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# **Petroleum Politics: China and Its National Oil Companies**

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*To Whom I owe my willing and my running*

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## ABBREVIATIONS

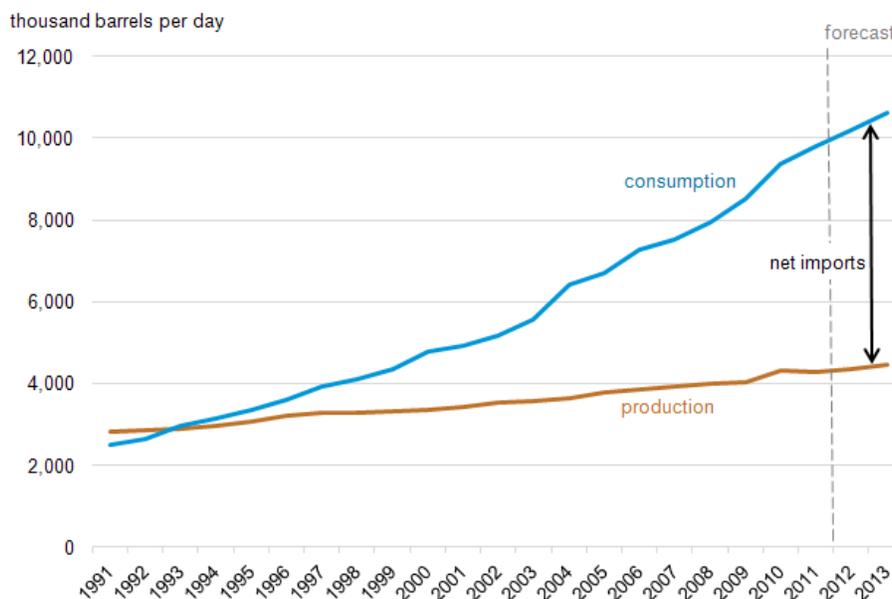
ABC	Agricultural Bank of China
BANDES	Banco de Desarrollo Económico y Social de Venezuela (Venezuelan Bank for Economic and Social Development)
BOC	Bank of China
CBRC	China Banking Regulatory Commission
CCB	China Construction Bank
CCP	Chinese Communist Party*
CDB	China Development Bank
CIC	China Investment Bank
CHI	Central Huijin Investment Ltd
CNOOC	China National Offshore Oil Corporation
CNPC	China National Petroleum Corporation
CNSPC	China National Star Petroleum Corporation
COD	Central Organization Department
CPC	Communist Party of China (also CCP)
E&P	Exploration and Production
EIA	Energy Information Administration
Exim	China Export-Import Bank (also China Exim)
FDI	Foreign Direct Investment
FOCAC	Forum of China Africa Cooperation
ICBC	Industrial and Commercial Bank of China
IEA	International Energy Agency
IMF	International Monetary Fund
IOC	International Oil Companies
M&A	Mergers and Acquisitions
MOF	Ministry of Finance
MOFA	Ministry of Foreign Affairs
MOFCOM	Ministry of Commerce
MOU	Memorandum of Understanding
MPI	Ministry of Petroleum Industry
NDRC	National Development and Reform Commission
NEA	National Energy Administration
NEC	National Energy Commission
NELG	National Energy Leading Group
NOC	National Oil Company
OFDI	Outward Foreign Investments
PAB	Petroleum Administrative Bureau
PBOC	People's Bank of China
PBSC	Politburo Standing Committee
PDVSA	Petroleos de Venezuela (Venezuelan NOC)

PetroChina	PetroChina Company Limited (CNPC)
PRC	People's Republic of China
PSA	Production-Sharing Agreement
RMB	Renminbi (The Chinese currency)
SAFE	State Administration of Foreign Exchange
SASAC	State-owned Assets Supervision and Administration Commission
SCO	Shanghai Cooperation Organization
SOBC	State-owned Commercial Banks
SBPCI	State Bureau of Petroleum and Chemical Industry
SETC	State Economic and Trade Commission
Sinopec	China Petrochemical Corporation (Sinopec Group)
SOE	State-owned Enterprise
Songangol	Sociedade Nacional de Combustiveis de Angola (Angolan NOC)
Unipet	China International United Petroleum & Chemicals Co. Ltd. (Sinopec Group)
UNOCAL	Union Oil Company of California
US	United States
WTO	World Trade Organization

## Chapter 1. Introduction

China's energy security is characterized by a progressive divergence of energy supply and demand since its transition to an oil-importing country in 1993. Over the years oil consumption has steadily increased from 6.5 million barrels a day (bbl/d) in 2005 to 9.4 million bbl/d and 9.8 million bbl/d in 2010 and 2011, respectively. However, China's oil production has only increased modestly from 3.9 million bbl/d in 2005 to 4.3 million bbl/d in 2011, a significant sign that China's oil fields are maturing and that oil production has peaked. This indicates that the net total oil imports have subsequently increased, reaching 5.5 million bbl/d in 2011 (see Table 1.1).

Table 1.1. China's Oil Production and Consumption, 1990-2013



Source: U.S. Energy Information Administration, *International Energy Statistics and Short-Term Energy Outlook* (August 2012)

With an economic growth that averaged 9% per capita for the last ten years and a population of 1.3 billion increasingly wealthy citizens, China's petroleum demand has mainly been upended by imports coming from petroleum-rich countries around the world. Deemed as a pillar industry, the oil sector has always been in the forefront of China's energy security policy. The long held belief that the ownership of equity oil could enhance the country's security of supply entails that the Chinese national oil companies (NOCs) are the core

instruments of this policy. The internationalization of these oil companies do not just reflect their importance to a broader economic strategy, but also underscores the government's control and support towards its state-owned enterprises (SOEs).

This thesis is a positive study of the interaction of the Chinese government and its national oil companies. It explores the dimension of state control that still exists despite claims that Chinese NOCs are autonomous in their strategies and policies. This paper contends that through administrative control, the government has deeply entrenched mechanisms that direct energy policy and pursue the state's strategic interests through the NOCs. Although the reforms, corporatization and internationalization of Chinese state-owned enterprises have given the NOCs operational autonomy, the underlying policy-making direction is still subject to the central government authority as with the funding and investments. The contention is that NOCs remain subjects of the state's political control through traditional ties and ownership, provision of preferential financial support as well as broad diplomatic assistance to the NOCs' international expansion. Furthermore, the analyses of the decentralization, marketization and other institutional reforms posit that all these efforts are made in order to strengthen the communist party exemplified by the subsistence of nomenklatura principles, the intertwined relations between politics and economics, and concretely the banking system and the SOEs. With these, the study argues that the only way to understand the on-going reforms and the interaction of agencies within the Chinese political economy is through a reassessment of the unique central authority of the Communist Party of China. The efforts for decentralization only make sense if the distinctive central control of the state is considered. There is no other alternative model, for even the reforms that have been instituted are all path-dependent.

## **1.1. Literature Review**

Recent literature on the relationship between the government and its NOCs uses the fragmented authoritarian model that touches on the three dimensions of centralization and decentralization, namely, value integration, structural elements and decision-making and policy processes (Lampton, 1987; Lieberthal and Oksenberg, 1988). This model focuses on the interactive processes that develop between constituent entities within the policy-making

framework and not the top-down and/or bottom-up interaction within the Chinese political system. It further claims that the building block of decision-making is consensus building and so is policy implementation (Taylor, 2012). Houser (2008), Kong (2010) and Downs & Meidan (2011) use the fragmented authoritarian model to claim that through their operational autonomy, NOCs can largely tailor policies to suit their own vested interests. These scholars argue that because of the decentralization of energy authority, corporatization of Chinese oil companies and internalization of business transactions, the NOCs have not only gained autonomy but also a potent political clout within the government. Kong (2010) further adds that the reforms, i.e. decentralization and pluralization, and globalization have changed how the Chinese political system works. Downs and Meidan (2011) reaffirms this as they claim that NOCs' political power, financial clout and technical expertise provide them with considerable influence over energy projects and policies in China.

In contrast however, Taylor (2012) characterizes the Chinese government and NOC relationship as a "collaboration governed by hierarchy". It postulates that although the NOCs have acquired operational autonomy and have indirectly influenced energy policy development because of their advisory capacity, NOCs are *"ultimately embedded in a hierarchal relationship with the government in which the flow of authority is decidedly top-down"* (Taylor, 2012). This explains the government's extensive efforts to reestablish control through institutional reforms and administrative reshuffling. According to Naughton (2007), the reforms since the mid-1990s have been significant in terms of defragmenting, streamlining and recentralizing political authority. Taylor (2012) further argues that although the different entities such as the NOCs within the Chinese political system might have varied interests, the ability of the Chinese Communist Party as a political institution to establish top-down control should not be underestimated. Bell and Hui (2009) observed that Chinese leaders have the ability to influence the government and restructure its entities which led them to conclude that far from being institutionally constrained, the Chinese political system is characterized by a hierarchal structure, and power on the top can be mobilized to afford change if deemed necessary. Though institutional development of the energy sector and the wider economic development of China have been characterized by reforms, for instance, they also illustrate a path-dependent approach as to the

gradual allotment of authority spread over government entities. The autonomy of state-owned companies, particularly of NOCs was not a result of a sudden change within the political system, but in contrary, *the state has been complicit in its own devolution in terms of control* (Taylor, 2012). Moreover, even with the corporatization and internalization of the NOCs, the political control of central government still remains institutionalized and intact through the Central Organization Department, the National Energy Administration and the State-owned Assets Supervision and Administration just to name a few.

## **1.2. Methodologies**

The analyses of this paper borrow from the collaboration governed by hierarchy theory to characterize the state-NOC relationship. Coming from a broader framework of organizational theories, the study further examines the vertical relationship of the state to its SOEs and the use of the horizontal connections of SOEs to each other as means of vertical support and control. This empirical research has relied on primary and secondary sources. Textual analysis of written primary sources includes official documents published in government websites, annual reports from the oil companies and banking entities and official policy papers released by the government ministries at related entities. Secondary sources include books, websites, journals articles, and topic-related theses. The information on government officials and their respective positions were taken from official publications of government websites while the statistical information came from official publications and statistical findings of international organizations, (i.e. International Energy Agency and UNCTAD) and other secondary sources. Because of unsubstantial data on certain topics of this research, content analysis of on-line and media resources were utilized (i.e. Xinhuanet, Bloomberg, Reuters, ChinaDaily, Chinavita and other major newspapers and media providers).

## **1.3. Objectives and Scope**

The main purpose of this paper is to contribute to the small body of literature dedicated to exploit the relationship between the state and its national oil companies from the collaboration governed by hierarchy perspective. This work is limited to the study of the

institutional and administrative mechanism of control of the Chinese government and its major national oil companies, namely, the China National Petroleum Corp (CNPC), Sinopec and China National Offshore Oil Corp (CNOOC). It does not seek to scrutinize the efficiency of Chinese state-owned enterprises nor does it offer administrative solutions and recommendations for such enterprises. However, it analyzes the dynamics of the relationship between the government and its SOEs and provides factors that support the claim that this relationship follows the fundamental state interest. Consequently, a brief study of the state-owned banks, including the policy banks are included to show the instruments of government support to its NOCs. The closer look at the financial and diplomatic assistance to the NOCs also enlarges the scope of this study to include the international reach of preferential leverages the NOCs receives from the government.

This thesis is composed of seven chapters including the introduction and conclusion. *Chapter Two* offers a historical overview of the development of the petroleum industry in China. It aims to prove that the gradualist approach to economic development has direct impact on the path-dependency of the Chinese petroleum sector. *Chapter Three* analyses the institutional framework of political control over the NOCs and the traditional ties and connections that characterize the relationship between the state and NOCs. *Chapter Four* provides a brief outlook on the institutional set up of the Chinese banking system, its ownership, structure, management and the preferential treatment it allots to the NOCs. *Chapter Five* illustrates how the state's broad economic development policy drives the state-owned companies, particularly the NOCs to expand and investment abroad. It further shows how to government provides financial backing to NOCs through policy banks and loans-for-oil. *Chapter Six* shows the massive diplomatic support the government affords the NOCs, the agreements that are signed during official state visits, and the structural means of control in NOC overseas investment.

## **Chapter 2. Historical Evolution of Chinese National Oil Companies**

### **2.1. The Central Government and “Self-Reliance” (1950- 1977)**

The development of the petroleum industry in China began in the early 1950s, when the first National Petroleum Congress was conducted establishing the Ministry of Fuel Industry (*ránliào gōngyèbù*). In 1955, the Ministry of Petroleum Industry (MPI), under the authority of the State Council was given primary responsibility for the development of China’s oil industry.

The breakthrough in the oil sector came with substantial support from the Soviet Union. The successful development of the Karamai and Dushanzi oil fields required technical assistance that initiated the first Sino-Soviet partnership, fostered a political and economic relationship between the two countries that eventually led to technical and knowledge transfers. Soviet-style administrative arrangements characterized by central bureaucratic planning also began to influence the Chinese oil industry development (Kambara and Howe, 2007). Under the MPI, the Oilfields Administration Department and the Exploration Supervision Department were formed, creating a centralized planning body of agencies under the direct administrative control of the State Council.

The discovery of the Daqing oil fields in the late 1950s and the subsequent collapse of the Sino-Soviet partnership initiated the withdrawal of Soviet technological support to the detriment of the petroleum industry. The unsuccessful adoption of the Soviet-style approach led Mao Zedong to unveil his new strategy for economic development, a move from foreign technical and capital resource dependencies to “self-reliance” and labor intensive approaches, key principles of the “Great Leap Forward”. However, the deterioration of the oil industry remained unstoppable so the MPI, under the authority of the State Council, introduced military style “massive campaigns” that included mobilization of men in battle formation, obeying Maoist ideology (Kambara and Howe, 2007). Supervision of all activities relating to exploration and production (E&P), oil-field development and construction of refineries were directly controlled by the MPI. Centrally planned under the State Planning Commission, it managed all modes of production, transportation, administration and marketing of petroleum and petroleum products. It also organized campaigns for exploration and managed financial

resources from the government which included the dissemination of resources in its subordinate petroleum administrative bureaus (PABs) around the country (Zhang, 2004).

