Statement before the U.S. Senate Energy and Natural Resources Committee

Hearing on the Important Role of U.S. LNG in Evolving Global Markets

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Chairman Murkowski, Ranking Member Manchin, and distinguished Members of the Energy and Natural Resources Committee, thank you for the opportunity to testify before you today.

As you know, some analysts believe there is tremendous potential for U.S.-China natural gas trade. They argue that exporting U.S. liquefied natural gas (LNG) to China will help rebalance the U.S.-China trade deficit, generate American jobs, and help China transition away from coal. I am here to share a different view. Arguments calling for the United States to export large amounts of LNG to China reflect deep misunderstandings about the global LNG market. They also reflect a deep misunderstanding about China's own national interests and how Beijing seeks to position China in global energy markets.

The market fundamentals are clear: there is no strong commercial business case for exporting large quantities of U.S. LNG to China. To be sure, in the near term, if China leverages natural gas to replace high-emission coal as a bridge to eliminate net greenhouse gas emissions altogether, that would be a positive development. However, China would not need access to U.S. LNG to do so—it is already receiving imports from 25 other nations, most of which are cheaper than the shipments they receive from the United States.

From a Chinese perspective, a high-volume U.S. LNG purchase is not a wise commercial move, but it could be a brilliant diplomatic move. Beijing is using an array of industrial policies to siphon off U.S. technical know-how, privilege Chinese firms in global markets, and move China up the global value chain. Those policies undermine U.S. economic security and generate U.S.-China trade frictions. Beijing is looking for ways to ease the frictions without giving up its problematic industrial policies. If China can leverage LNG purchases to do so, that will be a massive strategic victory for Beijing. If Chinese representatives offer to pay a price premium for U.S. natural gas, Americans should pay close attention to what Beijing expects to receive in return.

My testimony will cover four main points:

1. Transporting U.S. LNG to China is prohibitively expensive.
2. Long-term Chinese investments in U.S. natural gas projects are out of step with the global LNG market and risk undermining U.S. national security.
3. China's long-term energy goals will reduce natural gas imports.
4. If Chinese leaders use state funds to pay a price premium for U.S. LNG, they will expect something in return.

(1) Transporting U.S. LNG to China is prohibitively expensive.

China imports natural gas from 26 nations via a combination of overland pipelines and seaborne (LNG) tankers. LNG currently accounts for around 60 percent of China's total natural gas imports. Australian LNG is highly competitive in China due to the relatively short distance from Darwin to China's eastern seaboard, which keeps tanker transport costs low. Australia is China's largest LNG supplier: it provided 41 percent of China's total LNG imports in the first quarter of 2019. Imports from Southeast Asian nations—which also benefit from short transport distances—accounted for 18.6 percent. Imports from Qatar accounted for 16.9 percent.

From a Chinese perspective, importing LNG from the United States generally is not commercially attractive. U.S. production costs are relatively low, but transport costs from the U.S. Gulf Coast ratchet up the price beyond what China would pay for comparable shipments from Australia and other close-in exporters. When transporting natural gas to Shanghai, tankers from the U.S. Gulf Coast travel 10 days longer than tankers from Qatar and 15 days longer than tankers from Western Australia. As a result, shipping costs from the U.S. Gulf Coast to China are twice the shipping costs from Qatar and almost three times the costs from Australia.

Houston-based Cheniere Energy has a unique business model that is shipping limited amounts of LNG to China from its Sabine Pass liquefaction facility. Those small-volume shipments can meet targeted Chinese demand needs, but scaling them up to a high-volume export relationship does not make commercial sense. Based on 2017 pricing, China's seaborne LNG imports from the United States are more expensive than 73.8 percent of its seaborne LNG imports from other nations. U.S. LNG has a better comparative advantage in markets that are located closer to the U.S. Gulf Coast.

The market fundamentals are clear: The United States does not have a natural comparative advantage in China's natural gas supply chain. If Chinese entities import large quantities of LNG from the United States, they will be paying a price premium to do so. That raises questions about the potential political intentions behind those purchases.

(2) Long-term Chinese investments in U.S. natural gas projects are out of step with the global LNG market and risk undermining U.S. national security.

The most bullish analyses of potential U.S. LNG exports to China are hoping for long-term infrastructure investment deals. With this business model, the buyer agrees to invest in production infrastructure and, in return, gains access to the natural gas the project produces at a set price over 10- to 20-year time

horizons. Since prices can shift substantially over a decade and the upfront capital costs are spread out over a long time frame, this approach can make sense even when current price alignments are less than favorable.

