

# Chinese Oil Investment in Angola and The Quest to Evade the Resource Curse

By Ethan Cramer-Flood

## *The Context*

ANGOLA is the second largest producer of oil on the continent of Africa, after Nigeria.<sup>1</sup> In January of 2007, Angola joined the Organization of Petroleum Exporting Countries (OPEC),<sup>2</sup> reflecting its status as the 13<sup>th</sup> highest net exporter of oil globally.<sup>3</sup> According to the U.S. Energy Information Administration (EIA), Angola exported 1.36 million barrels per day in 2006.<sup>4</sup> Although it is not among the top 15 overall producers,<sup>5</sup> its limited domestic oil use allows it to export the vast majority of its production.<sup>6</sup> OPEC reported a slightly lower output for Angola in 2007, but both OPEC and the EIA agree that Angola's proven reserves are in the range of nine billion barrels.<sup>7</sup>

Logically, this makes Angola one of the primary targets of energy-hungry China's multinational search for fuel to feed its bustling economic development. Periodically over the past several years, Angola has been the number one supplier of foreign oil to China, eclipsing even Saudi Arabia on occasion.<sup>8</sup> According to the EIA, "in May 2006 China imported 750,000 bbl/d of crude oil from Angola, a 70 percent increase from the same month in 2005."<sup>9</sup>

The purpose of this brief is to look at the economic tactics China is using to acquire Angolan oil, and suggest a strategy for the Angolan government to ensure that Chinese-created oil largesse is used to the advantage of the Angolan people. As China's relationship with — and reliance on — Angola grows deeper, Angola has an opportunity to use its oil profits to boost its own economic development; but only if it can defeat the so-called "resource curse" that has bedeviled it and other poor countries for so many years.

## *The China Factor*

If Angola produces 1.34 million barrels per day, and China imports up to 750,000 of those barrels every day, it is not hard to discern the depth of the two countries' relationship. China has successfully ingratiated itself on the Angolan oil industry using the same strategy it has applied all over Africa: a whirlwind of spending, investment, and preferential loans with no strings attached other than oil rights.<sup>10</sup> In 2007, China pledged no less

than \$20 billion "to finance trade and infrastructure across the continent over the next three years," according to published reports.<sup>11</sup>

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Government-backed Chinese companies — and often the Chinese government itself — have thrown aid money at the Angolan leadership in amounts that dwarf the assistance provided by western international NGOs and aid organizations such as the World Bank. The Chinese finance enormous oil-backed loans for Angolan development, providing immediate liquidity for the government and a guarantee that the loan will pay itself back once the oil is produced.<sup>12</sup> Angola reports it has "taken out between \$8 billion and \$9 billion in loans from China since 2004, exchanging guarantees of oil supply for reconstruction work." The World Bank puts that number at \$12 billion.<sup>13</sup>

Chinese construction firms work directly on Angolan infrastructure, which facilitates both development and the Chinese capacity to efficiently extract resources. They have built a new airport, repaired the Benguela railroad, and constructed countless hospitals, schools, and roads.<sup>14</sup> All of this is designed to curry favor and gain exclusive future rights to Angolan oil deposits. It also provides convenient business opportunities for Chinese firms and employment for Chinese workers.<sup>15</sup>

Journalists Lydia Polgreen and Howard French of the *New York Times* provided an excellent summary of the Chinese and African views of one another in a summer 2007 article: "Chinese officials and their African allies like to call their growing relationship a win-win proposition, a rising tide that lifts all boats in China's ever-widening sea of influence...Many African scholars and political leaders say Africa has no need for the colonial baggage and paternalism of the West, and they welcome the Chinese approach of cowboy capitalism."<sup>16</sup> Meaning, many African governments prefer to be funded by the Chinese because unlike

with the West, there is no conditionality on the financing – the money comes with no requirements about human rights, transparency, or democratization. The Chinese narrative in Africa paints an optimistic picture, but history tells us there is a serious danger for the Angolans.