The Daqing project became an opportunity for the Chinese Communist Party to test its capacity to resolve crises after the Soviet withdrawal. As the progress of the project reached new heights, Daqing became a model to the Maoist “self-reliance” approach, a central industry figure to be followed by the agricultural and construction sectors. As the oil industry developed, it attracted significant political and administrative support from the government. The Daqing project became an affirmation of the Maoist ideology and economic policy focused on massive mobilization of physical and human resources. By 1963, Premier Zhou Enlai declared in the National People’s Congress that *“because of the discovery and construction of the Daqing oilfield, the country’s economic construction, the oil needs of defense and civilian applications which had depended on foreign imports in the past are now basically self-reliant”* (Lim, 2010).

The 1960s and 1970s brought a change in the bureaucratic structure within the petroleum administration ministries. The Ministry of Petroleum Industry was merged with the Ministries for Coal and Chemicals in 1970, followed by a break up in 1975. This was pivotal as the MPI gained more administrative control and political clout in the petroleum sector. With the support of Mao Zedong, Zhou Enlai and MPI Minister Yu Qiuli, the development of the oil industry was not only viewed as a political model, but also an integral part of the “Third Front”<sup>1</sup> (Kambara and Howe, 2007). This made the sector immune to the effects of the Cultural Revolution and the disruptions caused by the Gang of Four<sup>2</sup>.

## **2.2. Breakdown and Corporatization: First Reform (1978- 1991)**

The Great Leap Forward and the Cultural Revolution put the Chinese economy in the verge of collapse. By 1978, when Deng Xiaoping came into power, the Chinese factor productivity was so low that a change within the economic system became inevitable. Despite the considerable political and bureaucratic support from the previous leadership, the petroleum

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<sup>1</sup> The 'Third Front' refers to a large-scale program the country started in 1964 -- in response to the then volatile international situation -- to build a range of industrial bases in its remote yet strategically secured hinterland.

<sup>2</sup> The most powerful members of radical political elite convicted for implementing the harsh policies directed by Chinese Communist Party (CCP) chairman Mao Zedong during the Cultural Revolution (1966–76). The group included Mao’s third wife, Jiang Qing, and Wang Hongwen, Zhang Chunqiao, and Yao Wenyuan. The Gang of Four controlled four areas: intellectual education, basic theories in social sciences, teacher-student relations and school discipline, and party policies regarding intellectuals.

sector suffered a decline in its productivity. The withdrawal of the Soviet support has taken its toll in technological development and the techniques, knowledge and equipment gained from the Soviet Union became archaic. The Chinese oil industry was not as “self-reliant” as was believed though the opposition against foreign involvement in a “strategic industry” such as petroleum remained strong.

In 1978, the Ministry of Petroleum Industry (MPI) was re-established and became a separate body from the Ministry of Chemical Industry, which was responsible for the downstream segment of the oil industry. Another set of institutional changes followed in 1980 as the State Energy Commission was established to handle the Ministries of Petroleum and Chemical Industries and the Ministry of Electrical Power. This division of functions was aligned with the surge of interest in offshore exploration and development. Japan declared its interest in developing offshore sites and offered production-sharing agreements (PSAs)<sup>3</sup> to China. By 1980, the first contracts for exploration and development of Bohai Gulf and Beibu Gulf were signed between the Chinese Petroleum Corporation under the MPI administration, Japan-China Oil Development Company and the French national oil company, Total.

The “Big Contract” (*dà bāogǎn*) system in the oil industry was instituted by the central government following the contraction of state investment in oil exploration in 1981. To raise funds, ensure stability in existing oil fields and to further oil exploration, the government enabled the MPI to export oil and incur revenue from the international market. Under the system, the MPI was directly contracted with the government to produce 100 million tons of oil, allotting 94.5% of actual oil output to the state (Zhang, 2004). The excess oil above the production target was either exported or sold in the domestic market above the price set by the government and MPI was allowed to retain the revenue for the acquisition of foreign equipment and invest in new E&P. The government further permitted the MPI to contract with local petroleum administrative bureaus, allowing them to retain the revenue gained from excess production above the agreed target. Thus, in 1981 alone, the petroleum industry raised RMB 600 million in revenue, 25% of the RMB 1.7 billion invested by the government in the oil sector,

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<sup>3</sup> The production-sharing agreement stipulates that a foreign company undertaking exploration and development of petroleum sites are solely responsible of the risks incurred but any oil or gas discoveries should be shared with the home partner on a pre-agreed basis.

proof that “development with Chinese characteristics” was successfully initiated in the petroleum industry (Zhang, 2004).

The growing autonomy of the petroleum sector and its opening for foreign participation became catalysts for further production-sharing agreements with other foreign companies and initiated more institutional changes within the Chinese petroleum administration. The China National Offshore Oil Corporation (CNOOC) was established in 1982 to handle offshore explorations and joint contracts with foreign oil companies (see Appendix 2.1). In 1983, the state controlled ministries of Petroleum, Chemical and Textile were incorporated to form the China National Petrochemical Corporation (Sinopec). While CNOOC functioned under the MPI, Sinopec was under the direct supervision of the State Council and was tasked to operate downstream, including the formulation of policies for producing refined oil products and petrochemicals, supervision of the construction and operation of refining and petrochemical plants and the marketing of refined oil products and petrochemicals in China (Zhang, 2008). Though centrally planned, the CNOOC and Sinopec followed the profit retention trend of the Chinese state-owned enterprises that marked the first wave of corporatization. The existing economic ideology in the early 1980s was “building a socialist planned commodity economy” and the ability of the national oil companies to export and retain revenue was a fundamental manifestation of this development.

The Ministry of Petroleum Industry was restructured in 1988 to form the China National Petroleum Industry (CNPC). Charged to manage all assets of the MPI, CNPC was given full administrative functions and permitted to engage in onshore oil and gas development. The State Council also granted CNPC the right to oversee international cooperation in the planning, exploration, development and production of offshore shallow areas. Additionally, CNPC inherited MPI responsibilities, including formulating national quality standards for the oil industry and devising policy for environmental protection.

With the establishment of CNPC, CNOOC and Sinopec, the three NOCs now form China’s petroleum industry. They also indicated the end of the line ministries and the government’s direct control of the oil sector. The institutional transformation of the petroleum industry paved the way for the decentralization of other functions that used to be under the

State Council. By establishing the national oil companies (NOCs), the central government gave up control over the entire management of the petroleum production chain and shifted the responsibility of profits and losses to the NOCs (Kong, 2010). The operational autonomy given to the NOCs also included changes in price control mechanisms implemented by the government. By slowly integrating domestic and international prices of the petroleum products, the state did not only give decision-making authority over the petroleum industry to NOCs, but it propelled them to embrace domestic and global competition.

The corporatization of the Chinese national oil companies in the 1980s was taken as a fundamental move towards decentralization. However, central planning remained within the petroleum industry even if the functions and responsibilities of the NOCs have been clearly outlined and the market was opened to foreign involvement. For instance, the State Council still held its supervisory role over the NOCs instituted through vertical control (Kong, 2010). Though the line ministries have been abolished, the NOCs retained their administrative functions and bureaucratic ranks. The NOCs also played a dualistic role in the petroleum market for they were both the major market participants and the market regulators.

Consequently, the Chinese government held the authority over pricing, production targets and distribution of petroleum products. Investment strategies were also curtailed by the government for NOCs were not entitled to capital investment above RMB 500 million and RMB200 million for CNPC and Sinopec respectively. During this period, the NOCs were “administrative entities” rather than “economic entities” (Zhang, 2004). Moreover, the price of oil in the downstream market was artificially reduced below international levels affecting the industry’s profitability. The distorted price made the NOCs incur debts and redirect funds from exploration and development and upstream market investments. The NOCs also gained more debt as the labor cost increased along with the production costs, a direct impact of maturing oil fields and lack of investments in exploration and development. However, a move by the state council for oil sector reforms was hampered by the subsequent inflation in the economy. Following the 1989 Tian’an’men Square student protest, the government feared that oil price reforms might further increase inflation triggering social instability. Against this backdrop, the

central government decided that petroleum industry reforms must follow a gradualist and state-controlled process (Kong, 2010).

### **2.3. Decentralization: Second Reform (1992- 2003)**

In November 1993, the Third Plenary Session of the 14<sup>th</sup> CCP Central Committee adopted the document on the “Decision Concerning the Establishment of a Socialist Market Economic Structure”. The second wave of reforms following Deng Xiaoping’s southern tour in 1992, marks the central government’s move in transitioning the Chinese economy from traditional planning to a “socialist market economy” (*shèhuì zhǔyì shìchǎng jīngjì*). The objectives included both macroeconomic and microeconomic dimensions of the system from financial, tax and monetary reforms to the establishment of “socialist modern enterprises” (MacFarquhar, 2011). Property rights, ownership and management of enterprise assets and the adoption of accounting systems were all launched under this reform structure.

The impact of the reforms to the national oil companies came in 1997 when the need to prepare the NOCs for global competition arose in preparation for China’s World Trade Organization (WTO) membership. Until then, the NOCs were still operating within their allocated areas of specialization as instituted by the government. Under central planning, the NOCs were segmented and curtailed in a single area of operation. CNOOC was responsible for offshore E&P and cooperation with foreign companies, CNPC was focused on onshore E&P and Sinopec on downstream refining and petrochemical operations (Zhang, 2004). Moreover, with the WTO membership, the Chinese petroleum market will be opened for competition to international oil companies (IOCs) such as the British Petroleum (BP) and Exxon Mobil, corporations that outweigh Chinese NOCs in experience, expertise and resources in exploration and development (Kong, 2010). Thus with the impending competition and need for vertical integration within NOCs, the central government issued a major restructuring of the oil and petrochemical industry.

The restructuring of the oil sector began in 1998 with the vertical integration CNPC and Sinopec. As fully integrated oil and petrochemical groups, the new CNPC and Sinopec Group gained upstream and downstream portfolios. From being divided along functional

specializations, the NOCs were geographically restructured and operational transfers were allowed. With these reforms, CNPC gained direct access for refined products while Sinopec was able to secure reliable supplies of crude oil with its new oil-producing assets. Both companies also acquired complementary assets and capabilities for research and development and combined strengths in upstream and downstream technologies and integrated sales networks (Zhang, 2004). The reform also allowed the CNPC and Sinopec Group trading rights to participate in both domestic and international trade of petroleum products.

The size of the combined assets of CNPC and Sinopec Group made them dominate the Chinese petroleum industry. In 2003, CNPC and Sinopec Group lead the downstream and distribution operations accounting for about 90% of the total crude oil output and 75% of retail sales of China's total, respectively. The restructuring also allowed them to benefit from the advantages of scale economies and enable them to be more competitive in the oil market. It allowed them to access financial resources for further expansion in the global market and to obtain petroleum exploration and production opportunities.

Alongside corporate restructuring, the petroleum administration was decentralized when the Ministry of Petroleum Industry was abolished in 1993 and its administrative functions transferred to the NOCs. In 1998, the State Bureau of Petroleum and Chemical Industry (SBPCI) was established by the State Council under the State Economic and Trade Commission (SETC) to assume the administrative functions given to CNPC, CNOOC and Sinopec during the 1993 reforms. The SBPCI was responsible for the petroleum industry's overall development strategy and industrial planning as well as the restructuring of the 7,500 SOEs under CNPC and Sinopec (Zhang, 2004). However, while CNPC and Sinopec Group retained their ministerial rank and the CNOOC its vice-ministerial rank, the SBPCI was only a bureau level agency that lacked political clout to regulate the petroleum industry (Kong, 2010). So, to further restructure the oil sector, the State Council abolished SBPCI in 2001 replacing it with China Petroleum and Chemical Industry Association.

The decentralization of the petroleum industry has given substantial autonomy to NOCs and diluted the central government's regulatory control. Following the failure of SBPCI, the succeeding agencies formed by the State Council to regulate the petroleum industry either

lacked political clout or manpower. The Energy Bureau under the National Development and Reform Commission (NDRC) formed in 2003 had only 4 people in its Oil and Gas Department though it was to oversee 10 areas of China's oil and gas industry. Consequently, among the State Council's 28 ministerial bodies, 6 of them have some responsibilities over the petroleum industry (Kong, 2010). Functional authority including petroleum price setting, construction of oil infrastructures, oil production market, transportation and investments were given to these agencies, instead of being consolidated in the Energy Bureau. In contrast, the NOCs administrative control became highly centralized after the 1998 reforms. With their vertical integration, Sinopec and CNPC were authorized to manage and supervise all state assets of all subsidiaries under them. The succeeding stock market listings between 1999 and 2001 established a one-tier legal person system of NOCs that prevented their subsidiaries to operate independently (Zhang, 2004). Thus, while the state's petroleum administrative control loses its command and control authority over NOCs, the NOCs in turn were gaining centralized power, unifying core interests of the subsidiaries and the parent companies.

#### **2.4. Government Institutions and NOCs: A Move to Recentralization? (2003-2010)**

To strengthen and consolidate government control over the petroleum industry in China, the State Council established the National Energy Leading Group (NELG) in 2005 under the leadership of Premier Wen Jiao Bao and NDRC chairman Ma Kai. However, created separately from the Energy Bureau, the NELG was formed as a high-level research and advisory group, making it lack direct impact to the overall petroleum administration and any policy-making or regulatory powers. It did not draft regulations but outlined bureaucratic principles and guidelines. Additionally, the NELG overlapped with other existing bureaus under NDRC that handled petroleum portfolio, thus further fragmenting central control over the oil industry.

A move towards a more centralized energy authority was proposed at the First Plenary Session of the 11<sup>th</sup> National People's Congress in March 2008. The fragmentation of control over energy policy and the deficient regulatory instruments of NELG prompted proposals of an energy body with a ministerial rank. Because of the opposition from the NDRC and the NOCs,

the Energy Bureau was instead promoted to a vice-ministerial rank and renamed the National Energy Administration (NEA). However the new bureaucratic position of the NEA was still deficient in establishing regulatory clout within the sector, for the NOCs still held higher full ministerial ranks and administrative functions over the oil industry, while the central government authority remained fragmented between NDRC and its ministries (see Appendix 2.2). Its limitations in authority, autonomy, personnel and policy instruments made the NEA an ineffective regulatory agency (Kong, 2010).

