

The London School of Economics and Political Science

China's Oil Diplomacy:
Comparing Chinese Economic Statecraft in Angola and Brazil

Ana Cristina Alves

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DECLARATION

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ABSTRACT

This thesis aims to investigate the reasons for the variation in China's oil diplomacy performance in Africa and South America in the period 2000-2010. Lacking sound experience in pursuing oil security overseas and enjoying strong financial muscle, China's oil diplomacy is largely rooted in the extension of soft loans for infrastructure to oil-rich countries in exchange for steady oil supply and favoured access to oil acreage. Taking Angola and Brazil as case studies this thesis argues that differences in the institutional structure of the oil industry in each country, determined different outcomes regarding Beijing's oil security goals. This thesis has found that although this template fitted well with the more centralised institutional environment in Angola, it was highly unsuitable for the more liberal and regulated Brazil setting. Furthermore, the advent of the recent global economic crisis (2008-2009) caused China to adjust its approach to the institutional particulars of Brazil becoming more efficient in that country regarding its oil security goals.

Building on foreign policy analysis tools and concepts, an empirical analysis of the interplay between Chinese infrastructure-for-oil loans (hereby regarded as positive economic statecraft) and the institutional structure it met in each country, is presented. Through the case studies, this thesis aims to uncover to what extent the institutional context constrained Chinese oil diplomacy efficiency in Brazil for most of the past decade, and how innovation has surfaced in the context of the global financial crisis. This analysis thus gives interesting insights not only into the dynamics of China's oil diplomacy in Africa and South America, but also into Chinese economic statecraft in general and how constraints that surface at the implementation level feedback into foreign policy formulation.

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LIST OF ACRONYMS AND ABBREVIATIONS

ANIP	Angolan National Agency for Private Investment (Portuguese acronym)
ANP	National Oil Agency, Brazil (Portuguese acronym)
APEX	Export and Investment Agency, Brazil (Portuguese acronym)
bn	Billions
BNDES	Brazil National Development Bank (Portuguese acronym)
boe	Barrels of oil equivalent
bpd	Barrels per day
CADF	China Africa Development Fund
CDB	China Development Bank
CEBC	Brazil China Business Council (Portuguese acronym)
CEO	Chief Executive Officer
CFA	Central Foreign Affairs - LSG, China
CFP	Chinese Foreign Policy
CIC	Chinese Investment Corporation
CIF	China International Fund
CIS	Commonwealth of Independent States
CITIC	China International Trust and Investment Corporation
CNF	China Non-ferrous Metals Mining Co.
CNI	Industrial National Confederation, Brazil (Portuguese acronym)
CNOOC	China National Offshore Oil Corporation
CNP	National Council for Petroleum, Brazil (Portuguese acronym)
CNPC	China National Petroleum Corporation
CNPE	National Council for Energy Policy, Brazil (Portuguese acronym)
CSIH	China Sonangol International Holding (China-Sonangol)
DPNM	National Department of Mineral Production, Brazil (Portuguese acronym)
DRC	Democratic Republic of Congo
E&P	Oil exploration and production activities
EBX	Eike Batista Group, Brazil
ELG	Energy Leading Group, China

EPC	Engineering Procurement and Construction contract
EU	European Union
EXIM Bank	Export Import Bank of China
FDI	Foreign Direct Investment
FLEC	Front for the Liberation of the Cabinda Enclave
FNLA	National Front for the Liberation of Angola
FOCAC	Forum of China Africa Cooperation
FPA	Foreign Policy Analysis
FTA	Free Trade Area
Gasene	Southeast-Northwest Interconnection Gas Pipeline, Brazil
GRN	National Reconstruction Office, Angola
IADB	Inter-American Development Bank
IBAMA	Brazilian Institute for Environment and Natural Renewable Resources
ICBC	Industrial and Commercial Bank of China
IMF	International Monetary Fund
IOC	International Oil Company
IR	International Relations
LA	Latin America
LLX	Logistics arm EBX Group, Brazil
LSG	Leading Small Group, China
MAPA	Ministry of Agriculture, Brazil (Portuguese acronym)
MDIC	Ministry of Development Industry and Commerce, Brazil
Mercosur	Southern Common Market, South America
MINFIN	Ministry of Finance, Angola
MINPET	Ministry of Petroleum, Angola
MMX	Mining arm EBX group, Brazil
mn	Millions
MNC	Multinational Corporation
MNE	Ministry of Mining and Energy, Brazil (Portuguese acronym)
MOF	Ministry of Finance, China
MOFA	Ministry of Foreign Affairs, China
MOFCOM	Ministry of Commerce, China
MoU	Memorandum of Understanding

MPLA	Mouvement for the Liberation of Angola (Portuguese acronym), ruling party
MRE	Ministry of Foreign Affairs, Brazil (Portuguese acronym)
NDRC	National Development and Reform Commission, China
NEA	National Energy Administration, China
NEC	National Energy Commission, China
NGO	Non-governmental Organisation
NOC	National Oil Company
OFDI	Outward Foreign Direct Investment
OGX	Hydrocarbons arm EBX Group, Brazil
ONGC	Oil and Natural Gas Corporation, India
OPEC	Organisation of Petroleum Exporting Countries
PAC	Programme to Accelerate Growth, Brazil
PDVSA	Petroleos de Venezuela -Venezuelan NOC
Petrobras	Petroleo Brasileiro S.A. (Brazil NOC)
Petrosal	Pre-sal Petroleo S.A., (Brazil pre-salt NOC)
PRC	People's Republic of China
PSA	Partnership Sharing Agreement
SB	Signature Bonus
SGMB	Geological and Minerals Survey Office, Brazil (Portuguese acronym)
Sinopec	China Petrochemical Corporation (Sinopec Group)
Sinosure	China Export and Credit Insurance Corporation
SOE	State Owned Enterprise
Sonangol	Sociedade Nacional de Combustiveis de Angola-Angolan NOC (Portuguese acronym)
SOOG	Sinopec Overseas Oil & Gas
SSI	Sonangol Sinopec International
UNIPEC	China International United Petroleum & Chemicals Co. Ltd. (Sinopec Group)
UNITA	National Union for the Total Independence of Angola
US	United States of America
WB	World Bank
WISCO	Wuhan Iron and Steel Company, China

CHAPTER 1: INTRODUCTION

1.1. Summary

China's rise on the world stage is a direct consequence of its massive economic growth over the past three decades. During this process, the regime's legitimacy became gradually bounded to the sustainability of this growth pace. As a consequence, economic development became central not only to domestic policy making, but also to foreign policy formulation, and overriding to a great extent ideological and political concerns. Within this framework the quest for mineral resources has naturally surfaced as a major driver in Chinese foreign policy, since the major reliance on these external resources has threatened China's continued economic growth. This critical concern has become particularly evident in China's growing economic interaction with developing regions, where these resources abound.

This thesis focuses on the dimension of Chinese foreign policy that concerns its resources diplomacy in developing regions. Over the past decade China has extended numerous large soft loans to developing countries, through which it has secured steady supply and access to resources assets. Even though the bulk of these loans were earmarked for infrastructure, they targeted mainly resource rich countries and are in most cases to be repaid in kind. These types of loans have been more frequently extended to oil-rich countries. This is why they came to be known as 'infrastructure-for-oil loans', also often referred to as the 'Angola mode', since the first deal of this kind was signed with Luanda in 2004. This thesis will focus on this type of loan, and will examine the performance of China's oil diplomacy in Africa and South America. This analysis is inspired by a puzzling reality over the past decade. Although apparently associated with the same conditions, namely rich endowment of resources and a great need of infrastructure development, the extension of generous credit lines for infrastructure have been much more successful in pursuing China's energy security goals in Africa than in South America.

Despite being a widely acknowledge paradox, there is no scholarly work offering a systematic explanation based on empirical evidence, regarding the divide in terms of regional outcomes relating to the success of China's oil diplomacy. Although some possible explanations regarding what drives Chinese resources investment can be found scattered in the literature (mostly untested), little has been written on what determines outcomes.

The present research thus proposes to do an empirical examination to help clarify the reasons behind the outcome variation of ‘infrastructure-for-oil’ deals in Africa and South America. In order to do so, the study will present a comparative analysis of the performance of these types of loans in these two regions over the period 2000-2010. The comparison will be based on two case studies, one in each region (Angola and Brazil). The underlying argument is that the regional variation in terms of China’s energy security outcomes is explained by a structural difference in the institutional framework of each region. Although this foreign policy instrument proved to be appropriate in the African context, it was unsuitable for the much more liberalised environment that characterises South America.

In order to pursue the proposed research, this thesis will use foreign policy analysis concepts and tools. The emphasis will be on foreign policy implementation, rather than on policy making, as the object of study is the outcome of a specific policy and not its content. In this framework particular attention is given to: the role of positive economic statecraft as a foreign policy instrument, as Chinese soft loans fall within the category of economic incentives; and the interplay between instrument and target context (institutional framework).

Through this empirical research the candidate aspires to make a valid contribution to the field of Chinese foreign policy, by: a) looking at a often neglected segment which regards the implementation phase; b) adding to the scant research on China’s oil diplomacy in developing regions; and c) providing a pioneering empirical comparison bridging two of the most targeted regions in that regard (Africa and South America). Last, but not least, this study proposes to add to the limited research in the field of positive economic statecraft, as an effective instrument of foreign policy implementation.

1.2. Setting the context

1.2.1. China’s rise at the world stage

The rise of China as a key economic player on the world stage is perhaps the most single important shift that has taken place in the international system since the end of the Cold War. The economic reforms initiated in the late 1970s by Deng Xiaoping, led to three decades of sustained two-digit economic growth, which transformed a rural and locked country into the second largest world economy.

China’s accession to the WTO in 2001 played a key role in pushing its economy from a regional to a global level. From sixth position in the 2005 global ranking, China became the third largest economy (by nominal GDP) in 2007, overtaking on its way France, the UK and Germany. Important shifts in the world market can be increasingly traced back to China. The sharp rise in commodities’ value, the decline in

manufacturers' prices, the decreasing trend in wages, and growing unemployment in the sector around the world, are just the tip of the iceberg.

The onset of the global financial crisis in 2008 that was particularly harmful in developed countries propelled China's economy even further. In 2009 China became the world's largest exporter (surpassing Germany), and in 2010 the second largest economy (nominal GDP US\$5.9 trillion) after the US (US\$14.7 trillion), accounting for nearly 9% of global GDP.¹ Most estimates project China's nominal output to surpass that of the US around 2020,² while some project that in purchasing power parity (PPP) terms, the big shift will take place in 2012.³

China's escalating economic might and unique political and social synergies, have over the past decade been fuelling a debate on the feasibility of a seismic geopolitical shift in the international system. Academic discussions have been set around two major questions: whether China is on track to become the next superpower, and if so, what kind of superpower it will be.

Regarding the question of whether China is on track to become the next superpower, many have questioned whether China's economic ascendancy will automatically lead to its rise to superpower status. Gerald Segal was among the first to express his doubts in the late 1990s,⁴ and downplayed China's economic, military and political might on the global stage. Many others added to this view throughout the 2000s, emphasising that China still faces many challenges domestically, and has shortcomings at the global stage (military, scientific and technological capacity)⁵. In addition it has been stated that China still lacks a 'grand strategy',⁶ and therefore it has a long way to go before it can achieve 'great power' status and defy the existing super power, the US. Adding to this, Shaun Breslin argues that 'Western perceptions

¹ Data according to IMF, World Economic Outlook Database, April 2011, available online at: <http://www.imf.org/external/pubs/ft/weo/2011/01/weodata/download.aspx> (accessed 3 May 2011)

² John Ross, "Even optimists underestimated China's growth", China.org.cn, 30 January 2011, available online at: http://www.china.org.cn/opinion/2011-01/30/content_21843443.htm (Accessed 5 May 2011)

³ Conference Board, "Global Economic Outlook 2011", available online at: <http://www.conference-board.org/data/globaloutlook.cfm> (Accessed 5 May 2011)

⁴ Gerald Segal, "Does China Matter" *Foreign Affairs* 78:5, 1999, p. 24.

⁵ Articles on the subject gathered in: Barry Buzan and Rosemary Foot (eds.), *Does China Matter? A Reassessment* (London: Taylor and Francis, 2004).

⁶ Wang Jisi, "China's search for a grand strategy: a rising power finds its way" *Foreign Affairs* 90:2, 2011, pp. 68-79.

on China often exaggerate its wealth and power and this perceived power actually implies a real political leverage to the advantage of Beijing at the present stage'.⁷

On the other hand, China's increasing military expenditure and ventures in non-traditional regions, raise concerns about the nature of its ascendance on the world stage and the degree of China's 'socialization' into dominant normative underpinnings of the international system. This has inspired a significant number of studies in International Relations (IR) literature on China, most of which can be condensed in the classic realist dilemma: is China a *status quo* or a revisionist power? Iain Johnston's review of the existing literature concludes that although Beijing's engagement with the international community is consistent with greater compliance, it is hard to determine whether China has internalised the norms, principles and values that sustain the current *status quo*.⁸ Conscious of these debates and weary of its image abroad, China has come up with the concept of 'peaceful development' as a means to ward off any fears related to its economic rise on the world stage.⁹

Notwithstanding the relevance of these debates, it is not the aim of this thesis to engage further in these discussions, since it only serves the purpose of setting the broad academic context. Regardless of an immediate or still distant reality and the nature of its ascendance, the important fact for the present thesis, is that China's economic rise on the world stage has broadened the scope and caused seismic shifts in Beijing's foreign policy.

1.2.2. The primacy of energy security concerns

In tandem with a dramatic economic growth path, China's economic reforms also set in motion an irreversible opening up process that gradually buried Mao's dream of a socialist and self-reliant People's Republic of China. The fast expanding industrial base and urban population, led to escalating domestic demand for power and mobility that exhausted most of China's natural resources, and fuelled an ever-growing external reliance on fossil fuels and strategic minerals.

China has staged the world's fastest energy consumption growth rate over the past decade. While its primary energy consumption only expanded 27% between 1990 and 1999, it has more than doubled in the

⁷ Shaun Breslin, "Constructing visions of China: theories and purposes and interests", paper presented at: China in the Eyes of World Intellectuals: Perception and Image, II World Forum on Chinese Studies, China Academy of Social Sciences, Shanghai, September 2006.

⁸ A.I. Johnston, "Is China a Status quo power?" *International Security* 27:4, 2003, pp. 5-56; A.I. Johnston, "Trends in Theory and Method in the Study of Chinese Foreign Policy", paper presented at: Conference on China Studies, 50th Anniversary of the Fairbank Center for East Asian Research, December 2005 (revised version, February 2006).

⁹ For an analysis of this topic see: Chris Hughes, "The Global economy and China's peaceful development" *Daxiyangguo: Revista Portuguesa de Estudos Asiaticos* 2008, pp. 77-92.

period 2000-2009.¹⁰ Although China was already then the world's second largest consumer of primary energy,¹¹ in 2000 its consumption was below half of that of the US, the world largest consumer for nearly a century. Less than a decade later, in 2009, figures were neck and neck (US: 2.182 million tons of oil equivalent; China: 2.177 million tons of oil equivalent), each representing nearly 20% of global energy consumption.¹² Data advanced by the Paris-based International Energy Agency, claim that China has surpassed the US in 2010, owing to slowing American industrial activity and energy use in the context of the economic crisis.¹³

As of 2009, fossil fuels (coal, natural gas and oil) represented 93% of China's primary energy consumption. Although coal (used for power generation) accounts for the lion's share (71%), it is oil (19% - mostly for industrial and transportation purposes) that represents China's largest external reliance.¹⁴ While China's coal reserves and production allow it to be self sufficient¹⁵ (also the case with hydroelectric power), China's oil production has become largely insufficient to provide for its growing domestic needs.

In a relatively short time, China went from self sufficient (up to 1993), to the second largest world oil consumer (2003) and importer (2009) after the US. Despite being the world's fifth largest oil producer, its oil output in 2009 (189 million tons) barely provided for half of its needs that year (405 million tons).¹⁶ China's oil demand has almost doubled in less than a decade (4.8 million barrels per day - bpd - in 2000 to 8.6 million bpd in 2009)¹⁷ and is expected to register the world fastest growth rate over the next two decades, according to Organization of Petroleum Exporting Countries (OPEC) projections.¹⁸ In 2010, Chinese oil imports stood at 4.8 million bpd, up 17.5% from the previous year.¹⁹ According to Chinese Academy of Social Sciences (CASS) projections, China's oil production will peak at around 200 million

¹⁰ According to BP, "Statistical Review of World Energy 2010", Excel workbook, June 2010, Available online at: <http://www.bp.com/statisticalreview> (accessed 20 August 2010)

¹¹ Primary energy includes both non-renewable and renewable energy sources found in nature, namely: oil, natural gas, coal, nuclear power and hydro power.

¹² BP, *op. cit.*

¹³ Spencer Swartz and Shai Oster, "China tops US in energy use", *The Wall Street Journal*, 18 July 2010, available online at: <http://online.wsj.com/article/SB10001424052748703720504575376712353150310.html> (accessed 20 August 2010)

¹⁴ Data in this paragraph according to BP, *op. cit.*

¹⁵ China is the largest consumer and producer of coal and holds the third largest coal reserves (13%): EIA, *Country Analysis Brief: China*, July 2009, available online at: <http://www.eia.doe.gov/emeu/cabs/China/Full.html> (accessed 20 August 2010)

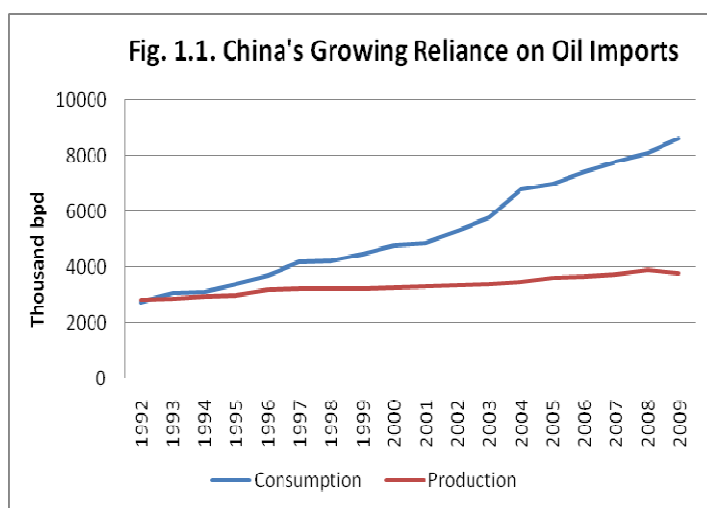
¹⁶ BP, *op. cit.*

¹⁷ BP, *op. cit.*

¹⁸ Figures as for the reference case in OPEC, *World Oil Outlook 2008* (Vienna: OPEC, 2008) p. 33.

¹⁹ Judy Hua and Chen Aizhu, "China 2010 crude imports up 17.5% to record high", Reuters, 10 January 2011, available online at: <http://af.reuters.com/article/energyOilNews/idAFTOE70607320110110> (Accessed 5 May 2011)

tons in 2010-2015, and is expected to gradually decline after 2020, when 64.5% of China's oil consumption is expected to be met by imports.²⁰ As China's largest oil fields mature, the demand/supply gap is expected to widen, further enlarging substantially its external reliance as evidenced in the chart below.



Source: BP, *Statistical Review of World Energy 2010*, *op cit.*

The value of China's imports of fuels and minerals has shown the fastest growth rate of all Chinese import categories, having increased over three-fold between 2004 (US\$89 billion) and 2008 (US\$307 billion). According to WTO data, in 2009 minerals and fuels accounted for a quarter of China's total imports.²¹ Despite the slight slowdown in China's imports in 2009 due to the global economic downturn, China's demand for hard commodities started to resume their upward course in the final quarter of that year, and is expected to expand strongly in coming years as the economy grows.

In this context, energy security gradually emerged as a serious concern for the Chinese Communist Party. As David Zweig and Bi Jianhai²² point out, not only China's continued economic growth became increasingly reliant on securing resources supply overseas, but also its social stability and ultimately the survival of the regime. Energy security concerns surfaced during the third leadership generation headed

²⁰ Xiao Wan - China Daily, "China depending more on imported oil", 20 January 2010, available online at: http://www.chinadaily.com.cn/china/2010-01/20/content_9346446.htm (Accessed 5 May 2011)

²¹ WTO, "China Trade Profile 2009", available online at: <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=CN>

²² For a detailed account on the emergence of energy security as China's foreign policy major driver, see: David Zweig and Bi Jianhai, "China's Global Hunt for Energy" *Foreign Affairs* 84:5, 2005, pp. 25-38.

by Jiang Zemin. Due to a slow growth pace in energy demand throughout the 1990s, supply strategies over this period emphasised self sufficiency, encouraging energy companies to expand domestic production.²³ The massive surge in domestic demand and the subsequent increasing external reliance in the 2000s, pushed energy security to the top of Hu Jintao's international agenda.

The rising importance of energy security for the regime is emphasized by the publication of a number of white papers. The first to be issued was on mineral resources in 2003 ('China's Policy on Mineral Resources'), followed by one specifically on energy in 2007 ('China's Energy Conditions and Policies'). Both white papers lined up strategies aimed at improving the resource security situation.²⁴ Moreover, the strategic importance of this issue within CFP was formally emphasised in the *White Paper on Diplomacy* issued in July 2008, which "placed energy security as a major centrepiece of the country's foreign policy",²⁵ with its first chapter being on "The issue of energy security during the period of high oil prices".

Although China has until now been able to feed its energy needs by buying in the international market, the sheer size of its expanding domestic consumption has made it particularly vulnerable to market price flows and potential shortages caused by, *inter alia*, cartelisation, blockades, and transportation disruptions. Indeed, the decision in the early 2000s to establish strategic reserves and a protective system for strategic mineral resources (oil and some base metals, namely copper, aluminium and iron ore), underline the growing unease about this issue.

Due to latent complementarities (discussed in more detail in chapter two), the energy security imperative has become particularly evident in China's interaction with developing regions over the past decade.

1.2.3. Targeting developing regions

In addition to diversification and securing steady supply in the international oil market, the acquisition of oil acreage abroad plays a key role, as a means to minimise supply risks in the long run, and also to have a greater say (from the production side) in the volatile hydrocarbons market. In line with this, Chinese NOCs have been expanding hydrocarbons assets overseas, now spanning from neighbouring Central and

²³ Michal Meidan, P. Andrews-Speed and Ma Xin, "Shaping China's Energy Policy: actors and processes" *Journal of Contemporary China* 18:61, 2009, p. 603.

²⁴ Chinese White Papers available online at: <http://www.china.org.cn/english/environment/236955.htm> (Accessed 5 May 2011)

²⁵ Russel Hsiao, "Energy security the centrepiece of China's foreign policy" *China Brief* 8:16, 2008, available online at: http://www.jamestown.org/programs/gta/single/?tx_ttnews%5Btt_news%5D=5095&tx_ttnews%5BbackPid%5D=239&no_cache=1 (accessed 20 August 2010)

Southeast Asia to far-away regions such as Africa and South America. This is the so called ‘new diplomatic frontier’,²⁶ signalling the broadening scope of China’s foreign policy to a global level.

China’s economic venture into non traditional regions such as South America and Africa is turning into one of the most striking features of its emergence as a global economic player in the 21st century. Over the past few years, this emerging reality has been attracting attention from politicians and scholars around the world, feeding a growing number of studies.

In terms of the pertinent literature, if only five years ago literature on the topic was very scarce, at present information and analysis abound, spanning from numerous articles in journals or online publications, through edited books and monographs, doctoral theses, and reports by governmental agencies, international organisation²⁷ and non-governmental organisations (NGOs). In addition, several institutions have been monitoring developments.²⁸ Reflecting the much faster engagement of China with Africa, research in this field has become more conspicuous and the degree of analysis gradually more complex.²⁹ China’s engagement with Latin America (LA), on the other hand, has produced few academic studies.³⁰ Unlike the reasonably diversified authorship of studies on China in Africa, in China-Latin America studies, US institutions and scholars are predominant. Despite the expansion of the field in recent years,

²⁶ Jianwei Wang, “China’s New Frontier Diplomacy”, in: Sujian Guo & Jean-Marc Blanchard (eds.), *Harmonious World and China’s New Foreign Policy* (Plymouth, UK: Lexington Books, 2008) pp. 21-37

²⁷ These include, namely the World bank: D. Lederman et al. (ed.), *China’s and India’s Challenge to Latin America: opportunity or threat?* (Washington: IBRD/WB, 2009); Foster et al, *Building Bridges: China’s Growing Role as Infrastructure Financier for Africa* (Washington: IBRD/WB, 2008); Harry Broadman, *Africa’s Silk Road: China and India’s New Economic Frontier* (Washington: IBRD/WB, 2008); and OECD: Andrea Goldstein et al., *The Rise of China and India, What’s in it for Africa?* (Paris: OECD, 2008); Javier Santiso (ed.), *The Visible Hand of China in Latin America* (Paris: OECD, 2007).

²⁸ These include, namely, the China Africa Project at SAIIA (Johannesburg); the Centre for Chinese Studies at Stellenbosch University (South Africa) fully dedicated to China’s relations with Sub-Saharan Africa; Beijing Axis (Private consulting company based in Beijing) which follows developments in Africa and LA through its major quarterly publication: *The China Analyst*. Also some websites provide regular information on this topic, particularly in what concerns China’s ventures in Africa, namely ‘emerging powers watch’ link in Fahamu’s website http://www.pambazuka.org/en/category/africa_china/ ; and MacaHub which provides information on China in Portuguese speaking countries <http://www.macaHub.com.mo/pt/news.php?ID=3748>

²⁹ Chris Alden, *China in Africa* (London & New York: Zed Books, 2007); Firoze Manji and Stephen Marks, *African Perspectives on China in Africa* (Cape Town, Nairobi, Oxford: Fahamu, 2007); Marcel Kitissou (ed.), *Africa in China’s Global Strategy* (London: Adonis & Abbey publishers, 2007); Chris Alden, Daniel Large and R. S. Oliveira (eds.), *China Returns to Africa: a rising power and a continent embrace* (London: Hurst, 2008); Robert I. Rotberg (ed.), *China into Africa: Trade, Aid and Influence* (Washington, D.C.: Brookings Institution Press, 2008); Kweku Ampiah and S. Naidu (eds.), *Crouching Tiger, Hidden Dragon: Africa and China* (Pietermaritzburg: University of Kwazulu-Natal Press, 2008); Ian Taylor, *China and Africa: engagement and compromise* (London: Routledge, 2009); Deborah Brautigam, *The Dragon’s Gift: the Real Story of China in Africa* (Oxford: Oxford University Press, 2009).

³⁰ R. Roett and G. Paz, *China’s Expansion into the Western Hemisphere: Implications for Latin America and the United States* (Washington, D.C.: Brookings Institution Press, 2008); reports cited above by the World Bank and OECD.

studies comparing China's interaction with both regions remain very scarce.³¹ The few existing academic publications covering China's relations with more than one developing region, do not pursue comparative analysis.³² In recent years Chinese scholars and institutions have also been contributing increasingly to the debate on both regions. Chinese scholars have been actively participating in seminars and conferences around the world, publishing in English³³ and simultaneously engaging a lot more with field research, regarded as a major hindrance in Chinese scholarly work until recently. In China, many old Africa and Latin America academic research units³⁴ have been revitalised and new centres have been set up.³⁵

A significant part of the ongoing academic debate on China's growing engagement with developing regions has, however, been locked into a debate of an increasingly ideological tone. This debate is around whether China is just another neo-colonialist power in search of raw materials and markets or if Beijing is just seizing opportunities in more levelled terrains. Although this debate falls outside the scope of this thesis, it underlines a common feature in the existing literature, which is the acknowledgment of China's resources quest as a defining trait of its engagement in Africa and South America.

The still scarce number of studies on China's oil diplomacy in developing regions tends to focus on Africa.³⁶ It is the candidate's contention that the debate is lacking empirical, systematic and much needed comparative data. By comparing China's oil diplomacy in Angola and Brazil, the present thesis proposes

³¹ Namely US Congressional Report Service, which has published several reports concerning China's engagement in LA and Africa: CRS, *China's Foreign Aid Activities in Africa, Latin America, and Southeast Asia*, February 2009, CRS online publication; Thomas Lum, *China's Assistance and Government-Sponsored Investment Activities in Africa, Latin America, and Southeast Asia*, CRS online publication, November 2009, available online at: www.crs.gov (accessed 5 January 2010)

³² The few existing publications on China and the developing world are mostly edited books containing a collection of diverse studies on China's relations with different countries or regions: Dorothy-Grace Guerrero and Firoze Manji (eds.), *China's New Role in Africa and the South: a Search for a New Perspective* (Cape Town, Nairobi, Oxford: Fahamu, 2008); J. Eisenman, E. Heginbotham and D. Mitchel, *China and the Developing World: Beijing's strategy for the 21st century* (New York: M.E. Sharpe, 2007).

³³ Among the very few works published in English stand out: Liu Hongwu and Yang Jiemian (eds.), *Fifty Years of Sino-African Cooperation: Background, Progress and Significance* (Chinese Perspectives on Sino-African Relations, Kunming: Yunnan University Press, 2009).

³⁴ These include the Institute of West Asian and African Studies (IWAAS) and the Institute of Latin American Studies at the Chinese Academy of Social Science, the Center for America Studies, and the Center for West Asian and African Studies at the Shanghai Institute for International Studies. For an overview of the evolution of African Studies in China since the early 20th century, see: Li Anshan, "African studies in China in the twentieth century: a historiographical survey" *African Studies Review* 48:1, 2005, pp. 59-87.

³⁵ Institute of Latin American Studies; Institute of African Studies at the China Institute of Contemporary International Relations in Beijing; and the newly opened Institute of African Studies at Zhejiang Normal University.

³⁶ Ian Taylor, "China's oil diplomacy in Africa" *International Affairs* 82:5, pp. 937-959; Erica Downs, "The Fact and Fiction of Sino-African Energy Policy" *China Security* 3:3, 2007, pp. 42-68; Wenran Jiang, "Fueling the Dragon: China's Rise and Its Energy and Resources Extraction in Africa" *The China Quarterly* 199, September 2009, pp. 585-609.

to make a contribution to filling this gap, which is critical for improving the understanding of China's interaction with developing regions.

1.3. Analytical framework: foreign policy Analysis

This thesis is concerned with a particular instrument of China's foreign policy (CFP) that has been extensively implemented in developing regions by Beijing in pursuit of its energy security goals: the extension of the so called 'infrastructure-for-oil loans'. In order to analyse this subject one shall draw on concepts and tools of foreign policy analysis (FPA).

1.3.1. Foreign policy analysis and theoretical approaches to Chinese Foreign Policy

Foreign policy analysis is a subfield of International Relations (IR) that seeks to explain foreign policy, drawing much of its insights from IR theory. Theories of international politics, as Waltz acknowledged,³⁷ cannot fully account for states' reactions to pressures in a given system. While IR is more concerned with patterns of outcomes of states interactions, FPA focuses on the dynamics behind states' behaviour in the international realm. The analysis of this process is in fact much more intricate than the study of international politics, since it merges two levels of analysis (domestic and international), in which actors and structures interact in a complex manner. This reality makes it difficult to conceptualise, explain and assess the role of agent and structure in this process,³⁸ a fact that made FPA a controversial analytical subject since its materialization following the Second World War.³⁹

Defying the challenging complexity of the subject, analysts struggled in the following decades to elaborate a general theory drawing on sets of different explanatory factors. Gideon Rose⁴⁰ divides these contributions into four main schools: the *Innenpolitik* theories which emphasise the role of domestic factors in foreign policy formulation; offensive realism which stresses the determining role of systemic factors; defensive realism which upholds that systemic factors explain most foreign policy decisions but not all; and neoclassical realism which attempts to account for both external and internal factors.

The *Innenpolitik* approach assumes internal factors such as political and economic regimes, socioeconomic structure, political factionalism, or national identity, are the independent variable. Most FPA studies produced between the 1950s and 1970s were of this nature and closely inspired by

³⁷ Kenneth Waltz, *Theory of International Politics* (Reading, Massachusetts: Addison-Wesley, 1979) pp. 71-72.

³⁸ Walter Carlsnaes, "Actors, structures and foreign policy analysis", in: Smith, Hadfield and Dunne, *op. cit.*, p. 86.

³⁹ For a comprehensive account on the historical evolution of FPA, see: Valerie Hudson, "The history and evolution of foreign policy analysis", in: Smith, Hadfield and Dunne, *Ibid.*, pp. 11-29.

⁴⁰ Gideon Rose, "Neoclassical Realism and Theories of Foreign Policy" *World politics* 51:1, 1998, pp. 146-151.

behaviouralism,⁴¹ stressed different domestic factors: the structure and process of groups making foreign policy decisions (Richard Snyder, 1950s); the influence of organizational process and bureaucratic politics (G. Allison and Halperin, 1970s); and the psychological dimension (Harold and Margaret Sprout, 1950s and 1960s). In the late 1970s the field began to fall out of fashion, set against the rise of rational choice modeling and the neorealist theory which emphasized systemic structures.

Stemming both from neorealist theory, the defensive and offensive realism schools depart from the same basic assumptions: states operating in an anarchical international system and the centrality of relative distribution of power. The structure of international system is thus the independent variable in both approaches. The main difference is that defensive realism (e.g. Waltz) is a little more benign, sustaining that states do not seek power beyond that is needed for security and survival, while offensive realism (e.g. Mearsheimer) argues that states seek hegemony and are ultimately more aggressive and act therefore to prevent the emergence of hegemons in other regions.⁴² In this latter view, foreign policy will be exclusively shaped by the state's relative capabilities and the external environment. In the case of defensive realism there is less room for domestic variables since aggressive behavior is seen as unnatural and dependent on the perception of the threat.⁴³

Like *Innenpolitik*, offensive and defensive realism oversimplify the equation by focusing on only one level (domestic factors or international structure, respectively) and hence provide inaccurate calculations. As Gideon points out, unit-level analysis fails to account why states with similar domestic structures act in different ways and why diverse states frequently act alike. The same is true about offensive and defensive realism, as different states facing similar systemic frameworks do not always act in similar ways, or even the same state in the same situation can act differently at two different points in time.⁴⁴

Drawing from a handful of works done in the post Cold War setting, Gideon Rose notes that a new approach emerged in the 1990s, that offers a way out of this predicament by inserting an intervening variable in the neorealist equation. In this perspective relative material power draws the basic contours of a state's foreign policy, but does not fully determine its foreign policy behaviour, as this depends on decision-makers' perceptions of relative material power.⁴⁵ This means, for instance, that leadership

⁴¹ Initiated in the US prior to the Second World war, and argued that all social sciences should model themselves on the natural sciences in order to move forward.

⁴² R. Jackson and G. Sorensen, *Introduction to International Relations: theories and approaches* (Oxford & New York: Oxford University Press, 2007, 3rd ed.) pp. 86-87.

⁴³ Gideon Rose, *op. cit.*, pp. 148-149.

⁴⁴ Gideon Rose, *Ibid.*, pp. 148-149.

⁴⁵ Gideon Rose, *Ibid.*, p. 146.

changes may account for foreign policy discontinuity in this regard, and that different balances between state structure and their respective society may affect their ability to allocate natural resources over time. Systemic factors do constrain foreign policy options, but it is the perceptions (sometimes misperceptions) at the unit level that influence the choices thereof.

Nonetheless, one must keep in mind that relative material power assumes a key position in this theoretical model⁴⁶ and therefore this should be the departure point for any foreign policy analysis. Relative material power refers to states' capabilities and resources to influence each other, and the relative position in the international system that derives from this. States' relative material power affects the way they perceive systemic forces and subsequently the way they behave.

Another important assumption of neoclassical realism is that more than security, states seek stability in an anarchical international system through attempting to control their external environment. Furthermore, states which search for influence, tend to follow closely the expansion or contraction of their material resources. The corollary is that the relative amount of material power resources shape the aspirations and the range of states' foreign policy.

Unlike the defensive and offensive branches of neorealism, which came into existence primarily as a means to interpret international politics, the neoclassical realist branch's core concern is in the analysis of foreign policy at a given place and time through the interface between the domestic and systemic realms.

China's increasing openness to the outside world and gradual engagement in multilateral *fora* such as the UN and the WTO, has exposed a bit more of the Chinese foreign policy 'black box' to scholarly research. This allowed for a closer look at the unit level structure and actors, access to which remained restricted throughout most of the existence of the PRC. China's Foreign Policy (CFP) studies emerged in the 1960s and 1970s within 'China' area studies, a significant part of which related to China's anti-colonial ventures in Africa.⁴⁷

International relations scholarly works on CFP remained relatively scarce until recently.⁴⁸ Nonetheless, the amount of literature has been increasing since the early 1990s, and fastened in the 2000s. Iain

⁴⁶ Gideon Rose, *Ibid.*, p. 150.

⁴⁷ Peter Van Ness, *Revolution and Chinese Foreign Policy: Peking's Support for Wars of National Liberation* (Berkeley: University of California Press, 1970); Bruce D. Larkin, *China and Africa, 1949-1972: The Foreign Policy of the Peoples Republic of China* (Berkeley: University of California Press, 1971); James David Armstrong, *Revolutionary Diplomacy: Chinese Foreign Policy and the United Front Doctrine* (Berkeley: University of California Press, 1977).

⁴⁸ A. Iain Johnston, *Trends in Theory*, *op. cit.*, pp. 6-11.

Johnston categorized the existing works on CFP according to a variety of theoretical approaches: historical; Mao-centred ideology; Classic realism; constructivism; sociological learning; domestic politics; structural realism/neo-realism; and neoclassical realism.⁴⁹

Interestingly enough, domestic politics⁵⁰ and neoclassic realism⁵¹ seem to have inspired a significant part of contemporary CFP studies. This is partly justified by the increasing access to domestic sources of Chinese foreign policy, and the manifest insufficiency of the neorealist school to assess the increasing complexity of China's foreign policy as it enters the global stage.

Offering arguably the most suitable theoretical framework to analyse CFP making, neoclassical realism has, nonetheless, its own shortcomings. The first one is related to the abstract nature of perceptions and thus the inability to assess, on the one hand, the ways in which ideational, cultural and psychological factors affect unit-level perceptions of their own and others relative to material power, and on the other hand how these perceptions turn into foreign policy.⁵² The second shortcoming relates to the increasing influence of new agents in foreign policy orientations. As Shaun Breslin argues, referring to the specific case of China's IR, these approaches miss key determinants such as the interaction of a multiplicity of economic and political agents active at the domestic and international levels,⁵³ that need to be equated to fully theorise contemporary Chinese foreign policy making.

1.3.2. Foreign economic policy: economic diplomacy and economic statecraft

Owing to its object of study (infrastructure-for-oil loans) this thesis is concerned with the economic realm of foreign policy. Even though security and political concerns have been predominant in foreign policy literature, economic issues have been a constant element in state's foreign policies from the early days. In

⁴⁹ A. Iain Johnston, Trends in Theory, *op. cit.*, pp. 11-18.

⁵⁰ Kenneth Lieberthal, "Domestic Politics and Foreign Policy", in: Harry Harding (ed.), *China's Foreign Relations in the 1980s* (New Haven: Yale University Press, 1984) pp. 43-70; Kenneth Lieberthal and Michel Oksenberg, *Policy Making in China: Leaders, Structures and Processes* (Princeton: Princeton University Press, 1988); Joseph Fewsmith and Stanley Rosen, "The Domestic Context of Chinese Foreign Policy: Does Public Opinion Matter?" in: David M. Lampton (ed.), *The Making of Chinese Foreign and Security Policy* (Stanford: Stanford University Press, 2001) pp. 151-187.

⁵¹ Thomas J. Christensen, *Useful Adversaries: Grand Strategy, Domestic Mobilization and the Sino-American Conflict: 1947-1958* (Princeton: Princeton University Press, 1996); Avery Goldstein, *Rising to the Challenge: China's Grand Strategy and International Security* (Stanford: Stanford University Press, 2005); Michael B. Yahuda, *China's Role in World Affairs* (New York: St. Martin's Press, 1978); Andrew J. Nathan and Robert S. Ross, *The Great Wall and the Empty Fortress: China's Search for Security* (New York: W.W. Norton, 1997).

⁵² Gideon Rose, *op. cit.*, p. 168.

⁵³ Shaun Breslin, "Beyond Bilateralism: Rethinking the Study of China's International Relations", National Europe Centre Paper No. 36, paper prepared for the Workshop on *Asia-Pacific Studies in Australia and Europe: A Research Agenda for the Future*, Australian National University, 5-6 July 2002, pp. 2-3.

fact trade motivated the earliest peaceful contacts and agreements between states, which written records date back to ancient civilizations (i.e. Egypt, Greece, China, etc.). Trade was also at the forefront of the first contacts between the 'old' and the 'new' worlds initiated by the Portuguese navigators in the 15th century. Notwithstanding, war and peace have remained the core concern of foreign policy makers and students until very recently.

Foreign economic policy (FEP) gradually surfaced as a relevant matter in the second half of the 20th century as a result of the progressive economic interdependence⁵⁴ ignited by the array of multilateral institutions that surfaced in the aftermath of the Second World War. The technological breakthroughs in the following decades steadily contracted time and space boundaries leading to the globalisation of world economy. With the end of the Cold War and the collapse of the ideological divide, economic affairs finally gained centre stage in foreign policy.

To a great extent foreign economic policy has evolved as a tool to manage domestic and international economic goals in a context of growing economic interdependence. As noted by Peter Katzenstein 'the main rationale of all strategies [of foreign economic policy] is to establish a basic compatibility between domestic and international policy objectives'⁵⁵ and as such these strategies 'grow out of the interaction of international and domestic forces.'⁵⁶

Ikenberry, Lake and Mastanduno identify three main theoretical approaches to explain foreign economic policy: international or system-centred; society centred and state centred.⁵⁷ Systemic approaches view FEP as a function of the state's relative material power and international constraints or opportunities. Society centred approaches explain FEP as a function of domestic politics - the result of the struggle for influence among various interest groups or political parties. State-centred approaches emphasize the institutional structures of the state and the capacity of government official to realise their objectives in light of domestic and international constraints. This thesis subscribes to Ikenberry et al view that seem to privilege this last approach as it provides a more comprehensive explanation by integrating domestic and international forces and by placing the state at the centre. Although the state is neither a unified entity nor the only actor, it 'is the principal national actor charged with the overall conduct of defense and foreign

⁵⁴ About economic interdependence see: Robert O. Keohane and Joseph Nye, *Power and Interdependence: World politics in Transition* (Boston: Little, Brown and Company, 1977)

⁵⁵ Peter J. Katzenstein, "Introduction: domestic and international forces and strategies of foreign economic policy", in: *International Organization* 31:4, 1977, p. 588 (pp. 587-606)

⁵⁶ *Idem*, p. 591

⁵⁷ G. John Ikenberry, David A. Lake, Michael Mastanduno, "Introduction: approaches to explaining American foreign economic policy", *International Organization* 42:1, 1988, pp. 1-14

affairs (...) [which gives its officials] a special legitimacy in the formulation and implementation of foreign economic policy'⁵⁸.

A significant part of foreign economic policy falls within the scope of what is commonly termed as 'economic diplomacy'.

A) Economic diplomacy

As economic interaction across the world intensified, economic diplomacy progressively surfaced in the second half of the 20th century as an autonomous subject of analysis within foreign economic policy. Throughout this period studies on trade negotiations have predominated in the nascent field, reflecting the reality of international economic relations.

Owing to its yet loose boundaries, the term economic diplomacy still lacks a widely accepted definition. Its fuzzy boundaries explain some conceptual confusion with the term 'economic statecraft', which is important to clarify in the context of the present thesis.

In their dictionary of diplomacy Berridge and James describe economic diplomacy as: 'diplomacy concerned with economic policy questions, including the work of delegations to conferences sponsored by bodies such as the World Trade Organisation.'⁵⁹ This definition mirrors, to a great extent, the dominant literature on commercial diplomacy.

Economic and commercial diplomacy, however, are not synonyms. As noted by Ambassador Kishan Rana⁶⁰ commercial diplomacy is a subset of economic diplomacy, which in fact has a much wider scope as it encompasses economic policy issues. Rana identifies four key pillars in contemporary economic diplomacy:⁶¹ (1) trade promotion (exports and imports), (2) investment promotion (inward and outward), (3) attracting suitable technologies and (4) management of economic aid/cooperation (be it from donor or receiving country perspective); all working towards the broader goal of enhancing the image of the country.

⁵⁸ *Idem*, p. 13

⁵⁹ Geoff Berridge and Alan James, *A Dictionary of Diplomacy*, 2nd ed. (London: Palgrave MacMillan, 2003) p. 81

⁶⁰ Kishan Rana, "Serving the private sector: India's experience in context", in N. Bayne and S. Woolcock (ed.s), *The New Economic Diplomacy: Decision Making and Negotiation in International Economic Relations* (3rd ed.) (Surrey: Ashgate Publishing Limited 2011), p. 94

⁶¹ Kishan S. Rana (2000) *Inside Diplomacy* (Manas, New Delhi), Chapter 4, pp. 96–127; Chapter 5, pp. 128–43

Bayne and Woolcock have made an invaluable contribution to this debate with three editions of *The New Economic Diplomacy* (2003, 2007 and 2011). Reflecting the increasingly complex and fast changing nature of contemporary foreign economic relations they underline the much wider scope and content of economic diplomacy. Economic diplomacy is ‘about how states conduct their international economic relations (...): how they make decisions domestically; how they negotiate with each other internationally; and how these processes interact.’⁶² Through their lenses economic diplomacy is concerned with⁶³:

- (1) International economic issues - domestic and international economic realms, however, have become closely intertwined due to spiralling interdependence;
- (2) Governmental activities in all its formats (ministries, departments, embassies and agencies) – though non-state actors such as private business sector and NGO’s increasingly shape governmental policies;
- (3) The impact of markets – unlike political diplomacy, economic diplomacy is sensitive to market developments in that they influence and shape the actors involved;
- (4) A wide range of instruments – from informal and voluntary cooperation to binding regulations as well as economic incentives and sanctions, also referred to as economic statecraft.

This apparent overlap between economic diplomacy and economic statecraft has sometimes led to the incorrect use of the two terms as synonyms. The clarification of this confusion is critical in the context of this thesis as it justifies why one employs the term ‘economic statecraft’ and not ‘economic diplomacy’. Bayne and Woolcock emphasise that economic diplomacy is not defined by its instruments but by the economic negotiation that provide its content, namely policies related to trade, investment, services, cooperation, aid, information and their regulation. Further to this they add that while economic diplomacy refers to concrete negotiations, economic statecraft has a broader connotation sometimes linked to a ‘grand strategy’.⁶⁴ This distinction is clearly in line with the thinking of one of the founding theorists of economic statecraft: D. Baldwin. According to him, diplomacy refers to influence attempts primarily through negotiation⁶⁵ while economic statecraft concerns influence attempts through the use of economic sanctions or rewards.

⁶² N. Bayne and S. Woolcock, “What is Economic Diplomacy”, in: N. Bayne and S. Woolcock (ed.s), *The New Economic Diplomacy: Decision Making and Negotiation in International Economic Relations* (Surrey: Ashgate Publishing Limited 2003), p. 3

⁶³ Idem, pp. 6-8

⁶⁴ N. Bayne and S. Woolcock, idem (2011), p. 4

⁶⁵ David A. Baldwin, *Economic Statecraft* (Princeton: Princeton University Press, 1985) p. 13

The above mentioned reasons justify thus why this thesis is not about economic diplomacy but about economic statecraft. Its focus is not on how a particular instrument of foreign economic policy came into being, its content and the negotiation process, but rather on the efficacy of the instrument at the implementation level in two different institutional contexts.

b) Economic statecraft as a foreign policy instrument

Policies are not self-executing. Channelling intentions into outcomes involves the selection and use of what, at the time, is assessed to be the best available means to achieve objectives. The wrong choice of means can not only distort original intentions, but also seriously compromise what is achieved by a given policy. The choice of the instrument to be used is therefore a key point in the implementation phase.

The use of instruments by policy makers, in order to pursue a certain foreign goal, is commonly referred to as statecraft. While there is no consensual taxonomy of foreign policy instruments, most authors tend to list them in ascending order from soft to hard measures, and ranging from diplomacy to military intervention. A less controversial sorting is Mastanduno's division of statecraft instruments into three major categories: diplomatic, military and economic.⁶⁶

Even though the use of economic instruments can be traced back to ancient Greece, diplomatic and military tools have historically occupied the centre stage in foreign policy making - inspiring most international relations literature from Machiavelli to Clausewitz. In sharp contrast with diplomacy (an attempt to influence through negotiations) and military statecraft (attempt to influence through the use of force), the use of economic statecraft has been underestimated by most analysts, and has therefore received little attention from scholars.⁶⁷

Economic statecraft can be defined as 'the use of economic instruments by a government to influence the behaviour of another state' and can involve the use of sanctions or inducements'.⁶⁸ Negative economic statecraft involves the use of economic sanctions, coercion or punishment (sticks, i.e. trade or investment restrictions, financial sanctions, assets seizure) to interfere with the economy of the target, so as force a change in its behaviour. Positive economic statecraft, on the other hand, involves the extension of

⁶⁶ Michael Mastanduno, "Economic Statecraft", in: Smith, Hadfield and Dunne, *op. cit.*, p. 172.

⁶⁷ D. Baldwin, *Economic Statecraft* (Princeton: Princeton University Press, 1985) p. 4.

⁶⁸ J.F. Blanchard et al., "The political economy of national security: economic statecraft, interdependence and international conflict", in: J.F. Blanchard, E.D. Mansfield and N. Ripsman (eds.), *Power and the Purse: Economic Statecraft, Interdependence and National Security* (London: Frank Cass, 2000) p. 3.

economic incentives or rewards (carrots, i.e. trade and investment promotion, financial incentives, and technology transfer) in return for compliance with the extender foreign policy goals.

During the Cold War, the use of economic sanctions became a popular foreign policy instrument. This triggered some academic interest on negative economic statecraft.⁶⁹ Research has focused on two major debates: what causes economic sanctions to fail or succeed, and on its usefulness as a foreign policy tool.⁷⁰ While some concluded that economic sanctions are not particularly efficient as a foreign policy tool,⁷¹ others consider them useful in signalling intentions or in complementing other forms of statecraft.⁷²

This thesis, however, is not concerned with the study of negative economic statecraft, as China does not have a record of making use of these tools bilaterally, nor multilaterally. Since its accession to UN Security Council in 1971, China has in most cases abstained from voting on economic sanctions resolutions. On the other hand, Beijing has made profuse use of economic inducements in pursuing its foreign policy goals since the founding of the PRC. China has, in fact, a long track of resorting to economic inducements in pursuing its foreign policy goals. In exchange for political allegiance to the communist cause, China extended in the 1960s and 1970s soft loans to African countries, some of which were for infrastructure construction using Chinese equipment and labour. The most celebrated example under Mao's rule was the construction of the Tazara railway.⁷³ China has also consistently deployed economic inducements to pursue another major political goal - the encirclement of Taiwan, by 'paying off' countries to establish diplomatic ties with Beijing at the expense of Taipei.⁷⁴ The success of China's 'dollar diplomacy' grew alongside its swelling financial resources throughout the 1990s and 2000s.⁷⁵

⁶⁹ D. Losman, *International Economic Sanctions: the cases of Cuba, Israel and Rhodesia* (Albuquerque, NM: University of New Mexico Press, 1979); G.C. Hufbauer, J. Schott and K.A. Elliot, *Economic Sanctions Reconsidered: History and Current Policy* (Washington, D.C.: Institute for International Economics, 1990); J. Kishner, *Currency and Coercion: the Political Economy of International Monetary Power* (Princeton: Princeton University Press, 1995); M. Doxey, *International Sanctions in Contemporary Perspective* (London: Macmillan Press, 1996).

⁷⁰ J.F. Blanchard et al., *op. cit.*, pp. 3-5; for a detailed analysis on the validity of positive and negative economic statecraft. see D. Baldwin, *op. cit.*

⁷¹ R. Pape, "Why Economic Sanctions do not work" *International Security* 22:2, 1997, pp. 90-136.

⁷² D. Baldwin, *op. cit.* – especially chapter 8.

⁷³ The railway was built to link Zambia's rich copper belt to the coastal port of Dar Es Salaam in Tanzania, so as to break the dependency on white-ruled Rhodesia. The decision to construct the railway grew out of a direct request from Zambian president Kenneth Kaunda, and seconded by his Tanzanian counterpart, Julius Nyerere. China assembled a US\$405 mn interest free loan for this project, representing at that point the largest single offer of economic assistance granted to an African state by a communist country.

⁷⁴ In the context of Beijing's 'one China policy', in order to establish diplomatic ties with China any country must sever ties with Taipei.

⁷⁵ At present only 16 countries (12 in Central and South America and four in Africa) have diplomatic ties with Taiwan.

Positive economic statecraft, as defined by Mastanduno, means “the provision or promise of economic benefits to induce changes in the behaviour of a target state.”⁷⁶ He distinguishes two types of positive economic statecraft in regard to the ends they intent to pursue: tactical linkage and structural linkage. The first one (also called specific positive linkage) envisages an immediate outcome through the provision of a specific economic inducement (i.e. Marshal Plan). Structural linkage (or general positive linkage), on the other hand, involves a long-term engagement providing a steady stream of economic inducements. These generally favour economic interdependence that gradually transforms domestic interests in the target country, and ultimately leads to a growing influence over the policy options of the weaker state, ultimately consolidating a coalition with the sanctioning states.⁷⁷ This type of economic inducement is in a way linked to the concept of ‘soft power’, developed by Joseph Nye (‘getting others to want the outcomes that you want’).⁷⁸

Although the use of economic inducements has become more apparent in the context of the fast growing economic interdependence that characterises the post Cold War World, academic research on positive economic statecraft remains scant. Aimed at contributing to filling this gap, this thesis argues that economic statecraft is a key tool in China’s current foreign policy towards developing regions, and that it has been reasonably successful in achieving Beijing’s goals.

In order to pursue its ends though, the means need to be deployed in the target country, where the interplay with the local environment will determine the outcome.

1.3.3. Foreign policy implementation

The aim of this thesis is to analyse the performance of a specific foreign policy instrument when put into practice. Because foreign policy choices are not self-executing, the emphasis is put on channelling intentions into outcomes. This entails the interplay between the actor’s strategy and the targeted context, knitting together the domestic with the international. Underlying this exercise is the agency-structure dilemma:⁷⁹ what best explains foreign policy outcomes: the actor’s preferences/interests or external

⁷⁶ Michael Mastanduno, *op. cit.*, (2008), p. 182.

⁷⁷ M. Mastanduno, “Economic statecraft, interdependence and national security: agendas for research”, in: J.F. Blanchard et al., *op. cit.* (2000), pp. 306-309.

⁷⁸ J.S. Nye, *Soft Power: the Means to Success in World Politics* (New York: Public Affairs, 2004) p. 5.

⁷⁹ For a comprehensive analysis of this topic see: A. Wendt, “The Agency Structure Problem in International Relations Theory”, in: *International Organization* 41:3, 1987, pp. 335-370; W. Carlsnaes, “The Agency Structure Problem in Foreign Policy Analysis”, in: *International Studies Quarterly* 36:3, 1992, pp. 245-270; C. Wight, *Agents, Structures and International Relations* (Cambridge: Cambridge University Press, 2006).

constrains? In order to better understand this interplay one shall depart from the ‘strategic-relational’ approach.

The strategic-relational model was originally developed by Colin Hay⁸⁰ and later applied to foreign policy analysis by Elisabetta Brighi.⁸¹ According to this model neither strategy nor context isolated can explain foreign policy outcomes. The success or failure of foreign policies is determined by the dialectic interplay between internal preferences and external constrains. It is called strategic, because the actor’s actions envisage the attainment of certain goals; and is relational because it only becomes intelligible when analysed in relation to its environment.⁸²

According to Brighi and Hill, in analysing foreign policy implementation through this model, one must consider three basic assumptions. First, context has a relational nature. The successful implementation of a given foreign policy depends on how strategically placed the actor is and how correctly they interpret constraints and opportunities in the surrounding context. Context has thus different meanings to different actors. Secondly, there is a constant interplay between actors and context at both material and perceptions levels, which are eventually internalised in the political process. And thirdly, this interactive process of action and reaction stimulates constant feedback from actor to context and vice versa, which may produce changes in the context or in the actor’s strategy.⁸³

From an analytical perspective, the ‘international’ entails two dimensions at the implementation level: horizontal and vertical. The horizontal dimension involves the perimeter scope of its foreign policy, spanning from local to regional and global. The scope depends on the actor’s position in the environment, the resources at its disposal and the strategic value of these. The vertical dimension results from the functional stratification of the actor’s interests/goals: political, economic, military, normative and cultural. The hierarchy amongst these varies according the actor.⁸⁴

To finalise this conceptualisation, there is always a degree of interaction between the ‘domestic’ and the ‘international’ spheres in the process of implementing a certain foreign policy. This entails the

⁸⁰ C. Hay, “Structure and Agency”, in: D. Marsh and G. Stoker (eds.), *Theory and Methods in Political Science* (London: Macmillan, 1995); C. Hay, *Political Analyst: A Critical introduction* (Basingstoke: Palgrave, 2002).

⁸¹ E. Brighi, “Europe, the US and the ‘Policy of the Pendulum’: The Importance of Foreign Policy Paradigms in the Foreign Policy of Italy (1989-2005)”, Conference Proceedings, Political Studies Association, 2006, available online at: <http://www.psa.ac.uk/2006/pps/Brighi.pdf> (accessed 5 December 2010)

⁸² E. Brighi and C. Hill, “Implementation and Behaviour”, in: S. Smith, A. Hadfield and Tim Dunne (eds.), *Foreign Policy: Theories, Actors, Cases* (Oxford: Oxford University Press, 2008) p. 119.

⁸³ E. Brighi and C. Hill, *op. cit.*, p. 120.

⁸⁴ E. Brighi and C. Hill, *op. cit.*, pp. 122-124.

mobilisation of material and immaterial (nation's support) resources to achieve certain foreign policy objectives, and the pursuit of domestic goals through foreign policy (or vice-versa).⁸⁵

The instrument-context dynamics are therefore critical in determining whether the outcome will coincide with (success) or diverge from (failure) the expected ends. The conceptualisation of the context will therefore allow for a better understanding of the causes behind different regional outcomes regarding China's oil diplomacy in developing regions.

1.3.3.1. Conceptualising the host institutional context

Here again emerges the 'structure-agency' dilemma. Even though the candidate argues for the primacy of the structure in explaining regional-level variations, agency is acknowledged as an influencing factor in explaining country-level discrepancies. This is the case with perceptions regarding the strategic importance of China *vis à vis* the target countries and vice versa.

Regarding the host country's perception of the strategic importance of China, these perceptions vary from strictly political to largely economic in nature. According to Philip Andrews-Speed, the strategic importance of China seems to be higher in countries where: a) there is a need to attract alternative investment in the face of sanctions or other international constraints (e.g. Sudan and Zimbabwe); b) need to reduce dependence on western international oil companies (IOCs, as a means to increase their bargaining power); c) resources on offer are of marginal interest to IOCs (Chad, Peru, Ecuador and Tanzania); d) there is a great need for investment in oil and infrastructures (most African cases and South America, having the advantage of offering non-conditional aid); e) there is a search for demand security (such is the case of major producing countries which in general see Asian partners as most promising in this regard); and f) where China is seen as critical political counter-balance *vis à vis* the West (i.e. Venezuela and Iran).⁸⁶ So, in these cases, China has naturally more chances of success.

Conversely, Chinese perceptions of the target country may also influence deviations from the regional pattern. The most relevant considerations of the Chinese government can be measured in terms of the volume of oil reserves of the target country, and its political relevance to China (as a strategic ally in international *fora* or simply in pursuing the encirclement of Taiwan). This is the case, for instance, with Venezuela, where the sheer size of its oil reservoirs have to a certain extent balanced the negative impact of the unstable institutional structure at play. This explains why, for instances in the face of the

⁸⁵ E. Brighi and C. Hill, *op. cit.*, pp. 124-126.

⁸⁶ Philip Andrews-Speed, "China's overseas oil investments: host countries perspectives", 12 October 2009, available online at: <http://www.dundee.ac.uk/cepmlp/gateway/index.php?news=30264> (accessed 7 November 2009)

nationalisation of some of China National Petroleum Corporation's (CNPC) assets in that country, the Chinese government pressed CNPC not only to stay in the country,⁸⁷ but even to invest more heavily in spite of the low return of its investments there - mostly resulting from regulatory volatility.

However, while agency (i.e. perceptions) is useful in explaining intra-regional deviations (country-level), when it comes to regional variations, structures hold a much stronger explanatory power. That is the reason why this variable will not be tested and there will be a focus instead on institutional structure, as conceptualised below.

Although the literature still lacks a systematised analysis of the factors operating at the context level - that influence the outcome variations in China's engagement in resources in developing regions - many different explanations have been suggested, with most of them of a structural nature. These explanations have been pointed out in a scattered manner, and regarding to what attracts Chinese resources investment to particular contexts. In table 1.1. (below), there is an attempt to summarize some of the factors that have been pointed out, mostly deriving from China-Africa studies as research is more plentiful in this specific segment. While this thesis is not concerned with what attracts Chinese investment, some of these factors may be useful in explaining what causes them to fail or succeed.

Table 1.1. Major factors attracting Chinese investment in resources sectors in developing countries

Nature	Factor	Hypothesis
Political	Power balance	Chinese resources investment is attracted to contexts where there is no other major power.
	Regime type	Chinese resources investment is attracted to autocratic regimes.
	Political risk	Chinese resources investment is attracted to stable political environments.
	Burden costs	Chinese resources investment is attracted by low indirect costs such as feeble labour and environmental standards.
Economic	Competition with other MNC	Chinese resources investment is attracted to contexts where there is low competition.
	Economic risk	Chinese resources investment is attracted to high risk context that promises high profit margin prospects.

Source: Elaborated by the author.

⁸⁷ Interview, CNPC, Beijing, 25 August 2009.

Regarding China's resource security quest, the context factor that seems to be more popular in the existing literature is related to the nature of the host's political regime. Many analysts believe there is an ambiguous nexus between China's resources ventures and autocratic contexts.⁸⁸ Regarding outcomes, the success of this nexus seems to be confirmed by a significant number of cases, i.e. Sudan, Angola, Iran and Venezuela, where China has acquired significant resources equity. However, there are other examples involving Chinese deals with autocratic regimes, where resources contracts were cancelled or revised (Guinea, Democratic Republic of Congo – DRC - and Gabon). For this reason, regimes, per se, cannot be considered a determining factor in China's resources ventures outcomes.

Numerous studies analysing the relationship between regime type and FDI flows, produced inconclusive results, suggesting an inconsistent correlation between different political regimes and FDI attraction.⁸⁹ A significant number of studies do suggest, nonetheless, a strong nexus between FDI and undemocratic regimes in developing countries. Heiner Schultz⁹⁰ argues that the nature of this correlation is actually more sectoral than political, since developing states attracting investments are primarily resource rich countries, and as such more frequently have autocratic governments - hence the link.

If, on the one hand, one may admit that Chinese resource ventures have been more successful in Africa where there is a higher incidence of non-democratic regimes compared to South America; on the other hand, the above discussion shows that regime type alone, cannot account for the observed regional disparity regarding China's performance in resources industries.

This thesis argues that, more than the nature of the regime, it is the institutional specificities of the business environment in the resources sector in each region that constrain the outcome. It is possible to identify, in an abstract manner, a structural difference between both regions that is to a large extent influencing this divide in regional engagement patterns. This could be named 'institutional structure', as it reflects a combination of institutionalised features. In the context of the present thesis, institutional structure shall thus be understood as the balance between executive constrains (pluralist and pro-active

⁸⁸ Chris Alden, "China in Africa" *Survival* 47:3, pp. 147-164; Ian Taylor, "China's oil diplomacy" *International Affairs* 82:5, 2006, pp. 937-959; D. Zweig and Bi Jianhai, "China's global hunt for energy" *Foreign Affairs* 84/5, pp. 25-38.

⁸⁹ Quan Li and Adam Resnick, "Reversal of Fortunes: Democratic Institutions and foreign direct Investment Inflows to Developing Countries" *International Organization* 57:1, 2003, pp. 175-211.

⁹⁰ Hein Schulz, 'Political Institutions and Foreign Direct Investment in Developing Countries: Does the Sector Matter?', University of Pennsylvania, online publication, p. 3, available online at: http://ipes2007.stanford.edu/afs/ir/dept/rde/WWW/ipes2007/papers/Schulz_FDI_Paper.pdf (accessed 7 November 2009)

civil society, government accountability and administrative complexity) and the institutional capacity of the state to mediate those.

The notion of region is, above all, a constructed idea grounded on a given geographic perimeter whose reality has been shaped by interactive historical, cultural, political and economic processes. These processes produced a certain degree of convergence with regards to the region's socio-political-economic foundations, accounting therefore for its distinctiveness *vis à vis* other regions. While the state system can be said to be primarily composed of democratizing and liberal states in South America,⁹¹ in Africa regimes assume in general a more authoritarian and monopolistic/oligopolistic nature.⁹² In the context of the present thesis, political-economic-social trends are thus regarded as determining critical differences in the institutional structure of resources sectors in each region. The present thesis will focus on a particular aspect of these structures, which is the balance between executive constraints and institutional capacity.

The above claim is inspired by the literature on the relationship between regime type and FDI and, particularly, on the findings of O. Bayulgen and J. Ladewig, who argue that FDI attractiveness varies according the institutional structure:

We hypothesize that high degrees of executive constraints create an investment environment that is credible for foreign investors only in political regimes that have the institutional capacity to build coalitions among veto players and resolve conflicts regarding investment policies. Weak executive constraints, alternatively, are attractive for foreign investors in political regimes that lack the institutional capacity to mediate among veto players. Hence, both consolidated democracies and autocratic regimes can produce investment policies that are attractive to foreign investors. Democratizing regimes, on the other hand, usually undergo increasing pluralism in the context of weak institutional capacity and are therefore less attractive for risk-adverse foreign investors.⁹³

⁹¹ Terry Lynn Karl, "Dilemmas of democratization in Latin America" *Comparative politics* 23:1,1990, pp. 1-21; F. Hagopian and S. Mainwaring, *The Third Wave of Democratization in Latin America: Advances and Setbacks* (New York: Cambridge University Press, 2005).

⁹² C. Clapham, *Africa and the International System: the politics of state survival* (Cambridge: Cambridge University Press, 1996); P. Chabal and P. Daloz, *Africa Works: Disorder as Political Instrument* (London: James Currey, 1999); Jean-Francois Bayart, *The State in Africa: The Politics of the Belly* (New York: Longman, 1993).

⁹³ O. Bayulgen and J.W. Ladewig, "Dictators and Democrats: The Political Sources of Success in Attracting Foreign Direct Investment", 2004, paper presented at the annual meeting of the Midwest Political Science Association, Palmer House Hilton, Chicago, Illinois, available online at: http://www.allacademic.com/meta/p84375_index.html (accessed 7 November 2009)

The transitional type of states found in South America are in general characterised by a poor institutional balance. The weakened central political power has not yet developed the institutional capacity to efficiently manage the increasingly decentralised and pluralist system characterised by strong and demanding constituencies (local powers, interest groups and civil society). This results in an investment environment marked by a convoluted regulatory framework, fragmented decision making process and a fuzzy line of authority.

In the case of Africa, authoritarian governments do not have the institutional capacity, but they do not face executive constraints either, since interest groups only exist within the patronage line. Investment wise, this is a friendlier environment as authority line is clear and decision making more concentrated in general. As Chabal & Daloz⁹⁴ note, even in apparently successful democratizing states in Africa, where multi-party elections have been introduced, in reality not much has changed. This is because political legitimacy continues to rest in personalised complex patronage networks, and political elites continue to manage state affairs informally and in their own interests and of their clients.

Stability of the institutional structure is a critical concept in this context, as it is perceived as a key determinant for investment to thrive. This is particularly so in resources, since it involves large upfront transfers of capital and technology, which are highly immobile thereafter. In the context of the resources sector, the concept of stability refers primarily to an enforceable and predictable framework defining ownership, dispute settlements, taxation and a regulatory framework that allows for the minimisation of investment risks in the medium-long term.

In China's case, in a context of high returns prospects, political risk measured purely in terms of violence/security threat seems to bear little effect over its involvement in resources sectors (China maintained its oil operations in Sudan and Ethiopia even after its nationals were targeted by local insurgents). On the other hand, regime stability seems to matter much more due to the negative impact it has in terms of contract and general regulatory stability (namely the case with Nigeria, where the incoming leadership in 2007 froze Chinese contracts signed during the former government). For this reason, one considers of particular importance the stability of the general institutional framework and in particular the stability of the regulatory framework of respective oil industries.

1.3.4. Learning and adaptation in foreign policy

⁹⁴ Patrick Chabal and Jean-Pascal Daloz , *op. cit.*, pp. 104-105.

There is one last dimension of implementation which is considered relevant in the context of the present thesis. This is how success and failure feed back into policy making and whether it is introducing changes in China's economic statecraft in developing regions. As the number of stakeholders and constituencies in CFP expands, feedback has become more relevant in the foreign policy making process.⁹⁵ This introduces the concept of learning in foreign policy.