### *The Problem and the Consequences*

The “resource curse” has been extensively explored in the academic literature on development economics, but the basic premise is that underdeveloped countries blessed with extensive natural resources tend to fall into traps of internal conflict and economic stagnation, rather than find a way to exploit their gifts in the name of general prosperity. The natural resource creates a motive for rent-seeking, prevents economic diversification, and often results in political violence over control of profits. Empirical evidence has shown a direct correlation between resource wealth in places like Angola (and Nigeria, Sudan, etc.) and “systemic corruption and the weakness of state institutions.”<sup>17</sup>

Internal instability caused by the resource curse can result not just from *greed* but also from *grievance*, according to prevailing theories.<sup>18</sup> Matthias Basedau of the German Institute of African Affairs explains the grievance hypothesis as such:

Segments of the population or regions might feel deprived of the benefits of resource-related income (while possibly carrying the ecological burden of production) and therefore take up arms. Typically, grievance is associated with secessionist upsurges: When central governments (tend to) monopolize resource income, the resource producing regions might develop feelings of deprivation and grievances that, in turn, trigger violent secessionist movements such as in the oil-rich regions of Cabinda in Angola.<sup>19</sup>

Angola’s civil war lasted for 27 years and was only recently resolved, thanks to the death of rebel leader Jonas Savimbi in 2002.<sup>20</sup> While Angola’s peace appears durable, the resource curse need not produce violence to have an impact. Exploitation of oil wealth at the elite level impedes economic development just as efficiently as civil war. The Cato Institute’s Moeletsi Mbeki describes a typical African experience:

Oil revenues make it possible for the political elite to become detached from the local population and economy. When that

happens, there is no need for the political elite and the state it controls to invest in public goods enjoyed by the population at large. Worse, oil revenue provides the political elite with the funds to repress the local population.<sup>21</sup>

Under this scenario, the country remains peaceful, but the population remains in misery. The government need not rely on taxation in order to function, and thus has no reason to feel answerable to the people. A vicious dichotomy develops.

An Angolan’s life expectancy, according to the World Bank, is a meager 41.4 years. The mortality rate in 2005 for those five years of age and under was 260 per 1,000. The GNI per capita in 2006 was just US\$1,980.<sup>22</sup> According to the United Nations, Angola is the 17<sup>th</sup> least developed country on earth, and some analysts believe that two-thirds of all Angolans live on less than \$2 a day (though the Angolan government claims the numbers are slightly less grim).<sup>23</sup> Few countries on earth have as desperate a need as Angola for a major injection of export profits to fund economic development projects, and circumstances generated largely by China are providing just such an opportunity. But how can they be sure it won’t all be for naught?

### *What’s Happening Now and What Needs to Happen*

On the surface, the trend for Angola is positive, especially with regard to pure economic growth. According to the Council on Foreign Relations, “the combination of record-high oil prices, increased oil production, and Chinese loans have jump-started Angola’s development.”<sup>24</sup> The World Bank reports that Angola grew at a remarkable 18.6 percent in 2006, with positive signs in both the oil and non-oil sectors<sup>25</sup> (this after growth rates of 12 percent in 2004 and 19 percent in 2005<sup>26</sup>). The IMF estimated that Angola grew at an astounding 24 percent clip in 2007,<sup>27</sup> a dizzying number that reflected both the historic high price of oil that year and the economic depths from which Angola started. Concurrently, government revenue was up 250 percent that year.<sup>28</sup>

The key driver for Angola has been its oil industry and the investment by China and others that has allowed oil exports to become a robust and dependable revenue source. Oil profits can also be considered part of the peace dividend, as development of Angola’s extractive industries was on hold for a generation thanks to its civil war.<sup>29</sup> Oil money represents about half of Angola’s GDP, 90 percent of exports,<sup>30</sup> and 80 percent of the national budget<sup>31</sup> (about half of all oil revenue in

Angola goes to the government).<sup>32</sup> In 2006, oil production was up 13 percent, thanks largely to new deepwater oilfields coming online,<sup>33</sup> an expensive and difficult process that requires international investment for a country like Angola.

As money flows into Angola like never before, the need to rigorously apply policies that will protect it against the resource curse is of paramount importance. This goes beyond mere energy policy, as the issues of corruption, poor government management, haphazard budgeting, lack of transparency, etc., cross all public sectors and represent the main threat to sustained Angolan growth. It is vital that Angolan leadership acknowledge that these pitfalls rank as a higher priority than ramping up oil production. A major

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report by the International Energy Agency (IEA) and the Organization for Economic Cooperation and Development (OECD) declared that although “a well-formulated upstream oil development policy can help improve the sustainability of revenue flows...the main bottleneck in the flow of benefits from this sub-sector to the population in Angola’s case does not appear to be the size or sustainability of such revenues.”<sup>34</sup> According to the IEA report, the main bottleneck is the issue of corruption and revenue management.