While bureaucratic infighting characterized the government's capacity to control the petroleum industry, the NOCs were gaining more political influence in policy-making, petroleum pricing, production and administration. Their vertical integration gave the NOCs economic power while the fragmentation of state authority enabled them to retain political clout. Holding ministerial ranks, the NOCs were far more bureaucratically superior than the agencies established to regulate them. Their experience and expertise in the petroleum sector were also essential tools to influence policy-making to further their own interests. For instance, Sinopec employees became involved in drafting the country's strategic oil reserve law because their company has the greatest expertise in this area (Downs & Meidan, 2011). Consequently, the shortage of expertise within the state controlling bodies limited the drafting of a cohesive energy strategy, prompting projects to shape energy policies instead of depending on such policies to guide project approvals (Chen, 2003).

The National Energy Commission was established in 2010 as a "super ministry" tasked to produce China's energy development strategy, review issues of energy security and development, and coordinate domestic energy exploration and international energy cooperation (Bo, 2010). Designed as a "cabinet within a cabinet" of the State Council, the NEC is composed of 21 high ranking officials from the State Council, ministries, commissions and even the military (see Appendix 2.3). Headed by then Premier Wen Jia Bao and Vice Premier Li Keqiang, NEC encompasses a vast political scope that seeks not just to direct and influence policy-making in the energy sector, but to establish control and recentralize command to the state. Receiving administrative control from the State Council and not from the Central Committee, NEC outweighs other ministerial rank including that of NOCs. By founding this

“super ministry”, the government is attempting to build intra-energy cooperation that will form a cohesive energy policy and launch strategic initiatives on energy issues.

As shown through its historical development, the Chinese petroleum industry has been shaped by ideology, history, political culture and macroeconomic landscape, contextual and path-dependent factors that influence the direction of the interaction between the state and the NOCs (Kong, 2010). As they were given autonomy, the NOCs political clout enlarges whereas the government tries to re-establish control by creating a “super ministry”. Thus the interaction between the state and the NOCs is an on-going dilemma between increasingly diverging interests. As the government tries to wield NOCs to pursue its political and economic interests the NOCs are using its political and economic clout for its own commercial gains (Kong, 2010).

The trajectory of the petroleum industry characterizes the broader macroeconomic development of China. The interaction between the state and the NOCs exemplifies the gradualist approach of the government in opening its industries to the market economy. From the Maoist ideology of “self-reliance” to the corporatization of NOCs, the oil sector typifies how the Chinese government reformed its economy and its state-owned enterprises. It shows how even with the corporatization of the NOCs, the state’s political clout remains strong in the industry that it considers as *zhizu chanye* or “pillar industry”. The measured allotment of autonomy of the NOCs corresponds to the larger framework of state planning and control. Though much has been given to the NOCs in terms of administrative functions and operational independence, pricing and distribution instruments still remain in the hands of the government and its ministries. As State Assets Supervision and Administration Commission (SASAC) Chairman Li Rongrong said, “The state should have absolute control by solely owning, or having a majority share in, enterprises engaged in power generation and distribution, oil, petrochemicals and natural gas, telecommunications and armaments” (Zhao, 2006).

## **2.5. Corporate Governance, Ownership and Marketization**

The Chinese government’s goal to integrate into the global economy during the 1990s led to the implementation of economic policies geared towards market-oriented strategies. As a consequence of the 1997 Asian financial crisis and its candidacy for World Trade Organization

membership, the Chinese economy underwent an overhaul, targeting state-owned enterprises including the national oil corporations. This transformation has been characterized as state-controlled privatization. Large SOEs were converted to shareholding cooperatives (*gufen youxian gongsi*) and limited liability companies (*youxian zeren gongsi*) (Zhang, 2008).

### 2.5.1. International Market

In line with the marketization of SOEs, the NOCs, particularly CNPC and Sinopec implemented major internal restructuring programs that separated their core business and non-core businesses in their subsidiaries. The core business in each of the subsidiary were set up as branch companies (*fen gongsi*) and were transformed into joint stock companies that were traded in both domestic and international markets (see Table 2.1).

Table 2.1 National Oil Companies Stock Market Listings

Parent Company	CNPC	Sinopec	CNOOC
Listed company	PetroChina	Sinopec Corp	CNOOC Ltd
Date of listing	April 2000	October 2000	February 2001
ADS price	16.44 dollars	20.645 dollars	15.40 dollars
Number of issued shares	175.58 billion (10% of the total)	1,803 billion (21.21% of total)	1.64 billion (27.5% of total)
Total IPO Funds	2.89 billion dollars	3.7385 billion dollars	1.26 billion dollars
Percentage of parent company shares	90%	Sinopec: 56% Bank of China: 27%	67.5%
Listed stock exchanges	Hong Kong, New York	Hong Kong, New York, London	Hong Kong, New York

Sources: CNOOC, Sinopec and CNPC Annual Reports, updated from Guo (2007)

PetroChina Company Limited was established in November 1999 as part of CNPC's system-wide restructuring program. As CNPC aimed to make its profitable businesses independent, it injected assets and liabilities involving the production, refining, marketing and exploration of petrochemicals and natural gas into PetroChina. By April 2000, it was listed in the Hong Kong and New York Stock exchanges gaining US\$2.89 billion dollars in its initial public offering (IPO). Consequently, Sinopec Corporation was formed in February 2000 as a joint stock entity under the China Petrochemical Corporation Group or Sinopec Group. By

October of the same year, it entered the Hong Kong, New York and London markets gathering US\$3.7 billion of funds in its IPO. It issued 1.8 billion shares, representing 20% of its total shares costing around US\$20.6 per share. Eighty percent of these issued shares are state-owned, distributed between the Sinopec Group and Bank of China, accounting to 53% and 27% of shares respectively. CNOOC also formed CNOOC Limited in October 1999 and was listed in Hong Kong, New York and London stock exchanges in February 2001. It gained US\$1.25 billion of funds in its IPO selling US\$15.6 dollars per share. It issued 27.5% of its total shares, 67.5% of which were held by its parent company. By October 2001, the Chinese State Council handed to the CNOOC exclusive rights in overseas transaction held with foreign partners in exploration and development of oil and gas.

Through the enlistment of PetroChina, Sinopec Corp and CNOOC Ltd in the three major international exchanges, Chinese NOCs were able to raise funds and expand their investment mechanisms in the global market. According to Guo (2007), aside from fundraising through IPO financings, the NOCs were also able to actualize “strategic foreign capital alliances” with other international oil companies that will push the NOCs to be more competitive in the international market.

### *2.5.2. Domestic Market*

Deemed as equity markets with “Chinese characteristics”, the government’s approach to NOC privatization did not mean selling of state-owned assets to non-state actors, but rather, financing growth by raising capital in the markets. The Chinese government’s ideological aversion to privatization and its distrust to any entity it entitles to hold its shares as a representative owner led it to introduce a system whereby company shares were defined in terms of the relationship of the shareholder to the state and made any state-related shares non-tradable (Walter and Howie, 2006). This affected the pricing of the shares according to the entity that sought to acquire them. Private investors, including foreign companies buy the shares according to price set by the market whereas state agency to state agency trade standardized the share price as RMB 1 per share. Additionally, A shares are the only tradable shares that were reserved for non-state actors while state and legal person shares owned by any public investor

could not be traded. For instance, the value of non-tradable shares of PetroChina, Sinopec Corp and CNOOC before 2005 averaged around 70% of the total shares issued in the market.

Because of transaction difficulties, financial restrictions over mergers and acquisitions (M&As), and international pressure from its WTO membership, the Chinese government reformed the market flexibility of state and legal person shares. In 2005, the government eliminated the various share ownership types and made all shares legally tradable. By 2007, 97% of listed companies in the mainland market have completed the non-tradable shares reform that valued RMB 9 trillion that year. Although this share restructuring affected 1,301 listed SOEs, PetroChina is the only NOC that has implemented it to date. In 2010, PetroChina's 157.5 billion restricted shares valued at RMB 1.89 trillion, held by its parent company China National Petroleum Corp, were made tradable in the Shanghai Stock Exchange. However, Sinopec has yet to reform its 6,712,195 non-tradable shares, 77.42% of the total shares that are owned by China Petrochemical Group.

The split share reform that gave SOEs their operational autonomy and abolished the discriminatory pricing of China's listed company shares also made corporate transactions more efficient and in line with international standards. However it had no impact on the ownership structure of the SOEs for fundamentally, they belong to the government (Beltratti, et al, 2011). The reform made the shares tradable, but with around 70% of shares held by the state through the SASAC and other government entities, the State Council still has to capacity to exert effective corporate governance from within the firm, irrespective of a functioning outside market for corporate control (Jiang, et al, 2007). The administrative power over PetroChina, Sinopec and CNOOC continues to rest within the central government despite the change of shareholders in both domestic and international markets.

## **Chapter 3. Chinese Politics and NOC Governance**

Chinese state-owned enterprises (SOEs or *yangqi* in Chinese) are defined as national firms whose majority of assets are owned (or fully owned) by the state or more specifically by the State Assets Supervision and Administration Commission (SASAC). Currently, the SASAC holds around US\$3.7 billion of assets of its 116 flagship SOEs, among which, the national oil companies (NOCs) are the largest. Sinopec, China National Petroleum Corporation (CNPC) and China National Offshore Oil Corporation (CNOOC) are all Global Fortune 500 companies.

As the NOCs gain more assets domestically and internationally through their mother companies and subsidiaries, their financial and political clout are also expanding. However, this study argues that major national oil companies such as Sinopec, CNPC and CNOOC still remain under the authority of the Chinese Communist Party (CCP) through the variety of ways, namely: institutional mechanisms through the Central Organization Department (COD) and SASAC; political and administrative mobility of senior executives between the corporate and government jurisdictions and the system of personal connections or *guanxi* that catalyzes cliques and political networking.

### **3.1. CCP's Controlling Mechanisms**

#### ***3.1.1. State Assets Supervision and Administration Commission (SASAC)***

The ownership and control of shares and assets of SOEs fall on the authority of the State Assets Supervision and Administration Commission (SASAC). Created in May 2003, the SASAC was founded “*on the principle of separating government administration from enterprise management and separating ownership from management*” (Trade Policy Review, 2006). Under the 2003 charter “Interim Regulations on the Management of Enterprise State-owned Assets”, the definitions of authority over SOEs were clarified. The central government’s executive organ, the State Council, received the government ownership authority and the SASAC, created directly under its control was to take the investor and administrative responsibilities over the SOEs (Naughton, 2006). The SASAC currently holds 116 central SOEs ranging from

telecommunications, airlines and shipping, automobile, energy and mineral industries including all major NOCs with a total of US\$3.7 trillion in assets. The ten largest Chinese firms by revenue are all state-controlled and the revenues of the top 20 centrally-managed SOEs amount to more than 50% of China's GDP each year (Lee, 2012). Sinopec, CNPC and CNOOC, China's largest SOEs are all national oil companies listed in Global Fortune 500 with combined revenues of around US\$800 million in 2012 alone (Global 500, 2012).

Although the SASAC's responsibilities do not extend to the company operations, production and development, it holds the majority of shares of SOEs and has executive control over corporate policy and executive appointment. Its main priority is to ensure efficient company performance through the control of its board of directors and setting on the company's main strategy agenda (Szamosszegi and Kyle 2012). It also retains regulatory authority over reforms and restructuring of SOEs. According to Li Rongrong, former SASAC chairman, SASAC controls over 90% of the assets in China's pillar industries of oil, electric power and defense.<sup>4</sup>

As an investor, the SASAC exercises strategic ownership rights over the NOC's assets. Investment strategies, financial planning, corporate development and asset and equity management are all controlled by the SASAC. This includes all transactions involving assets and liabilities of both parent company and NOC subsidiaries. The SASAC also exercises regulatory powers over the remuneration allocation, disposal of substantial assets and restructuring plans including all mergers and acquisitions. The NOCs could not mobilize capital, file bankruptcy or issue company bonds without the SASAC's approval. Moreover, the defining and registering property rights, appraising, verifying and staking stock of state assets and liabilities together with supervising and managing property rights trading of NOCs are also under the supervision of the SASAC (Kong, 2010).

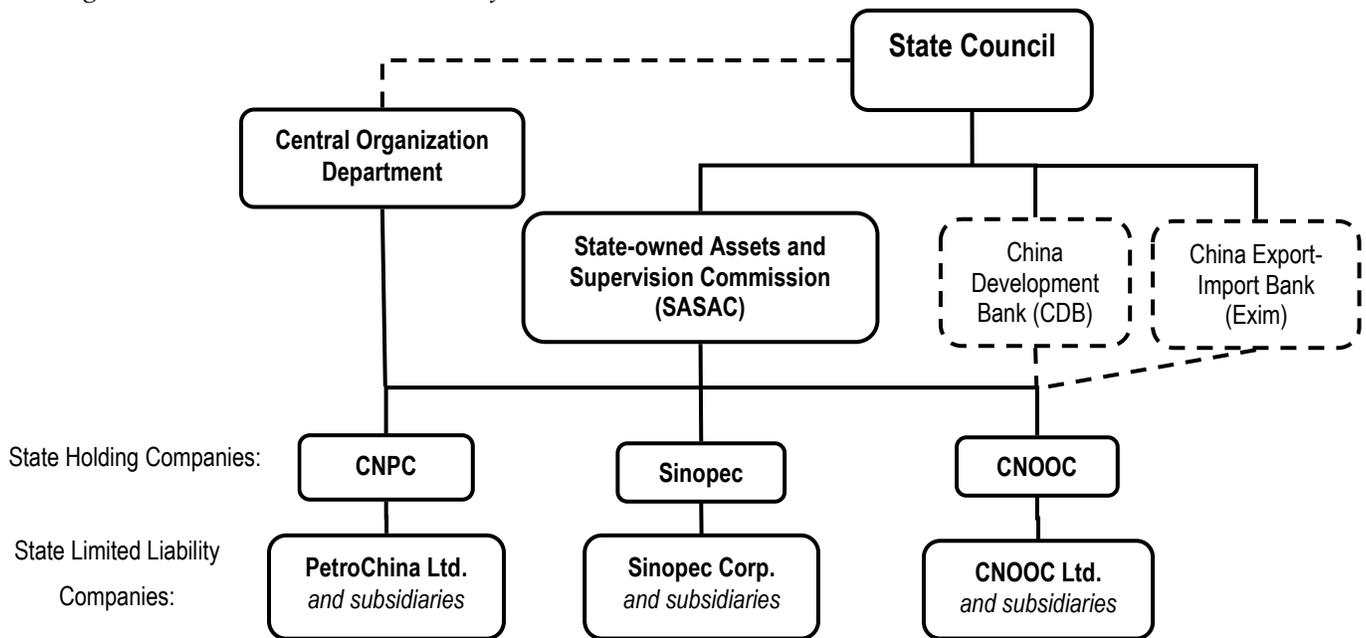
This combined ownership and regulatory tasks has given an enormous power to the SASAC over NOC policies and mandates. Though the NOCs have operational autonomy, the strategic and administrative control of the SASAC over them limits their capacity to pursue

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<sup>4</sup> The total assets of SASAC companies exceed 2 trillion Yuan. (2010, August 20). Xinhuanet. [http://news.xinhuanet.com/fortune/2010-08/12/c\\_12440586.htm](http://news.xinhuanet.com/fortune/2010-08/12/c_12440586.htm).

their own interests that may be divergent from the state’s interests. As SASAC is a direct ministerial body of the State Council, CCP then is assured that its “national interests”, control and higher strategic objectives and agenda are set and followed by the NOCs (see Figure 3.1). As Li Rongrong noted in an interview, “The state (CCP) said that my reforms are not strict and strong enough and the procedures that were taken were too slow; the older generation of the Standing Committee of People’s Congress said my management control is not disciplined enough, making lots of losses of state assets” (Xinhuanet, 2010)<sup>5</sup> referring to the criticism he received from the CCP after the SOEs listed losses after 2008.

