountered technical problems and are making substantial financial losses that affect both Chinalco and its Vietnamese partner, VINACOMIN.<sup>13</sup> Despite these problems, the Vietnamese government supported the continuation of the projects, the first of which was commissioned in 2013.<sup>14</sup>

In Papua New Guinea, the Metallurgical Corporation of China (MCC) has encountered a number of obstacles in bringing its US\$ 2 billion Ramu nickel and cobalt mine into production having taken over operation of the project in 2005. The preference of both the Papuan and Chinese governments for conducting discussions at a national level precluded the involvement of local governments, land-owners and communities. Disputes have arisen over issues such as the disposal of waste and tailing, the large size of the Chinese labour force during construction, low wages paid to local workers, and land access.<sup>15</sup> These disputes delayed the commissioning of the mine to 2012. However, MCC appears to have learned many lessons and the mine was operating at 72% of its nameplate capacity at the end of 2014,<sup>16</sup> despite a violent attack on the mine by local people in August of that year.<sup>17</sup>

## CONCLUSION

Among Asian energy and resource companies, the Chinese have the largest footprint in Southeast Asia's energy and natural resource sectors. These are generally, but not always, large state-owned companies, with substantial workforces and access to generous financing. The corporate motivations vary between sectors, but the overwhelming objective is to gain access to resources either to send back to China or to boost production of the resource. Overseas investment also gives them access to international markets, technology and skills, as well as allowing them to escape domestic regulatory constraints. Although not the richest region in the world in terms of energy and mineral raw materials, Southeast Asia does have a

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<sup>12</sup> 'Bauxite bashers. The government chooses economic growth over xenophobia and greenery', *The Economist*, <http://www.economist.com/node/13527969>; Le Hong Hiep, 'The dominance of Chinese engineering contractors in Vietnam', Institute of Southeast Asian Studies, *ISEAS Perspective*, 2013 #04.

<sup>13</sup> Hunter Marston, 'Bauxite mining in Vietnam's central highlands: an arena for expanding civil society?', *Contemporary Southeast Asia*, 34 (2), 2012, 173-196; Claire Mai Colberg, *Catching Fish with Two Hands: Vietnam's Hedging Strategy Towards China*, A Thesis submitted to the Interschool Honors Program in International Security Studies, Stanford University, June 2014.

<sup>14</sup> 'Bauxite project still effective', Vietnam Business Forum, 21 April 2015, [http://vccinews.com/news\\_detail.asp?news\\_id=32009](http://vccinews.com/news_detail.asp?news_id=32009)

<sup>15</sup> Yingjie Guo, Shumei Hou, Graeme Smith and Selene Martinez-Pacheco, 'Chinese outward directed investment. Case studies of SOEs going global', in John Garrick (ed.) *Law and Policy for China's Market Socialism*, Routledge, 2012, 131-143.

<sup>16</sup> 'Ramu Nickel', Highlands Pacific corporate website, <http://www.highlandspacific.com/current-projects/ramu-nickel>

<sup>17</sup> Sonali Paul, 'China's Ramu nickel mine in PNG restarts after attacks', Reuters, 7 August 2014, <http://in.reuters.com/article/2014/08/07/papua-nickel-ramu-idINL4N0QD0GY20140807>

range of resources of interest to Chinese companies and has the advantages of geographic proximity and historic ties.

The Chinese government provides these enterprises with policy support through financial and diplomatic channels for a variety of reasons. Principally, it wants to promote the internationalisation of large SOEs, to enhance the security of supply for critical raw materials, and to use this economic engagement for diplomatic purposes. This latter objective has particular resonance in Southeast Asia, a region of particular strategic importance to China. For the host governments, the entry of Chinese companies with home government support bears the promise of resource development, infrastructure construction, fiscal revenues and, in some cases, raw material or energy supply.

This rapid surge to extract the resources of its neighbours has not met with unalloyed success on account of a combination of the limited international experience of the Chinese enterprise and poor standards of governance on the part of the host nations. A small number of notorious cases have led to disputes, project delays, financial losses and occasional violence, all leading a growing level of distrust and reputation loss for China. Such cases can also undermine trust between communities and their own governments.

From a broader perspective the increasing involvement of Asian energy and resource companies may prove a mixed blessing to Southeast Asia on account of the state-centric motivations, the lack of international experience and occasional poor operating practices. Although these enterprises bring much needed investment to the region, there is a strong risk that the strong strategic motivations undermine Southeast Asia's development by failing to deliver sufficient benefits for the host nations and their peoples.

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