The IEA credits Angola with making some tentative positive steps in this regard, especially in the realm of transparency, thanks to a government sponsored “diagnostic of oil revenues” produced by consulting firm KPMG.<sup>35</sup> Since then, Angola has produced a more “unified” oil-related budget and has “incorporated spending that was previously off-budget.”<sup>36</sup> Other analysts are less sanguine on the matter, however.<sup>37</sup>

There are also major transparency concerns relating to Angola’s relationship with China. A comprehensive picture of China’s total involvement is not publicly available, and can only be guessed at by piecing together various reports, statements, and anecdotes. No one knows exactly how much money China is providing, how many contracts exist, how they are awarded, or how many Chinese firms and workers are currently in the country.<sup>38</sup> Vast sums of Chinese money could be disappearing into the private accounts of the elites, and no one would know. Also, Angola should be more

concerned with tracking Angolan employment rates at Chinese firms. These statistics are unknown, but there is reason to suspect Chinese infrastructure projects mostly employ Chinese workers. As the Council on Foreign Relations puts it, “Angola should be wary of outsourcing jobs Angolans could do themselves; importing labor may be sowing the seeds of future resentment.”<sup>39</sup> Transparency International ranks Angola as the 10<sup>th</sup> most corrupt nation on earth.<sup>40</sup> They claim that up to 12 percent of GDP disappears every year,<sup>41</sup> a devastating total for a country as poor as Angola. According to a 2003 Angolan newspaper report on the wealthiest citizens in the country, “Twelve of the top 20 [richest people] were government officials; five were former government officials.”<sup>42</sup> As Chinese oil money flows in unabated, well-intentioned government ministers must find a way to prevent it from disappearing. Instead, it must be directed towards Angola’s desperate needs in health, education, and economic development.

Beyond issues of corruption and lack of transparency in Angola’s oil dealings with China, there are also tactical issues that the country needs to consider. First off, Angola is quickly becoming too dependent on China as its primary customer, a situation which could come back to haunt them in the event of an economic reversal in China or a geopolitical situation that strains their relations. Second, the Angolan government’s policy of relying on oil-backed loans is mortgaging future oil revenue flows.<sup>43</sup> Although Angola has a great need for financing at the moment, they are putting tremendous pressure on themselves to use the money wisely on the first go. As their oil industry matures into an even more powerful export machine, they will see little benefit as profits are diverted for years into paying back loans. Payments will go mostly to China, who will be monopolizing much of the new crude oil product as well. Given how well the relationship with China is working for Angola in the short term — and how dramatically the economy is currently growing — it is difficult to recommend the government ease off from the courtship. But over the long run, Angola might do well to not accept every single Chinese loan offer and to work on diversifying its customer base.

On a broader strategic scale with respect to oil production and national development, there are valuable lessons to learn regarding Angola’s national oil company (NOC), Sonangol. Sonangol was founded in the late 1970s and was quickly designated as “the sole concessionaire for oil exploration and production in Angola.”<sup>44</sup> It is vital for Angola that Sonangol emulate the behavior of

the world's most effective NOCs, such as Saudi Arabia's ARAMCO or Norway's Statoil; and avoid the deterioration of overburdened and mismanaged NOCs, such as Venezuela's PDVSA or Iran's NIOC. A well-run NOC can fund vital government programs, provide budgetary flexibility, be a force for modernization and technological development, and otherwise assist in all manner of poverty reduction and state-strengthening. But if a NOC falls under the ideological sway of politicized state leaders, it can easily become an inefficient albatross. In the wrong hands, NOCs can become geopolitical foreign policy tools, sources of political patronage, and saddled with over employment – all of which will impede the NOC's ability to efficiently run an oil industry and produce extra revenue.

Angola must follow the conventional wisdom on how to keep a NOC tightly leashed to the business of oil extraction and sales. Sonangol should maintain an independent board of advisors, offer limited ownership to international shareholders, seek international financing (and the transparency that it would require), and be given limited authority of its own revenues (in order to ensure sufficient reinvestment). Additionally, the Angolan government should create another NOC to foster competition between the two, and should allow limited competition with International Oil Companies (IOCs). According to the United States' EIA, Sonangol currently "works with foreign companies through joint ventures and production-sharing agreements, while funding its share of production through oil-backed borrowing."<sup>45</sup> Most of the world's major IOCs had at least some limited operations inside Angola as of 2007,<sup>46</sup> which means there is plenty of opportunity for Sonangol to learn and grow from partnerships and competition. Eventually Angola must develop domestic expertise at all forms of oil extraction in order to maximize national revenues in the future.