Figure 3.1. Administrative Control of NOCs



Source: Consolidated by the author from CCP State Council Website, NOCs’ websites

### 3.1.2. Central Organization Department

While the SASAC owns and regulates the NOCs, one of the most important institutional mechanisms of political and administrative control of CCP is the Central Organization Department (COD). Based on the Leninist *nomenklatura* system, the COD has powers over the executive appointment within the CCP, including ministerial, vice-ministerial positions and

<sup>5</sup> “社会上说我改革的力度不够，步子太慢，但是人大的一些老常委们，批评我管得不够严，让国有资产流失很严重。” Interview with Li Rongrong. (2010, September 8). Xinhuanet. [http://news.xinhuanet.com/fortune/2010-09/08/c\\_12530988\\_4.htm](http://news.xinhuanet.com/fortune/2010-09/08/c_12530988_4.htm).

even the SASAC, provincial leaderships, business organizations, academia and media. Under this system, 5,000 top positions in the party are controlled by the COD. Although major SOEs are allowed decision-making competencies in recruitment, management and production, the government still retains the authority of these executive posts which are then ratified by the Politburo and implemented by the Ministry of Personnel, one of the many agencies whose officials are also holding positions in the Central Organization Department (Downs & Meidan, 2011).

Along with other state-owned enterprises, the overall control and nominations of the three most senior positions, the general manager, party secretary and chairman of national oil companies (NOCs) are also under COD. All executives chosen to hold these positions are consequently members of the CCP and the chairman of the company is also a party secretary. This duality of ranks characterizes the Chinese administrative model where the board chairman of a company is viewed as the *de facto* leader whose authority supersedes that of the Chief Executive Officer (CEO).

Since the CCP considers energy security as one of its key strategic priorities, tight control over executives in the energy sector is instituted. The detailed guidelines on these leadership positions include political reliability through CCP membership, strong administrative qualities and practical work experience. Moreover, political and military ties and a system of patronage within the CCP itself also play fundamental roles in securing executive positions in the sectors mentioned above.

The reshuffling of oil executives in 2011 was a major demonstration of the CCP's control through the Organization Department over China's state-owned companies. In April 2011, Su Shulin, the general manager, party secretary and chairman of Sinopec was appointed governor and deputy party secretary of Fujian Province. Holding the same senior positions in CNOOC, Fu Chengyu was transferred to Sinopec while Wang Yilin, the deputy general manager, party committee member of CNPC and non-executive director of PetroChina became the chairman, party secretary and chairman of the Board of directors of CNOOC.

The technical knowledge of the domestic and global energy industries, on the ground experience and their bureaucratic rank make the NOC executives indispensable to the CCP's

concerns on energy security and stable economic growth and development. However, with their career advancement under Party control through the COD, the NOC executives fully understand that alongside stable corporate results, success and profitability, they also need to ensure that their firms advance the Party's interests (Downs & Meidan, 2011).

### 3.2. Transference Between Government and Corporate Positions

Jiang Jiemin, the previous general manager and party secretary of CNPC, chairman of PetroChina is the newly appointed head of the SASAC and current and a member of 18<sup>th</sup> Central Committee of the Communist Party of China (CPC). Su Shulin also a member of 18<sup>th</sup> Central Committee was the vice minister of Liaoning Province before becoming the general manager, chairman and party secretary of Sinopec. He is now the governor and deputy party secretary of Fujian Province. Fu Chengyu, the current general manager and party secretary of CNOOC served under the Central Commission for Discipline Inspection of the 17<sup>th</sup> Central Committee. Wang Yilin, the new chairman of CNOOC used to be a party secretary of Xinjiang Province and is also now a member of the 18<sup>th</sup> Central Committee. These are few examples of the interchanging and often times overlapping functions of executives between the government and businesses in the past few years (see Table 3.1).

*Table 3.1 Political-Corporate Positions of Chinese Executives*

<b>China National Petroleum Corporation (CNPC)</b>	
Jiang Jiemin	<i>Alternate Member of the 17th CPC Central Committee</i> Chairman of Board of the Directors of PetroChina Company
1999- present	Years worked in CNPC
2007— 2013	Chairman, China National Petroleum Corporation (CNPC), Board of Directors
2004— 2013	President, China National Petroleum Corporation (CNPC)
2013 —	Chairman, State Assets Supervision and Administration Commission (SASAC)
Su Shulin	<i>Alternate Member of the 17th CPC Central Committee</i> Governor of Fujian Province Deputy Secretary of the Fujian CPC Provincial Committee
2002—2006	Deputy General Manager, China National Petroleum Corporation (CNPC)
2002—2006	Member, China National Petroleum Corporation (CNPC)
2002—2006	Vice-President, China National Petroleum Corporation (CNPC)
Zhou Yongkang	<i>Member of the Standing Committee of the Politburo Bureau of the 17th CPC Central Committee</i> Director of the Public Security Commission of the CPC Central Committee

1988-1998	Years worked in CNPC
1996—1998	General Manager, China National Petroleum Corporation (CNPC)
Sun Xiaoqun	<i>Member of 17th CPC Central Committee</i> , Vice-Chairman of the 11th CPPCC National Committee Ethnic and Religious Affairs Committee
1988—1990	Deputy Director, China National Petroleum Corporation (CNPC), Business Management Department
Ma Fucai	<i>Alternate Member of the 16th CPC Central Committee</i> General Executive of China National Petroleum Corporation Chief Executive of PetroChina Co. Ltd.
1972-present	Years worked in CNPC
1998—	General Executive, China National Petroleum Corporation (CNPC)

### **Sinopec Group**

Zhang Gaoli	<i>Member of the Standing Committee of the Politburo of the 18<sup>th</sup> CPC Central Committee</i>
1970-1985	Years worked in Sinopec
1984—1985	Manager, Sinopec Corp., Maoming Petrochemical Company
Li Yizhong	<i>Member of the 17th CPC Central Committee</i>
1980-2000	Years worked in Sinopec
2000—2003	Chairman, Sinopec Corp., Board of the Directors
Zhang Youcai	<i>Vice-Chairman of the Financial and Economic Committee of the NPC</i>
2003-present	Years worked in Sinopec
2006—	Vice-Chairman, Sinopec Corp., Supervisory Committee
Chen Jinhua	<i>Vice-Chairman of the 9th CPPCC National Committee</i> Chairman of the Chinese Federation of Enterprises
1983— ?	General Manager, Sinopec Corp.

### **China National Offshore Oil Corporation (CNOOC)**

Fu Chengyu	<i>Member of the 17th CPC Central Commission for Discipline Inspection</i> Chairman of the Board of the Directors of SINOPEC
1983-2011	Years worked in CNOOC
2003—2011	General Manager, Chairman, Chief Executive Officer, China National Offshore Oil Corporation (CNOOC)
Wei Liucheng	<i>Member of the 17th CPC Central Committee</i> Chairman of Hainan Provincial People's Congress Standing Committee
1982-2003	Years worked in CNOOC
1999—2003	Chairman, China National Offshore Oil Corporation, Board of Directors
1999—2003	General Manager, Chief Executive Officer, Secretary, China National Offshore Oil Corporation (CNOOC)

Source: Author's database updated from Downs & Meidan (2011)

The criteria for selecting political leadership personnel in CCP changed after the official declaration of the Chinese “socialist market economy” in 1992 (Heimann, 2000). Across China,

the Central Organization Department passed guidelines for the selection and promotion of junior personnel who have university education and technical experience. To meet the new demands of economic development these guidelines became compulsory requirements for all civil servants holding white collar positions whether in the government or SOEs. Currently, of the 205 members of the 18<sup>th</sup> Central Committee, 80% were born in the 1950's and 95.7% of the members have received education at the university level or above (China Daily, 2012)<sup>6</sup>.

Consequently, the CCP values SOE executives for their strong administrative skills, deep knowledge of global trends and markets, and experience in corporate operations. While handling high management positions in SOEs, these executives are evaluated based on how they balance corporate objectives and general CCP interests and priorities. Those who excel are promoted to provincial and national leadership positions (Downs & Median, 2011). For instance, following the surge of oil prices in the market in 2009, Sinopec, under Su Shulin's leadership suffered profit losses as the government prevented it from raising oil domestic prices. However, this was followed by foreign acquisitions abroad to help curb the dwindling supply of oil and obtain leverage positions in oil-rich areas around the world. One of the biggest deals in 2010 was with the acquisition of 40% of Repsol's Brazilian oil and gas assets amounting to US\$7 billion (Chen, 2010). This procurement did not only bring profit-seeking advantages as Repsol holds one of the richest oil sands in the area, but also opened an opportunity for China (and other Chinese SOEs) to tap Brazilian oil reserves without getting into close scrutiny from the country as it would without Repsol. This transaction became pivotal for China to gain ground in South America and extend its acquisitions even to the northern continent. After this success Su Shulin, Sinopec's chairman was appointed the governor of Fujian Province 2011.

Downs and Median (2011) characterized this as the "revolving door" between government and businesses in China. Increasingly, SOEs executives become primary candidates for leadership positions in the government. The senior managers of all central SOEs are almost all senior members of the CCP Central Committee (Pei, 2006). At the 18th Party Congress more than six full Central Committee members are SOE bosses including Jiang Jiemin and Wang Yilin from NOCs, compared to just one five years ago. According to Downs and Median (2011), the

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<sup>6</sup> *CPC Congress Concludes, New Central Committee Elected.* (2012, November 14). China Daily.

presence of SOE executives in the Central Committee is an indication that the government recognizes that the technical and administrative capacities the executives developed in businesses are transferrable to the government.

The success of high-ranking officials with oil industry experiences within the CCP did not just come from their skilled competencies in management, finance and technical areas. As with the case of Sinopec-Repsol acquisition, corporate success should also be aligned to state interests. The promotion of Su to govern Fujian Province and the recent appointment of Jiang Jiemin as the SASAC chairman shows that promotion to executive positions are used by the central government as a control mechanism and an approach to incentivize individuals that simultaneously promote corporate and state-directed interests.

### **3.3. Traditional Connections and the *Guanxi***

The secrecy of the recruitment of executives within the Central Organization Department and the direct ties of SASAC to the State Council exposes these agencies to the political influences of their core decision-makers. Because the proceedings of executive nominations and approval of SOE administrators are opaque, a system of personal networking, the *guanxi* becomes inevitable. Everyone involved in the CCP political system, from Politburo members, ministers and key industrial executives to provincial party secretaries all vie to put their own people in these powerful positions (McGregor, 2009). In turn, the appointed executives have to return the favor by following the strategic agenda of their patrons, thus creating interdependent relationships that are centered on the administration rather than the enterprise (Zhang, 2008).

The *guanxi* can be characterized by different levels of relationships that transcend traditional familial boundaries. Lineage, extended family networks, place of origin, personal connections through sharing the same school or job assignment, or even introduction by middle men all serve as basis for *guanxi* (Jacobs, 1979). Moreover, according to Jacobs (1979), the level of ties within the *guanxi* is based on social interaction and professional usefulness. It cannot be inherited but needs to be earned personally through trust and has to be proven through unquestionable loyalty and professional achievements (Zhang, 2008). As trust cannot be given

nor earned overnight, young cadres have to prove their professional and organizational competencies in order to be promoted. The CCP through the COD evaluates the would-be government officials and corporate executives through assignments in the provinces. The assignments are in the same sector thus forming a strong basis of *guanxi* for the people involved.

During the 1980s for instance, Zeng Qinghong, then working as a deputy manager of the Liaison Department of the Ministry of Petroleum Industry and CNOOC met Zhou Yongkang in the Liaohe Fields where he worked from 1970-1985 (Downs & Meidan, 2011). Zhou was concurrently promoted as Zeng Qinghong moved from the CCP Standing (Provincial) Committee in Shanghai to the CCP Central Committee (1989-2012), including a post the Central Organization Department (1999-2002). Zhou then having gained extensive experience in CNPC, was transferred to Sichuan Province as a party Secretary (1999-2002) and then back to the Central Committee and ultimately to the Politburo Standing Committee (2002-2012). Meanwhile, Jiang Jiemin, then making his name as the director of Petroleum Administration in Qinghai became the Assistant President of CNPC in 1999. He later became the governor of Qinghai in 2003 and the following year, the president, deputy secretary and deputy general manager of CNPC (see Table 3.2). He has been recently promoted to the chairmanship of SASAC in March 2013. It is said that Zhou promoted anyone above director level in CNPC who worked at the Shengli oil fields, where he spent his early career in the oil industry, including Jiang (Downs & Meidan, 2011).

Consequently, Fu Chengyu, the current chairman and party secretary of Sinopec worked for CNOOC from 1983 to 1994, overlapping with Zeng Qinghong's time there as a deputy manager (1983-1984). According to Downs and Meidan (2011), Fu worked as an assistant to Zeng and the later reportedly helped Fu climb the corporate ladder at CNOOC. Similarly, Zhang Gaoli who is currently a member of the 18<sup>th</sup> Central Committee is said to be a protégé of Zeng Qinghong. Zhang has extensive experience in the oil industry having served as a manager of Sinopec in mid-1980s.

