מרכז אליאנס ללימודים איראניים
THE ALLIANCE CENTER FOR IRANIAN STUDIES
TEL AVIV UNIVERSITY אוניברסיטת תל אביב مرکز ایران شناسی آلیانس دانشگاه تل آویو

ACIS Iran Pulse
Updates & Overviews on Iranian Current Affairs

No. 87 December 18, 2018

Iran Cannot Rely on Chinese Energy Investments after China-U.S. Trade Détente

Micha'el Tanchum*

In the wake of December 3, 2018 truce in the U.S.-China trade war, Beijing agreed to suspend a major investment in Iran's most important natural gas field, accommodating one important aspect of Washington's sanctions program against Iran's energy industry. In return, Washington has acceded to China's continued investment in parts of Iran's oil sector to prevent Beijing from accruing major losses. China – the largest purchaser of Iranian oil – was among the eight nations in November to receive a 180-day waiver from U.S. sanctions on Iranian oil exports. In a similar post-trade war truce *quid pro* quo, Beijing made a mid-December, announcement that it would resume crude oil purchases from the U.S. at increased volumes. These events suggest that Beijing and Washington may come to a further mutual understanding in the run-up to the waiver's expiration in 2019 leading China to further limit its involvement with Iran's energy sector.

In December 2018, three Chinese executives revealed that the state-owned oil company China National Petroleum Corporation (CNPC) would suspend its investment in Iran's South Pars field, the world's largest natural gas field. CNPC's freezing its involvement in South Pars' development phase 11 is a stunning turnaround as Iran announced only on November 25th that CNPC had taken over phase 11 from the French energy giant Total. Two months earlier, Total had informed Tehran that it would withdraw from the South Pars project after it failed to obtain a sanctions waiver from Washington. CNPC's suspension is a powerful blow to Tehran's efforts to maintain financing for Iran's flagship energy project, with negative effects on Tehran's ability to attract and retain financing for all of its hydrocarbon development projects. Because Iran needs to inject gas into its maturing oil fields to ensure continued oil recovery, a slowdown in Iran's natural gas output can negatively impact Iran's ability to produce and export oil.

In a seemingly reciprocal gesture, the U.S. agreed to accommodate CNPC's need to continue investments in Iran's North Azadegan and Masjed Soleyman oil fields in order to recover its multi-billion dollar investments under buy-back contracts signed with Iran several years earlier. The only form of contract Iran offered to international oil companies (IOCs) prior to the JCPOA, the unattractive buy-back contracts allowed an IOC to invest in the development of a field on condition that it would then hand over the field to Iran's National Oil Company or one of its subsidiaries. The IOC recoups its investment and receives an agreed upon profit from the oil revenues derived from the field's production, on condition that benchmark prices are sufficiently high. Iran's North Azadegan field began production in 2016 and produces approximately 80,000 barrels per day of crude oil. Without CNPC's engineering work and production equipment, Tehran will be challenged to maintain oil output resulting in multi-billion dollar losses for CNPC.

The preservation of Chinese involvement in the North Azadegan field constitutes a significant boost for Iran's overall oil output, as the Azadegan field is one of Iran's largest oil finds in the past thirty years and contains an estimated 5.2 billion barrels of recoverable reserves. Because of China's rights to the production in the North Azadegan field, the oil received from it, and from similar fields in which China owns a stake, will probably not be counted in the 360,000 bpd allotted to China under the sanctions waiver.

However, China's North Azadegan operations do not necessarily indicate a desire on Beijing's part to completely thwart U.S. sanctions against Iranian oil. China's oil policy is driven by an imperative to ensure its security of supply above all other factors. From January to September 2018, China's imports from Iran averaged 631,556 bpd. Even with additional oil imports because of Chinese investment in Iranian fields that will raise China's imports above the 360,000 bpd limit, China will still face a shortfall that needs to be filled.