Although the question of what learning can be drawn from history has always been latent in the minds of foreign policy makers and analysts, the issue became theorised for the first time only in the 1970s. The inability of structural approaches to explain change in Soviet foreign policy, and the subsequent dismissal of the Soviet Bloc, inspired a new wave of research on learning in the 1990s.⁹⁶ Learning as a tool to understand change processes has since been applied to different structures and actors spanning from leaders, institutions to epistemic communities, and analysed using diverse theoretical and methodological perspectives, from social psychology (heuristic and cognitive approaches) to game theories.⁹⁷

This thesis is only concerned with learning from experience and not with deductive learning (e.g. lessons from history). Jack Levy understands experiential learning as “a change of beliefs (or the degree of confidence in one's beliefs) or the development of new beliefs, skills, or procedures as a result of the observation and interpretation of experience.”⁹⁸ Levy distinguishes two phases in the political learning process: firstly the observation and interpretation of experience that leads to change in individual beliefs, and secondly when that belief change influences subsequent behaviour and becomes institutionalised.

The reason for this distinction is that learning does not necessarily entail political change. As Levy stresses, learning is not necessary or sufficient for change.⁹⁹ It is not necessary because change can occur through other variables such as structural adjustments and political change. Also it is not sufficient, because even when learning occurs, it may not be translated into policy changes, as it might be blocked by political or organizational constraints.

⁹⁵ Thomas G. Moore and Dixia Yang, “Empowered and restrained: Chinese foreign policy in the age of economic interdependence”, in: David Lampton (ed.), *The making of Chinese Foreign and Security Policy in the Era of Reform* (Stanford: Stanford University Press, 2001) pp. 202-203.

⁹⁶ George W. Breslauer, “Ideology and Learning in Soviet Third World Policy” *World Politics* 39, 1987, pp. 429-448; George W. Breslauer and Philip E. Tetlock (eds.), *Learning in U.S. and Soviet Foreign Policy* (Boulder, Colorado: Westview Press, 1991).

⁹⁷ For a more detailed review on learning in FP literature, see: Jack T. Levy, “Learning and Foreign Policy: Sweeping a Conceptual Minefield” *International Organization* 48:2,1994, pp. 279-282.

⁹⁸ Jack T. Levy, *op. cit.*, p. 283.

⁹⁹ Jack T. Levy, *op. cit.*, p. 289.

There is another experiential process which is often viewed as a lesser type of learning, because it is more mechanistic (trial and error, adjustments to constraints and incentives). Since it overlaps to some extent with the neorealist concept of structural adjustment,¹⁰⁰ it is sometimes referred to as the ‘neorealist approach to learning.’¹⁰¹ Philip Tetlock refers to it as ‘tactical learning’¹⁰² and by E. Haas as ‘adaptation’.¹⁰³ The main difference between tactical/adaptive learning and learning is that the former does not necessarily entail a change in beliefs. Adaptation is ‘the ability to change one’s behaviour so as to meet challenges in the form of new demands without having to reevaluate one’s entire program of reasoning on which that program depends for legitimacy’.¹⁰⁴ Adaptation results from the acknowledgement of flaws in the policies being deployed, and the attempt to fix them through a cost-effective equation between means and ends. It entails adapting means to new constraints or incentives, that do not necessarily question the beliefs that underlie the selected ends. Learning, on the other hand, pre-supposes the recognition of conflict amongst values. While learning entails a change in means and ends, adaptation leads only to a change in means.

Drawing from the literature on learning in foreign policy, P. Tetlock theorises that foreign policy beliefs are hierarchically organised as follows: fundamental assumptions and policy objectives at the top of the system, followed by strategic policy beliefs and preferences, and tactical beliefs and preferences at the base of the system. He then summarizes four hypotheses on the conditions under which learning is likely to occur and the types of learning that come out of this: a) Most learning take place at the tactical level, as policy makers are more willing to make frequent tactical adjustments to face constraints than to question policy fundamentals; b) policy makers only question their strategic policy beliefs after repeated tactical failures; c) they only reconsider fundamental goals after recurrent failure of strategic solutions; d) unit-level actors tend to minimise changes in beliefs by trying to accommodate new evidence and arguments into the pre-existent belief system.¹⁰⁵ Since most learning (the adaptive/tactical kind) seems to take place at the tactical level, one may conclude that policy changes are more likely to happen at the this stage, excluding, of course, the emergence of new systemic or domestic structural constraints.

¹⁰⁰ Which is, basically, states’ rational adjustment to systemic (relative power) pressures.

¹⁰¹ Philip Tetlock, “Learning in U.S. and Soviet Foreign Policy: in Search of an Elusive Concept”, in: G. Breslauer and P. Tetlock, *Learning in US and Soviet Foreign Policy* (Boulder, Colorado: Westview Press, 1991) pp. 24-27.

¹⁰² Philip Tetlock, *Ibid.*, p. 28.

¹⁰³ Ernest B. Haas, *When Knowledge is Power: Three Models of Change in International Organization* (Berkeley: Univ. Of California Press, 1990) p. 33-34.

¹⁰⁴ Ernest B. Haas, *Ibid.*, pp. 33-34.

¹⁰⁵ Philip Tetlock, *op. cit.*, (1991), pp. 28-31.

Even though normative changes in Chinese foreign policy are unlikely to occur in the short-term as covered by this thesis, it is argued that the implementation of Chinese economic statecraft is producing changes of a more practical nature. For this reason, the concept of adaptation/adjustment will be used in searching for relevant policy change. Its focus will thus be on changes that occurred through tactical learning. This is based on the argument that, at the present time, the most likely cause of change in Chinese foreign policy is what it is ‘learning from practice’ through immersion in the context, where it is trying to pursue its ends.

1.4. The use of positive economic statecraft in China’s oil diplomacy

1.4.1. The economic drive and pluralisation of actors in Chinese Foreign Policy

In spite the ideological continuity that Chinese officials like to stress in public discourses,¹⁰⁶ the fact is that China’s contemporary foreign policy hardly resembles that of the early days of the People’s Republic of China (PRC), when those guidelines emerged.

Even though the political structure of the regime remained mostly unchanged, the growing synergies between the fast changing domestic and international contexts, led to a profound reappraisal of Chinese Foreign Policy (CFP). The master shift behind this reassessment was the emerging economic drive, which led to seismic changes in the content of CFP, its formulation, and the way it is implemented.

Under Mao Zedong’s rule, Chinese foreign policy was geared up around political and military security interests, framed by the ideological competition with its former enemies (the US and Soviet Union).¹⁰⁷ In sharp contrast, economic reforms gradually introduced an element of economic pragmatism in CFP decision making. With Deng Xiaoping, economic development became CFP’s top priority in the 1980s. In this framework, China’s foreign policy focused in normalizing diplomatic ties with as many countries as possible, irrespective of their ideological orientation (*zhoubian zhengce*, or peripheral policy).¹⁰⁸ A more friendly international posture was seen as essential to attract investment and boost trade. If under Mao

¹⁰⁶ Among these figure the ‘Five principles of peaceful co-existence’, centrality of south-south cooperation, and the quest for a new economic order more just towards developing countries.

¹⁰⁷ Under Mao, China’s development strategy had no direct impact on its foreign policy, because of its self reliant nature. For a detailed analysis of development strategy impact in CFP during Mao and in the reform period up to the mid 1990s, see: Barry Naughton, “The foreign policy implications of China’s economic development strategy”, in: Thomas W. Robinson and David Shambaugh (eds.), *Chinese Foreign Policy: Theory and Practice* (Oxford & New York: Oxford University Press, 1994) pp. 47-69.

¹⁰⁸ For a detailed account on this peripheral diplomacy and China’s quest to stabilise its relations with its Asian neighbours throughout the 1980s and 1990s, see: Suisheng Zhao, “The making of China’s periphery policy”, in: Suisheng Zhao (ed.), *Chinese Foreign Policy: Pragmatism & Strategic Behavior* (NY & London: M.E. Sharpe, 2004) pp. 256-275.

foreign trade and economic cooperation were used as instruments to pursue CFP international political goals, in the reform era the situation reversed as CFP gradually became subservient to domestic development imperatives.¹⁰⁹

By the end of the 1990s, the ‘open door policy’ had successfully placed China among the top Foreign Direct Investment (FDI) recipients and leading world exporters. During this process, Chinese enterprises became successful exporters as they gained knowledge and experience with foreign capital through joint ventures (JV) with multinational corporations (MNC) in China. Facing fierce competition internally (output capacity outpacing domestic demand) and scarcity of domestic supply of strategic resources, Chinese firms were naturally compelled at the turn of the century to venture overseas. The launching of ‘going global policy’ by Beijing, surfaced thus as a way to promote the globalisation of Chinese firms through specific policy incentives, political backing and financial support. Chinese state owned enterprises (SOE) were naturally the major beneficiaries. By accessing strategic inputs abroad (raw materials, top end technology and ‘know how’), increasing its market share and by creating/acquiring global brands, the regime aspires to upgrade its production value chain, and move beyond the export-development model, and through this means sustain China’s growth pace.

Gradually deprived of its ideological legitimacy throughout the economic liberalisation process, the regime became increasingly dependent on maintaining the country in a steady development path. In order to pursue that goal without causing major doctrinal ruptures, Chinese foreign policy has become increasingly characterised by what Suisheng Zhao labelled “pragmatism and strategic behaviour”.¹¹⁰

If during the ‘open door policy’ period the domestic economic agenda gradually emerged as an influential element in CFP formulation, with the implementation of the ‘go out policy’ in the 2000s, Chinese economic interests became paramount in China’s foreign affairs. Even though the core national interests remain mostly the same, namely regime stability, sovereignty and territorial integrity, national unification and economic development,¹¹¹ the relevance of this last aspect came to be the cornerstone, as all others became ultimately reliant on it.

¹⁰⁹ For a concise study on Chinese foreign policy drivers from Mao to Jiang Zemin, see: Thomas W. Robinson, “Chinese Foreign Policy from the 1940s to the 1990s”, in: Robinson and Shambaugh, *op. cit.*, p. 568.

¹¹⁰ Suisheng Zhao, “Chinese Foreign Policy: Pragmatism & Strategic Behavior”, in: Suisheng Zhao, *Chinese Foreign Policy*, *op. cit.*, pp. 4-5.

¹¹¹ For a detailed analysis of the changing features of China’s national interest from Mao to the present see: Ye Zicheng, “China’s grand diplomacy: change of configuration, interest and environment”, in: *Global Review* 1:1, 2009, pp. 31-37.

The primacy of economic concerns over political ones was further reinforced by the wider international context. The end of the Cold War and the emergence of the information age further accelerated the intensification of economic flows at the global stage. Within this rapid changing framework, the importance of economic statecraft¹¹² increased substantially *vis à vis* diplomatic and military instruments in foreign relations.

If during Mao's rule foreign policy making was highly centralised and the exclusive realm of a handful of individuals under the direct control of the Great Helmsman, in the reform period progressive professionalization and institutionalisation have made the process significantly more complex.¹¹³ While senior leaders still have considerable latitude in major issues of strategy, the setting of broad agendas and crisis management, an increasingly large number of bureaucratic institutional actors are assuming a more active role in routine issue,¹¹⁴ particularly in what concerns economic affairs.¹¹⁵ The increasing complexity of issues facing decision makers in the context of economic interdependence and the relative inexperience of the paramount leaders in the matter, has provided room not only for proliferation of new agents in lower bureaucratic echelons, but also for them to have a greater say in decision making.

According to Lu Ning there are three types of actors intervening in contemporary Chinese foreign policy decision making:¹¹⁶ the central leadership, the foreign policy leading small group (LSG), and the central bureaucracy. This picture reflects the complexities of interlocking between the party and the governmental structures in which the first remains paramount. The central leadership is composed of the highest ranks of the party structure (who retain the key posts in the government): the paramount leader and his inner circle of trustees, the Standing Committee of the Politburo, and the Politburo members - in this order of authority. The central leadership determines the guiding principles and orientation of foreign policy, retaining the ultimate decision making power over all issues. Furthermore, the Central Foreign Affairs LSG is an informal decision making consulting body that includes leading members of party, government and military ministerial ranking agencies involved in foreign affairs. In addition to its policy

¹¹² Michael Mastanduno, "Economic Statecraft", in: S. Smith, A. Hadfield and T. Dunne (eds.), *Foreign Policy: Theories, Actors, Cases* (Oxford: Oxford University Press, 2008) pp. 171-187.

¹¹³ Suisheng Zhao, "The making of Chinese Foreign Policy: actors and institutions", in: K. Ampiah and S. Naidu (eds.), *Crouching Tiger Hidden Dragon? Africa and China* (Pietermaritzburg: University of KwaZulu-Natal Press, 2008) pp. 39-40.

¹¹⁴ David Lampton, "China's Foreign and National Security Policy Making Process: Is it Changing, and does it matter?", in: David Lampton (ed.), *The making of Chinese Foreign and Security Policy in the Era of Reform* (Stanford: Stanford University Press, 2001) p. 2.

¹¹⁵ For a practical case study on this particular trend, see: Margaret Pearson, "The case of China's accession to GATT/WTO", in: David Lampton (ed.), *op. cit.*, pp. 337-370.

¹¹⁶ The following three paragraphs are drawn upon: Lu Ning, "The central leadership, supra ministry coordinating bodies, state council ministries and party departments", in: David Lampton (ed.), *op. cit.*, pp. 39-60.

consultation prerogative, it also serves as a policy coordination and supervision mechanism. The central bureaucracy includes a number of ministerial ranking institutions that are in charge of foreign policy implementation. At the governmental level and as far as economic foreign policy is concerned, the most important are the Ministry of Commerce (MOFCOM) and the Ministry of Foreign Affairs (MOFA).

Also, according to Lu Ning, the rationale shift from national security to economic development generated critical shifts concerning the role of different actors in foreign policy making. These include the erosion of the role of the paramount leader in favour of a collective core, decentralisation of decision making power in favour of MOFA at the expense of the central leadership, and growing influence of MOFCOM at the expense of MOFA.

MOFCOM¹¹⁷ has had an increasingly primary role in devising strategies, planning and implementing foreign trade and economic cooperation policies. Notwithstanding, MOFCOM's control over foreign economic policy is also being eroded by the growing economic international assertiveness of sub-national bureaucratic and corporate agents such as provincial authorities and state owned enterprises (SOEs).¹¹⁸ It is worth noting, as David Lampton underlines, that:

Decentralization has been most evident in the international economic arena and least so in handling of high level diplomacy and national security strategy.

Decentralization and pluralization are, in fact, intimately related, inasmuch as the delegation of authority to lower level actors (for example, provinces), and the toleration of increased initiative by them gives rise to the growing number of actors that influence Chinese foreign policy.¹¹⁹

¹¹⁷ MOFCOM presently has 31 departments, which can be divided in three main categories: functional, regional and special (Taiwan, Hong Kong and Macau) departments. In what concerns foreign economic relations, the most relevant in the functional category are: Treaty and Law, Foreign Trade, Outward Investment and Economic Cooperation, Aid to Foreign Countries, International Trade and Economic Affairs, WTO Affairs, and Foreign Affairs. The regional category comprises: Asian Affairs, Western Asia and African Affairs, European Affairs and America and Oceania Affairs. Within these there are sub-regional divisions. As for MOFCOM's international missions, which are usually attached to China's embassies and consulates, there are 201 spread around the world (36 in Asia, 65 in Western Asia and Africa, 47 in America and Oceania and 54 in Europe). There are still two in Hong Kong and Macau (one each) and another four in international organizations (UN and WTO). Available online at: <http://english.mofcom.gov.cn/#> (accessed 20 August 2010)

¹¹⁸ For a detailed analysis on the impact on CFP of Chinese provinces in international relations, see: Peter Cheung and James Tang, "The External relations of China's provinces", in: David Lampton (ed.), *op. cit.*, pp. 91-120.

¹¹⁹ David Lampton, *op. cit.* (2001), p. 19.

Pluralisation challenges, though, are not limited to proliferation of actors and decentralisation at the lower echelons of the bureaucracy. CFP making has also had to cope with growing inputs from Chinese think tanks and public opinion.¹²⁰

While the discussion above is important to understand and analytically frame Chinese foreign policy making at present, this thesis is particularly interested with foreign policy synergies emanating from China's energy security concerns. The section below will elaborate further on this topic.

1.4.2. Energy security in CFP: unpacking the domestic institutional structure

As highlighted above China's foreign policy choices became increasingly driven by domestic economic imperatives. Among these, energy security concerns stand out as it substantiates one of its major external liabilities featuring therefore high in CFP agenda.

The relevance of energy security in a given country's foreign policy is directly proportional to its reliance on external supply of energy sources, which are in most cases non-renewable. Despite the large array of energy sources (oil, gas, coal, uranium, etc.), energy security is largely associated with security of supply of hydrocarbons due to the more uneven distribution of its reservoirs.

Ensuring oil security in the current global context is a daunting task.¹²¹ The fast expanding gap between ever-growing global consumption and finite oil resources has fuelled fierce competition for supplies leading to skyrocketing oil prices. To this adds increasing supply uncertainty owing to greater reliance on supply markets historically plagued by political instability, manipulation, terrorism, nationalisation policies etc.

There is no single universally recognised definition of energy security. Definitions vary across countries, reflecting their particular contexts and concerns. While in producing countries energy security is tied to ensuring a steady demand, for an oil importer the security lies on steady supply. Most states though tend to address energy concerns in supply and demand sides (namely consumption restraining and expansion of renewable sources), and some even integrate environmental and socio-economic concerns. A widely

¹²⁰ Suisheng Zhao, *op. cit.*, (2008), pp. 48-50. For an analysis of the growing impact of public opinion on Chinese foreign policy see: Fewsmith and Rosen, *op. cit.* (2001), pp. 151-187.

¹²¹ For an analysis of the new energy security challenges surfacing in the new century see: Daniel Yergin, "Ensuring Energy Security", in *Foreign Affairs*, 85:2, 2006, pp. 69-82

spread and more basic connotation describes energy security as ‘the availability of sufficient supplies at affordable prices’¹²².

According to the Energy Research Institute at the NDRC¹²³ and official documents,¹²⁴ China’s energy security strategy presently seems to be addressing two equally important fronts: domestic and overseas supply. Domestically, the strategy encompasses improving efficiency in consumption (reducing waste and diversifying the energy matrix through renewable energy) and increasing production (by attracting foreign investment and new exploration technologies). On the overseas front, the strategy encompasses ensuring steady supply and the diversification of its import sources.

This thesis is concerned with the overseas front. As previously discussed, Beijing’s greatest energetic external reliance is oil. For this reason, the present thesis will focus on China’s oil diplomacy, hereby understood as the policies and strategies devised to ensure steady supply of oil at reasonable prices and the diversification of its import sources.

Successive institutional reforms in the energy sector in recent years underline the centrality of this issue for the present leadership. These reforms featured an attempt to reassert central authority over the sector, so as to increase coordination and allow for the implementation of a much needed overarching energy security strategy. Following the disbanding of the Ministry of Energy in 1993, energy policy making became dispersed between several ministries, bureaucratic bodies and SOEs. The first attempt to centralise the sector took place in 2003, with the creation of the Energy Bureau, which was aimed at coordinating, regulating and implementing energy policies. This was followed by the establishment of a high level Energy Leading Group in 2005 (ELG, advisory role to the State Council), supported by a State Energy Office (administrative body). The new institutional structure, however, struggled to assert primacy over energy SOEs and the existing energy bureaucracy.¹²⁵ A new reform was needed. The Energy Bureau was replaced by the National Energy Administration (NEA, placed under the National Development and Reform Commission, NDRC¹²⁶) in 2008. An attempt was also made in 2008 to reinstate the Ministry of

¹²² Idem, p. 70-71

¹²³ Interview, Energy Research Institute/NDRC, Beijing, China, September 2, 2009.

¹²⁴ White Paper on Energy (2007), the 11th Five Year Plan (2006-2010).

¹²⁵ Erica Downs, “China’s new energy administration” *China Business Review* 38, November-December 2008, p. 46.

¹²⁶ The NDRC is a key policy-making body within the State Council that enjoys ministerial ranking. The commission is the successor of the State Planning Commission (SPC), in charge of China’s centrally planned economy since 1952. In 1998 the SPC merged with the State Council Office for Restructuring the Economic System (SCORES), and was renamed the State Development Planning Commission (SDPC). In 2003 the State Economic and Trade Commission (SETC), responsible for outward investment approval amongst other things, was integrated with SDPC, giving birth to the NDRC. NDRC plays a critical role in lining up macro-economic policies and

Energy, but the initiative was blocked by vested interests in the sector. In January 2010, the ELG was replaced by the National Energy Commission (NEC, advisory board under the State Council). NEC is headed by Premier Wen Jiabao, NDRC's chairman and the head of NEA. The committee integrates 21 members of various government agencies,¹²⁷ and is a clear effort to accommodate the various stakeholders' interests.¹²⁸

The formulation and implementation of China's energy security goals has become increasingly complex integrating inputs from an array of different state actors spanning from supra-ministerial organs, several ministries and respective departments, governmental financial institutions and corporate agents. In the context of China's oil diplomacy a handful of NOCs have become paramount in pursuing Beijing's interests overseas.

Although the new structure represents a significant improvement, Erica Downs notes that its efficiency is crippled by insufficient manpower, authority and autonomy necessary to coordinate the interests of all the stakeholders (ministries, commissions and SOEs).¹²⁹ The fragmented nature of the energy sector is particularly evident in the oil industry, its roots laying deep in the history of the sector. Even though China had a ministry of oil (Ministry of Petroleum Industry, MOPI¹³⁰) for a considerable long period of time (1955-1988) the liberalisation of the sector in the 1980s led to the gradual fragmentation of authority in the sector. In 1982 MOPI established its first oil corporation, China National Offshore Oil Corporation (CNOOC). The aim was to facilitate the opening up of the sector to foreign participation in offshore fields, envisaging an increase in oil production by accessing their superior technology. The following year another enterprise was established, China National Petrochemical Corporation (Sinopec) to which authority was granted over most of the refining complex of the country. In 1988 MOPI was dissolved to give way to another oil corporation, China National Oil Corporation (CNPC), retaining however

overseeing China's overall economic development. Energy issues are critical for the country's development, and this is the reason why energy management has been placed under its authority.

¹²⁷ Xinhua, "China sets up national energy commission headed by Premier", *People's Daily Online*, 27 January 2010, available online at: <http://english.people.com.cn/90001/90776/90785/6880663.html> (Accessed 20 August 2010)

¹²⁸ For further discussion on China's energy security bureaucracy, actors and synergies, see: Erica Downs, *China's Quest for Energy Security* (Santa Monica CA: RAND, 2000); Philip Andrews-Speed, *Energy Policy and Regulation in the PRC* (London: Kluwer Law, 2004); Erica Downs, "The Chinese energy security debate" *The China Quarterly* 177, March 2004, pp. 21-41; Erica Downs, *The Energy Security Series: China* (Washington DC: The Brookings Foreign Policy Studies, December 2006); Zha Daojiong, "China's energy security: domestic and international issues" *Survival* 48:1, 2006, pp. 179-190; Joseph Y. S. Cheng, "A Chinese view of China's energy security" *Journal of Contemporary China* 17:55, 2008, pp. 297-317; Michal Median (ed.), *Shaping China's Energy Security: The Inside Perspective* (Paris: Asia Centre, 2007), pp. 64-89.

¹²⁹ Erica Downs, 'China's new energy administration', *China Business Review*, November–December 2008, p.43

¹³⁰ MOPI was created in 1955 to take over the National Bureau of Petroleum Administration (Under the Ministry of Fuels) which ran Sino-Russian onshore oil exploration in Xinjiang province.

ministerial ranking. Oil trading monopoly was given to China National Chemical Import Export Corporation (Sinochem).¹³¹

Although in the beginning CNPC, Sinopec and CNOOC had their activities well delimited (CNPC concentrating in onshore operations, CNOOC in offshore, Sinopec in downstream), all of them gradually integrated upstream and downstream operations in the 1990s. Notwithstanding, Sinopec remains the major player in domestic refinery; CNOOC still retains control over offshore production and CNPC in onshore output. Mostly owing to its advantage starting point (formerly the Ministry of Petroleum Industry) CNPC remains China's largest oil and gas producer and supplier. CNPC, CNOOC and Sinopec went through major restructuring in the late 1990s, including listings in international stock exchanges, namely Hong Kong, New York and London. A recent study, however, suggests that this move was prompted by political motivations (increase NOCs profile and prestige overseas) more than commercial ones.¹³²

Notwithstanding, it should be noted that some studies point to a progressive ascendancy of commercial interests in NOCs outbound investment strategies,¹³³ while some others suggest that the central government is increasingly struggling to coordinate and retain control over all agents involved in the foreign policy process. As pointed out by Erica Downs in regards to the energy sector, the high profile of the agents involved makes the authority line fuzzy and the diversity of agendas and sometimes conflicting interests makes coordination a very problematic issue not only among them but also with the corporate actors at the bottom.¹³⁴ These evolving trends raise critical challenges to Beijing regarding the ability to efficiently control the outcome of its oil diplomacy, summed up in the classic 'principal-agent dilemma'. The emerging contradictions between China's foreign policy goals (principal) and its gradual distortion along the implementation chain that integrates a plurality of bureaucratic and corporate agents with their own interests and agendas.

¹³¹ For an extensive overview of how China's domestic oil market developed : Houser [XXXX](#)

¹³² Hung, Mingyi, Wong, T.J. and Zhang, Tianyu , 'Political Relations and Overseas Stock Exchange Listing: Evidence from Chinese State-Owned Enterprises' (August 13, 2008). Available at: <http://ssrn.com/abstract=1224162>

¹³³ Shaoming Cheng, and Roger R. Stough, 'The pattern and magnitude of China's outward FDI in Asia', April 2007, available at: <http://www.icrier.org/pdf/25-26April07/Session2/Shaoaming%20Cheng%20and%20Roger%20R%20Stough.doc> ; E. Hong and L. Sun 'Dynamics of internationalization and outward investment: Chinese corporations' strategies', *The China Quarterly*, 187, 2006, 610-634

¹³⁴ Erica S. Downs, 'China Security: the fact and fiction of Sino-African energy relations', in: *China Security*, Vol. 3 No.3 Summer 2007, pp. 42-68 Erica Downs, *China*, Energy Security Series, The Brookings Foreign Policy Studies, December 2006, p.16-24

The relationship between Chinese NOCs and the central government does need special mention. While these companies have become increasingly moved by profit and managed on a corporate basis as a result of SOEs reform in the late 1990s, Beijing still has the means to influence NOCs' decision making process. This is illustrated by a raft of bureaucratic facts. A recent study¹³⁵ underlines that the central government's grip over SOEs is evidenced by its ownership structure. In most cases, two thirds of the outstanding shares are non tradable, directly or indirectly under the government's control, leaving no room for private shareholders to influence corporate decisions. Moreover, the CEOs of the largest NOCs are political appointees, nominated by the Communist Party of China with other senior board positions appointed by SASAC.¹³⁶ This means that in most cases these cadres are pursuing political careers and therefore report to the Party or SASAC instead of shareholders. Further to this, control by the state is ensured through investment approval procedures, which involve clearance by key ministerial ranking bureaucracies such as NDRC, MOFCOM and the State Administration of Foreign Exchange (SAFE).¹³⁷ Ultimately, the companies' compliance with the state strategic interests is ensured through the necessary prior approval by NDRC and the State Council.¹³⁸ In addition to this, a significant proportion of the financing of these companies comes from Policy Banks. Finally, the central government plays an important role in directing the destination of resources investments either through incentives policies or inter-governmental deals. According to Wang, 'the Chinese government believes that it is not feasible to allow unregulated investment in every sector and in every country. The government aim has been to carry out FDI in targeted sectors and industries in accordance with China's long-term strategies.'¹³⁹

The monitoring role played by the central government suggests that there is still a large margin for Beijing's political and strategic agenda to influence NOCs investments overseas. This, however, is not an exclusive feature of Chinese NOCs as noted by Alden and Davies.¹⁴⁰ Indeed, this has been the case with French NOCs (Elf/Aquitaine and Total) operating in Africa where an interlock between oil companies,

¹³⁵ Randall Morck, Bernard Yeung and Minyuan Zhao, 'Perspectives on China's Outward Foreign Direct Investment', August 2007, pp. 11-14, available at:

<https://www.bschool.nus.edu.sg/Departments/BussPolicy/BY%20papers/perspectives%20china%20outward%20fdi.pdf>

¹³⁶ The State-owned Assets Supervision and Administration Council (SASAC) was created in 2003 under the State Council, with the aim of tightening supervision and improve the performance of the non-financial state-owned enterprises under the Central Government.

¹³⁷ SAFE is the government's agency in charge of China's foreign exchange control system, and therefore responsible for regulating the use of foreign exchange in outward investment projects.

¹³⁸ All projects over US\$200 million are to be reviewed by NDRC and approved by the State Council.

¹³⁹ Mark Yaolin Wang, 'The Motivations behind China's Government-Initiated Industrial Investments Overseas', in: *Pacific Affairs*, Vol. 75, No. 2, Summer, 2002, Published by: Pacific Affairs, University of British Columbia, p. 3

¹⁴⁰ Chris Alden and Martyn Davies, 'A Profile of the Operations of Chinese Multinationals in Africa', *South African Journal of International Affairs*, Volume 13, Issue 1, Summer/Autumn 2006, p. 84

armaments industry and Paris' Africa development policy has recently been exposed. In China's case, however, the interlock between the government and the NOC's seems to be much tighter.

This state of affairs seems to corroborate Katzenstein's postulate of a direct linkage between political strategies and domestic structures: the more centralised the state is the wider the range of instruments at the disposal of policy makers to conduct its foreign economic policy. This is largely explained by a stronger coalition between the state and the business sector and the more integrated policy network linking public and private sector.¹⁴¹ This linkage is evidenced by Chinese positive economic statecraft in the form of infrastructure –for-oil loans.

1.4.3. Infrastructure-for-oil loans as positive economic statecraft

Even though China has resorted to military statecraft in the past,¹⁴² it has clearly privileged diplomacy and positive economic statecraft as foreign policy implementation instruments since the onset of the economic reforms introduced by Deng Xiaoping. The preference for peaceful means is largely explained by the imperative of creating a friendly international environment, which is favourable to its domestic development.

A significant part of Chinese positive economic statecraft falls under the category that Beijing officially designates as 'foreign aid'.¹⁴³ Chinese foreign aid dates back to the early days of the PRC in the 1950s, when Beijing started channelling economic aid and technical assistance to communist countries first (Vietnam and North Korea) and then newly independent African countries - in search of political allegiance. In 1995 China started providing medium- and long-term low interest loans to developing countries. In the 2000s, using its swelling financial might, Chinese foreign aid increased substantially, averaging nearly 30% in the 2004-2009 period.

Unlike North-South cooperation, Chinese aid has a very distinctive economic and pragmatic nature, ultimately justified by its developing economy status. Rooted in the core principles of equality, non-conditional and particularly common development and mutual benefit, Chinese aid is designed to benefit both the extender and the receiver. In this context, while providing assistance, China's contemporary foreign aid is also an instrument to pursue economic goals overseas.

¹⁴¹ P. Katzenstein, op. cit., pp. 604-605

¹⁴² Supporting North Korea in the Korean War in the 1950s, the military training of African independence movements in the 1960s, and military intervention in Cambodia in the late 1970s.

¹⁴³ Information Office of the State Council of the People's Republic of China, 'China's Foreign Aid', white paper issued in April 2011, full text available online at: http://news.xinhuanet.com/english2010/china/2011-04/21/c_13839683_20.htm (accessed 5 May 2011)

The centrality of the Ministry of Commerce in China's foreign aid administration¹⁴⁴ further illustrates the strategic role that economic concerns play in Chinese foreign policy. In the absence of a proper cooperation agency, MOFCOM sits at a centre of a complex web that integrates several state institutions. MOFCOM is responsible for the formulation, approval, implementation, management and oversight of foreign aid projects. The Export-Import Bank of China (EXIM Bank)¹⁴⁵ is responsible for the management of projects involving concessional loans; and the embassies and consulates responsible for local coordination and management of projects in the receiving country. The State Council and NDRC play a strategic role in policy making and in monitoring the whole process. MOFCOM regularly consults with the Ministry of Finance (MOF) and the Ministry of Foreign Affairs in drafting foreign aid programmes and funding plans, having established a coordinating mechanism for that purpose in 2008 (inter-agency coordinating mechanism).¹⁴⁶

Chinese aid assumes many different forms: technical cooperation, human resource development, medical aid, emergency humanitarian aid, overseas volunteer programmes, debt relief and financial aid. Chinese authorities distinguish between three types of financial aid: grants, interest free loans and concessional loans.¹⁴⁷ While the first two are sourced from China's state finances, the last one is provided by The Export and Import Bank of China (EXIM Bank).

Concessional loans for infrastructure have been used in the past by China as foreign policy instrument, with reasonably successful results in pursuing China's political aims in Africa in the 1960s and 1970s. After a long break, the use of concessional loans as a foreign policy instrument resurfaced in the late 1990s.¹⁴⁸ Unlike in the 1970s though, the goals behind this type of economic inducement are now primarily economic.

¹⁴⁴ For a detailed account of China's administration of foreign cooperation, see: Penny Davies, *China and the End of Poverty in Africa: Towards Mutual Benefit?* (Sundbyberg, Sweden: Diakonia, July 2007), available online at: http://www.eurodad.org/uploadedFiles/Whats_New/Reports/Kinarapport_A4.pdf (accessed 15 October 2007)

¹⁴⁵ The Export-Import Bank of China was created in 1994, is fully owned by the Chinese government, and is under the direct leadership of the State Council. It plays an important role in promoting foreign trade and economic cooperation, acting as a key channel of policy that finances the Chinese import and export of mechanical and electronic products, equipment and technologies, and in undertaking offshore construction contracts and overseas investment projects by Chinese companies. Info according to EXIMBANK official website: http://english.eximbank.gov.cn/profile/intro_shtml (accessed 15 November 2009)

¹⁴⁶ Information Office of the State Council of the People's Republic of China, *China's Foreign Aid*, white paper issued in April 2011, full text available online at: http://news.xinhuanet.com/english2010/china/2011-04/21/c_13839683_20.htm (accessed 5 May 2011)

¹⁴⁷ Information Office of the State Council of the People's Republic of China, *Ibid.*

¹⁴⁸ Paul Hubbard, "Aiding Transparency: what we can learn about China's Exim Bank concessional loans", Center for Global development, Working Paper 126, September 2007, p. 4, available online at: http://cgdev.org/files/14424_file_AidingTransparency.pdf (accessed 18 January 2010)

Evidence (see below) suggests that a substantial part of concessional loans have been used by China as a positive economic statecraft vehicle to access resources (oil, minerals and other commodities) in exchange for infrastructure, hence the name ‘infrastructure-for-resources’ deals. Most of these loans have been extended to oil-rich countries, reason why the term ‘infrastructure-for-oil’ is more profuse in the literature. Even though the blue print of infrastructure-for-oil formula is often attributed to the concessional credit line extended to Angola in 2004 by EXIM Bank (reason it is also dubbed ‘the Angola mode’), similar financial facilities had been previously used by China with other oil producing countries, namely, Sudan and Republic of Congo in 2001.¹⁴⁹

With the subsequent mushrooming of this kind of loans, references to it started to surface in China-Africa literature in the second half of the last decade, rapidly becoming part of its vocabulary. The concept however remained somewhat loose. The first attempt to fully conceptualise the term was made in a World Bank Report in 2008.¹⁵⁰ Although the deal structure is not new in the oil industry (it had been largely used by developed countries, including Japanese oil backed loans extended to China in the 1970s)¹⁵¹ the scope and sheer size of Chinese oil-for-infrastructure loans pushes it up to a new level.

Reflecting the general perception, Foster et al stress two major features of Chinese infrastructure-for-oil package deals: (1) the extension of concessional loans is largely aimed at infrastructure development and (2) repayment is to be done in kind. The candidate would like emphasise a third feature that is of great relevance in the context of this thesis: (3) favoured access to oil equity as collateral to the loan, which is referred *en passant* in the above mentioned report.

In regards to the first dimension it should be noted that, in general this type of loan is rooted in two legal instruments: a framework cooperation agreement signed by the two governments stating the general terms (volume, purpose, interest rate and maturity) and a loan agreement signed by EXIM Bank and the borrower. What makes these loans concessional is that its interest rate (2 to 3%) is below the benchmark of People’s Bank of China, with the difference being subsidised by the central government. The reimbursement period is relatively long (up to 15-20 years, including 5-7 years grace).¹⁵² Although

¹⁴⁹Vivien Foster et al., *Building Bridges: China’s Growing Role as Infrastructure Financier for Sub-Saharan Africa* PPIAF/World Bank (Washington, D.C.: WB, July 2008), p. 57

¹⁵⁰idem, pp 52-57.

¹⁵¹ Deborah Brautigam, *The Dragon’s Gift: The Real Story of China in Africa* (Oxford: Oxford University Press, 2009) p. 47

¹⁵² Information Office of the State Council of the People’s Republic of China, *Ibid.*

designated as foreign aid, Chinese concessional loans do not match most of the OECD criteria¹⁵³ to be classified as Official Development Assistance (ODA). Chinese economic assistance has a grant level below 25%, and is not channelled through a proper state cooperation agency. In the same way, these credit lines fall out of the commercial loans category as their interest rates are normally lower. Although unconditional, these credit lines come tied to the procurement of services, goods and labour in China (minimum of 50%), leaving in general only a small margin for local content in the target country. The money never actually leaves China. It is administered on a project basis through the borrower's account with EXIM Bank with payments made directly to Chinese contractors after completion of the construction project. Although EXIM Bank concessional loans also target industry, resources development and agriculture, they are primarily earmarked for infrastructure construction.

According to Chinese official statistics, by the end of 2009 nearly 64% of its concessional loans had been directed to infrastructure.¹⁵⁴ While only 9% targeted resources development there is a clear geographic overlap between China's infrastructure commitments and its resource investments in Africa as underlined by the above mentioned World Bank report.¹⁵⁵ Up until 2008, China had infrastructure finance commitments in 35 countries across Sub-Saharan Africa. Three of these countries (Nigeria 34%, Angola 20% and Sudan 8%)¹⁵⁶ alone account for nearly two thirds of the total value, and not surprisingly they are all oil-rich countries.

Regarding the second feature, repayment in kind, it is rooted in the fact that concessional loans require a sovereign guarantee, which is largely problematic in developing countries due to their low creditworthiness. In oil rich countries this issue is solved by placing the local NOC as the guarantor of the loan and by requiring repayment to be done in kind. The reimbursement of the loan is done using proceeds from sale of oil from the host country's NOC directly to Chinese Oil Company. Although in general contracts refer to a certain amount of barrels of oil per day (bpd) to service the loan, it is agreed that the figure will in fact fluctuate according to oil prices oscillation, which might imply adjustments to the term of the loan. In this sense, as noted by Foster et al, 'credit deals tied to repayment in oil are not really a hedge against the future price of oil, but rather provide a way of securing a steady supply into the medium term' in line with Chinese oil security goals.

¹⁵³ According to OECD, the definition of ODA is: "flows of official financing to developing countries provided by official agencies which have a clear development or anti-poverty purpose and are at least partially concessional in nature", containing a grant element of at least 25%. "OECD Glossary of Statistical Terms", available at: <http://stats.oecd.org/glossary/index.htm>. (accessed 7 November 2009)

¹⁵⁴ Information Office of the State Council of the People's Republic of China, *op. cit.*

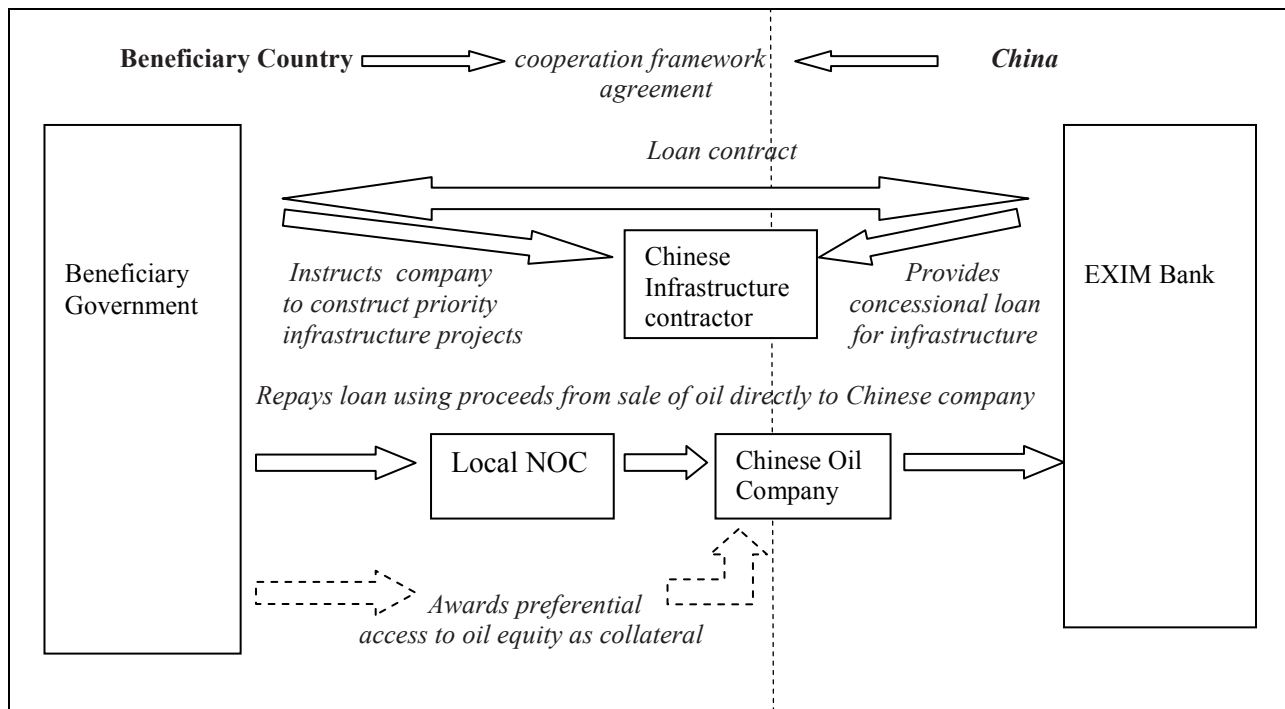
¹⁵⁵ Vivien Foster et al, *op. cit.*, pp 37-38.

¹⁵⁶ *idem.*, pp 37-38.

Lastly, this type of loans has also served the goal of opening the gates for Chinese national oil corporations to enter oil-rich countries in the developing world. The diplomatic exchanges at the highest level and the inter-governmental cooperation framework agreement that precedes the actual extension of the loan, enhances China’s political capital over the receiving country, particularly when the latter is in ‘dire straits’. Even though the written deals do not explicitly state that in exchange for the extension of the soft-loan the receiving country is to facilitate China’s access to oil acreage, the framework deals normally refer to increased cooperation in energy sector and closer ties between the two countries NOCs. This usually happens in the form of a joint venture between the local NOC and one of the Chinese oil companies (normally CNPC or Sinopec) which is established simultaneously to the loan agreement. Shortly after, this is normally followed by the award of exploration rights in the host country’s oil industry without having to compete directly with the more experienced and much better equipped (technology and expertise) international oil companies (IOCs). These loans thus create the conditions for Chinese oil companies to have privileged access to acreage overseas, fulfilling through this positive economic statecraft instrument Beijing’s oil security goals.

The diagram below illustrates the structure of infrastructure for oil deals.

Diagram 1.1. Structure of China’s infrastructure-for-oil package deal



Source: Author, adapted from: Vivien Foster et al, 2008, p. 56.

Chinese NOCs penetration in oil markets in developing regions appears to be closely associated with the extension of this type of loans. The massive financial resources at the disposal of China and the need to turn these into valuable hard assets overseas, combined with China's growing oil security concerns in the 2000s, accounts to a great extent for the emergence of this 'infrastructure-for-oil' formula as a key instrument of positive economic statecraft within China's oil diplomacy. As highlighted by Brighi and Hill, the choice of foreign policy instruments is a function of the resources available to the state and '(...) the nature of the available instruments tends to shape their policy choices in the first place.'¹⁵⁷

In recent years China Development Bank (CDB)¹⁵⁸ has resorted to a similar formula having extended large multibillion dollars loans to oil rich countries in the global crisis context (i.e. US\$10bn to Brazil's Petrobras and US\$ 25bn to Russia's Rosneft). These loans are different from concessional loans in that the borrower is a NOC rather than the national government; they are extended in more commercial terms (higher interest rates than EXIM Bank's concessional loans, but still below market costs) and are not to be repaid in kind. These loans are often referred to simply as 'loans-for-oil'. Nonetheless, China has secured through them collateral long term supply contracts covering the repayment term and also favoured access to resources equity for Chinese NOCs. According to a recent study on CDB loans to oil rich countries,¹⁵⁹ the credit is calculated on basis of the amount of oil the borrower can service and in view of their actual or potential relevance to China's oil security strategy suggesting that, like concessional loans, they are highly synchronised with Beijing's oil diplomacy.

The same way NOCs are regarded here as an element within this particular positive economic statecraft instrument, devised to serve the interests of China's oil security policy. Notwithstanding NOCs' own corporate interests and strategies, and the fact that they may on some occasions diverge from the ones devised in Beijing, the central government, as previously discussed, still has some leverage over them, particularly when it comes to ventures overseas.

What makes Chinese infrastructure-for-oil loans so unique in the global oil industry is not only its size and scope but also the degree of governmental control as all the players involved on the Chinese side

¹⁵⁷ E. Brighi and C. Hill, *op. cit.* (2008), p. 130.

¹⁵⁸ China Development Bank was created in 1994, also under the jurisdiction of the State Council, aiming at providing financial support for China's macro-economic development strategies, namely long-term financing for key projects in infrastructure as well as support financially the development of pillar industries vital to the development of the national economy. Info according to CDB official website:

<http://www.cdb.com.cn/English/Column.asp?ColumnId=96> (accessed 15 November 2009)

¹⁵⁹ IMANI, "Don't put all hopes in \$3bn Chinese loan", in Ghanaweb, 3 January 2012, available online at: <http://www.ghanaweb.com/GhanaHomePage/NewsArchive/artikel.php?ID=226868> (accessed 9 January 2012)

(MOFCOM, policy banks and oil companies) are state agents, suggesting as such a higher degree of coordination and ultimately the prevalence of Beijing's oil security concerns.

In the context of the present thesis, it is important to distinguish between two layers of goals underlying the use of this type of loans. The first encompasses a long term political goal, in the spirit of what Mastanduno termed structural linkage. By instigating the gradual emergence of economic interdependence, China hopes to build up its leverage over weaker states, so as to enact a coalition that will favour its interests in the long run. Infrastructure-for-oil loans, however, are only one among a set of many other positive economic statecraft instruments (such as trade promotion, and setting up of multilateral mechanisms such as the Forum for China Africa Cooperation, FOCAC, and Free Trade Agreements, FTAs) being applied by China and envisaging this outcome.

The second layer of goals in relation to soft loans refers to more immediate ends, which are primarily economic in nature – such as the promotion of Chinese business overseas (services, goods) and Beijing's oil security goals. This thesis is especially concerned with this layer of goals. Chinese infrastructure-for-oil loans are an important instrument in this regard, as they attempt to fulfil this goal through the locking up of future oil supplies through repayment of loans in kind and by securing oil equity as collateral to the deals. These two goals will be the measurement tools used to assess the degree of success of this particular positive economic statecraft, in pursuing China's oil security goals.

1.5. Methodological notes

Drawing from the analytical framework set out above, this section will elaborate a bit more on how it will be used in the current thesis, in order to analyze a particular dimension of China's foreign policy concerning the pursuance of its energy security goals in developing regions.

1.5.1. Research question and hypothesis

Although social/political phenomena lack the straightforward laws of natural science, research in the social sciences tends to parallel to the extent possible the methodology in an effort to make social phenomena scientifically intelligible. This effort involves dialectic interplay between ideas and evidence. In the words of C. Ragin: “ideas help social researchers to make sense of evidence and researchers use evidence to extend, revise and test ideas”.¹⁶⁰

¹⁶⁰ Charles C. Ragin, *Constructing Social Research: the Unity and Diversity of Method* (Thousand Oaks, CA: Pine Forge Press, 1994) p. 55.

A closer look into China's economic engagement in Africa and South America, reveals that China's stakes in the latter region have remained much lower throughout most of the decade under analysis. This is particularly intriguing if one considers that LA has traditionally attracted a lot more investment than Africa (in 2009: LA US\$120bn while Africa attracted US\$59bn).¹⁶¹ If one considers resources sectors, this paradox is even more astounding, particularly so if one takes into account that:

1) South America and Africa are equally important in China's resources security strategy. Both regions are well endowed in mineral resources, and their relevance in China's strategy has been confirmed over the past decade by the sharp rise in bilateral trade, in which Chinese imports of resources (oil and minerals) have had a key participation.

2) Both regions have a high deficit in infrastructures of all kinds (e.g. transportation, energy, sanitary) and are therefore in desperate need of investment, as the existing bottlenecks are increasingly threatening the pace of economic growth.

3) Chinese policy banks and resources companies have time and again throughout the past decade pledged to extend loans/increase investment in infrastructure and resources sectors in South America. A pledge was made by President Hu Jintao himself, during his first official visit to LA in 2004, to double Chinese investment by the end of the decade.

The above state of affairs thus inspires the research question that underlies this thesis:

What explains that Chinese oil diplomacy has been less successful in pursuing Chinese energy security goals in South America than in Africa?

In this context this thesis will therefore attempt to answer the research question by analyzing the performance of soft loans in Africa and South America. This will aim to explain why this positive economic statecraft tool has granted China more acreage and supply contracts in Africa than in South America, throughout the past decade.

In line with preliminary findings, the author's research hypothesis is thus as follows:

Owing to its elitist approach and unsophisticated nature, Chinese oil diplomacy is less likely to succeed in meeting Beijing's energy security goals in countries with more liberal institutional structures, where there

¹⁶¹ UNCTAD, *World Investment Report 2010*, July 2010, 'Regional trends', available online at: <http://www.unctad.org/Templates/Page.asp?intItemID=5544&lang=1> (accessed 20 August 2011)

is a lower level of control of the state over the oil industry, and which is more commonly found in South America.

In addition to testing the validity of the stated hypothesis, the analysis of this specific regional paradox will also offer a privileged window to assess, on the one hand, the practical strengths and pitfalls of China's positive economic statecraft when exposed to different sets of conditions, and, on the other hand, its resilience. In line with this, attention will also be paid to any relevant changes that may have emerged in course of the past decade, and which may signal important shifts regarding Chinese energy security strategies in both regions.

1.5.2. Justifying the case studies

Given time and financial constraints, the hypothesis will be tested through a comparative analysis of two carefully selected case studies: Angola and Brazil.

This choice is justified, in the first instance, because both countries are perceived as the most representative in each region regarding Chinese engagement patterns in resources sectors and the respective institutional structures. This will thus enable a rigorous hypothesis testing.

China's resources security concerns undoubtedly play a major role in its relations with both Angola and Brazil. These two countries are China's largest trading partners in their respective regions, and the bulk of China's imports from both countries are commodities. China-Angola trade accounted for over a fifth of China-Africa trade in 2010. Bilateral trade with Angola has grown 25 fold in the period 2002-2010 - the bulk of which is Chinese oil imports. Attesting the strategic importance of Luanda in China's energy security strategy, is the fact that it is China's largest oil supplier in the continent (accounting for half of Beijing's oil imports from Africa), and the second largest in the world following Saudi Arabia, with whom Luanda has been disputing the first place in recent years. As for Brazil, bilateral trade has also grown exponentially over the past decade, with Chinese commodities imports accounting for nearly half of total value, and reflecting the regional trend. Although dominated by resources, China's import chart from Brazil is a bit more diversified, including foodstuffs (soy beans) and mining, along with oil. China's strategic interest in the Brazilian oil industry has spiked in recent years as a result of its newly found reservoirs. The fact that Chinese oil imports from Brazil have doubled from 2009 to 2010, confirms this proposition. Brazil is China's second largest supplier in the region after Venezuela. Despite its much larger oil reserves, the instability of the oil industry in Venezuela has favoured Brazil's profile as a more reliable oil supplier in the region.

In addition, both Angola and Brazil can be said to be particularly representative of the different institutional structures found in their respective region. Angola combines a highly oil-dependent economy with weak institutional capacity and weak executive constraints, from which emerged a highly centralized institutional structure that enables the state to fully control the oil industry. Brazil, however, presents a more diversified economy combined with a complex state bureaucracy. This translates into a weak institutional capacity *vis à vis* the high level of executive constraints, which have converged in a more fragmented line of authority in resources management.

Although Brazil has a more diversified economic structure which might suggest an increased negotiation leverage with China over resources *vis à vis* Luanda (since Brazil is less dependent on resources than Angola), this is to some extent offset by the fact that Angola also has a negotiating leverage over China since its oil sector is, on the other hand, much more diversified than Brazil's in terms of partnerships. This state of affairs thus minimizes the distorting effect that this type of 'agency' could have in the research design.

A clarification is due in order to justify the choice of Brazil instead of Venezuela as the most representative case study for South America. Despite being China's largest oil supplier, Venezuela is regarded in this context as a deviation from the normal regional institutional pattern. In this case the 'agency' (Chavez voluntarism regarding the oil industry and his eagerness to replace the United States - US- with China) has to a certain degree caused to deviate from the general structural pattern. As such, Venezuela's context, in a way, resembles more the type of institutional environments found in Africa than in South America. This explains why Chinese economic inducements have been able to penetrate more easily here than in the rest of the region. Since one is looking at how Chinese oil diplomacy performs in different institutional contexts, rather than similar ones, Brazil stands out as the best case study to test the hypothesis.

Further justification is that Angola and Brazil's potential as oil producing countries is presently within the same range (despite its declining production Venezuela has one of the largest oil reserves in the world). Furthermore, in both countries oil reservoirs are mostly located offshore in ultra-deep waters (onshore and oil sands in the case of Venezuela), and the Chinese oil company acting in both countries is the same: Sinopec (China Petrochemical Corporation; Venezuela: China National Petroleum Corporation - CNPC). In the framework of the present research which proposes to compare the performance of a specific engagement strategy in resources sectors in two different regional institutional settings, Angola and Brazil

offer thus a more precise comparative research design. This approach will keep contextual differences to a minimum, therefore minimizing possible distortions.

1.5.3. Research methodology

In order to test the above hypothesis, the current study will apply a comparative methodology.¹⁶² While for practical and ethical reasons the experimental method is seldom an option in the social sciences, the comparative method allows the social scientist some degree of control, by “holding certain things constant while examining and accounting for observed differences”.¹⁶³ This method allows for generalisations which can then be useful in prediction and in building more general theories.

The current comparative analysis follows an inductive logic, since the hypothesis stated above draws from observation of empirical evidence and aims at adding to explanatory theories. This contrasts with deductive analysis, in which the hypothesis is inspired by an existing theory and then applied to the selected case studies.¹⁶⁴

The study is based on qualitative research conducted through extensive field work and intensive desktop research. Fieldwork was conducted in 2007 (September-December in China), 2008 (January-April in Angola; August-September in China), 2009 (February-March in Angola; June-July in Brazil; August-September in China), 2010 (May in China) and 2011 (February in Angola). In-depth interviews with qualified informants conducted throughout this period constitute a major primary source. Interviewing was based on an interview guide with open-ended questions to facilitate discussion in a semi-structured way. Altogether were conducted 38 in-depth interviews in Angola, 27 in Brazil and 25 in China. Interviewees include governmental officials from the ministries of energy, foreign affairs, commerce and finances, national banks, investment promotion institutions, and from the national oil companies of the three countries concerned. Informants also included scholars, journalists and business associations.

Written primary sources include official documents (cooperation agreements and business contracts) and internal reports and relevant legislation, regarding the oil sectors in Brazil and Angola. The primary sources collected during the course of this project enabled the researcher not only to uncover relevant information, but also to access and triangulate the views of all contributions involved. Fieldwork was, for

¹⁶² The methodology followed is based on the following readings: David Marsh and Gerry Stoker (eds.), *Theories and Methods in Political Science* (London: Macmillan Press, 1995); G. King, R.O. Keohane and S. Verba, *Designing Social Theory Inquiry: Scientific Inference in Qualitative Research* (Princeton: Princeton Univ. Press, 1994); Todd Landman, *Issues and Methods in Comparative Politics: An Introduction* (London: Routledge, 2000).

¹⁶³ Todd Landman, *op. cit.*, p. 14.

¹⁶⁴ Richard Rose, “Comparing Forms of Comparative analysis” *Political Studies* 39:3, 1991, p. 449.

this reason, critical in understanding the context, process and synergies that make up the topic under consideration.

Secondary sources include books, journal articles, conference papers, unpublished theses on related themes (namely on Chinese foreign policy, China's energy security, China in Africa/Angola and China in LA/Brazil). Statistical data were drawn from official publications by Chinese, Angolan and Brazilian authorities and international organizations (i.e. WTO and UNDP).

As for the case studies, owing to minimal existing research on the research topic, the analysis is mostly rooted in interviews, official documents and legislation, relevant governmental and NOCs websites, specialized intelligence (e.g. Upstream online, Oil and Gas Journal Online, Africa-Asia Confidential, Africa Mining Intelligence, USGS, Business Monitor International) and media (Bloomberg, Reuters, Xinhua, Angop, Agencia Brasil, Macau-Hub and Chinese, Angolan and Brazilian major newspapers).

Regarding the structure of this thesis, it comprises six chapters, including the introduction and conclusion. Following the analytical framing of the object of the study, the second chapter offers a comparative overview of China's engagement in Africa and South America. It presents a synopsis of historical ties, and an analysis of the major features of Chinese contemporary economic diplomacy, with particular reference to China's engagement in the oil sector in both regions. The main purpose of this is to uncover the paradox regarding China's much lower degree of success in South America, particularly concerning oil acreage access. The third chapter offers an examination of the institutional structures that surround the oil sector in both case studies, which is aimed at emphasising the major differences. The fourth and the fifth chapters of the thesis dissect the ebb and flow of China's engagement in the oil sector in each of the case studies (Angola and Brazil in this order) over the past decade. This is aimed at explaining how the institutional structure impacted the outcome of the infrastructure for oil loans in each country. The concluding remarks include the analysis of the hypothesis testing, and what can be drawn from this.

CHAPTER 2: CHINA'S ECONOMIC STATECRAFT IN SOUTHERN AFRICA AND SOUTH AMERICA: FROM IDEOLOGY TO RESOURCES

This chapter intends to provide an insight into China's resources drive, with particular reference to Southern Africa and South America, which constitute the regional framework of the case studies under analysis: Brazil and Angola. The aims of this chapter are: (a) to provide a brief historical background of PRC's foreign policy towards developing regions and to emphasise the gradual increase of the economic drive of its diplomacy; (b) to demonstrate the critical role of resources in China's contemporary relations with the regions under study; and (c) to identify regional similarities and differences in China's patterns of engagement, with particular reference to oil.

The main objective of this chapter is to emphasise that despite fast expanding trade relations with both regions and the systematic deployment of other positive economic statecraft instruments, China's resource diplomacy has been much less successful in South America. This question undergirds the present thesis, which proposes to explain why Chinese engagement in resources sectors is taking so long to lift off in South America, despite the increasing relevance of this region as a hard commodities supplier to China, and given that some of China's earliest resources investments in the 1990s were made in this region.

2.1. Historical background of China's foreign policy towards the developing world¹⁶⁵

While China's relations with developing regions such as Southeast Asia and Central Asia date back to ancient Middle Kingdom times, in the cases of Africa and LA, relations are relatively recent. Although there are records of China-Africa contacts through Muslim traders throughout much of the Christian era, the first direct official contacts only occurred through Admiral Zheng, during his short maritime incursions in East Africa in the early 15th century, prior to the arrival of Europeans. Contact resumed again in the late 19th century through the colonial powers use of importing Chinese labour to work in

¹⁶⁵ Parts of this section draws on: C. Alden and Ana C. Alves,, "History and identity in the construction of China's Africa policy" *The Review of African Political Economy* 35:115, 2008, pp. 43-58.

African plantations and mines. However, due to internal turmoil in China and in Africa, bilateral relations were insignificant throughout the first half of the 20th century.¹⁶⁶

As for LA, sheer distance made contacts an even more recent phenomenon. Despite uncertain accounts of earlier contacts,¹⁶⁷ proven encounters seem to have started indirectly with Mexico via the Philippines (both Spanish colonies) in the late 16th century. Direct contacts began in the 19th century, mostly through the importing of Chinese labour ('coolies') by the newly independent countries, to work in railway construction and mines. In the late 19th century some LA countries established diplomatic ties with imperial China (Brazil, Mexico, Peru, Panama and Cuba), while a few more did so after the republican revolution (Chile, Bolivia, Guatemala and Nicaragua).¹⁶⁸

Until the foundation of the PRC in 1949, China's relations with Africa and LA were mostly *ad hoc*. From that point on, Chinese policy towards those specific regions gradually developed a more proactive and assertive approach, framed by its evolving 'Third World'¹⁶⁹ policy.

This 'Third World' policy has its foundations in a raft of facts, guiding principles and official documents, that are scattered through the six decades of PRC's existence. Indeed, China's Third World policy underpinnings integrate the ideological contributions of all four generations of leaders. These are based in their respective experiences and the changing nature of national interest, in the context of a shift from a planned to a market economy. Two broad phases can be distinguished in CFP towards the Third World: the Maoist period, marked by a strong political-ideological motivation, and the reform period initiated in 1978, increasingly driven by pragmatic political-economic aspirations.

¹⁶⁶ For a detailed account on China-Africa relations prior to the establishment of the PRC, see: Gao Jinyuan, "China and Africa: the Development of Relations over Many Centuries", in: *African Affairs* 83:331, 1984, pp. 241-250; Philip Snow, *The Star Raft: China's encounter with Africa* (New York: Grove Press, 1988).

¹⁶⁷ Gavin Menzies, *1421: the Year China discovered the World* (London: Bantam Press, 2004).

¹⁶⁸ For a brief account on China-Latin America relations prior to the establishment of the PRC, see: Jiang Shixue, "On the Development of Sino-Latin American Relations" *China International Studies* Winter 2007, pp. 76-102, available at: <http://blog.china.com.cn/jiangshixue/art/915285.html> (accessed 15 November 2009)

¹⁶⁹ The 'Third World' concept first appeared in the French literature (*Tiers Monde*) in the mid 1950s, framed by the emergence of the non-aligned movement following various independence struggles, and which led to the Afro-Asian conference in Bandung in 1955. Having emerged in a bipolar context, the term was intended to emphasise the birth of a third international force, distinct from the two major alliances led by the US and the Soviet Union. At that point Third World membership was determined by six main criteria: '...history (previously colonized by the west), economics (poor/or underdeveloped), race (non white), culture (non Western), geography (situated in Asia, Africa and LA) and politics (non-aligned)' - Peter Van Ness, "China and the Third World: Patterns of Engagement and Indifference", in: S. Kim (ed.), *China and the World: Chinese Foreign Policy faces the New Millennium* (Boulder and Oxford: Westview Press, 1998) p. 153. Despite the notion having lost its political nexus as a third force following the collapse of the Soviet Union, it is nonetheless still a valid concept since all other criteria could be said to match the countries that today fall in the category of developing countries.

2.1.1. The Maoist period (1949-1977): ideology primacy

Without doubt, China's policy towards the developing world had its genesis in the 1950s. In the context of its quest for international diplomatic recognition, especially among the newly independent countries, the launching of the Five Principles of Peaceful Coexistence (mutual respect for territorial integrity and sovereignty, mutual non-aggression, mutual non-interference in internal affairs, equality and mutual benefit)¹⁷⁰ emerged as the core foundation. At this time China was a close ally of the Soviet Union, and its primary interest was thus to oppose the US. However, by 1960 an ideological rift led to the Sino-Soviet split, which further reinforced Beijing's own Third World policy.

In 1963 Mao constructed his 'dual intermediate zones' theory, according to which a large intermediate zone existed between the US and the Soviet Union. This zone was divided into the areas under American control (Western Europe, Canada, Australia and Japan) and the areas under Soviet influence, mostly comprising developing regions (Asia, Africa and Latin America). China belonged to the latter zone and, following the split with the Soviet Union, Beijing embarked on stiff competition with Moscow for the leadership of the communist world.

As a consequence of these developments, China's Third World policy assumed subversive contours in the 1960s, especially in Southeast Asia and Africa, where Beijing became actively involved in several insurgencies, providing support in the form of military training, financial assistance and weaponry, in an attempt to supersede Soviet influence in the newly independent regional nations.¹⁷¹ Due to the fierce anti-communist stance of most LA countries, under the US aegis, China's revolutionary policy did not penetrate the region at this stage.¹⁷² Its influence was limited to unofficial contacts, such as support to the Cuban revolution (1959) and episodic statements of rhetorical support condemning US interference in the region.¹⁷³ By the end of the 1960s, nearly 20 African countries had recognised the government in Beijing,

¹⁷⁰ These principles were first put forward by Zhou Enlai in 1953 during negotiations with India over the settling of the Tibet issue, and introduced in the preface of the final agreement signed in 1954. Zhou Enlai reiterated the principles during the Bandung Conference and these were fully integrated into the final declaration of the summit. The Five Principles have served as the basis for the establishment of diplomatic relations with other countries and were written into the PRC's constitution in 1982.

¹⁷¹ For an analysis of China's subversive activities in Africa in the 1960s, see: Peter Van Ness, *Revolution and Chinese Foreign Policy: Peking Support for Wars of National Liberation* (Berkeley: University of California Press, 1970); Richard W. Hull, "China in Africa" *Issue: A journal of Opinion* 2:3, 1972, pp. 49-50; Mohamed A. El-Khawas, "China's Changing Policies in Africa" *Issue: A journal of Opinion* 3:1, 1973, pp. 24-28; For a detailed analysis of African response to Chinese Foreign Policy, see: G. T. Yu, "Dragon in the Bush: Peking's Presence in Africa" *Asian Survey* 8:12, 1968, pp. 1023-1025.

¹⁷² Xiang Lanxin, "An Alternative Chinese view", in: R. Roett and G. Paz (eds.), *China's Expansion into the Western Hemisphere* (Washington, D.C.: Brookings Institution, 2008) p. 46.

¹⁷³ Jiang Shixue, "The Chinese Foreign Policy Perspective", in: Roett and Paz, *op. cit.*, p. 29.

while only one LA country, Cuba (1960), maintained diplomatic ties with China. Instead of raising China's profile internationally, this period of radicalisation in CFP caused severe damage to China's image abroad. This perception, coupled with the advent of the Cultural Revolution in 1966, gradually led to the end of China's subversive incursions overseas in the late 1960s.

Furthermore, the increased Chinese perception of the Soviet threat, led to a gradual rapprochement with the US. From then on China's foreign policy concentrated on regaining Beijing's lost prestige through normalising diplomatic ties with developed and developing countries alike, regardless of their ideological orientation. This shift in Beijing's foreign policy was critical in gaining its United Nations Security Council seat in October 1971, in which developing countries, particularly from Africa, played a crucial part.¹⁷⁴ By the end of the decade, China was conducting diplomatic relations with 120 countries around the world, including 26 new recognitions amongst African states and 13 in LA.¹⁷⁵

In a speech at the United Nations General Assembly in 1974, Deng Xiaoping introduced Mao's 'Theory of the Three Worlds' (originally developed by Zhou Enlai),¹⁷⁶ which divided the world into three zones. The first one was led by the US and the Soviet Union. The second was controlled by the remaining industrialised countries, namely Western Europe, Japan, Canada and Australia. Lastly, the Third World, led by China, was mostly composed of non-aligned developing countries of the three A's (Asia, Africa and Latin America), which shared its peaceful coexistence and anti-hegemonic views, and its pledge to bring about a new international economic order. Two aims were therefore behind the speech's formulation: uniting the third and second worlds against the superpowers (US and Soviet Union), and organising and mobilising the Third World to form a new and more just international order.¹⁷⁷

During the 1960s and throughout the 1970s, although trade relations were mostly insignificant, China played a meaningful role in Africa as an aid provider.¹⁷⁸ Its aid, focusing on agriculture, health, education, technical assistance and high prestige projects, was based on the eight guiding principles of China's

¹⁷⁴ For a detailed account of the African states' role in China's UN Admission, see: Mohamed A. El-Khawas, "Africa, China and the United Nations" *African Review* 2:2, 1972, pp. 109-118.

¹⁷⁵ MOFA, 'The Third Wave of Establishing Diplomatic Relations with other Countries', 17 November 2000, available at: <http://www.mfa.gov.cn/eng/ziliao/3602/3604/t18014.htm>. (accessed 15 November 2009)

¹⁷⁶ Derek Mitchell and Carola McGiffert, "China's Interaction with the Developing World", J. Eisenman, E. Heginbotham and D. Mitchell (eds.), *China and the Developing World* (New York: M.E. Sharpe, 2007) p. 17.

¹⁷⁷ George T. Yu, "China and the Third World" *Asian Survey* 17:11, 1977, p. 1036.