This complex system of personal networking not only forms a means of control over the mobility of high-ranking personnel within and between NOCs and the government but are also

used to secure preferential treatment, obtain essential resources and help avoid unnecessary risks. As seen in the case of Zeng Qinghong, his influence paved the way for the Zhou Yongkang to further his own political career. As the head of the COD, Zeng co-decided with other PBSC and COD members to promote Zhou to the Central Committee, provided of course that Zhou passes all the fundamental criteria of NOC leadership that the COD has set.

*Table 3.2 Comparison of Working Experience of Zhou Yongkang and Jiang Jiemin*

<b>CCP, Central Committee</b>		
Zhou Yongkang	1992—1997	Alternate Member 14th CPC, Central Committee
	1997—2002	Member 15th CPC, Central Committee
	2002—2007	Member 16th CPC, Central Committee
	2007—2012	Member 17th CPC, Central Committee
Jiang Jiemin	2007—2012	Alternate Member 17th CPC, Central Committee
	2012—	Member 18th CPC, Central Committee
	2013 —	Chairman, State Assets Supervision and Administration Commission (SASAC)
<b>CCP, Leading Party Group: Petroleum Administration</b>		
Zhou Yongkang	1988—1996	Director-General Petroleum Administration in Shandong Province, Shengli
	1988—1996	Secretary Petroleum Administration in Shandong Province, Shengli
Jiang Jiemin	1993—1994	Deputy Director Petroleum Administration in Shandong Province, Shengli
	1994—1999	Director Petroleum Administration in Qinghai Province
<b>China National Petroleum Corporation (CNPC)</b>		
Zhou Yongkang	1988—1996	Deputy General Manager China National Petroleum Corporation (CNPC)
	1988—1996	Deputy Secretary China National Petroleum Corporation (CNPC)
	1996—1998	General Manager China National Petroleum Corporation (CNPC)
	1996—1998	Secretary China National Petroleum Corporation (CNPC)
Jiang Jiemin	1999—1999	Assistant President China National Petroleum Corporation (CNPC)
	2004—	President China National Petroleum Corporation (CNPC)
	2004—2006	Deputy Secretary China National Petroleum Corporation (CNPC)
	2004—2006	Deputy General Manager China National Petroleum Corporation (CNPC)
	2006—2007	General Manager China National Petroleum Corporation (CNPC)
	2006—2007	Secretary China National Petroleum Corporation (CNPC)
	2007—2008	Chief Executive Officer China National Petroleum Corporation (CNPC)
2011—2013	Chairman PetroChina Compant Ltd., Board of Directors	

*Source: Consolidated by the author from government websites and online achives*

### **3.4. Convergence of NOC Politics**

The Chinese national oil companies have strong political and economic influences domestically and globally. Their financial clout and technical expertise make them prized flagship companies owned by the state. However, they remain under the authority of the Chinese Communist Party, institutionalized through its agencies; the Central Organization Department and the State-owned Assets Supervision and Administration Commission. The COD has powers to appoint NOC executives to senior leadership positions and this gives it enough political clout to control the management of NOCs as exemplified by the 2011 NOC executive reshuffle. The SASAC with its ownership and regulatory responsibilities to the NOCs is directly under the authority of the State Council. Thus, under its institutional arms, the CCP has power and control not just to set NOC interests, priorities and agenda but also to wield NOCs to further the party's economic and political interests.

The guidelines for institutional mobility of executives within the government and the NOCs set the required criteria to be civil servants in China. Nowadays this means acquiring a university education or higher. This is to ensure that both political and corporate leaders have technical knowledge to meet the global demands of the overall economic development of the country. However, merits, technical experience and administrative skills are not the only sought-after elements to assure institutional mobility within the party. Executives vying for senior positions should also pursue the party's political goals, economic interests and have political backing if they aspire for promotion. Not only executive positions are instrumentalized as a controlling factor of the state, they are also used to incentivize decision-making deference to state interests. Moreover, acquiring a network of senior supporters within the party is a requisite for success. By assuring that political mobility is possible through corporate achievements, the party ensures that its future senior leaders have the management, technical and political capabilities to execute the state's future goals and interests.

## **Chapter 4. The “Big Four”: Overview of the Chinese Banking Sector**

Like the NOCs, the development of the China’s financial sector followed a piecemeal, gradualist trend guided by the government. Until 1979, the People’s Bank of China (PBOC) was the only bank in the country and mainly operated under state planning. Following the economic 1978 reforms promoted by Deng Xiaoping, four commercial banks were set up, the Bank of China, (BOC), the China Construction Bank (CCB), the Agricultural Bank of China (ABC) and the Industrial and Commercial Bank of China (ICBC). The “Big Four” grew as a result of economic reforms and increased dependence of SOEs for their operations and investment financing. However, although the Big Four had market dominance over deposit and assets, they never operated solely on commercial basis<sup>7</sup> (Yusuf, et.al., 2006). Even with the establishment of China Development Bank (CDB) and China Export-Import Bank (Exim) and the introduction of the 1995 Commercial Bank Law<sup>8</sup>, China’s banking system remained under state-control. Aside from government bailouts<sup>9</sup> during the early 2000s, state influence over the banking sector was further stipulated in the Commercial Law as the commercial banks were given responsibility over profits and losses, depositor protection and autonomy from the government but at the same time were required to adhere to China’s “national industrial policies” (Szamosszegi and Kyle, 2012).

Thus the development of the banking industry corresponds to the development of SOEs, particularly the NOCs. Although both sectors have experienced broad administrative and institutional reforms gaining operational autonomy to pursue commercial interests, the ownership of entities under these industries remained in the hands of the state. As policy banks, the CDB and Exim are fully state-owned while the ICBC, CCB, BOC and ABC are considered as joint-stock corporations or state-owned commercial banks (SOCBs). Over the years, these banks have accumulated enormous market capitalizations and like the NOCs, rank the largest

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<sup>7</sup> Consequently, Yusuf (2006) argues that unlike Chinese state-owned banks, autonomous commercial banks do not provide preferential treatments to state enterprises by providing them financing upon request, negotiable taxes and cheap administratively allocated input that are increased to help out unprofitable enterprises.

<sup>8</sup> The Commercial Bank Law defines a commercial bank as an autonomous entity with legal person status that is sufficiently capitalized to engage in banking services (The Commercial Bank Law of the People’s Republic of China).

<sup>9</sup> Because of the accumulation of non-performing loans (NPL), the Big Four became insolvent and needed bailouts: US\$33 billion in 1998, US\$22.5 billion in 2003-2004, US\$15 billion and US\$85.5 billion (bank debts) in 2005.

entities<sup>10</sup> in their sector. Like the listed subsidiaries of NOCs, PetroChina, Sinopec Corp and CNOOC Ltd., the majority of shares of the listed banks is non-tradable and held by government ministries and agencies particularly the Ministry of Finance (MOF), a ministry under the State Council, primarily responsible for state fiscal revenue and expenditures, and taxation policies and Central Huijin Investment Ltd (CHI)<sup>11</sup>, a firm holding certain equity investments authorized by the State Council (see Table 4.1). The overall assets controlled by government entities average 70% of total shares issued by the commercial banks. Thus, the terms of ownership of China's banking sector are not only comparable to the ownership of NOCs and their listed companies but are similarly controlled by the state.

*Table 4.1 Major Shareholders of Listed Commercial Banks*

Banks	Central Huijin Investment	Ministry of Finance	State-owned Shares	Other Shares	Total Shares
Industrial and Commercial Bank of China (ICBC)	123,965 35.50%	123,316 35.30%	262,824 75.20%	86,794 24.80%	349,618 100%
China Construction Bank (CCB)	133,262 57.03%		133,262 57.03%	25,580 43.97	233,689 100%
Agricultural Bank of China (ABC)	130,398 40.10%	127,362 39.20%	275,184 84.70%	49,612 15.30%	324,794 100%
Bank of China (BOC)	188,553 67.55%		189,308 67.83%	79,614 100%	268,923 100%

*Sources: Consolidated by the author from the banks' annual reports 2009-2013 (shares in millions)*

Another trend that parallels the control mechanism of the central government over the NOCs to the management of state-owned banks is the appointment of top banking executives by the Central Organization Department (Deng, et al, 2011). As discussed in the preceding chapter, in 2011, the NOCs underwent a management reshuffle matching the change within the executive positions in the banking sector. Wang Hongzhan, the deputy governor and party secretary of the People's Bank of China was transferred to the China Construction Bank

<sup>10</sup> Industrial and Commercial bank of China (ICBC) is the world's largest bank in terms of market capitalization, profitability and customer deposits amounting to US\$233.6 billion by April 2013. China Construction Bank (CCB) is the second largest bank in the world with market cap of CNY1.28 trillion (US\$208 billion). Aside from ICBC and CCB, two Chinese banks are also on the top 10 largest banks in the world, ABC with US\$142.9 billion and BOC US\$130 billion, rank sixth and ninth respectively (<http://www.relbanks.com/worlds-top-banks/market-cap>).

<sup>11</sup> Central Huijin Investment Ltd does not engage in other commercial activities. It exercises legal rights and obligations on behalf of the PRC.

following the promotion of Guo Shuqing<sup>12</sup> as the head of China Securities Regulatory Commission. Agricultural Bank of China's chairman and party secretary Xiang Junbo was similarly advanced to the commission which led to the promotion of Jiang Chaoliang from China Development Bank to the ABC leadership. Jiang's leadership trajectory not only exemplified the administrative control of the government over state-owned entities but also characterized the revolving door between corporate recruitment and state appointments. As with the oil executives, Jiang formerly held a government position as Hubei Province's deputy governor before reentering the banking sector as chairman of the Bank of Communications and subsequently as the head of the CDB (Xiu, 2011). Moreover, all newly appointed executives held dual roles, as chairmen of their respective banks and Communist Party secretaries.

The bureaucratic structure of the bank management and regulatory bodies also highlights the opaque relationship between state-controlled entities. The multiple functions of the Chinese government as the owner, regulator, tax authority and primary borrower are not clearly institutionalized in the banking system and may overlap with each other. The Ministry of Finance for instance is one of the majority shareholders of ICBC and ABC and is directly accountable to the State Council. As a shareholder, it seeks to pursue the SOCB interests yet ultimately, as a state-controlled entity, it is responsible for the governance and performance of the banks (Szamoszegi and Kyle, 2012). Thus, through this bureaucratic mechanism, the top-down leadership role of the central government within the banking sector still characterizes the current banking system in China.

The role of the Chinese government as the *de facto* owner of state-owned policy and commercial banks enables it to institutionalize controlling mechanisms to further state interests. As with the NOCs, the reshuffling of top executive positions among the banking sector is used as both regulatory and incentive instruments for individuals vying for promotion within the state. The duality of roles as corporate leaders and party secretaries consequently blur functional lines assigned to both commercial and government positions. The most recent example would be the reinstallation of Zhou Xiaochuan as the PBOC chairman in 2013. At 63

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<sup>12</sup> In March 2013, Guo Shuqing was appointed acting governor of Shandong Province. He served under the China Securities Regulatory Commission for one year and a half ([http://news.xinhuanet.com/english/china/2013-03/29/c\\_132271831.htm](http://news.xinhuanet.com/english/china/2013-03/29/c_132271831.htm))

years old, he is close to the forced retirement age of 65 but because of his proven track record and expertise in handling China's central bank, he was assigned as one of the chairmen of Chinese People's Political Consultative Conference (CPPCC), an equivalent a of senatorial body with no actual policy-making power. However in the party-state system, chairmanship of the consultative body is equivalent to a national leader position that would entitle Zhou to hold office until he is 70 (Hui, 2013). This apparent fixing does not only have profound consequences to the continuity of Zhou's banking policies, but also bespeaks of the underlying government control over the installation of executives in the banking sector.

### **Preferential Treatment**

Over the years, the Chinese banks have shifted more towards a market-based business model as the central government gives them more operational and managerial autonomy. However, state ownership and administrative control still influence the business practices of both policy and state-owned commercial banks. These mechanisms permit the government to direct the policies the banks have to pursue. Moreover, the State Council or its representatives, the Ministry of Finance, the People's Bank of China (PBOC) or the China Banking Regulatory Commission (CBRC)<sup>13</sup> still interfere with the banks' operations through preferential treatment of SOEs in regards to their access to financial flows and allocation, interest regulation and credit distributions (see Figure 4.1). This also includes directives that identify the recipients of the financial backing which primarily are the state-owned companies.