Beijing has demonstrated an interest in making long-term investments in West Virginia and Alaska. When President Trump visited Beijing in November 2017, the two presidents oversaw the signing of a preliminary agreement between Alaska and three Chinese state-owned enterprises—China Petrochemical Corp (Sinopec), China Investment Corp (China's sovereign wealth fund), and Bank of China—in which the Chinese firms would bankroll Alaskan pipeline infrastructure in exchange for guaranteed access to 75 percent of the gas produced over the duration of the project. That same trip produced a memorandum of understanding between state-owned China Energy Investment Corporation and West Virginia. The West Virginia deal is particularly light on details, but some local leaders are hoping China Energy Investment Corp. will invest around $83 billion in a suite of natural gas projects ranging from power stations to petrochemical plants.

Those deals are a concern for two reasons. First, even if Beijing's intentions are pure, long-term investments are out of step with current market trends. Global LNG markets are shifting from oil-linked to hub-based pricing, and that is making long-term contracts less attractive. Natural gas infrastructure is also evolving. Technical innovations are making it possible to deploy cheaper and more flexible floating import and export terminals, which reduce the need for massive fixed-infrastructure investments. As more floating terminals come online, they are reshaping the global market. Nations keen to either buy or sell LNG in relatively small amounts—amounts that do not justify sinking billions into fixed infrastructure—can do so more cheaply using floating units. A rush of smaller buyers and sellers can have as big or more of an impact as the movements of one big player such as China. Between 2014 and 2017, 12 countries, taken together, drove more demand growth than China, and floating import terminals enabled three-quarters of that growth.

Second, the United States cannot assume Beijing's intentions are pure. Chinese state-owned enterprises, including oil majors, answer to the Chinese Communist Party. Those firms are tools of the state and behave accordingly. If those firms obtain massive shares in U.S. natural resources—large enough to potentially control how those resources are used and effectively bankroll the state and local economies in which they operate—that raises important questions about how that might affect U.S. national security. If those deals move forward, the Chinese Communist Party will have tremendous leverage over local economies in two great American states. In future, Beijing could seek to use that leverage to deter the United States from taking actions to protect its own national interests vis-à-vis China.

(3) China's long-term energy goals will reduce natural gas imports.

The U.S. Energy Information Administration estimates that China may have as much or more shale gas than the United States. Development has been sluggish, but Beijing is hoping to change that. The barriers are largely political: Beijing currently allows state-owned enterprises to dominate the sector, and state control inhibits market activity and technical innovation.

Going forward, if Chinese leaders get serious about reform, the next unconventional gas revolution could occur in China. China is already the third-largest global shale gas producer behind the United States and Canada. U.S. natural gas exporters should take China's production potential into account—and Beijing's growing determination to unlock that potential—when making investment decisions that hinge on a continued rise in Chinese import demand.

Chinese natural gas demand may also fall in time if it transitions to clean energy in order to eliminate net greenhouse gas emissions, as the Intergovernmental Panel on Climate Change has recommended.

(4) If Chinese leaders use state funds to pay a price premium for U.S. LNG, they will expect something in return.

China does not need U.S. LNG. It already has access to imports from at least 25 other nations, most of which are cheaper than what they pay for U.S. imports. Over the longer-term, Beijing does not want China to depend on LNG imports from the United States or any other nation—it wants China to produce its own energy supplies, just like the United States does today.

Beijing also wants continued U.S.-China economic integration on terms that allow China to continue tilting the playing field in its favor, boosting its own economic competitiveness at U.S. expense. Chinese leaders have already demonstrated that they are willing to devote trillions of dollars in state capital to achieve their economic goals. The United States should not be surprised to see some of that capital directed toward the U.S. natural gas sector.

When dealing with a non-market economy, it is critical to understand the exact terms of the deal being offered, as those terms often extend beyond the commercial sphere. If Beijing offers to pay a price premium for U.S. LNG—or invest billions of dollars in U.S. natural gas development projects—Americans must understand what they are giving China in return. At a bare minimum, even if Beijing's intentions are pure, those deals would increase U.S. economic dependence on China at a time when that dependence brings growing risks. U.S. states, companies, workers and families whose livelihoods depend on LNG shipments to China or Chinese investments in local natural gas projects could find themselves in the same position many American soybean farmers are in today.

The United States should think twice before needlessly deepening our economic dependence on our biggest competitor. If China is offering a deal that would also require the United States to back down on core trade complaints—or any other critical U.S. national interests—that deal could undermine U.S. economic security for decades to come.

Thank you and I look forward to your questions.