¹⁷⁸ For an extensive analysis of the impact of China's development assistance in rural Africa in the 1970s to the 1990s, see: Debora Bräutigam, *Chinese Aid and African Development: Exporting Green Revolution* (Basingtoke: Macmillan Press, 1998).

foreign aid¹⁷⁹ launched in the early 1960s by Zhou Enlai. This was premised during his visit to Ghana and Mali, and was designed to help post-colonial states modernise and become self-reliant. China's aid, though, was concentrated in a few countries, namely Tanzania, Algeria, Ghana, Congo-Brazzaville and Mali. A particular emphasis was placed on Tanzania, not only because that country was China's most constant ally, but also because of its strategic location as an Indian Ocean gateway to mineral-rich Sub-Saharan Africa. China decided to concentrate its development aid in fewer countries and in large projects to function as showcases. This was in order to acquire a precious leverage over the rest of Africa, by undertaking major infrastructure projects denied by Western powers, such as the Tazara railway.¹⁸⁰ Additionally, loans were given to other African countries (e.g. US\$84mn to Ethiopia in 1971 and US\$190mn to Sudan)¹⁸¹ on very favourable terms: interest free repayment over thirty years, to start after a five year period of grace with no strings attached. This was a pattern similar to China's existing practice in the continent. The aim though, was mainly political-ideological: advancing China's leadership role first in international communism, and then in the non-aligned Third World, as well as mitigating the influence of Taiwan.¹⁸² The full potential of these aid packages was, however, curtailed by the limited resources

¹⁷⁹ (1) The Chinese Government always bases itself on the principle of equality and mutual benefit in providing aid to other countries. It never regards such aid as a kind of unilateral aims [sic] but as something mutual. (2) In providing aid to other countries, the Chinese Government strictly respects the sovereignty of the recipient countries, and never attaches any conditions or asks for any privileges. (3) China provides economic aid in the form of interest-free or low-interest loans and extends the time limit for repayment when necessary so as to lighten the burden of the recipient countries as far as possible. (4) In providing aid to other countries, the purpose of the Chinese Government is not to make the recipient countries dependent on China, but to help them embark step by step on the road of self-reliance and independent economic development. (5) The Chinese Government tries its best to help the recipient countries build projects which require less investment while yielding quicker results, so that the recipient governments may increase their income and accumulate capital. (6) The Chinese Government provides the best-quality equipment and material of its own manufacture at international market prices. If the equipment and material provided by the Chinese Government are not up to the agreed specifications and quality, the Chinese Government undertakes to replace them. (7) In providing any technical assistance, the Chinese Government will see to it that the personnel of the recipient country fully master such technique. (8) The experts dispatched by China to help in construction in the recipient countries will have the same standard of living as the experts of the recipient country. The Chinese experts are not allowed to make any special demands or enjoy any special amenities. (According to the Chinese Ministry of Foreign Affairs: <http://www.fmprc.gov.cn/eng/ziliao/3602/3604/t18001.htm>.) (accessed 15 November 2009)

¹⁸⁰ The railway was built to link Zambia's rich copper belt to the coastal port of Dar Es Salaam, so as to break the dependency on white-ruled Rhodesia. The decision to construct the railway grew out of a direct request from Zambian president Kenneth Kaunda, and seconded by his Tanzanian counterpart, Julius Nyerere. China assembled a US\$405mn interest free loan for this project, representing at that point the largest single offer of economic assistance granted to an African state by a communist country.

¹⁸¹ Richard W. Hull, *op. cit.*, p. 50.

¹⁸² For a brief account of the features of Chinese development aid in the Maoist period, see: Gregory Chin and B. Michael Frolic, *Emerging Donors in International Development Assistance: the China Case*, December 2007, pp. 3-4, available at: http://www.crdi.ca/uploads/user-S/12441473751Case_of_China.pdf; for a more detailed study on the evolution of China's foreign aid since the 1950s, see Li Xiaoyun, "China's Foreign Aid", paper presented at OECD Conference, 25 April 2008, available at: <http://www.oecd.org/dataoecd/27/7/40378067.pdf> (both accessed 15 November 2009)

available to China, since it was still an impoverished developing country, lacking successful domestic experience. Its technical and economic assistance, though valuable, was not comparable with that of the US or the Soviet Union, and this was the determining factor for its failing to exert meaningful influence over the continent at that stage.

While in the 1950s and 1960s China's policy towards Africa and LA was largely driven by ideological concerns, in the 1970s it gradually became more flexible and pragmatic, reinforcing its prestige through fostering state to state relations and motivated by the quest to isolate Taiwan diplomatically. On the LA front, China's rapprochement with the US in the 1970s opened the way for a breakthrough in relations. At this stage many countries in the region established diplomatic ties with Beijing, namely Mexico (1972) and most South American countries;¹⁸³ however there is very little to report in terms of bilateral economic cooperation in this period.

2.1.2. The reform period (1978-1999): economic pragmatism awakening

With the demise of Mao and the subsequent focus on domestic economic reforms initiated by Deng Xiaoping in 1978, China's relations with the developing world entered a new phase. At the Twelfth National Congress of the Chinese Communist Party held in September 1982, Beijing proclaimed its independent foreign policy¹⁸⁴ *vis a vis* Washington and Moscow, in spite of the rapprochement underway with these two former enemies. It reiterated the validity of the Five Principles of Peaceful Coexistence as its guiding doctrine, and reaffirmed its commitment to the Third World. This stance took shape in the context of increasing competition for the leadership of the Third World, between China and Cuba. Cuba assumed a defiant position towards China, mostly due to Beijing's rapprochement with Washington.¹⁸⁵

a) Adjournment in the 1980s

The announcement of the new 'independent policy' was followed by Premier Zhao Ziyang's Africa tour to eleven countries (December 20, 1982 to January 17, 1983),¹⁸⁶ aimed at launching a new African policy

¹⁸³ Chile established diplomatic ties with China in 1970 - the only Latin American country, besides Cuba, to recognize China before its accession to the UN, Peru followed in 1971, Argentina and Guyana in 1972, Brazil and Venezuela in 1974 and Suriname in 1976. The smaller Central American countries have remained a stronghold for Taiwan until the present.

¹⁸⁴ For a more detailed analysis of this new 'independent policy' and its impact in the Third World, see: Sarah-Ann Smith, "China's Third World Policy as a Counterpoint to the First and Second Worlds", in: Lilian C. Harris and Robert L. Worden (eds.), *China and the Third World: Champion or Challenger* (London & Sydney: Croom Helm Limited, 1986) pp. 59-61.

¹⁸⁵ Frank Mora, "Sino-Latin American Relations: Sources and Consequences" *Journal of Interamerican Studies and World Affairs* 41:2, 1999, p. 96.

¹⁸⁶ Algeria, Congo, Egypt, Gabon, Guinea, Kenya, Morocco, Tanzania, Zaire, Zambia and Zimbabwe.

summarized in the “Four Principles on Sino-African Economic and Technical Cooperation”.¹⁸⁷ Divorced from ideological baggage, these four principles were inspired by economic pragmatism in tune with the new domestic developmental priorities, and China’s limited resources¹⁸⁸. This also signalled the realignment of Beijing’s international assistance with its more pragmatic national interests. The growing commitment to its domestic modernisation process, however, led China to scale down its aid to Africa, bringing to an end the large-scale technical assistance projects. The focus instead was now on low profile cooperation projects requiring smaller investments and quicker returns that could enhance mutual self reliance and create mutual economic benefit.

The first high-level Chinese delegation to LA (Mexico, Colombia and Venezuela) was dispatched in 1981, headed by Foreign Minister Huang Hua.¹⁸⁹ While economic assistance dominated China’s economic relations with Africa in the 1980s, LA trade relations showed some dynamism. Prompted by the context of simultaneous economic liberalisation processes, China and LA started to explore the complementarities of their economies in this decade. The value of trade increased from US\$176mn in 1970, to US\$1.3bn in 1980, and thereafter to US\$2.9bn in 1989 - with Brazil accounting for half of that volume throughout most of the 1990s.¹⁹⁰ Like trade, the few Chinese investments in the region over this period were largely dominated by resources, mostly mining (at the time China was still an oil exporter). Reflecting the upgrading in relations, Premier Zhao Zyang visited the region in 1985 (Colombia, Brazil, Argentina and Venezuela). Another distinct feature in China-Latin America relations, *vis a vis* China-Africa relations over this period, was the launching of science and technology cooperation programmes. These were in nuclear energy (Argentina and Brazil) and joint construction of satellites (Brazil), and reflecting the different stages of development in both regions. Nonetheless, in relative terms, at this stage trade and technological and scientific cooperation between China and LA represented an insignificant fraction of the former’s respective relations with the developed world.

In fact, despite the Chinese rhetoric, LA and Africa, and the rest of the developing world, remained low on China’s foreign policy agenda throughout the 1980s. Rather, China was preoccupied with the need to access capital and technology, which was only available in the developed world. Thus China’s foreign policy was increasingly dominated by the imperatives of domestic modernisation and development, and

¹⁸⁷ The four principles are: equality and mutual benefit, practical results, variety of cooperation forms, and common progress.

¹⁸⁸ George Yu, “Africa in Chinese Foreign Policy” *Asian Survey* 20:8, 1988, p. 857.

¹⁸⁹ Frank Mora, “Sino-Latin American Relations: Sources and Consequences” *Journal of Interamerican Studies and World Affairs* 41:2, 1999, p. 97.

¹⁹⁰ Frank Mora, *Ibid.*, p. 99.

its focus on deepening its relations with the US and Western Europe. As a result of this the proclaimed consolidation of relations with the developing world was adjourned.

b) Revitalising ties in the 1990s

Structural domestic and international changes at the turn of the decade brought the developing world back onto China's foreign policy agenda in the 1990s. Facing growing diplomatic isolation from the developed world in the wake of the Tiananmen Square massacre in June 1989, Beijing was facing the threat of becoming a pariah state, as the remaining communist power in the wake of the Soviet Union's collapse in 1991. To circumvent the encirclement promoted by the West, China launched a diplomatic offensive targeting the Third World, in order to realign its international relations in the emerging new international framework. Chinese officials were dispatched on goodwill missions worldwide; exchanges with foreign leaders were actively promoted; efforts were made to normalise relations with as many countries as possible, irrespective of their ideological allegiance; and a policy of moving closer to developing countries within international institutions was pursued.

Chinese efforts to cultivate closer ties were particularly welcomed by African leaders, not only because these arrived at a time when American interest in the continent was fading away (in the wake of the collapse of the Soviet Union), but also because China's culturally relativist stance regarding democracy and human rights echoed the concerns of many African regimes under pressure from Western donors. Between June 1989 and June 1992, Chinese Foreign Minister Qian Qichen visited 14 African countries, while numerous African leaders visited Beijing in return. Aid to African countries boomed from right after the Tiananmen events, mainly directed to African states that had stood by China during the crisis. In 1990, China-Africa aid amounted to US\$374.6mn spread among 43 recipients, which is significant when compared to US\$60.4mn in 1988 distributed among 13 countries.¹⁹¹

With regard to LA, most countries adopted a moderate position regarding the Tiananmen episode, choosing not to pressure China. Signalling China's commitment to foster relations with the region, two Chinese presidents toured LA (Yang Shangkun and Jiang Zemin) between 1990 and 1993, visiting five different countries. Over that same period, nine LA presidents visited China.¹⁹² Economic, trade, science and technology cooperation agreements intensified: the first major investments by Chinese SOEs in Latin America resources took place in the early 1990s. Chinese mining company Shougang acquired major

¹⁹¹ Ian Taylor, "The 'All-Weather Friend'? Sino-African interaction in the 21st Century", in: Ian Taylor and Paul Williams (eds.), *Africa in International Politics: External Involvement on the Continent* (London: Routledge, 2004) p. 87.

¹⁹² Frank Mora, *op. cit.* (1999), p. 111.

Peruvian iron-mining company, Hierro Peru, for US\$120mn in 1992. In the following year CNPC engaged in its first oil exploration venture in the region (also in Peru), while other Chinese companies expressed interest in investing in Brazil (iron ore) and Chile (copper).

Another critical factor in the revitalization of CFP towards developing regions was the Taiwan issue, with LA and Africa increasingly becoming a battleground for the island's diplomatic recognition throughout this period. The tussle between China and Taiwan for such recognition has been essentially waged with financial instruments - the so called 'dollar diplomacy' - with Beijing and Taipei trying to better each others' bids. Being in an advantageous position as an emerging global power, China has been gradually winning this game, although not without periodic setbacks. Currently, of the 23 states that still recognise Taiwan, twelve are located in Central and South America and four in Africa.

The Taiwan missile crisis in 1996, raised Beijing's fears of further isolation from the West. Once again the developing world materialised as an important supporting platform for China. President Jiang Zemin and Premier Li Peng's Africa-Asia tours in 1996 and 1997, respectively, and Premier Li Peng's LA visits in 1995 (Mexico, Cuba and Peru) and 1996 (Brazil, Chile and Venezuela), took place when the Taiwan issue was being discussed and a resolution on China's human rights situation was being voted on at the United Nations Human Rights Commission.

These high level exchanges were also a prelude for the full revival of both regions in China's foreign policy that materialised at the dawn of the 21st century. In fact, it was during the 1996 Africa tour that Jiang Zemin launched the idea of creating the Forum on China-Africa Cooperation (FOCAC) in order to foster economic ties (formally created in 2000), which Li Peng expounded in his visit to LA that same year. They were guided by the four key priority areas for expansion of relations: trade, direct cooperation among enterprises, joint tapping of natural resources, and exchanges in science and technology.¹⁹³ Although no similar multilateral mechanism emerged with LA, mostly to avoid US discomfort,¹⁹⁴ China has been engaging in a number of dialogue platforms with the region since the 1990s. These are the Rio

¹⁹³ Frank Mora, *Ibid.*, p. 102.

¹⁹⁴ Cynthia A. Watson, "U.S. Responses to China's Growing Interests in Latin America: Dawning Recognition of a Changing Hemisphere", in: Woodrow Wilson International Center for Scholars, *Enter the Dragon? China's Presence in Latin America*, February 2007; Peter Brookes, "Russia, China, Move in on Latin America", Heritage Foundation, November 27, 2008.

Group (since 1990),¹⁹⁵ Mercosur (Southern Common Market) and ALADI (the Latin American Association for Integration , as an observer since 1994).

A few distinctive features of CFP over this timeframe are worth noting with regard to Africa and LA. Although in the 1950s and 1960s Africa was a relevant element in CFP when Beijing actively supported the anti-colonialist struggle in the continent, the continent's strategic importance gradually faded as China's position became more moderate. Beijing's China-Africa policy reached its lowest ebb in the 1980s, as proven by the lowest levels of Chinese economic assistance in the continent.¹⁹⁶ Even though the policy was revitalised in the 1990s, to a great extent it continued to be limited to economic assistance, mostly servicing China's strategic politico-diplomatic interests (to isolate Taiwan and ensure support within multilateral *fora*).

On the other hand, despite the late start in relations with China, LA not only saw bilateral trade flourish throughout the 1980s and 1990s, but also the flourishing of other forms of cooperation: technological and scientific. Nonetheless, these carried little weight in the broader picture of LA's foreign relations. Ultimately, LA remained marginal in the context of China's broad external relations, and like Africa, its value for CFP was mostly instrumental in the context of Beijing's politico-diplomatic constraints throughout the 1990s. Notwithstanding, by the end of the 1990s, China's relations with LA had clearly achieved a more diversified cooperation pattern than with Africa.

The different approach to LA is mostly explained by the wider synergies between China and LA at that time, in terms of their stages in economic development. In addition to the inherent complementarities emerging from its condition as a resource-rich region, like Africa, countries in LA were undergoing the same liberalisation and industrialisation processes as China, which placed their economies at a similar level and opening up a large platform of common interests. Indeed, they shared a considerable number of concerns: growing protectionism from developed markets, the need to attract investments and improve their technological base, and both regions were interested in building up their political, economic and technological autonomy *vis a vis* developed countries.

¹⁹⁵ The Rio Group was set up in 1986 by eight LA countries to foster dialogue on regional integration issues. It presently comprises 18 countries: Argentina, Brazil, Colombia, Mexico, Uruguay, Venezuela, Chile, Ecuador, Bolivia, Paraguay, Peru, Panama, Costa Rica, Honduras, El Salvador, Nicaragua, Guatemala, and Dominica,

¹⁹⁶ For a detailed account of China's assistance to Africa since the early 1950s, see: Li Xiaoyun, "China's Foreign Aid to Africa", 2008, available at: <http://www.iprcc.org.cn/ppt/2008-05-13/1210662570.pdf> (accessed 15 November 2009)

Despite LA and Africa's relatively low profile in China's foreign policy during the 1990s, it is worth noting that a significant share of China's first major investments overseas took place in these regions in this period: CNPC's investments in oil exploration in Peru (1994) and in Sudan (1996). These, however, resulted from the company's independent internationalisation drive in the face of growing domestic demand and maturing reserves at home (China became a net oil importer in 1993), having ventured abroad at its own risk. The government backing only came at a later stage (1998), when the company started earning its first profits in Sudan.¹⁹⁷ Despite these initial ventures, resources would only become a driving force in China's foreign policy towards these regions in the following decade.

2.2. Resources drive in China's economic statecraft towards Sub-Saharan Africa and South America

As shown in chapter one although China's overall foreign policy throughout the 1980s and 1990s was increasingly shaped by an economic rationale, its weight became particularly overwhelming at the turn of the century. While its economic diplomacy was previously geared towards developed countries so as to attract investment and access to the WTO, over the past decade China's foreign economic policy has exhibited a much broader spectrum. This is due to the emergence of new imperatives: on the one hand, to internationalise its companies and access new markets for its exports, and on the other, to secure a steady supply for its growing mineral resources needs in order to sustain its domestic economic growth.

Emulating the same pattern observed in most developed economies during the initial stages of its economic expansion overseas, China's trade, investment and cooperation flows to and from developing regions, point to the clear prominence of mineral resources, especially in its relations with Sub-Saharan Africa and South America. The upgrading of LA and Africa in CFP in the 2000s, is clearly illustrated by these rapidly expanding trade flows, and the intensifying diplomatic exchanges at the highest level. For instance President Hu Jintao alone headed four tours to Africa and three to LA since he took office.¹⁹⁸ Starting at US\$10bn in 2000, bilateral trade surpassed the US\$100bn benchmark with LA in 2007 (three years ahead of the timeframe set by Hu Jintao during his first official visit to LA in 2004), and with Africa in 2008 (a year before the target set at the 2006 China-Africa summit in Beijing).

¹⁹⁷ Interview, CNPC, Beijing, 24 August 2009.

¹⁹⁸ Hu Jintao visited Africa in January 2004 (Egypt, Gabon and Algeria), in April 2006 (Mozambique, Nigeria and Kenya), in January/February 2007 (Liberia, Sudan, Zambia, Cameroon, Namibia, South Africa, Mozambique and the Seychelles), and lastly in February 2009 (Mali, Senegal, Tanzania and Mauritius); and LA in November 2004 (Brazil, Argentina, Chile and Cuba), November 2008 (Costa Rica, Cuba and Peru) and April 2010 (Brazil, Venezuela and Chile - although visits to the last two were cancelled at the last minute as the President had to return to China due to a severe earthquake in Qinghai Province).

<http://www.chinavivae.com/vip/index.php?mode=events&type=cv&id=19>. (accessed 20 August 2010)

China's impressively swift engagement with LA and Africa throughout the 2000s has increasingly captured the attention of the rest of the world. While in the 1990s its relations with Southeast Asia were dominating the news, in the 2000s its expanding involvement in LA and Africa dominated in the context of China's relations with the developing world. By economically penetrating these regions in search for alternative markets and supply sources, China is clearly expanding its diplomatic scope from a regional to a truly global level.¹⁹⁹

2.2.1. China's charm offensive

Aware of the potential negative charge of its greater economic involvement in developing regions (particularly when access to resources plays an important part in this), China has not spared any diplomatic efforts to underscore its good intentions and the mutual benefit of a closer economic interaction. As such, Beijing's discourse concerning its growing engagement in these regions, centres on the promotion of world peace and the development and emergence of a just and equitable new political and economic order by fostering unity amongst developing countries. Adjacent to these principles is a subliminal claim of the superior moral justness of China's policies.²⁰⁰ This stance unmistakably links China-Third World ties to the broader Chinese discourse of 'Peaceful Development and Harmonious World' - Hu Jintao's legacy to the party's theory,²⁰¹ that currently outlines its foreign policy as a rising power. This underlines China's positioning itself as a third path away from the limited US engagement in Africa (the narrow pursuit of resource diplomacy) and the EU's and US's complex engagement (economic, political and military ties)²⁰² in Africa and LA, respectively; and by doing so mitigating any fears of asymmetrical power relations. Indeed the ideational underpinnings of Beijing's policy towards

¹⁹⁹ For a detailed discussion on this topic see: Jianwei Wang, "China's New Frontier Diplomacy", in: Sujian Guo and Jean-Marc Blanchard (eds.), *Harmonious World and China's New Foreign Policy* (Plymouth, UK: Lexington Books, 2008) pp. 21-37.

²⁰⁰ For a detailed discussion on this topic, see: Chih-Yu Shih, *China's Just World: The Morality of Chinese Foreign Policy* (Boulder-Colorado & London: Lynne Rienner Publishers, 1993).

²⁰¹ See Hu Jintao's speech at the opening session of the UN in September 2005, "Build towards a Harmonious World of Lasting Peace and Common Prosperity" available at: www.fmprc.gov.cn/ce/ceun/eng/zt/shnh60/t212915.htm (accessed 15 November 2009); Chris Alden and Christopher Hughes, "Harmony and discord in China's Africa strategy: some implications for foreign policy" *China Quarterly* 199, 2009, pp. 563-584.

²⁰² Chris Alden, "Africa as China's Cornucopia: the Changing Role of Beijing's Resource Diplomacy", in: R. Beri and U. Sinha (eds.), *Africa and Energy Security: Global Issues, Local Responses* (Delhi: Academic Foundation, 2009) pp. 109-120.

developing regions largely account for what can be viewed as China's 'exceptionalism' *vis à vis* traditional donors.²⁰³

Aligned with this purpose, China has sought a closer relationship with Africa and LA. With respect to the African continent, China has, amongst other things, established its own multilateral cooperation platform, FOCAC;²⁰⁴ it organised the China-Africa summit in Beijing in 2006 (the largest number of African leaders gathered outside Africa); it has also revitalised its participation in the African Development Bank (a member since 1985)²⁰⁵ and the African Union; and in 2007 it established the China-Africa Development Fund (CADF) to finance Chinese ventures in the continent.

Concerning LA, China's engagement has been limited to participation in existing multilateral *fora*, which to some extent can be interpreted as a way to circumvent the US's disquiet. As such, China became a permanent observer of the Organisation of American States (OEA) in 2004, with strong support from its major trade partners in the region (Brazil, Chile, Venezuela and Mexico); in that same year the Chinese National People's Congress signed a cooperation agreement with the Latin American Parliament (Parlatino). Furthermore, and after three years of tough negotiations,²⁰⁶ China finally joined the Inter-American Development Bank (IADB, in January 2009), with an initial contribution of US\$350mn, giving China donor status and as such, the possibility to bid for IADB-funded infrastructure projects in the Americas. China is also soon to be admitted to the UN Economic Commission for Latin America and the Caribbean (ECLAC). In addition, it has established FTAs with two South American countries - Chile in 2006 and Peru in 2010 - while negotiations are underway with Costa Rica. Furthermore, Beijing is lobbying to establish a FTA with Mercosur.²⁰⁷

²⁰³ C. Alden and D. Large, "China's exceptionalism and the challenges of delivering difference in Africa" *Journal of Contemporary China* 20:68, 2011, pp. 21-38.

²⁰⁴ According to the founding declaration, FOCAC is a multilateral dialogue platform for cooperation between China and Africa based on equality and mutual benefit, and that seeks to promote economic and social development. FOCAC assumes as its ideational base the principles stated in the constitutive charters of the United Nations and the African Union, plus the Five Principles of Peaceful Coexistence, with particular relevance to peaceful settlement of disputes, non interference in domestic affairs, cooperation for mutual benefit and common development. It also highlights some other specificities of the Chinese cooperation model, namely the 'no strings attached' principle and a more flexible approach towards universal human rights. FOCAC, the permanent secretariat of which is based at the Chinese Ministry of Foreign Affairs, meets at a summit level every three years, alternating between Beijing and Africa, in order to approve an action plan for the following three years.

²⁰⁵ AfDB, <http://www.afdb.org/en/about-us/members/non-regional-member-countries/china/> (accessed 5 December 2010)

²⁰⁶ China's bid was initially blocked by the US on the grounds that it was a recipient of WB and IMF loans and therefore there was a risk that it could borrow from these to loan to developing countries in the Americas.

²⁰⁷ This issue has stalled, however, because of Paraguay's recognition of Taiwan.

In addition to these developments, the publication of a white paper on Africa in January 2006, and a policy paper on LA in November 2008 outlining China's policies towards these regions, further emphasises the increasing relevance of the two regions within China's foreign policy. This is particularly so if one takes into account that besides these two papers, China has only published another one addressing a region -regarding its policy towards Europe (2003). Unlike the situation in the 1950-1970s, when China's policy towards developing regions was driven by politico-ideological reasons, or in the 1980-1990s, when it was dominated by politico-diplomatic considerations, the two policy papers mentioned above clearly reveal that politico-economic motivations increasingly inspire contemporary CFP toward these regions.

The two white papers present a very similar outline. They begin by emphasizing the economic potential of each region within the current international context, the common ground with China (in the LA case the similar development stage and in Africa's case the long history of relations) and stress progress in relations during recent years. The papers continue by laying down the Five Principles and the One China Principle as the foundations of relations and subsequently outline a comprehensive cooperation programme covering all features of relations, within which economic aspects clearly stand out. Among other things, China commits itself to actively encourage investments by Chinese enterprises; to expand mutual benefit exploration of resources; and to engage in infrastructure development, which is a critical bottleneck affecting resources development in both regions.

Both papers were issued in very specific contexts. While, on the one hand, the timing of the Africa Policy Paper was symbolic, in that year China-Africa celebrated 50 years of relations (named the year of Africa in China), on the other, the Latin America Policy Paper was strategically presented by President Hu Jintao at the APEC summit in Peru in November 2008, precisely when the worst period of the world economic crisis was unfolding and developed countries were scaling down investments in the region. Furthermore, in the context of growing global media scrutiny of China's expanding economic leverage in Africa throughout the crisis period (2009-2010), Beijing released a second white paper on economic and trade cooperation with Africa. This document underscores the mutual benefits and positive outcomes of China's closer economic interaction with the continent.²⁰⁸ These timely and quick reactions are clearly indicative of these regions' relevance in China's contemporary foreign policy.

²⁰⁸ In November 2010, certain Wiki Leaks cables uncovered corruption practices by Chinese firms in Africa and exposed comments by a high ranking US official questioning China's good intentions in Africa.

Even though China's overall economic foothold in these regions still lags far behind that of the traditional powers, the gap has been closing rapidly over the past decade. China became Africa's major single trade partner in 2009 and the third largest of LA. In addition to this, Beijing has gained significant clout in these regions, through all the bilateral and multilateral diplomatic initiatives mentioned above, which have substantially increased its soft power. This new reality has raised concerns among the US and the European Union (EU) in particular as these regions have long been under their influence. This is not only because of economic competition, but is also due to China's distinctive 'no strings attached' approach (the 'Beijing Consensus') that counters the conditional cooperation practices of traditional donors (the 'Washington Consensus').²⁰⁹ The issuing of the policy papers mentioned above, to a certain extent, can thus be interpreted as Beijing's attempt to ease the increasing anxiety among developed countries regarding China's dealings in these regions. In this context, major concerns have clearly been Beijing's growing intake of resource exports from these regions, and the fast growing interests of Chinese SOEs in resources sectors there, which was until recently an exclusive realm of Western MNCs.

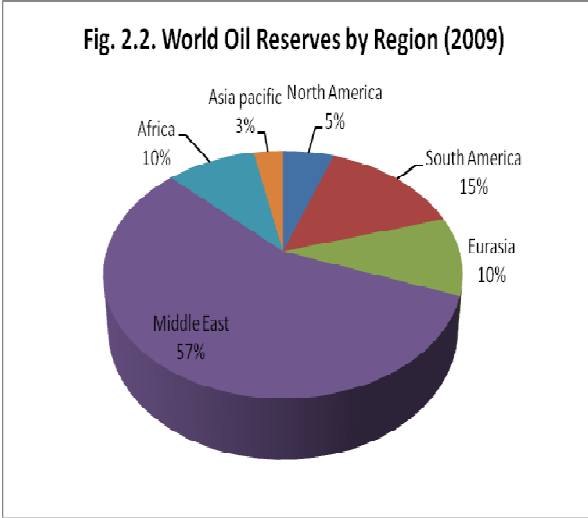
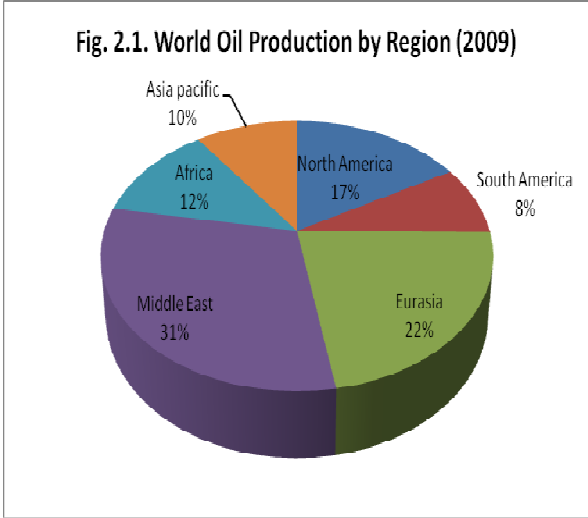
2.2.2. Uncovering economic complementarities

To a great extent, the rapidly flourishing relationship between China and LA and Africa at the dawn of the 21st century, can be explained by a timely convergence between a cash-loaded China in search of raw materials to sustain its domestic growth, and two underdeveloped regions with a vast pool of mineral deposits (hydrocarbons and base metals), the exploration of which has been hindered for decades by infrastructure bottlenecks. This inherent complementarity provides China with a privileged position to implement its economic statecraft, rooted in the provision of much needed infrastructure in exchange for access to resources.

Although the Middle East remains China's largest oil supplier, its share has been decreasing in relative terms as China diversifies its oil sources due to the unstable environment in that region. As a result, China has been increasingly active in Africa and LA, which together represent 20% of global oil output and a quarter of world known reserves as of 2009.²¹⁰ The charts below (fig 2.1 and fig. 2.2) offer a global perspective on South and Central America and Africa, in the oil resources context.

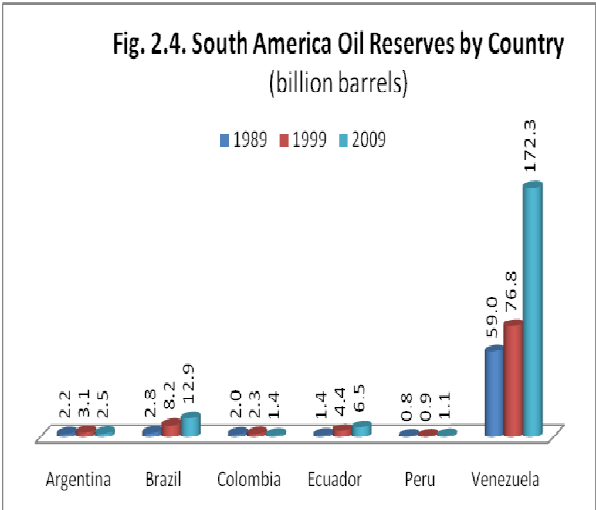
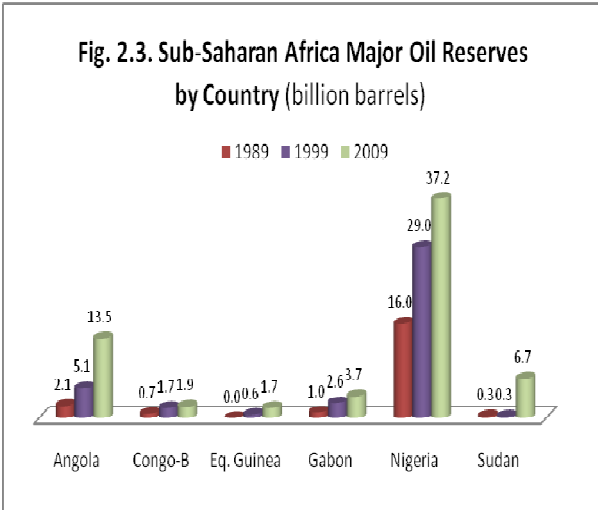
²⁰⁹ For a brief discussion on China's impact on resources sector governance in Africa, see: Alden, C. and Alves, Ana C., "La Chine et les ressources naturelles de l'Afrique" *Les Temps Modernes* 657, 2010, pp. 28-51.

²¹⁰ Unless otherwise stated, all figures in this and the following four paragraphs are according to BP, "Statistical Review of World Energy 2010", Excel workbook, June 2010, Available online at: <http://www.bp.com/statisticalreview> (accessed 20 August 2010)



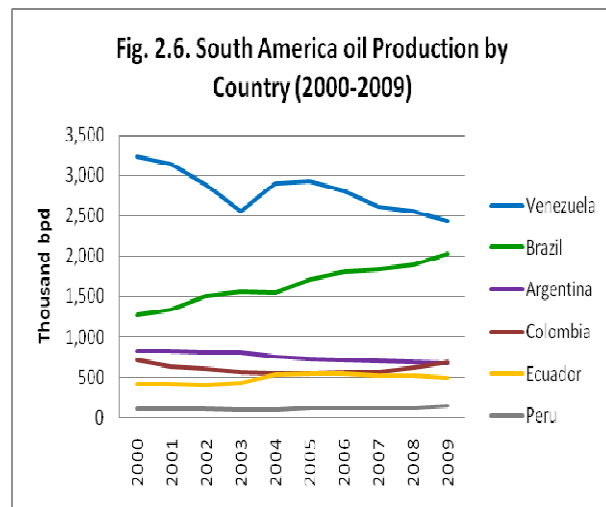
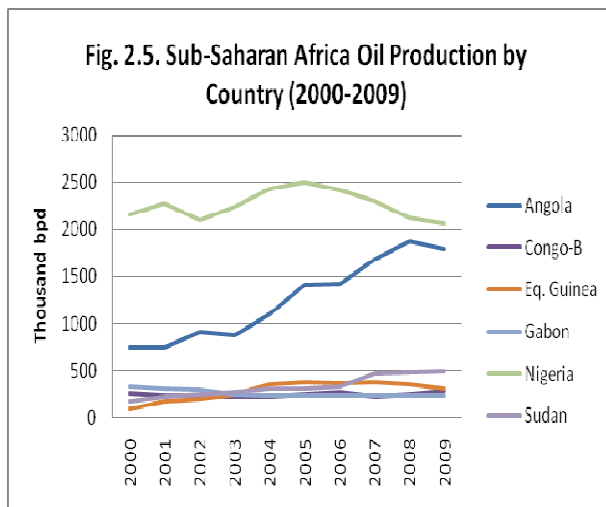
Source: BP, Review of World Energy 2010.

South American countries account for nearly all reserves and production figures under the category of South and Central America. South America’s oil reserves (197 billion barrels) are currently the second largest in regional terms (15% of global oil deposits), followed by Africa with a share of 10% (128 billion barrels). Although much less representative than the Middle East (57% of global deposits), South America’s oil reserves have registered the world’s fastest expansion rate, having nearly tripled over the past two decades (from 70 billion barrels in 1989 to 197 billion barrels in 2009). This is followed by Africa, the reserves of which have doubled over the same period.



Source: BP, Review of World Energy 2010.

Sub-Saharan Africa holds 52% of known oil deposits in the African continent,²¹¹ with Nigeria, Angola and Sudan accounting for the bulk (86%) of that share (fig. 2.3, above). Unlike Africa, South American reserves are geographically very concentrated. Venezuela alone accounts for over 86% of regional crude deposits, followed by Brazil with 6.5% (fig. 2.4, above). In fact Venezuelan oil reserves, estimated at 172 billion barrels by BP in 2009 (13% of global known deposits), are second only to Saudi Arabia (265 billion barrels = 20% of global reserves). If we add to conventional crude oil, the sand deposits in the Orinoco Delta, Venezuela's reserves become the largest in the world, with estimates of those deposits ranging from 380 to 652 billion barrels.²¹² Brazil oil deposits have also expanded significantly as a result of the newly discovered deposits located offshore in ultra-deep waters (see Appendix II). Its reserves have increased from 8 billion barrels in 1999 to 13 billion barrels in 2009.



Source: BP, *Review of World Energy 2010*.

Some 56% of Africa's oil production originates in Sub-Saharan Africa (nearly 8% of global output), with Nigeria and Angola accounting for 71% of that share.²¹³ Although Northern Africa produces a significant share of African oil (44%), in recent years most of these countries (e.g. Algeria, Egypt, and Libya) have been showing signs of stabilisation in oil output, which contrasts with the expanding trend observable in most SSA producers. In this regard, Angola has registered the fastest growth rate in production over the

²¹¹ Northern Africa accounts for the remaining 48% oil reserves, mostly concentrated in Libya (44 bn barrels), Algeria (12 billion barrels) and Egypt (4 billion barrels).

²¹² USGS, 'An Estimate of Recoverable Heavy Oil Resources of the Orinoco Oil Belt, Venezuela', 11 January 2010, available online at: <http://pubs.usgs.gov/fs/2009/3028/pdf/FS09-3028.pdf>. (accessed 5 December 2010)

²¹³ Nigeria and Angola accounted for 21% and 18% , respectively, of Africa's oil production in 2009. Other large producers are Algeria (19%) and Libya (17%).

past decade (see fig. 2.5, above), and as a result has been disputing, with Nigeria, the first position in this ranking since 2006.²¹⁴

In spite of its impressive oil reserves, South American oil production still lags far behind most other regions, accounting for a meagre 9% of global production in 2009. This is largely explained by the declining trend in Venezuelan oil production since the early 2000s (which fell by nearly 700 thousand bpd over the last decade), mostly due to Hugo Chavez's populist interventions in the sector (see fig. 2.6, above). In sharp contrast, Brazil has seen its production nearly double from 1.1 million bpd in 2000 to 2 million in 2009 (fig. 2.6, above). Oil output of other South American countries is much less significant, representing altogether 33% of total regional production (Venezuela alone accounts for 36% and Brazil for 30%). While Peru and Ecuador have seen modest expansion in their reserves and production over the last decade, Colombia and Argentina, the third and fourth largest producers respectively, face dim prospects as their reserves are decreasing.²¹⁵

China is the world second largest oil consumer after the US, and it became the second largest net oil importer in 2009, overtaking Japan, and is projected to account for 37% of expected increase in oil demand over the period 2009-2011.²¹⁶ Even though new oil discoveries in China's offshore fields are expected to offset some of the decline registered in its mature onshore fields (which account for 85% of production), its external reliance is expected to continue growing in coming years. The need to ensure a steady supply explains why Chinese oil companies have been increasingly looking abroad for oil equity. China's overseas oil production expanded from 140,000 bpd in 2000 to 900,000 bpd in 2008, representing 23% of China's total oil production that year.²¹⁷

Sub-Saharan Africa and South America's rich endowment in oil, perfectly match China's growing demand for this commodity, which is much needed to sustain its fast pace of modernisation and industrialisation.

2.2.3. Resources factor in bilateral trade²¹⁸

²¹⁴ Although Angola's production has been increasing exponentially, this situation is partly due to increasing unrest in Nigerian southern oil fields.

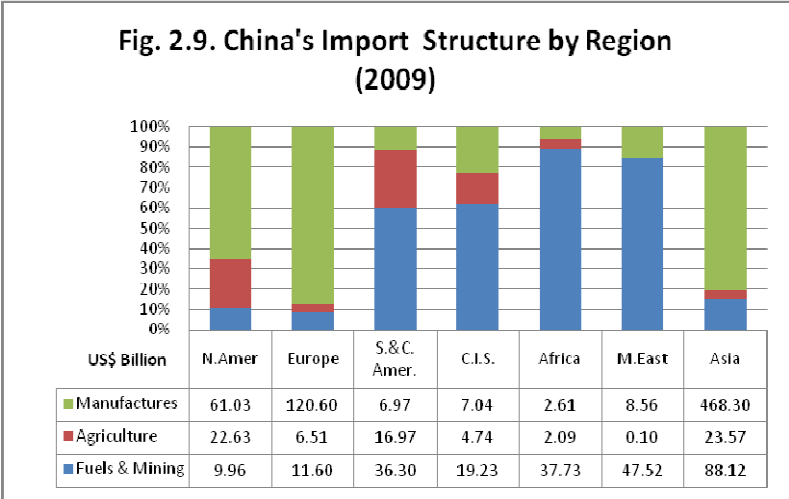
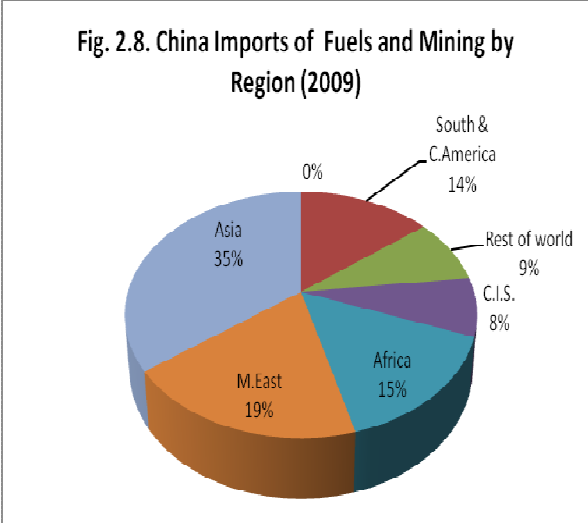
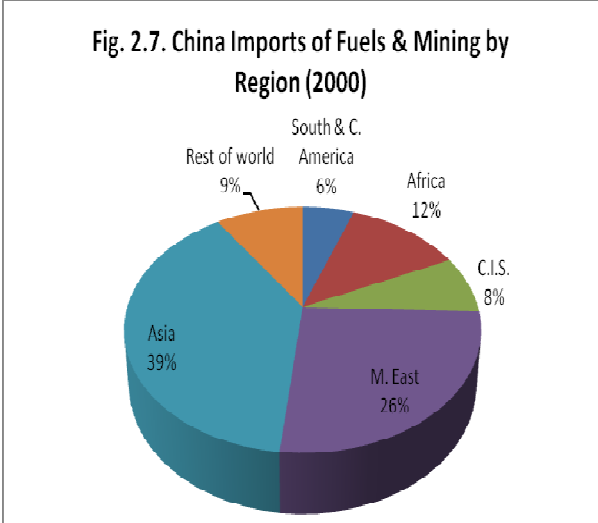
²¹⁵ Data adapted from BP, *op. cit.*

²¹⁶ EIA, *Country Analysis Brief: China*, November 2010, p. 3, available online at: <http://www.eia.doe.gov/cabs/China/Oil.html>. (accessed 5 December 2010)

²¹⁷ Figures according to EIA, *Ibid.*, p. 7.

²¹⁸ Unless otherwise stated, all figures for China trade in the following paragraphs are according to WTO *International Trade Statistics*, 'Merchandise Trade by Product, Region and Major Trading Partner - China', data (various years), available online at: http://www.wto.org/english/res_e/statis_e/statis_e.htm (accessed 10 January 2011)

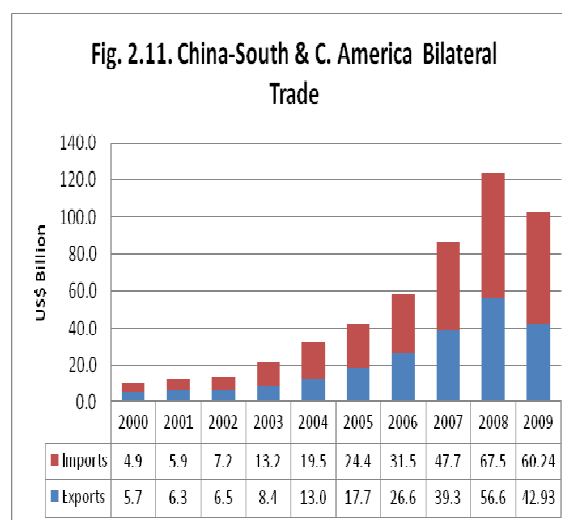
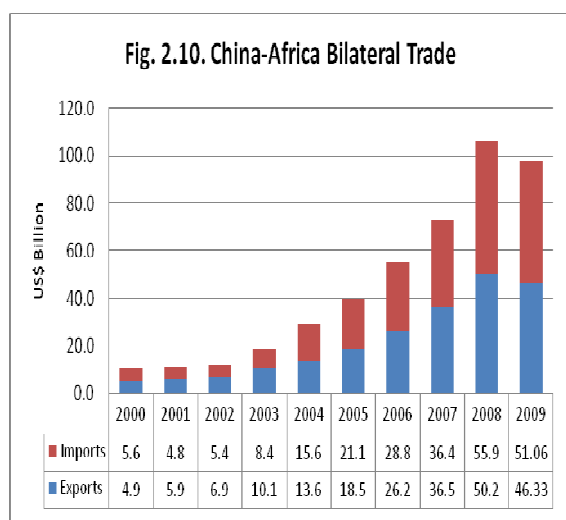
One of the most notable changing traits in China’s foreign trade structure over the past decade has been the increasing share of minerals and fuels in its global imports, having grown from 15% (US\$34bn) in 2000 to 27% (US\$307bn) in 2008. This trend clearly indicates Beijing’s growing external reliance on such commodities, and hence the rising profile of resources security within CFP. As seen in the charts below (Figs 2.7 to 2.9), the majority of Chinese minerals and fuels imports originate in developing regions, justifying to a great deal the increasing relevance of these regions in CFP since the early 2000s.



Source: WTO, *International Trade Statistics* (various years), merchandise trade by product, region and major trading partner - China; available online at: http://www.wto.org/english/res_e/statis_e/statis_e.htm

Over the past decade, South America and Africa’s shares in China’s global imports of hard commodities have seen the fastest expansion amongst all regions. South America’s stake more than doubled from 6% in 2000 to 13% in 2008, while Africa’s stake grew from 12% to 16% over the same period. Put together, these two regions presently account for nearly one third of China’s mineral and fuel imports. Since all other regions’ shares have decreased in relative terms, this further underlines the growing relevance of South America and Africa as mineral resource providers to China, throughout the present decade.

However, in the broader picture, Africa and South America still account for a relatively small part of China’s total foreign trade (4% and 5% respectively in 2009); but the fact that their share has more than doubled since 2000 (around 2% each), is indicative of the enormous potential for future expansion in trade relations. In absolute terms, China-Africa trade has registered a remarkable tenfold expansion, growing from US\$10.5bn in 2000 to US\$106.7 bn in 2008 (see fig. 2.10, below). Bilateral trade growth was even more dramatic with regard to South and Central America: from US\$10.6bn to US\$124.5bn over the same period (fig. 2.11). Another notable feature in China’s trade with both regions is its consistent deficit since the early 2000s, mostly a result of its swelling resources imports.



Source: WTO, *International Trade Statistics* (various years), merchandise trade by product, region and major trading partner - China; available online at: http://www.wto.org/english/res_e/statis_e/statis_e.htm

The year 2009, though, registered the first decline in bilateral trade with both regions since the late 1990s, scaling down to US\$89.7bn with Africa and to US\$103.2bn with South and Central America. This contraction of 16% and 17% respectively is explained by the context of the economic crisis. The

contraction in oil imports' value alone (from US\$39bn in 2008 to US\$27bn in 2009), represented the equivalent of 75% of the drop registered in China-Africa total trade in 2009 (US\$90bn down from US\$106.7bn in 2008), further underlining the critical importance of that commodity in bilateral trade. Considering that 2009 thus represents an atypical year as regards China's trade relations with these regions and in the absence of consolidated data for 2010, 2008 data will be used in most cases while noting meaningful developments regarding resources in 2009. Preliminary data for 2010 certainly indicate a resumption of the growth trend in China's bilateral trade with both regions, since China's trade with Africa from January to November 2010 amounted to US\$115bn.²¹⁹

The regression in bilateral trade values in 2009 is partly explained by fluctuations in commodities prices (particularly oil: from US\$140 a barrel in June 2008 to US\$40 in early 2009), not necessarily by the contraction of China's intake from these regions. In fact, and in most cases, the volume of Chinese minerals and fuels imports expanded significantly in that year, as illustrated in table 2.1, below.

Table 2.1. Chinese mineral and fuel imports 2008-2009

<i>Commodity</i>	<i>2008</i>		<i>2009</i>	
	Volume (10,000 tons)	Value (US\$ Billions)	Volume (10,000 tons)	Value (US\$ Billions)
Iron Ore	44356	60.5	62778	50.1
Manganese Ores	757	3.5	962	1.8
Copper Ores	519	10.4	613	8.5
Chromium Ores	684	2.7	676	1.3
Aluminum Oxide	459	1.8	514	1.3
Crude Oil	17888	129.3	20379	89.3

Source: NBS, *China Statistical Yearbook 2010*

The crisis context provided an opportunity for China to further increase its purchases from Africa. Indeed, there was a considerable increase in Beijing's intake of oil and minerals, taking advantage of the 'sale' prices, in order to fuel its strategic stockpiling programme initiated in recent years. In the first five months of 2009, China's oil imports reached the volume of the entire previous year (3.6 million bpd). For instance, from January to March 2009 imports from Sudan (217 thousand bpd) surpassed the total volume

²¹⁹ Information Office of State Council, "China-Africa Economic and Trade Cooperation White Paper", 23 December 2010, available online at: http://english.gov.cn/official/2010-12/23/content_1771603.htm.

of 2008 (209 thousand bpd), while in that same period imports from Angola reached 76% of the volume of the previous year.²²⁰

It was actually in this crisis context, that China became Africa's major single trading partner in 2009. As for LA, in less than a decade China has displaced Japan as the region's major Asian trading partner. Moreover, China already features among the top three regional trading partners, and is projected to overcome the EU to become LA's second largest trading partner around 2015.²²¹ Beijing has made impressive inroads into South America, already ranking as the number one export destination for Brazil (12th in 2000) and Chile (from 5th), the number two in Peru (from 4th) and Argentina (from 6th), and number three in Venezuela (from 37th)²²² – with all these countries being major mineral resource producers.

As illustrated in table 2.2, China's growing appetite for mineral and fuels from Africa and South America has greatly contributed to the rapid expansion in bilateral trade. If Asia (Australia and Southeast Asia) and the Middle East are still China's major hard commodities suppliers, imports from South America and Sub-Saharan Africa have displayed the fastest growth rate of all regions (expanding 21 and 12 fold respectively, from 2000 to 2008). This illustrates the growing relevance of both regions in Beijing's resources supply diversification strategy over the past decade.

Table 2.2. China fuel and mineral imports by region (US\$bn)

	2000	2004	2008	2009
South & Central America	1.89	8.80	39.88	36.30
Africa	4.21	12.31	49.49	37.73
Comm. of Indep. States (CIS)	2.60	7.00	22.57	19.23
Middle East	8.85	17.74	72.22	47.52
Asia	13.18	33.84	102.90	88.12
Rest of world	3.21	9.81	19.82	21.45
Total	33.34	89.5	306.87	250.46

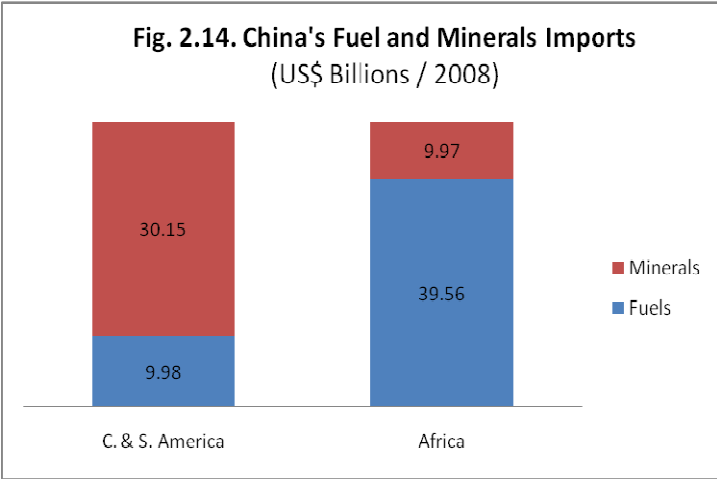
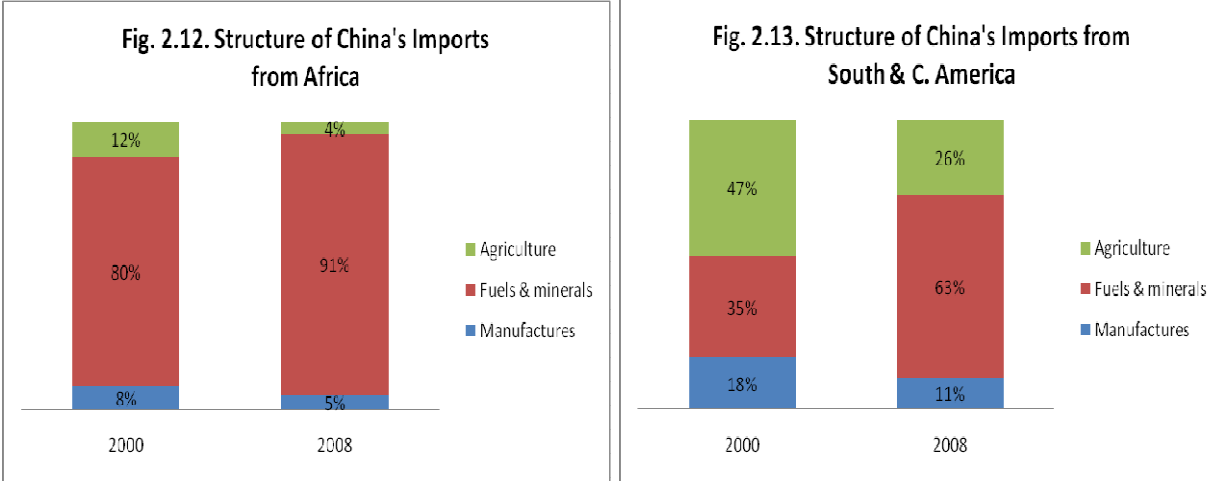
Source: WTO, *International Trade Statistics* (various years), merchandise trade by product, region and major trading partner - China; available online at: http://www.wto.org/english/res_e/statis_e/statis_e.htm

²²⁰ EIA, *op. cit.* (accessed 10 January 2011)

²²¹ CEPAL, "La Republica Popular de China y America Latina y el Caribe: hacia una relacion estrategica", April 2010, p. 14, available online at: <http://www.eclac.org/cgi-bin/getProd.asp?xml=/publicaciones/xml/2/39082/P39082.xml&xsl=/comercio/tpl/p9f.xsl&base=/tpl/top-bottom.xsl> (accessed 10 January 2011)

²²² CEPAL, *Ibid.*, p. 18.

China’s resources drive in South America and Africa throughout the 2000s is certainly confirmed by the fact that imports from these regions are increasingly concentrated in hard commodities at the expense of manufactured and agricultural products, as illustrated in Figs 2.12 to 2.14, below. While Chinese import flows from Africa only confirm a trend towards concentration already initiated in the late 1990s, there is a structural change underway with respect to South America, as hard commodities are quickly dwarfing the proportion contributed by agriculture and manufacturing in LA’s exports to China.



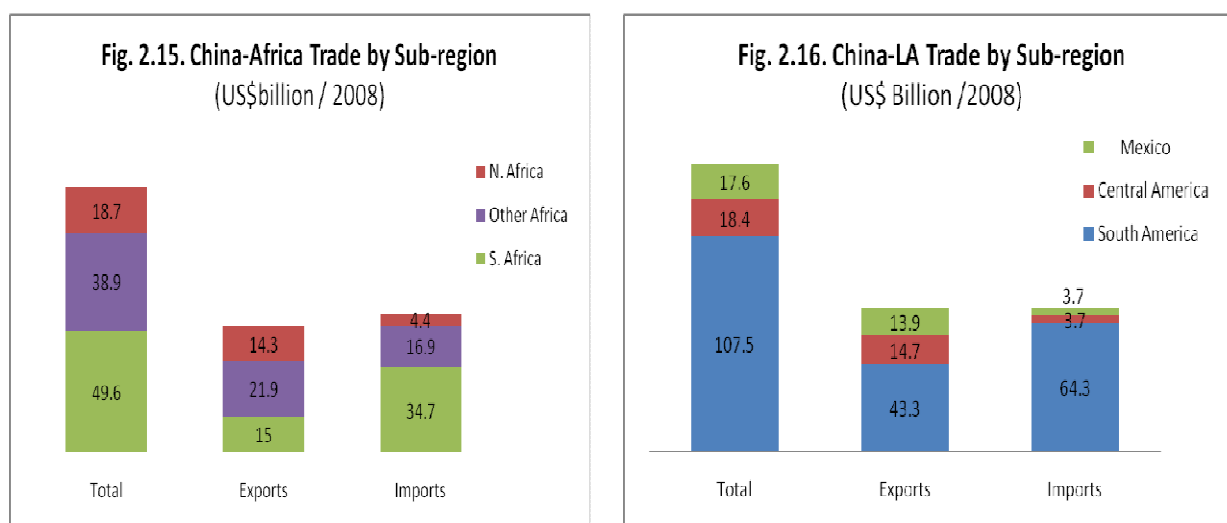
Source: WTO, *International Trade Statistics* (various years), merchandise trade by product, region and major trading partner – China; available online at: http://www.wto.org/english/res_e/statis_e/statis_e.htm

In terms of the structure of Chinese imports of hard commodities from these regions, a few differences need to be emphasised. While Beijing’s major import product from Africa is crude oil (US\$39.6bn or 73% of total imports from that continent in 2008), as regards Central and South America, the bulk of Chinese imports comprises ores and other minerals (US\$33bn or 47% of imports from that region in 2008).

Nonetheless it should be noted that the share of ores and minerals in China's imports from Africa has been rapidly increasing (to 18% in 2008), which is also the case with the share of fuels in South America (to 16%). This indicates that there is much room for the share of resources to grow in China's trade with both regions.

According to WTO data, in 2008 South and Central America accounted for 21% of China's total minerals imports and 6% of its oil imports. Africa, on the other hand, accounted for 24% of total Chinese oil imports, followed by minerals at 7%. Combined, these two regions currently account for nearly 30% of China's minerals and fuels imports, up from 18% in 2000. This suggests that these regions are playing an increasingly important role in China's global strategy to ensure resources security.

As illustrated in fig. 2.15 and fig. 2.16 (below), the bulk of China's trade with Latin America and Africa is accounted for by South America and Southern Africa,²²³ respectively.



Source: NBS, *China Statistical Yearbook 2009*.

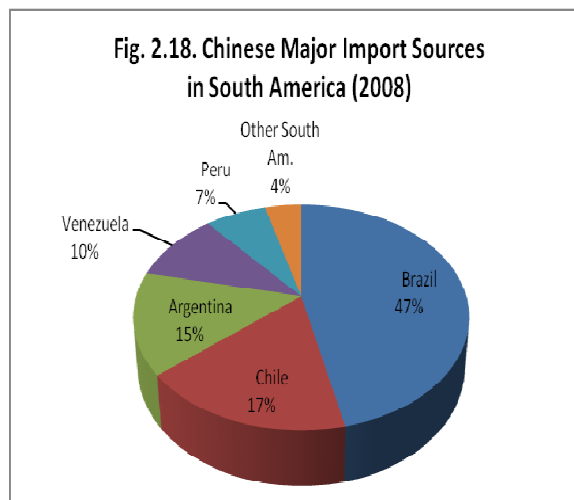
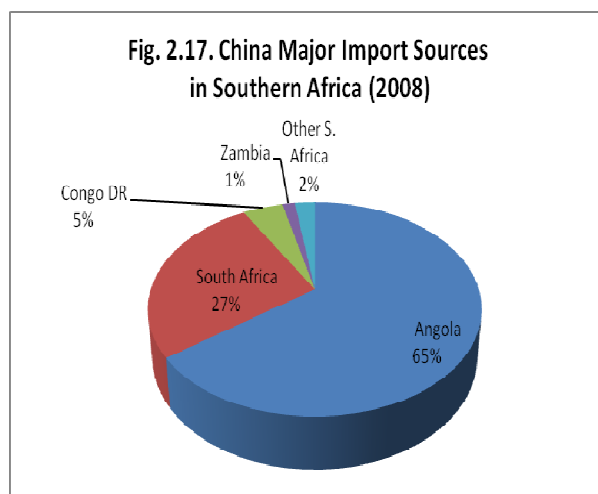
The figures also show that over 60% of China-Africa imports originate in Southern Africa (8% in North Africa and 30% in the rest of Africa), while this concentration is even higher in LA where South America accounts for 90% of Chinese imports from the region (Mexico and Central America with 5% each).²²⁴ In

²²³ For the purpose of this thesis, Southern Africa's geographical boundaries are those of the SADC (Southern African Development Community) countries: Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

²²⁴ NBS, *China Statistical Yearbook 2010, Value of Imports and Imports by Country of Origin/Destination (Beijing: NBS, 2010)*.

2008 approximately 90% of Chinese imports from the SADC consisted of mineral resources (63% oil and roughly 24% mining commodities).²²⁵ The fact that the bulk of China's imports from South America and Southern Africa comprise minerals and fuels again suggests that resources are a key element in Beijing's foreign policy towards these sub-regions, therefore justifying the focus of this thesis.

In each of the sub-regions, a handful of countries alone account for the lion's share of China's resource imports (see fig. 2.17 and 2.18 below).



Source: NBS, *China Statistical Yearbook 2009*.

In Southern Africa two countries alone (Angola and South Africa) account for 87% of Chinese imports. Virtually all Chinese oil imports from the SADC originate in Angola (US\$22.4bn in 2008). This represents 58% of its oil imports from Africa and 17% of its global oil imports, which makes Luanda China's second largest oil supplier after Saudi Arabia.²²⁶ Apart from Southern Africa, other important oil suppliers are Sudan and Libya, both among China's top ten oil suppliers in 2009 (5th and 9th respectively), according to Chinese customs statistics. Together, Angola, Sudan and Libya accounted for over a quarter

²²⁵ TRALAC, "Africa's Trading Relationship with China 2010" (data sourced from World Trade Atlas), available online at: http://www.tralac.org/cgi-bin/giga.cgi?cat=1044&limit=10&page=0&sort=D&cause_id=1694&cmd=cause_dir_news#china. (accessed 20 August 2010)

²²⁶ TRALAC, *Ibid.*

of China's global volume of oil imports in 2009.²²⁷ Other less significant African oil suppliers to China include Equatorial Guinea, Congo, Gabon and Algeria.

With respect to South America, five countries alone account for 96% of Chinese imports from the region. Argentina's exports to China are mostly agricultural products (soy and oilseeds). However, Chinese imports from the other four countries are dominated by mineral resources. In less than a decade some of these countries ascended to the top ranking of China's mineral commodities suppliers: Chile (copper), Peru (copper and lead), Bolivia (tin) and Brazil (iron ore).²²⁸

Although nearly one-fourth of Brazil exports to China comprised soy in 2008, the remaining share is largely dominated by minerals, with iron ore taking the largest share (nearly two thirds), followed by crude oil with a share of 10%, and which is expected to grow further in coming years as Brazil's oil output expands.²²⁹ Venezuela is China's major oil supplier in LA and ranks 11th in its global suppliers' list, accounting for nearly 3% of China's overseas oil intake. Other minor Chinese oil suppliers in South America include Peru and Ecuador. Here too, Chinese oil imports are expected to grow further in the near future, as more recent Chinese investments start to come on stream.

In addition to sourcing resources overseas, China's energy security strategy is also targeting the acquisition of production equity overseas, so as to guarantee a steady supply and a say in international market developments. For this reason a review of investment flows will offer further insight into China's strategy in these regions.

2.2.4. Resources factor in China's investments overseas

Chinese outbound investment is a relatively new development, which only began to expand in 2000, propelled by the 'go out' policy. Chinese outward foreign direct investment (OFDI) has registered remarkable growth over the past decade, having expanded from US\$2.7bn in 2002 to US\$56.5bn in 2009. In that year it became the fifth largest foreign investor in the world, after the US, France, Japan and Germany, accounting for over 5% of global investment flows. Unlike trade, the financial crisis seemed to

²²⁷ China Customs data cited by: Xiao Wan, "China Depending More on Imported Oil", *China Daily*, 20 January 2010, available online at: http://www.chinadaily.com.cn/china/2010-01/20/content_9346446.htm (accessed 20 August 2010).

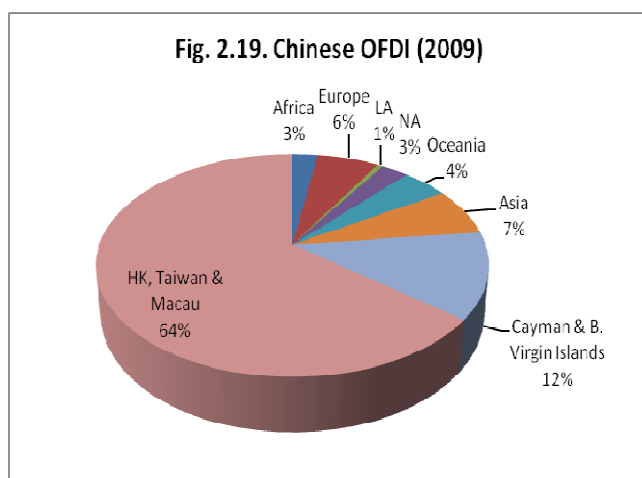
²²⁸ All figures in this paragraph according to: Pui-Kwan Tse, "The Mineral Industry of China", in *2009 Minerals Yearbook*, USGS, November 2010, p. 26, available online at: <http://minerals.usgs.gov/minerals/pubs/country/2009/myb3-2009-ch.pdf> (accessed 5 December 2010).

²²⁹ SECEX/MDIC, 'Exportacao Brasileira por Produto: China, 2008-2009', statistical data available online at: <http://www.desenvolvimento.gov.br/sitio/interna/interna.php?area=5&menu=2033&ref=576> (accessed 5 December 2010).

have little impact on Chinese investment flows. Against the backdrop of global FDI contraction in 2009 (43%), China's OFDI grew 1.1%.²³⁰

Not surprisingly, nearly one-fourth (US\$13.3bn) of its OFDI for 2009 was directed at mining industries. Chinese official investment figures, however, are believed to only partially cover the real picture. According to a recent survey,²³¹ for instance, of 34 mergers and acquisitions over US\$100mn undertaken by Chinese enterprises in 2008/2009, 15 cases were in the mining industry (US\$26.2bn), whereas 13 (US\$27.8bn) involved the energy industry.

Another aspect that one must take into consideration when analysing official Chinese OFDI statistics, is that all investment flows across the mainland's customs are considered outward investment, including therefore Hong Kong, Macau and Taiwan. Hong Kong alone accounted for nearly two thirds (US\$35.6bn) of Chinese total outward investment in 2009 (see figure 2.19. below), and 88% of what shows as OFDI into Asia. Most of this investment in Hong Kong is actually round tripping, eventually ending up back in China, since Hong Kong is the single largest investor in the mainland (US\$42bn in 2008).²³²



Source: MOFCOM, *Statistical Bulletin of China's Outward FDI 2009*.

²³⁰ Unless otherwise stated, All figures for Chinese investments referred to in this and the following paragraphs, are according to: MOFCOM, *Statistical Bulletin of China's outward FDI 2009*, December 2010, available online at: <http://hzs2.mofcom.gov.cn/statistic/statistic.html> (accessed 10 January 2011).

²³¹ Wang Duanyong, *A Report on China's Overseas FDI Risks: 2008-2009*, SAIIA Policy Report, January 2011, p. 7.