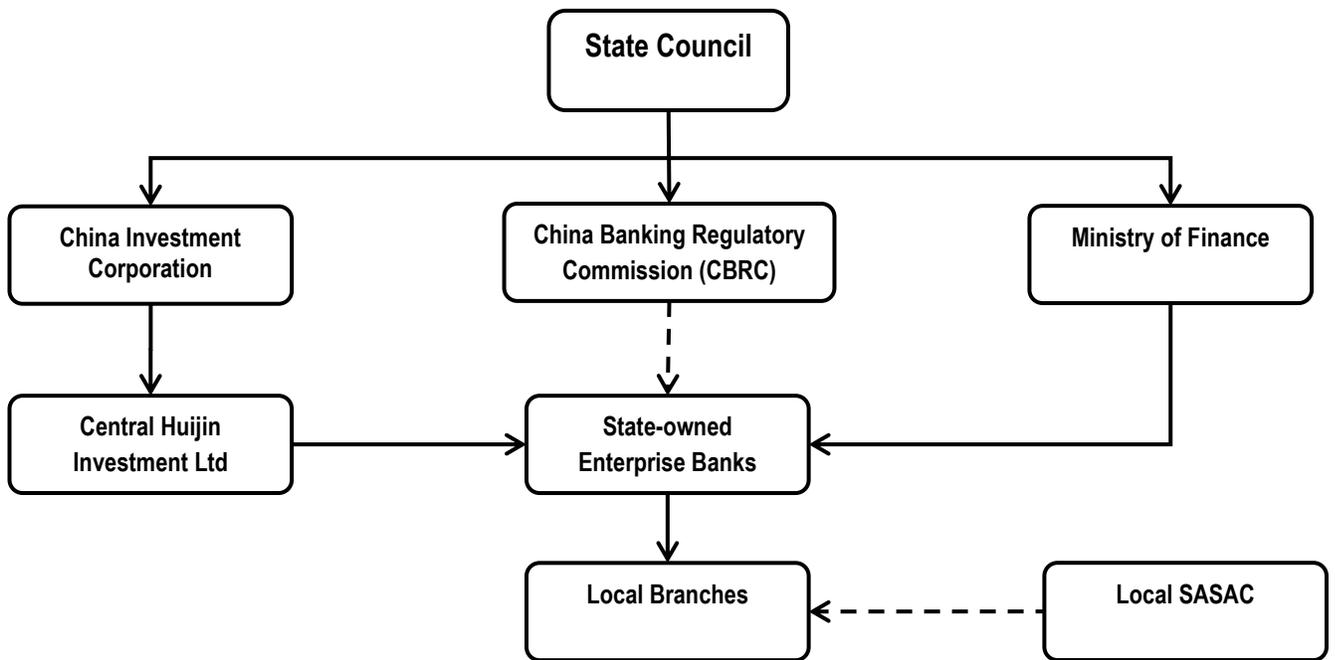
To pursue its economic development goals, the Chinese government allocates funding to its strategic SOEs by providing them loans with favorable interest rates (Szamoszegi and Kyle, 2012). A study made by Hale and Long (2013) also stipulates that loans offered by Chinese banks differ depending on the ownership types of the firms. They observed that SOEs have easier access to funding than their private counterparts, the interest rate as a ratio to total debt is

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<sup>13</sup> CBRC does not hold ownership rights over state-owned banks. Established in 2003, it acts as China's independent banking regular and is under the direct control of the State Council. Its tasks include: (1) an overall assessment of the risk profile of all deposit-taking institutions; (2) a comprehensive on-site review of the supervisory loan classification system and areas for potential improvement; (3) to promote the comprehensive reform of the state-owned banks and undertake a trial project for restructuring rural credit cooperatives; (4) the revision of banking rules and regulations in line with the legally defined regulatory and supervisory responsibilities; and (5) the stress on development, while exploring creative thinking and new approaches to addressing the problems at hand in the interest of further reform and opening up to the outside world.

almost twice as high for private firms as it is for SOEs. To illustrate this, in 2004, a special credit support notice was released by the National Development and Reform Commission (NDRC) and China Exim Bank expressing financial support to foreign resource acquisitions. This document clearly outlined that in compliance to the overseas planning development of the state, Exim will “arrange for a certain scale of credit funds (referred to “special loans for overseas investments”) to support key overseas investment projects encouraged by the State. Preferential export credit interest rates as provided by the Export-Import Bank of China shall apply to the special loans for overseas investments”.<sup>14</sup>

Figure 4.1. Relationships Between China’s SOE Banks and Their Owners and Regulators



Sources: Szamosszegi and Kyle (2012); Deng, Morck and Wu (2011)

The CNOOC Ltd bid to acquire Unocal<sup>15</sup>, an American company in 2005 is one of the most controversial cases that further demonstrate the extent of state support to the petroleum industry. The bid CNOOC made was US\$18.5 billion, outranking Chevron’s offer of US\$16.5 billion. However, the Chinese NOC bid included a \$4.5 billion subordinated loan at the below-

<sup>14</sup> Full text of the Notice of the National Development and Reform Commission, the Export-Import Bank of China on Giving Credit Support to the Key Overseas Investment Projects Encouraged by the State can be viewed at [http://209.200.107.14/english/law2\\_disp.asp?sublawcode=SUB4885447119161114&lawcode=LAW4861112671113915&country=China](http://209.200.107.14/english/law2_disp.asp?sublawcode=SUB4885447119161114&lawcode=LAW4861112671113915&country=China).

<sup>15</sup> The CNOOC Ltd attempt to acquire Unocal led to protests from other oil companies and eventually to a US Congress inquiry over the ownership structure and preferential funding of CNOOC.

market interest rate of 3.5% and a \$2.5 billion subordinated two-year bridge loan at zero interest from its state-owned parent company (Downs and Evans, 2006). Similarly, the acquisition of PetroKazakhstan by CNPC in 2005 and the subsequent US\$2.27 billion CNOOC procurement of an offshore field in Nigeria are successful proofs of government backing in Chinese national oil companies.

The preferential treatment of Chinese state-owned banks through providing financial assistance to the national oil companies is thus consistent with the central government's interests in pursuing development in strategic industries. As the majority owner of the SOEs, the central government is able to coordinate the policies pursued by its SOEs despite the market-based reforms it increasingly introduced overtime. Through administrative control, political incentives and ownership mechanisms, state-owned companies in both petroleum and banking sectors directly follow the political and strategic set by the State Council. This system of administrative control and policy coordination is further illustrated in China's "Going Out Policy" that has been the focal characteristic of the country's economic strategy and foreign policy in the past decade.

## Chapter 5. Oil Security and The Going Out Policy

### 5.1. The Policy Driver: Equity Oil

China's petroleum industry has always been viewed as an imperative to its economic development and geostrategic goals. With a steady increase of oil consumption reaching 9.8 million bbl/day in 2011, and the maturing of its oil fields, China's vulnerability to oil supply disruption is augmenting. The onshore production of its oil fields only accounted for 4.3 million bbl/d, thus increasing its net total oil imports to 5.5 million bbl/d in 2011 (EIA Full Report: China, 2012).

The NOCs were specifically tasked to guarantee the country's steady supply of oil, especially in the period of crisis. Since 1993 when China became oil import-dependent, the government has mobilized massive restructuring, reform and support that sought to alleviate its oil industry, particularly the NOCs. The state also equated social stability to constant energy supply, thus preventing the NOCs to be fully privatized but mandated under government control. The Chinese government also wanted to diversify its petroleum resources for it was heavily dependent on Saudi Arabian oil, which makes up almost a quarter of its oil supplies (EIA Report, 2011). Its reliance on the Strait of Malacca where around 75% of its total oil consumption travels through further enhances its China's security concerns. Thus the issue of equity oil<sup>16</sup> is not just at the forefront of the government's massive support to NOC investments abroad, but also a driving force behind its national energy security. According to an interview done by Kong (2010) with a government think tank<sup>17</sup>, *"equity oil is superior to oil traded on the market because the former would give Chinese NOCs additional security in time of market turbulence and supply disruptions."* Furthermore, a report by the Development and Research Center of the State Council highlighted that *"securing equity oil should be the major operation mode"* of the NOC's overseas expansion (Kong, 2010).

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<sup>16</sup> Amount oil produced under a production sharing agreement (PSA) that correspond to the NOC's percentage ownership in a particular field. The owner reserves the right of sales or shipment of the designated amount of oil produced.

<sup>17</sup> The think tank has a seat in the National Energy Expert Advisory Committee (Kong, 2010).

## 5.2. The Going Out Policy (*zou chu qu*)

The declaration of then President Jiang Zemin at the 16<sup>th</sup> Party Congress in 2002 marked the onset of the Chinese government's Going out Policy. By *"bringing in" and "going out" a number of strong multinational enterprises and brand names, China should take an active part in regional economic exchanges and cooperation while paying great attention to safeguarding its national economic security*<sup>18</sup>. This implied that the state will promote "national champions" and embark on overseas investment projects particularly in resource exploration. This global-scale policy was also aimed to further China's global economic profile by supporting SOEs in asset-accumulating ventures that will increase their technical expertise, productivity and profitability, competitiveness and capacity to pursue state interests in strategic sectors. The state support included preferential access to low-cost financing, tax exemptions and diplomatic assistance.

The 17<sup>th</sup> Party Congress headed by President Hu Jintao and Premier Wen Jiabao further supplemented the "Going Out Policy" instituted by the Zemin administration. Backed by government support, SOEs were encouraged to pursue investment interests in strategic industries, especially in oil and gas explorations. In 2009, Wen Jiabao boosted the overseas expansion and acquisitions by saying, *"we should hasten the implementation of our 'going out' strategy and combine the utilization of foreign exchange reserves with the 'going out' of our enterprises"* (Anderlini, 2009). Subsequently, the Chinese outward foreign investments (OFDI) and mergers and acquisitions (M&A) increased from US\$4 billion in 1994, to US\$28 billion in 2000 and US\$298 billion by the end of 2010 (Davies, 2012). Additionally, the Ministry of Commerce confirmed that Chinese OFDI for the year 2012 was US\$77.6 billion, up from US\$74.7 billion in 2011 (Scissors, 2013).

### 5.2.1 The Development of OFDI and NOCs

The Going Out Policy remains to be the most fundamental step China has taken to expand its reach and embrace globalization. In the early 2000s, the central government has realized that it could not remain isolated and by opening up its economy to foreign investors, it too could benefit from globalization. As the foreign direct investment of international entities

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<sup>18</sup> People's Daily website, full text of Jiang Zemin's Report at the 16<sup>th</sup> Party Congress, November 18, 2002, [http://english.people.com.cn/200211/18/eng20021118\\_106984.shtml](http://english.people.com.cn/200211/18/eng20021118_106984.shtml)

piled up in China, it acquired vast foreign reserve assets. As the country developed, it needed massive amounts of natural resources to feed its growing economy. Against this backdrop, the Going Out Policy was born, a direct result of globalization and growing natural and mineral resource insecurity. Moreover, the national oil companies, being directly administered by the State Council through the SASAC became the central figures for this new economic venture. Although the acquisition of foreign petroleum assets and M&As did not originally stem from the central government's directives but were initialized by the NOCs themselves, the substantial government support when the Going Out Policy was instituted paved the way for NOCs to expand overseas. In 1993, CNPC, under the leadership of Wang Tao implemented a strategy called "walking on two legs" characterized by deepening of reforms through attracting foreign investments, technology and expertise and at the same time "going out" for resource exploration and development (Kong, 2010). This proclamation followed the pivotal US\$6.64 million investment CNPC made in Canada operated by the Alberta Oil Sands Technology and Research Authority (AOSTRA) in 1992. After the announcement of the "going out" strategy, CNPC acquired assets in Peru for US\$25 million<sup>19</sup>. Although relatively small in sizes, the success of these ventures opened the door for NOCs to gradually expand abroad. Though still lacking extensive government support and financing, both Sinopec and CNOOC devised their own strategies for their overseas campaign. In 1994, CNOOC embarked on its first investment project abroad, acquiring 32.58% of ARCO's rights in the Malacca Strait, Indonesia making CNOOC the largest shareholder of the oil field.<sup>20</sup> Consequently, Sinopec also initiated its international expansion by focusing on service provisions in the early 1990s and acquiring its first upstream project with the National Iranian Oil Company in 2001 (see Appendix 5.1).<sup>21</sup>

With the foreign exchange reserves amounting to US\$3.2 trillion in 2011 (Rabinovitch, 2013) the 12<sup>th</sup> Five Year Plan implemented in 2011 further broadened the scope of the Going Out Policy to include research and development, technological acquisition, manufacturing investments and M&As. Although the policy does not explicitly dictate the direction of its overseas foreign direct investments, its strategic interest, particularly in energy security creates

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<sup>19</sup> CNPC acquired Block VII of the Talara Oilfield in northern Peru.

<sup>20</sup> Atlantic Richfield Company. Full chronology of CNOOC history can be accessed at <http://en.cnooc.com.cn/data/html/news/2007-03-23/english/228522.html>.

<sup>21</sup> The exploration and development project covered 4,670 square kilometers in Zavareh-Kashan.

a trend where capital is invested in a specific region at a certain period of time. Because strategic sectors especially large scale energy resource acquisitions remain on the top of the government's priorities, resource-rich countries like Venezuela, Sudan and even Canada have seen a massive influx of Chinese OFDI in the past decade. China's oil and gas companies OFDI was US\$92 billion in 2009 and a record of US\$35 billion in 2012 (Ross, 2013). The government's perceived vulnerability to energy supply interruptions and oil price volatility drive its policy towards an increasing expansion of oil and gas resource acquisitions. Thus, it employs different instruments of support that further enhances the capacity of NOCs to pursue overseas expansion, among which, financial assistance, "loans-for-oil" and diplomatic support.

### *5.2.2. Trends of Outward Foreign Investments*

The Chinese outward foreign investments have seen a dramatic increase following the policies that promoted trade liberalization and the Going Out policy (see Appendix 5.2). In 2005, the OFDI was a mere US\$12.3 billion but surged to US\$26.7 billion in 2007, a staggering 217% increase. From 2007, it again grew by 209% to US\$55.9 billion in 2008, while the global FDI outflow suffered a 12% decline<sup>22</sup> following the 2008 financial crisis. Although the increase has been lower than the subsequent years, the OFDI in 2009 has also seen a slight growth by 8.2% reaching US\$56.5 billion. Consequently, as the global FDI reached US\$1.3 trillion in 2010, the accumulative amount of Chinese OFDI reached US\$285.8 billion that same year. Following the increasing trend, 2012 has also seen a growth from US\$74.7 billion in 2011 to US\$77.7 billion that year, a total of US\$438.3 billion, an impressive 769% rise of OFDI in a 7-year period.