### *Privatization?*

While no one would argue with the policy objective of increasing transparency, reducing corruption, and improving management and budgetary competence, some analysts would offer opposing policy advice on Angola's NOC. Specifically, they would do away with it entirely and leave the oil industry to the private sector. This pro-market prejudice is reflected between the lines of the IEA's advice to Angola. For instance, they encourage Angola to improve its transparency for the purposes of attracting more private investment in the oil sector, rather than to ensure that oil revenues are appropriately directed at economic development.<sup>47</sup> A common theme among

neoliberal economists is the absolute superiority of market forces over government decision-making. Specifically, many oil analysts believe that NOCs are incapable of performing efficiently, and thus are automatically inferior to private firms. By using NOCs, according to this point of view, maximizing revenue is impossible, oil extraction is slowed, and resources are wasted. From this perspective, Angola would be doing its economy a favor by disbanding Sonangol and leaving it up to private firms (national or international) to run the industry according to traditional economic principles of supply and demand, comparative advantage, and so on.

The problem with privatization and the philosophy of market fundamentalism is that it treats *efficiency* as an end in and of itself. This perspective believes that maximizing the efficient extraction of oil and getting it to the market with the highest possible profit margins is the only goal. In reality, for a place like Angola, selling oil is a means to an end that is utterly detached from the global oil markets. The point of oil profits for a country like Angola is to assist with national

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development, and if oil profits were streaming to private companies, the government would be unable to pursue that goal. Angola is better off with its NOC than with IOCs because it keeps oil revenues inside the country and provides a constant financial stream for a government that would otherwise be unable to provide the slightest public service to its people.

According to the Angolan government (via the *New York Times*), since 2002, “it has rebuilt 2,400 miles of crumbled roads — more than half of the nation's system — and renovated airports in Luanda and three other cities. More than 430 miles of new rail track have been laid.”<sup>48</sup> All of this has been possible thanks to oil revenues that might otherwise have gone into private hands — hands that would have made no effort to repair public roads and train tracks. IOCs are tremendous profit machines, but they are only appropriate for developed economies. Poor countries need their NOCs to help with development and to avoid any destabilizing public perception that national resources are being stolen by foreign elements. Additionally, NOCs can be a valuable tool for providing cheap and subsidized fuel to a

population that otherwise would not be able to afford gasoline and heating oil at international prices. In the long run, fuel subsidies can wreak havoc on supply and demand curves inside a country and can become a debilitating burden on national budgets. But in the short run, when a country is as poor as Angola, it is a great boon for impoverished citizens to be able to afford vital fuels. As the country's per capita income grows, subsidies should be indexed to GDP growth in order to avoid long-term traps.

### Conclusion

Most of the advice Angola must follow is nothing new to oil-rich undeveloped countries. This issue has been studied, and the proper course of action has been laid out by an army of development economists and extractive industry analysts. The country needs a strong regulatory framework to provide "sufficient stability for existing contracts and for continued attraction of foreign investment."<sup>49</sup> The government must, "enhance coordination between the Ministries of Finance and Petroleum, Central Bank and other financial, governmental and international institutions in its efforts to improve transparency in the management of oil revenues,"<sup>50</sup> etc. The list of advice that would also apply to any other country in Angola's position goes on and on. Nonetheless, it is vital that the Angolan government find a way to operationalize this advice and buck the trend of corruption and waste that has buried so many of their peers in Africa.

According to journalist Stephen Kotkin, "every recalibrated program to finally enable the African masses to share in a hydrocarbon mother lode has crashed and burned."<sup>51</sup> Angola is the latest to try to reverse this unfortunate history, and on the surface they are off to a good start. Here's hoping that an enlightened leadership, chastened by years of brutal warfare, will find a way to do the right thing; and that China will stay out of the way.

*Ethan Cramer-Flood is currently teaching international relations at the China Foreign Affairs University in Beijing, where he happily allows the students and faculty to refer to him as "professor." He graduated in May 2008 with an M.S. in Global Affairs from NYU's Center for Global Affairs. While he was at NYU he was the graduate assistant to Michael F. Oppenheimer, and co-wrote and co-edited Professor Oppenheimer's first two CGA Scenarios reports on Iraq and Iran. Before graduate school, Mr. Cramer-Flood worked at the New York City Department of Health and Mental Hygiene as an*

*emergency planner, and as a researcher at the Center for Responsive Politics in Washington, DC. Mr. Cramer-Flood is from Syracuse, NY, and has a BA in History from Haverford College.*

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