²³² Beijing Axis, *The China Analyst*, January 2010, p. 35. Available online at: <http://www.thebeijingaxis.com/en/news-a-media/the-china-analyst> (accessed 7 February 2010)

In addition to Hong Kong, there are two other major safe havens that absorb a significant part of Chinese outward investment, and therefore contribute to further distortion of the overall picture: the Cayman and the British Virgin Islands. In 2009 they together accounted for over 12% (US\$7bn) of China's total OFDI and 96% of Chinese investment in LA. Although it is difficult to determine the final destination of that investment due to the nature of these financial markets, as is the case with Hong Kong, a significant part of that money is likely to revert back to China. This is because, according to Chinese official statistics, the Cayman and the British Virgin Islands are the second and fifth largest investors in the mainland (US\$15.9bn and US\$3.1bn, respectively, in 2008).²³³

The elimination of these two categories, which in 2009 together represented nearly 75% of China's OFDI, will thus provide a much smaller figure, but a more accurate representation of Chinese investment abroad (see table 2.3. and figs. 2.20. and 2.21. below). For the purpose of this thesis, the researcher shall refer to it as 'overseas FDI', adopting the terminology defined by Wang Duanyong.²³⁴

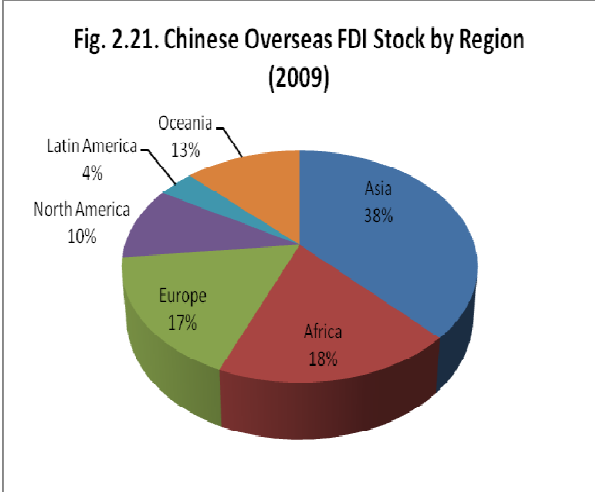
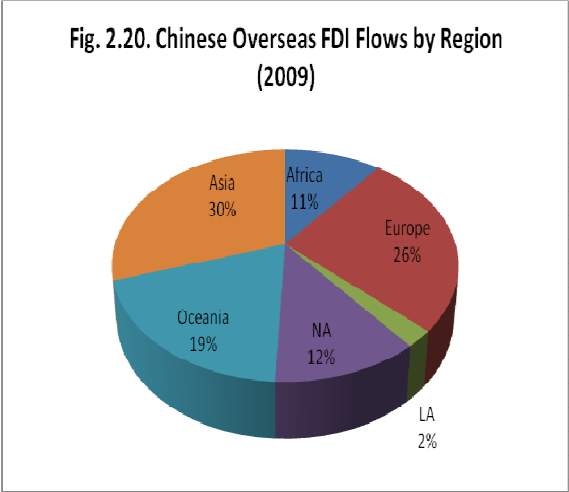
Table 2.3. Chinese overseas FDI by region (2003-2009) US\$ million

	<i>2003</i>	<i>2004</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>	<i>2008</i>	<i>2009</i>	<i>2009 Stock</i>
Asia	0.318	0.343	0.942	0.773	1.603	4.267	4.351	19.211
Africa	0.075	0.317	0.400	0.520	1.570	5.490	1.439	9.332
Europe	0.150	0.170	0.510	0.590	1.090	0.880	3.353	8.677
North America	0.058	0.126	0.320	0.260	1.130	0.360	1.522	5.185
Latin America	0.023	0.088	0.080	0.102	0.420	0.052	0.355	1.958
Oceania	0.034	0.120	0.200	0.130	0.770	1.950	2.480	6.419
Total amount	0.658	1.164	2.452	2.375	6.583	12.999	13.500	50.782

Source: Data 2003-2008, adapted from Wang Duanyong, A Report on China's Overseas FDI Risks: 2008-2009; data for 2009 as in MOFCOM, Statistical Bulletin of China's outward FDI 2009.

²³³ Beijing Axis, *Ibid.*

²³⁴ Wang Duanyong, *Ibid.*, p. 3.



Source: MOFCOM, *Statistical Bulletin of China's outward FDI 2009*.

Asia, a category of Chinese statistics that includes all countries from Japan to Turkey, absorbs the largest share of Chinese overseas investment. Within this region, Southeast Asia has been traditionally the largest destination of Chinese overseas FDI, having accounted for nearly 70% of it (US\$2.7bn) in 2009, the remaining stake (US\$1.7bn) being divided among Northeast Asia, Central Asia and the Middle East. The fact that most Chinese investment in Southeast Asia is directed to infrastructure construction and manufacturing, and that the other of China's major regional resources suppliers, namely Central Asia and the Middle East, account for only a marginal share of China's Overseas FDI, suggests that China's investments in resources sectors have privileged Oceania (Australia mainly) and Africa.

Nonetheless, Chinese investments in Africa have registered a steady and fast increase from 2003 to 2008 (from US\$75bn to US\$5.5bn in only five years), having even surpassed Asia that year. This was largely due, though, to a single major investment in South Africa (the ICBC acquisition of a 20% stake in Standard Bank for US\$5.5bn). According to Chinese statistics, however, Chinese investment in Africa dropped significantly in 2009. A white paper on China-Africa Relations released in December 2010 by the information office of the State Council, however, provides a much larger figure for Chinese investment in Africa in 2009: US\$9.3bn. This would confirm African as the largest regional destination of Chinese overseas investment, which accounts for nearly 70% or over twice as much as Asia. In fact, this figure may be much closer to reality, given the large number of resources assets acquired by Chinese companies since the onset of the recent financial crisis. Further stressing the relevance of Africa in Chinese OFDI, the continent ranks second in terms of investment stock after Asia and ahead of Australia. Conversely, China's share in Africa's investment inflows has expanded considerably, having accounted for 7.6% of

total Africa investment inflows in 2008 (US\$72bn), most of which was resource seeking and involved state owned enterprises.²³⁵

Chinese investment flows have generally fluctuated in both China and Africa; for this reason, an examination of investment stocks will provide a more accurate view. As of 2009 52% of China's investment stock in the continent (US\$9.3bn) was located in Southern Africa (US\$4.8bn), confirming the importance of this sub-region for China. Indeed, half of the top ten African investment destinations are SADC countries, among which stand out South Africa (US\$2.3bn, accounting alone for nearly one-quarter of the total), Zambia (US\$844mn) and the DRC (US\$397mn). Outside the SADC, other large Chinese investment stocks are located in Nigeria (US\$1bn), Algeria (US\$751mn) and Sudan (US\$564mn), further confirming Beijing's preference for resource rich countries.

With regards to LA, 79% of China's investment stock in the region (US\$1.96bn) is located in South America (US\$1.55bn), with Brazil (US\$361mn), Peru (US\$296mn) and Venezuela (US\$272mn) at the forefront, emulating the same geographical pattern found in bilateral trade. However, in sharp contrast with trade figures, LA's intake of Chinese investment is well below that of Africa. In fact, Chinese overseas investment into LA ranks last in terms of flows (2%) and stock (4%). China's investment there has yet to take off, remaining at comparatively low levels and presenting a very variable pattern over the last decade. This reality is particularly striking when compared with the steady increase, over the same period, of China's investment flows towards African, which shares a very similar pattern to LA regarding bilateral trade with Beijing. Moreover, LA has historically attracted a much larger volume of global FDI than Africa. Conversely, investments by LA companies (mostly from Brazil and Mexico) in China, over the past decade, have been well above those of African companies.

A survey of announcements and pledges (rather than actual economic assistance) of Chinese preferential loans, assistance and state sponsored investments in the 2002-2007 period, conducted by the Wagner School of New York University and the US's Congressional Research Service on China's foreign aid to developing regions,²³⁶ suggests, however, that this reality cannot be blamed on the lack of Chinese interest in LA.

²³⁵ UNCTAD, *World Investment Report 2010*, p. 34, available online at: http://www.unctad.org/en/docs/wir2010ch2_en.pdf. (accessed 13 November 2010)

²³⁶ Wagner School - New York University, *Understanding Chinese Foreign Aid: A Look at China's Development Assistance to Africa, Southeast Asia, and Latin America*, April 2008, cited by: CRS, *China's Economic Assistance and Government-Sponsored Investment Activities*, Nov. 2009, available online at: <http://www.fas.org/sgp/crs/row/R40361.pdf>. (accessed 15 November 2010)

According to this study, even though presenting a lower volume in total, LA has attracted a significant share of China's attention, particularly concerning investment intentions in resource sectors (see table 2.4. below). In this context, the low volume of Chinese investment in LA is particularly striking, taking into consideration that Chinese investors have actually shown a strong willingness to invest in that region in recent years. This is especially so in resources, a sector where this interest has enjoyed a sturdy political and financial backing from Beijing. In his tour to the region in 2004, President Hu Jintao pledged to invest heavily in LA. This fact is at the very foundation of this thesis: analysing why Chinese investment in South American resources is slow in growing, despite evidence of the importance of the region.

Table 2.4. China's reported economic assistance 2002-2007 (US\$ millions)

By Sector	Africa	Latin America	By Type	Africa	Latin America
Natural resources extraction and production	9,432	18,585	Government sponsored investment	8,042	24,389
Infrastructure and public works	17,865	7,535	Concessional loans	22,379	1,950
Not specified	5,024	608	Grant	1,851	421
Humanitarian	802	32	Debt Cancellation	850	0
Military	4	0	In kind aid	21	1
Technical Assistance	10	1			
Total	33,137	26,761	Total	33,137	26,761

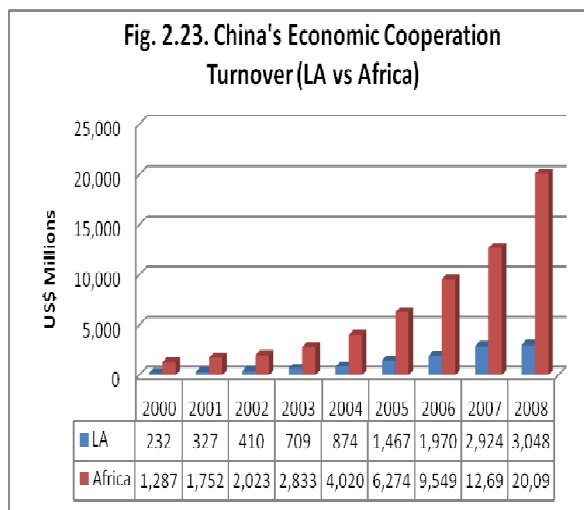
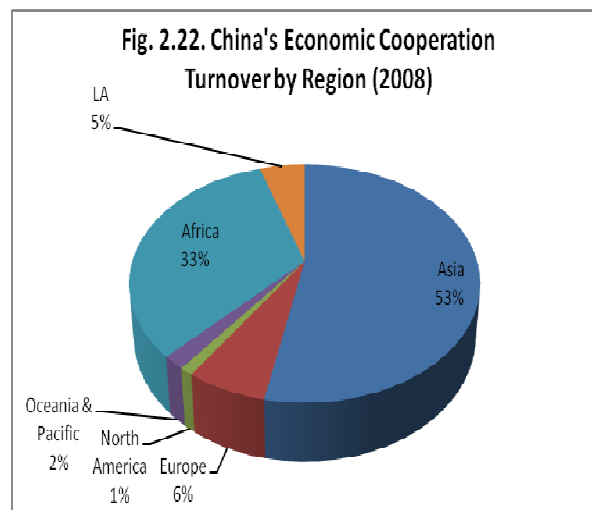
Source: CRS, China's Economic Assistance and Government-Sponsored Investment Activities, Nov. 2009.

The above survey also suggests that the bulk of Chinese economic engagement in resources in both regions is channelled through government initiatives (government sponsored investment and concessional loans), justifying as such a more in depth analysis of Chinese economic statecraft in these regions.

2.2.5. Resources factor in China's economic statecraft

According to Chinese official economic cooperation statistics - which include overseas contracts, labour exports and consulting services (integrated in Chinese aid programmes or gained through normal bidding processes) - such cooperation expanded six fold from US\$11bn in 2000 to US\$65bn in 2008, being much

larger figures than overseas investment. Africa is the second major recipient of Chinese cooperation, having absorbed US\$20bn (33%) in 2008 (see fig. 2.22 below), one-fourth of which (US\$5.6bn) was directed at Southern Africa, with Angola as the largest recipient (US\$3.3bn, second largest in the continent). Notably, four countries alone, Algeria, Angola, Sudan, and Nigeria, accounted for over half of China's cooperation with Africa that year.²³⁷



Source: NBS, *China Statistical Yearbook* (2009, 2008, 2006, 2004, 2002).

As with China's overseas investment flows, LA only accounts for a modest 5% (US\$3bn) of total cooperation flows, and has shown a much slower increase throughout the past decade (see fig. 2.23. above). Again, most of Chinese economic cooperation with LA ends up in South America (US\$2.2bn or 73% in 2008), with Brazil (US\$935mn) and Venezuela (US\$777mn) being major recipients.

The first recipients in Africa of Chinese economic cooperation were oil-rich countries, namely Angola, Sudan and Nigeria. Only at a later stage did China begin its outreach to mineral producers like Gabon, DRC and Zambia, based on the same package-deals aimed at funding infrastructure in exchange for access to mining supplies and equity.

As previously mentioned, the blueprint of such cooperation deals (provide infrastructure in return for resources) was devised with Angola in 2004. The deal included a concessional loan of US\$2bn by China's EXIM Bank. The loan was earmarked for infrastructure development listed in Luanda's public works budget, and is to be repaid in oil supplies. As collateral for the loan, Sinopec acquired its first equity stake

²³⁷ Figures in this and the following paragraph according to: NBS, *China Statistical Yearbook 2009*, Beijing: NBS, 2010.

in the Angolan oil industry.²³⁸ Even though the infrastructure to be constructed with the EXIM Bank credit line is not directly related to oil exploration, which is largely located offshore, the deal undoubtedly paved the way for China to enter Angola's oil sector.

Nigeria under Olegun Obasanjo also embraced the infrastructure-for-oil formula, with loans from EXIM Bank reportedly totalling US\$12 bn.²³⁹ Indeed, Chinese NOCs (CNPC, CNOOC and Sinopec) obtained their first stakes in the Nigerian oil sector during Obasanjo's final years of rule (2005-2007), in exchange for engaging in major infrastructure projects. These include the rehabilitation of the Kaduna oil refinery by CNPC (US\$2bn), the Lagos-Kano railway (1,350km), and the Mambilla hydroelectric station to be funded by EXIM Bank (US\$2.5bn) with partial backing by Nigerian oil blocks. Most Chinese oil exploration contracts awarded by Obasanjo and loans signed under his rule were, however, frozen by his successor Umaru Musa Yar'Adua, right after the elections in 2007.²⁴⁰

Other African countries who signed massive infrastructure-for-resources deals with China include DRC²⁴¹ and Gabon²⁴². More recently, Ghana discovered major oil reserves offshore. In September 2010 it signed a US\$10bn loan for infrastructure development with EXIM Bank, to be repaid in oil over 20 years, and thereafter signed another US\$3bn with China Development Bank (CDB) for oil sector development. Many other African countries received much smaller loans from China throughout the past decade, in most cases targeting specific infrastructure projects. This trend has intensified after the onset of the financial crisis. According to the recent white paper on China-Africa cooperation (December 2010), Beijing will make available US\$10bn in preferential loans for infrastructure to African countries between 2010 and 2012, doubling the figure for the 2007-2009 period. These developments demonstrate that

²³⁸ This deal will be explored in detail in Chapter 5.

²³⁹ Interview, ExIm Bank, Beijing, China, 26 August 2009.

²⁴⁰ For a detailed study on China's engagement in Nigeria, see: "Gregory Mthembo-Salter, "Elephants, Ants and Superpowers: Nigeria Relations with China", SAIIA Occasional Paper, Nr. 42, October 2009.

²⁴¹ In September 2007 China signed a similar deal with the DRC. The initial US\$5bn loan was extended to US\$9bn in January 2008. Under the agreement, US\$6bn would be allocated in the first phase to the rehabilitation and construction of infrastructure, and US\$3bn to mining exploration. A joint venture named Sicominex was set up between the Congolese state mining company Gecamines; Sinohydro; and China Railway Engineering Corporation (CREC) - 68% owned by the Chinese partners²⁴¹. The loan (for both infrastructure and mining) is to be repaid with revenue obtained through the exploration rights over two copper and cobalt concessions located in Katanga Province. The project development, however, has been stalled by the DRC's vulnerability to the IMF's criticism, the loan having been revised and downsized to US\$6bn in 2009 on Kinshasa's request.

²⁴² In 2006 the Gabonese government granted a Chinese consortium led by a construction company (China National Machinery and Equipment Corporation, CMEC) the right to develop Belinga mines, the largest known untapped deposit of iron ore in the world.²⁴² The US\$3bn deal, to be funded by ExIm Bank, included the construction of a new 560 km railway line linking Belinga to the coast, a deep-water mining harbour, a hydroelectric dam and a steel mill. These would be in exchange for exploration rights through the establishment of a new mining company (Compagnie Minière du Belinga, COMIBEL), 75% owned by the Chinese partner. The Belinga project, however, is yet to begin, apparently due to the inaccurate planning and lack of capacity of the Chinese consortium.

China's infrastructure-for-resources loans model is set to continue driving its engagement strategy in Africa for the foreseeable future. Southern Africa received a significant share of this type of loan over the past decade (Table 2.5. below).

Table 2.5. Major Chinese 'resources for infrastructure' loans in Africa (2002-2010)

<i>Country</i>	<i>Main export to China</i>	<i>Year</i>	<i>Pledged amount</i>	<i>Loan Provider</i>	<i>Major funded projects</i>	<i>Collateral to agreement</i>
Angola	Oil	2004	US\$2bn	EXIM Bank (repaid in oil)	Public Infrastructure	4 oil blocks (Sinopec)
		2007	US\$2.5bn	EXIM Bank (repaid in oil)	Public Infrastructure	
		2009	US\$1.5bn	CDB	Public Infrastructure and Agriculture	
			US\$2.5bn	ICBC (repaid in oil)	Public Infrastructure	
			US\$6bn	EXIM Bank (repaid in oil)	Public Infrastructure	
Gabon	Iron ore	2006	US\$3bn	EXIM Bank (repaid in cobalt)	Infrastructure and mining development	Iron ore mining equity
DRC	Cobalt	2007	US\$5bn*	EXIM Bank (repaid in cobalt)	Infrastructure and mining development	Cobalt mining equity
Total amount pledged			US\$22.5 billion			

* extended to US\$9 bn in Jan. 2008, reduced to US\$6 bn in Aug. 2009.

Source: Beijing Axis, *The China Analyst*, May 2009, September 2009 and January 2010; various media reports and interviews by the author.

Among the African countries that recently signed for smaller loans regarding infrastructure with Beijing, were Zimbabwe (2009, US\$950mn)²⁴³ and Tanzania (2009, US\$400mn to build a coal power plant).²⁴⁴

²⁴³ BBC News, "China Agrees huge Zimbabwean loan", 30 June 2009, available online at: <http://news.bbc.co.uk/2/hi/8126555.stm> (accessed 5 November 2009).

²⁴⁴ Steelguru, "China to give loan to Tanzania for coal based power plant", 16 June 2009, available online at: http://www.steelguru.com/raw_material_news/China_to_give_loan_to_Tanzania_for_coal_based_power_plant/107075.html (accessed 5 November 2009).

China's eagerness to provide cheaper and unconditional aid and willingness to embrace large infrastructure projects neglected by Western donors is a valuable competitive advantage in accessing resources in the African continent.

It should be pointed out, though, that the first Chinese investments in resource sectors in Africa, namely CNPC in Sudan (1996) and China Non-Ferrous Metals Mining Company (CNMC) in Zambia (through the acquisition of 85% of Chambishi copper mine in 1998), followed a different pattern (that of greenfield investments). This is where these companies acted on their own, enjoying no significant support from Beijing at the beginning of their operations. Nevertheless, Beijing's active involvement in infrastructure funding in both countries has undoubtedly contributed to cementing its companies' position *vis à vis* Khartoum and Lusaka.

The 2008/2009 economic crisis context provided China with a golden opportunity to further expand its equity portfolio in Africa. Among the resource assets snapped up by Chinese companies in Africa - the acquisition of Addax Petroleum by Sinopec stands out as the largest successful overseas takeover by a Chinese company. The purchase of the Swiss-based company, listed in London and Canada, has given Sinopec access to sizeable oil and gas equity. Proven and probable reserves are estimated at 537 million barrels and annual production at seven million tons per year in 2009 (143,000 bpd), 72% originating from Nigeria, 20% in Gabon and 8% from the Kurdistan region in Iraq.²⁴⁵ Chinese NOCs have been particularly active, not only in major oil producers such as Libya, Nigeria and Angola, but also in the newest oil producing countries where the industry is still in formation, namely in Ghana, Uganda and Niger. In Southern Africa Chinese mining companies have been particularly successful over this period.

While China's formula of infrastructure-for-resources has proved reasonably successful in accessing resources equity in Africa, particularly so Southern Africa, this seems not to be the case in South America. This is particularly intriguing if one considers that the necessary conditions are met: on the one hand there is growing Chinese demand for South America's mining and fuels, and on the other hand South America is facing serious infrastructure bottlenecks. Although the infrastructure scenario in South America is better than in Sub-Saharan Africa,²⁴⁶ the region is also facing serious logistical shortcomings as a result of over

²⁴⁵ Brunswick Group - Sinopec, "Sinopec Group Completed the Acquisition of Addax", 18 August 2009, available online at: http://www.addaxpetroleum.com/press_room/159 (accessed 5 November 2009).

²⁴⁶ The World Bank estimates that US\$ 93bn will need to be injected every year in infrastructure development over the next decade. Angie Gentile, "Africa's Infrastructure: Closing the 'Efficiency Gap'", 10 April 2009, available online at: <http://blogs.worldbank.org/meetings/africa-s-infrastructure-closing-the-efficiency-gap> (accessed 5 November 2009).

two decades of public divesting.²⁴⁷ The new growth cycle prompted by resource revenues is therefore being challenged by infrastructure bottlenecks, namely in transport structures (roads, railways and ports) that are obstructing export corridors, and thereby placing infrastructure development at the top of South American governments' agendas.

Although a number of infrastructure projects in South America involving China's funding have been mentioned in the press throughout the past decade, including a mega transcontinental railway linking Santos Port (Brazil) on the Atlantic coast to Antofagasta Port (Chile) on the Pacific coast, the reality is that most of these credit lines for infrastructure failed to materialise. Despite the strong interest shown by both parties and a number of cooperation framework agreements signed, at bilateral high level exchanges, the few credit lines that materialised involved relatively small projects (bridges and roads in Argentina) and no significant resources assets were produced as collateral.

Most resource assets China possessed in South America before the onset of the global financial crisis were acquired by Chinese state enterprises in the 1990s. These include CNPC oil assets in Peru (1994), Venezuela (1997); and Shougang Group, who acquired Peru's biggest iron ore mine in 1993. At that point these had little support from Beijing,²⁴⁸ and no major engagement with infrastructure. These investments, however, have been struggling to take off, as these companies have faced many unanticipated obstacles, from strong trade union action to violation of property rights by nationalist governments (Venezuela and Peru).

The onset of the global economic crisis in late 2008, however, seems to have reversed this picture, judging by the number of deals (loans and investment) that were signed in 2009 and 2010 alone (see table 2.6, below).

²⁴⁷ The last significant investment in infrastructure in the region dates back to the 1970s, when governments were awash with cash from rising raw materials revenues. In the 1980s the debt crisis led to a contraction of public spending in infrastructure, while the liberalisation in the 1990s failed to bring private investment into the sector, discouraged by high risks and widespread nepotism. For a brief account on the status quo of LA infrastructure, see: Latin American Logistics, 'The State of Latin American Infrastructure and Logistics', undated, available online at: <http://www.latinamericanlogistics.org/articles/the-state-of-latin-american-infrastructure-and-logistics.htm>.

²⁴⁸ Interview, CNPC, Beijing, China, 24 August 2009.

Table 2.6. China's major loans to South America (2009-2010)

<i>Country</i>	<i>Main export to China</i>	<i>Year</i>	<i>Pledged amount</i>	<i>Loan Provider</i>	<i>Major funded projects</i>	<i>Collateral to agreement</i>
Brazil	Iron ore, Oil, Agriculture	Feb. 2009	US\$10bn	CDB (to Petrobras)	Oil exploration and production in the pre-salt layer	10 year oil supply contract + Sinopec JV with Petrobras to explore 2 oil blocks
Venezuela	Oil	April 2010	US\$20bn	CDB (to be repaid in oil)	Oil, gas exploration/production, refining and various kinds of infrastructure	CNPC JV with PDVSA to explore and refine oil from Orinoco Delta
Argentina	Soy complex	July 2010	US\$10bn	CDB	Railway and underground network and rolling stock	Sinopec and Sinohydro JV with ENARSA
Ecuador	Oil	June 2010	US\$1.7bn	EXIM Bank	Hydroelectric dam	
		Aug. 2010	US\$1bn	CDB	Various infrastructure and oil and mining sector projects	4 year oil supply contract

Source: Various news reports (Bloomberg & Reuters).

As table 2.6 shows, the crisis period has been particularly positive for China in its outreach to South America, having finally succeeded in extending loans for infrastructure there. However, with the exception of Venezuela, none of these are to be repaid in oil. Nonetheless, in some cases they have produced access to equity and oil supply contracts.

Venezuela was the first South American country to embrace large amounts of Chinese funding, having established a joint investment fund of US\$6bn in 2007 with China, directed at various development projects in infrastructure, industry and energy. This fund was doubled in 2008 to US\$12bn and is also to be repaid in oil (presently 450,000 bpd).²⁴⁹ The US\$20bn loan announced in April 2010 is actually the combined sum of two soft loans (one in dollars and the other in Chinese currency, US\$10bn each) directed at infrastructure and to be repaid by oil over a ten year period,²⁵⁰ thus emulating the

²⁴⁹ Business News Americas, "Chavez Signs 26 Cooperation Agreements with China", 27 September 2008, available online at: http://www.bnamericas.com/news/waterandwaste/Chavez_signs_26_cooperation_agreements_with_China (accessed 5 November 2009).

²⁵⁰ Starting with 250,000 bpd in 2010; 250,000 bpd in 2011 and 300,000 bpd from 2012 onwards.

infrastructure-for-resources formula Beijing is applying in Africa. This loan constituted collateral for another JV between Petroleos de Venezuela (PDVSA) and CNPC (for 25 years), who secured a larger stake this time (40%), to explore oil in the Junin-4 field in the Orinoco belt. This is an investment estimated at US\$16bn, most of which is expected to be injected by China. This block is expected to produce 400,000 bpd of extra heavy oil by 2016, most of which will be sent to China to be processed in the refineries presently being jointly built by PDVSA and CNPC.²⁵¹ In December 2010, PDVSA signed another two agreements with Sinopec (to develop Junin1 and 8 which are expected to produce 200,000 bpd plus the Cabruta refinery) and China National Offshore Oil Corporation (CNOOC; to develop a natural gas project expected to produce 37,000 bpd of condensed gas). The combined planned investments of the three Chinese NOCs in Venezuela are expected to reach US\$40bn by 2016.²⁵²

After many years trying to enter the oil sector in Brazil, the global crisis context finally provided a breakthrough when Petrobras (Brazil's NOC) was struggling to attract funding from international markets to develop its newly discovered (2007) offshore oil reserves in the pre-salt²⁵³ layer (see Appendix 2). The US\$10bn CDB loan to Petrobras provided China with a long term supply contract, and Sinopec with its first equity in Brazil: two oil blocks to be explored in partnership with Petrobras.²⁵⁴ Demonstrating its growing interests in Brazil, which is set to become a major oil producer in the near future, Sinopec acquired a 40% stake in Repsol Brazil for US\$7.1bn in late 2010, accessing by these means equity in the newly discovered pre-salt layer deposits. Moreover, earlier that year Sinochem succeeded in acquiring a stake in the Peregrino oilfield (offshore) that went up for sale, having paid US\$3.1bn.²⁵⁵ In addition to oil, Chinese companies obtained important mining assets in Brazil in 2009-2010, mostly by acquiring stakes of private mining companies that came up for sale; some of the deals included infrastructure upgrades.

In Argentina, which has been excluded from financial markets for years, China Development Bank clinched another US\$10bn loan to upgrade and expand the national railway system and acquire the rolling

²⁵¹ PDVSA, "PDVSA and CNPC form a JV to produce and improve 400 mbd of crude oil", 19 April 2010, available online at: http://www.pdvs.com/index.php?tpl=interface.en/design/salaprensa/readnew.tpl.html&newsid_obj_id=8566&news_id_temas=1 (accessed 8 June 2010).

²⁵² Energy-pedia News, "CNPC, Sinopec and CNOOC Sign Oil and Gas Agreements with Venezuela", 5 December 2010, available online at: <http://www.energy-pedia.com/article.aspx?articleid=143265> (accessed 7 January 2011).

²⁵³ The pre-salt refers to a geological formation first found in the continental shelf off Brazil, where major hydrocarbons reserves were found. The deposits are located in deep sea waters (2,000-3,000m), under a thick layer of rock (2,000) and salt (2,000). Drilling is very expensive (around US\$100 million, twice as much as deep waters) and technologically challenging.

²⁵⁴ This deal will be explored in detail in chapter five of this thesis.

²⁵⁵ Leslie Hook and Jude Webber, "China Taps into Argentina's Oil Prospects", *Financial Times*, 12 December 2010, available online at: <http://www.ft.com/cms/s/0/7acec448-0626-11e0-976b-00144feabdc0.html#axzz1BNkQPIWN> (accessed 7 January 2011)

stock. At the same time a cooperation agreement was signed between the state energy company, ENARSA, and Sinopec and Sinohydro, which points to closer ties in the energy sector. Although Argentina's main export to China is soy complex, one must not forget that it offers huge mineral potential, as a large part of the country remains unexplored. Furthermore, despite declining oil production, Argentina boasts potentially rich offshore oil and gas reserves, the exploration of which has been constrained by price controls and its tough fiscal regime.²⁵⁶ Argentinean energy companies also possess important equity in the region, which in conjunction with the divesting strategies of some IOCs in the crisis context, explains the Chinese NOC's acquisition spree in 2010. Indeed, in early 2010 CNOOC acquired 50% of Bidas Corporation (a private Argentinean oil company that owns proved oil reserves of 636 million barrels across Argentina, Bolivia and Chile) for US\$3.1bn. Soon after, CNOOC/Bidas acquired BP's 60% stake in Argentina's Pan American Energy (the other 40% belonged to Bidas) for US\$7bn. In December 2010 Sinopec acquired Occidental Petroleum operations in Argentina for US\$2.45bn.

Table 2.7. Major Chinese investments in South American Oil Sector 2009-2010

<i>Country</i>	<i>Year</i>	<i>Pledged amount</i>	<i>Chinese Company</i>	<i>Deal</i>
Brazil	2010	US\$7.1bn	Sinopec	40% stake in Repsol Brazil
		US\$3.1bn	Sinochem	Acquisition of stake in Pelegrino oilfield
Argentina	2010	US\$3.1bn	CNOOC	50% stake of Bidas Corp.
		US\$7bn	CNOOC/Bidas	60% stake Pan American Energy
		US\$2.45bn	Sinopec	Occidental Petroleum operations in Argentina
Venezuela	2010-2016	US\$40bn	CNPC, Sinopec and CNOOC	Various E&P and refining operations

Source: various news reports (Upstream online, Reuters, Bloomberg).

On the back of souring relations with the World Bank and the IMF, China has also recently extended significant loans to Ecuador. EXIM Bank is funding 85% of a US\$2 bn hydroelectric dam which is expected to supply one-third of the country's power needs. In August 2010 another US\$1bn loan for

²⁵⁶ L. Hook and J. Webber, op. cit.

infrastructure was extended by CDB to Ecuador, which is, allegedly, tied to an oil supply contract.²⁵⁷ Taking into consideration that Ecuador is known for failing to meet its repayment commitments, these two loans again signal China's willingness to take higher risks and buy political sympathies that may benefit its companies.

In early 2011, Colombia announced it was negotiating a US\$7.6bn loan from China to build a 710 km railway line linking the Pacific and Caribbean coasts. The Trans-Colombian railway would facilitate coal exports to China and function as an alternative to the Panama Canal²⁵⁸. These specific projects signal China's willingness to engage in mega infrastructure projects that would facilitate the outflow of natural resources, as in Africa.

China extended smaller loans to other South American countries, for example Bolivia, with whom it signed a US\$67mn loan in April 2010 to fund infrastructure in a mineral-rich region and another US\$60mn credit line to purchase natural gas drilling rigs. The nature of these loans further discloses the resources drive underlying China's credit facilities to South America.

Interestingly enough, Peru and Chile, China's largest lead and copper suppliers respectively, have not signed any significant loans or investment deals with China over the same period. This is even more striking if one takes into consideration that these are the only countries in South America that have signed FTA agreements with China, one of the stated aims being to foster Chinese investment.

2.3. Chapter conclusions

From a historical point of view, in terms of China's relations with LA and Africa, two main interacting patterns can be discerned. First, Chinese foreign policy towards developing regions has gradually moved from confrontation (revolution) to *de facto* peaceful coexistence and cooperation, as ideology gave place to economic pragmatism and China became more integrated into the international community. Second, throughout this period, China's policy towards these regions was always a function, not an independent element, of Beijing's relations with the superpowers (the US and the Soviet Union). This was the case when China's policy entered the radical stage in the 1960s, to counter Soviet advances in Africa; and when the rapprochement with the US facilitated relations with LA in the 1970s. In the 1980s the

²⁵⁷ News wires, "Ecuador Seals US\$1bn China Loan", *Upstream Online*, 31 August 2010, available online at: www.upstreamonline.com. (accessed 7 January 2011)

²⁵⁸ Jonathan Manthorpe, "China's Trans-Colombian Railway won't Harm Panama Canal", *The Vancouver Sun*, 21 February 2011, available online at: <http://www.vancouversun.com/business/China+trans+Colombian+rail+harm+Panama+traffic/4319274/story.html> (accessed 21 February 2011).

economic dependence on developed countries dictated the adjournment of the Third World project, while in the 1990s the strained relations with the West once again returned the Third World to China's agenda.

However, recent developments point to an important shift in this pattern. At the beginning of the 21st century Beijing's motivation to seek a closer association with the Third World seems not to be so dependent on its relations with the remaining power, the US, or on the current international system's structure. This time, domestic economic reasons seem to be the major stimulus, namely, the urge to diversify and find new sources to provide resource security upon which depend the maintenance of China's economic growth and ultimately the legitimacy of its regime.

Indubitably, having consolidated its position as a major importer of most mineral commodities throughout the 2000s, resource security naturally emerged as an increasingly important factor in CFP towards Africa and LA due to these continents' large endowments of resources. This fact is confirmed by the structure of bilateral trade flows, as Chinese imports are largely dominated by resources. This is particularly the case in Southern Africa and South America, where a handful of countries account for the bulk of trade with China. Among these Angola stands out, accounting for nearly half of China's trade with Southern Africa in 2008 (US\$25bn, 23% of total trade with Africa) and two-thirds of China's imports from the region (mostly oil). And on the other hand Brazil, which is responsible for 44% of South America's bilateral trade with China (US\$48bn, 34% of its trade with LA) and nearly half of its imports from the region (mostly minerals).

If a similar rapid growth pace is observable in China's bilateral trade with both regions, the same, however, is not true as regards Chinese investment and cooperation flows. As demonstrated above, while Chinese economic statecraft based on infrastructures-for-resources deals have made impressive inroads in Africa, the success of this approach was very limited in South America, until the onset of the global economic crisis. This reality is even more striking if one takes into account that there has been considerable interest from both parties in this regard, judging by the increasing number of high level exchanges and bilateral framework agreements involving extractive industries. In addition, at first sight, South America possesses the necessary prerequisites, namely a rich resources endowment and an urgent need to upgrade and expand its depleted infrastructure system.

This paradox underpins this thesis, which aims to uncover the reasons for these diverging patterns, and why the situation improved with the onset of the global economic crisis. This is done through an in-depth analysis of China's relations with its largest trade partners in each region: Angola and Brazil. With this

purpose in mind, the following chapter will explore the differences regarding the institutional structure of the oil sector in both case studies.

CHAPTER 3: COMPARING THE INSTITUTIONAL STRUCTURES OF THE ANGOLA AND BRAZIL OIL SECTORS

The purpose of this chapter is to provide an overview of the institutional structure that frames the oil sectors in Angola and in Brazil. In both cases the analysis will focus first on how the present structures came into existence, and how these were shaped by their contemporary history. Secondly, the institutional dynamics of their current respective oil industries are examined, this aimed at unpacking the synergies at work in both countries. The main aim of this is to uncover the major institutional differences affecting the oil industry in both countries, emphasizing the sharp contrast between Angola's highly centralized pattern and the fragmented nature of the structure in Brazil. To complement this section, a detailed account of Angola and Brazil's oil industry is presented in Appendix I and II.

3.1. Institutional structure of the oil sector in Angola

During the last decades of colonial rule, Angola enjoyed a diversified economy. Before 1975, aside from a flourishing mining industry (diamonds and iron ore) and a nascent oil industry, Angola had a thriving agriculture sector and emerging industrial park served by a large and modern transportation network and power grid. Following independence, however, the economy collapsed. The country lost most of its skilled labour overnight following the massive and hasty withdrawal of the Portuguese population in the wake of independence and the economy's decline accelerated as civil war broke out and lasted for almost 30 years.²⁵⁹ Over this period the economy became increasingly dependent on the oil sector, and this industry gradually fell under the absolute control of the Presidency.

²⁵⁹ Independence was granted to Angola in November 1975 following a military coup in Portugal (1974) that brought to an end over four decades of dictatorship. In the midst of a muddled political environment in Lisbon, authority in Luanda was transferred, in haste, to a transitional government integrating the three main independence movements: MPLA (Movimento para a Libertacao de Angola), FNLA (Frente Nacional para a Libertacao de Angola) and UNITA (Uniao Nacional para a Independencia Total de Angola). This fragile arrangement collapsed almost immediately, giving way to a civil conflict that drew in major international actors in the framework of the Cold War. The Marxist-Leninist MPLA held Luanda with military support from Cuba and Soviet armies, while the UNITA-FNLA alliance held the central region (Huambo) with the military support of South Africa, China and the US. After FNLA major defeats in the North, Western powers eventually focused all their support in UNITA, led by Jonas Savimbi.

3.1.1. Oil: empowering the Presidency throughout the civil war²⁶⁰

The Angolan oil industry was under ruling party (MPLA)²⁶¹ control from the onset of the conflict. With Angolan hydrocarbon reserves mostly located offshore, the oil industry was never affected by the civil war. The conflict's progress, however, was greatly impacted by the fluctuation in oil prices, as oil revenues were critical in funding MPLA's war effort. The national oil company, Sociedade Nacional de Combustiveis de Angola (Sonangol, whose role is further detailed below), assumed a key role within this context by acting as a guarantor for short term loans to fund MPLA's military expenditure.

The evident synergies gradually knit the oil industry and the MPLA close together. Throughout the war period President Dos Santos²⁶² consolidated his grip first over MPLA, and subsequently Sonangol. In this setting the Presidency and Sonangol emerged as Angola's paramount institutions.

Following the end of the Cold War and the withdrawal of foreign powers (Soviet, Cuban and South African troops) the civil conflict became increasingly 'angolanized'²⁶³, led by personal ambitions and mutual distrust and progressively more reliant on its own domestic resources. The civil war gradually became a resource-based conflict between urban MPLA that controlled the oil, and UNITA²⁶⁴ that controlled the diamond mining areas in the northeast and southeast of the country. Up until 2002 Angolan resources were almost exclusively directed to fund the conflict, neglecting the state and all economic sectors, and most importantly the population that was pushed to the limits of extreme poverty.

Having lost its main funding sources (US and South Africa) with the end of the Cold War, diamond revenues became vital for UNITA in the 1990s. When Savimbi refused to accept defeat in national elections held in 1992, and resumed the conflict, diamonds became the only funding source to purchase armament, pay its officials and buy the sympathy of neighbouring governments. UNITA's control over the diamond mining areas was, however, disrupted by government mercenary led operations and the signing

²⁶⁰ This section draws heavily on: Ana Cristina Alves, "Angola's Resources: from conflict to development", in: Ruchita Beri and Uttam K. Sinha (eds.), *Africa and Energy Security* (New Delhi: Academic Foundation, 2009) pp. 155-175. History, political and economic background based in: EIU, *Angola Country Profile 2008*, London: EIU, 2008; EIU, *Angola Country Report*, London: EIU, September 2009; CIA, *The World Fact Book: Angola*, available online at: <https://www.cia.gov/library/publications/the-world-factbook/geos/ao.html> (accessed 15 December 2010)

²⁶¹ MPLA - Movimento Popular de Libertação de Angola.

²⁶² Angola's first President, Agostinho Neto, died in September 1979, only four years after independence. He was immediately replaced by oil engineer José Eduardo dos Santos, an eminent pro Soviet MPLA princeling, who was then the Foreign Affairs Minister (1975-79). At the age of 37, dos Santos assumed along with the Presidency the functions of President of MPLA and Commander in Chief of the armed forces, remaining in office up to the present.

²⁶³ Phillipe le Billon, "Angola's political economy of war: the role of oil and diamonds, 1975-2000", in: *African Affairs*, 100, 2001, p. 58.

²⁶⁴ UNITA - União Nacional para a Independência Total de Angola.

of the Lusaka Peace Protocol in 1997, which forced UNITA to hand over important diamond fields. When the war resumed in 1998, UNITA had much smaller resources.

MPLA, in contrast, saw its oil revenues increase substantially in the late 1990s, fuelled by the surge in oil price and new found reserves. As a result, MPLA's military capacity improved dramatically, breaking the war impasse in favour of Luanda. UNITA was further weakened by the increasing military pressure of governmental troops and growing isolation, resulting from western institutions' sanctions.²⁶⁵ UNITA's difficulties of resupply, internal fragmentation (a rebel faction that favoured the peace process emerged within its leading ranks) and the loosening of the command chain, all contributed to the encirclement and decapitation of its forces in February of 2002.

After the peace treaty signed on April 4, 2002, UNITA gave up its diamond mines and demobilised, and from then on the MPLA government steadily established control over the diamond sector, bringing thus all resources under the Presidency.

After dealing with UNITA, MPLA was finally able to focus on the separatist movement in the Cabinda enclave,²⁶⁶ in which offshore a significant part of Angolan oil production originates. Indeed, soon after the end of the civil war, MPLA managed to disband the separatist movement in Cabinda, who unlike UNITA had very limited resources. This was done through increased military presence, playing out the internal divisions and co-option of the leaders (namely Bento Bembe who is presently the Angolan Minister for Human Rights).

The interlock between the conflict and resources throughout this phase was so profound, that it is hard to establish if it was a resource-based civil war or a war for resources. The fact remains that oil revenue greatly influenced the course of the war and peace was only possible when one of the contenders (MPLA) secured the monopoly over all the resources. With no means of funding, the defeated opponents (UNITA

²⁶⁵ In June 1998, the UN Security Council froze UNITA's bank accounts and declared a worldwide ban on the sale of unofficial Angolan diamonds ('blood diamonds'). Although it did not stop UNITA diamond transactions, it did substantially increase transaction costs.

²⁶⁶ Based on historical reasons, Frente para a Libertação do Enclave de Cabinda (FLEC) declared Cabinda's independence in August 1, 1975, and formed a provisional government headed by N'zita Tiago and Ranque Franque as President. Angolan troops occupied Cabinda right after independence (November 11, 1975), and incorporated the territory in Angola. Since then FLEC has been fighting Luanda's rule over the territory, and over the years has split into several groups (major ones: FLEC-Renovada and FLEC-FAC forças armadas de Cabinda). In September 2004 the two main rebel movements (FLEC-FAC and FLEC-R) merged and created a dialogue platform, Fórum Cabindês para o Diálogo (FCD), that integrates civil society and church representatives, and which is presided over by António Bento Bembe (FLEC-R). On July 17, 2006, Bento Bembe signed a ceasefire with Luanda and a Memorandum for Peace and Reconciliation of Cabinda which includes a special statute for the province. However, this is still contested by N'zita Tiago and other Cabindans, and some low intensity fighting persists.

and FLEC) had no option but to lay down arms and integrate the political system commanded by the Presidency.

3.1.2. The consolidation of the patrimonial state in the post-conflict setting

By the end of the conflict, the Angolan economy was fully dependent on the oil industry, and by virtue of the war economy that ruled the country for almost three decades, oil was by then very much the exclusive patrimony of the presidency.

Having no war effort to sustain now, the Presidency focus in the peaceful setting was thus placed on applying the state's expanding oil revenue (four fold increase between 2002 and 2006, from US\$7.5bn to US\$30bn),²⁶⁷ to ensure the necessary support to remain in power.

By exerting absolute control over the formal system of checks and balances, namely judicial power, parliament and civil society,²⁶⁸ the Presidency has effectively managed to evade accountability and maintain the *status quo*. Its control over the executive and the parliament gives it a substantial leeway to manage state interests as its own. Most legislation is composed of executive decrees in which the parliament has no say. Moreover, the president holds a strong political control over the judiciary by, amongst other things, retaining the right to appoint key judges to the Supreme Court, without the need for sanctioning by the national assembly. The Presidency has also been successfully using state resources to weaken the opposition through a combined strategy of co-optation, intimidation and infiltration. All opposition parties have been subject to the same erosion²⁶⁹ and none of them, including UNITA, pose any real challenge to the ruling party at present. This picture is further complemented by a particularly weak civil society, largely uneducated and often manipulated to drum up public support for the president. Dos Santos has actively sought to improve his image across the country, namely through the social projects developed by Eduardo dos Santos Foundation created in 1996. The centralised political institutional synergies that originated in the socialist period, thus not only survived but even strengthened throughout the transition to a multiparty system.

By taking advantage of its tight control over the means of production and accumulation, and framed by a weak regulations and law enforcement environment, the Presidency was also able to reinforce its grasp

²⁶⁷ BNA, *Boletim Estatístico Junho 2008* (Luanda: BNA- Departamento de Estudos e Estatística, 2008) p. 45.

²⁶⁸ For a detailed account on how the Presidency steadily established control over these, see: Christine Messiant, "The mutation of hegemonic domination: multiparty politics without democracy", in: Patrick Chabal and Nuno Vidal (eds.), *Angola: The Weight of History* (London: Hurst, 2007) pp. 109-120; Nuno Vidal, "The Angolan Regime and the move to multiparty politics", in: P. Chabal and N. Vidal, *op. cit.*, pp. 143-157.

²⁶⁹ Christine Messiant, *op. cit.*, p. 108.

over the economy. This was done through the gradual establishment of a rentier class in the context of the progressive liberalisation of Angola's economy. Massive resources were progressively transferred to individuals or private companies,²⁷⁰ namely through privileged access to capital, licences, contracts and in particular concessions under the close supervision of the Presidency. The red tape involving all business activities in Angola further holds back competition by allowing business opportunities to be kept within the Presidency's inner circle. According to IFC's *Doing Business Report 2010*,²⁷¹ Angola ranks 169th out of 183 countries listed on its *Ease of Doing Business Index*. The strategy fostered a loyal indigenous business class that presently spans across party peers, independents and former opponents, which strongly support the *status quo* and the Presidency.

The new political-business class was encouraged by the Presidency to enter the oil industry in the post-conflict context. Through Sonangol the presidency gave local companies (e.g. Somoil, Prodoil) privileged access to licensing, particularly to onshore and shallow waters of less interest to oil majors, and openly started to give preference to exploration consortia that included Angolan companies. In addition, it promoted the creation of local services companies and legally forced foreign oil operators to contract these.²⁷²

Although the patrimonial nature of the Angolan state is in effect a pattern commonly found in African authoritarian states (e.g. Paul Biya in Cameroon; Gabon under Omar Bongo), what makes it so outstanding, as Tony Hodges notes, is that "the scale of resources under the control of the presidency has no parallel elsewhere in Sub-Saharan Africa except Nigeria".²⁷³ The power of the ruling elite in Nigeria, however, is curtailed by political alternation cycles, which have not yet materialised in Angola.

Unlike Obasanjo in 2007, Dos Santos rule was confirmed by the general elections in September 2008 (the first held in the post-civil war setting). The landslide victory of MPLA, grasping 81% of the votes and 191 parliamentary seats out of 220, is in sharp contrast with the slim 10% margin of the votes for UNITA with 16 seats),²⁷⁴ was endorsed by a strong turnout of almost 80% and by foreign poll observers.

²⁷⁰ For a more detailed account on the emergence of this rentier class, see: Tony Hodges, "The Economic Foundations of the Patrimonial State", in: P. Chabal and N. Vidal, *op. cit.*, pp. 186-194.

²⁷¹ IFC, *Doing Business 2010 Report*, 2009, available online at www.doingbusiness.org (accessed 21 February 2010)

²⁷² Similar developments occurred in the early 1990s in the diamond sector, with the introduction of legislative changes to allow the participation of national interests, which, however, ended up acting as sleeping partners who owned the exploration licences while the capital and technology were fully brought in by foreign investors.

²⁷³ Tony Hodges, *op. cit.* (2007), p. 186.

²⁷⁴ In the previous legislature (resulting from the 1992 elections) MPLA controlled 129 seats out of 220, while UNITA secured 70.

As a consequence, dos Santos has emerged more powerful than ever before. In the peaceful setting his power is uncontested as it is now legitimised by a strong popular mandate.

Furthermore, a new Constitution was approved in January 2010 that further expands the President's power in the current peaceful context.²⁷⁵ The new document abolished the post of Prime Minister created in 2002 - reinstating the President as the executive head. It also removed presidential elections, giving the party with most seats in parliament the right to nominate the head of state, whom can serve two consecutive four year mandates. This new constitutional setting opens the door for dos Santos to remain in power until 2020,²⁷⁶ given that MPLA is not expected to face any solid competitors in the next legislative elections to be held in 2012. The cabinet reshuffles in February and October 2010 followed the traditional pattern whereby ministers are chosen from amongst the President's key allies. Despite the progressive empowerment of a MPLA technocrat clique within the government since the end of the war, dos Santos remains ultimately in control of the decision making process.

Taking into account these recent developments and the rising oil production prospects, no significant change to the institutional context that frames Angola's oil industry is expected in the foreseeable future. In fact, the magnitude of financial resources concentrated in the structure commanded by the President's office, has made it possible for Angola to effectively resist even external pressure for increased transparency and good governance, by some western states, NGOs and multilateral institutions. This was the case with the IMF, which was unable to complete any of the previous staff-monitored programmes (SMP, 1995 and 2000-2001) geared up to increase transparency in governance of public accounts, having both times clashed with vested interests and faced the public opposition of the presidency.²⁷⁷ Angola's leverage derived from its condition as a large oil producer and in the context of high oil prices. This has also played out in its bilateral relationships, namely with France. As a consequence of its activism in the 'Angolagate'²⁷⁸ affair, Sonangol refused to renew Total's expiring oil concessions in 2006.

²⁷⁵ *Constituicao da Republica de Angola*, 2010, available online at: http://imgs.sapo.pt/jornaldeangola/content/pdf/Constituicao_da_Republica_de_Angola_projecto_final.pdf (accessed 20 August 2010)

²⁷⁶ Eduardo dos Santos will be 78 years old by then, completing over four decades in power.

²⁷⁷ Tony Hodges, *Angola: Anatomy of an Oil State* (Norway: Fridtjof Nansen Institute, 2004, 2nd ed.) pp. 118-122.

²⁷⁸ Judicial process over financing of Russian arms purchases to Angola (1993-98 while a UN arms embargo was in place, and with the arms being critical for MPLA's victory over UNITA), with oil-backed loans. These involved intermediation of French citizens (the Franco-Brazilian financier Pierre Falcone, Jean-Christophe Miterrand, son of the French president, and the then Minister of Interior, Charles Pascua), an Israeli-Russian arms dealer (Arcadi Gaydamak) and Angola's nomenclature top echelons. In order to give him diplomatic immunity and to avoid his testimony in court, Angola nominated Falcone to the post of UNESCO ambassador. This move was firmly contested by Paris who refused to acknowledge his credentials, in the face of which Luanda suspended recognition of the

The oil price crash in 2009, on the other hand, prompted Luanda to sign a third SMP with IMF in November 2009 for a US\$1.4 bn loan (to promote macro-economic stability and economic diversification), which is presently under implementation. This further confirms the over-dependency of the Presidency on the oil industry, by evidencing how vulnerable it is to fluctuations in the oil price.

3.1.3. Unpacking the centralized nature of the regulatory framework

Oil prospection started in Angola in 1910 in the Kwanza and Congo Basins, with Canha & Formigal, a Portuguese company. Although well-digging started early on (1915), it took four decades to find the first commercially viable well, located in the Kwanza River basin. In 1953 ANGOL (Sociedade de Lubrificantes e Combustíveis) was established as a subsidiary of the Portuguese oil company SACOR, to manage the nascent oil industry in Angola. Later that year exploration rights for the Cabinda enclave offshore were granted to an American company, the Gulf Oil Company.²⁷⁹ The first oil well in Cabinda was discovered in 1962 and production started soon thereafter. Following new investments in the late 1960s, production tripled from 50,000 bpd in 1969 to 173,000 bpd in 1974, on the eve of independence - having surpassed coffee as Angola's main export commodity in 1973.

In 1976 the nationalisation of ANGOL gave birth to the national oil company Sonangol (Sociedade Nacional de Combustíveis de Angola) in 1976, and the National Direction of Petroleum (DNP - DL 66/77; placed under the Ministry of Industry) in 1977. The Decree Law Nr. 52/76, established Sonangol as a state owned company responsible for managing the exploration of hydrocarbons in Angola. After brief negotiations, Sonangol took over the operations and infrastructure left behind by Mobil, Texaco, Fina and Shell, who fled the country after independence.

The first Petroleum Law (Law Nr. 13/78) was published two years later, establishing the legal scope of upstream activities. Although this Law was replaced by a new one (Law Nr. 10/04)²⁸⁰ in November 2004, to integrate new concepts and practices originated by the evolution of the industry over the years, the same basic principles remained. These are:

French Ambassador in Angola and refused to renew Total's oil concession for block 3/80. Soon after, the French government recognised Falcone's immunity. Nevertheless, the trial proceeded and the recent conclusion (October 2009) led to a verdict of six years in prison for Pierre Falcon and Arcady Gaydamak, three years for Pascua and two for Miterrand.

²⁷⁹ This was later formally turned into a subsidiary, Cabinda Gulf Oil. Gulf Oil Corporation merged in 1984 with Chevron and Chevron with Texaco (ChevronTexaco) in 2001. Cabinda Gulf Oil kept the name, while becoming a subsidiary of the major oil giant.

²⁸⁰ Ministerio dos Petroleos, *Lei Geral das Actividades Petrolíferas* (Lei 10/04), 12 November 2004, available online at: <http://www.minpet.gov.ao/LegislacaoD.aspx?Codigo=273> (accessed 7 January 2011).

- a) All oil mineral rights belong to the state (art. 1 and 2);
- b) Sonangol is the exclusive concessionaire of exploration and production rights on behalf of the state²⁸¹ - a role assumed by Sonangol E.P. (Sonangol Empresa Publica, the official designation of the group);
- c) Sonangol is also entitled to participate in exploration and production activities (E&P) (art.13), having for this purpose established Sonangol P.P.²⁸² (Sonangol Pesquisa & Producao, in Portuguese);
- d) All oil companies entering the industry have to do so in association with Sonangol (art. 13) by creating a commercial enterprise (JV), a consortium or through a Production Sharing Agreement (PSA)²⁸³ (art. 14).

Through this legal framework Sonangol was placed at the core of the Angolan oil industry from the very beginning, combining quasi-regulator competences (e.g. organising oil auctions and signing PSA) with E&P activity. Other important legal aspects that favour Sonangol's position in the sector include the preferential right (art. 16, nr. 5), which gives the NOC the right of first refusal when one of its associates is to sell its position (or part of it) in a block. In recent years, Sonangol has exerted extensively this right in view of profit, having in most cases sold the parcel later for a higher price. In addition, all data acquired by companies during the exploration phase are legally considered property of the state, with the right of use by Sonangol.

Throughout the years Sonangol's power was further reinforced by the growing importance of the oil sector and the gradual institutionalisation of a number of practices. In addition to holding the exclusivity of concession rights and being involved in E&P activities, Sonangol created an extensive network of subsidiaries to supply services and goods to the industry (Sonair for air transport; Sonaship for crude

²⁸¹ The Ministry of Petroleum is in charge of prospection rights concession.

²⁸² Sonangol E&P was created in 1992 and took over its first operatorship stake in 2003 (block 3). Presently Sonangol E&P has participation in 33 out of the 35 operating oil blocks. It is operator in seven offshore blocks (3; 2/85; 3/05; 3/05A; 4/05; 2/05; 34) and one onshore (Norte).

²⁸³ Production Sharing Agreements are a special civil contractual form between a state and an investor that determines the area, conditions and timeframe regarding subsoil use. The state retains the ownership of the soil and of the produced product. The contractor, who bears all the expenses at its own risk (prospecting, exploration and extraction of mineral resources), has the right to use the revenue from produced oil to recover expenditures it incurred (cost oil). In Angola, PSAs usually state that up to 50% of the revenue can be appropriated by the contractor to offset investment cost recovery in the initial stages. After development costs have been fully recovered (average time in Angola 7-8 years, against 12-15 in most oil producing countries), the remaining income (profit oil) is split between the government and the contractor, normally at a rate of about 80% for the government, 20% for the company. Each PSA is negotiated individually with Sonangol. (Interview, Sonangolp, 19 March 2009, Luanda, Angola.)

transportation; MSTelcom for telecommunications; ESSA for human resources development; and AAA for integrated insurance). These have benefited widely from the effort of ‘angolanisation’ of the industry (art. 27), whereby foreign operators are obliged to procure local services and goods (when these offer the same quality and are up to 10% more expensive than the imported ones). In addition, Sonangol also retains a dominant position downstream. Over the years the Angolan NOC also expanded to other lines of business, namely banking (Banco Africano de Investimentos and Banco de Comercio e Industria), real estate, healthcare (Clinica Girassol), construction (Bricomil) and retail (Sodispal and WACO). At the same time, Sonangol has expanded its business overseas, having established trading and operations offices in London, Houston, Hong Kong and Singapore.

Although other institutional players are legally obliged to perform as regulators to the sector, namely the Ministry of Finance and the Ministry of Petroleum (MINPET), their roles have been dwarfed by Sonangol’s growing influence over the industry. MINPET was created in 1978 (Decree 15/78), having absorbed the DNP into its structure. It went through several major restructurings in 1984, 1991 and 1996. According to article 1 of its internal statute,²⁸⁴ MINPET’s main responsibilities are executing the national oil policy and to coordinate, monitor and control the activities in the sector. Among its competences, stand out proposing new regulatory legislation, defining blocks’ areas, issuing prospecting licences, and promoting studies and inventories of national oil resources (art. 2). Although the legal framework portrays MINPET as the central administration body in charge of the oil sector, its influence over developments in the industry pales when compared to Sonangol.

These developments are mostly explained by the synergies that emerged in the sector in the context of the civil war, largely attributable to the lack of competent cadres and subsequent bureaucratic paralysis that affected not only MINPET, but most Angolan governmental institutions throughout the conflict. The fact that the establishment of Sonangol preceded the creation of the Ministry, determined that the NOC not only was granted the existent infrastructure, but also that it absorbed all qualified human resources available in the sector, that were left behind by the companies leaving Angola.

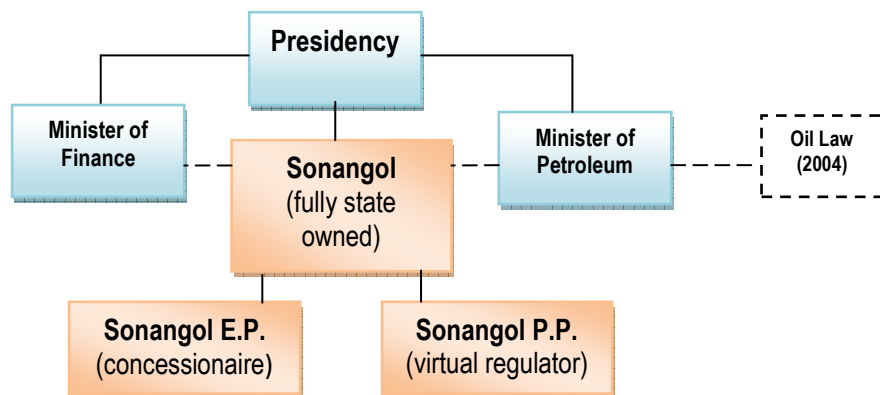
In fact, the Angolan NOC was insulated from the rest of the state apparatus since its inception in 1976. Managed as a private company, and with close links to the international oil economy, Sonangol has followed a distinctive administrative path that kept it aside from the pattern of incompetence and negligence that characterised most Angolan institutions. Over the years the company developed valuable

²⁸⁴ Ministerio dos Petroleos, *Estatuto Organico do Ministerio dos Petroleos*, (DL 10/96), 18 October 1996, available online at: <http://www.minpet.gov.ao/LegislacaoTodos.aspx> (accessed 7 January 2011).

human capital and expertise, which is unique in the context of Angolan economy. As such Sonangol gradually assumed a number of responsibilities on behalf of other state institutions, namely the treasury and the National Bank.²⁸⁵ In this setting and given the centrality of oil to the economic survival of MPLA, Sonangol gradually emerged as a key internal economic actor.

In addition to lacking human resources, MINPET also lacked access to capital. Being only able to issue prospection licences, MINPET had no access to major revenues in the sector, since E&P oil profit was to be directly paid to Sonangol, and taxes and royalties channelled to the Ministry of Finance. With much better human capacity and direct access to abundant financial resources, it is thus not surprising that the Presidency privileged Sonangol, allowing it to extend its influence over the sector - much beyond its legal responsibilities.

Diagram 3.1. Representation of the institutional structure of the oil sector in Angola



Source: Elaborated by the author, based on the current regulatory framework.

The authority chain in Sonangol is very straightforward, featuring a Board of Administrators integrated by a chair and four deputy-chairs, below which stand all the operational departments of the company. This board is responsible for both policy making and implementation. There is no fiscal council, executive board or general assembly. The interlock between Sonangol and the Presidency is further evidenced by the appointment of its close allies to the top positions in the company. The current CEO, Manuel Domingos Vicente (Director general of the company since 1991), was appointed to chair the board of directors in 1999 by Ministers Council Decree (a body presided over by dos Santos). Lacking effective oversight from other state institutions, namely the Central Bank and the Ministry of Finance, the oil

²⁸⁵ For a detailed account on these activities and the dual economy originated by these procedures, see: The World Bank, *Angola: Oil, Broad-Based Growth, and Equity* (Washington D.C.: The World Bank, 2007) pp. 49-50.

industry became increasingly opaque, allowing the Presidency to easily dispose of huge resources without being held accountable for it. Throughout the civil war, oil revenue, especially signature bonuses, served not only to pay for armaments' purchases, but also nurtured the presidential patronage network. Human Rights Watch estimates that in the last five years of the civil war (1997-2002), approximately US\$4.2bn went missing from the public treasury.²⁸⁶

The growing integration of Angola into the global economy in the peaceful context has, however, made the government more vulnerable to mounting criticism from NGOs and multilateral institutions (World Bank -WB and International Monetary Fund -IMF). This reality, combined with existing plans for the public listing of Sonangol in international stock exchanges, has prompted the leadership to gradually improve its management practices in the oil sector. Among these practices, stand out the introduction of regular audits to Sonangol (Ernst and Young conducted the first one in 2003), the posting on the Ministry of Finances website of detailed and updated monthly information regarding oil production, exports and revenue (by block), and the disclosing of signature bonuses²⁸⁷ in the last two oil licensing rounds (1999 and 2005/06). These actions were actually part of a list of recommendations by the World Bank in an oil sector diagnostic study elaborated in 2004. A lot, however, remain to be addressed, namely regarding expenditures performed by Sonangol on behalf of the government, the publication of the audits, a stronger engagement with civil society in public finances management, and the separation of concessionary and operator roles of Sonangol.²⁸⁸

Indeed, the concessionary and operator roles simultaneously assumed by Sonangol are a major obstacle with regards to improving transparency in the sector. There is an obvious conflict of interests here, being that Sonangol assumes a quasi-regulator role and at the same time engages directly in E&P and services supply. This centralized structure allows the Presidency to use Sonangol not only as its business arm, but also as a political instrument. Despite the World Bank and IMF pressure to transfer the role of concessionaire and regulator to MINPET, Luanda has been able to resist on the grounds that the MINPET and MINFIN still lack the institutional and technical capacity to assume this function.²⁸⁹ As such, and even though the Ministry of Finance and the Central Bank have in recent years significantly improved

²⁸⁶ Human Rights Watch, *Transparency and Accountability in Angola, an update* (New York: HRW, April 2010) p. 1

²⁸⁷ Signature Bonus refers to a common practice in some oil producing countries, by which bidders make a one-off payment in advance, to secure the right to develop and explore an area. The size of the bonus is based upon presumed recovery potential and value on the market's interest in the right.

²⁸⁸ For a detailed account on progress and challenges remaining in the Angolan oil industry, see: The World Bank, *Angola: Oil, Broad-Based Growth, and Equity* (Washington D.C.: The World Bank, 2007) pp. 50-53.

²⁸⁹ The World Bank, *op. cit.* (2007), pp. 50-53.

their capacity in this regard, they still lack control over the totality of Sonangol's financial flows. In this context, Sonangol's primacy in the sector is set to remain unchallenged in the foreseeable future. In spite of all this, Sonangol retains responsibility for the success of the oil industry in Angola. Sonangol successfully created, as R. Soares de Oliveira points out, "a parallel economic system that insulates oil companies from the unreliability of local conditions, with its own acceptable legal framework and logistical efficiency. In such enclave contexts, companies can operate freely and do not face the rent-seeking, contractual uncertainty or threat of expropriation that are widespread outside the oil sector."²⁹⁰

Lacking capital, expertise and technology to develop the oil industry in Angola, Sonangol's strategy to develop the industry was from the start to form partnerships with foreign companies. This was done by maintaining the concession agreements regarding onshore and shallow water blocks that were already in production at that stage (mostly located in Cabinda and Soyo), and the introduction of Production Sharing Agreements for new contracts. For this reason, and although Sonangol production has been on the rise, IOCs account for the bulk of Angolan oil production.

In sharp contrast with most oil producing countries in Africa, and in the midst of domestic chaos, Sonangol managed to lay down an efficient and stable regulatory environment that conquered the trust of major operators in the sector. This was made possible, first, by the fact that oil was mostly located offshore and thus remained unaffected by the civil conflict; second, as the same regime remained in power throughout all this time; and third, given that contract stability characterised the sector. Indeed, Sonangol has always honoured its commitments and has no major disputes in its record. Reflecting this favourable context, Angola ranks fifth in Business Monitor International's upstream business environment rating in Africa, ahead of Algeria and one point behind Nigeria.²⁹¹

In addition to its critical role domestically, Sonangol has also become a key foreign economic statecraft instrument for the Presidency in recent years. Sonangol has been driving the country's investments overseas, acting much as a sovereign wealth fund. In addition to expanding its upstream (Gabon, Nigeria, Iraq, Gulf of Mexico and Brazil), and downstream (Congo, Equatorial Guinea, Cape Verde, São Tomé, Nigeria, US, Portugal and Argentina) activities overseas, Sonangol has been very actively investing in other lines of business (e.g. banking, energy, construction and real estate), in Portugal, Brazil and other Portuguese speaking countries. This strategy clearly serves a political purpose of strengthening Luanda's

²⁹⁰ Ricardo Soares de Oliveira, "Business success, Angola style: post colonial politics and the rise of Sonangol" *The Journal of Modern African Studies* 45:4, 2007, p. 610.

²⁹¹ Business Monitor International, "Angola Oil and Gas Report Q1 2011" (Executive summary), January 2011, available online at: <http://www.researchandmarkets.com/reportinfo.asp?r=1501380> (accessed 17 January 2011).

influence, namely in the region and in the Lusophone area. In addition, Sonangol has been used as an instrument to diversify Luanda's foreign partnerships, specifically through the gradual attraction of other players to invest in the Angolan oil industry, namely Asian companies. The NOC has also served the purpose of minimising external pressure from bilateral partners and multilateral organisations, such as the WB and IMF, by serving as guarantor for bilateral and commercial loans which account, respectively, for one and two-thirds of the country's public debt.²⁹²

Angola is presently a well established hydrocarbons producer, with a very good track on exploration success, having registered a rapid expansion of reserves and production over the past decade. Even though the growth pace of new reserves and production may be affected by increasing operating costs as the drilling goes deeper, Angola has bright prospects in terms of new oil potential (see Appendix I). Having successfully resisted mounting external and domestic pressure throughout the post-conflict setting, Sonangol has managed to retain its primacy in the sector management. In the same way, the Presidency has effectively reinforced its hegemony in the peaceful setting, being now legitimised by a powerful mandate. Therefore the synergies between Sonangol and the Presidency have not only survived, but have also prospered in the new setting. If confirmed commercially viable, the Angolan pre-salt reservoirs may sustain this *status quo* beyond 2025, when conventional reserves are expected to dry up and drag down the regime. In this context, the links to the Presidency-Sonangol nexus are to remain a determining factor in the Angolan oil industry in the foreseeable future, particularly so for new entrants.

3.2. The institutional structure of the oil sector in Brazil

Unlike Angola, the Brazilian economy has had an intimate relationship with the resources sector since early colonial times. In fact, the hunt for precious metals and stones (mostly gold, silver, copper, diamonds and emeralds) can be held, to a certain extent, responsible for the expansion of the country's frontiers, almost to a continental level, under Portuguese colonial rule (1500-1822). If on the one hand, the Portuguese had exhausted most of Brazilian gold and silver alluvial deposits by the time of independence (1822), they left behind what is presently the fifth largest country in the world by area (8.514.876 km²) and the largest in South America - accounting for nearly half of the landmass of that subcontinent.

²⁹² Banco Nacional de Angola-Departamento de Estudos e Estatística, *Boletim Estatístico 2002-Junho/2010* (BNA: Luanda, Junho 2010) p. 45.

Unlike Angola, however, and mostly because of its much longer independence history and peaceful framework, Brazil managed to develop a vibrant diversified economy following independence, having currently a thriving services sector, along with extremely dynamic industrial and agribusiness sectors.