The geographical distribution of this OFDI is difficult to determine from official statistics, for much of it is routed via Hong Kong and the Caribbean tax havens (Davies, 2012). According to the data set collected by the Heritage Foundation (2013)<sup>23</sup>, North America was the major recipient of Chinese investments, the United States and Canada accounting for US\$54.2 billion and US\$36.7 billion respectively (see Table 5.1). Additionally, East Asia with US\$80.2 billion of Chinese OFDI is surpassed by Sub-Saharan Africa, which accounted for US\$97.8

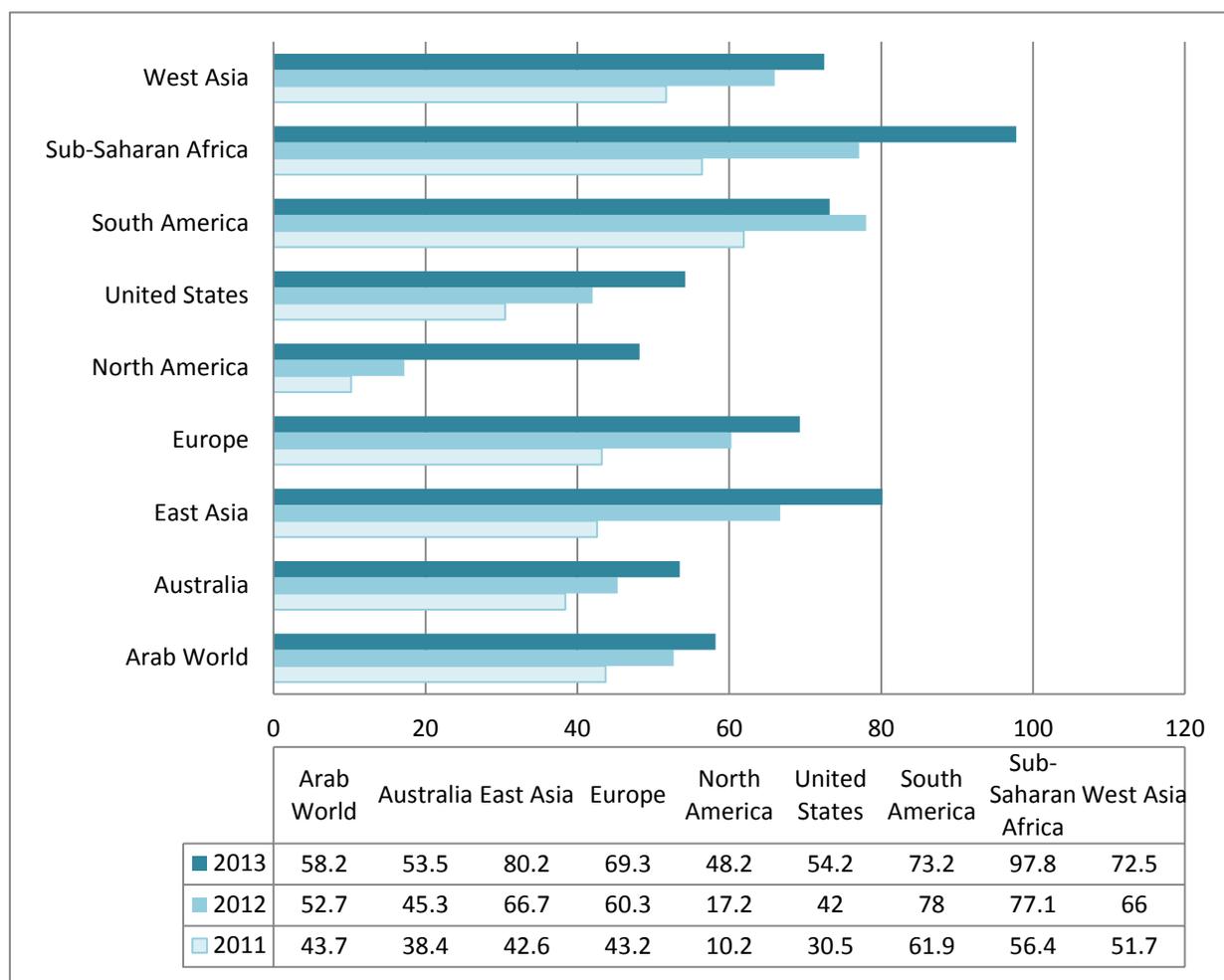
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<sup>22</sup> Data from Global FDI flow, UNCTAD FDI Statistics website: <http://unctadstat.unctad.org>

<sup>23</sup> In the Heritage Foundation report (2013), Hong Kong is not treated as a final destination, but rather a transit point of Chinese OFDI which is said to account for US\$35 billion of Chinese capital annually. Figures are thus compiled differently but are closely similar to government results.

billion, Nigeria receiving US\$15.6 billion, 37.5% of total investments in the continent. Europe received US\$69.3 billion, a 27% increase from the Chinese capital received in 2011, which was US\$43.2 billion. South America and West Asia received almost a similar amount of OFDI in 2012, US\$73.2 billion and US\$72.5 billion respectively. However, Australia, with US\$38.4 billion capital in 2011 and US\$53.5 billion in 2012 was outranked by the United States as the largest developed country recipient of Chinese investments.

Table 5.1. Chinese OFDI Destination by Region, 2011-2013 (amount in US\$ billions)



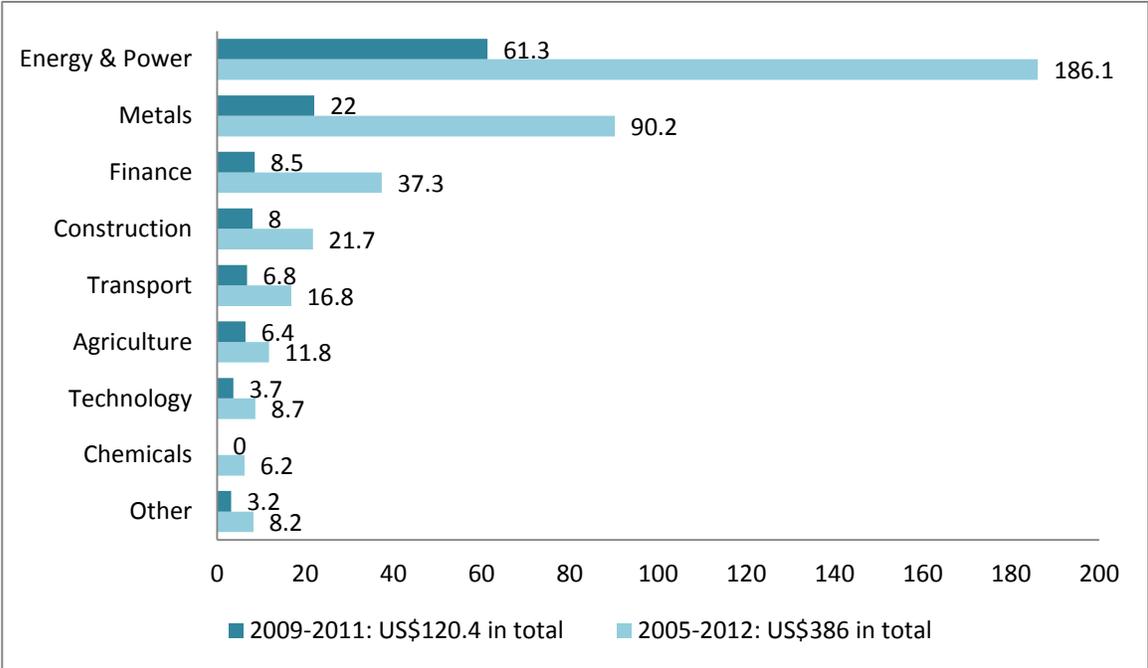
Source: The Heritage Foundation, China Global Investment Tracker dataset (2011-2013)

Note: The United States is not included in data for North America

As the destination countries change over time, a pattern can be detected in the geographical distribution of Chinese OFDI. According to Derek Scissors (2013), Chinese

enterprises invest in the region by the bulk. Because the SOEs are the main conduits of this OFDI, a certain bandwagon trend issues when a region opens up for Chinese investments. For instance, Australia was the most prominent destination in mid-2000s. Following the massive investments in Sub-Saharan Africa in the late 2000s, the focus was turned to South America, which gained US\$78 billion in total Chinese OFDI in 2011. The most recent data shows a huge increase in OFDI in North America including the United States, with a total Chinese capital of US\$102.4 billion in the beginning of 2013.

Table 5.2. Chinese OFDI Sector Breakdown (amount in US\$ billions)



Source: The Heritage Foundation, China Global Investment Tracker dataset: July 2011 and January 2013

The value that the central government attaches to its strategic industries illustrates why the leading sectors for OFDI are energy and mineral (see Table 5.2). The US\$15 billion CNOOC acquisition of Nexen in 2012 for instance made North America the leading OFDI destination in 2013. To date, the CNOOC-Nexen deal is that largest investment made by a Chinese SOE in the continent. Similarly, most M&As done with Chinese capital in the past decade are in resource industries (see Appendix 5.3). In 2010 for instance, Chinese companies bid a total of US\$39.6 billion of foreign energy assets. Sinopec purchased a 40% share of Repsol’s Brazilian subsidiary

for US\$7.1 billion and acquired a 9% share in Syncrude Canada for US\$4.7 billion. China National also bought a 35% stake in Royal Dutch Shell PLC's Syrian oil and gas unit for US\$1.6 billion in 2011.

### **5.3. State Financing: The Chinese Policy Banks**

One of the most important support mechanisms the Chinese government lends to NOCs to pursue the Going Out Policy is the vast financing capacity of the state's "policy banks". Following the waves of reforms experienced by state-owned enterprises, in 1994, China Development Bank (CDB) and the China Export-Import Bank (Exim) were established. Solely owned by the Chinese government and directly controlled by the State Council, the banks are deemed as "policy banks" for they were specifically tasked to support the state's policy initiatives and to free commercial banks from policy lending (Jeong and Weiner, 2012). CDB was originally founded to finance international trade and investments made by SOEs while Exim was to provide backing for domestic development projects to boost exports. However, following the Going Out strategy, both CDB and Exim have progressively engaged in the foreign asset acquisitions especially in resource-based projects. Currently, the CDB boasts total assets of RMB 7.52 trillion in 2012 making it the world's largest development bank by total assets. Exim on the other hand holds RMB 1.56 trillion in total assets. Together, CDB and Exim are China's biggest providers of currency loans, foreign aid packages and state financing.

Being fully state-owned banks, the CDB and Exim's financial allocation programs directly corresponds to the central government's policy directives. According to Kong (2010), the Chinese government only showed minimal support for NOC foreign acquisitions in the early 1990s but when the Going Out policy was instituted in 2003, both policy banks developed their own financial strategies to allocated funding to the NOCs. For instance, after CNOOC's successful bid for Arco's shares in the Malacca fields, its foreign acquisition ventures were paralyzed because of financial constraints. CNPC's acquisition of Sudanese oil fields (Block 6) was initially met with disapproval and only after intense lobbying did the China Exim Bank provided CNPC the aid to pursue the project (Kong, 2010). However, subsequently after Jiang Zemin's proclamation of the state's Going Out Policy in 2003, the policy banks overhauled their

strategies in support to the petroleum sector. As resource acquisition is central to the state's global strategy, financial endowments through preferential credits became easily available to the NOCs (see Appendix 5.4). As cited in the previous chapter, in 2004, China Exim Bank published the *"Circular on Supportive Credit Policy on Key Overseas Investment Projects Encouraged by the State"*, outlining the bank's renewed support to the NOC's international investment projects. Chen Yuan the head of China Development Bank also declared CDB support to the international expansion of Chinese energy and mining companies in the early 2000s. Since then, CDB's outstanding loans have increased dramatically. From US\$16.5 billion in 2005, it reached US\$97.4 billion in 2009 and further increased to US\$248.7 billion in the first quarter of 2013.

Aside from following state policy directive, the drive of Chinese banks to support international resource acquisition can also be attributed to the 2008 global financial crisis. In 2007, the CDB and China's sovereign wealth fund, the China Investment Bank (CIC), invested in the Western financial sector by securing equity shares in the Wall Street. CDB's acquired shares from Barclays which plummeted 79%<sup>24</sup> of its original value at the end of 2008, while its assets in Morgan Stanley lost 66% of its value per share. Similarly, CIC originally paid the Blackstone Group US\$3 billion at US\$29.605 a share which by December only valued at US\$5.34, for a loss of \$2.46 billion, or 82%. This huge financial cost prompted a loss of the State Council's confidence in the profitability of their financial investments in the West. President Hu Jintao issued a statement highlighting that the global crisis might have negative effects in China's quest for growth. Consequently, the chairman and chief executive of CIC, Luo Jiemin declared, *"Right now we do not have the courage to invest in financial institutions because we do not know what problems they may have,"* (Bradsher, 2008). As the crisis deepens, Western banks experience a credit-crunch that fueled their inability to back resource-related investments. The hands of international oil companies (IOCs) were financially tied, for funding for existing projects was short. The global oil prices also plummeted from US\$147 per barrel in July 2008 to US\$40 per barrel in December mitigating the effects of the financial crisis to IOCs' sustainability and profitability.

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<sup>24</sup> Per share cost of CDB shares acquired from Barclays was US\$14.81 in 2007 but dropped to US\$2.24 in December 2008 (Downs, 2011).

As the global petroleum industry retreats, the Chinese government saw an opportunity to guarantee its international investments. With the Going Out Policy already on the track, the state-owned policy banks embarked on a campaign of providing loans in exchange for access to oil products. The CDB and Exim, with the blessing from the State Council pursued loans-for-oil deals, an attempt to secure long-term oil supplies by issuing credits to oil-rich countries.

#### **5.4. Loans for Oil**

In 2010, the Chinese policy banks issued a total of US\$37 billion of loan commitments to Latin American countries, an amount higher than the loans allotted by the World Bank, Inter-American Development Bank and the United States Export-Import Bank combined (Gallagher, Irwin, & Koleski, 2012). The overall amount of loans supplied by Chinese banks to these countries from 2005 to 2011 was US\$75 billion, CDB accounting for 82% of issued loans while China Exim and ICBC contributed 12% and 6% respectively (see Table 5.3). This amount includes US\$10 billion loan to Petrobras in return for Sinopec's access to 200 mb/d<sup>25</sup> of oil and a US\$4 billion deal with Venezuela to finance projects that will increase Venezuelan exports to China from roughly 350 mb/d to 1 mmb/d by 2015 (Mohamedi, 2009). The Chinese Development Bank also signed two loan agreements with Rosneft and Transneft, providing US\$15 billion and US\$10 billion of funding, respectively in exchange for 300 mb/d of oil shipments via the East Siberia-Pacific Ocean (ESPO) pipeline. The Kazakh government also secured the flow of Chinese financial support to its 3,000 km China-Kazakhstan pipeline by letting CNPC acquire a 50% stake of Mangistaumunaigaz' (MMG) assets which holds roughly 370 mmb in reserves.

The loans-for-oil agreements benefit China in three ways. Primarily, it enhances the country's oil security by obtaining long-term supplies of petroleum products. For example, the loans for Russia's Rosneft and Transneft have twenty-year terms and will be paid from the sale of 300,000 bbl/d to CNPC. Although the recipient countries have the option to pay in cash, most of them agree to China's preference of oil revenue payments. Another example is the loans-for-oil acquired from the sale of 150,000 bbl/d for the first year, and subsequent 200,000 bbl/d in the

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<sup>25</sup> Millions of barrels per day (mb/d).

next nine years by Brazil's Petrobras in 2009 worth US\$10 billion (Downs, 2011). The loans are backed by oil export revenue from petroleum sales to Unipec, a subsidiary of Sinopec.