In this regard, the reliability of the U.S. as a supplier of crude oil to China forms one of the important considerations in Beijing's approach to U.S. sanctions on Iran. Thus, the mid-December announcement by Unipec that it would resume purchases of U.S. crude oil in "significant volumes" impacts Beijing's calculus concerning its oil imports from Iran. The trading arm of China's Sinopec, the world's largest oil refiner, had been buying U.S. crude oil in record volumes prior to its suspension of U.S. crude oil imports in August 2018. In June 2018, the U.S. crude oil exports to China reached a new one-month high of 510,000 barrels per day (bpd). According to Chinese customs data, U.S. oil exports to China during the period of January to September increased 155% year-on-year, averaging 326,000 bpd and worth approximately $6.74 billion. As a result of the U.S.-China trade war with its threats of new tariffs, U.S. oil exports to China fell to zero in October 2018. The resumption of Chinese imports of U.S. oil in 2019 could ease the way for Beijing to curtail its consumption of Iranian oil.

To replace Iran's exports to China, the U.S. and its Gulf partners will also have to counter the heavy discounts Tehran has offered to Chinese buyers to preserve Iran's position in China's oil market. For November and December, Iranian Heavy crude sold to China has been priced $1.25 per barrel lower than Saudi Arabia's Arab Medium grade, a discount not offered since 2004.

While it is possible that China will limits its purchases of Iranian oil and continue to limit its investments in Iran's energy sector, China will likely continue to expand its infrastructure investments in Iran in other sectors. The decline in the Iranian economy as a result of energy sanctions will enable China to acquire stakes in Iranian assets at bargain-basement prices. Already during the two years since sanctions were lifted under the JCPOA, large volumes of Chinese capital have flowed into Iran to fund a wide variety infrastructure development projects. Beijing now has plans to invest up to $25 billion in Chinese-led projects in Iran. In mid-September 2018, China's state-owned investment firm CITIC group, a global Fortune 500 company, opened at $10 billion credit line for investments in Iran. Concurrently, the Iranian state news agency IRNA reported that the China Development Bank signed a memorandum of understanding to extend upward of $15 billion for development projects in Iran.

China's non-oil investments in Iran constitute one of the factors that led China's Kunlun Bank to resume transactions with Iran on December 10. Kunlun Bank, of which CNPC is the majority stakeholder, was originally created to shield China's imports of Iranian oil from U.S. secondary sanctions during the previous U.S.-led sanctions regime. It remains the institution responsible for the plurality of China's financial transactions with Iran. On November 1, 2018, just days prior to re-imposition of U.S. oil sanctions, Kunlun announced it would stop processing transactions with Iran. Following the U.S. granting China a waiver for Iranian oil imports and agreeing to a truce in its trade war with Beijing, Kunlun Bank decided to reverse its policy. The Iran-China Chamber of Commerce informed the Iranian press that an unspecified volume of trade between Iran and China will resume via Kunlun Bank.

Even with U.S. sanctions, China will not withdraw its commercial interests in Iran and will likely seek to aggressively expand them. Iran constitutes a key component in China's Belt and Road Initiative as Beijing seeks to orient Eurasian commercial connectivity, both overland and maritime, to serve China's economic interests. Within this framework, Beijing can tolerate a weakening of Iran's energy sector, as long as the security of China's own oil and natural gas supplies are ensured by affordable and reliable alternative suppliers. The recent reciprocal measures between Beijing and Washington concerning Iran's South Pars gas field and its North Azadegan oil field along with Washington's waiver for China's Iranian oil imports and Beijing's resumed purchasing of U.S. crude oil all indicate that China is amenable to partially accommodating U.S. energy sanctions against Iran under the right conditions. With the possibility of Beijing and Washington arriving at a greater consensus prior to the current waiver's expiration in 2019, Tehran can no longer comfortably rely on China to financially underwrite the expanded development of Iran's oil and natural gas sectors.

---

*Dr. Micha'el Tanchum is a Fellow at the Truman Research Institute for the Advancement of Peace, Hebrew University and non-resident, affiliated scholar with the Center for Strategic Studies at Başkent University in Ankara, Turkey (Başkent-SAM).

The Alliance Center for Iranian Studies (ACIS)
Tel Aviv University, Ramat-Aviv 61390, Tel Aviv P.O.B. 39040, Israel
Email: IranCen@tauex.tau.ac.il, Phone: +972-3-640-9510
Fax: +972-3-640-6665
Iran Pulse No. 87 • December 18, 2018