3.2.1. Private initiative and decentralisation (1822-1930)²⁹³

When independence was declared on 7 September 1822, the new monarchy retained the pre-existent resource logics separating ownership of land and eventual riches underneath. The state retained exclusive ownership over all subsoil resources, issuing concessions rights separately for exploration and development. Reflecting a new economic context highly dependent on agriculture, the new constitution (1891) following the proclamation of the Republic (United States of Brazil) in 1889, established, however, that the land proprietors also had ownership over the subsoil resources. Under this new legal framework the federal government lost its authority over mining activities. Nevertheless, after the turn of the century, the federal government steadily started to be more assertive in regard to the resources sector. In 1907 the first state organ in charge of mining activities was created: the Geological and Mining Service of Brazil (Serviço Geológico e Mineralógico do Brasil, SGMB) under the Ministry of Agriculture. Two laws promulgated in 1915 (Lei Calógeras) and 1921 (Lei Simões Lopes) attempted to reintroduce the separation of surface and subsoil ownership and to regulate mining activities, working in practice as a germinating mining code. Fearful of exploitation by external powers (e.g. US in Venezuela), a constitutional amendment was introduced in 1926, limiting the participation of foreign companies in mining activities.

During period over 10 wells were drilled looking for oil in S. Paulo, Bahia and S. Catarina, by private entrepreneurs. Lacking the necessary capital, the legal incentives, adequate equipment and expertise, these, however, failed to produce any significant results. Nonetheless, institutionally, pioneering steps were taken such as the creation of SGMB that produced important studies, the capacity building that took place under the mining school in Minas Gerais, the germination of a mining code with the above mentioned adopted laws, and the increasing debate over the state's developmental role with regards to resources.

²⁹³ The following overview is based on: Adriana Fiorotti Campos, "A reestruturação da Indústria do Petróleo Sulamericana nos anos 90", Doctoral Thesis, Universidade Federal do Rio de Janeiro, December 2005, 367 pp., unpublished; Luiz Antônio Bongiovanni, "Estado, Burocracia e Mineração no Brasil 1930-1945", Masters Thesis, Universidade Estadual de Campinas, November 1994, 113 pp., unpublished; "Espaço Conhecer" Petrobras website: http://www2.petrobras.com.br/espacoconhecer/APetrobras/linhatempo_ano90.asp; and relevant Brazilian legislative acts, available online at: <http://www.presidencia.gov.br/legislacao/> (accessed 7 February 2010).

3.2.2. Centralising under the developmental state (1930-1989)

The emerging clash between the old rural oligarchy behind the First Republic and the new urban-industrial class, combined with the dramatic effects of the world economic crisis of the late 1920s, precipitated a regime change through a military coup in 1930. Benefiting from weakening regional constituencies in face of a crumbling coffee lobby, the new highly militarized republic led by Getúlio Vargas (1930-1945), managed to swiftly achieve a high level of power concentration in the federal executive. Favoured by expanding nationalist currents, Vargas pursued a strong developmental role for the federal executive in the economy. Through the elaboration and implementation of concerted national policies encompassing all economic sectors, Vargas promoted the industrialisation of the country, launching the basis of an economic institutional structure that would have an enduring impact over the following decades.

a) Launching the basis of the developmental state and resources sector administrative emancipation (1930-1945)

Owing to its strategic importance for national development and defence, resources sectors assumed a central role in Vargas's plan to undertake fast modernisation of the country. The new constitution promulgated in July 1934 re-enacted the distinction between ownership of the land and of the subsoil, stating that: 1) it was the exclusive right of the Union to legislate about the resources deposits, 2) the federal executive owns the exclusive rights to authorise exploration and development of resources, 3) only Brazilian citizens or enterprises domiciled in Brazil can access those concessions, and 4) all known deposits ought to be registered at the National Department of Mineral Production (DPNM in the Portuguese acronym, created in 1933) and be nationalised.

This was shortly followed by the promulgation of the first Mining Code (1934). According to this new law, all resources deposits became national patrimony and were to be developed by the state. Through this legal instrument, the federal executive not only achieved total control over resources, but it also managed to foster the emergence of national companies by privileging and protecting the local business class from international competition.

The whole modernisation project, however, got jammed as the legislative arena quickly became a battlefield of the various economic interests at stake. Backed by the military, the fascist segments of the administration and the entrepreneurial class, Vargas installed a dictatorship in 1937 ('Estado Novo', 1937-1945). In December 1937 a new constitution was promulgated, concentrating all the power in the

President, so allowing Vargas to resume the fast industrialisation path in the terms he had planned in the early 1930s.

The new constitution reinforced the nationalist content, reflecting an intimate nexus between resources, the development of base industries and national defence. Reflecting the increasing evidence of oil deposits in the country, legal dispositions defining the regime of national oil and natural gas reserves, were integrated into the mining code in 1938.

Vargas decided to give more autonomy to the resources sectors by creating outside the Ministry of Agriculture, two state agencies responsible one for oil and the other for mining. In 1938 the National Council for Oil (Conselho Nacional do Petróleo, CNP) was created, under the direct authority of the Presidency, to elaborate oil policy and supervise the oil administration. The same decree declared that the import, export, transportation, distribution and commercialisation of oil and its derivatives, as well as refining activities, were of public utility, and therefore placed under the control of CNP. This state agency controlled the prices, authorised exploration and development and supervised the activities of the oil enterprises operating in the domestic market. In 1939 oil was found in Lobato (Bahia) and the first oil area (Recôncavo) was defined.

When Vargas was forced to step down in October 1945, the basis of the modern capitalist state had been launched, and because of its strategic importance to economic progress, oil and mining had been placed at the core of the developmental agenda.

b) Defining resources institutional structure along the rise and fall of the developmental state (1946-1989)

The finding of the first commercially viable oil well in 1941 (Bahia) under the CNP, enlarged the prospects for future exploration. In the following years, national oil exploration gradually became critical in the context of fast rising domestic demand and the limited financial capacity to expand oil imports.

The new president, Eurico Dutra (1946-51), attempted to reintroduce a more liberal regulating system. Although featuring the same nationalist character of the previous one, the new constitution promulgated in 1946, allowed for the participation of foreign capital in resources exploration, justified by limited domestic financial capacity and technical expertise to rapidly develop the oil industry. In line with this, a special commission was nominated to draw up a new oil law. This initiative, however, raised strong opposition, leading to a nationalist campaign («o petróleo é nosso» – the oil is ours) opposing foreign

capital participation in the national oil industry. In the Congress, the law also faced the dissatisfaction of the liberal faction, who thought it too restrictive to foreign participation.

Following Vargas's reelection (1951-54), the creation of a national oil company was proposed, *Petróleo Brasileiro S.A. (Petrobras)*, to overcome the impasse. After a long and fierce debate, the new oil law was finally approved by the congress and promulgated by the president in late 1953. The new law (Law 2004/3 October 1953) defined the main institutional features of the Brazilian oil sector, which remained more or less intact for the next four decades. This law established the Union Monopoly over all oil development phases, excluding distribution; created Petrobras as a mixed capital enterprise, but fully owned by national public and private capital, and controlled by the federal state with the goal of executing the state oil monopoly; and defined CNP (directly subordinated to the Presidency) as the agency responsible for general policy orientation, oversight of that monopoly, and to supervise the national oil supply. Foreign private capital was only authorized to participate in distribution of oil derivatives. CNP's patrimony was transferred to Petrobras. The national oil company thus started its activities with two refineries (Bahia and S. Paulo), 22 oil tankers and a maritime terminal in Bahia.

Under Juscelino Kubitschek's rule (J.K., 1956-1961), the relationship between CNP and Petrobras was further clarified (Decree 40.845/28 January 1957), detailing the supervision responsibilities of CNP over Petrobras activities. But the major advancement made under J.K. was the creation of the Ministry of Mining and Energy (*Ministério de Minas e Energia, MME*), which finally came into existence in 1960 (Law 3.782/22 July 1960), at last emancipating mining and energy issues from the Agriculture Ministry. The new Ministry was installed in February 1961. The scattered mining and energy agencies (DNPM and CNP in the oil sector) and state enterprises active in the sector (Petrobras and *Companhia Vale do Rio Doce-CVRD*), were all placed under the jurisdiction of the new Ministry. The emerging leftist wave under the J. Goulart Presidency (1964) led to the nationalization of the two private refineries and of distribution activities, completing the monopoly of the Union over all oil development phases.

The growing political instability and the fear that the raising communist influence might jeopardize the development of the country, led to a new military coup in March 1964, installing a military dictatorship that would last for twenty years (1964-1985). Although political freedom was much restricted in the context of progressive power concentration in the executive,²⁹⁴ the economy grew significantly in the following years, to a great extent benefiting from a less politicized approach of the authoritarian

²⁹⁴ Political parties were abolished in 1965, presidential indirect elections were constitutionally enforced in 1967, and congress was closed in 1968.

developmental state. As such, this period introduced some liberal nuances to the institutional structure. One of the first measures taken was to annul Goulart's nationalization of the refineries and distribution, and to authorize private investment, national and foreign, in the petrochemical industry - so as to foster competition domestically.

In 1967 CNP's competences of guidance and supervision of the Union²⁹⁵ oil monopoly, and of monitoring Petrobras and its subsidiaries' activities, were further clarified (Decree 60184/8 Feb. 1967). In that same year, a new Mining Code was issued. Although it determined that only Brazilian citizens and companies based in Brazil were to have access to exploration and development concessions, the new law did not determine that the composition of the Brazilian firms' capital ought to be fully national.

The growing interest of IOCs in the Brazilian oil industry following the first oil shock in 1973, combined with the deteriorating economic situation internally, led to the first active attempt to attract foreign investment to the national oil sector. In 1975 the first upstream liberalisation attempt was pursued through the introduction of Risk Agreements Contracts. These stipulated that the state, through Petrobras, was to exert a high monitoring degree over exploration and production, along with having the exclusive ownership rights over the reserves to be found. Three licensing rounds took place (1976-77-78), but the results fell well below expectations. The controversy surrounding this episode revived the debate over state monopoly once again.

The second oil shock in 1979, further emphasized the vulnerability of the Brazilian oil-dependent economy. Petrobras started investing heavily in upstream activities domestically and abroad (Norway, US, Mexican gulf and UK), in an attempt to expand its reserves and production. Like other Brazilian state-owned companies facing the lack of financial sources domestically during this period, Petrobras was forced to secure capital abroad. The investment Petrobras made during this period allowed for the acquisition of offshore equipment and technical expertise, that would place this NOC on track to become a leader in deep-water drilling technology. Building on several onshore and offshore findings throughout the 1980s, Brazil's oil production grew three-fold by the end of that decade (616,000 bpd).

The deep economic crisis Brazil faced in the 1980s, however, weakened the military dictatorship and led, ultimately, to the collapse of the developmental state. In 1988 a new constitution re-established democracy, and inaugurating the 'New Republic'. The first direct presidential elections since 1964 took place in 1989. This new constitution, however, reinforced the nationalist approach to resources

²⁹⁵ In 1967 the official name of Brazil was changed to the Federative Republic of Brazil, although to this day the term 'Union' is used to refer to the Federation.

exploration, by re-establishing the state monopoly over resources exploration, prohibiting further oil concessions under risk agreements, and again excluding foreign capital participation.

3.2.3. Liberalising resources sectors in the 1990s

This restrictive approach, however, would not last long. The new international framework following the end of the Cold War and the advent of a fast globalization era, prompted a liberal wave across the globe sanctioned by the IMF, which favored a lesser state role in economic affairs. The debate between statist and liberals again surfaced in Brazilian politics.

After some twists and turns, the liberal position finally became the mainstream under the presidency of Fernando Henrique Cardoso (FHC, 1995-2002). In this context, and facing divestment prospects with the drop in the price of raw materials in the early 1990s, a constitutional amendment was adopted (No. 06/15 Aug. 1995, concerning Article 176th §1) in August 1995, allowing for the participation of foreign capital in mineral resources exploration.

Another constitutional amendment (No. 09/ 9 Nov. 1995, concerning art. 177th §1) later that year, would introduce ground-breaking changes to the oil sector. This amendment brought to an end Petrobras's exclusivity rights to execute the Union monopoly over oil and natural gas reserves. By these means, activities in upstream and downstream were opened to participation by other public and private enterprises, national or foreign, and aimed at improving market conditions by fostering competition. Further to this, in August 1997 a new law was promulgated (Law 4978/6 Ago. 1997) defining the national energy policy. This law, that came to be known as 'Lei do Petróleo' (Oil Law), further clarified the structure and rules of the domestic oil industry. According to this law, the Union retains the exclusive right to exercise the national monopoly over E&P of all hydrocarbon deposits, refining activities, import and export, and transportation (maritime and pipelines). The new law also opened the way for the privatisation of some of Petrobras subsidiaries and to the privatisation of part of its capital (including foreign capital). Petrobras was listed in several stock exchanges, namely in S. Paulo, New York and Paris. To appease the growing opposition to the alienation of Petrobras, the Presidency publicly assumed the commitment to not fully privatize the company, and that the federal government would maintain its golden share. As such, Petrobras retained its statute as a state owned oil company.

The new Oil Law also created an advising council - National Council for Energy Policy (Conselho Nacional de Política Energética, CNPE). CNPE (Chapter II, Law 4978/97) is a policy advising organ headed by the Minister of Energy and Mines, and administratively placed under the President. Its goal is

to propose national policies envisaging, amongst other things, to foster the rational use of domestic energy resources, ensure energy supply to remote areas, and to line up directions for the import and export of oil and natural gas to ensure national supply. Other significant institutional changes introduced by the new Oil Law were the establishment of a regulating agency for the sector - the National Oil Agency (Agência Nacional do Petróleo, ANP) - and the introduction of annual auctions for hydrocarbons concessions.

From this point on, upstream activities were subject to concession contracts (Chapter V, Law 4978/97) to be signed by the winning companies/consortiums with the concessionaire ANP. A one off signature bonus (which minimum amount is set in the licensing announcement) is to be paid when the contract is signed. Concession contracts are divided into two phases: exploration and production. Exploration is to be developed by the contractor under its own risk, and all deposits found belong to the Union. If a commercial discovery is made, the contractor is entitled to the production extracted, provided the incumbent taxes and contractual charges are paid. Royalties are payable monthly and vary between 5 and 10 % of total production, according to the exploration risk.

As the regulator, ANP²⁹⁶ competences (Chapter IV, Law 4978/97) include the study and determination of the oil blocks to be licensed, the promotion of licensing rounds, regulating, contracting and monitoring the E&P concessions. Having lost its legal monopoly in the oil industry, Petrobras was obliged to transfer its valuable geological surveys portfolio to ANP (in exchange for a fee).

Towards the end of the 1990s, the executive dealing with a very thorny dialectic trying, on the one hand, to rectify the institutional limitations of the politico-economic structure it inherited and, on the other hand, coping with a growing number of increasingly more powerful constituencies pushing in different directions. Nevertheless, under FHC, Brazil was gradually stabilized through steady administrative reforms that transformed the executive's developmental structure into a liberalized one.

3.2.4. Unpacking the fragmented nature of the institutional structure

Unlike Angola, Brazil's oil sector has a long history of institutionalization, which despite the central role of the state, involved from the start a plurality of state, sub-state and non state agents. This historical legacy and the need to sustain a nationalist approach while interacting with an increasing number of

²⁹⁶ ANP was in a way the rightful successor of CNP, that was abolished in 1990 to create the National Direction of Fuels (Direção Nacional de Combustíveis, DNC), which was absorbed by ANP when it was installed in 1998.

constituencies in the context of liberalisation, led to the complex institutional structure that characterizes the sector at present.

a) The overall complexities of the institutional structure

Looking at the state level and comparing with the case of Angola, the executive checks and balances are much stronger.²⁹⁷ Despite well known inefficiencies (widespread corruption, for example), the legislative, judiciary and federal states (empowered by the 1988 Constitution) can be quite effective in using their democratic prerogatives to block executive initiatives that counter their interests.

The judiciary system in Brazil is a very complex structure involving several layers of courts at federal and state levels, and multiple appeal possibilities. Some of the cases involving resources sectors include, for instance, the freezing of the 2006 oil auction by judicial sentence, and which has not yet been solved, or the still ongoing judicial process to reverse CVRD privatisation.

The legislative power is bicameral (Chamber of 513 deputies and 81 Senate Chamber) and loyalties are divided between party and states' allegiance. In fact, the regional lobby cuts across ideological boundaries and makes it difficult to enforce party discipline' not only in the congress' but also in the government itself.²⁹⁸ In this setting, most legislative debates are addressed by their regional impact, which has a particular appeal when resources-related legislative acts are under discussion, because of the underlying royalties question. As such, inquiry commissions involving resources issues are frequently set up in congress, and extended debating periods are normal for new legislation, namely the case with the new pre-salt code (discussed below).

The federal states' autonomy further fragments the picture. State governors have been elected by direct suffrage since 1982, and the 1988 constitution further strengthened their autonomy. Each state has its own legislature and administration. State governors tend to hold a strong influence over the MPs and senators under their jurisdiction, regardless of party affiliation. To this fragmentation of the federal executive, adds the pressure coming from sound independent civil society constituencies, namely labour syndicates, socio-environmental movements, and a well established independent business class.

All the above have contributed in different ways to a complex institutional structure in the oil sector. This state of affairs is acknowledged by all players and agents as a serious institutional constraint, affecting

²⁹⁷ For a concise analysis of the checks and balances in Brazil and their influence over decision making since the 1980s, see: Marcus F. de Castro and Maria Izabel de Carvalho, "Globalisation and recent political transitions in Brazil" *International Political Science Review* 24:4, 2003, pp. 465-490.

²⁹⁸ EIU, *Brazil Country Profile 2008* (London: EIU, 2008) p. 6.

negatively the development of resources sectors at present.²⁹⁹ The main reason for this state of affairs is unclear/overlapping jurisdictions of different levels of authority and of regulatory frameworks.

The environmental licensing is a recurrent illustration of this reality. Every mineral resources project (oil, natural gas or mining) needs an environmental license in order to start operations. The law (Law 6.938/81) defines that the Brazilian Institute for Environment and Natural Renewable Resources (Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renováveis, IBAMA) shares the licensing competence with federal states and municipalities. It establishes that IBAMA is in charge of issuing licenses for projects that have a potential environmental impact in more than one state or in offshore areas. The issue is that not always is it easy to determine the potential extension of the environmental impact and hence the competent jurisdiction to issue the environment license. This has frequently led to the blockage of major projects, and not always for purely environmental reasons.³⁰⁰ Oil companies winning operatorship bids in Brazil have therefore to navigate and endure a complex environmental licensing system.

To this add the relative regulatory instability of the sector. This is mostly due to bureaucratic inefficiency, lack of synergy among state agents at the various levels, and also the latent nationalistic pressure over resources regulations. Although the benefits of privatisation and competition gradually became evident, not only through the significant improvement in these companies' performances, but also in the more sustainable socio-economic progress generated,³⁰¹ most labour syndicates still advocate the 're-statisation' of some of the privatised enterprises and the re-enactment of the state monopoly over upstream activities in the oil sector.³⁰² Even if there is only a slim chance of the privatisation process being completely reverted, there is still room for these pro-state monopoly forces to influence critical future decision making regarding the oil sectors.

Adding more weight to this structure, Brazil also has strict regulations regarding local content. Indeed, from the beginning of the liberalisation of the oil sector, local content - along with signature bonuses and exploration plans - became one of the main criteria to evaluate the bids. Over the years this local content

²⁹⁹ Various interviews, Brasília, S.Paulo and Rio de Janeiro, 23 June-30 July 2009. The other main constraint was structural: infrastructure bottlenecks due to underinvestment in the 1990s, which have turned existent infrastructure (roads, railways, ports, power plants) largely insufficient to cope with the economic growth of the 2000s.

³⁰⁰ Georges Landau, "Brasil", in: S. Weintraub et al. (eds.), *Cooperação Energética nas Américas: Entraves e Benefícios* (Rio de Janeiro: Elsevier Editora, 2008) p. 242.

³⁰¹ Daniela Camargos e José Edward, "Foi bom vender" *Veja* Nr.1642, 29 March 2000, available online at: http://veja.abril.com.br/290300/p_092.html (accessed 28 November 2009).

³⁰² Central Unica dos Trabalhadores (CUT), "Defesa da Petrobras une movimento sindical e social", 26/05/2009, available online at: http://www.fetecsp.org.br/index2.php?option=com_content&do_pdf=1&id=43468 (accessed 28 November 2009).

clause has become more demanding and complex, including different specifications for onshore and offshore, the various water depths, and developmental stages. A certification system for dealing with this was introduced in 2007.³⁰³

These institutional constraints, however, are to some extent overshadowed by the country's hard resources potential as shown by Fraser Institute's *Annual Survey of Mining Companies*,³⁰⁴ which measures mineral potential against the policy framework. In the 2010/2011 ranking, Brazil ranked 49th out of 79 countries, scoring 43.2 out of 100 in the policy potential index (regulatory institutional framework). But when add to that equation the mineral potential of the country, with Brazil ranked 18/79. Nevertheless, new investors still need to assimilate the institutional complexities of the Brazilian market, and need to learn how to navigate through the fragmentation, overlaps and instability of the sector, when investing in the country.

b) The oil institutional structure: Petrobras's role

Through its monopoly over the sector, Petrobras played a central role in Brazil's oil industry throughout 45 years. The progress the sector registered during this period was thus much intertwined with the company's undertakings and achievements. The end of monopoly and the company's public listing brought more autonomy for the company, that could now concentrate fully in its E&P activities. Having retained ownership over all E&P areas it was operating at the time, as well as all refining, equipment and transport infrastructure (oil and gas pipelines), Petrobras departed from a very advantageous position.

Increased competition has prompted the diversification of Petrobras operations beyond hydrocarbons, to encompass biofuels, hydropower and other energy sources such as solar and hydrogen. In 2010 Petrobras hydrocarbon reserves were estimated by ANP at 15.9 billion boe (barrels of oil equivalent - includes oil and natural gas), its production having reached 2.6 million boe that year.³⁰⁵ Throughout the years Petrobras has created an extensive network of subsidiaries, among which stand out Transpetro, responsible for transport and storage of hydrocarbons and biofuels through 11,000km of ducts, terminals and a large fleet of tankers; Gaspetro, which manages over 7,000 km of gas ducts across the country;

³⁰³ ANP website, "Conteúdo Local", available online at: <http://www.anp.gov.br/?id=516> (accessed 7 April 2011).

³⁰⁴ Fraser Institute, *Annual Survey of Mining Companies 2010/2011*, March 2011, available online at: <http://www.fraserinstitute.org/uploadedFiles/fraser-ca/Content/research-news/research/publications/mining-survey-2010-2011.pdf> (accessed 7 April 2011).

³⁰⁵ Petrobras, "Alcancamos lucro líquido recorde em 2010", 25 February 2011, available online at: <http://www.petrobras.com.br/pt/noticias/alcancamos-lucro-liquido-recorde-de-r-35-bilhoes-189-milhoes-em-2010/> (accessed 7 April 2011).

Petroquisa (petrochemicals), Petrobras Biocombustíveis (biofuels) and Petrobras Distribuidora (downstream).

In addition to its growth in the domestic market, Petrobras has also expanded overseas, and is currently running operations in 27 countries across five continents. In addition to representative and trading offices in the UK, Singapore, China and Japan, the NOC has significant investment in South America (9 countries: E&P, refining, transportation and distribution of hydrocarbons), Africa (5 countries: E&P), Oceania (exploration in Australia and New Zealand), Iran (Exploration) and the US (E&P and refining).³⁰⁶

Reflecting its exponential growth over the past decade, Petrobras was ranked third in the PFC Energy 2010 ranking of the world's largest 50 listed energy firms by market capitalization - up from 27th in 1999. Its market value was estimated at US\$229bn as of 31 December 2010.³⁰⁷ With the bright prospects of the Brazilian oil industry, the company is expected to grow further in coming years as investment expands. The company's strategic planning calls for an investment of US\$224bn over the 2010-2014 period, 95% of which is to be invested domestically.

Unlike Sonangol, Petrobras is a publicly traded corporation. Although Brasilia has kept a controlling stake in the company through the ownership of 54% of its voting shares (31% of overall corporate ownership), the company remains accountable to its other shareholders.

According to the Statute of the company,³⁰⁸ the administration board and its President (5 to 9 members, decision making body) are elected for a one year mandate (renewable) by the assembly of voting stock holders. Presently, the President and six counsellors represent the interests of the controlling stakeholder (Federal Union), one the interests of the minority common stock holders and the last one the interests of preferential stock holders. The Administration board elects from its members the Chair of the board of directors (executive body, three years mandate) and appoints the remaining six directors from Brazilian nationals resident in the country.

Political appointments to the administration board of Petrobras became common during Lula's rule. The previous board included two ministers and the chairperson was the chief of the civil cabinet of the President (Dilma Ruseff, now President of Brazil). This trend initiated by President Lula da Silva has to

³⁰⁶ According to information posted on Petrobras's website, available online at:

<http://www.petrobras.com.br/pt/quem-somos/principais-operacoes/> (accessed 7 April 2011).

³⁰⁷ PFC, *PFC Energy 50*, January 2011, available online at: <http://www.pfcenergy.com> (accessed 7 April 2011).

³⁰⁸ Petrobras, *Estatuto Social*, Chapter 4, section 1, available online at: <http://www.petrobras.com.br/pt/quem-somos/estrategia-corporativa/downloads/pdf/estatuto-social.pdf> (accessed 7 April 2011).

some extent favoured state interventionism in the strategic corporate policy of the company.³⁰⁹ This is evidenced by the setting up of operations in Cuba and Iran. Moreover, in the present board, the elected Chair (Guido Mantega) is the current Finance Minister, and other members include the Executive Secretary of the MME and the President of BNDES (Brazil's Development Bank).

The fact that Petrobras is a company of mixed capital makes it accountable to two different constituencies, which most of the time pursue different goals. In this context, the institutional fragmentation is also evident inside Petrobras. While the private stake is moved by pure revenue interests and is market oriented, the state golden share is answerable to public constituencies. It is therefore also oriented by political considerations and national constraints such as internal supply needs, the executive energy strategy, government revenue priorities and civil society demands.³¹⁰

The leftist nature of the current regime and the latent nationalism of Brazilian civil society with regards to the oil sector, further add to this picture. The same attempt to exert political influence also became evident in the sector's regulating body, ANP, during Lula's rule. The fact that its directing board is to be appointed by the president (Law 9478, Art. 11), gives the Executive some leeway in this regard. This fact is evidenced by Lula's nomination in 2006 of an old leftist ally (Haroldo Lima) to the post of Director General, who, unlike his predecessors, had no background in the oil industry. Nevertheless, the necessary sanctioning by the Senate limits to some extent the executive's appetite. The Presidency has already faced blockage by the Senate in the nomination process of some ANP directors.

ANP was legally established in 1997 as an autarchy (patrimonial, financial and administrative autonomy) within the MME, with the purpose of implementing the national oil and natural gas policy on behalf of the Union. As the regulating body, its competences include regulating, contracting and supervising all activities in the hydrocarbons sector (upstream and downstream). In line with this, ANP is responsible for devising the exploration areas, organizing the annual oil auctions (the main instrument for concessions), contracting the winners, and supervising the contracts execution. As pointed by Georges Landau,³¹¹ ANP's influence over the sector was much curtailed by practical limitations, such as insufficient funding due to budget cuts during Lula's first term, unclear work division between MME and ANP, the fact that its decisions can be blocked by judicial sentence (leading to long court battles), and finally because of the overlapping political jurisdiction (Presidency and Senate) over the nomination of the Board of Directors.

³⁰⁹ Georges Landau, "State or Market? Strategic Choices in Brazil's Energy Sector", in: Tanya Harmer and Guy Burton (eds.), *Powering Up: Latin America's Energy Challenges* (London: LSE Ideas Centre, 2010) p. 21.

³¹⁰ Michelle Foss et al., "Organização e regulação do sector de Hidrocarbonetos", in: S. Weintraub et al. (eds.), *op. cit.*, (2008), p. 427.

³¹¹ Georges Landau, "Brasil", in: S. Weintraub et al. (eds.), *op. cit.*, (2008), pp. 241-242.

The relationship between ANP and Petrobras is, nonetheless, fairly straightforward and amicable. As the local NOC, Petrobras enjoys some privileges, namely the right of preference in the case of an oil bid draw, and the right to the areas of exploration that are left out of the auctions due to their small size. Under the 1997 Oil Law, Petrobras was given by ANP the concession rights (without tender) to all its producing blocks at the time of the end of the monopoly, and also the blocks under exploration in which it had proven financial capacity to develop. Furthermore, many of ANP cadres are former Petrobras officials. Such is the case of one of the current directors (Magda Chambriard). Despite some natural friction, there is a ready flow of information between the various national agents in the sector, being the National Council for Energy Policy (CNPE) integrated by members of MME, Petrobras and ANP.

Despite the new institutional and regulatory framework aiming at promoting the liberalisation of the hydrocarbons industry, and the fact that it has been in place for almost 15 years, Petrobras retains, to this day, a virtual monopoly over the sector. This is true in upstream operations where it holds the largest hydrocarbon acreage in the country, and accounts for the bulk of its oil output; and also downstream, where it owns most of the country's gas and oil ducts, and refineries in Brazil. This fact is largely explained by the company's vast oil acreage portfolio, and by its unmatched geological expertise and technological skills accumulated over the four decades it enjoyed exclusivity in the sector.³¹²

c) Institutional changes introduced by the new 'Pre-salt Law'

The potential magnitude of pre-salt reserves (50-100 billion barrels) and its implications for the country's development, triggered once again the nationalist debate around oil exploration. Immediately after the discovery of the Tupi field (now renamed Lula) in late 2007 in Santos basin, CNPE suspended the auction of the 41 offshore blocks (26 of which are around Tupi) on offer in the 9th licensing bid under ANP. The following year the auction did not include offshore blocks in the pre-salt area.³¹³

Although most stakeholders agreed that there was need to define a new regulating framework for the pre-salt area, they could not agree on the terms, and thereafter there was a long period of discussions during which no auctions were held (2009 and 2010). The new law was originally submitted to the Congress in August 2009, where it marinated for over a year. The process was further delayed by the Presidential

³¹² Interview, Ministry of Foreign Relations, Brasília, Brazil, 23 June 2009.

³¹³ Estado de S. Paulo, "Rodada é a primeira sem oferta de blocos no mar", *Estado de S. Paulo*, 11 September 2008, available online at: <http://www.power.inf.br/pt/?p=817>; Jornal do Comércio, "CNPE define da 11ª rodada este ano", *Jornal do Comércio*, 23 November 2009, available online at: <http://www.power.inf.br/pt/?p=12208>; Reuters Brasil, "ANP sugere blocos para a 11ª rodada que deve incluir pre-sal", 9 November 2009, available online at: <http://oglobo.globo.com/pais/mat/2009/11/09/anp-sugere-blocos-para-11a-rodada-que-deve-incluir-pre-sal-914666817.asp> (accessed 5 December 2010).

elections scheduled for October 2010. Disagreement focused, namely, on revenue distribution among the various states, the exploration regime (concession or PSA) and the role of Petrobras.

The 28% parcel of the pre-salt area that was successfully auctioned prior to 2007, located in the Santos basin and which includes the Tupi and Iara fields, remains, however, under the old concessions law. The remaining 72% of the pre-salt area is to be developed under the new regulatory mark in which the state is to play a greater role, reflecting the populist nature of the current Brazilian administration. In late August 2009, Lula submitted four bills to the congress proposing four pillars for the new legal context governing the pre-salt area: the creation of a new public company for the pre-salt, the introduction of a production sharing agreement regime, reinforcement of state capital in Petrobras, and the creation of a social fund.³¹⁴ In his speech to the Congress presenting the four bills in 31 August 2009,³¹⁵ Lula argued that the need for a new regulatory framework rests in the fact that the royalties-based concessions introduced in 1997 contemplated a totally different reality: exploration risks were higher, the economy was weaker and national ambitions were more modest (self-sufficiency). The much higher stakes in what concerns profits and the smaller exploration risk of the pre-salt layer required, in his view, a different legal arrangement.

The new law (Law 12.351/2010),³¹⁶ was approved by the Congress in the last quarter of 2010, and sanctioned by the President on December 22, although he vetoed two articles.³¹⁷ The first veto regarded the royalties even distribution among all states of the Union – in compliance with an agreement Lula had previously made with the governors of the two states where most of pre-salt production will take place (Rio de Janeiro e Espírito Santo). The second veto regarded the allocation of half of the social fund³¹⁸ to education programmes. According to Presidential changes, royalties are now to privilege the producing states and the social fund is to be more evenly distributed among education, the environment, sports, science and technology, and fighting poverty programmes. The new law was then sent back to the

³¹⁴ Blog do Planalto, “Atenção total à votação do marco regulatório no congresso”, 12 November 2009, available online at: <http://blog.planalto.gov.br/atencao-total-a-votacao-do-marco-regulatorio-do-pre-sal-no-congresso/> (accessed 5 December 2010).

³¹⁵ Video of the launching of the pre-salt regulatory law at the Congress, available online at: <http://www.paulohenriqueamorim.com.br/?p=17677> (accessed 5 December 2010).

³¹⁶ Presidencia da Republica, Lei 12.351 de 22 Dezembro 2010, available online at: http://www.planalto.gov.br/ccivil/_Ato2007-2010/2010/Lei/L12351.htm#art62 (accessed 7 February 2011).

³¹⁷ Carolina Pimentel-Agencia Brasil, “Lula Sanciona a lei do pre-sal com veto a partilha dos royalties”, in: *Exame*, available online at: <http://exame.abril.com.br/economia/brasil/noticias/lula-sanciona-lei-do-pre-sal-com-veto-a-partilha-dos-royalties> (accessed 7 February 2011).

³¹⁸ The social fund, inspired by the Norwegian model, is to administer public oil proceedings to benefit socio-development goals and to minimize the potential negative impact over the diversified industrial base of the country.

Congress, and at the time of writing was still pending approval. The first oil auction for the pre-salt is to take place in the second half of 2011, soon after the expected approval by Congress of the new law.³¹⁹

The new law introduces three major institutional changes that directly affect players in the pre-salt. The first one is the introduction of a production sharing regime (Chapter III, PSA, Law 12.351), whereby the executive retains ownership of a large parcel of the production after exploration, and development costs are amortized. Unlike the concessions regime where the largest bid wins, in the new PSA regime the winning bid will be the one that offers the largest production parcel to the Union (Art. 18). This will give the executive more control, not only over the destination of the oil, but of the pace and volume of extraction, and thus theoretically allowing for a more efficient management of the impact of this revenue on the rest of the economy.³²⁰

The second change introduced by the new law pertains to the role of Petrobras. According to the new law, the NOC will be the exclusive operator in the pre salt (Art. 4). It is, nonetheless, allowed to form JV with other companies retaining a minimum stake of 30% in every project (Art. 10c). Under the CNPE proposal, Petrobras may be directly contracted (PSA) for exploration and production activities (E&P) in the pre-salt by the Union, and without need for auction (Art. 12).

The third change regards the establishment of a public company (Pre-sal Petroleo S.A., commonly referred to as 'Petrosal'), fully owned by the executive and to be placed under the MME. This company will administer all PSA contracts on behalf of the Union (Art. 8, §1), and will be responsible for marketing the Union's share of profit oil, and may subcontract Petrobras for this purpose (Art. 45). Although not performing any E&P activities, the company will integrate all consortiums in representation of the Union's interests in the PSA (Art. 21; this includes the ones contracted directly with Petrobras). The consortiums will be administered by a operational committee integrated by all parties, with Petrosal being responsible for the appointment of half of them and the president (Art. 23), who will have veto power over any decision making (Art. 25).

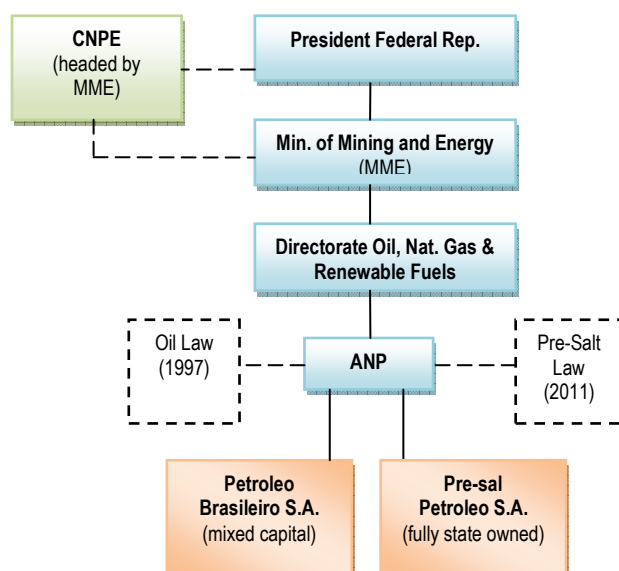
According to the new law, CNPE and ANP maintain their main competences in the pre-salt area as policy formulating and regulatory bodies, respectively. The law also stipulates that as in the previous system, there shall be a minimum local content in terms of services and goods (Art. 15, VIII), which is to be defined by the MME (and sanctioned by CNPE) and specified in the tender notice to be elaborated by

³¹⁹ Reuters-Brazil, "Primeiro leilao do pre-sal sera no segundo semestre, diz Lobao", *Veja*, 3 January 2011, available online at: <http://veja.abril.com.br/noticia/economia/primeiro-leilao-do-pre-sal-sera-no-segundo-semester-diz-lobao> (accessed 7 February 2011).

³²⁰ Interview, BNDES, Rio de Janeiro, Brazil, 20 July 2009.

ANP. This is expected to become even more demanding in the new framework, in line with Brasilia’s plans to use the pre-salt as an industrial policy instrument to promote the emergence of strong technology and an equipment and services industry to support Petrobras’s efforts in developing the new reservoirs, and to boost its shipbuilding and petrochemical industries.³²¹

Diagram 3.2. Representation of the institutional structure of the oil sector in Brazil



Source: Elaborated by the candidate according to the new regulatory framework and based on information posted in the MME website: <http://www.mme.gov.br/mme> (Acronyms - CNPE: National Council for Energy Policy; ANP: National Petroleum Agency).

Although the partial re-enacting of Petrobras’s monopoly is appealing to most civil society circles,³²² criticisms over the efficacy of the various features of the new regulatory framework abound, and perceptions are quite fragmented across the oil sector and even amongst national and foreign investors.³²³ Ultimately, what is at stake here is the old debate regarding the role of the state in resources

³²¹ Interview, Ministry of Foreign Affairs, Brasilia, Brazil, 23 June 2009.

³²² Senado Federal, “Projecto que torna exploração do petróleo monopóleo da União é aprovado por comissão”, 4 November 2009, available online at: <http://www.senado.gov.br/agencia/verNoticia.aspx?codNoticia=%2097036&codAplicativo=2>; CUT, “Defesa da Petrobras une movimento social e sindical”, 26 May 2009, available online at: http://www.fetecsp.org.br/index2.php?option=com_content&do_pdf=1&id=43468 (accessed 5 December 2010).

³²³ Interview, Instituto Brasileiro de Petroleo, Rio de Janeiro, Brazil, 23 July 2009.

management.³²⁴ Through its controlling share in Petrobras and the sole ownership of Petrosal, the Union is ensured a much larger control over the pre-salt, which is where the future of the Brazilian hydrocarbons industry lies. As such, and at this particular point, the nationalist faction seems again to have taken over developments.

In line with this, the Union has also reinforced its control over Petrobras through an oil-for-shares swap agreement. Through this accord, the government gave Petrobras the rights to 5 billion boe reserves in the pre-salt, in exchange for US\$42.5bn worth of common shares in the company.³²⁵ The swap, approved by the Congress, took place in the context of the company's bond issuing in the New York and São Paulo Stock Exchanges, in November 2001. The capital increase operation was aimed at sourcing funding for its strategic development plan 2010-2014. Totalling nearly US\$70bn, this was Petrobras's biggest ever bond issuing, and a world record. By these means the executive raises its controlling share from 56% to 64%.³²⁶

The introduction of the new law for the pre-salt signalled the willingness of Lula's leftist administration to reinforce the Union's control over the hydrocarbons sector. Although the Dilma Administration is expected to have a more pragmatic approach in managing the sector,³²⁷ the changes introduced make the oil industry institutional structure more complex and difficult to navigate. The co-existence of two different legal regimes has the potential of raising various technical challenges. This is particularly so in overlapping jurisdiction areas, where conflicting interests of federal states involved, may take long time to clear and as such delay implementation. In addition, and according to a significant part of the interviewees in the oil sector in Brazil,³²⁸ Petrosal might end up playing a marginal role and only adding up the weight of bureaucracy due to its political nature. Further empowered by the new regulatory framework (the only operator and with participation in all blocks), Petrobras is therefore expected to remain the foundation in Brazil's oil industry, due to its much larger financial resources and technological and geological expertise.

³²⁴ For a detailed analysis on this current debate, see: Ricardo U. Sennes and Thais Narciso, "Brazil as an international energy player", in: L. Brainard and L. Martinez-Diaz (eds.), *Brazil as an Economic Superpower?* (Washington: Brookings Institution Press, 2009) pp. 45-53.

³²⁵ Mark Langevin, "Brazil's Big Oil Play: How This Nation is Charting National Energy Security" *Journal of Energy Security*, 29 September 2010, available online at: http://www.ensec.org/index.php?option=com_content&view=article&id=264:brazils-big-oil-play-how-this-nation-is-charting-national-energy-security&catid=110:energysecuritycontent&Itemid=366 (accessed 5 December 2010).

³²⁶ BMI, *Brazil Oil & Gas Report Q2 2011* (London: BMI, February 2011) p. 63.

³²⁷ For an analysis of the challenges and prospects of the Brazilian oil industry under Dilma's rule, see: Susana Moreira, "Dilma Rousseff and Brazil's oil sector", An Americas Society and Council of the Americas Energy Action Group Issue Brief, March 2011, available online at: http://www.as-coa.org/articles/3093/Issue_Brief_Dilma_Rousseff_and_Brazils_Oil_Sector/ (accessed 8 April 2011).

³²⁸ Various interviews, Brasília, São Paulo and Rio de Janeiro, 23 June-30 July 2009.

3.3. Chapter conclusions

If on the one hand the Angola and Brazil oil industries present the same bright perspective in terms of future potential (see Appendix I and II), on the other hand their oil industries present very different institutional frameworks. The reasons for such disparity lies in the historical record of both countries. While Angola has a much shorter independence history, mostly under martial law and the same ruler, Brazilian history spans almost over 200 years, with many different rulers and regimes, all of which left an imprint in the current institutional structure of the oil industry.

In spite of the formal appearance of a multiparty democracy, power in Angola remains, in reality, highly concentrated in the Presidency. Indeed, the presidential office holds absolute control over the executive (the President is the head of government and he nominates the ministers), legislature (MPLA holds absolute majority in the national assembly and therefore it is a mere sanctioning instrument of the President), judiciary (judges are nominated by the President, from constitutional to provincial courts), and local powers (provincial governors are political appointees). In addition to the state institutional structure, the President also controls the major source of state revenue (oil through Sonangol) and the means of production (through his vast patronage network among the business class). To complement this highly centralised structure, civil society is practically non-existent. In this setting, there is no real accountability at any level, that can dispute the decisions emanated from the Presidency. This has enabled the Presidency to control the political and economic life of the country, while formally projecting an image of a multiparty system and a market economy. In such a highly centralised environment, fostering a close and stable relationship with the President's office, emerge thus as one of the most important factors in doing business in Angola, especially so when it comes to the oil sector.

In sharp contrast, Brazil's long independence history, filled with ups and downs, has gradually produced not only a pluralist and democratic regime, but also very strong constituencies. At a very early stage the Brazilian state showed little interest in evaluating the riches beneath its land and did not give much incentive to do so. Therefore resources prospection was mostly led out of curiosity and led by strong perseverance of a handful of barons. The first signs of a real potential for oil emerged in the context of growing nationalism around 1900, and from then on the Brazilian state gradually took over resources. Under the authoritarian developmental state, oil exploration became a monopoly of the state and the national oil company became the exclusive concessionaire. The democratising context in the 1990s, however, led to liberalisation of the sector, with the state assuming a regulatory role. Despite having lost its exclusivity rights, Petrobras maintained a dominant position in E&P. Along this path many other

institutions were created, abolished and reinvented, largely contributing to the complex dynamics of the sector at present.

Brazil now boasts a solid and independent business class and a very pro-active and demanding civil society, which has played an important role in the gradual democratization and liberalisation of the country. Despite the evident weaknesses of the executive institutional capacity (e.g. overlapping jurisdictions, rampant corruption at all levels of the Union bureaucracy, including at parliamentary and judiciary level), the executive remains ultimately accountable to those strong constituencies.

Petrobras's dominance over upstream activities in Brazil, however, is much higher than that of Sonangol in Angola. This is mostly explained by the fact that Petrobras enjoyed a legal monopoly over the sector throughout nearly four-fifths of its history, which legacy has granted the NOC a virtual monopoly over E&P activities even in a liberalized context. Sonangol, on the other hand, lacking the resources and expertise, had to bring in other players from the start, which now account for a significant part of production. Nonetheless, due to the highly centralized nature of the surrounding institutional structure, the executive in Angola has a much stronger grip over Sonangol (fully state owned), and therefore has a much larger latitude to influence developments in the oil industry. In Brazil, on the other hand, the executive's influence over Petrobras and the sector is curtailed by the semi-private nature of its NOC, and the checks and balances that have been put in place in the process of liberalisation of the sector.

Recent developments in the regulatory framework in Brazil, however, suggest that the state is to play a much larger role in the sector in the near future, which is regarded by many as a partial reversal of the liberalisation of the sector initiated only a decade ago. This is being engineered through the reinforcement of the federal executive in Petrobras's voting capital, and by granting the NOC a dominant position in the development of the massive pre-salt reservoirs. Although these changes may strengthen the executive's grip over the sector in the near future, they may not necessarily ensure the best outcomes for the industry. In a political leftist environment, this may imply the prioritizing of macro-economic and social objectives over commercial considerations. Even if a Venezuela-like scenario seems unlikely in Brazil, these recent shifts may impact negatively on Petrobras's operational autonomy, which has placed the NOC among the top energy companies in the world.

Structural changes are also looming on the horizon in Angola, namely the listing of Sonangol and the creation of an autonomous regulating body, which have the potential to limit the Presidency's control over Sonangol and the oil industry. This, however, for the reasons discussed above, is unlikely to take place

anytime soon. Therefore, the institutional structure that has characterized the oil industry in Angola for the past three decades is expected to remain unchanged in the foreseeable future.

Having mapped out the specificities of the institutional structure of the oil industry in Angola in Brazil, the following two chapters will analyse in detail the how China's oil diplomacy interacted with these two diverse contexts over the past decade and assess how successful it was in achieving Beijing's energy security goals in each country.

CHAPTER 4: CHINA'S OIL DIPLOMACY IN ANGOLA

This chapter offers an in-depth analysis of the first case study, Angola. Its aim is to examine China's relations with that country, focusing on the performance of infrastructure-for-oil loans, with regard to Beijing's energy security goals. For this purpose, this chapter presents: (a) a brief analysis of China-Angola relations and historical background throughout three distinctive periods (gradual rapprochement in the late 1970s, a dormant phase in the 1980s and 1990s, and a flourishing phase in the 2000s); (b) a detailed study of different features of bilateral relations in this last phase, aimed at demonstrating how critical and pervasive the oil factor is in contemporary bilateral relations; (c) an analysis of China's infrastructure-for-oil loans in Angola, so as to illustrate how the relationship is structured around that formula; and (d) an assessment of how these loans performed in pursuing China's oil security goals in Angola.

The overall aim of this chapter is to emphasise how this instrument of China's economic statecraft (infrastructure-for-oil deals) has been relatively successful in achieving Beijing's oil diplomacy goals - access to oil equity and long term supply contracts - in Angola.

4.1. Contextualising China-Angola relations

4.1.1. Historical background

Owing to Angola's long colonial history and the fact that it was among the last African countries to gain independence, the historical record of China in that country is relatively recent. It dates back to China's controversial involvement in Angola's liberation war in the 1960s and 1970s. Over that period Beijing had supported all three liberation movements, sometimes simultaneously.

a) China's controversial involvement in Angola's liberation war (1960s and 1970s)

Although at first China supported the largest liberation movement, MPLA,³²⁹ Beijing soon decided that it was too urban-based and pro-Soviet. As a result, Beijing switched its support to FNLA³³⁰ in 1963. Chinese relations with the FNLA were strained, however, by the fact that Chinese delegates were not

³²⁹ Movimento para a Libertação de Angola (headed then by Agostinho Neto), the party in power since independence in 1975.

³³⁰ Frente Nacional para a Libertação de Angola.

allowed into the DRC, where the movement was based. In 1964, Beijing switched again and started supporting UNITA,³³¹ formed by a rebel group that had split from FNLA. Its leader, Jonas Savimbi, underwent military training in China in 1964 and 1965, before the formal establishment of UNITA in 1966. Unlike MPLA and FNLA, UNITA sought support in indigenous sources, and started to build internal bases, proclaiming Maoism as its doctrine. However, in the early 1970s, China abandoned UNITA, to approach again, first, the MPLA, and then the FNLA. After formal independence in 1975 and the onset of civil war, Beijing covertly supported both the FNLA and UNITA, in an effort to preclude victory from the Soviet-backed MPLA.³³² This fact put a dent in China's relations with the ruling MPLA in the years following independence. For the above reasons, unlike most other African countries, China had no record of aid and cooperation in Angola .

b) Gradual rapprochement and the dormant phase (1980s and 1990s)

The gradual improvement of Sino-Soviet relations in the early 1980s, and the change of guard in both countries (Deng Xiaoping in China 1978, and dos Santos in Angola in 1979), paved the way for a gradual rapprochement between Beijing and the MPLA. Diplomatic ties were formally established on January 12, 1983. In the following year, an inconsequential trade and cooperation agreement was signed, and in 1988 a mixed economic and trade commission was set up, which remained mostly inactive until the turn of the century. Owing to Angola's volatile domestic situation, bilateral trade flows remained practically non-existent throughout the 1980s and 1990s. With nothing much happening, bilateral relations can thus be characterised as dormant over this period.

c) Thriving bilateral relations (2002-2010)

It was only in the 2000s that conditions in both China and Angola were ripe to bring bilateral relations to a new level. The launch of China's 'going out policy' coincided with the end of the civil war in Angola in 2002, setting the stage for the expansion of China-Angola economic relations in the following years. Signalling the growing weight of economic cooperation in bilateral relations, the dormant economic and trade commission was reactivated³³³ (meetings were held in 1999, 2001, 2007, 2009 and 2010). This is also indicative of the urge for a closer coordination at the policy making level, so as to ensure better

³³¹ União Nacional para a Independência Total de Angola (headed by Jonas Savimbi).

³³² For a detailed account of China's involvement in Angola in the 1960s and 1990s, see: Steven F. Jackson, "China's Third World Foreign Policy: The Case of Angola and Mozambique, 1961-93", in: *The China Quarterly*, 142, 1995, pp. 388-422.

³³³ Interview, Ministry of Foreign Affairs, Luanda, Angola, 11 March 2009.

management of the fast expanding economic flows between the two countries. In the 2010 meeting of this commission, five cooperation agreements were signed, mostly for infrastructure construction, equipment provision and capacity building in education, health and defence.³³⁴

4.1.2. Bilateral relations in the 2000s

4.1.2.1. *Building closer political ties*

Due to Angola's internal turmoil and the marginal importance of the relationship for both countries until the early 2000s, official visits and exchanges were very scarce, as is shown in the table 4.1 (below). Nevertheless, there were some important Chinese state visitors to Angola, including Foreign Minister Qian Qichen and Vice-Premier Zhu Rongji, and two official visits by President Dos Santos to China were undertaken ten years apart.

Reflecting the changing context, the exchange has clearly intensified since the end of the civil war. Amongst other Chinese high ranking officials and numerous delegations from Chinese banking institutions (EXIM Bank, CDB) and entrepreneurs, Angola welcomed Premier Wen Jiabao, and the Minister of Commerce Chen Deming. As for Angola, after a ten year break, President Dos Santos visited China twice in 2008 - in August for the Olympics inauguration and again in December to ensure the continued flow of Chinese funds. Premier Wen Jiabao guaranteed that China would not reduce its financial assistance,³³⁵ and President Hu Jintao even raised four proposals³³⁶ to deepen cooperation and further extend bilateral exchanges. Dos Santos's visit was followed shortly thereafter by China's Minister of Commerce Chen Deming's visit to Luanda in January 2009. During his stay, he restated that China would not only honour previous financial commitments, but would also further strengthen its cooperation with Angola in a variety of sectors, including oil, construction and agriculture.³³⁷

³³⁴ Interview, Ministry of Foreign Affairs, Luanda, Angola, 2 February 2011.

³³⁵ Ministry of Foreign Affairs of the PRC, "Wen Jiabao meets with Angolan President Dos Santos", 20 December 2008, available online at: <http://www.fmprc.gov.cn/eng/zxxx/t527821.htm> (accessed 8 November 2009).

³³⁶ Ministry of Foreign Affairs of the PRC, "Hu Jintao holds talks with Angola President Jose Eduardo dos Santos", 18 December, 2008, available online at: <http://www.fmprc.gov.cn/eng/zxxx/t526951.htm> (accessed 8 November 2009).

³³⁷ According to Chen Deming, and responding to the Angolan government's appeal, China is soon to send a team of agro-technicians and to jointly develop in the near future, four agricultural projects located in Huíla and Uíge.

Table. 4.1. Selected China-Angola high ranking official bilateral exchanges (1988-2010)

<i>Chinese Government dignitaries official visits to Angola</i>		<i>Angolan Government dignitaries official visits to China</i>	
year	Name and rank	year	Name and rank
August 1989	Foreign Minister Qian Qichen	October 1988	President Eduardo dos Santos
August 1995	Vice-Premier Zhu Rongji	October 1998	President Eduardo dos Santos
January 2001	Foreign Affairs Minister Tang Jiaxuan	2006	Prime Minister F. Piedade dos Santos
February 2005	Vice Premier Zeng Peiyan	August 2008	President Eduardo dos Santos
June 2006	Premier Wen Jiabao	December 2008	President Eduardo dos Santos
January 2009	Minister of commerce Chen Deming	June 2010	Minister of Environment M. Fatima Jardim
March 2009	Vice-Minister of Commerce Jiang Zengwei	July 2010	Minister of Defence Candido Van Dunen
November 2010	Vice-President Xi Jinping	September 2010	Vice President F. Piedade dos Santos

Source: Elaborated by the candidate, with data collected from: <http://www.chinavitae.com> ; <http://www.macauhub.com.mo> and <http://www.forumchinapl.org.mo>

The year 2010 was particularly rich in high level bilateral exchanges, namely Angola’s Vice President Fernando Piedade dos Santos’s visit to Shanghai World Expo in September accompanied by several other ministers (Geology, Mining and Industry; Education, Science and Technology; Commerce; Urban Development and Construction; Agriculture and Rural Development). That same year in November, the Chinese Vice President Xi Jinping visited Luanda, where a joint declaration was signed to upgrade bilateral relations to ‘strategic partnership’, aiming at reinforcing coordination and strengthening cooperation in all sectors. While in Angola, Xi proposed four points to foster bilateral strategic partnership: enhancing political trust, pushing forward substantial cooperation, expanding people-to-people and cultural exchanges, and reinforcing coordination in international *fora*.³³⁸ During his visit, another seven inter-governmental agreements were signed in the areas of economic technology, energy, mining, agriculture and finance.

It is worth noting that this bilateral strategic partnership was an enterprise initiated by the Angolan government in early 2010, and that it was publicly announced by President Eduardo dos Santos in his

³³⁸ Xinhua, “China, Angola set up strategic partnership”, CCTV news channel online, 19 November 2010, available online at: <http://english.cntv.cn/20101120/103692.shtml> (accessed 5 December 2010).

speech addressing the ‘state of the nation’ in October 2010, and signalling the rising importance of China in Luanda’s policy making elite. According to the Ministry of Foreign Affairs, unlike relations with all other countries, Angola-China affairs are carried out at the highest level, involving the Ministry of Foreign Affairs, Ministry of Finance, and Ministry of Planning, and are closely monitored by the President’s office.³³⁹

According to this strategic partnership agreement a bilateral commission is to be established, which will be headed by the Angolan and Chinese Vice-Presidents. It is aimed at devising multi-year action plans to be implemented and coordinated through a joint operational mechanism, yet to be defined.³⁴⁰ Following Xi Jinping’s visit, a team integrating cadres from the Angolan Ministries of Finance, Foreign Affairs and Planning, plus the President’s Office, was set up to identify priority cooperation areas.³⁴¹ Cooperation reinforcement, namely in infrastructures, energy and mining is to be promoted, mostly through the reinforcement of Chinese public credit lines and the fostering of public-private and private partnerships.³⁴²

The intensifying of political exchanges described above has been to a great deal propelled by the blossoming economic ties between the two countries throughout the past decade. Indeed over this period of time the economic features of the relationship have shown an unprecedented dynamism that uplifted bilateral relations to new heights. This results mostly from China’s growing engagement in Angola through development assistance, trade, infrastructure development and the oil industry.

4.1.2.2. Using aid as positive economic statecraft

Unlike its African neighbours that have been benefiting from Chinese assistance since the 1960s, Beijing’s aid to Angola is very recent. It was only in the early 2000s that China began to work with Angola in health, education and agriculture. Meaningfully, these cooperation efforts mostly occurred following the first oil-backed loan package signed with EXIM Bank in 2004 (discussed below).

The largest hospital in the country, Hospital Geral da Província de Luanda, was rehabilitated with a grant from the Chinese government. Within the framework of Beijing’s concessional loans, Chinese companies

³³⁹ Interview, Ministry of Foreign Affairs, Luanda, Angola, 2 February 2011.

³⁴⁰ Jornal de Angola, “Declaração conjunta de Angola e República Popular da China”, *Jornal de Angola*, 21 November 2010, online version, available at:

http://jornaldeangola.sapo.ao/20/0/declaracao_conjunta_de_angola_e_da_republica_popular_da_china (accessed 25 November 2010).

³⁴¹ Interview, Ministry of Foreign Affairs, Luanda, Angola, 2 February 2011

³⁴² Details according to first draft of the joint-declaration, in which the candidate played a small role.

have been constructing and rehabilitating a large part of the existing health centres and hospitals around the country. Additionally, there are also a number of Angolan doctors pursuing post-graduation studies in China, with Chinese grants.³⁴³ Furthermore, a protocol was signed in 2005 with the Chinese Ministry of Health (International Cooperation Department) to send Chinese medical teams (18 doctors / two years missions) and to donate much needed medicines.³⁴⁴

With respect to education, The Chinese government has expanded the number of scholarships for Angolans from 20 to 60 a year in 2010,³⁴⁵ clearly envisaging a substantial increase in the number of Angolan students enrolled in Chinese universities. In addition, several Angolan administrative cadres enrol every year in short-term human resources development courses in China and in Macau, as part of the activities promoted by the Permanent Secretariat of the Macau Forum (423 between 2003-2008) and the Ministry of Commerce in Beijing.³⁴⁶ Finally, and also within the framework of the credit lines, Chinese firms have been building or rehabilitating several polytechnic institutes and universities in the main urban centres of Angola, namely Universidade Agostinho Neto in Luanda - which is the main public university.

Agriculture is also an area that has benefited from China's credit lines. China has been financing equipment acquisition and irrigation projects in Angola's major producing provinces of Huíla, Huambo and Moxico. In December 2008, during Dos Santos's last visit to Beijing, a memorandum was signed to send Chinese technical teams to help develop cereal crops.

Despite not having military attaches in their respective embassies, military assistance is the oldest form of cooperation between Angola and China. Cooperation consists mainly in acquisition of Chinese equipment and training, conducted mostly in Angola by Chinese officials, and including the airforce.³⁴⁷ Additionally, China has also been assisting in the removal of land mines all over the country.³⁴⁸

³⁴³ Interview, Angolan Embassy in Beijing, November 15, 2007

³⁴⁴ *Semanário Angolense*, "China teria concedido mais 2 bilhões de dólares a Angola", *Semanário Angolense*, nº 168, Junho 2006, available online at: www.semanarioangolense.net/full_headlines.php?id=4753&edit=168 (accessed 14 February 2008).

³⁴⁵ *Jornal de Angola*, "China garante mais bolsas para estudantes angolanos", *Jornal de Angola*, 22 November 2010, online version, available at: http://jornaldeangola.sapo.ao/20/0/china_garante_mais_bolsas_para_estudantes_angolanos (accessed 25 November 2010).

³⁴⁶ Information according to "Activities Report 2006-2009", Forum Macau Secretariat, internal document.

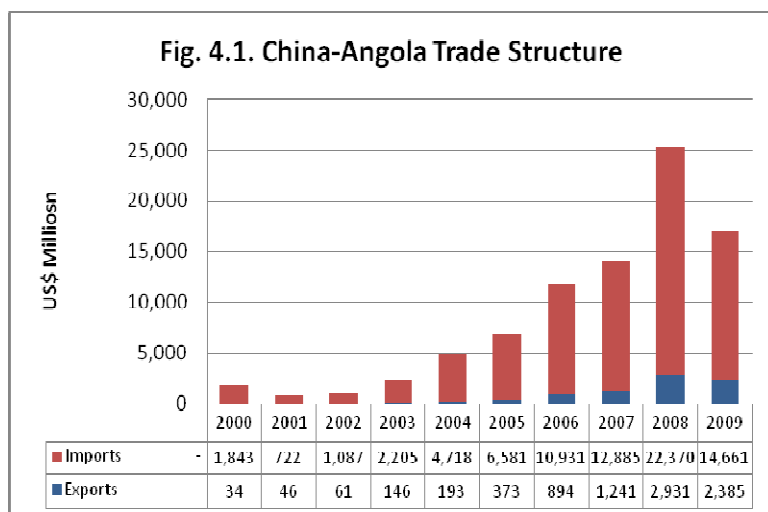
³⁴⁷ Interview, Angolan Embassy in Beijing, November 15, 2007.

³⁴⁸ Information according to e-mail exchanged with official at the International Cooperation Department of the Chinese Ministry of Commerce, March 31, 2008.

Despite a late start, Chinese cooperation has become increasingly visible around Angola in recent years, and is therefore fulfilling its goal of portraying a positive image of China in Angola. Notwithstanding, the rapid rise in bilateral trade flows in recent years remains by far the most notable feature of the increasingly strong relations between Luanda and Beijing.

4.1.2.3. *Bilateral trade – uncovering the oil drive*

Trade figures appear to be the most striking trait of contemporary bilateral relations between Angola and China. Bilateral trade has grown over twelve-fold in less than a decade, reaching US\$25bn in 2008, up from US\$2bn in 2000. Fig. 4.1 (below) shows that most bilateral trade is accounted by Chinese imports, 99.5% of which is oil. Although diamonds imports have steadily increased in recent years (from US\$6mn in 2005 to US\$52mn in 2009) it still represents only a meagre 0.3% of Chinese imports from Angola. In 2009, Chinese oil imports alone accounted for 88% (US\$15bn) of the total value of bilateral exchanges.³⁴⁹



Source: TRALAC, “Africa’s Trading Relationship with China 2010”

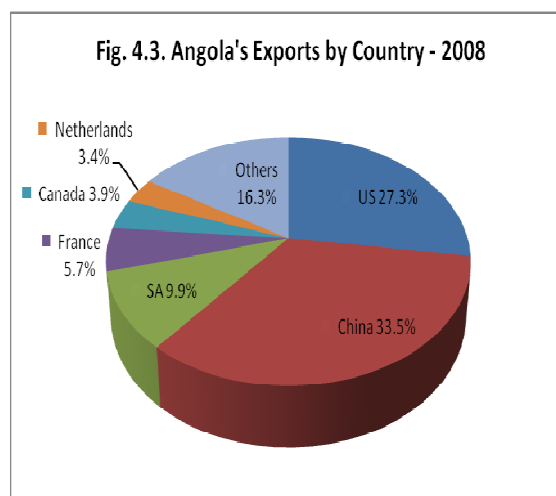
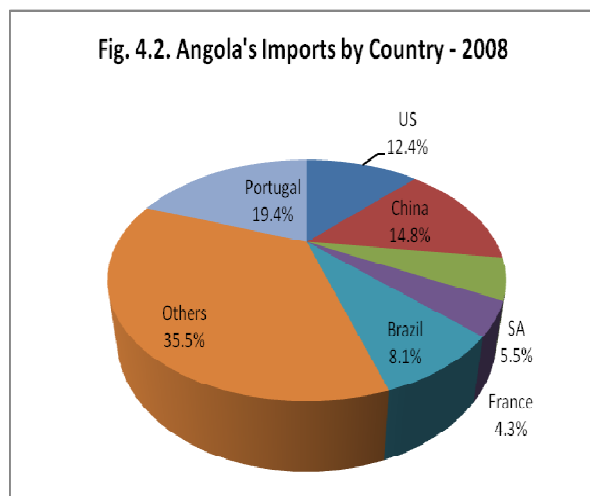
The sharp drop in bilateral trade registered in 2009 (US\$17bn), reflects mostly the fall in oil prices and is not a real contraction in trade flows between the two countries. In fact, preliminary figures for 2010, put bilateral trade back at US\$25bn³⁵⁰, indicating the resumption of the upward trend.

³⁴⁹ Unless otherwise stated, all figures in this paragraph are according to data in: Departamento de Estudos e Estatística, *Boletim Estatístico 2002- Junho 2010* (Luanda: Banco Nacional de Angola, June 2010) p. 43.

³⁵⁰ O Pais Online, “China Reve Tarifas Alfandegarias para produtos de Angola”, *O Pais Online*, 17 Jan 2011, available online at: <http://www.opais.co.mz/index.php/economia/38-economia/11789-china-reve-tarifas-alfandegarias-para-produtos-de-angola.html> (accessed 7 February 2011).

Although representing only a tiny share of bilateral trade, Angola's imports from China have been rising at a relatively rapid pace, particularly in recent years. Imports from China have more than doubled from 2007 to 2008 (US\$1.2bn to US\$2.9bn), contributing to China's rise from fourth (with a share of 9.5%) to second major source of imports in just one year.³⁵¹ Angola's imports from China are to a great extent a collateral effect of China's oil drive, since the bulk of imports is composed of construction materials and equipment that have been used in Angola's reconstruction, as part of the Chinese oil-backed loans granted since 2004. According to the National Trade Department (Direcção Nacional de Comércio) of the Angolan Ministry of Commerce, over two-thirds of Angolan imports from China are construction materials, machinery, and vehicles - the remaining being accessories, electrical appliances and furniture.³⁵²

In a relatively short period, China-Angola trade relations achieved a dramatic level of inter-dependency. Not only did Angola become China's major trading partner in Africa in 2006, displacing South Africa, but also preliminary data³⁵³ for 2010 suggest that China became Angola's major trading partner that year. After overtaking the US as a major exports destination in 2007, China overtook Portugal in 2010 as Angola's major source of imports. Both these countries had occupied those positions throughout most of the country's modern history (see fig. 4.2 and 4.3 below).



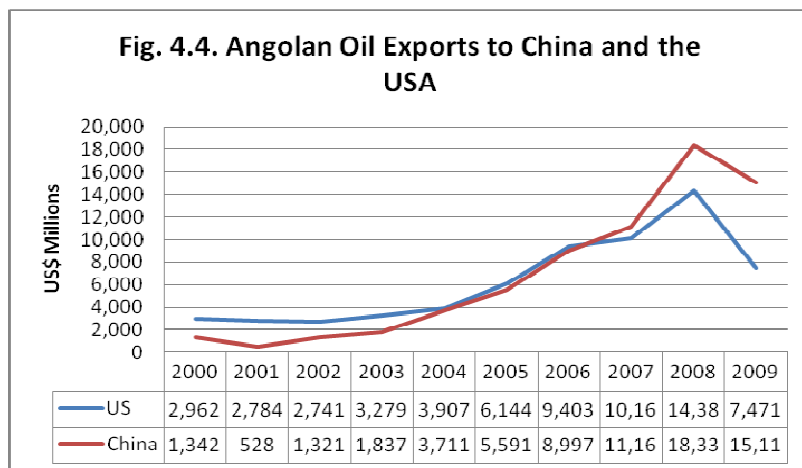
Source: EIU, *Angola Country Report*, September 2009.

³⁵¹ EIU, *Angola Country Profile 2008* (London: EIU, October 2008); EIU *Angola Country Report* (London: EIU, September 2009).

³⁵² Interview, Angolan Ministry of Commerce, Luanda, March 19, 2008.

³⁵³ Angolahub, "China foi o Principal Parceiro comercial de Angola no primeiro trimestre", *Angolahub*, 25 June 2010, available online at: http://www.angolahub.com/index.php?option=com_content&view=article&id=155%3Achina-was-angolas-main-trading-partner-in-first-quarter&catid=35%3AAngola&Itemid=64&lang=pt (accessed 20 August 2010)

In 2007 (see fig. 4.4, below) China became Angola’s main oil export destination, absorbing 26% of its total export value, against 24% going to the US. China’s share has expanded to 29.7% in 2008, while the US’s share decreased to 23.3%. In 2009 the gap increased even further, with China having accounted for 38.4% of Angolan exports, and the US for 19%.³⁵⁴



Source: BNA, *Balança de Pagamentos 2007* & BNA, *Boletim Estatístico 2000-Junho/10*.

