The Phantom Menace: The Rise of China's State-owned Monopolies

Wonho Yeon

Ph.D., Associate Research Fellow, China Team
Korea Institute for International Economic Policy

The first episode of the blockbuster movie Star Wars is called "The Phantom Menace" - titled so because of the chancellor of the galactic republic hiding his true identity as an evil villain behind the face of a devoted public servant. Maybe we are living in the world of another type of phantom menace.

There is a group of giant firms with a little reputation outside China are quietly taking a dominant lead globally in some particular industries: energy and utilities. As we saw in the Huawei incident, the West's attention is now all taken up by China's ICT security threats. However, the real threat might lie in these China's state-owned companies arising as the worldwide monopolies of the future.

In 2010, there were 49 Chinese companies on the Fortune Global 500 list. In the most recent list, China is now home to 129 enterprises and about 85% of these are state-owned. Among the top five, three are Chinese companies: energy giants Sinopec Group (ranked second), China National Petroleum Corporation (CNPC, ranked fourth), and utility colossus State Grid (ranked fifth). Considering that none of them were listed in the world's top 65 companies just 15 years ago, their explosive growth suggests that we will probably hear a lot more about them in years to come.

Interestingly, these three gigantic Chinese firms are all 1) state-owned and 2) energy-related companies. In China under the leadership of Xi Jinping, there has been a reversion to a more statist stance toward economic policy, with a more consolidated Communist Party role and greater weight placed on state-owned enterprises (SOEs). SOEs are not only important economic players but also a firmly established part of the political system. They are strategic instruments and at the heart of Xi Jinping's approach to China's development and international ambitions.

China's state-owned firms have been able to generate record revenues and profits because of favorable legislations, protective regulations, and unlimited access to inexpensive financing, as well as relatively high growth in the domestic market. The Chinese government has been committed to making SOEs bigger, stronger, and more efficient. Moreover, this is particularly relevant to certain strategic sectors including energy and utilities. Thanks to the strategic support of the government and ample financial firepower, China's state-backed companies have been able to widely invest in foreign companies in these sectors.

According to China's Ministry of Commerce (MOFCOM), China has invested a total of $1,171 billion in outward foreign investment from 2005 to July 2019. Among these investments, the most money by a wide margin was invested in the energy and power sector ($379 billion), while technology investment only accounts for $62 billion.

Why has China strategically invested in the energy sector? Probably the major reason is because we are and will be living in the era of ABC: A.I., Big Data, and Cloud Computing. In the world of ABC, the data center is the key infrastructure that uses large amounts of energy. Global data centers are already the largest consumers of electricity, which store our information on the cloud, process it, and communicate data in almost every industry in the world. In 2018, data centers in the world used about 200 billion kilowatt-hours of electricity, according to a report by the International Energy Agency (IEA). That is more than the yearly national energy consumption of Spain. In particular, all data centers in the U.S. make up approximately 2 percent of total U.S. electricity consumption. According to a report by the National Resources Defense Council, U.S. data centers are expected to consume 140 billion kilowatt-hours of energy by 2020. That is equivalent to the annual output of 50 giant (500 megawatts) coal-powered power plants. The world-renowned science journal Nature expects data-center electricity consumption is likely to surge to 3,000 billion kilowatts by 2030. Many experts even warn that the coming explosion in need for data storage, network, and electricity may simply prove impossible to meet on Earth.

Coming back to China's SOEs, Sinopec and CNPC are the world's two largest oil and gas companies. Sinopec had revenues of $414 billion and CNPC had revenues of $393 billion in 2018. Sinopec owns companies of various nationalities that run oil fields all over the world from Africa, Middle East, South Asia to South and North America. By the end of 2017, Sinopec owned 50 oil and gas exploration and production projects in 26 countries and it is currently operating in 65 countries. CNPC, meanwhile, has been building an unrivaled energy empire in countries that have challenging business conditions: it operates in Afghanistan, Chad, Iran, Iraq, Niger, South Sudan, Syria, Turkmenistan, and Venezuela among other nations. This April CNPC also invested in Russian Novatek's new project of developing Arctic natural gas worth $4 billion.

In addition, State Grid is the world's largest utility firm, which has annual revenues of $387 billion. This is equivalent to Singapore's or Israel's GDP and more than the combined revenues of the next five largest global utilities firms. State Grid also owns and operates a growing portfolio of assets around the world: it bought Brazil's second-largest utility firm, CPFL Energia, and signed to run the Philippines' national grid TransCo until 2058. It also has significant shares in major Australian, Greek, Italian, and Portuguese utility firms.

Some experts argue that the global expansion of China's energy SOEs is just a part of its Belt and Road Initiative (BRI). However, we should understand that the reasons probably run deeper than that. One thing I can confidently conclude is that this expansion is linked to the new ABC era, technological innovation, and China's long-term global strategy beyond BRI. One piece of evidence is, among China's gigantic outward foreign investment, its investment in BRI countries is minor compared to its investment in the developed countries. Since Xi Jinping announced China's BRI project in late 2013, the top 10 investment recipients have attracted a total of $418 billion. Among the top 10 investment recipients only two are BRI members and none in the top five. Only about 10% of $418 billion went to these BRI countries (Singapore: $25 billion, Italy: $21 billion). The U.S. ($123 billion) hosted the most Chinese investment, which was followed by the U.K. ($60 billion), Switzerland ($53 billion), Australia ($37 billion), Brazil ($30 billion), France ($17 billion), and Canada ($16 billion).

As Lee Kuan Yew predicted in his memoirs, now we are facing a moment when China has enough weight to project its influence into the region and moreover into the world using its economic and military power. Everyone is keeping a close watch on China making its fateful choice: whether to become a global hegemon or to remain as a good global citizen. Will the rise of China's SOEs be the menace of reality or the menace of unreality? Will China be exposed as a phantom hiding behind the false facade or emerge as a genuine public leader?

Even amid the current U.S.-China confrontation, another rapidly growing Chinese state-owned oil and gas company China Energy Investment is trying to sign a contract worth $84 billion to develop a natural gas field in West Virginia, U.S.A. which is even larger than West Virginia's GDP in 2017 of $75 billion.