The widening gap in 2009 is mostly due to a sharp contraction in the volume of oil exports to the US throughout that year, whereas exports to China registered a much smaller drop, mostly justified by the fall in oil prices. In fact, in terms of volume, oil exports to China actually registered a substantial increase in that year. The gap between exports to the US and China expanded even further in 2010, with China importing from Angola an average of 879,000 bpd in the first six months of that year, against an average of 409,000 bpd by the US.³⁵⁵

In 2009 Angola was the source of 57% of the volume of Chinese oil imports from Africa and 15.5% of its global oil imports, placing Luanda as China’s second largest supplier after Saudi Arabia (19.8%).³⁵⁶ The gap is closing up further. After having temporarily overtaken Saudi Arabia as China’s largest oil supplier in the first quarter of 2006, and again in the same period of 2008,³⁵⁷ Angola was China’s largest oil supplier in the first eight months of 2010, accounting in August that year for 19% of Chinese global oil

³⁵⁴ According to data in: BNA-Departamento de Estudos e Estatística, *Balança de Pagamentos 2007* (Luanda: BNA, 2008) p. 26; and BNA, *Boletim Estatístico 2002-Junho/10* (Luanda: BNA, 2010) p. 43.

³⁵⁵ Interview, Angolan oil sector expert, Luanda, Angola, February 2011.

³⁵⁶ EIA, “Country Analysis brief: China”, November 2010, available online at:

<http://www.eia.gov/cabs/China/pdf.pdf> (accessed 5 December 2010).

³⁵⁷ Oil Voice, “Angola becomes largest oil supplier to China; Saudi Arabia in second place”, 22 April 2008, in: www.oilvoice.com (accessed 5 December 2010).

imports.³⁵⁸ Although at the end of that year Saudi Arabia (896 bpd) remained China's largest supplier, the gap between the two is now much smaller (Angola: 791 bpd). This recent development clearly underlines the increasing relevance of Angola in China's energy security strategy.

As demonstrated above, the phenomenal rise in bilateral trade is a direct consequence of the rapid expansion of China's oil imports from Angola, which became particularly evident after 2004 (the year that China extended its first credit line) - with a clear intensification of flows over the few years. This fact unmistakably places the 'oil factor' as the driving force behind the thriving China-Angola trade flows.

4.1.2.4. Funding Angola's reconstruction

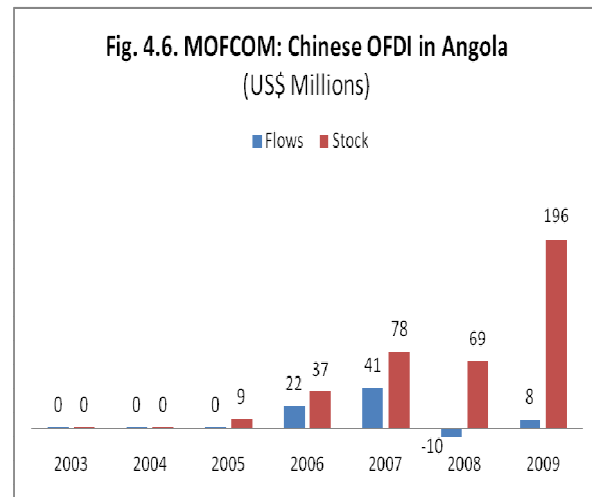
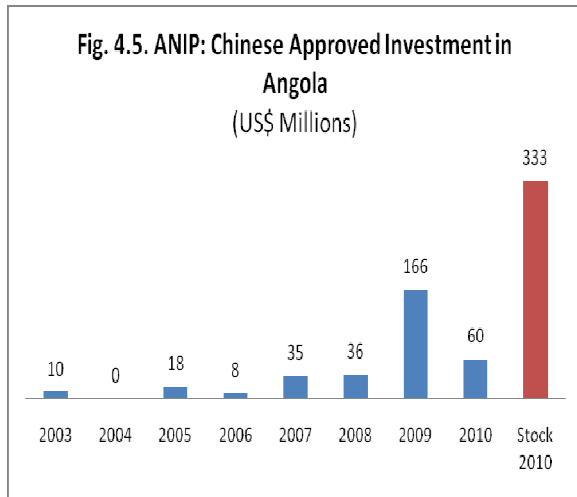
China's role in Angola's national reconstruction has also intensified throughout the decade, with its participation in the sector becoming widely visible across the country. According to the National Agency for Private Investment (ANIP in the Portuguese acronym) data,³⁵⁹ 80% of Chinese investment approved between 2000 and 2010 was targeted at the construction sector (72% of which equipment), being the majority of projects located in Luanda province.³⁶⁰ Despite significant discrepancies in Chinese and Angolan official statistics³⁶¹ figures regarding Chinese private investment in Angola, figs 4.5 and 4.6 (below), show that Chinese OFDI flows to Angola, although fluctuant, have been more consistent in the second half of the decade.

³⁵⁸ Ni Dandan, "Angola producing more oil than quota", Global Times, 28 September 2010, available online at: <http://china.globaltimes.cn/diplomacy/2010-09/577855.html> (accessed 5 December 2010).

³⁵⁹ This data excludes investments in the oil sector.

³⁶⁰ ANIP, 'Dados Estatísticos do Investimento Privado 2000-2010', internal document, courtesy of ANIP, February 2011.

³⁶¹ The differences are mostly because ANIP's figures reflect the total amount of approved investment, the disbursement of which may be spread over a few years, while Chinese statistics present actual investment disbursed that year. Nonetheless, both sets of figures are known to be inaccurate.



Source: ANIP, “Estatísticas de Investimento Privado 2010”; MOFCOM, *2009 Statistical Bulletin of China's outward FDI*.

The fact that investment flows have been more consistent in the second half of the decade suggests that Chinese companies ventures in Angola’s construction sector were triggered by Beijing’s credit lines for infrastructure, the first one having been extended in 2004. Encouraged by political stability and fast economic growth, some companies established headquarters in Luanda and started venturing outside the Chinese credit lines, further expanding China’s presence in the country’s construction sector. Among these are: China Road and Bridge Corporation, China State Construction Engineering Corporation, China Guangxi International Construction Lda and China Jiangsu. According to ANIP data, Chinese approved investment in Angola over the past decade (2000-2010) totals US\$348mn (3% of total FDI) and ranks fourth after Portugal (US\$1.7bn), the Netherlands (US\$502mn) and the US (US\$356mn).

Nevertheless, and despite the rising private investment trend, the bulk of Chinese engagement in the sector is still happening in the context of Chinese credit lines. Much like in the rest of Africa, Beijing seems to be particularly keen on delivering high prestige infrastructure projects such as the rehabilitation of the Ministry of Finance, the High Court, various convention halls, as well as edifices for the population at large - like hospitals, schools and stadiums.³⁶² Additionally, its engagement in housing, the transportation network, water supply and the electrical grid’s improvement and extension, have had a wide impact in improving local living standards. The fact that Chinese construction projects have also been completed within (or even before) the allotted time, and within (or below) budget, has certainly

³⁶² Chinese companies built the bulk of the sports pavilions to host the Afrobasket Cup in August 2007, and the four main stadiums to host the African Football Cup (CAN) in 2010.

enhanced China's political capital, maximising goodwill among the Angolan government and the general population *vis à vis* China.

Unlike the oil sector (where the largest Chinese investments in Angola have taken place) Chinese involvement in the construction sector put China directly under the public spotlight. This is mostly because of the objective presence it entails across the country in terms of Chinese labour, equipment and the products delivered - making it more prone to criticism. Indeed, a few emerging issues are currently threatening to stain China's reputation in Angola. These include the alleged poor quality of Chinese work (the General Hospital of Luanda collapsed in 2010, only four years after its inauguration), the lack of maintenance procedures, problems with technological equipment (failure or inability of locals to operate it), very low work standards (safety and salaries), the large numbers of Chinese workers brought to work in Angola, and qualms about their skills.³⁶³ If criticism grows in this sector, following what has happened in other African countries where China's physical presence is greatly felt like in the DRC and Zambia (mining) or Cameroon and Gabon (retail), China's image in Angola may well suffer. This would certainly have a negative impact on its quest for oil equity in Angola, since in such a highly centralised decision making structure, political perceptions and voluntarism at the highest level can overshadow the brightest business prospects. Nevertheless, at this stage China's partnership in Angola, is in general well regarded, not only by the political elite, but also by the population, who has seen an improvement in living standards, namely due to new infrastructure and the availability of cheap Chinese consumer goods.

4.1.3. Infrastructure-for-oil loans: the making of the 'Angola Mode'

China's first funding experience in Angola dates back to the year the civil war ended. In 2002 China Construction Bank and the EXIM Bank funded small infrastructure projects in Angola - the first phase of Luanda's railway rehabilitation and electrical grid projects in four cities - valued at over US\$150mn.³⁶⁴ This initial experience in Angola made Beijing conscious of the massive infrastructure challenge Luanda was facing in the post-conflict setting.

Soon after the peace accord was signed in April 2002, Angola's diplomacy focused its efforts in promoting a donors' conference in order to get funding for much needed reconstruction. Its efforts, however, were undermined by Luanda's poor relations with the IMF. In 2003 Angola tried to obtain the

³⁶³ Various interviews, Luanda, February-March, 2008, and March 2009.

³⁶⁴ Indira Campos and Alex Vines, "Angola and China, a pragmatic partnership", working paper presented at the CSIS conference on Prospects for improving US-China-Africa cooperation, 5 December 2007, p. 6, available online at: http://csis.org/files/media/csis/pubs/080306_angolachina.pdf (accessed 5 December 2010).

required funds by approaching several countries bilaterally, including South Korea and Japan. These countries, however, also demanded from Angola an improvement in relations with the IMF.³⁶⁵

It was in this context that the first large Chinese credit line materialised. Aware of the slim prospects Angola was facing in getting funding in international markets, the Chinese government proposed in mid 2003, a non conditional and large concessional loan for infrastructure development in exchange for oil. Negotiations started soon after.

Angola was the first African country to receive this type of infrastructure-for-oil loan from China on such a large scale. In fact, the success of this formula in Angola, helped establish a pattern of resource collateralised loans dubbed ‘Angola Mode’, which became one of the most distinctive characteristics of Beijing’s engagement with Africa from 2000 to 2010. This kind of financial assistance differs from traditional donors and commercial loans in many regards. Firstly, it has no conditions attached (such as improvements in transparency and democracy); secondly, it offers more favourable terms than regular commercial loans (namely interest rate and repayment conditions); thirdly, it is normally secured by natural resources; and lastly, it comes tied to the procurement of goods, labour and contractors from China. This model reflects thus the eminently pragmatic nature of China’s assistance, and is designed to benefit both the lender and the borrower, fitting into the ‘win-win’ cooperation and ‘mutual benefit’ models that Beijing defends.

Other countries with a strong economic presence in Angola have been resorting to similar financial instruments, also using oil as a loan guarantee (namely Brazil, Spain and Israel).³⁶⁶ Nonetheless, the infrastructure-for-oil formula matrix introduced by China remains unparalleled, not only by its volume and low interest rate (highly subsidised by the Chinese state), but also by the large margin of Chinese content. From Angola’s point of view, the non-conditional nature of China’s cooperation aid is undoubtedly appealing, given its well known record of resisting IMF’s pressure to improve its transparency and accountability record. Owing to its political stability and significant oil reserves, Angola has been one of the major beneficiaries in Africa of China’s financial largesse over this period. From Beijing’s perspective, Angola remains among the most successful and less troublesome economic partnerships in the region.

a) The first phase of Chinese public credit lines

³⁶⁵ Angolense, “Uma breve cronologia do empréstimo”, *Angolense*, 29 July 2006, p. 22; plus various interviews with government officials between January and March 2008, and March 2009.

³⁶⁶ Interview, Ministry of Finance - Department of Debt Management, Luanda, Angola, 3 February 2011.

According to the Secretary of Cooperation at the Ministry of Foreign Affairs, Angola warmly welcomes Chinese cooperation, since it is ‘more advantageous than that one offered by the other countries as it does not impose political conditions and financially there are many advantages, namely regarding the volume of credit, financial conditions (interest rate and repayment term), projects’ execution time, high productivity and easy integration of Chinese labour in both urban and rural areas, among others.’³⁶⁷

According to the office responsible for running the Chinese loans at the Angolan Ministry of Finance (MINFIN),³⁶⁸ Luanda Executive has signed three loan agreements with EXIM Bank, worth a total of US\$4.5bn. The first one, of US\$2bn, was signed in March 2004, for infrastructure construction and rehabilitation. A second one, of US\$500mn, was signed in July 2007, to finance complementary works required to finish the projects started under the first credit line. A third agreement was signed in September 2007, for another US\$2bn. The credit lines were given to finance the projects listed in the government’s public infrastructures programme (PIP, in the Portuguese acronym, listed in the national budget).

The combined loan of US\$4.5bn was originally to be repaid over 17 years, following a grace period of five years, with an interest rate Libor + 1.5% (later reduced to 1.25%). It is managed as a current account of the Angolan government at EXIM Bank in Beijing. Sonangol is the guarantor of the loan, and repayment is to be done with the proceeds of oil sells from Sonangol to UNIPPEC (China international United Petroleum & Chemicals Co. Ltd, Sinopec group), which are to be deposited in the Angolan Ministry of Finances (MINFIN) account at EXIM Bank.³⁶⁹ In accordance with the agreement signed, and although there were a fixed number of barrels to sell daily,³⁷⁰ the volume of oil to be sold to UNIPPEC each month for repayment of the loan, varies according to market oil prices. If the amount deposited exceeds the debt service of that month, it shall be discounted in the following month. Up to the present, Angola has fully complied with its repayment schedule, and according to one source in Luanda, the volume of oil being sent to China at the end of 2010 for loans repayment was around 60,000 bpd.³⁷¹

³⁶⁷ Closing speech delivered by the Secretary of Cooperation - Angolan Ministry of Foreign Affairs, at the conference ‘China in Africa: challenges and opportunities for Angola’, 31 January 2011, Luanda, Angola.

³⁶⁸ Interview, Ministry of Finance, Luanda, Angola, March 5, 2008.

³⁶⁹ Interview, Ministry of Finance, Luanda, Angola, March 19, 2009.

³⁷⁰ Originally, repayment was to be the equivalent of contract sales of 10,000 bpd in the first two years and 15,000 bpd thereafter, according to Afrodad, “China development aid to Angola”, available online at: <http://www.afrodad.org/downloads/publications/Angola%20Factsheet.pdf>

³⁷¹ Interview, oil sector expert, Luanda, Angola, 1 February 2011.

Under the agreement, 70% of works have to be contracted with Chinese companies and the same proportion of construction material, equipment and labour has to be contracted in China.³⁷² This feature has not raised any serious obstacles in Angola, since there are no relevant laws protecting local industry or labour. Moreover, the local business class and local industry lack the capacity to supply such large scale reconstruction projects, and labour is to a large extent unqualified. In addition, labour unions are non-existent, and business associations are weak and disorganised. In this context, the Chinese content is reportedly much larger in reality, as local contractors (30%) end up sub-contracting Chinese services, labour and goods, as they tend to be cheaper and more expeditious.

Loan disbursements are made on a project-by-project basis. The tendering, management and payment of projects are jointly managed by the Chinese Ministry of Commerce and the Angolan Ministry of Finance (who coordinates the Ministries undertaking the projects in Angola). MINFIN submits the projects for tendering, EXIM Bank selects the Chinese candidates running for each project, and a joint commission makes the final selection.³⁷³ Around 10% of the capital is released at the start of the project, and the remaining upon project completion (after completion is confirmed by MINFIN). The payment is made directly into Chinese companies' accounts at EXIM Bank in China.³⁷⁴

According to the former Angolan Finance Minister, the first US\$2bn was mainly spent in projects related to energy and water supply, as well as education, these sectors having benefited from 18% and 20%, respectively, of the first consignment.³⁷⁵ The bulk of the complimentary works batch (US\$500mn) was directed to health (31%) and education (18%).³⁷⁶ The remaining US\$2bn (3rd phase) is being channelled to integrated infrastructure (Malange, Zaire & Cabinda), roads and transportation (rolling stock for railways and urban public transportation).³⁷⁷ According to the Ministry of Finance, in early 2011 the first two credit lines had been completely disbursed and were under repayment. Regarding the third batch, all projects have been assigned, some have already been completed and are under repayment.³⁷⁸

The management of the EXIM Bank credit line has been relatively transparent, especially since the emergence of allegations of mismanagement regarding the CIF fund in 2004 and 2007 (see below). The

³⁷² Interview, Ministry of Finance, Luanda, Angola, March 5, 2008.

³⁷³ Interview, Ministry of Finance, Luanda, Angola, March 5, 2008.

³⁷⁴ Chinese money is thus only 'virtually' present in Angola, seriously reducing the possibility of embezzlement.

³⁷⁵ A full list of the projects is available on the Finance Ministry's website:

<http://www.minfin.gv.ao/docs/dspProjGov.htm> (accessed 5 December 2010).

³⁷⁶ Angola Press Agency, "Energy takes much of China loan", 11 April 2008, available online at:

<http://allafrica.com/stories/printable/200804110421.html> (accessed 6 November 2008).

³⁷⁷ Interview, Ministry of Finance, Luanda, Angola, 12 March 2009.

³⁷⁸ Interview, Ministry of Finance, Department of Debt Management, Luanda, Angola, 3 February 2011.

latter allegations were particularly damning, because they involved a former close ally of the President charged with insubordination.³⁷⁹ This led the Ministry of Finance to issue a press release on the topic, and to post on its website detailed information concerning the Chinese dossier, including number of projects, value and progress status.³⁸⁰

b) The private arm: China International Fund

Another large Chinese credit line to Angola started to take shape in late 2004 and early 2005, channelled through a private Chinese fund based in Hong Kong: the China International Fund (CIF).³⁸¹ CIF apparently came into existence through personal connections linking Hong Kong-based tycoons (some allegedly former SOEs' senior cadres and others with links to Chinese intelligence), Sonangol cadres and a Lusophone financier.³⁸² This credit line was set up to fund projects under the Angolan National Reconstruction Office (Gabinete de Reconstrução Nacional, GRN). Although this credit line features private Chinese capital and therefore is not pursuing Beijing's energy security goals, it is important to elaborate a bit further on it, as significant synergies emerged between the two.

According to some reports, the establishment of the GRN in 2004 followed a visit by the Angolan Finance Minister to Beijing.³⁸³ It is said that at that time the Chinese secret services had concern over alleged illegal rent-seeking by Angolan officials involving the EXIM Bank credit line.³⁸⁴ Soon after, the GRN was created, with the main purpose of administering the bulk of public works part of the government's national reconstruction programme. The GRN was placed under direct control of the presidential office, and one of dos Santos's closest allies put in charge of it, namely General Helder Vieira

³⁷⁹ José Kaliengue, "Minfin Nega desvio de biliões da China", *Semanário Angolense*, 236, 2007, available online at: www.semanarioangolense.net/full_headlines.php?id=8636&edit=236 (accessed 6 November 2008).

³⁸⁰ This practice seems, however, to have been abandoned by the new cabinet following the legislative elections in September 2008, as the last update was made in July 2008.

³⁸¹ CIF was originally created as the construction arm of Beiya International Development, now Dayuan group - the parent company of China Angola Oil Stock Holding, which imports oil from Angola. This Hong Kong fund is discussed in more detail below.

³⁸² Interview, Think Tank, Shanghai, China, 13 August 2009; L. Levkowitz, M. Ross and J.R. Warner, *The 88 Queensway Group* (Washington: US-China Economic and Security Review Commission, 10 July 2009). This report attempts to uncover the complex web of Chinese, Angolan, and Lusophone individuals and companies with which CIF is associated, and to reveal the extent of its links to the Chinese government, which is increasingly trying to distance itself from the group in the context of CIF's latest venture in a massive mining deal with the Guinea-K junta, and that became public in October 2009.

³⁸³ Manuel Ennes Ferreira, "China in Angola: Just a Passion for Oil?", *C. Alden, D. Large and R.S. Oliveira (eds.), China Returns to Africa: A Rising Power and a Continent's Embrace* (New York, NY: Columbia University Press, July 2008) p. 313.

³⁸⁴ *Semanário Angolense*, "Chineses refreiam os aguçadíssimos apetites de dignatários angolanos", *Semanário Angolense*, 103, 2005, available online at: www.semanarioangolense.net/full_headlines.php?id=911&edit=103 (accessed 6 November 2008).

Dias, also known as ‘Kopelipa’, and head of Casa Militar (an army central institutional structure under the President’s direct control).

The CIF loan to Angola stands out for the opacity of its financial records and project management. Nevertheless, and although falling out of MINFIN jurisdiction, the Ministry of Finance informed in a press release, published in October 2007, that the first batch of this fund totalled US\$2.9bn and was contracted in the same terms of the EXIM Bank loan, and thus directed to infrastructure, tied to Chinese contractors and to be repaid in oil. According to the World Bank, CIF’s pledged credit totals US\$9.8bn.³⁸⁵

Without the Chinese governmental apparatus overtly behind it, but certainly riding the wave started by EXIM Bank, the CIF credit line also managed to establish through a handful of well related individuals, a direct connection to the Presidency in Angola. Not only the management of the infrastructure fund in Angola was placed under the Presidency through GRN, as the Hong Kong group behind this initiative came to be closely associated with Sonangol, the powerhouse of the Presidency.

CIF was funding some of the largest infrastructure projects in Angola, namely the three railway lines, the new airport, the Special Economic Zones, and mega housing projects in line with President dos Santos’s pledge to built one million homes by 2012. Most of CIF construction projects, however, came to a halt in late 2007, allegedly due to unrealistic planning.³⁸⁶ CIF apparently failed to consider a few logistical constraints, like the insufficient capacity of Angolan harbours to cope with a sharp increase in port traffic, which resulted in a shortage of construction materials such as cement. Most importantly though, there seem to have been significant disbursement problems at CIF,³⁸⁷ having repeatedly failed to honour its financial commitments and complete all flagship infrastructure projects under its responsibility, raising concern among the Angolan political elite.³⁸⁸ CIF’s problems forced the Angolan Ministry of Finance to issue short term debt titles (US\$3.5bn)³⁸⁹ in 2007 and 2008, to pay Chinese companies undertaking the contracts, and to facilitate the resumption of works.

³⁸⁵ World Bank delegation in Luanda, *Angola Interim Strategy 2007-2009* (Luanda: WB, 2007) p. 49.

³⁸⁶ João Marcos, “Chineses enxergaram mal a dimensão do caminho-de-ferro de Benguela”, *Angolense*, 4 August 2007, p. 15.

³⁸⁷ Various interviews, Luanda, Angola, January-March 2008 and March 2009; *Semanario Angolense*, “China reconhece que está a patinar”, *Semanário Angolense*, 224, 2007, available online at: www.semanarioangolense.net/full_headlines.php?id=7898&edit=224 (accessed 6 November 2008).

³⁸⁸ Various interviews, Luanda, Angola, January-March 2009, and rumours circulating in the press on the eminent dismissal by the President himself, of Gabinete the Reconstrução Nacional’s (GRN) head (Gen. Kopelipa) - who was in charge of the reconstruction projects funded by CIF.

³⁸⁹ Interview, Ministry of Finance, Luanda, Angola, March 5, 2008.

Further to these developments, in mid 2008 the Angolan government was made aware that CIF was receiving oil payments for contracts that were not yet being executed.³⁹⁰ Having finally realised that the GRN-CIF platform did not have the financial or management capacity to undertake the massive construction programme they had been assigned, the government started to deplete GRN of its responsibilities in late 2010. President dos Santos replaced General Kopelipa with General Flores and announced that all housing projects under GRN³⁹¹ were transferred to Sonangol Imobiliaria (Real Estate arm of the national oil company), which would also manage the Special Economic Zone Luanda-Bengo.³⁹² Furthermore, the President also announced that the management of other infrastructure projects under GRN³⁹³ would also be assigned to other national institutions.³⁹⁴ This episode clearly illustrates the extent of the President's control over national institutions, and again the key role Sonangol plays in the domestic context.³⁹⁵

Despite Beijing's efforts to distance itself from CIF,³⁹⁶ the private fund gradual decline and the debacle around its failure to deliver from late 2007 onwards had, to a certain extent, a negative impact on China's image and interests in Angola. This situation was reinforced by the fact that most of the companies hired to undertake projects funded by CIF, were the same Chinese SOEs working for projects under the EXIM Bank credit lines.

c) Reinforcing the public arm: new Chinese credit lines in the making

³⁹⁰ Interview, Angolan oil sector expert, Luanda, Angola, 1 February, 2011.

³⁹¹ Consisting of 215,000 housing units in Luanda and in 17 other provinces.

³⁹² Germano Gomes, "Imobiliaria da Sonangol gere novas centralidades", *Sonangol Noticias*, October 2010, pp. 11-13; various interviews in Luanda, Angola, February 2011.

³⁹³ This includes the three railway lines that run eastwards from the three main ports on the coast (Luanda, Lobito and Namibe). The Luanda-Malange line was inaugurated in January 2011 and the other two are scheduled to be fully operational in 2012. The Benguela railway links Angola to the copper belt area in the DRC and in Zambia, where China has strong mining interests. The Benguela railway track is by far the shortest and fastest way to transport these commodities out of the continent. The Moçamedes railway, which links the Namibe port to the mineral rich Huíla (iron ore) and Cuando Cubango (copper, iron ore and diamonds) provinces, is planned to connect with Namibia's railway network, and with the Benguela railway in the north. Rolling stock of the Moçamedes railway and staff training were left out of the Chinese contract, and handed over to an Indian company as part of New Delhi's credit line to Angola (US\$40 mn). Other projects being ran by CIF include road rehabilitation; the industrial zone of Luanda (in Viana); the new Luanda airport, and studies for the hydro-electric power project in the Kwanza River, the New Luanda City project, and the new administration complex in Luanda. The new airport, located between Viana and Bom Jesus (40 km outside Luanda), is projected to have the largest operational capacity (passengers and cargo) of Sub-Saharan Africa, and is a clear attempt to become the region's air traffic hub, in tune with Angola's ambition to become a regional power.

³⁹⁴ Germano Gomes, *op. cit.*, pp. 11-13; plus various interviews in Luanda, February 2011.

³⁹⁵ Despite the CIF/GRN debacle, Sonangol has recently joined CIF in ventures in the oil sector in Guinea and Madagascar.

³⁹⁶ Interview, Forum Macau Secretariat, Macau, China, 18 August 2009; Interview, Chinese Embassy in Angola, Luanda, Angola, 28 March 2009.

As in 2004, the reinforcement of China's position as a funds provider in Angola in recent years, benefited from Angola finding itself yet again in dire straits, this time owing to the onset of the global economic crisis. The elections in 2008 set in motion a cycle that put MPLA under pressure to deliver much needed infrastructure before the next poll due in 2012. The oil price plunge, however, substantially cut back Angolan oil revenue estimated to have contracted by 39% in 2009.³⁹⁷ In addition, the onset of the global economic downturn had an adverse effect on Angola's strategy of diversifying its funding sources, since credit became increasingly scarce in international financial markets. Despite the gradual rebound in oil prices throughout 2009/2010, the endurance of the global financial crisis in western economies continued to limit Luanda's funding prospects. President Dos Santos's tours to Europe, the Middle East and Russia in 2009/2010, produced little results in this regard, considering the sheer size of its funding needs. As such, the financial contraction context, and Luanda's urge to sustain the pace of the large infrastructure programme, placed China once again in a favourable position to reinforce its position as a development cooperation partner.

It was in this particular framework that agreements for three new official Chinese credit lines were signed in late 2009: EXIM Bank (US\$6 bn), Industrial and Commercial Bank of China (ICBC, US\$2.5 bn) and China Development Bank (CDB, US\$1.5 bn).³⁹⁸

Negotiations between China Development Bank (CDB) and the Angolan government started in early 2008.³⁹⁹ During a visit of CDB's president to Luanda to set the final details, it was disclosed that this credit line was to be directed to infrastructure (social housing in Cazenga and Camama, and transport and telecommunications) and agricultural development (mainly cereal crops and agro-industry).⁴⁰⁰ Although the CDB had been expressing its willingness to participate in Angola's reconstruction effort, it is meaningful that it was only in this specific crisis context that this credit line finally materialised. This loan is expected to be increased in coming years⁴⁰¹ and is the only one already being disbursed amongst the new ones.⁴⁰² Unlike the other two, this credit line is not backed by oil.⁴⁰³

³⁹⁷ Based on data in: EIU, *Angola Country Report* (London: EIU, September 2009) p. 8.

³⁹⁸ Ricardo Gazel, "Macro Brief: Angola", World Bank office in Angola, February 2010, p. 1; various interviews in Luanda, Angola, in March 2009; interview, ExIm Bank, Beijing, China, 3 June 2010.

³⁹⁹ Angola Press Agency, "Head of State analyses cooperation with Chinese financial institution", 17 April 2008, available online at: <http://allafrica.com/stories/printable/200804171177.html> (accessed 5 November 2009).

⁴⁰⁰ *Jornal de Angola*, "Chefe de Estado chinês discute financiamento de banco chinês ao sector da agricultura", *Jornal de Angola*, 13 March 2009, p. 2.

⁴⁰¹ Interview, Ministry of Finance, Luanda, Angola, 12 March 2009

⁴⁰² Interview, Ministry of Finance, Debt Management Department, Luanda, Angola 3 February 2011.

⁴⁰³ Various interviews in Luanda, March 2009; "China/Angola: no oil guarantees", in: *Africa-Asia Confidential*, 1: 7, May 2008, p. 6.

Negotiations for a new US\$6bn credit line for infrastructure development from EXIM Bank took place throughout 2009.⁴⁰⁴ Like the previous ones, this loan is secured by Sonangol, and is to be repaid in oil⁴⁰⁵ (100,000 bpd 2010-2018)⁴⁰⁶ following the same procedure of the previous ones. In November 2009, a third loan of US\$2.5bn was announced with Industrial and Commercial Bank of China (ICBC), and is also directed at infrastructure development and to be repaid in oil (10,000 bpd in 2010; 40,000 bpd in 2011-2013; 30,000 bpd in 2014-2016), using the same *modus operandi*.⁴⁰⁷ Although not much information is available on EXIM Bank and ICBC loans, as of January 2011 these were yet to be disbursed according to the Ministry of Finance.⁴⁰⁸

The combined figure of the new loans rises to US\$10bn, and when added to the previous US\$4.5bn of EXIM Bank, makes up a total of US\$14.5bn in public funding from China, which will be the largest in Africa when disbursed. Moreover, the combined volume of other bilateral (Brazil, Portugal, Spain, Germany and US) and multilateral (IMF, 2010 US\$1.4bn) credit lines contracted by Angola over the past decade, hardly match the magnitude and soft conditions of Chinese loans. The fact that Angolan President dos Santos visited Beijing twice in the second half of 2008⁴⁰⁹ and that a significant number of Ministers in the Angolan cabinet visited China in 2010, clearly signals Beijing's rising importance in Luanda, providing concrete evidence of the success of Beijing's positive economic statecraft.

4.2. Assessing the performance of infrastructure-for-oil loans in Angola

Although Chinese participation in the oil sector has been driven by direct investment of one of China's National Oil Companies (Sinopec), its penetration of the industry was largely propelled by the extension of Beijing's infrastructure-for-oil credit lines to Luanda, as discussed below.

4.2.1. The initial period of grace

⁴⁰⁴ Interview, ExIm Bank, Beijing, China, 26 August 2009.

⁴⁰⁵ Various interviews in Luanda, Angola, March 2009; Interview, ExIm Bank, Beijing, China, 26 August 2009.

⁴⁰⁶ Figures according to an early version of the contract to be signed with Sonangol: Sonangol: "Parceria Estrategica Angola China: a contratacao de petroleo bruto", 4 March 2010 (internal document). These figures merely indicate the exact number of barrels to be sent daily to China, depending on the oil price.

⁴⁰⁷ Figures according to an early version of the contract to be signed with Sonangol: "Parceria Estrategica Angola China: a contratacao de petroleo bruto", 4 March 2010 (internal document).

⁴⁰⁸ Interview, Ministry of Finance, Debt Management Department, Luanda, Angola 3 February 2011.

⁴⁰⁹ Especially evident if considered that: dos Santos did not visit China for over a decade; that the President's official visit to China has been on the agenda for several years but was constantly postponed until this point; and that he did not take part in the historical FOCAC Beijing meeting in 2006, but showed up for the opening of the Olympic Games in August 2008.

Sinopec Group acquired its first stake in an Angolan oil block shortly after the signing of the first EXIM Bank credit line in March 2004. The stake in question is 50% of oil block 18, in which BP is the operator owning the remaining 50%. The surrounding framework and procedures involved in the acquisition process, illustrate well the critical role played by the timely loan and the connections at the highest level that came with it.

The stake was being relinquished by Shell in mid 2003, allegedly due to rising cost in exploration and unsuccessful drilling. In April 2004 Shell reached an agreement to sell its stake to the Indian state owned Oil & Gas National Company (ONGC).⁴¹⁰ From mid 2003 the Angolan government had been negotiating with China EXIM Bank the first batch of the much needed loan, in which Sonangol played a key role as guarantor and responsible for repayment in kind. By mid 2004 it became clear that Sonangol was going to exert its pre-emptive rights in block 18 and jointly explore it with Sinopec.⁴¹¹ Sinopec's bid to buy Shell's share at US\$725mn was allegedly much higher than ONGC's. For this purpose, a JV was established between Sonangol and Sinopec Group subsidiary Sinopec Overseas Oil & Gas (SOOG) in September 2004: Sonangol Sinopec international (SSI). In December 2004 Sonangol formally exerted its pre-emptive rights to buy the 50% stake on oil block 18 from Shell (executive decree no 148/2004, December 14) and the stake was formally transferred to SSI in February 2005 (Diário da República, no 22, Series I, 21 February 2005).

It is worth noting that, through this JV, Sinopec became closely associated with an obscure network based on personal connections. This intricate web connects the top echelons of the Angolan elite to the same group of Chinese private interests based in Hong Kong, that in 2005 started channelling infrastructure funds to Angola through CIF. A brief look at the dynamics of this network offers a key insight into the complexities of China's engagement in Angola's oil industry.

Sonangol had become formally associated with the Honk Kong fund in June 2004⁴¹² (Sonangol Asia, see diagram below). China Sonangol International Holding Ltd (CSHI,⁴¹³ commonly referred to as China

⁴¹⁰ Africa Asia Confidential, "Luanda Diversifies its portfolio", 23 September 2009, available online at: http://pambazuka.org/en/category/africa_china/58957 (accessed 5 November 2009).

⁴¹¹ Semanario Angolense, "A Índia não está a dormer", *Semanário Angolense*, 89, 2004, available online at: www.semanarioangolense.net/full_headlines.php?id=241&edit=89 (accessed 5 November 2008).

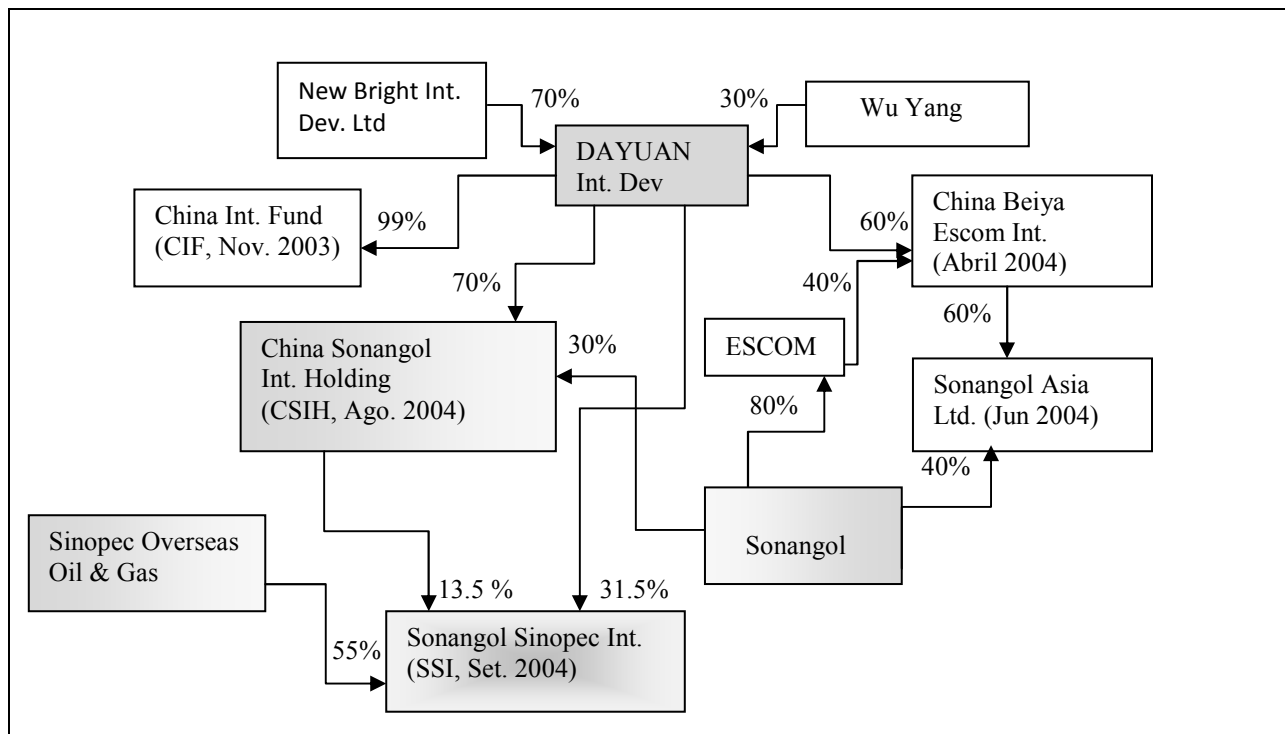
⁴¹² Through the establishment of a JV, Sonangol Asia Ltd, 40% owned by Sonangol and 60% by China Beya ESCOM international (40% ESCOM, and 60% Dayuan International Development - the core company of the group). Info according to L. Levkowitz, M. Ross and J.R. Warner, *op. cit.*

⁴¹³ Although most of the capital of this JV is Chinese, this study chose not to focus on China Sonangol, because it features private Chinese interests articulated with Angolan state interests (Sonangol). Furthermore, its management suggests that despite having a minority stake, it has been mostly used as a Sonangol instrument, and thus more prone to pursue Angolan interests than Chinese.

Sonangol) was established in August 2004 with the purpose of expanding the Hong Kong group energy projects in Angola, and to allow Sonangol to access funding. It is 70% owned by Dayuan International Development Ltd (core company of the Hong Kong-based group) and 30% by Sonangol. Only a month later, Sinopec Group (through SOOG) became formally associated with this private fund through its majority stake in Sonangol Sinopec International (55%). Dayuan International Development holds a 31.5% share and China Sonangol the remaining 13.5%.⁴¹⁴ In spite of the much larger participation of Dayuan, SSI was since its inception been addressed by Luanda as a JV between Sonangol and Sinopec. Indeed, even though with only a marginal formal participation in the JV through its 30% share in CSIH, Sonangol played the key role as the recognised counterpart of the venture, illustrating its ascendancy in the structure.

This web of personal connections linking all the way up to Sonangol’s managing elite and the Presidency, is thus critical in understanding, not only how Sinopec entered the Angolan oil sector so swiftly, but also the underlying dynamics of the system. This intricate web (see Diagram 4.1. below) explains, for instance, the unconventional transfers of acreage between SSI and China Sonangol (discussed below).

Diagram 4.1. How Sonangol Sinopec International fits into the Hong Kong group



⁴¹⁴ Alex Vines et al., *Thirst for African Oil: Asian National Oil Companies in Nigeria and Angola*, Chatham House Report (London: Chatham House, August 2009).

Sources: Author, adapted from diagrams in L. Levkowitz et al., *The 88 Queensway Group*(2009), and Alex Vines et al., *Thirst for African Oil* (2009).

Shortly after the transfer of 50% of block 18 to SSI, the Chinese Vice-Premier paid a three day visit to Luanda (25-27 February 2005), during which time he held private meetings first with President dos Santos, and then with Minister of Oil Desidério Costa and the CEO of Sonangol, Manuel Vicente. He also coordinated with the Angolan Prime Minister, Piedade dos Santos, the signing of nine cooperation agreements (five inter-governmental and four entrepreneurial). It is meaningful that in the wake of the extension of the first credit line and Sinopec's first oil equity access, four of the five inter-governmental agreements and three out of the four entrepreneurial ones were energy related. The first category contemplated an agreement envisaging closer cooperation in energy, mining and infrastructure, a Memorandum of Understanding (MoU) to create a bilateral commission on this topic, and two cooperation agreements between the National Development and Reform Commission (NDRC, China's policy making core) and the Ministry of Petroleum and the Ministry of Geology and Mining. As for the entrepreneurial deals, Sonangol signed a long term supply contract with Sinopec (term of seven years - 40,000 bpd due in the first three years), and the two companies also signed a memorandum to jointly study exploration in oil block 3/80,⁴¹⁵ and to jointly develop the Sonaref refinery project.⁴¹⁶

Through its links to the Hong Kong clique, later that year Sinopec secured additional long term supply through a loan syndication masterminded by the French investment Bank Calyon, whereby China Sonangol (CSIH) was placed as the borrower, Sinopec as the guarantor, and UNIPEC (Sinopec's Trading Company) as the off taker. The syndication of the loan which was over-subscribed enabled Sonangol to raise USD 3 billion.⁴¹⁷ This same successful financial expedient was used in May 2006, to raise USD 1.4 billion on behalf of Sinopec Sonangol International, in order to develop its share in block 18. By virtue of the above mentioned oil-backed loans Sinopec became ultimately the receiver of most of the oil produced by SSI in block 18.⁴¹⁸

The close relationship that Sinopec had by then established with Sonangol, largely explains the expansion of China's equity in the licensing bid round that took place between November 2005 and May 2006.

⁴¹⁵ Block 3/80 was operated by Total, and Sonangol was not going to renew the contract that was to expire in 2005, due to the 'Angolagate' affair, which, as noted before, involved individuals with very close links to the Presidency.

⁴¹⁶ Angop, "Angola e China assinam nove acordos de cooperação", 25 February 2005, available online at: http://www.portalangop.co.ao/motix/pt_pt/noticias/politica/2005/1/8/Angola-China-assinam-nove-acordos-cooperacao.952208c2-aded-4a88-960c-1ebf143e6ea8.html (accessed 5 November 2008).

⁴¹⁷ Africa Intelligence, "The Cash Just Keeps Coming", 403, 26 October 2005.

⁴¹⁸ A. Vines et al., *op. cit.*, August 2009, p. 43.

Although Sinopec was not awarded the stakes in the shallow water block 3/80⁴¹⁹ as the signature of the joint study programme signed in February 2005 originally suggested, SSI was awarded three stakes in some of the most disputed new ultra deep-water blocks: 20% in block 15/06 (operated by AGIP/ENI), 27.5% in block 17/06 (led by Total) and 40% in block 18/06 (operated by Petrobras).

Through its net share (27.5%) in block 18, Sinopec oil output in Angola can be approximately estimated at 44,000 bpd as of 2009 (see table 4.2. below).⁴²⁰ With estimated reserves of over 500 mn barrels and a potential output of 240,000 bpd, block 18 came on stream in 2007. In 2010 it accounted for 10.5% of Angolan oil exports (fifth largest in Angola).⁴²¹ This asset has the potential to increase Sinopec's daily overseas oil production by 8.8% (72,520 bpd), and its proven reserves by 3.6% (102 million barrels).⁴²²

Table 4.2. Sonangol Sinopec International oil acreage in Angola

Oil Asset	Consortium	Estimated Reserves* (Barrels)	Known Investment	Progress Stage, Depth and Crude Grade	Total Production 2009	Sinopec Estimated Net Share 2009***
50% Block 18 2004	Op. BP 50%	1 bn	US\$1.4bn	Production (largest find Plutonio, start Oct. 2007); Deep-water (1,200-1,500 m); Light crude (33.2 API)	160,000 bpd	27.5% (44,000 bpd)
20% Block 15/06 2006	Op. ENI 35%; Sonagol E.P. 15%; Total 15%; Falcon Oil 5%; Gemas 5%	1.5 bn	[Total Signature Bonus (SB): US\$902 mn Total Social Bonus (Soc. B): US\$50mn] SSI share** SB: US\$207 mn Soc.B: US\$12 mn	Exploration (largest find: Cabaça South Oct. 2010); Deep-water (400-1,500 m); Light crude (34 API)	-	11%

⁴¹⁹ Later renamed 3/05 and 3/05-A, and which were awarded to China Sonangol instead In 2007 these stakes were for a brief period handed over to SSI, according to A. Vines et al., *op. cit.*, August 2009, p. 44.

⁴²⁰ Technical problems with Greater Plutonio FPSO, brought down the production in 2010, estimated at around 90,000 bpd. The problem is expected to be solved by mid 2011.

⁴²¹ According to data in the Angolan Ministry of Finance website, "Exportacoes e receitas de petroleo (2010): receitas consolidadas", available online at: <http://www.minfin.gv.ao/docs/dspPetrolDiamond.htm> (accessed 7 March 2011).

⁴²² Bloomberg, "Sinopec buys Angola oil stake; sees refining challenges", 28 March 2010, available online at: <http://www.businessweek.com/news/2010-03-28/sinopec-buys-angolan-field-stake-warns-of-refining-challenges.html> (Accessed 5 December 2010)

27.5% Block 17/06 2006	Op. Total 26%; Sonangol E.P. 24%; Falcon Oil 5%; ACR 5%; Partex 2.5%; Somoil 10%	1bn	(Total S.B: US\$1.1bn) SSI share: SB: US\$398 mn Soc.B: US\$32 mn	Exploration phase (largest find: Begonia, Apr. 2010); Deep-water (600-1,900 m); Light crude (36 API)	-	15.3%
40% Block 18/06 2006	Op. Petrobras 30%; Sonangol E.P. 20%; Falcon Oil 5%; Gemasp 5%	700 mn	(Total SB US\$1.1bn) SSI share: SB: US\$540 mn Soc.B: US\$50 mn	Exploration phase (Largest find: Magnesium-01, Nov. 2009); Deep-water (750-1750 m); Medium crude (API around 20s)	-	22%
Total	-	-	US\$2.64 bn (approx.)	-	-	Reserves: 972 million barrels Production: 44,000 bpd

*Refers to potential reserves estimates by Sonangol and other operators.

** All participants have to pay the equivalent to their respective share in the block, plus Sonangol's share divided by all.

*** This figure is merely indicative, as the effective final number of oil barrels varies according to the profit oil margin that is due to the government, and which depends on oil price.

Sources: Ministério dos Petróleos de Angola; Africa Energy Intelligence; EIA; Sonangol; ENI; Total; Petrobras; various news reports (Upstream online, Offshore, Oil & Gas, Bloomberg).

When the blocks acquired in 2006 (Blocks 15/06, 17/06 and 18/06) whose combined potential reserves are estimated at 3.2 billion barrels⁴²³ come on stream (2013-2015), Sinopec's production may well expand to over 100,000 bpd.⁴²⁴

4.2.2. The souring of relations

The honeymoon between the Angolan and Chinese NOCs was, however, of short duration. Sonangol-Sinopec relations suffered an initial backslide during the 2006 tender following a misunderstanding over the signature bonus.⁴²⁵ On the brink of bid submission, SSI realised, through contacts in petroleum circles in Luanda, that the bonuses would be much higher than expected, and alerted Sinopec to this fact. When the bids were known, Sinopec realised that its offers had exceeded the highest by about USD150 million. Unhappy about this fact, the Chinese NOC pressurised Sonangol for its bonuses to be lowered to the

⁴²³ Agência Lusa - Shanghai office, "Petrolífera chinesa obtém áreas de exploração em Angola", 13 June 2006, <http://www.agencialusa.com.br/gpdf.php?iden=1877> (Accessed 8 November 2008)

⁴²⁴ AFX News Limited, "China's Sinopec wins bid for stakes in Angola oil blocks", 13 June 2006, available online at: <http://www.forbes.com/feeds/afx/2006/06/12/afx2810979.html> (Accessed 8 November 2008)

⁴²⁵ Interview, Angolan oil sector expert, Luanda, Angola, 1 February 2011.

highest value offered by other companies. Discontent with the mounting pressure from the Chinese side, Sonangol temporarily moved these assets (Blocks 15/06, 17/06 and 18/06) to China Sonangol and started inviting other companies to take over those stakes. Faced with the prospect of the eminent loss of that equity, Sinopec immediately took the bonuses and the assets were moved back to SSI.⁴²⁶ According to Wood Mackenzie, the bids paid for during this round were at the time the highest ever offered for oil acreage anywhere in the world.⁴²⁷ The bidding level had supposedly been pushed up by Sinopec, which allegedly offered US\$2.2bn in signature bonuses for the acquisition of blocks 17/06 and 18/06. Shortly after the bidding round, Vice-Premier Wen Jiabao visited Angola (2006, June 20-21).

The following year another episode damaged further the relationship. In accordance with the prerequisites for the blocks 15/06 17/06 and 18/06, Sonangol and Sinopec signed in March 2006 a partnership agreement to develop a Refinery (Sonaref).⁴²⁸ The negotiations over the details of the project started shortly afterwards. The refinery had long been on the agenda of the government, since Luanda imports 70% of its refined fuel.⁴²⁹ Angola has only one small refinery, located in Luanda, which is operating at half of its capacity (39,000 bpd),⁴³⁰ and is thus largely insufficient to supply the booming economy.

The US\$3.5bn refinery to be built in Lobito (near the southern city of Benguela), and with a capacity to process 200,000 bpd (in which Sonangol held 70% and Sinopec 30%), was projected to start operations in 2010. The technical development of the project had been awarded in 2000 to Korea's Samsung, but the lack of funding kept the project from starting. Under the agreement, Sinopec was to fund the totality of the project,⁴³¹ the second largest downstream project after Angola's new LNG plant (US\$5 bn).

Despite the favourable framework laid down by the previous ventures and the favouritism Sinopec clearly enjoyed amongst the Angolan executive,⁴³² negotiations stalled in January 2007, and the whole project collapsed in March 2007. Reports on the media at the time point to a sharp disagreement over which

⁴²⁶ Interview, Angolan oil sector expert, Luanda, Angola, 1 February 2011.

⁴²⁷ Stanley Reed, "A Bidding Frenzy for Angola's Oil", 7 June 2006, available online at: http://www.businessweek.com/globalbiz/content/jun2006/gb20060607_581473.htm (Accessed 8 November 2008)

⁴²⁸ Agência Lusa, "Refinaria do Lobito pode estar operacional em 2010", 5 December 2005, available online at: http://www.angonoticias.com/full_headlines.php?id=7938&b (Accessed 8 November 2008)

⁴²⁹ Sonangol Universo, "Sonangol 35 year milestone of success beckons", in: *Sonangol Universo*, December 2010, p. 39.

⁴³⁰ Rogério Oliveira, "Petroleio: 100 anos de exploracao", *Sonangol*, October 2010, p. 27.

⁴³¹ Angop, "Sonangol rubrica acordo para desenvolvimento da refinaria do Lobito", 16 March 2006, http://www.angonoticias.com/full_headlines.php?id=9228&b (Accessed 8 November 2008).

⁴³² According to reports, Angola's elite preferred to seal the business with Sinopec instead of ONGC, that had also run for this project. Projects Today, "ONGC bids for refinery project in Angola", 1 November 2005, available online at: <http://www.projectstoday.com/News/NewsDetails.aspx?smid=16&nid=14266> (Accessed 8 November 2008).

supply market to target. In a press conference held on February 23, the head of Sonangol publically admitted “we have reached a point where we cannot make concessions - we cannot build a refinery to produce for the Chinese market.”⁴³³ Various field interviews conducted both in China and in Angola⁴³⁴ corroborated this. More specifically, the point of disagreement was on the technology to be used which, because of different specifications in Asia and the West, would limit from the start, the supply markets. While Beijing wanted to supply the Chinese market, Luanda envisaged supply its own domestic market and western markets (US and Europe). The reason for this disagreement was purely commercial. From the Angolan perspective, the profit margin would be much slimmer in exporting to Asia, due to longer distances (transport costs) and the fact that fuel is highly subsidised in most markets there, including China. In contrast, exporting to western markets will ensure bigger profit margins, due to proximity and higher fuel prices in these markets.

Some of the interviewees (in China and in Angola in 2008 and 2009) gave some further insight into the Chinese perspective, advancing that although the technology to apply was publicly presented as the major issue, Sinopec was from the start not really interested in the refinery project, having become involved only to please the Angolan government, who had linked the refinery project to the concession blocks (2006). The reason why they were not so interested is unclear though. It could have been because the profit prospects were very low, since petrol prices are controlled and highly subsidised in Angola. The alleged limited interest of Sinopec would have decreased during the negotiations owing to the narrowing prospect of profit given that Sonangol planned to construct a highly sophisticated refinery with technology that Sinopec does not have at its disposal. This fact would substantially inflate the project cost as it would make it unviable from the outset to contract subsidiaries of Sinopec in favour of Western companies. Within this context, the project would be less advantageous to Sinopec as it planned to capitalise not only on marketing of the products, but on loan interest and project construction.

Lastly, the location of the Lobito refinery seems to also raise serious techno-logistical challenges, which would add to the cost. In this context, Sinopec may have found in the technological question a way out of a deal it was not really interested in - without ‘losing face’. Furthermore, the fact that no other investor stepped forward to help finance this particular project, whilst in the midst of high oil prices and Angolan

⁴³³ Sousa Neto, “Sonangol incompatibiliza-se com Chineses e Franceses”, 3 March 2007, available online at: http://www.angonoticias.com/full_headlines.php?id=13633<b (Accessed 8 November 2008).

⁴³⁴ Various Interviews, private and public sector, Luanda, Angola, January to March, 2008, March 2009, and in China and Macau in October-December 2007.

efforts,⁴³⁵ further attests to this interpretation. What most analysts interpreted as a show-case of strength of the Angolan government⁴³⁶ in the face of a growing presence of China in key economic sectors (construction and oil), might thus in the end have been just a pragmatic withdrawal of the Chinese.

In the end, backed by increasing oil revenue, the Angolan government decided to go ahead alone with the project. In late 2008 the technical execution of the project was awarded to an American company, Kellogg Brown & Root (KBR),⁴³⁷ with the cost of the project increased to US\$8bn and with production (200,000 bpd) projected to start in 2015.⁴³⁸

By late 2007, as a sign of souring relations, Sinopec Overseas Oil & Gas renounced its rights to the new blocks it had acquired in 2006 through SSI, and the existing stakes were handed over to China Sonangol⁴³⁹ - the minor shareholder of SSI. After a period, the three stakes were respectively placed under SSI Fifteen, SSI Seventeen and SSI Eighteen.

Sinopec did, however, underestimate the impact this episode would have in the pursuit of its oil security interests in such a centralised political environment, especially in a high oil price context.

4.2.3. Efforts rebuffed and an attempt at rebalancing

Despite this unexpected hindrance, Sinopec Group continued in its quest to expand its oil equity in Angola. Only a few months after calling off the Sonaref partnership, Sinopec entered the oil bid opened later that year (2007). Evidencing the straining of relations with Sonangol, Sinopec placed a separate bid to SSI. Owing to the latest developments, in Sinopec's perspective the JV had become counter-productive, limiting therefore its prospects in the industry.

The list of pre-qualified companies included Sinopec International Group (as an operator) and SSI (as a non-operator).⁴⁴⁰ The oil round was, however, frozen in mid 2008, initially due to coming legislative

⁴³⁵ According to the US Embassy in Angola, Chevron was briefly interested on this project, but after studying the dossier pulled out due to its unviable nature. Interview, US Embassy in Angola, Luanda, Angola, 17 March 2009.

⁴³⁶ Lucy Corkin, "Angola flexes newfound muscle", in *Business day*, 23 March 2007, available online at: <http://www.ccs.org.za/downloads/Angola%20flexes%20newfound%20muscle%20-%20Business%20Day%20-%2023032007.pdf> (Accessed 8 November 2008).

⁴³⁷ Angop, "Sonagol e KBR assinam acordo para a criação da refinaria do Lobito", 6 November 2008, available online at: http://www.angonoticias.com/full_headlines.php?id=21566&b (Accessed 8 November 2008).

⁴³⁸ Germano Gomes, "Feira Internacional de Luanda consolidou prestígio", *Sonangol*, October 2010, p. 16.

⁴³⁹ Interview, Private Law Firm, Luanda, Angola, March 31, 2008.

⁴⁴⁰ To see the list of pre-qualified companies, see Sonangol's website: <http://www.sonangol.co.ao> (accessed 8 February 2011)

elections (September 2008), and after that due to the global economic downturn. Despite the upturn trend in oil prices in 2010, its reopening remains uncertain.

In late 2008, Sinopec made another attempt to secure acreage in the Angolan oil industry, divorced from Sonangol. For this purpose, Sinopec joined hands with CNOOC to bid for a 20% stake in ultra-deep water oil block 32⁴⁴¹ (operated by Total), that was being relinquished by the American oil company Marathon in the midst of the financial crisis. The joint offer by Sinopec and CNOOC (US\$1.3bn), out-bid rival bids from ONGC, Petrobras and even another Chinese NOC: CNPC. The final deal was reached between Sinopec/CNOOC and Marathon in July 2009, and was expected to be closed at year end.⁴⁴² Nevertheless, and corroborating what a source close to the Presidency and Sonangol had suggested earlier that year,⁴⁴³ in September 2009 Sonangol made public its intention to exert its right of first refusal,⁴⁴⁴ blocking the access of the Chinese NOCs to this asset.

According to the source mentioned above, this move was purely based on market considerations by Sonangol, as the stake was being sold at a much lower price than its real value (valued at US\$1.4-1.6bn by Goldman-Sachs, and Marathon had originally tagged the stake at US\$2bn). Whether the change of attitude on the part of Sonangol was still a consequence of Sinopec's withdrawal from the Sonaref project in 2007, or was just a move to protect the market and avoid the decline of oil stakes prices,⁴⁴⁵ remains unclear.⁴⁴⁶ Nevertheless, the important message is that there was an evident change in the relationship between Sinopec and Sonangol after that episode. If in 2004 Sonangol used its pre-emption rights to benefit Sinopec, the same expedient was now being used to prevent Chinese companies from accessing acreage, which is all the more striking taking into consideration the economic crisis context. Sonangol bought the 20% stake from Marathon in February 2010 for US\$1.3bn, aiming at selling the equity for a

⁴⁴¹ A promising investment with estimated recoverable reserves of 1.5 billion barrels of light crude.

⁴⁴² Marathon Press release, "Marathon Announces \$1.3 Billion Sale of 20 Percent Interest in Angola Block 32", 17 July 2009, available online at: http://www.marathon.com/News/Press_Releases/Press_Release/?id=1308708 (accessed 8 February 2011)

⁴⁴³ Interview, Private International Law Firm, Luanda, Angola, 17 March 2009.

⁴⁴⁴ Benoit Faucon, Dow Jones Newswires, "Sonangol wants to Block Marathon's share to China", 11 September 2009, available online at: <http://online.wsj.com/article/BT-CO-20090911-713371.html> (accessed 5 December 2010)

⁴⁴⁵ Indeed, if Chinese oil companies were paying above the odds and pushing the market up before the crisis, they were now bringing it down by, in the context of the crisis, bargaining in a market where its competitors' financial capacity had contracted significantly.

⁴⁴⁶ Based on the interviews conducted in Luanda (March 2009) and reports by the media, there seems to be a dividing line between government officials or individuals close to the executive and external observers (civil society), concerning the nature of the changing relationship between Sonangol and Sinopec. The first group denies any political change and reinforces market-oriented considerations, and the second one conveys a souring relationship perspective - drawing from the Sonaref episode.

better price when the market was more favourable.⁴⁴⁷ This asset currently (December 2011) appears in Sonangol's concessions map under China Sonangol.

The successful acquisition of 20% in block 32 would have made a significant addition to Sinopec's oil assets in Angola, by adding access to another 1.5 billion barrels estimated reserves⁴⁴⁸ and 130,000 bpd,⁴⁴⁹ when the project comes online in 2014/15. That stake in block 32 would have added an estimated 26,000 bpd to Sinopec's oil production in Angola.

Despite all the efforts, Sinopec's attempts to venture into the Angolan oil sector divorced from Sonangol in the period 2007-2009, produced thus no equity. This contrasts sharply with the previous period (2004-2006), when the Sinopec-Sonangol connection was thriving, having granted Sinopec access to important acreage.

In face of this, and having been kept out of the closed tender for the Angolan pre-salt (2010-2011) and with slim prospects of open tenders in the near future, Sinopec came to the conclusion that its best chance to expand its acreage in the Angolan oil industry lies in the partnership with Sonangol. In March 2010 Sinopec International (listed arm of Sinopec Group - China Petrochemical Corporation) acquired from its parent company the 55% controlling stake in SSI, which was under Sinopec Overseas Oil and Gas. The deal totalled US\$2.46bn, US\$0.76bn of which was debts owed by SSI to SOOG.⁴⁵⁰ This move clearly indicates Sinopec's willingness to revamp the JV with Sonangol, by replacing the Cayman Island registered SOOG with the much higher profile Hong Kong-listed arm of the Sinopec Group.

This reorganisation exercise by Sinopec took place at the same time that negotiations between Luanda and Beijing were starting for the extension of the new infrastructure-for-oil loans (end 2009/early 2010). Even though it remains unclear to what extent these two developments were coordinated, they point nonetheless to China's return to the same formula that had worked so well in 2004, as a means to improve its prospects in the Angolan oil industry.

⁴⁴⁷ Upstream, "Marathon wraps up block 32 sale", 9 February 2010, available online at: <http://www.upstreamonline.com/live/article205997.ece> (accessed 5 December 2010).

⁴⁴⁸ Africa-Asia Confidential, "Luanda diversifies its portfolio", 23 September 2009, available online at: http://pambazuka.org/en/category/africa_china/58957 (accessed 5 December 2010).

⁴⁴⁹ EIA, "Angola Country Analysis Brief", March 2008, available online at: <http://www.eia.doe.gov/cabs/Angola/Oil.html> (accessed 8 November 2008)

⁴⁵⁰ Scandinavian Oil and Gas, "Sinopec to acquire a stake in block 18, Angola", 2 April 2010, available online at: <http://www.scandoil.com/moxie-bm2/news/sinopec-to-acquire-a-stake-in-block-18-angola.shtml> (accessed 5 December 2010)

In sharp contrast with Sinopec’s frustrated attempts, China-Sonangol⁴⁵¹ was awarded significant equity in 2010 and 2011 (see table 4.3. below) in the context of the estrangement of relations between Sonangol and Sinopec. Even though Sinopec had an earlier start (2004, 50% in block 18) with acreage in deep waters, its last acquisitions dated back to 2006. China Sonangol, on the other hand, whose acreage started in 2006 with two stakes in shallow waters, had gained access in 2010 to two relinquished stakes in ultra-deep waters, one of them at the expense of Sinopec (the Marathon 20% stake in block 32). In addition to this, China Sonangol was listed as one of the winners in the first licensing round for the Angolan pre-salt area,⁴⁵² having been awarded in January 2011 stakes in four (blocks 19, 20, 36 and 38) out of the eleven blocks on offer.

Table 4.3. China Sonangol (CSIH) and SSI oil acreage in Angola

<i>China Sonangol</i>	<i>Year</i>	<i>Location</i>	<i>SSI</i>	<i>Year</i>	<i>Location</i>
25% block 3/05A 25% block 3/05	2006 (oil bid)	Shallow waters	50% block 18 (from Shell)	2004 (blocks being relinquished)	Deep water
5% block 31 (from TEPA) 20% block 32 (from Marathon)	2010 (blocks being relinquished)	Ultra Deep Waters	20% block 15/06 27.5 block 17/06	2006 (oil bid)	
10% block 19 10% block 20 20% block 36 15% block 38	2011 (oil bid)	Pre-Salt	40% block 18/06		

Source: Sonangol Concessions Map (December 2011); interview (Luanda, 3 February 2011) for blocks acquired in 2011.

Unlike China Sonangol, Sinopec was not part of the companies shortlisted by Sonangol to bid for the pre-salt, nor was SSI. Meaningfully, the only company with no relevant experience awarded acreage in this licensing round, was China Sonangol. Most acreage of the two companies, however, is still in the development phase. Only block 3/05 (China Sonangol) and block 18 (SSI) are currently on stream, with a

⁴⁵¹ 30% Sonangol capital and 70% private Chinese capital from Hong Kong.

⁴⁵² Benoit Faucon and Isabel Ordonez, “Angola awards oil rights in new frontier area”, Dow Jones Newswires, available online at: http://www.advn.com/news_UPDATE-Angola-Awards-Oil-Rights-In-New-Frontier-Area_46147521.html (accessed 26 January 2011)

production of 48,000 bpd and 160,000 bpd, respectively, in 2009.⁴⁵³ According to the Angolan Ministry of Petroleum,⁴⁵⁴ SSI ranks seven out of the 21 companies exporting oil in Angola.

Table 4.4. China Sonangol and SSI shares in Angolan oil exports

		2006	2007	2008	2009
China Sonangol	Thousand barrels	1,970	2,955	985	1,969
	Thousand US\$	128,022	210,643	115,537	143,519
SSI	Thousand barrels	0	3,924	25,581	25,851
	Thousand US\$	0	339,664	2,430,181	1,607,896
Angola Total	Thousand barrels	495,919	605,482	675,024	646,938
	Thousand US\$	30,393,320	42,357,156	62,401,503	39,219,541

Source: Angolan Ministry of Petroleum, *Oil Sector Report 2009*, July 2010.

As demonstrated in the table 4.4 (above), despite the setback in recent years regarding the acquisition of new acreage, Sinopec is in fact drawing much more profit from its operations in Angola, than China Sonangol is. Sinopec owes this to its very first oil acreage in Angola in block 18, acquired as collateral to the first EXIM Bank infrastructure-for-oil loan.

The above analysis reveals an interesting Sonangol - SSI - China Sonangol dynamic. Whenever misunderstandings arise between Sinopec and Sonangol, the blocks are temporarily transferred to China Sonangol (as demonstrated in the bonus and Sonaref episodes) and when resolved, the assets return to SSI. Unconfirmed reports citing the adjunct-director of SSI (a senior Sonangol official),⁴⁵⁵ point to the possible transferral of China Sonangol's acreage (with the exception of blocks 3/05 and 3/05A) to Sonangol Sinopec International in the near future as soon as relations with the Angolan NOC warm up again. In line with this, China's infrastructure for-oil-loans may still be the most efficient economic statecraft instrument to pursue Chinese oil security interests in Angola.

⁴⁵³ Ministerio dos Petroleos, Departamento de Planeamento e Estatistica, *Relatorio de actividades do Sector Petrolifero relativo ao ano 2009* (Luanda: Ministerio dos Petroleos, August 2010) p.15.

⁴⁵⁴ Ministerio dos Petroleos, *Ibid.*, p.15.

⁴⁵⁵ Interview, Angolan oil sector expert, Luanda, Angola, 1 February 2011.

4.3. Chapter conclusions

The intensifying relations between China and Angola are mostly explained by the emergence of growing economic complementarities in the post conflict phase. The launching of China's 'going out' policy, inspired by its expanding financial might and growing thirst for markets and resources, coincided with the end of the civil war in Angola in 2002, its national reconstruction urge and rising crude oil output. This set the stage for the astounding expansion of China-Angola economic relations seen in recent years.

These matching conditions are at the very foundation of the contemporary China-Angola relationship. Having, at an early stage, correctly identified infrastructure development as a critical need of post-conflict Angola, Beijing offered to fund the government's reconstruction project in exchange for access to equity and a long term oil supply. Building on this infrastructure-for-oil formula, China's engagement with Angola became naturally most evident in the sectors that have been driving Angola's rapid economic growth in recent years: infrastructure construction and the oil industry.

As a result, in less than a decade, China managed to carve out a prominent position in Angola's economy, namely as its largest trading partner, a major provider of funds, and the largest operator in the country's reconstruction project. Even though not so evident at first sight, a closer look reveals that the oil factor pervades all aspects of China's economic engagement in Angola, as oil imports account for the bulk of bilateral trade, credit lines for infrastructure are backed by oil, and the largest share of Chinese investment in the country is directed towards the oil industry. This scenario demonstrates the centrality of oil factor in China-Angola relations, and the key the role infrastructure-for-oil formula plays in pursuing its energy security goals in Angola.

As demonstrated above, the specificities of this formula and the perfect timing of the first credit line were critical in allowing China to engage in the oil industry in Angola. It generated the necessary goodwill among the highly centralised political elite in Luanda, to facilitate Sinopec's debut in the oil sector in Angola in 2004/2005, which led to its linkage to a network structured around personal connections rooted in Hong Kong. This granted the company direct access to the top echelons of Sonangol and the Presidency, which proved vital in such a highly centralised and personalised institutional framework. This 'guanxi' network, whose interests in Angola are driven by Sonangol, is a key factor in understanding Sinopec's success in the country.

In only two years (2004-2006), Sinopec amassed significant oil acreage, having secured access to reserves of nearly 1 billion barrels in some of the most promising Angolan deep-water blocks. All four stakes

Sinopec accessed were in deep-water blocks adjacent to the current major producing blocks (15 and 17), and were acquired through its 55% share in SSI. In addition, it has also secured a considerable amount of its oil supply through the repayment of credit lines and also by being the off taker of the loan for development of block 18.

Nevertheless, the ‘bonuses’ episode in 2006 and the Sonaref debacle in 2007, undermined China’s relations with Sonangol, and as a result Sinopec struggled to make further acquisitions on its own in the sector afterwards. In the context of strained relations with Sonangol, Sinopec has pursued all available ways to access, on its own, more oil acreage in Angola’s oil sector - but to no avail. Against this background, Beijing is again trying to revamp the JV with Sinopec, and to boost the goodwill of Angola’s political elite through the extension of new infrastructure-for-oil credit lines.

Despite the setbacks underlined above, China’s oil diplomacy in Angola can thus be said to have been relatively successful in achieving the two main goals of Beijing’s oil diplomacy in Angola. Not only has it secured access to important oil acreage but also long term oil supply. The following chapter will analyse how the same type of economic inducement was performed in the Brazilian context.

CHAPTER 5: CHINA'S OIL DIPLOMACY IN BRAZIL

This chapter provides an in-depth analysis of the second case study, Brazil. In line with the previous chapter, it examines China-Brazil relations from the perspective of Beijing's economic statecraft performance in relation to its energy security goals. In order to facilitate the comparison, the chapter is structured in a very similar way to chapter four. Firstly, a brief historical background of China-Brazil relations over three different periods marked by the setting up of foundations (1970s and 1980s), a stagnant stage in the 1990s, and a flourishing phase in the 2000s are discussed. Secondly, a detailed study of the most relevant features of bilateral relations in the present phase is presented, aimed at stressing the much more advanced institutionalisation stage of the dialogue and the increasing relevance of the oil factor in relations in recent years. Thirdly, the chapter considers the infrastructure and resources sectors as the least developed dimension of the relationship, in spite of evidence of strong mutual interest. Finally, an evolving picture of China's struggle to achieve its energy security goals in Brazil is presented, and how China finally managed to succeed in this by the end of the decade, in the context of the global financial crisis.

The overall aim of this chapter is to emphasise the unsuccessful deployment of China's economic inducements in Brazil throughout most of the decade, and how the onset of the global economic downturn in 2008 gradually changed this situation.

5.1. Contextualising China-Brazil relations

5.1.1. Historical background⁴⁵⁶

Brazil-China diplomatic relations can be traced back to the late 19th century, when Brazil sent a diplomatic mission to China in 1879, aimed at attracting Chinese emigration to work in Brazilian plantations. Beijing, however, forbade Chinese emigration to Brazil, due to ill treatment of its emigrants in other parts of America (US, Cuba and Peru). Notwithstanding this, in the context of the 'unequal

⁴⁵⁶ Unless otherwise stated, information in this section is according to: Danielly S. R. Becard, *O Brasil e República Popular da China: política externa comparada e relações bilaterais 1974-2004* (Brasília: Fundação Alexandre Gusmão, 2008). This is currently the most comprehensive study on the history of Brazil-China relations.

treaties',⁴⁵⁷ Brazil got China to sign a treaty of friendship, trade and navigation in 1881, which led to the opening of a Brazilian consulate in Shanghai in 1883. The establishment of the PRC in 1949 by Mao Zedong, led to the severing of diplomatic relations, the closure of the Shanghai consulate and the opening of an embassy in Taipei in 1952.⁴⁵⁸ Although some isolated political and economic rapprochement attempts were made with the mainland, bilateral relations remained frozen for the following twenty two years. While China was at this time fighting for the leadership of the communist world, Brazil was a capitalist developmental state in the US orbit.

The first attempt to improve relations with China took place under President Jânio Quadros. An entrepreneurial delegation was sent to China in August 1961, headed by Vice-President João Goulart, the first Latin American government official ever to visit China. This prelude was postponed for another decade by a coup in 1 April 1964, that overthrew President J. Goulart and installed a military dictatorship.

a) Gradually setting up the foundations (1970s and 1980s)

Although the military dictatorship had at first repudiated revolutionary China, developments in the early 1970s determined a gradual relaxation of its policy towards Beijing, that would culminate in the establishment of diplomatic ties on 15 August 1974. This was to a great extent a product of US-China political rapprochement, and China's accession to the UN in 1971. The new context paved the way for overcoming the ideological obstacles, and led finally to the pragmatic embrace of their shared interests. In the sequence of an exchange of business/trade delegations in 1974, diplomatic ties were formally established in August of that year.

Trade figures showed a meaningful increase which led to the signing of the first bilateral trade agreement in January 1978. By the end of that decade, over 40% of Chinese imports from Brazil were mining and metallurgic products, and 95% of Brazilian imports from China was oil. The large share of oil in Chinese exports to Brazil became a pattern in the following decade and an important factor in relations.⁴⁵⁹

It was in this context that the Brazilian Minister for Foreign Affairs, Ramiro Saraiva Guerreiro, headed a mission to China in March 1982, with the purpose of promoting Braspetro's (international arm of

⁴⁵⁷ This category includes all treaties that China was forced to sign with foreign powers in the wake of the Opium Wars in the 19th century. These treaties forced Beijing to grant most favoured nation treatment and extra-territoriality privileges to its western counterparts.

⁴⁵⁸ Henrique Altemani de Oliveira, "Brazil-China: trinta anos de uma parceria estratégica", in: *Revista Brasileira de Política Internacional* 47: 1, 2004, pp. 10-11.

⁴⁵⁹ Figures in this paragraph according to Danielly S. R. Becard, *op. cit.*, pp. 72-78.

Petrobras) participation in exploration of the Chinese offshore.⁴⁶⁰ This signalled the start of a long standing interest of Petrobras in oil exploration in China's offshore, that remains unmet until the present day, and which explains to some extent, the dynamics between the Brazilian NOC and the Chinese NOCs at the present.

The sharing of the same international aims and similar national development projects, led to the diversification of Brazil-China relations in the 1980s. This decade saw the signing of 22 inter-governmental agreements between the two countries,⁴⁶¹ most of which were inked during high level bilateral exchanges. The agreements ranged from scientific and technological collaboration in many different areas (including metallurgy, transportation, industrial technology, pharmacy and traditional medicine, power generation, research and the production of satellites) - to political, economic, commercial, military, cultural and educational cooperation. These laid down, not only the basis of a comprehensive bilateral dialogue, but also the fundamental traits that still define bilateral relations at present.

Following a considerable rise in bilateral trade flows in the first half of the 1980s (from US\$316 mn in 1980, to US\$1.2bn in 1985)⁴⁶² trade volume decreased significantly towards the end of the decade (US\$756mn in 1989). Oil imports from China also declined substantially (98% of total imports in 1987 to 51% in 1989) as a result of both China's decreasing surplus production and Brazil's rising oil output. The expansion of bilateral trade was halted mainly by the high cost of transportation, which impacted negatively the competitiveness of Brazilian goods, and the poor infrastructure on the Chinese side - namely the insufficient capacity of its railroads and ports to receive large ships, affecting in particular Brazilian mining exports to China.⁴⁶³

b) Stagnation and rebound (1990s)

The economic and political reforms affecting both countries in the late 1980s led to a temporary inward looking phase and the subsequent stagnation of bilateral relations. Attempting to recover the credibility lost throughout the 1980s (indebtedness and macro-economic instability), Brazil gave preference to developed countries over alternative alliances in its external relations. In the same way, China also

⁴⁶⁰ See: João Figueira, "Petróleo no Brasil e na China e possibilidades de cooperação", in: Samuel Pinheiro Guimarães (ed.), *Multipolaridade Brasil-China* (Brasília: IPRI/FUNAG, 2003) pp. 143-148.

⁴⁶¹ According to: Brazilian Ministry of Foreign Affairs, "Atos em vigor assinados com a República popular da China", available online at: <http://www2.mre.gov.br/dai/bichina.htm> (accessed 8 February 2010)

⁴⁶² Of these, US\$400 mn were Chinese oil exports to Brazil and US\$640mn were China mining and metallurgical products imports from there.

⁴⁶³ All figures and information in this paragraph is according to: Danielly Becard, *op. cit.* (2008), pp. 121-126.

prioritised its relations with developed countries, aiming at attracting much needed investment and technology, as well as fostering trade flows upon which its modernisation process was dependent. In this context, China and Brazil failed to address the bottlenecks affecting bilateral trade and cooperation. As a result, and although official exchanges at the highest level were never interrupted,⁴⁶⁴ commercial relations deteriorated even further, and scientific and technological cooperation declined due to a lack of funding. With exports and imports declining steadily from 1985 (US\$1.2bn) onwards, commercial exchanges reached the lowest level in 1991 (US\$355mn).⁴⁶⁵

After President Itamar Franco took office in 1992, an active effort was made to reverse this scenario. This was matched by China's eagerness to strengthen ties with LA in the wake of Tiananmen. The flow of Chinese high representatives to Brazil in the following year is clearly indicative of the relevance Brazil had assumed in that context (see table 5.1. below). Important cooperation agreements were signed, with special emphasis in the revitalisation of the joint satellite project, hydro-electric technological cooperation, the intention to foster iron ore exports to China, and the joint exploration of iron ore reserves. As a result, bilateral trade doubled from 1992 to 1993, exceeding again the US\$1bn mark. While Brazilian exports to China continued to be concentrated in a few items, namely iron ore, metallurgical products and soya oil, imports from China diversified slightly in this period.

Aside from the renewed dynamism in bilateral political and economic relations, political dialogue with China was also reinforced within multilateral *fora* framed by the new ambitions of both countries. This included China's accession to the WTO and Brazil's willingness to become a permanent member of the United Nations Security Council. Reflecting both countries willingness to upgrade relations, a long term strategic partnership agreement was signed during President Jiang Zemin's visit to Brazil in November 1993.

In Brazil, President F. Henrique Cardoso (FHC, 1995-2002) made a serious effort to revitalise the relationship with China, having paid an official visit to China (12-17 December 1995) in the first year of his mandate. Nevertheless, and even though significant results were achieved in other areas - namely the successful launching of the first Sino-Brazilian satellite in 1999 - bilateral trade remained stable at just above US\$2bn until 1997, and fell to US\$1.5bn in 1999. This was mostly the result of an unfortunate combination of factors: the impact of the Asian financial crisis on the Chinese side, and the collapse in Brazilian exports due to the overvaluation of the Brazilian currency under the 'Plano Real'. This led to a

⁴⁶⁴ President Yang Shangkun visited Brazil in May/June 1990, only a year after Tiananmen.

⁴⁶⁵ MDIC/SECEX, "intercambio Comercial Brasil-China", available online at: <http://www.desenvolvimento.gov.br> (accessed 6 February 2011)

trade deficit with China for five consecutive years (1996 -2000). While Chinese exports to Brazil remained more or less stable at around US\$1bn over this period, Brazilian exports to China fell to almost half of the 1995 level (US\$1.2bn), reaching US\$676mn in 1999.⁴⁶⁶

Both countries realised, at this stage, the potential of a closer alliance, not only regarding the long-standing goal of developing an independent policy *vis à vis* the traditional powers, but also in promoting economic synergies to advance their economic and scientific development. Nevertheless, it was not until the turn of the century, that bilateral relations started to come to real fruition. Indeed ten years after the establishment of the ‘strategic partnership’, its full meaning and the mechanisms to develop the partnership remained much undefined, as pointed out by Henrique Altemani.⁴⁶⁷

5.1.2. Bilateral relations in the 2000s

By the early 2000s, China’s dramatic economic expansion had already produced significant political clout at the world stage, elevating it to the status of a great power in the making. At this time, China’s economic scope was expanding to a global level - in search of capital, technology and commodities to fuel its growth. The gradual stabilization of the Brazilian economy towards the end of the decade (resulting from the economic monetary reform initiated in 1994 with ‘Plano Real’) coincided thus with the start of China’s quest for new markets and commodities supply sources overseas. In this context, China assumed an increasingly critical role in Brazil’s foreign relations under FHC, and his successor Lula da Silva.⁴⁶⁸

The increased pro-activeness of Brazil towards China became particularly evident under President Lula (January 2003-2010), who perceived this partnership as a critical means to boost Brazil’s economic expansion and political leverage at the world stage. The core issue on Lula’s bilateral agenda, rapidly became the push for a greater dynamism of the economic and commercial features of the relationship, but in a way that would better suit Brazil’s economic interests.

This flourishing phase in bilateral relations was accompanied by the intensification of high ranking bilateral exchanges, the institutionalisation of bilateral dialogue mechanisms and instruments, and a dramatic expansion in the volume of trade.

5.1.2.1. Revamping political ties

⁴⁶⁶ MDIC/SECEX, *Ibid.*

⁴⁶⁷ H. Altemani, *op. cit.* (2004), p. 18.

⁴⁶⁸ Alexandre C. Leite, “As Relações Comerciais entre Brasil e China de 1979 a 2008: Lições de Estratégia Política e Económica”, p. 20, paper presented at: International Seminar on China, India and Latin America: Economy, Strategy and Foreign Policy, 19-21 June 2009, Rio de Janeiro, Brazil.

Table 5.1 (below) provides a snapshot of the high level bilateral exchanges between the two countries over the last five decades. The table illustrates the periods in which exchange was more intense: the early 1990s, around 2004 and after a few years break, exchanges seem to have resumed again in the context of the world economic crisis.

Table 5.1. Selected China-Brazil high ranking official bilateral exchanges (1961-2010)

Chinese Government dignitaries official visits to Brazil		Brazil Government dignitaries official visits to China	
<i>Year</i>	<i>Name and rank</i>	<i>Year</i>	<i>Name and rank</i>
-	-	August 1961	Vice President J. Goulart
October 1985	Premier Zhao Zyang	March 1982	Foreign Affairs Minister J. Batista Figueiredo
May 1990	President Yang Shangkun	July 1988	President Jose Sarney
March 1993	Foreign Affairs Minister Qian Qichen	December 1995	President F. Henrique Cardos
May 1993	Vice-Premier Zhu Rongji		
November 1993	President Jiang Zemin		
November 2004	President Hu Jintao	May 2004	President Lula da Silva
January 2009	Foreign Affairs Minister Yang Jiechi	May 2009	President Lula da Silva
February 2009	Vice-President Xi Jinping		
March 2010	President Hu Jintao	April 2011	President Dilma Russeff
(2 nd half 2011)	(Premier Wen Jiabao)		

Source: Elaborated by the candidate with data collected from: <http://www.chinavitae.com> ; <http://www.macauhub.com.mo> and <http://www.forumchinaplp.org.mo>

In May 2004, the year both countries celebrated the 30th anniversary of bilateral relations, President Lula headed a mission of 430 delegates to China, the largest in his first mandate. President Lula set, as his main task, the strengthening of the economic-commercial axis, namely through the expansion of bilateral

trade and investments.⁴⁶⁹ From the perspective of this thesis, a critical point in the agenda was the attraction of Chinese funding for infrastructure development in Brazil, since infrastructure bottlenecks are currently a serious constraint to the expansion of bilateral trade. In line with this, one of the eleven agreements signed laid down the foundations for joint construction of railroads and ports in Brazil to facilitate the outflow of iron ore, soya, ethanol and timber in particular.⁴⁷⁰ Furthermore, in the wake of the signature of a number of deals in the mining sector earlier that year (see trade and investment section below), attracting Chinese investment to the commodities sectors was also high on Lula's agenda.⁴⁷¹

Shortly afterwards, in November 2004, President Hu Jintao paid an official visit to Brazil, heading a diplomatic mission integrating some 150 Chinese entrepreneurs. Beijing's main interest at this stage was to push forward its formal recognition as a market economy, by Brazil. President Lula, however, made this dependent on an agreement to promote Brazilian meat exports (Chicken and beef), the guarantee that the initial agreement of purchase by Chinese airlines of AVIC II Embraer's Jets would be respected, and that China would invest in Brazilian infrastructure development.⁴⁷² In his address to the Brazilian congress, Hu Jintao said that with efforts by both parties, China-Latin America trade could reach US\$100bn by 2010, and announced that China was willing to double its investment in LA over the same period.⁴⁷³

The following five years, however, saw a cool-down in relations, with nothing much happening in terms of bilateral exchanges. This trend only reversed in the context of the global economic downturn. Presidential meetings took place at the G20 summit in London (April), at the G8+5 meeting in Hokkaido (June), and in Copenhagen at the Climate Change Summit (December). At the bilateral level, high ranking

⁴⁶⁹ President Lula's speech at Beijing University, "Política Externa Brasileira no Século XXI e o Papel da Parceria Estratégica Sino-Brasileira", 25 May 2004, available online at: http://www.mre.gov.br/portugues/politica_externa/discursos/discurso_detalhe3.asp?ID_DISCURSO=2362 (accessed 16 February 2010).

⁴⁷⁰ MoU on cooperation signed between the Brazilian Ministry of Planning, Budget and General Administration, and the Ministry of Commerce of China, on 24 May 2004, available online at: http://www2.mre.gov.br/dai/b_chin_85_5305.htm (accessed 16 February 2010).

⁴⁷¹ Other important negotiations during this visit included the opening of the Chinese market for other major Brazilian productive sectors other than soya and iron ore, namely : dairy and meat; the increment of exports of flex-fuel cars to China, nuclear cooperation and the lowering of tariff barriers affecting Brazilian ethanol exports.

⁴⁷² Reuters, "Brazil reconhece China como economia de mercado", 12 November 2004, available online at: <http://noticias.uol.com.br/ultnot/reuters/2004/11/12/ult1928u591.jhtm> ; Sérgio Leo, "Brazil aumenta pressão para que China cumpra acordo", 15 March 2005, available online at: http://www.defesanet.com.br/brasil/brasil_china_1.htm (accessed 16 February 2010).

⁴⁷³ The Brazilian press wrongly reported Hu Jintao as saying that China would invest US\$100 bn in LA by 2010, a mistake that was then used in several reports on China-Latin America relations. Jiang Shixue (CASS) in an interview with the BBC, 15 May 2007, available online at: <http://blog.china.com.cn/jiangshixue/art/878278.html> (accessed 16 February 2010).

exchanges in 2009 included Yang Jiechi (Chinese Minister of Foreign Affairs)⁴⁷⁴ and Vice-President Xi Jinping's⁴⁷⁵ visits to Brazil in January and February, respectively, and President Lula's second state visit to China in May. The intense interchanges at the highest level indicate that the crisis was perceived by both countries as an opportunity to strengthen the South-South axis, and to promote a new international financial architecture.

President's Lula's second diplomatic mission to China took place from 18-20 May 2009. Although trade expanded at an unprecedented rate from 2004 onwards, the same fundamental problems remained at the economic level. In this context, Lula's economic cooperation agenda in 2009 included the same items as five years before, namely, attracting Chinese investment to joint projects in Brazil with a particular focus on mining and infrastructure. Infrastructure had in fact become key in Lula's last mandate within the framework of his programme to accelerate economic growth (PAC, Programa de Aceleração do Crescimento).⁴⁷⁶ This programme was launched in 2007, and became the iconic landmark of his last mandate, as well as the platform campaign for his successor, Dilma Russef. In addition to the signature of 13 bilateral cooperation documents,⁴⁷⁷ major deals were inked in the field of infrastructure and oil.⁴⁷⁸

On 14-15 March 2010, President Hu Jintao paid his second official visit to Brazil in the framework of the BRICs⁴⁷⁹ summit. In the joint declaration signed then, amongst other issues, reference was made to the opportunities for cooperation in infrastructure development opened by PAC. This was particularly in the transport and energy sectors, some Chinese enterprises having shown interest in participating in the bidding for the high speed train. Notably, the Brazilian side also expressed its openness towards the

⁴⁷⁴ In his meeting with Foreign Minister Celso Amorim, the parties discussed bilateral ties and major international issues of common interest, such as cooperation in the framework of the global economic crisis, the reform of the international financial system, the revitalization of Doha Round negotiations, UN reforms, and south-south cooperation. In: Lusa - Rio de Janeiro, "Brasil e China manifestem interesse em diálogo estratégico e defendem reforma da ONU", 19 January 2009, available online at: <http://tv1.rtp.pt/noticias/?article=151693&visual=3&layout=10> (accessed 16 February 2010).

⁴⁷⁵ Mylena Fiori, Agência Brasil, "China e Brasil condenarão medidas protecionistas de países ricos em reunião do G20", 19 February 2009, available online at: <http://www.agenciabrasil.gov.br/noticias/2009/02/19/materia.2009-02-19.5480173551/view> (accessed 16 February 2010).

⁴⁷⁶ For more details on PAC, check: <http://www.brasil.gov.br/pac/> (accessed 16 February 2010).

⁴⁷⁷ The areas covered, ranged from political and legal areas to science and technology, spatial and financial issues, agriculture products, trade, energy and ports. Other significant developments included the opening at last of the Chinese market to Brazilian poultry meat exports, and talks were held on bilateral exchanges to be done in their respective currencies (Real and Yuan) instead of using the American dollar - an idea launched by Lula during the G20 meeting. According to: Xinhua, "Brazil's Lula, on China visit, secures 13 deals", 20 May 2009, available online at: <http://english.people.com.cn/90001/90783/91300/6661358.html>; Xinhua, "Brasil estuda comércio com China em reais e yuan", 10 April 2009, available online at: <http://br.china-embassy.org/por/jmwl/t556878.htm> (accessed 16 February 2010).

⁴⁷⁸ These deals are addressed in more detail below.

⁴⁷⁹ Brazil, India, Russia and China - emerging countries dialogue platform.

participation of Chinese oil companies in the pre-salt area development. During his visit, 15 bilateral agreements were signed. Among these stand out an agreement between EBX (Eike Batista group) and WISCO (Chinese SOE mining company from Wuhan) regarding mining equity acquisition and port facilities construction; a strategic cooperation agreement between Petrobras, Sinopec and China Development Bank (CDB), and a contract signed by Petrobras and Sinopec regarding the transferrals of exploration rights in two oil blocks.⁴⁸⁰

5.1.2.2. *Bilateral trade – the raising importance of oil*

Prompted by China’s accession to WTO in 2001 and the stabilization of the Brazilian economy, two-way trade expanded at an unprecedented rate thereafter (see fig. 5.1. below). From little over US\$2bn in 2000 it reached US\$9.2 billion in 2004⁴⁸¹ and US\$36.5bn in 2008, overcoming two years ahead of schedule, the US\$30bn target established by Hu Jintao during his first visit to Brazil. The third commercial partner of Brazil since 2004, China came second in 2008. In 2009, China became Brazil’s major trading partner, with a total trade volume of US\$36.1bn (US\$35.9bn with the US).⁴⁸² China consolidated that position in 2010, with bilateral trade expanding 52%, and reaching US\$56.4bn (US\$42bn with the US).⁴⁸³



Source: MDIC-SECEX, available online at: <http://www.desenvolvimento.gov.br>

⁴⁸⁰ All information in this paragraph, according to: Ministerio das Relacoes exteriores - Assessoria de Imprensa do Gabinete, “Visita ao Brasil do Presidente da Republica Popular da China, Hu Jintao - 14 e 15 de Abril de 2010 - comunicado a imprensa”, 15 April 2010, available online at: <http://www.itamaraty.gov.br/sala-de-imprensa/notas-a-imprensa/2010/04/15/visita-ao-brasil-do-presidente-da-republica> (accessed 5 December 2010).

⁴⁸¹ MDIC/SECEX, “intercâmbio Comercial Brasil-China”, available online at: <http://www.desenvolvimento.gov.br> (accessed 8 February 2011)

⁴⁸² MDIC, “Ajustes na balança commercial colocam a China como principal parceiro comercial do Brazil”, 14 January 2010, available online at: <http://www.desenvolvimento.gov.br/sitio/interna/noticia.php?area=5¬icia=9560> (accessed 8 February 2011)

⁴⁸³ MDIC-SECEX, available online at: <http://www.desenvolvimento.gov.br> (accessed 8 February 2011)

As shown in the table 5.2 (below), China's imports increased by nearly one-fourth in 2009, explaining the very small contraction in total bilateral trade value that year. The significant trade deficit that emerged in 2009 (US\$5.1bn), resulted mainly from a sharp contraction in Brazilian imports from China, explained by the economic crisis context. In 2010, the normal trade path was resumed, with Chinese imports increasing by 47% and exports by 61%.⁴⁸⁴

Table 5.2. China-Brazil trade (2000-2010)

(US\$ billions)				
Year	Imports	Exports	Balance	Total
2000	1.1	1.2	0.136	2.3
2001	1.9	1.3	- 0.573	3.2
2002	2.5	1.6	- 0.967	4.1
2003	4.5	2.2	- 2.385	6.7
2004	5.4	3.7	- 1.731	9.1
2005	6.8	5.4	- 1.481	12.2
2006	8.4	8.0	- 0.412	16.4
2007	10.8	12.6	1.873	23.4
2008	16.4	20.1	3.641	36.5
2009	21.0	15.9	- 5.093	36.1
2010	30.8	25.6	- 5.193	56.4

Source: MDIC-SECEX, <http://www.desenvolvimento.gov.br>

China's share in Brazil's total imports rose from 2.2% in 2000 to 13.7% in 2010, being presently the second source of Brazilian imports after the US (14.8%).⁴⁸⁵ Brazilian imports from China are mostly comprise manufactured goods (97% in 2007, over half of which are machinery, equipment and electric appliances),⁴⁸⁶ most of which directed to the industrial productive chain. China's share in Brazil's exports also grew substantially in recent years: from 1.8% in 2004 to 15.4% in 2010.⁴⁸⁷ China alone absorbed half of Brazilian exports to Asia (31%) in 2010, which had become its major regional exports destination in 2009 (27% of total outflows), surpassing LA and the European Union.⁴⁸⁸

In 2010, trade with China accounted for nearly 15% of Brazil's total foreign trade, up from a meagre 2% in 2000. As for Brazil, although its share in Chinese foreign trade remains modest, it has increased three fold over the same period (0.5% in 2000 to 1.6% in 2009).

⁴⁸⁴ MDIC-SECEX, *Ibid.*

⁴⁸⁵ MDIC-SECEX, *Ibid.*

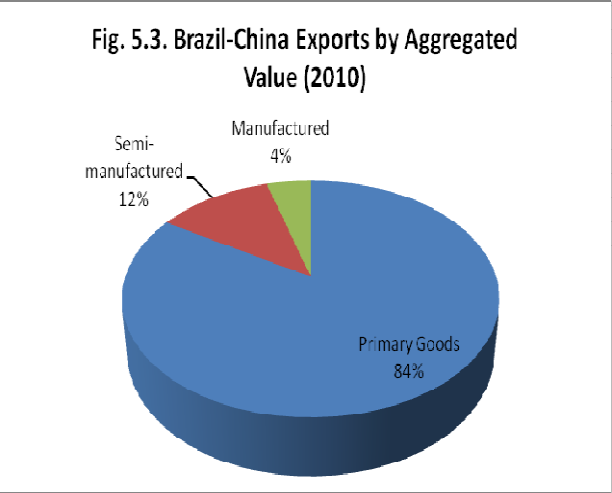
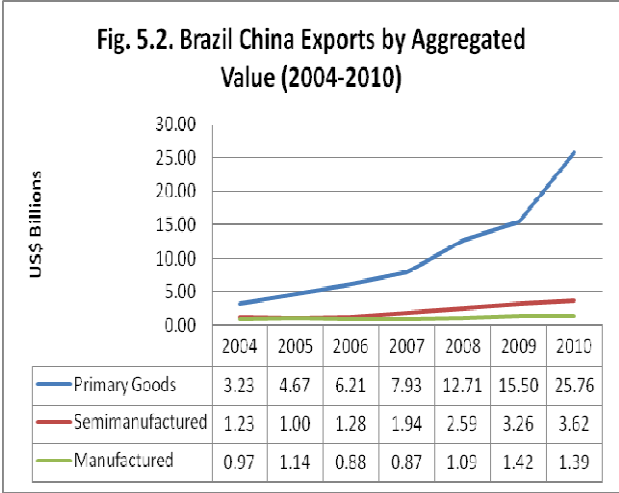
⁴⁸⁶ MDIC, *Agenda China: Ações Positivas para as Relações Econômico-Comerciais Sino-Brasileiras*, July 2008, p.18.

⁴⁸⁷ MDIC-SECEX, *Ibid.*

⁴⁸⁸ MDIC-SECEX, *Ibid.*

The expanding trade with Asia and particularly China, is causing critical shifts in a very short period, not only regarding the expansion of primary goods share in Brazil’s exports, but also regarding Brazil’s economic partnerships. The most meaningful change in this regard, was the replacement of its long standing top trade partner (US). This implies a critical geopolitical change, not only for Brazil, but also for South America in general, since Brazil is the largest economy of the region.

Brazil’s exports to China are increasingly concentrated in primary goods (84% in 2010, up from 59% in 2004). This contrasts sharply with Brazilian imports from China, which gradually evolved to include a reasonably diversified chart, largely comprising manufactured goods. It is worth noting that the Brazil-China exports structure contrasts with the general pattern of Brazil outflows to the rest of the world, which present a much more diversified structure.



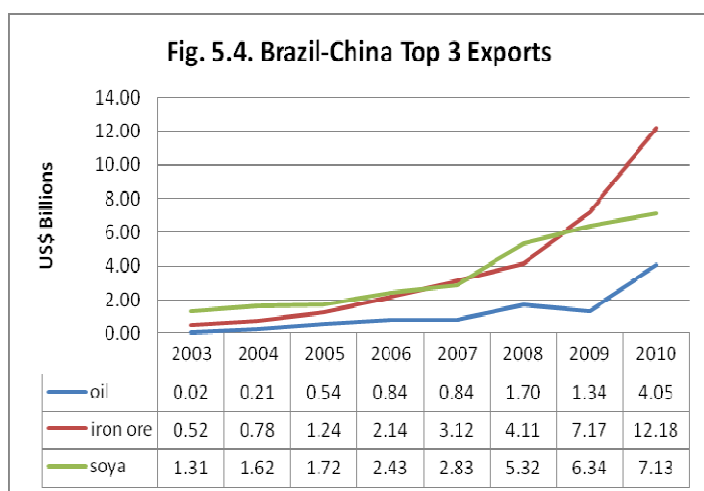
Source: MDIC-SECEX, <http://www.desenvolvimento.gov.br>

Figs 5.2 and 5.3 (above) clearly illustrates that the dramatic increase in exports to China in the 2000s is mostly accounted for by primary goods. In 2010, Brazil’s commodities exports to China represented 46% of total bilateral trade value (US\$25.8 billion of the total US\$56.4 billion). Three commodities alone (soya, iron ore and oil) accounted for nearly 76% of export flows to China in 2010, up from 48% in 2004.⁴⁸⁹ Although exports of added value products have shown a moderate rise since 2006, in particular semi-manufactured goods, the share of primary goods in exports to China is still rising at a much faster rate, meaning that this will remain a major trend in the years to come.

⁴⁸⁹ MDIC-SECEX, *op. cit.*

Even though this state of affairs does not seem to bother the Chinese parties, the diversification of its exports have become central in Brasilia’s bilateral agenda with China in recent years. This raises serious concerns, since over-reliance could make the Brazilian commodities sector more vulnerable to swings in Chinese demand.⁴⁹⁰ The *status quo* is to a great extent attributable to the belated awakening of the Brazilian executive in adopting an active stance to place its manufactured goods in the Chinese market.⁴⁹¹ Other reasons explaining the high concentration of commodities in exports are: the largely insufficient knowledge of each other markets, the high costs of transportation and logistics due to geographic distance, and the high tax burden and poor infrastructure in Brazil.⁴⁹²

In 2010, iron ore (raw and semi-processed) accounted for 45% of export value to China, followed by soya complex which accounted for 26%, and crude oil 13%. Soya’s share (only entered the export chart to China in the late 1990) has remained more or less unchanged throughout the 2000s at around 30%, while iron ore and oil shares have been expanding at a faster pace in recent years (see Fig. 5.4, below).



*Figures do not include semi-processed iron ore and soya.

Source: MDIC-SECEX, available online at: <http://www.desenvolvimento.gov.br> .

Having vanished from bilateral trade in the early 1990s, oil resurfaced in the bilateral trade chart in the 2000s, but this time with flows going in the opposite direction. After proving the potential of its pre-salt reservoirs Brazil is gradually emerging as a major oil producer (see appendix 1). Despite being a very recent feature, oil rapidly became the third largest component of exports to China. Representing only

⁴⁹⁰ Amaury de Souza, ‘Brazil-China: an uneasy partnership’, China Latin America Task Force, 14 February 2008, p. 4.

⁴⁹¹ Ernesto Heinzelmann, *op. cit.*, p. 6.

⁴⁹² Danielly Becard, *op.cit.*, 2008, p. 13.

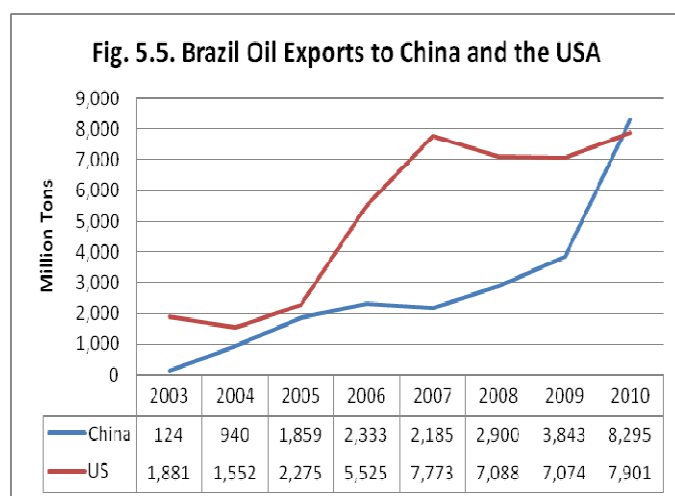
0.5% of total Brazilian exports value to China in 2003, the oil share expanded to 13% in 2010. In terms of volume, oil exports have risen steadily from 940 thousand tons in 2004, to 2.9 million tons in 2008.

Table 5.3. Brazil oil exports to China (2000-2010)

	US\$ Million	% of total	Tons
2000	36.1	3.33	227,867
2002	0	0	0
2003	22.3	0.49	123,997
2004	210.1	3.86	939,624
2005	541.6	7.93	1,859,420
2006	835.9	9.95	2,333,408
2007	839.9	7.81	2,185,109
2008	1,702.5	10.38	2,900,324
2009	1,338.3	6.37	3,843,263
2010	4,053.5	13.17	8,294,694

Source: MDIC-SECEX, <http://www.desenvolvimento.gov.br>

As demonstrated in table 5.3 (above), the fall in export value in 2009 merely reflects the oil price crash in the context of the economic crisis. In terms of volume, oil exports actually expanded by almost one-third that year, illustrating Beijing's growing thirst for Brazilian oil - whose heavy grades suit China's refineries. These figures expanded exponentially thereafter, and more than doubled in the following year to 8.3 million tons (US\$4bn). Owing to this surge, China in 2010 became Brazil's major oil export destination, and surpassing the US which had occupied that position since the early 2000s.



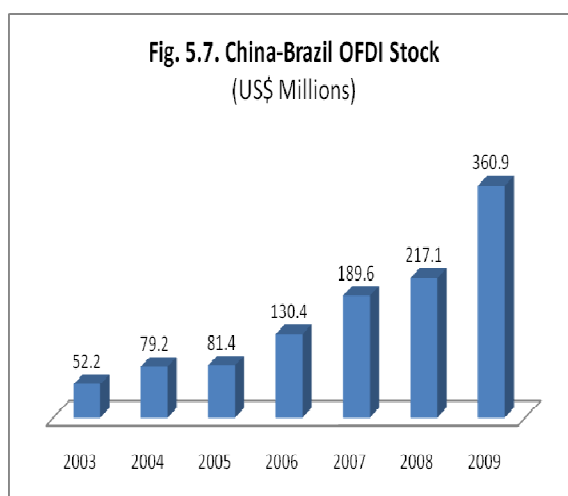
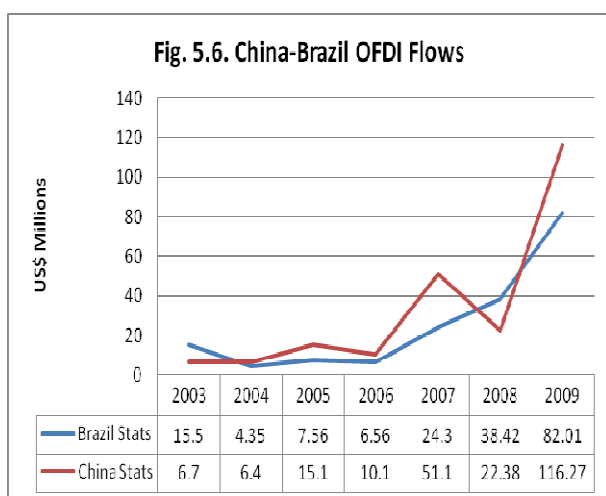
Source: MDIC-SECEX, <http://www.desenvolvimento.gov.br>

The sharp increase in the volume of Brazil's oil exports to China from 2009 to 2010, uncovers the takeoff of a new dimension in bilateral trade that is set to expand significantly in coming years, as Brazil

consolidates its position as an oil exporter. The potential of the pre-salt reservoirs will soon place Brazil amongst the world largest oil producers. As such, it is now regarded by Beijing as a very promising long-term oil source. This new feature in Brazil-China trade, unmistakably illustrates the emergence of Brazil in China's oil security strategy.

5.1.3. Struggling to link infrastructure loans with access to oil

In sharp contrast with the bright picture in bilateral trade, China's engagement in Brazil's resources sectors, has been struggling to take off throughout most of the past decade. Indeed, in spite all the framework agreements signed and official calls for Beijing to engage in infrastructure, and the announcement of several multibillion dollar deals targeting the mining and oil industry in Brazil, Chinese investment stock remained very small until the onset of the global financial crisis (see fig. 5.7. below).



Sources: Brazil Central Bank/RENAI; MOFCOM, *Statistical Bulletin of Chinese OFDI 2009*.

As shown in Fig. 5.6 (above), there are some discrepancies between both countries' official statistics, the Chinese figures being a bit inflated for most years. Nonetheless, both sources seem to have registered a sharp rising curve from 2008 onwards. As a result, China jumped from the 36th position in 2008 to the 17th in 2009 - in terms of Brazilian foreign investors ranking.⁴⁹³ China's official share in Brazilian investment inflows is, however, still very far from resembling the one in trade. According to Brazil statistics, it represented only 0.3% of the US\$30.4 billion Brazilian FDI intake in 2009, far behind the five major

⁴⁹³ Folha de S. Paulo, "Investimento chinês cresce 72% até abril", 3 August 2009, available online at: <http://www.sistemacnt.org.br/portal/webCanalNoticiasCNT/noticia.aspx?id=6929be87-e476-41c0-9960-b29c4c27c30c> (accessed 8 February 2011)

investors in Brazil: the Netherlands (US\$5.7 bn or 19%), US (US\$4.9 bn, 16%), Spain (US\$3.4 bn, 11%), Germany (US\$ 2.4 bn, 8%) and France (US\$2.1 bn, 7%).⁴⁹⁴

While according to statistics China's actual investment seems to be directed to wholesale, light manufactured goods and services,⁴⁹⁵ the highest expectations are naturally set around the eminent Chinese engagement in mineral commodities exploration and related infrastructure development. In fact, as discussed above, since the early days of relations, China has shown a constant interest in investing in the mineral sector in Brazil; and Brasilia has over the past decade shown a strong interest in Beijing's participation in much needed infrastructure development in the country. This is evidenced by Minmetal's willingness in the 1980s to explore iron ore in Brazil, the long standing Chinese NOCs' relationship with Petrobras, and the more recent Baosteel's venture with Vale (formerly known as CVRD, 2001-2008) to build a steel plant in Maranhao - all of which failed to materialise.

During Lula's first visit to China in 2004, important cooperation was drafted, envisaging closer cooperation in the oil sector involving the oil parastatals of both countries.⁴⁹⁶ In addition to a short-term supply contract, Petrobras and Sinopec signed a 'Strategic Cooperation Agreement' to identify and develop downstream, upstream and midstream opportunities. Under this agreement, later that year Sinopec signed a contract with Petrobras to participate in the construction of a gas pipeline linking Rio de Janeiro and Bahia states (US\$1.1 billion, Gasene, analysed in detail below) with funding from EXIM Bank. A compromise was also worked out with CNOOC to explore opportunities for closer cooperation in offshore oil exploration on the Chinese and Brazilian coasts - although nothing concrete came out of it. It was in the wake of these agreements, that Petrobras opened a representation office in Beijing in 2004. However, despite all the goodwill expressed by both parties and of the many agreements inked, nothing concrete was produced in terms of Chinese engagement in the Brazilian oil industry or infrastructure sector (with the exception of the Gasene project). This is a curious phenomenon, with the same scenario also observable in the mining industry.

Just before President Lula's first official mission to China, major deals were announced in the mining industry, involving Vale and some of the major Chinese parastatals of the sector - China Alumina

⁴⁹⁴ According to data in: Banco Central do Brasil, *Investimento Directo Estrangeiro*, available online at: <http://www.bcb.gov.br/rex/ied/port/ingressos/htms/index3.asp?idpai=INVEDIR> (accessed 16 December 2010)

⁴⁹⁵ RENAI/Secretaria do Desenvolvimento da Producao, *Conjuntura Macroeconómica do Investimento*, 2009, p. 16, available online at: <http://investimentos.desenvolvimento.gov.br/arquivos/RENAI-BOLETIM-06042009-FINAL-SITE.pdf> (accessed 16 February 2010)

⁴⁹⁶ Folha de S. Paulo, "Petrobras vai quase triplicar a venda de petróleo à China", 25 march 2004, available online at: <http://www1.folha.uol.com.br/folha/brasil/ult96u61142.shtml> (accessed 16 February 2010)

Corporation (US\$1bn to build a alumina factory to export to China), Minmetals (US\$2 billion pig iron plant) and Baosteel (US\$1-2bn to build a steel plates factory in Maranhão to export to the North American market).⁴⁹⁷ All of which are Chinese SOE's and the projects were to be funded by Chinese policy banks. In this context, the Minister for Development, Luiz Fernando Furlan, estimated that Chinese investment in Brazil would reach US\$5-8bn over the following three years.⁴⁹⁸ Heavy investments in infrastructure by Chinese consortia were also announced after that, namely the North-South railway and the rehabilitation of Itaqui Port (in Maranhão by a Chinese consortium headed by China International Trust and Investment Corporation -CITIC, a project valued at U\$4bn).⁴⁹⁹ All these infrastructures had in common the purpose of facilitating the outflow of commodities from inland areas. None of these projects, however, saw the light of day.

This reality is even more striking if one considers that contrasting with the constant postponement of Chinese investment in resources in Brazilian soil, investments have more swiftly materialised in the opposite direction. Indeed, and despite having no exploration concessions, Brazil's largest mining company, Vale, has already eight JV in China in order to process nickel (5), coal (2) and pellets (1).⁵⁰⁰

Throughout his second mandate, Lula's executive became particularly active in courting Chinese investment to participate in its US\$330 bn (R\$504bn, the official figure in local currency) infrastructure development plan (PAC 2007-2010), aimed at boosting economic expansion.⁵⁰¹ The lion's share (55%) of the PAC budget is allocated to energy infrastructure, with major planned infrastructure in the oil and natural gas sector, contemplating the construction of four refineries and 4,526km of natural gas pipelines.⁵⁰² In addition to domestic fund-raising through public and private organizations (with Petrobras and Vale assuming a significant share), the Brazil government has undertaken several missions abroad, with the purpose of attracting foreign capital for this massive undertaking. Sitting on the largest world

⁴⁹⁷ Denise Bacoccina, "Com dinheiro em caixa, Chineses investem no Brasil", BBC Brazil, 4 February 2004, available online at: http://www.bbc.co.uk/portuguese/economia/story/2004/02/040204_chinesescl.shtml (accessed 16 February 2010)

⁴⁹⁸ "China investe de forma significativa no Brasil", *Observatório de Política Externa Brasileira*, Nr.3, 24/04/2004 to 30/04/2004, available online at: <http://www.fcs.edu.uy/investigacion/observatorioFFAA/Pol%EDtica%20Exterior%20Brasil/Observatorio%20PEBrasil%2003.htm> (accessed 16 February 2010)

⁴⁹⁹ Edla Lula - Agência Brasil, Xangai, "Chineses investirão na recuperação da malha ferroviária brasileira", 27 May 2006, available online at: http://www.ccibc.com.br/pg_dinamica/bin/pg_dinamica.php?id_pag=1015 (accessed 16 February 2010)

⁵⁰⁰ Interview, Vale, Rio de Janeiro, Brazil, 17 July 2009.

⁵⁰¹ Becca Wilkins, "Boosting Brazil Infrastructure: challenges ahead of major sporting events", 22 December 2009, available online at: <http://www.khl.com/magazines/international-construction/detail/item50277/Boosting-Brazil:-Infrastructure-challenges-ahead-of-major-sporting-events---/> (accessed 16 February 2010)

⁵⁰² According to information posted on the PAC official website: http://www.brasil.gov.br/pac/conheca/infra_estrutura/ (accessed 16 February 2010)

foreign exchange reserves and with proven expertise in all these areas, China naturally emerged as a major target in this diplomatic endeavour. Several official missions have been dispatched to present the infrastructure projects that include 25 year concessions to potential Chinese funding institutions.⁵⁰³ In addition to infrastructure development, and according to interviews conducted in Brazil and in China, both sides seem to converge in identifying the agribusiness and oil sectors as the most promising in terms of attracting investment from China in the near future.

Brazilian National Development Bank (BNDES, responsible since its creation in the early 1950s for domestic infrastructure development) has been working since 2008 with major Chinese funding institutions, namely EXIM Bank, CDB and Sinosure (China export and credit insurance company), in order to identify and develop joint projects.⁵⁰⁴ Additionally, BNDES has been particularly interested in getting China's sovereign wealth fund (CIC, China Investment Corporation) to invest in the oil and gas industry in Brazil.⁵⁰⁵

According to Jiang Shixue, Brazil is naturally a very attractive investment market for Chinese entrepreneurs. Firstly, because of its natural resources' endowment and, secondly because it is a means to enter the regional market (Mercosur) through the front door.⁵⁰⁶ Over the years the strategic importance of the Brazilian resources sector to China, has been corroborated by numerous investment announcements and by the increasing relevance of commodities in bilateral trade. Moreover, the interest of both parts in making joint efforts to develop Brazilian mineral resources, has been repeatedly endorsed by both governments through the signature of numerous cooperation agreements.

All this considered, in spite of having encountered in Brazil the apparent ripe conditions (lack of infrastructure and abundance of resources) and the necessary overture by the local government - China's infrastructure-for-oil/mining formula struggled to succeed in that country. It was only in the context of the global financial crisis at the end of the decade, that China finally made a breakthrough in this regard. In 2009-2010, major Chinese investments were announced, this time however most actually materialised.

⁵⁰³ Folha Online, "Chineses querem investir mais em projectos do PAC", 11 July 2008, available online at: <http://www.crasp.gov.br/clippingnews/jul08/2008711/CN03.htm> (accessed 16 February 2010)

⁵⁰⁴ In just one decade, the positions of Brazil and China have inverted significantly. The first cooperation project with a Chinese funding institution was made in 1996, when BNDES extended a credit line to CDB (then State Development Bank) to fund three turbines for the Three Gorges Dam.

⁵⁰⁵ Information in this paragraph according to: Interview, BNDES/International Relations Division, Rio de Janeiro, Brazil, 23 July 2009.

⁵⁰⁶ Jiang Shixue, "Relações de Investimento entre o Brasil e a China em direção ao século XXI", in: Samuel Pinheiro Guimarães (ed.), *Brasil-China*, (Brasília: IPRI & FUNAG, 2003) pp. 428-429.

Not surprisingly, the bulk of the investment volume announced in 2010 (nearly US\$30 billion - if combining finalised deals under negotiation and announced) was directed at the oil and mining sectors.⁵⁰⁷

Along with meaningful developments in the oil sector (which shall be discussed below), significant investments were also made in the mining and energy sector over the same period. In February 2010, Chinese state owned WISCO (Wuhan Iron and Steel Co.) acquired 21.5% of a private Brazilian mining company MMX (Mineracao e Metalicos SA, part of the Eike Batista group - EBX) for US\$ 400 mn.⁵⁰⁸ During Hu Jintao's visit to Brazil in April 2010, WISCO formalised a JV with the logistics arm of the same group (LLX), to build a steel mill in Açú port (Rio de Janeiro).⁵⁰⁹ The project in which WISCO will retain a 70% stake (EBX 30%) is estimated at US\$4.7bn. Earlier in 2010, a Chinese company registered in the Cayman Islands and listed in Hong Kong, Honbridge Holdings, bought an iron ore project in Northern Minas Gerais state from Votorantim for US\$430mn.⁵¹⁰ The Chinese company is also expected to invest an additional US\$3.5bn to develop the project (mine, 470km mining duct, mining port at north Ilheus, Bahia state, and a pellets production plant). In mid March 2010, another Chinese company, ECE, acquired a private Brazilian iron ore company, Itaminas, for US\$1.2 bn.⁵¹¹ Among other infrastructure investments announced in this period also figure the West-East railway and the port of Sul-Ilhéus in Bahia state.⁵¹²

Also in 2010, State Grid Corporation of China acquired seven Brazilian electricity distribution companies, for nearly US\$1bn.⁵¹³ Throughout that year many other smaller investments in telecommunications, and the automotive and services sectors, were also announced.⁵¹⁴

⁵⁰⁷ Antonio Barros de Castro et al., "Investimentos Chineses no Brasil", *Carta Brasil-China/CEBC*, March 2011, p. 9.

⁵⁰⁸ Agencia Estado, "Eike acerta parceria com grupo chinês", 20 May 2009, available online at: <http://noticiasmineracao.mining.com/2009/05/20/eike-acerta-parceria-com-grupo-chines/>; Brasil Mineral OnLine, "MMX e Wuhan próximas de acordo para Porto Açú", 11 November 2009, available online at: <http://www.brasilmineral.com.br/BM//default.asp?COD=4579&busca=&numero=427> (accessed 16 February 2010)

⁵⁰⁹ Henrique Altemani, "Síntese de atualidade econômica e empresarial Brasil-Ásia-Pacífico", April-May 2010, p. 2, available online at: www.iberiasia.org (accessed 8 February 2011)

⁵¹⁰ Henrique Altemani, "Síntese de atualidade econômica e empresarial Brasil-Ásia-Pacífico", March-April 2010, p. 4, available online at: www.iberiasia.org (accessed 8 February 2011)

⁵¹¹ Georges Landau, "Brazil-China", in: *Brazil Focus Newsletter*, April 2010.

⁵¹² Associação Açú Ilhéus, "Os novos colonizadores e a corrida do ferro", 3 July 2009, available online at: <http://www.acaoilhéus.org/news/971-os-novos-colonizadores-e-a-corrida-do-ferro> (accessed 16 February 2010)

⁵¹³ WSJ, "China State Grid to buy Brazilian power firms", *Wall Street Journal*, available online at: <http://online.wsj.com/article/SB10001424052748703581204576032841364944586.html> (accessed 8 February 2011)

⁵¹⁴ Raquel Landin, "Brazil e China fecham contratos milionários", *Estadão*, 15 April 2010, available online at: http://www.estadao.com.br/estadaodehoje/20100415/not_imp538439.0.php (accessed 8 February 2011)

Although some of these deals are yet to be finalised and approved by both governments, they clearly point to a massive surge in China's investment in Brazil in 2010, and has the potential to make China the largest foreign investor in the country. To a great extent this was prompted by the mounting financial needs of Brazil to fund its massive infrastructure plan against the backdrop of the global financial crisis.

This state of affairs justifies a deeper analysis in order to understand, firstly, why Chinese resources enterprises enjoying full and active support from both governments have struggled throughout most of the decade to penetrate the Brazilian market; and, secondly, what explains the apparent success over the last few years.

The next section throws some light on these issues and questions, by examining in detail China's quest to engage in the Brazilian oil sector over the past decade.

5.2. Assessing the performance of infrastructure-for-oil deals in Brazil

As mentioned previously, oil is not a new feature in bilateral relations. Petrobras has expressed interest in participating in offshore oil exploration in China since the early 1980s, and throughout most of that decade oil exports to Brazil accounted for a sizeable share of bilateral trade. Throughout the 1990s and early 2000s, however, oil practically vanished from the bilateral agenda. Contacts between Petrobras and the Chinese NOC continued, nonetheless, mostly sustained by interest in China's offshore. From 2004 onwards a renewed interest in the oil sector emerged on both sides. This is proven by short term oil supply contracts signed with Petrobras and a number of governmental agreements inked from 2004 onwards, aiming at creating a favourable institutional environment to advance joint cooperation projects in this field.⁵¹⁵ Unlike in previous decades China has now assumed a proactive stance in this regard. This is mostly explained by the fact that Brazil became a net oil exporter in 2006, and that its reserves increased substantially following the pre-salt deposits announcement in 2007. Despite CNPC's much more consolidated position in South America and CNOOC's much longer contact's record with Petrobras (mostly due to Petrobras's long efforts towards starting China's offshore oil exploration), Sinopec was the

⁵¹⁵ Memorando de Entendimento sobre cooperação entre o Ministério de Minas e Energia da República Federativa do Brasil e o Ministério do Comércio da República popular da China, Beijing, 6 September 2004; Memorandum of Understanding on Establishing the Energy and Mining Sub-commission of the Sino-Brazilian High-Level Coordination Commission between the Ministry of Mining and Energy of the Federative Republic of Brazil and the National Development and Reform Commission of the People's Republic of China, Beijing, 5 June 2006; Agreement on Strengthening the cooperation in the Implementation of Infrastructure Construction between the Government of the Federative Republic of Brazil and the Government of the People's Republic of China, Beijing, 6 June 2006; Protocol Between the Government of the Federative Republic of Brazil and the Government of the People's Republic of China on Cooperation in Energy and Mining, Brasília, 19 February 2009; all courtesy of the Brazilian Ministry of foreign Affairs - International Acts Division.

first Chinese NOC to succeed in entering the hydrocarbons sector in Brazil - which happened downstream, through the construction of a natural gas pipeline.

5.2.1. Failing before the global financial crisis

The Southeast-Northeast Interconnection Gas Pipeline Project (GASENE) is part of the Petrobras Gas Production Anticipation Plan (PLANGAS in the Portuguese acronym) to expand, by 2010, supply to the south-eastern gas pipeline network, and by connecting this with the north-eastern network, ensuring supply from the southern basins' gas fields, namely - Espírito Santo Basin whose production is expected to reach 18.7 million cubic meters per day by 2010. With a transport capacity of 20 million cubic metres per day, Gasene project has a total extension of nearly 1,400km, crossing three coastal states: Rio de Janeiro (RJ), Espírito Santo (ES) and Bahia (BA). The project comprises three sections (south to north): from Cabiúnas terminal (RJ) to Vitória (ES), Vitória to Cacimbas (ES)⁵¹⁶ and Cacimbas to Catu (BA).⁵¹⁷

Gasene was presented as one of Brasilia's major infrastructure projects to a MOFCOM delegation that visited Brazil in late April 2004. When Lula visited China in May 2004, Petrobras and Sinopec signed a strategic cooperation agreement to identify and develop joint projects in the oil and natural gas sector, listing the Gasene project as a possible start. Backed by the strategic agreement between both NOCs and the inter-governmental agreement to expand cooperation in infrastructure signed in June, and encouraged by Petrobras to enter the tender for the project,⁵¹⁸ Sinopec submitted a bid. Notably, it was supported in this endeavour by a credit line from China EXIM Bank to BNDES, requiring SINOPEC to be the contractor for the project. Accordingly, later that year, in September 2004, a MoU was signed between Petrobras, Sinopec, EXIM Bank and BNDES, and including several generic dispositions regarding the loan conditions, the Engineering Procurement and Construction (EPC) contract, and the execution calendar in case Sinopec was the selected contractor.⁵¹⁹

During Hu Jintao's visit to Brazil in November 2004, Dilma Rousseff, then Minister of Mining and Energy, announced that the Chinese proposal was the one offering better conditions in terms of the

⁵¹⁶ The construction of this section (129 km) had been contracted to another company.

⁵¹⁷ Petrobras, 'Gasene project financing', 14 December 2006, available online at: http://www2.petrobras.com.br/ri/spic/bco_arq/2890_financ_bndes_gasene_ing.pdf (accessed 16 February 2010)

⁵¹⁸ According to a Petrobras source, CNOOC was also invited to participate in the bid. Interview, Petrobras, Beijing, China, 1 September 2009.

⁵¹⁹ Petrobras, "Gasene project financing", 14 December 2006, available online at: http://www2.petrobras.com.br/ri/spic/bco_arq/2890_financ_bndes_gasene_ing.pdf (accessed 16 February 2010)

repayment interest rate.⁵²⁰ The signature of Gasene cooperation agreement was part of Hu Jintao's official agenda in Brazil, and Sinopec set up its Gasene team the following month. In April 2005, a subsidiary of Sinopec was established in Brazil (Sinopec International Petroleum Service do Brasil Ltda, Sinopec Brasil) to run its operations in the country, in accordance with the local laws. The inter-governmental framework, the actors and the procedures of this deal, point to the fact that China was trying to implement in Brazil, a pattern consistent with the infrastructure-for-oil formula it had been deploying in Africa.⁵²¹

Negotiations between BNDES and China EXIM Bank for the loan concession, however, stalled in early 2005. According to BNDES this was because EXIM Bank had designed this credit line in similar moulds to its African loans, as it wanted to include in the contract a large share of labour, services and goods procured in China.⁵²² Having a large industrial base, a thriving services sector, a massive labour force and very strict labour laws, and to that add the political context of a leftist government, BNDES was in no position to make concessions. Expectations were that the Gasene project would generate 12,000 new direct jobs and 36,000 indirectly.⁵²³ With powerful and very active worker associations, the importation of Chinese law was clearly unfeasible. In what concerns procurement of goods and services, BNDES had already established the limits in the MoU signed in September 2004, which referring to the EPC contract (part V) states: "Petrobras, under the guidance of the Brazilian Government, requires that Brazilian construction companies and material/equipment and services suppliers to be part of the EPC contract, resulting in minimum Brazilian content of 75% of the project."⁵²⁴ In March 2006, the Brazilian side decided to kick-start the project, resorting to provisional loans while negotiations with EXIM Bank continued.

Notwithstanding this, Petrobras kept Sinopec ahead of the first phase of the project (GASCAV, Cabiúnas-Vitória, 300km) and following long and difficult negotiations, the US\$239mn EPC contract was finally signed in April 2006,⁵²⁵ with construction starting in June, almost a year behind the original schedule.

⁵²⁰ Gazeta Mercantil, "*Chineses devem participar do gasoduto Sudeste-Nordeste*", 12 November 2004, available online at: http://www.camara.gov.br/mercosul/A_RelatorioAtiv/CE_23-nov-04.htm (accessed 16 February 2010)

⁵²¹ Around this same time, another inter-governmental deal of the same kind was being negotiated in the mining sector, involving a partnership between Baosteel and Vale for the construction of a Steel plant valued at US\$5.5 bn, and to be mostly funded by CDB. The project never took off.

⁵²² Interview, BNDES/International Division, Rio de Janeiro, 23 July 2009.

⁵²³ Petrobras, "Gasene project financing", 14 December 2006, available online at: http://www2.petrobras.com.br/ri/spic/bco_arq/2890_financ_bndes_gasene_ing.pdf (accessed 16 February 2010)

⁵²⁴ MoU between Petróleo Brasileiro S.A. - Petrobras, China Petrochemical Corporation - Sinopec, the Export-Import Bank of China - China ExIm Bank, Banco Nacional de Desenvolvimento Econômico e Social - BNDES, Beijing, 6 September 2004 - courtesy of the Brazilian Ministry of foreign Affairs, International Acts Division

⁵²⁵ Reuters, "Petrobras assina contrato de US\$239 mi com Sinopec para Gasene", 17 April 2006, Available online at: <http://noticias.uol.com.br/ultnot/2006/04/17/ult29u47290.jhtm> (accessed 16 February 2010)

Despite the problematic start, construction works went smoothly thereafter with only residual Chinese content and having Sinopec sub-contracted several Brazilian construction firms. The first phase of Gasene was successfully concluded in February 2008.

With no signs of progress from EXIM bank in providing the necessary funding, in February 2007 Petrobras cancelled Sinopec's contract for the second phase of Gasene (GASCAC, Cacimbas-Catu, 946 km).⁵²⁶ A new tender was launched and a handful of domestic companies had already been pre-selected when, following contacts at the governmental level, China Development Bank was authorised to replace EXIM Bank.⁵²⁷ Negotiations for the signing of the second phase EPC contract started in July, and the contract was signed on 27 December 2007.⁵²⁸ CDB signed a US\$750mn loan with BNDES to fund GASCAC (with a total estimated cost of US\$2.6bn).⁵²⁹ BNDES passed on the loan to Petrobras, which contracted Sinopec to run the project. Construction started officially in May 2008, following the sub-contracting of domestic companies. The pipeline was successfully completed on schedule, just before Hu Jintao's visit to Brazil in April 2010.

From the point of view of China's energy security concerns, Sinopec's engagement in the Gasene project failed to produce meaningful results, as it did not facilitate China's access to oil equity, nor secure any long term oil contracts. Although Sinopec had successfully entered the sector downstream, Sinopec's major target in Brazil is actually upstream, according to Sinopec Brazil's website regarding the company's target for 2020: "become one of the world five largest companies in the sector of oil and gas and consolidate a position in the offshore segment in Brazil."⁵³⁰ The onset of the financial crisis, however, produced structural changes that would ultimately play in China's favour.

5.2.2. Succeeding in the crisis context

Despite falling short in terms of China's major oil diplomacy goals, the Gasene project secured a good foundation in Brazil, not only for Sinopec, but also for CDB. This certainly played a role when the Brazilian oil company approached CDB in late 2008 for another batch of funding, this time to develop the 'golden eggs' – the pre-salt deposits.

⁵²⁶ Sinopec Brasil, "Landmarks of Gasene project" (accessed 15 April 2009), available online at: <http://www.sinopecbrasil.com.br/pt/> (accessed 16 February 2010)

⁵²⁷ Interview, BNDES/International Division, Rio de Janeiro, 23 July 2009.

⁵²⁸ Petrobras, "Petrobras to begin construction of the third Gasene", 27 December 2007, available online at: http://www2.petrobras.com.br/ri/spic/bco_arq/GaseneIng.pdf (accessed 16 February 2010)

⁵²⁹ Folha Online, "Chineses querem investir mais em projectos do PAC", 11 July 2008, available online at: <http://www.crasp.gov.br/clippingnews/jul08/2008711/CN03.htm> (accessed 16 February 2010)

⁵³⁰ Sinopec Brasil, "Mission and Vision", available online at: <http://www.sinopecbrasil.com.br/en/missao-visao.php> (accessed 16 February 2010)

According to Petrobras's 2009-2013 Investment plan,⁵³¹ the first one to include the new pre-salt deposits, the company intends to invest US\$28bn in exploration and production (E&P) in the pre-salt.⁵³² Because of technical challenges, each well costs in average US\$100mn to drill. Petrobras has developed the technological skills to undertake this endeavour on its own, but lacks the necessary funding. Nonetheless, like Angola, Brazil's oil assets represent an advantage when it comes to raising funding in the international market. One year after the announcement of the pre-salt deposits, Petrobras started searching for funding abroad. 2008, however, turned out to be a bad year for this endeavour, due to the global credit crunch. In November 2008, on his way back from an unfruitful trip to the US and Japan, Petrobras CEO, José Sérgio Gabrielli, did a stopover in Beijing, where he met with the CDB president. Although the economic context was very unfavourable (with freefall in oil prices the sustainability of pre-salt exploration was hardly profitable), the CDB answer was immediately positive, having set the figure for the loan at US\$10bn, to be taken as a first batch depending on its performance.⁵³³ In the following months the details of the contract were negotiated between both parties while the respective governments were brought in to give political backup.

In February 2009, during Xi Jinping's visit to Brazil, a significant number of bilateral agreements were signed relating to the resources sectors, namely a governmental cooperation protocol on energy and mining⁵³⁴ and a number of MoUs signed by Petrobras. Among the latter stand out an agreement signed with CDB for the extension of a US\$10bn loan; one with CNPC to export 40-60,000 bpd of crude oil, and another with Sinopec to sell 60-100,000 bpd (2009-2010).⁵³⁵

The US\$10bn loan agreement was formally signed by CDB and Petrobras in May 2009 during President Lula's visit to China. According to Petrobras's CEO (quoted by Xinhua Agency), the interest rate of the loan is below 6.5%, and is to be repaid in cash over ten years.⁵³⁶ In addition, a MoU was signed with Sinopec regarding cooperation in exploration, refining, petrochemicals and the supply of related goods and services. The US\$10bn loan from CDB is the largest foreign funding ever obtained by Petrobras. The

⁵³¹ Investment estimated at US\$174.4bn, a 55% increase over the previous year plan.

⁵³² Petrobras, "Petrobras apresenta seu plano de negócios 2009-2013", 23 January 2009, available online at: <http://www.clickmacae.com.br/?sec=47&pag=noticia&cod=6775> (accessed 16 February 2010)

⁵³³ Interview, Petrobras, Beijing, China, 1 September 2009.

⁵³⁴ The protocol included fuels, electricity, joint exploration and processing of minerals (iron ore, copper, aluminium and coal), natural gas and oil joint exploration, and cooperation in the refining of heavy crude oil.

⁵³⁵ Mylena Fiori, Agência Brasil, "China e Brasil condenarão medidas protecionistas de países ricos em reunião do G20", 19 February 2009, available online at: <http://www.agenciabrasil.gov.br/noticias/2009/02/19/materia.2009-02-19.5480173551/view> (accessed 16 February 2010)

⁵³⁶ Xinhua, "Petrobras to borrow US\$10bn from CDB, raise oil exports to China", 20 May 2009, available online at: http://www.china.org.cn/business/2009-05/20/content_17803160.htm (accessed 16 February 2010)

final loan contract was signed in November 2009⁵³⁷ and the first batch of US\$3bn entered Petrobras's account just before the end of that year.⁵³⁸

The loan agreement also refers to China supplying “equipment and services in the areas of liquefied natural gas (LNG) facilities, offshore drilling rigs and service ships.”⁵³⁹ Allegedly, the loan agreement states that US\$3bn of the remaining US\$5bn batch should be earmarked for the procurement of machinery and equipment from China.⁵⁴⁰ This, however, might be not as straightforward in practice, given that Brazilian legal dispositions require high levels of local content and public tenders to be undertaken. According to a Brazilian energy sector analyst, some difficulties regarding the loan already emerged during 2010 owing to Chinese content issues. This state of affairs explains why no official announcement has yet been made regarding an extension of a second batch of US\$10bn that has been profusely reported in the media over the past year, and the negotiation around which has been corroborated by Petrobras.⁵⁴¹

China does, however, have a very good technical capacity in the sector, and is thus likely to grab a significant share of the contracts in the end. There is actually a lot of Chinese oil industry equipment already being used by Petrobras, namely a new round oilrig engineered by Norway and which was built in China.⁵⁴² The issue, however, is that Brazil has now a strong interest in developing these industries domestically. In line with this, a Sinopec manufacturing plant to produce oil equipment in Brazil is under negotiation.⁵⁴³

As collateral to the US\$10bn loan, Petrobras signed a ten year oil supply contract with Sinopec's trading company, UNIPEC, to provide 150,000 bpd in the first year and 200,000 bpd in the following nine years. Furthermore, shortly after the loan extension, Petrobras offered Sinopec partnership in two oil blocks.

The two oil blocks are located off the coast of Northern Brazil, in the Amazonas River mouth (Pará-Maranhão Basin: BM-PAMA-3 and BM-PAMA-8). Petrobras had gained 100% control over these two deep-water blocks (1,000 m) in 2001 and 2004 auctions. Sinopec is expected to participate in the venture

⁵³⁷ Petrobras, “Assinatura do contrato com China Development Bank Corporation”, 4 November 2009, available online at: http://www2.petrobras.com.br/ri/spic/bco_arq/Assinaturacontrato_CDBFinalPort.pdf

⁵³⁸ Nielmar Oliveira - Agência Brasil, “Banco chinês repassará US\$ 3 bilhões para Petrobras ainda este ano”, 9 November 2009, available online at: <http://www.agenciabrasil.gov.br/noticias/2009/11/09/materia.2009-11-09.2929662662/view> (accessed 16 February 2010)

⁵³⁹ According to: Interview, Petrobras, Rio de Janeiro, Brazil, 21 July 2009; Fareed Mohamedi - PFC Global Risk, “China: a new model in overseas oil strategy”, 11 September 2009, available online at: http://www.china.org.cn/opinion/2009-09/11/content_18509242_2.htm (accessed 16 February 2010)

⁵⁴⁰ Georges Landau, “Brazil-China”, in: *Brazil Focus Newsletter*, April 2010.

⁵⁴¹ Interview, Petrobras, Beijing, China, 1 September 2009.

⁵⁴² Interview, Petrobras, Beijing, China, 1 September 2009.

⁵⁴³ Interview, Petrobras, Beijing, China, 1 September 2009.

with investment and equipment, and the JV is understood by Petrobras to be a trial before venturing together into ultra-deep water.⁵⁴⁴ The stakes in those blocks, however, were not immediately made accessible to Sinopec. It took a year of negotiations between the two companies before final agreement was signed during Hu Jintao's visit to Brazil in April 2010, whereby Sinopec was formally given access to 20% stakes in each block.⁵⁴⁵ The amount China paid for the stakes was not disclosed. The two blocks are still in prospection phase and after a few delays, the drilling is scheduled to start in BM-PAMA-3 in early 2011 and BM-PAMA-8 later that year. The delays were mostly due to difficulties in obtaining all the required environmental permits, since these blocks are located in a very sensitive area (Amazon River mouth). Although prospects are good, drilling operations will be costly (estimated US\$100 mn for each well, same as in the pre-salt) and environmental and logistic challenges are massive (namely, drilling depth up to 6,000 m and subsea currents from the Amazon).⁵⁴⁶

The year 2010 was auspicious for Chinese interests in the oil industry in Brazil. In addition to the equity acquired as collateral to the CDB loan, Chinese NOCs also accessed important oil acreage in Brazil through mergers and acquisitions, benefiting from severe liquidity contraction of other players active in the Brazilian oil industry.

In May 2010, Sinochem farmed in a 40% stake for US\$3bn from Statoil's Peregrino field⁵⁴⁷ in Campos basin (BM-C-7 block), 85 km from Rio de Janeiro. Notably, among the unsuccessful bidders figure CNOOC.⁵⁴⁸ Peregrino, in which Statoil retained a 60% operatorship stake,⁵⁴⁹ is a shallow-water field (100-120 m) estimated to have recoverable reserves of between 300-600 million barrels of heavy crude oil.⁵⁵⁰ It is expected to come on-stream in 2011, and its output to increase up to 100,000 bpd by early 2012, with a life span of 30 years.⁵⁵¹

⁵⁴⁴ Interview, Petrobras, Beijing, China, 1 September 2009.

⁵⁴⁵ Gareth Chatwynd, "Sinopec leads Chinese investment charge in Brazil", *Upstream Online*, 28 May 2010, available online at: www.upstreamonline.com (accessed 8 February 2011).

⁵⁴⁶ Fabio Palmigiani, "Sinopec gets set for Brazil deep debut", *Upstream Online*, 29 October 2010, available online at: www.upstreamonline.com (accessed 8 February 2011).

⁵⁴⁷ Leslie Hook and Jude Webber, "China Taps into Argentina's oil prospects", *Financial Times*, 12 December 2010, available online at: <http://www.ft.com/cms/s/0/7acec448-0626-11e0-976b-00144feabdc0.html#axzz1BNkQPIWN> (accessed 8 February 2011).

⁵⁴⁸ News wires, "Chinese pair bid on Peregrino", *Upstream Online*, 13 May 2010, available online at: www.upstreamonline.com (accessed 8 February 2011).

⁵⁴⁹ Statoil had bought its partner Anadarko a 50% share in 2008 for US\$1.8 bn.

⁵⁵⁰ Gareth Chetwynd and Xu Yihe, "Sinochem swoops for Peregrino deal", *Upstream Online*, 28 May 2010, available online at: www.upstreamonline.com (accessed 8 February 2011). Statoil had bought its partner Anadarko a 50% share in 2008 for US\$1.8bn.

⁵⁵¹ Upstream, "Statoil closes in at Peregrino", *Upstream Online*, 10 December 2010, available online at: www.upstreamonline.com (accessed 8 February 2011).

Towards the end of the year, China acquired its most significant stake in Brazil's oil industry to date - opening the door to pre-salt exploration. In October 2010, Sinopec signed an agreement with Repsol YPF SA, to buy a 40% share in its Brazil unit for US\$7.1bn - the largest energy deal that year and Sinopec's second largest overseas acquisition after Addax in 2009 (US\$7.2 bn). Repsol Brazil had originally planned to issue a public offering of its shares to raise the capital needed to develop its acreage in Brazilian pre-salt. Its recoverable reserves in Brazil were then estimated at 1.2 bn barrels.⁵⁵² The deal gave birth to *Repsol Sinopec Brazil* in December, creating one of the largest LA energy companies.⁵⁵³ The price Sinopec paid for the stake is, apparently, much higher than its real value. Wood Mackenzie had at that time valued Repsol's assets in Brazil at US\$1.6 bn.⁵⁵⁴ The high premium paid can only be explained by assumptions of high oil prices in the future, and high expectations about new reserves to be found. The high price paid for this asset also signals China's eagerness to acquire acreage overseas.

Repsol's Brazil Unit was the third largest oil producer in Brazil in 2009, and is the second largest holder of exploratory rights after Petrobras in Santos, Campos and the Espirito Santo Basins, which cover the pre-salt area.⁵⁵⁵ Repsol has participation in 24 blocks, holding operatorship stakes in 11 of them.⁵⁵⁶ Most of its exploration rights (19) are located in Santos Basin, home to the mega Tupi well discovery in 2007 (reserves estimated at 5-8 billion barrels). Among its assets figure one producing field, eight discoveries, and many exploratory projects and identified areas of potential.⁵⁵⁷ The producing field, Albacora Leste - located in Campos basin - has estimated reserves of 565 million barrels of heavy crude oil (deep-water).

⁵⁵² John Duce, "Sinopec Group pays very high premium for Brazil oil reserves", Bloomberg, available online at: <http://www.bloomberg.com/news/2010-10-02/sinopec-invests-7-1-billion-in-repsol-brazil-unit-to-tap-offshore-fields.html> (accessed 8 February 2011).

⁵⁵³ Upstream staff, "Repsol ties up \$7.1bn Sinopec deal", *Upstream Online*, 29 December 2010, available online at: www.upstreamonline.com (accessed 8 February 2011)

⁵⁵⁴ Cited by: Christopher Helman, "Sinopec dreaming big in deal for Repsol's Brazil fields", *Forbes*, 1 October 2010, available online at: <http://blogs.forbes.com/christopherhelman/2010/10/01/sinopec-dreaming-big-in-deal-for-repsols-brazil-fields/> (accessed 8 February 2011).

⁵⁵⁵ Repsol Press Release, "Repsol and Sinopec form alliance in Brazil", 1 October 2010, available online at: http://www.repsol.com/es_en/corporacion/prensa/notas-de-prensa/ultimas-notas/01102010Repsol-brasil-sinopec.aspx (accessed 8 February 2011)

⁵⁵⁶ Repsol Press Release, "Repsol announces the commercial viability of Piracuca field in Brazil", 13 April 2009, available online at: http://www.repsol.com/es_en/corporacion/prensa/notas-de-prensa/ultimas-notas/Repsol_campo_piracuca_en_brasil.aspx (accessed 8 February 2011)

⁵⁵⁷ Repsol Press Release, "Repsol and Sinopec form alliance in Brazil", 1 October 2010, available online at: http://www.repsol.com/es_en/corporacion/prensa/notas-de-prensa/ultimas-notas/01102010Repsol-brasil-sinopec.aspx (accessed 8 February 2011)

Production started in 2006⁵⁵⁸ and current output is 180,000 bpd, nearly 10% of Brazil total production.⁵⁵⁹ In May 2010, evidence of oil was found under the pre-salt layer of the Albacora field.⁵⁶⁰

Other major finds in Repsol's acreage took place in Santos Basin. These include Piracuca (BM-S-7), where Repsol holds a 37% stake, and with an estimated 550 million boe;⁵⁶¹ and Guara and Carioca (both in BM-S-9), where Repsol holds a 25% share. Guara alone is estimated to have recoverable reserves of 1.1-2 billion barrels of oil, and is expected to start production in early 2013 with an output of 120,000 bpd,⁵⁶² which will make it the second largest producing well in that basin after Tupi. Carioca alone was in 2008 reported to have potential reserves of 33 billion barrels, which would make it the largest find in the last 30 years. Petrobras, however, has been very cautious in putting forward a final figure, as it remains unclear how much of that reservoir is recoverable. Other relevant discoveries in that basin include Iguacu, Vampira and Panoramix.

Table 5.4. Chinese NOCs oil acreage in Brazil

Oil Asset	Consortium	Estimated Reserves (Barrels)	Known Investment	Progress Stage, Depth and Crude Grade	Total Production (year start)	Chinese NOCs net share
SINOCHEM 40% Block BM-C-7: Peregrino Campos Basin (May 2010)	Satoil 60% (Op.)	300-600 million	US\$3bn	Development phase; Shallow-water (100-120 m); Heavy crude (14-15 API)	100,000 bpd (to start early 2011)	40% production: 40,000 bpd (2011) reserves: 120-240 million barrels
SINOPEC	Petrobras 80% (Op.)	Unknown	Undisclosed	Exploration phase (drilling)	-	

⁵⁵⁸ Upstream staff, "Petrobras scents oil at Albacora Leste", *Upstream online*, 17 May 2010, available online at: <http://www.upstreamonline.com> (accessed 8 February 2011)

⁵⁵⁹ Portugal Digital, "Vazamento de gás suspende temporariamente produção de plataforma da Petrobras", 7 February 2011, available online at: <http://www.portugaldigital.com.br/noticia.kmf?cod=11459762&canal=159>

⁵⁶⁰ Upstream staff, "Petrobras scents oil at Albacora Leste", *Upstream online*, 17 May 2010, available online at: <http://www.upstreamonline.com> (accessed 8 February 2011).

⁵⁶¹ Repsol Press Release, "Repsol announces the commercial viability of Piracuca field in Brazil", 13 April 2009, available online at: http://www.repsol.com/es_en/corporacion/prensa/notas-de-prensa/ultimas-notas/Repsol_campo_piracuca_en_brasil.aspx (accessed 8 February 2011).

⁵⁶² Diana Kinch, "Brazil Petrobras starts long term test at Guara pre-salt site", 27 December 2010, Dow Jones Newswires, available online at: <http://online.wsj.com/article/BT-CO-20101227-705231.html> (accessed 8 February 2011).

<p>20% Block BM-PAMA-3 & 20% Block BM-PAMA-8 Para-Maranhao (May 2010)</p>				<p>to start early 2011);</p> <p>Ultra-deep water (up to 5,880 m);</p> <p>Crude grade unknown</p>		<p>20%</p> <p>20%</p>
<p>REPSOL-SINOPEC (October 2010)</p> <p>10% Albacora Leste (Campos Basin)</p> <p>37% BM-S-7 Piracuca (Santos Basin)</p> <p>25% BM-S-9 (Santos Basin)</p> <p>Guara</p> <p>Carioca</p>	<p>Petrobras 90% (Op.)</p> <p>Petrobras 63% (Op.)</p> <p>Petrobras 45% (Op.), BG Group 30%</p>	<p>565 million</p> <p>550 million</p> <p>1.1-2 billion</p> <p>(Yet Unknown)</p>	<p>US\$7.1bn</p>	<p>Production phase; Deep-water (800-2,000 m); Heavy crude (20 API)</p> <p>Exploration phase; Pre-salt (5,175 m); Medium crude</p> <p>Development (found June 2008); Pre-salt (2,141 m); Medium crude (28 API)</p> <p>Exploration Phase (found Sep. 2007); Pre-salt (2,151 m); Medium crude (26 API)</p>	<p>180,000 (2006)</p> <p>-</p> <p>120,000 (to start in 2013)</p>	<p>4% Production: 7,200 bpd Reserves: 22.6 million barrels</p> <p>14.8% Reserves: 81.4 million</p> <p>10% Production: 12,000 bpd (2013) Reserves: 110-200 million</p>
<p>Total Chinese NOCs</p>	-	-	<p>US\$10.1bn</p>	-	-	<p>Production: 2011: 47,200 bpd 2013: 59,200 bpd Reserves 305-515 million barrels</p>

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Sources: Agencia Nacional do Petróleo; Petrobras; Repsol; Statoil; various news reports (Upstream online, Offshore, Oil & Gas, Bloomberg).

As shown in the table 5.4 (above), Chinese NOCs' oil equity in Brazil only materialised in 2010, the most promising of which was through direct acquisition. Of these only one is in production phase (Albacora, Sinopec's net share: 7,200 bpd), with another well scheduled to come online in 2011 (Peregrino, Sinochem net share: 40,000 bpd), and a third one expected to start producing in 2013 (Guara, Sinopec: 12,000 bpd) - according to table 5.4, Chinese NOC total production is expected to reach nearly 60,000 bpd that year. This summation is, however, an under-estimate as it only shows blocks declared commercially viable at the end of 2010.

More recently, in November 2011 Sinopec signed a USD 5.2 billion deal to acquire 30% stake in the Brazil unit of Galp Energia (Portuguese oil company) (Ma 2011). Galp has stakes in 33 blocks in Brazil, four of which located in the pre-salt Santos Basin. It's most valuable asset is a 10% stake in Lula field (former Tupi, or BM-S-11), the most promising in the pre-salt, which recoverable reserves are estimated at 8.3 billion barrels of oil and gas (Galp Energia 2011). Although at very early stages of production it is expected to reach 100,000 bpd by 2012.

Furthermore, Chinese NOCs are also eyeing BG (British Gas) and OGX's (hydrocarbons arm of Brazilian billionaire Eike Batista Group, EBX) oil assets in Brazil. With this in mind, and taking into account Chinese NOCs' willingness to participate in the next oil auction (still to be scheduled) there is much potential for China's equity in Brazil oil industry to expand further in coming years.

The way Sinopec accessed this oil equity in 2010 is, however, raising some eyebrows in Brazil. This is mostly explained by the fact that in a very short period of time, Chinese state-owned companies obtained significant acreage through favoured access, mergers and acquisitions. This was therefore outside of what is regarded as the main legal instrument to enter the sector: through bidding in competitive oil auctions. The equity accessed as collateral (in association with Petrobras) has fed into the common perception in the oil industry in Brazil, that Chinese NOCs prefer to do business on a government to government level and directly with Petrobras, as in their view that increases their chances of being favoured in accessing oil equity.⁵⁶³ In the words of a former ANP president: "the Chinese want concessions, they do not enter bidding processes."⁵⁶⁴

⁵⁶³ Interview, Instituto Brasileiro de Petróleo, Rio de Janeiro, Brazil, 23 July 2009

⁵⁶⁴ Interview, J.F.Associados Consulting, Rio de Janeiro, Brazil, 23 July 2009

5.3. Chapter conclusions

The China-Brazil axis is undoubtedly one of the most prosperous alliances in the southern hemisphere at present. This reality, however, took long to accomplish, with bilateral relations having lingered throughout three decades. The most striking and successful feature of contemporary relations is bilateral trade, with China having become Brazil's major trading partner in 2009. During the 2000s, China-Brazil bilateral trade was characterised by dramatic growth rate and an increasing concentration of China's imports in low aggregated value products. The commodities share in Chinese imports rose sharply over this period, being dominated by iron ore, which has had a relevant position in exports chart since the early days, and soya, the exports of which picked up in late 1990. The most significant shift in bilateral trade over this period, however, was the addition of a third commodity to the Brazil-China exports chart: oil. Oil's share in terms of trade increased exponentially towards the end of the decade. In line with this trend, and given Brazil's rising profile as an oil producer in the wake of the pre-salt discoveries, China's interest in Brazil's oil industry increased substantially towards the end of the decade.

Even though the necessary conditions were present from the start (China's financial might and thirst for resources on the one hand and Brazil's infrastructure needs and abundant resources on the other), China's infrastructure-for-oil formula has struggled to secure long term supply and facilitate the penetration of Chinese investment in Brazilian resources sectors. This is even more striking, considering that both parties have repeatedly expressed - throughout the decade - strong willingness to expand Chinese investments in Brazil's mining and oil sectors. Although China managed to secure an infrastructure contract (Gasene project) for Sinopec through a CDB loan, it failed to meet its own oil diplomacy goals. The major benefit for China was the raising of Sinopec's profile in Brazil, through the successful management of this project.

The case study has shown, however, that Chinese economic incentives performed better in the crisis context. The extension of the US\$10bn credit line to Petrobras, granted China a long-term oil supply contract and stakes in two blocks as collateral. Nonetheless, the collateral equity fell slightly below expectations, since these were minority stakes in shallow waters. Furthermore, these blocks are yet to start producing and took long to materialise. In sharp contrast, Chinese NOCs venturing on their own managed to secure much better assets that same year through farming in deals.

Against this background, it could be considered that Chinese oil diplomacy failed to meet expected outcomes (long term oil supply and access to assets) in the first phase of bilateral relations, and even though it performed better in the crisis setting, success with regard to equity access, was still modest.

The final chapter will elaborate on the explanation of this state of affairs and on overall findings across the two cases studies.

CHAPTER 6: CONCLUSION

Chinese energy companies launched several successful cooperation projects with resources-rich countries in the exploration and operation of energy sources, either through joint ventures or acquisition (...). Now we are offering these countries bank loans, and that's a new way of cooperation. 565

Zhang Guobao (Deputy Minister of NDRC and Head of NEA)

The above citation clearly demonstrates the critical role that economic incentives play in pursuing China's energy security goals overseas. As discussed above this is particularly evident in China's oil diplomacy towards Angola and Brazil over the past decade.

Infrastructure-for-oil loans surfaced as a default positive economic statecraft instrument, justified by the relative inexperience of China's foreign policy makers in pursuing its energy security goals overseas, an endeavour that emerged for the first time at the turn of the century. It was not a carefully devised strategy based on detailed knowledge of the contexts it was targeting, but rather was rooted in China's domestic experiences (the oil backed loans for infrastructure it received from Japan in the 1970s; its highly centralised domestic institutional structure) and strengths (financial muscle and booming infrastructure sector). The approach also works as a risk management tactic in unknown markets, and in a way to insulate its NOCs from direct competition with IOCs which have a significant technological competitive advantage - particularly regarding ultra-deep water exploration. This state of affairs largely explains why Beijing attempted to deploy the same template in both Angola and Brazil, in the initial stages of its ventures overseas.

Based on the findings of the two case studies, the candidate distinguishes two different phases in the deployment of this particular economic inducement in Africa and South America. The marker that divides the two periods is a structural change that occurred at the international system level, and which affected

⁵⁶⁵ China Global Think Tank Summit, which took place in Beijing in an early July gathering of world energy leaders. Shangyu Foreign Trade and economic Cooperation Bureau, "Energy cooperation urged at think tank", available online at: http://sywjmj.gov.cn/zsj/etzzx/Article_Show.asp?ArticleID=2834 (accessed 15 January 2011).

all players - ultimately reflecting in their relations. This structural shift was the onset of the global financial crisis in late 2008, which profoundly impacted international oil markets, affecting behaviour in both demand and offer sides. This assessment is justified by the current research, which has shown that significant changes to the original template occurred over the crisis period in South America. For this reason, the validity of the hypothesis prior to the crisis is assessed first, followed by an analysis of the most relevant adjustments that were inflicted by the global financial crisis.

6.1. Assessing the hypothesis prior to the crisis

The analysis of the thread of events throughout this period, has clearly demonstrated the causal link between fundamental institutional differences in both regions, and the outcome variation of Chinese energy security goals, as proposed in the hypothesis.

The analysis of Angola and Brazil's institutional structures (chapters 3 and 4) has verified fundamental differences between them, largely rooted on their respective historical backgrounds. While in Angola the patrimonial state managed to consolidate through liberalisation, in Brazil the centralised rule installed by the developmental state was shattered by the liberalisation process. Despite the emergence of an institutional structure strongly suggestive of legality and democratic practice in Brazil's oil industry, the changing balance between liberal and leftist forces, combined with weak institutional capacity and strong executive constraints, makes the structure somewhat unstable and more difficult to navigate. In Angola, on the other hand, despite the feeble institutional capacity of the structure, the combination of the Presidency's absolute control over the state apparatus and resources, with insubstantial executive constraints, produced a highly centralised and clear-cut institutional structure in the oil industry.

Owing to its highly centralized nature, the institutional and regulating structure of the oil sector in Angola has remained mostly unchanged and stable for over three decades. Concurrently assuming the role of virtual regulator and concessionaire, Sonangol was from the beginning placed at the core of the oil industry of Angola, at the expense of the Ministry of Petroleum. The linear and uncontested authority chain rooted in the Presidency-Sonangol nexus, ensures the executive easy control over developments in the sector.

In sharp contrast, the oil industry in Brazil presents a much more fragmented institutional structure. It encompasses several layers of authority, namely the Presidency, the Congress and the Senate, the energy advisory body (CNPE), the responsible ministry (MME), the regulating agent (ANP), the Union states and the public company (Petrobras). Moreover, the regulatory framework is also much more complex in

Brazil, owing to an intricate and sometimes conflicting set of regulations - the Oil Law, and environmental and labour rules.

The critical impact of the underlying institutional structure upon the original infrastructure for oil template, is proven in the first instance by the sharp contrast in negotiation processes regarding the first credit lines extended to Angola (EXIM Bank, US\$2bn for various infrastructure projects) and Brazil (EXIM Bank, initial US\$239mn for an gas pipeline) in 2004. The detailed analysis of both case studies has shown that, while there was a swift negotiation progression and almost immediate disbursement of funds in Angola, in Brazil the process was contentious and lengthy, taking three years to settle. This was largely due to EXIM Bank's demands regarding Chinese content, which collided with Brazilian labour regulations and industrial policy. This was never an issue in Angola, where the agreement was readily settled on 70% Chinese content (services, equipment and labour).

The case studies also demonstrated diverging outcome patterns regarding China's oil security goals. While in Angola Sonangol assumed the role of loan guarantor enabling China to secure long-term supply through repayment in kind; in Brazil the Union assumed the role of guarantor and the deal produced no long-term supply contracts, either as collateral or as reimbursement.

The study of the Brazil and Angola cases also revealed that in both instances Beijing pushed for a close association of Sinopec with the local NOCs on the fringes of the loan, ultimately envisaging the achievement of favoured access to oil acreage. In line with this, Sinopec signed cooperation agreements with both Sonangol and Petrobras within the broad loan negotiations framework, which confirms that Beijing approached the two countries in a similar way. However, only in the Angolan case was an actual close association between the two NOCs enacted in the form of a JV (Sonagol Sinopec International), and immediate access to oil assets was produced (50% of block 18) shortly after the loan signature. In sharp contrast, in the Brazilian case, the partnership between Petrobras and Sinopec remained only on paper, and no oil assets were produced for Sinopec.

The analysis of the Brazilian case clearly points to the underperformance of infrastructure-for-oil strategy in Brazil. Firstly the deal (Gasene project) materialised in very different terms of what was originally conceptualised by China. In order to secure the gas pipeline construction contract for Sinopec, Beijing was forced to sacrifice the fundamentals of its infrastructure funding model (namely regarding Chinese content), to accommodate the complexities of local institutional constraints. Secondly, the deal did not produce long-term supply contracts or any oil equity as collateral. This state of affairs exposes the

unsuitability of this specific instrument of Beijing's positive economic statecraft towards Brazil's decentralized and more regulated institutional framework.

In contrast, the analysis of the Angolan case study, has clearly shown how the perfect match between China's infrastructure-for-oil formula and the Angolan centralised institutional structure concurred to produce a successful outcome with regard to China's energy security goals. The close elite ties built up through the inter-governmental platform of the loans extension (and also through the personal connections established by Sinopec through the Hong Kong clique), were undoubtedly a critical element in ensuring success in such a highly centralised environment. Another issue ensuring success was the Angolan executive's strong grip over Sonangol (fully state owned), and hence its larger latitude to manipulate developments in the oil industry.

Unlike in Angola, the high level contacts between the two governments were not sufficient to secure the expected results in Brazil. This is explained by the fact that Brasilia's influence over the oil industry is curtailed by the semi-private nature of Petrobras, and the checks and balances that have been put in place during liberalisation of the sector. Even though Brazil's federal government has a controlling stake in Petrobras, it does not have full ownership of the NOC. The fact that Petrobras is also accountable to its private shareholders means that it is less susceptible to political influence in its decision making. In addition to this, in spite of Petrobras's virtual monopoly over the local oil industry, the sector is managed by a separate regulatory body responsible for oil auctions, contracting and overseeing developments in the industry. This state of affairs thus limits the possibilities for Chinese interests to penetrate the sector by special favour.

Against this backdrop, it could be concluded that the hypothesis is fully verified. Due to its elite-based approach and specificities (i.e. Chinese content) the extension of infrastructure-for-oil loans works best (regarding energy security goals) in institutional contexts where there is a high degree of control of the executive over the oil sector (i.e. Angola), and conversely it performs poorly in more liberalised contexts (i.e. Brazil).

In the broader regional frame, the above suggests that although Beijing had correctly identified similar key prerequisites in Africa and South America for the deployment of infrastructure-for-oil loans, namely the need to upgrade much depleted infrastructure and generous resources endowment, it failed to take into account structural differences in the social, economic and political environments, which ultimately dictated different degrees of success. The much more liberalised institutional structure and sophisticated regulatory framework that is commonly found in South America, which contrasts sharply with what it

encountered in Africa (more similar to China's own domestic structure), largely explains the lower performance of this formula in South America.

6.2. Adjusting infrastructure-for-oil deals in the context of the financial crisis

The research conducted uncovered that significant changes have emerged in 2009-2010 regarding China's oil diplomacy in Brazil. These changes have largely been a result of new synergies that emerged in the context of the global financial crisis. First and foremost, China's position as a global lender improved dramatically in tandem with the credit crunch in the international financial markets, particularly so in developing regions where many governments were facing low credit ratings in a context where infrastructure and resources development had become a critical element to sustain the economic growth cycle. Secondly, Chinese companies were the only ones with abundant financial resources in a period where many resources assets were placed on the market by western NOCs in financial difficulty. This state of affairs opened a window of opportunity for Chinese NOCs to expand their resources asset portfolios in both regions.

In Brazil, Petrobras greatly needed funds to develop newly found pre-salt reservoirs, and the economic crisis context finally placed China in a position where it would be favourably considered. After many years of unsuccessful attempts to access oil acreage through the infrastructure-for-oil formula, developments in Brazil during 2009 and 2010 showed that Beijing's economic incentives have finally adjusted to local institutional constraints.

The revised formula is, however, largely rooted on the original template and devised to pursue the same oil security goals. Although the US\$10bn loan extended by CDB to Petrobras in 2009 is not to be repaid in oil, it has an oil supply contract attached (signed between Petrobras and Sinopec) covering the duration of the loan repayment; and secondly, Petrobras offered Sinopec partnership in E&P activities in two deep-water blocks as collateral to the deal. The similarities in the approach are justified by the fact that at this particular point Beijing still perceived the close partnership with Petrobras as its best chance to enter the promising pre-salt reservoirs. This perception was further strengthened by the suspension of annual oil auctions in 2008, and that Petrobras's grasp over the pre-salt was expected to be reinforced by the new regulatory framework being drafted.

On the other hand, there are a number of changes in the above-mentioned deal that reveal some degree of adjustment to the specificities of the local institutional structure. Firstly, the loan was directly negotiated and extended to the NOC and not to the Brazilian executive, and although lower than commercial rates,

the interest rate was higher than Chinese concessional loans. Secondly, the deal was not aimed at infrastructure but rather to finance development of the pre-salt reservoirs. Thirdly, the loan is not to be repaid in oil shipments. Lastly, building on the experience with the Gasene credit line, the Chinese content was reduced to a minority parcel, in order to cope with the local content restrictions imposed by the Brazilian regulations. The above developments show, therefore, that China had at last realised the unsuitability of some features of its positive economic statecraft in the institutional framework in Brazil.

The acreage collateral to the Petrobras loan, however, took a long time to materialise. Sinopec underwent a long negotiating process with Petrobras (May 2009 to April 2010) regarding the acquisition of 20% stakes in two oil blocks. In addition, the blocks are still in the development stage and out of the much more promising pre-salt belt. This state of affairs shows that although China achieved better results after adjusting its strategy to fit the institutional framework in Brazil, the outcome was still much less successful than in Angola.

This strategy has thus proven to have short-term prospects of securing meaningful oil equity in Brazil, especially in the pre-salt. Indeed, and even though Brazil has a real interest in expanding its oil exports to China and in fostering Sino-Brazilian JV in the sector (particularly in downstream, midstream and to produce oil equipment in Brazil), its interest in forging partnerships with Chinese NOCs for E&P in the pre-salt is in reality, limited. This is mostly because, first, the companies are seen as pursuing Chinese state interests; and secondly, that Chinese NOCs lack the necessary technological skills and expertise to qualify as critical partners in the initial development phases of the pre-salt. In this setting, Petrobras is more likely to privilege partnerships with oil IOCs over Chinese NOCs, which might only get supply and service contracts and some marginal equity in exchange for funding.

Even if China has found that its funding provided a bargaining instrument to enter the Brazilian oil market, the future leverage of this instrument will depend on how badly Petrobras needs Chinese funds. With its swelling oil reserves and production, Petrobras will likely have no difficulty in raising funding domestically and in international financial markets. This was recently proven by the US\$70bn issue of new shares in 2010.

In this setting, and having no prospects of developing the necessary top-end drilling technology in the short run, the best option for Chinese NOCs is thus to participate in coming bidding rounds or to buy equity from other players divesting in the sector. And looking at recent developments, they seem to be finally reaching that conclusion.

In 2010 the international economic crisis context opened a window of opportunity for Chinese companies to grab oil equity in Brazil outside intergovernmental agreements. With most IOCs facing serious liquidity shortages in a setting where large investments needed to be made to develop pre-salt acreage, many assets were placed in the market in 2010. It was in this framework that Sinopec accessed its first acreage in the much sought after pre-salt reservoirs. This happened through a merger with Repsol Brazil, without any inter-governmental supporting platform or any special favour from the local NOC.

Similar developments surfaced in other South American countries. The signing of a number of infrastructure loans in 2009 and 2010 (Ecuador, Colombia, Argentina) alongside direct acquisitions and mergers, suggests though that the revised infrastructure-for-oil formula remains a resourceful instrument for China in pursuing its oil security interests in South America. According to available information on these new infrastructure loans, and although Chinese engineers are to oversee operations, the labour is largely local and so is the bulk of local content (contractors and equipment). In the same way, South American governments tend to retain the majority stake in resources joint ventures with Chinese State companies, a trend mostly explained by the nationalistic nature of a significant number of regimes in the region. Like in Brazil, and Venezuela excepted, none of these loans are to be repaid in oil, although some of them entail supply contracts as collateral covering the repayment period (Brazil and Ecuador). Interestingly, unlike in Africa, this type of Chinese positive economic statecraft seems to be privileging oil-producing countries in South America, having left out until now major mining producers such as Chile and Peru. In addition, the swift acquisitions in 2010 suggest that the acquisition of oil equity in the region is becoming more rooted in market rules, and less so in inter-governmental platforms.

The impact of the financial crisis produced a very different set of nuances in Angola. As discussed in the Angola case study, following the souring of relations with Sonangol in the sequence of the Sonaref episode in 2007, Sinopec attempted to expand its oil portfolio in Angola by venturing on its own when the economic crisis began. However, the direct acquisition strategy that proved so fruitful in Brazil, failed to produce results in Angola, as Sonangol blocked its bids to acquire new oil assets in that country. In this context, and with no licensing round expected in the near future, recent developments indicate that Beijing has returned to its original model (based on solid inter-governmental relations and a strong partnership with the local NOC). This is demonstrated by the extension of new infrastructure-for-oil credit lines (US\$10bn) in 2009, and Sinopec's attempt (March 2010) to revitalise its partnership with Sonangol through the cosmetic change in ownership of its 55% stake in the JV (SSI).

Unlike in Brazil, the crisis context in Angola forced Beijing to return to its original approach. Recent developments, as discussed in the Angola case study, suggest that in face of this shift, Luanda is making a new overture to accommodate Chinese energy security interests. This demonstrates that this particular instrument of China's positive economic statecraft is as well fitted now as it was in 2004, for the centralised institutional framework that characterises the Angolan oil industry.

In both Angola and Brazil cases, the changes introduced were ultimately adjustments to the surrounding institutional structure, which further confirms the hypothesis put forward at the beginning of the thesis. However, it is important to stress that in spite of the adjustments of the means, China's energy security goals remain the same – to secure long-term supply and favoured access to oil equity. In theoretical terms, this means that what is ultimately at stake here is in fact the lesser form of learning that occurs at the tactical level, dubbed adaptation.

6.3. Emerging trends, challenges and future prospects

As demonstrated above, the adjustments that took place in China's economic statecraft allowed Beijing to pursue its oil security goals more efficiently in South America. As China learns with practice, and adjusts its strategies to fit different institutional structures, its economic statecraft is bound to assume distinct characteristics in each region.

Since corporate strategies have proved to work better in the more liberalised South American context, direct acquisition and mergers are becoming the norm for China in accessing oil equity in this region. Notwithstanding this, the provision of soft loans remains a resourceful tool here, particularly to secure long-term oil supply contracts - a goal that remains paramount in Chinese energy security since most of its NOCs' acreage overseas is yet to start producing. Moreover, the recent negotiation spree in terms of loans for infrastructure (Argentina, Ecuador, Colombia - all oil producing countries) signals China's eagerness to pursue this positive economic statecraft formula in the region. However, as discussed above, Chinese soft loans in the region (either for infrastructure or resources development) are assuming a few distinguishing features, namely a reduced share of Chinese content and, with the exception of Venezuela, the loans are not to be repaid in kind.

Conversely, China's access to oil acreage in Africa is likely to remain very reliant on the provision of preferential credit for infrastructure to resource-rich countries, and not many changes are expected regarding its major defining features. Even though Chinese NOCs are also becoming more aggressive in African oil markets, the farming in strategy has met with mixed results (i.e. successful acquisition of

Addax in 2009; blocked bids for stakes in Angola and Libya in 2009; and no relevant oil assets through direct acquisition in Africa in 2010).

Against this background, the extension of preferential credit lines is expected to remain as a major Chinese positive economic statecraft tool for pursuing its energy goals in both regions. The major difference is that Chinese loans to South America will tend to emphasise securing long-term supply (as collateral contracts rather than repayment in kind) over access to acreage, while in Africa these types of loans will still serve both goals.

Even though the gradual consolidation of market-orientated strategies in accessing oil acreage is to be expected in both regions, Chinese economic statecraft still actually plays a significant role in this regard. China's 'policy banks' are likely to remain a key vector in pursuing the central government's broad resources security strategy, not only by providing this type of loan, but also by funding NOCs' overseas expansion strategies. This backup will be particularly important in the post-crisis setting, as Chinese companies will most likely have to pay then a significant premium for assets. This will be in order to offset its technology gap *vis à vis* western competitors, a trend that was already emerging before the onset of the crisis.

Despite the initial success of the new approach in South America, there are many challenges ahead for Chinese NOCs. Among these stand out the lack of expertise and of top technology, particularly regarding ultra-deep water exploration. Although the deep pockets of Chinese NOCs may offset this factor to some extent, it will not be sufficient to grant them operatorship stakes, nor access to the most profitable fields. Another major challenge is NOCs scarce experience in managing complex cross-border mergers and navigating heavily regulated markets. This is a particularly daunting challenge in countries with overlapping jurisdictions and complex regulations, such as Brazil. Even though this annoyance is to some extent avoided through farming in agreements, Chinese NOCs will eventually have to tackle the issue when they start bidding in the coming oil auctions.

The parastatal status of Chinese NOCs also raises concerns among some target countries, limiting in some cases their expansion prospects. A sovereign state company buying into another state's resources, does not sit well with most recipient countries. Although this type of resistance has been until now more common in the West (CNOOC-Unocal in the US in 2005; Chinalco-Rio Tinto in Australia in 2009), some concern in this regard is already surfacing in Brazil following swift acquisitions by Chinese NOCs in Brazil in late 2010. Finally, the regulatory instability of the resources sectors of some countries in both regions (e.g.

Venezuela and Nigeria) also raises serious challenges to this particular instrument of Chinese economic statecraft.

Notwithstanding all these issues, prospects are now much better than before the crisis. Chinese interests in South American resources markets are bound to expand further in the near future, and are therefore expected to close the gap with Africa in coming years.

6.4. Wider implications

In addition to the above conclusions relating to the aim of this study, the research has demonstrated that - contrary to the belief that economic statecraft is a less efficient foreign policy instrument - in China's case this tool has been quite effective in pursuing its oil security interests in developing regions. This justifies the need for more research on other forms of economic inducements used by China (e.g. namely the ones under the category of Chinese foreign aid), and their efficacy regarding the economic and political goals they pursue. A more comprehensive analysis will also help elucidate the efficacy of China's positive economic statecraft in building up long-term alliances (Mastanduno's structural linkage), and how this feeds into the expansion of its soft power, and ultimately its peaceful rise at the world stage.

This study has also shown that despite China's inexperience as a global economic player, its strategies are extremely resilient, being constantly refined through practice, and as a result they are becoming much more efficient. Furthermore, the research has demonstrated that experiences on the ground are providing an important feedback in this regard. This state of affairs clearly illustrates that in regard to China's oil diplomacy, important learning takes place at the implementation level, justifying therefore the urge to further unpack the dynamics and synergies at place in this particular phase. It should be noted, however, that even though China's infrastructure-for-oil formula experienced significant changes, these were, ultimately, mere tactical adjustments since the goals and normative underpinnings remained mostly unchanged, a finding that ultimately feeds into 'China's socialisation' debate.

Another conclusion particularly relevant for Chinese foreign policy studies, is that the changes verified in this particular case only surfaced when a structural shift occurred (the global economic crisis). This suggests that despite Beijing's agency in putting forward these economic inducements, the refining of the oil diplomacy strategy thereafter, has been to a large extent pushed by structural constraints and the pro-activeness of its agents (NOCs) on the ground.

The analysis has also exposed the high degree of pragmatism behind this particular instrument of Chinese positive economic statecraft, which knits together oil security, south-south cooperation, and 'go out

policy' goals. In this regard, this thesis has also something to say about how critical Beijing's political and financial backing has been in the globalisation of its SOEs, unveiling the emulation of the formula that was successfully developed by Japan and South Korea in the twentieth century.

This thesis has revealed that Chinese oil diplomacy is becoming increasingly resourceful and assertive in the two regions under analysis, and that positive economic statecraft will continue playing a key role in this regard. The deployment of the same type of economic inducements by China in other regions during the crisis period, namely in Russia and Kazakhstan, allows for further comparisons which would be extremely useful for a more comprehensive understanding of the dynamics and efficacy of this particular policy instrument, in pursuing Beijing's energy security goals.

All considered, in spite of China's increasingly efficient undertakings to expand its oil acreage in Africa and South America, it is still far from achieving the ultimate goal of minimising dependence on market fluctuations, since production from its equity is still largely insignificant when compared to its major competitors that have been active in these regions for decades. As China's interests spread out on the global stage, the geographical scope of its economic statecraft is likely to expand further and to become more versatile. Its efficacy regarding oil security goals will, however, depend increasingly on Beijing's awareness of the target countries' institutional frameworks and expectations, on favourable structural conditions, and in more liberalized markets, increasingly on the competitiveness of its own NOCs.

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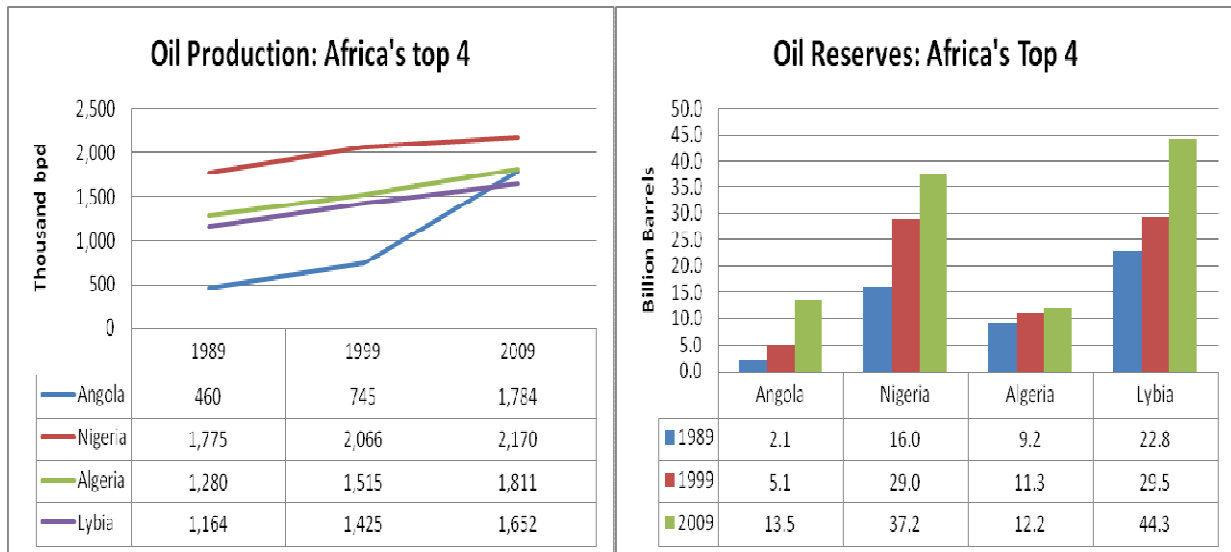
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APPENDIX 1: OVERVIEW OF THE ANGOLAN OIL INDUSTRY

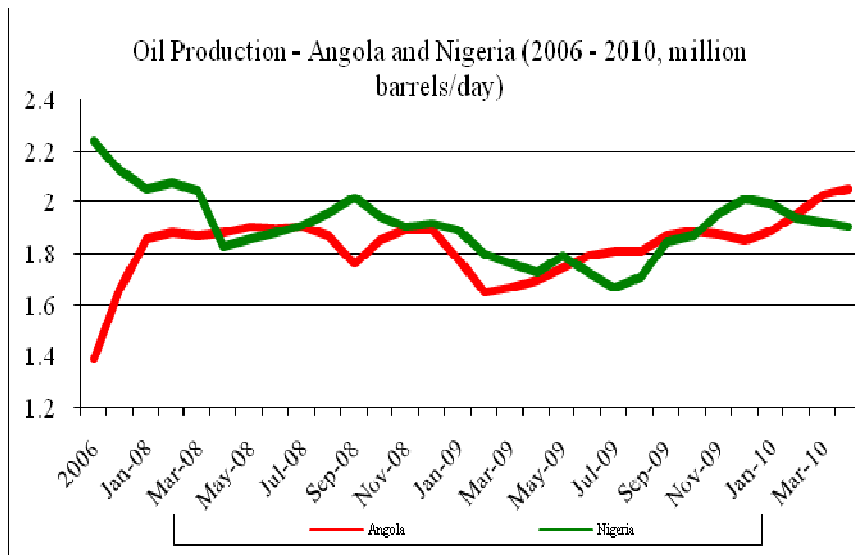
Angola is Africa’s third largest oil producer behind Nigeria and Algeria. It sits on the third largest proven crude reserves in the continent. At the end of 2009 Angola accounted for 19% of African oil output and held the equivalent to 11% of its known reserves.¹



Source: BP, *Statistical Review of World Energy 2010*

As shown in the charts above Angola’s position in the African oil industry has expanded remarkably over the past ten years, having production and reserves more than duplicated. In the process, it overtook Algeria in terms of proven oil reserves as well as Libya regarding oil output. Moreover, it is closing fast the oil production gap with Algeria and even Nigeria, with whom it has been disputing the position of largest oil producer in Sub-Saharan Africa since 2008.

¹ BP, *Statistical Review of World Energy 2010*, June 2010, available online at: <http://www.bp.com/productlanding.do?categoryId=6929&contentId=7044622> (accessed 17 August 2010)



Source: World Bank Office in Luanda, *Angola Macro Brief*, April/May 2010

In spite of having a larger output capacity and reserves, Nigeria has seen its production fall in recent years mostly due to the instability in the Niger Delta.

In contrast, the Angolan oil industry expansion has been favoured by the peaceful setting since 2002, the stable political environment and its solid record in terms of contract stability. In this auspicious context, FDI into the Angolan oil sector has expanded in recent years, having gone up from US\$2bn in 1999 to US\$16.5bn in 2009² and is expected to reach US\$18bn in 2011.³ Around 83% of 2009 FDI was directed to E&P activities in the upstream sector. This sharp rise in investment explains to a large extent the expansion of Angola's oil output and reserves over the past decade, which have projected Angola from a medium oil producer in the 1990s to one of the most promising oil producing states at present.

In a political move to ascertain its ascending relevance in the world oil industry, Angola joined OPEC in January 2007. This, however, has proved to be a costly move. In 2009 Angola was forced to downsize production from its 2 million bpd potential to 1.560m bpd in order to respect its quota, as part of OPEC's efforts to stop the fall in oil prices. Notwithstanding, figures indicate

² Ministério dos Petróleos, *Relatório de Actividades do Sector Petrolífero 2009*, Luanda: Gabinete de Estudos e Estatística – MINPET, July 2010

³ Africa 21, 'Ministro Angolano dos Petróleos anuncia no Brasil licitações para novas concessões', 27 October 2009, available at: <http://www.minpet.gov.ao/NoticiaD.aspx?Codigo=8745> (accessed 17 August 2010)

that Angola has exceeded its OPEC quota by around 20% (1.75 million bpd), following the footsteps of other fellow OPEC members like Venezuela and Iran.⁴

According to Business Monitoring international Oil and Gas forecast (first quarter 2011)⁵ Angola boosts the greatest oil output growth potential in Africa. This is mostly due to its sizable oil reservoirs, the large number of IOCs present in the industry and decent licensing terms. Its oil production is forecasted to grow from estimated 1.81 million bpd in 2010 to 2.38 million bpd in 2015. It is expected to reach peak production in the following year (2.45 million bpd) and gradually fall down to 2 million bpd by 2020.

Major characteristics and developments in the Angolan oil industry

Angola's oil exploration is organised in three depth bands that cut across four sedimentary basins: Congo (Cabinda and Lower Congo), Kwanza, Benguela and Namibe. Band A, onshore and shallow waters (up to 200m deep) include blocks 0 to 13; band B, in deep-waters (200m-1,500m) encompasses blocks 14 to 30; and band C in ultra-deep waters (over 1,500m) which integrates blocks 31-45.

At the time of independence exploration was concentrated in the Cabinda enclave and onshore the Kwanza Basin, with five operating areas and three operators.⁶ Production remained at around 150,000 bpd until 1984 when it passed the 200,000 bpd barrier, steadily rising to 475,000 bpd in 1990.⁷ Presently there are 35 blocks in operation, of which eleven are in production (three in Cabinda onshore and offshore; and the remaining in the Lower Congo Basin shallow and deep waters).

Although oil exploration in Angola started onshore and in shallow waters around Cabinda (block 0 - Chevron), the bulk of Angolan oil activity is presently concentrated in deepwater blocks in the Lower Congo Basin. Benguela and Namibe (South coast) basins remains much under-explored having yielded no significant commercial discoveries

⁴ EIU, *Angola Country Report*, September 2009, p. 13

⁵ Business Monitor International, 'Angola Oil and Gas Report Q1 2011 – Executive summary, January 2011, available online at: <http://www.researchandmarkets.com/reportinfo.asp?r=1501380> (accessed 21 January 2011)

⁶ Duncan Clarke, 'Petroleum prospects and political power', in: *Angola's War Economy*, ed. by Jakkie Cilliers and Christian Dietrich, Pretoria: the Institute for Security Studies, 2000, p. 198

⁷ Data according to BP, *Statistical Review of World Energy 2009*

This state of affairs was prompted by the advancement of deepwater technology from the mid 1980s onwards. The high-potential of deep water deposits in the lower Congo Basin started attracting increasing interest in the late 1980s. When Sonangol open an oil auction for 17 deepwater blocks in 1993, the oil majors flocked to the country to secure the most promising blocks. Among these figure block 14 (Chevron), 15 (ExxonMobil), 17 (Total) and 18 (BP) which have combined estimated reserves of 10 billion barrels.⁸ The high successful exploration rate of these blocks throughout the 1990s generated fierce competition when ultra-deepwater blocks 31 to 34 were auctioned in 1999, which resulted in record high signature bonuses (combined sum of US\$935mn).⁹ Although the exploration success rate has been smaller than the previous ones, these blocks (still under exploration) have estimated reserves of nearly three billion barrels.¹⁰

Through these two oil auctions western major IOCs - Chevron, Texaco (which later merged), Total, ExxonMobil, Shell, BP and AGIP secured important stakes in the country's booming oil industry. Through its Cabinda assets Chevron dominated the oil production scene throughout the 1990s. Nonetheless, other major players that possess the funds, technology and the expertise to explore deep (200m to 1500m) and ultra deep (over 1500m) offshore wells, have seen their share in production increase substantially in the 2000s.

Some NOCs, like Pedco (Korea), Petrogal (Portugal), Petrobras (Brazil), Petronas (Malaysia), Norsk Hydro (Norway) also entered Angola's oil industry in the late 1990s. Most of them focus, however, in shallow waters (less than 200m), onshore blocks and smaller stakes in deepwater blocks operated by the majors.

The licensing round that followed (2005-2006) auctioned expired segments of the 1993 bid, namely attached to blocks 15, 17 and 18 - dubbed the golden blocks. Attesting the increasing value of Angola's Lower Congo Basin, three blocks alone (15/06, 17/06 and 18/06), attracted a record sum of over US\$3bn in signature bonuses.

⁸ Christopher Brown – Wood Mackenzie, 'A Golden decade for Angola's deepwater', Penn Energy, available online at: <http://www.pennenergy.com/index/petroleum/display/5955590589/articles/offshore/volume-69/issue-12/west-africa/a-golden-decade-for.html> (accessed 17 August 2010)

⁹ Tony Hodges, *Angola: Anatomy of an Oil State*, Norway: Fridtjof Nansen Institute, 2004 (2nd ed.), p. 145

¹⁰ Christopher Brown – Wood Mackenzie, op. cit

The attractiveness of the Angolan oil industry is further enhanced by the very high exploration success rate (60% of exploration wells in 2008 struck oil,¹¹ twice the world's average for ultra-deep waters) and the good quality of Angolan oil (medium to light crude, with low sulphur grades). The success of Angolan deepwater offshore has brought cutting edge deepwater technology into the country, namely floating production, storage and offloading units (FPSO) and subsea sectors.

Until the early 2000s Chevron's operated blocks 0 and 14 off Cabinda's coast accounted for the bulk of Angolan oil production. Although Cabinda still accounts for a significant part of national production (15%) its output has stabilised in recent years. According to Ministry of Petroleum data the major producing block is currently block 15, with an output of 227 million barrels in 2009 (600,000 bpd; 35% of total). Combined, the three deepwater blocks (15, 17 and 18) in Congo Basin accounted for nearly 70% of Angola's total oil production in 2009. All of them are operated by western oil majors. The new shining stars are deepwater blocks 15 and 17, with most oil originating from Kizomba (15) and Girassol (17) oilfields that came on stream in 2005 and 2006 respectively. Block 17 is operated by Total (40% stake) and the consortium include Esso (20%), BP (17%) and Norsk Hydro (10%). Block 15 is developed by a consortium led by ExxonMobil through its subsidiary ESSO Angola (40% stake), BP (27%), ENI (20%) and Statoil (13%).¹²

Even though a considerable part of Angolan oil production is accounted for by western companies Sonangol's share has increased significantly since the early 1990 when it assumed its first operatorship. As of 2009 Sonangol accounted for 38% of Angolan oil production.¹³ In recent years Asian countries have been absorbing an increasing share of Angolan oil exports. In terms of volume, 51% of Angolan oil exports went to Asia in 2009, with China accounting for the bulk of it (39%). The second regional destination of Angolan oil in 2009 was North America

¹¹ Ministério dos Petróleos, *Relatório de Actividades do Sector Petrolífero 2008*, Luanda: Gabinete de Estudos e Estatística – MINPET, July 2009

¹² All figures in this paragraph according to: Ministério dos Petróleos, *Relatório de actividades do Sector petrolífero 2009*, July 2010, p. 15

¹³ Ministério dos Petróleos, *Relatório de actividades do Sector petrolífero 2009*, July 2010, p. 15

with 26% (US accounting for 20%). The rest of Angolan oil is headed to Europe (16%), Africa (4%) and South America (2%).¹⁴

In line with its diversification strategy, Luanda, has been seeking to branch out its oil partnership portfolio in recent years. Part of this strategy were two licensing rounds (2005/2006 and in 2007/2008) that offered small and marginal fields as well as onshore exploration. One of the aims was to attract new comers such as Indian, Chinese and Japanese companies that lack the deep sea exploration technology. The licenses were successful having attracted big and small contenders from all over the world. Angola's oil future, however, lies in ultra-deep waters.

The 2007 licensing bid included onshore (Cabinda Central, adjacent to block 0 in Cabinda; Kwanza blocks 11 and 12), shallow water (block 9, offshore Benguela Basin), deep water (19, 20 and 21, located in the Kwanza basin) and ultra-deep water blocks (46, 47, 48, to the west of Congo Basin). The pre-selection was completed in early 2008, having 43 candidates pre-qualified for operator and 38 for non-operating shares. The auction, however, was suspended in 2008, initially due to the upcoming legislative elections (as it could raise legitimacy issues) and afterwards due to the sharp drop in oil prices in late 2008.

In the wake of the massive oil reservoirs found off the coast of Brazil in 2007, interest started to grow in a new oil exploration frontier in Angola: the pre-salt. Available data points to a close match between the continental shelves of Brazil and West Africa (Namibia, Angola, Congo and Gabon). Geological similarities predict huge hydrocarbon reserves of light oil in the pre-salt layer, which seem to be particularly auspicious in the Angolan sequence. Unlike in Brazil, though, the pre-salt layer in Angola is expected to encompass offshore and onshore fields (4,000m deep) alike,¹⁵ around the Kwanza Basin and probably extend to the south (Benguela and Namibe Basins). The scarcity of available geological data to the south of Lower Congo

¹⁴ Ministério dos Petróleos, *Relatório de actividades do Sector petrolífero* 2009, July 2010, pp. 29-30

¹⁵ Peter Howard Wertheim, 'Geological similarities with Brazil pre-salt attract investments to Africa', *Offshore Magazine*, 10 July 2010, available online at: http://www.offshore-mag.com/index/article-display.articles.offshore.volume-70.Issue_7.latin-america.Geological_similarities_with_Brazils_pre_salt_attract_investments_to_Africa.OP129867.dcmp=rss.page=1.html (accessed 17 August 2010)

Basin makes this a high risk endeavour,¹⁶ with chances of success at around 30% at this stage.¹⁷ However, if major discoveries like in Brazil are made, Angola's hydrocarbons reserves and output could well double.

This has led to increasing pressure over Sonangol to release the pre-salt.¹⁸ Given the challenges involved (extremely high financial costs and technological capacity), in 2010 Sonangol shortlisted 13 companies with proven expertise to bid for 11 new ultra-deepwater blocks (Kwanza and Benguela basins) for pre-salt exploration. The list of successful bidders was released in January 2011. The operators include BP, Total, ENI, Statoil (first operatorship in Angola), Repsol, Conoco-Philips and Cobalt International Energy. Other equity partners are Exxon, China-Sonangol and Sonangol E&P, which has participation in all blocks. Among companies invited that did not acquire any equity stand out Chevron, Maersk Oil and Petrobras. Signature bonuses and PSA contracts negotiations are expected to be concluded by mid 2011¹⁹ and exploration is likely to start in the last quarter of the year.²⁰

With the opening of this new frontier, it is highly unlikely that the frozen 2007/2008 oil auction will be reopening any time soon. A significant number of the pre-qualified companies will now be fully engaged in the pre-salt, seriously compromising their financial and technical capacity to bid for and develop other new blocks.

¹⁶ The cap rock (salt layer) could be faulted in which case oil would have leaked out and the deposits will be filled with water instead.

¹⁷ Interview by email, geologist working in the Angolan oil sector, 22 February 2011.

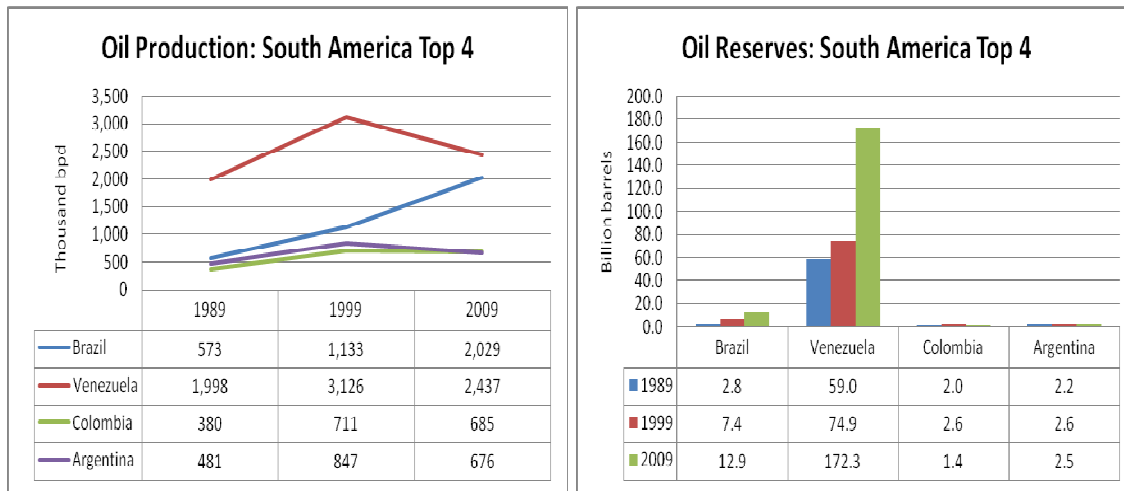
¹⁸ Sonangol, 'Treasure in the salt cellar', *Universo*, September 2010, pp.46-49

¹⁹ 'Angola takes pre-salt plunge', *Petroleum Economist*, 17 February 2011, available online at: <http://www.petroleum-economist.com/default.asp?Page=14&PUBID=46&ISS=25743&SID=727825> (accessed 28 February 2011)

²⁰ 'Exploration of pre-salt layer in Angola expected to begin in last quarter of the year', *Macau Hub*, 28 February 2011, available online at: <http://www.macauhub.com.mo/en/news.php?ID=11055> (accessed 28 February 2011)

APPENDIX 2: OVERVIEW OF THE BRAZILIAN OIL INDUSTRY

According to BP data, as of 2009, Brazil held the second largest hydrocarbons reserves in the region (after Venezuela) and was South America’s second largest oil producer, accounting for over 30% of South America oil output.¹



Source: BP, *Statistical Review of World Energy 2010*

As shown in the charts above Brazil’s oil industry has staged an impressive expansion over the last decade, having almost doubled its oil production and reserves. In the process Brasilia has steadily closed down the production gap with Venezuela. Despite holding much larger oil reserves, Caracas has seen its output decline over the same period, mostly resulting from the wave of nationalisations affecting the sector under Chavez populist government which led to a contraction in investments.

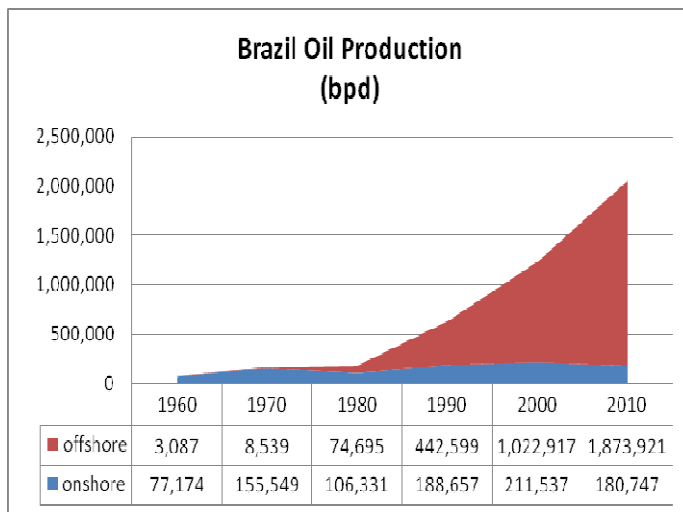
¹ BP, *Statistical Review of World Energy 2010*, June 2010, available online at: <http://www.bp.com/productlanding.do?categoryId=6929&contentId=7044622> (accessed 17 August 2010)

According to EIA, in 2010 Brazil overtook Venezuela as the largest hydrocarbons liquids producer, with an output of 2.7 million boe (includes oil and natural gas; Venezuela: approximately 2.4 million boe). According to the same source, Venezuela oil output was only slightly higher than Brazil's (2,025 million bpd) in 2010. This state of affairs suggests that Brazil might soon become the leading oil producer in the region.

According to Business Monitor International,² Brazilian oil output is expected to grow 110% over the 2010-2020 period, reaching an estimated 4.53 million bpd by the end of the 10 years forecast (Venezuela output is forecasted to reach 4 million bpd in the same period).

Major characteristics and developments in the Brazilian oil industry

Brazil oil E&P activities spread across 16 sedimentary basins, 11 of which are located on the continental shelf. The offshore basins stretch along the coastal line of the country from the Amazon River mouth in the north to Porto Alegre state in the South. As one may see in the chart below, since 1980 the bulk of the country's oil production has been originating offshore (91% in January 2011).³



² Business Monitor International, 'Brazil Oil and Gas Report Q1 2011 – Executive summary, 25 November 2010, available online at: <http://www.marketresearch.com/product/display.asp?productid=6001446> (accessed 16 January 2011)

³All figure as of January 2011. Unless otherwise stated all figures in this and the next paragraph according to ANP, *Boletim de Producao de Petroleo e Gas Natural – Janeiro 2011*, 1 March 2011, available online at: <http://www.anp.gov.br/?pg=44246&m=&t1=&t2=&t3=&t4=&ar=&ps=&cachebust=1299677123875> (accessed 5 March 2011)

Source: Petrobras website (1960-2000), ANP website (2010)

Campos Basin (Southeast coast, off Rio de Janeiro state) accounts for the bulk of oil output (85%), followed by Potiguar (2.9%, North East coast) and Espirito Santo (2.6%, Southeast, off Espirito Santo State). As of January 2011 there were 301 concessions, operated by 23 different companies (75 offshore and 226 onshore). Five fields in Campos Basin (Roncador, Marlim Sul, Marlim, Marlim Leste and Barracuda) account presently for half of Brazil's output (2.1 million bpd as of January 2011). Roncador is presently the largest producing field (303,000 bpd).

Most of Brazilian oil is produced in deep and ultra-deep waters (up to 6,000m) and its crude is of medium density (average API gravity was 23.8 in January 2011). Exploration success rate is around 55%.⁴

The steady growth of Brazil's oil output was in a great deal pushed by its fast expanding domestic demand and the quest for self sufficiency. In this context, the state was at the forefront of the industry's development through Petrobras, who has traditionally channelled the bulk of investments in E&P activities in the sector (99% in 2009).⁵

Although the first commercial well came on stream in 1941 (onshore) and exploration activities continued uninterruptedly in Bahia and other states under CNP in the following years, it was only after Petrobras took over operations (1953) that the oil industry started to produce meaningful results. In 1954, Petrobras was producing 2,700 bpd representing then a meagre 3% of national oil demand.⁶ In 1968 Petrobras initiated offshore exploration. The first oil well was discovered the following year near the state of Sergipe (in the northeast of the country, next to Bahia). In 1974 the first important discovery was made in Campos Basin. Production jumped to 178,000 bpd, covering only 29% of domestic demand. By 1984 oil output was 500,000 bpd supplying 45% of internal consumption. Between 1984 and 1996 other major fields were uncovered in Campos Basin, namely Marlim, Albacora, Barracuda and Roncador, raising

⁴ Petrobras, 'Os campos de Petróleo no Brasil',

http://www2.petrobras.com.br/Petrobras/portugues/plataforma/pla_campos_petroleo.htm (accessed 17 August 2010)

⁵ According to data in: ANP, *Anuário Estatístico Brasileiro do Petróleo, Gás Natural e Biocombustíveis 2010*, available online at: <http://www.anp.gov.br/?pg=31286> (accessed 17 August 2010)

⁶ Unless otherwise stated, data in this and the following paragraphs according to BP, *Statistical Review of World Energy 2009*. With the same 2.7% share (2,4bn b/d), Brazil was in 2008 the seventh largest global consumer along with Saudi Arabia and ahead of South Korea and Canada (2,6%).

production to 1 million bpd in 1998 (58% of national consumption). Following the end of monopoly in the 1990s, Petrobras expanded prospection operations to other areas looking for oil in new basins in the Southeast, namely Santos and Espírito Santo, and in older basins where deepwater exploration was yet to be made (Bahia, Sergipe and Alagoas).

With the new fields in Campos Basin coming on stream, oil production soared. In 1998 the 1 million bpd barrier was overcome and five years later, in 2003, production reached 1.5 million bpd. Virtual self sufficiency was finally achieved in 2006 when crude output finally matched national demand (around 1.8 million bpd),⁷ whereby Brazil officially became a net oil exporter.

The announcement of the massive Pre-salt oil reservoirs in November 2007 marked a turning point in Brazil oil industry. These reserves are located 250-350km off the Southeast coast of the country (Espírito Santo, Rio and S. Paulo states) covering an area of 149,000 km² across Espírito Santo, Campos and Santos Basins. The oil deposits are found at depths of over 5,000m, under a 2,000m salt layer, raising huge technological challenges. Unlike the current oil produced by Brazil, this is mostly light crude. First large field to be uncovered was Tupi in Santos Basin in 2007 with an estimated 5-8 billion barrels. The second one was Iara, with reserves estimated at 3-4 billion barrels.⁸ The largest find (Libra) was made in late 2010 and is estimated to hold up to 15 billion barrels of oil.⁹ These finds clearly demonstrate the high potential of the Brazilian oil industry.

When Tupi was discovered the president of Petrobras, José Sérgio Gabrielli, estimated that total pre-salt deposits could expand Brazil's oil and gas reserves up to 70-100 billion barrels. This would place Brazil's reserves among the 10 largest in the world (was then 24th in the ranking),

⁷ Virtual self sufficiency has to do with the fact that Brazil refinery complex, mostly assembled during the developmental state when it was a net importer, was built to process light grades of crude, while most crude produced in Brazil has a higher density. This means that most of its oil output is exported and a large share of its refining needs still have to be met by imports.

⁸ Revista Digital, 'Reservas do Brasil com Tupi e Iara', 11 September 2008, http://www.newslog.com.br/site/default.asp?TroncoID=907492&SecaoID=508074&SubsecaoID=538090&Template=../artigosnoticias/user_exibir.asp&ID=182842&Titulo=Reservas%20do%20Brasil%20com%20Tupi%20e%20Iara (accessed 17 August 2010)

⁹ Rafael Rosas, 'Libra pode ter até 15 bilhões de barris', *Valor*, 29 October 2010, available online at: <http://www.valoronline.com.br/online/petrobras/4426/329885/libra-pode-ter-ate-15-bilhoes-de-barris-diz-anp> (accessed 10 December 2010).

somewhere between Nigeria and Venezuela.¹⁰ Although the pre-salt production at present (72,000 bpd in January 2011)¹¹ accounts for only a small share of Brazil total oil output, it is expected to double the country's current production over the next decade. In an interview in mid 2009 Gabrielli estimated that, in order to achieve the goal of adding 1.8 million bpd to national production by 2020, Petrobras will have to invest US\$111 billion until 2020 in the development of the pre-salt area.¹²

As production expanded in Campos basin and new discoveries were made, Brazil's oil industry rose in value in the international market having IOCs started venturing in the sector in the mid 2000s through the annual tenders initiated in 1999. Nonetheless, Petrobras retained a dominant position in the sector. The NOC operates 93% of all producing fields accounting for nearly 92% of total oil production in January 2011.¹³ Out of the 20 major producing blocks, only two are not operated by the NOC: Ostra (4.1% of total) operated by Shell, and Frade (3.3%) operated by Chevron. The remaining 20 operators account for less than 1% of Brazil's oil output.

Shell and Chevron are presently the largest foreign players by production. Other IOCs that entered Brazil's oil industry in the 2000s include Repsol, Anadarko, Devon, Statoil, BG group, Maersk Oil. Numerous domestic private oil companies have also ventured in the oil sector through these auctions. Among these stand out OGX – the oil arm of millionaire Ike Batista group – which include former officials of Petrobras and has significant equity, namely, in Campos and Santos Basins. Among NOCs, it is worth noting that ONGC from India also gained through tender operatorships in two blocks in Espirito Santo and Campos basins, respectively.

In such a bright scenario the 11th oil licensing round scheduled for the second half of 2011 is expected to attract a serious amount of interest, particularly among the IOC's and Chinese companies.

¹⁰ Kelly Lima, 'Brasil pode ter 8ª maior reserva de petróleo do mundo', *Exame*, 8 November 2007, <http://portalexame.abril.com.br/ae/economia/m0143013.html> (accessed 17 August 2010).

¹¹ ANP, *Boletim de Producao de Petroleo e Gas Natural – Janeiro 2011*, 1 March 2011, *op. Cit.*

¹² Folha Online, 'Petrobras investirá US\$ 111 bilhões no pré-sal até 2020', diz Gabrielli, 9 June 2009, <http://www1.folha.uol.com.br/folha/dinheiro/ult91u578513.shtml> (accessed 17 August 2010)

¹³ All figure as of January 2011. Unless otherwise stated all figures in this paragraph according to ANP, *Boletim de Producao de Petroleo e Gas Natural – Janeiro 2011*, 1 March 2011, *op. cit.*