Table 5.3. CDB and China Exim Loans for Oil, 2008-2013

Year	Country	Borrower	Amount (US\$ billion)	Notes
2008	Venezuela	BANDES and PVDSA	4	Supply of 130,000 barrels a day to CNPC
2009	Angola	Government	1	Since 2002, China provided an estimated US\$5 billion in oil-related loans.
2009	Bolivia	Government	2	In return for energy contracts.
2009	Brazil	Petrobras	10	150 kb/d of oil in 2009; 200 to 250 kb/d from 2010 to 2019 at market price.
2009	Ecuador	PetroEcuador	1	96 kb/d for 2 years.
2009	Ghana	Government	3	Sinopec and GNPC signed MOU on upstream, midstream and downstream related oil projects. The loans provided to GNPC are for the development of its offshore Jubilee Oilfield. (15-year term)
2009	Kazakhstan	KMG	10	US\$3.3 billion used to buy 49% of Manguistaumunaigas (MMG) from Indonesia's Central Asia Petroleum.
2009	Russia	Rosneft	15	300 kb/d for 20 yrs (2011-2030, 15 Mt/y +/-4.1%). Market price at Nakhodka port to CNPC. Pricing could be quoted monthly. Will sell 9 Mt to CNPC and 6 Mt to Transneft
		Transneft	10	For construction of pipeline linking East Siberia-Pacific pipeline system (ESPO) at Skovorodino to Chinese Daqing oilfield. Capacity 600 kb/d, length 1 030 km. Transneft to build part in Russia (70km) and CNPC to build part in China (980 km). China part finished June 2010.
2009	Turkmenistan	Turkmengaz	4	40 bcm/y of natural gas for 30 years.
2009	Venezuela	BANDES and PVDSA	4	200 kb/d of oil to CNPC, market price, term contract, USD 1-2/b discount is offered, invoiced monthly.
2010	Ecuador	Government	1.7	Use to fund hydroelectric dam, Coca Codo Sinclair under 15-year terms
2010	Venezuela	BANDES and PVDSA	20.6	Petroleos de Venezuela and CNPC to form joint venture to jointly develop Junin 4 block. It will produce 2.9 billion barrels of heavy oil over the next 25 years. Also tied with infrastructure projects including freeways and power plants.
2011	Ecuador	Government	2	8-year term
2011	Venezuela	PDVSA	4	Funding for infrastructure
			4	Funding for housing
2013	Kazakhstan	KazMunaigas	1	Financing refinery to produce 2.4m tons per year of fuel oil and vacuum gas oil
2013	Sudan	Government	1.5	(currently undefined)
2013	India	Essar	1	(on negotiations)
2013	Venezuela	PDVSA	4	(on negotiations)
2013	Russia	Rosneft	25-30	(on negotiations)

Sources: Author's database updated from Downs (2011), Gallagher, Irwin, & Koleski, (2012)

According to an interview with Chen Yuan, the CDB chairman published in *Caijing Magazine*, “if the loans are dependent on the stability of the company, revenues, etc., a lot risks may be incurred so in the end, everything must be valued in terms of oil. The payment in China must come from oil revenue; to reduce further unnecessary uncertainty, the loans must be recovered from the money paid for oil.”<sup>26</sup> By insisting that the debtors pay from the revenue they incur from oil sales to Chinese NOCs, China is assured a steady long-term supply of petroleum products and stable collateral for the investments that it made in these countries.

Secondly, China also gains from loans-for-oil by using its financial leverage to acquire entry to previously inaccessible resource-rich countries. In 1994, China and Russia started negotiations for the construction of a cross-border pipeline from Daqing in northeast China to Angarsk in Siberia. It took nearly ten years for the agreement to be signed in 2003. For the following years, Russia was lukewarm to the deal turning its attention instead to Japan’s offer of building an oil pipeline from Taishet to Nakhodka. However, when the 2008 financial crisis ensued, most IOCs lost their financial capability to invest in new E&P projects and stalled their investments on Russian’s oil fields. With the credit crunch, the decline of global demand for oil, and its intent to balance its dependence on oil demand from Europe, Russia was pushed to the margins and signed a US\$25 billion loans-for-oil deal with China in 2009.

A similar trend happened to China’s loans-for-oil with the Angolan government and its national oil company, Sonangol<sup>27</sup>. Ravaged by war and increasing pressures from the International Monetary Fund (IMF) and other Western creditors, the Angolan NOC opened its doors to China in 2004. Although economic trade agreements have been signed between Angola and China since the 1980s, resource trade between two countries remained low mainly because of the easily accessible credit Angola enjoyed from Western banks such as BNP Paribas of France, Standard Chartered of the UK and Commerzbank of Germany (Brautigam, 2011). However, subsequently after the civil war in 2002, Angola was deeply in debt and these Western creditors, spearheaded by the IMF would only extend the government’s line of credit if they promise to institute reforms. Thus, China with its non-interference policy and cheaper

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<sup>26</sup> *Phoenix TV’s Exclusive Interview with Chen Yuan and Chen Zhu*. *Caijing Online*. May 20, 2009.

<sup>27</sup> Sonangol Group (Sociedade Nacional de Combustíveis de Angola) is Angola’s powerful state-owned oil company that oversees the production of oil. Sonangol mainly cooperates with international oil companies through joint ventures and production sharing agreements.

credit line<sup>28</sup> was able to penetrate the Angolan oil market in 2004. The US\$2 billion deal from China Exim Bank included Sinopec's access to Angola's oil field blocks. Sinopec also gained production rights in Block 3/80 and subsequently established a joint venture, the Sonangol Sinopec International Ltd. (Zhao, 2011). Consequently, this was followed by more deals between Angola and Chinese NOCs that accounted for loans of US\$2 billion in 2005, US\$1 billion in 2007 and US\$2.5 in 2007. By 2010, the estimated amount of loans-for-oil from Chinese state-owned banks was US\$10 billion, with China Exim Bank accounting for US\$6 billion, ICBC for US\$2.5 billion and CDB for US\$1.5 billion (see Table 5.4). As initialized by the loans-for-oil deals between Angola and China, the later became the Angolan oil sector's biggest recipient of crude oil exports accounting for 43.8% in 2010 (see Table 5.5).

Table 5.4. Foreign Credit Lines Signed from 2009-2010

Lending Entities	Millions of US\$
China Exim Bank	6,000
Industrial and Commercial Bank of China	2,500
China Development Bank	1,500
Brazil	500
Portugal Cossec	500
Goldman Sachs LLC	300

Source: African Development Bank Report on Angola, 2011

Table 5.5. Angolan Exports in 2010

Major Exports	% of Total	Leading Markets	% of Total
Crude Oil	95.9	China	43.8
Diamond	1.8	United States	23.6
Refined Petroleum	0.7	India	8.3
Liquefied Natural Gas	0.6	France	4.1

Source: The Economist Intelligence Unit, Angola Fact Sheet, 2010

<sup>28</sup> The credit line offered by the China Exim Bank in 2004 and subsequent years was cheaper than the ones offered by Western Banks. Angola, a relatively high-risk country, has been borrowing at a premium of up to 2.5 percent over LIBOR (the London Inter-Bank Offered Rate, the benchmark interest rate for international finance). The Chinese loan is at LIBOR plus 1.5 percent. The Chinese credit has also a grace period of five years, with payment over a further twelve years, far longer than the European banks' normal term of four or five years, without any grace period (Brautigam, 2011).

The largest Chinese NOC acquisition to date is the CNOOC's successful bid of the Canadian oil company, Nexen. After much controversy that entailed a US Congress inquiry over its previous attempt to acquire Unocal, an American oil company, CNOOC finally broke the mold of Chinese NOC acquisitions in February 2013. Although eliciting concerns over national security, the pivotal CNOOC-Nexen deal came with crucial advantages to both companies. According to Glenn Maguire of Asia Sentry Advisory, Canada needs US\$657 billion of investments for resource development projects, funding that it cannot acquire from cash-strapped Western investors (Chua, 2012). It also diversifies Canada's customer base for petroleum exports. On the Chinese side, the US\$15.1 billion deal is pivotal to the state's interest of developing national champions and developing its SOEs brand names across the globe. It also opens the opportunities for other NOCs and SOEs as they pursue the Going Out Strategy. According to industry analysts, CNOOC's recent acquisition will make it easier for the Chinese government to invest abroad (Chua, 2012). The CNOOC-Nexen deal entails the procurement of Nexen's petroleum assets in Canada, the North Sea, Gulf of Mexico and offshore Nigeria.

Aside from securing long-term oil supply chains and gaining access to petroleum-rich countries, loans-for-oil also create new export markets for Chinese goods and services. Although Chinese banks do not attach any policy conditions for their loans, they usually compel the borrowers to spend part of the funding on Chinese products (Gallagher, Irwin, & Koleski, 2012). Typical of loans-for-oil, this type of requirement is most salient in Latin America where the Chinese banks want to mitigate loan risks by tying credit lines to purchasing agreements. In 2010 for instance, CDB and the Venezuelan Bank for Economic and Social Development (BANDES) signed a loan contract of US\$20.6 billion, half of which were denominated in Chinese RMB, requiring Venezuela to specifically buy Chinese goods and services. The loan stands on three agreements, a US\$10 billion to BANDES under the English law, a RMB 70 billion (US\$10.6 billion) to BANDES under Chinese law and an oil supply contract between PDVSA and China oil under the Venezuelan law (Pugh, 2010). Out of the US\$10 billion agreement, US\$4 billion and all of the RMB 70 billion have to be used to fund bilateral projects between countries. This includes infrastructure development, social services and resource-based projects in Venezuela and China. Aside from the procurement of physical

materials produced in China, the loan also secures the use of Chinese services. According to Downs (2011), part of the loan from CDB will be used by in constructing housing units in Venezuela, a project that will be run by China's state-owned CITIC Group. Similarly, China Exim also issued RMB-denominated credit lines to Jamaica and Bolivia stipulating equipment and construction purchases (Gallagher, Irwin, & Koleski 2012). The US\$1.7 billion loan signed between Coca-Codo Sinclair and China Exim for a hydroelectric dam in Ecuador carries the same strings of market provisions for Chinese goods and services. The contract entailed 100% Chinese export credits, including a stipulation that the construction of the dam would have to be done by the Chinese state-run company, Sinohydro Corp. Moreover in Africa, the Ghanaian government and the CDB agreed on a US\$3 billion loan, of which 60% of all contracts under the loan will go to Chinese companies (see Appendix 5.5).

Operating under the umbrella of the State Council, all state-owned companies, primarily the NOCs and the policy banks thus use loans-for-oil to open extra opportunities for other Chinese export industries<sup>29</sup> to penetrate their borrowers' market for goods and services. This does not only corresponds to the central government's Going out policy but also to the creation of national champions, competitive SOEs that vie for global market share. Thus the investments made by Chinese national oil companies do not only warrant commercial objectives for their designated industry but also larger, more diversified commercial objectives set and supported by the central government.

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<sup>29</sup> Aside from oil, borrower purchases include Chinese construction, telecommunications, satellite and infrastructure equipment.

## Chapter 6. China's Petroleum Diplomacy

As China broadens its economic reach through the steady increase of its outward foreign direct investments, it recognized the need to build a robust diplomatic corps that would effectively implement its foreign policy<sup>30</sup> and ultimately pursue the state's interest. Energy security, being at the heart of this strategy has received massive support from the government, from preferential allotments and credits to international financing and loan contracts. As the main conduits of this interest, the NOCs have increasingly expanded abroad, through mergers and acquisitions, loan agreements and joint-project cooperation not just with other petroleum companies but with resource-rich countries directly. Alongside this, the Chinese government has revamped and reequipped its diplomatic body in order to establish closer relationships with oil-rich countries, facilitate resource contract agreements, and secure access to more investment opportunities (Kong, 2010). According to an energy expert, stability, security and the continuity of China's energy supply while safeguarding its energy security are the fundamental goals of China's energy diplomacy.<sup>31</sup> This government support of NOCs through diplomatic channels has been referred to as "petroleum diplomacy". Kong (2010) defined this as the intersection between China's petroleum and diplomatic interests, whose purposes may overlap one another. Characteristic of a central administrative control however, petroleum diplomacy exemplifies the symbiotic relationship that continues to exist between the state and its enterprises, the interaction of which results to the ultimate pursuit of state interest.

In July, 2006 at the G8 Summit<sup>32</sup> in St. Petersburg, Russia, then President Hu Jintao defined China's international energy policy for the first time. According to his written speech, President Hu outlined that, *"to ensure global energy security, we need to develop and implement a new energy security concept that calls for mutually beneficial cooperation, diversified forms of development and common energy security through coordination"* (Chinese Government Site, 2006)<sup>33</sup>. He further

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<sup>30</sup> Deemed as the "Peaceful Rise" China's official statement concerning its foreign policy strategy: *"China adheres to an independent foreign policy as well as to the five principles of mutual respect for sovereignty and territorial integrity, mutual non-aggression, non-interference in each other's internal affairs, equality and mutual benefit, and peaceful coexistence in developing diplomatic relations and economic and cultural exchanges with other countries"*. (<http://english.people.com.cn/92824/92845/92870/6441512.html>)

<sup>31</sup> Interview with Xia Yishan of China Institute of International Studies, a government think tank (Kong, 2010).

<sup>32</sup> G8: Group of Eight countries namely, Canada, France, Germany, Italy, Japan, Russia, the United Kingdom and the United State of America.

<sup>33</sup> [http://english.gov.cn/2006-07/17/content\\_338026.htm](http://english.gov.cn/2006-07/17/content_338026.htm)

elaborated that the achievement of global energy security could only be made possible through international coordination and China along with its global partners should focus on three priority areas namely, mutual cooperation for energy development and utilization; development of advanced energy technologies; and maintaining a sound political climate favorable to energy security and stability. Hu's emphasis on international cooperation and coordination in pursuing energy security came from the political backlash China has suffered from its aggressive expansion in the energy sector. The failure of CNOOC's bid for acquiring Unocal in 2005 brought political consequences to China and fostered a Congressional inquiry in the United States. The seemingly market-driven attempt for M&A became politicized and prompted skepticism to Chinese-led transactions<sup>34</sup> especially among developed countries.

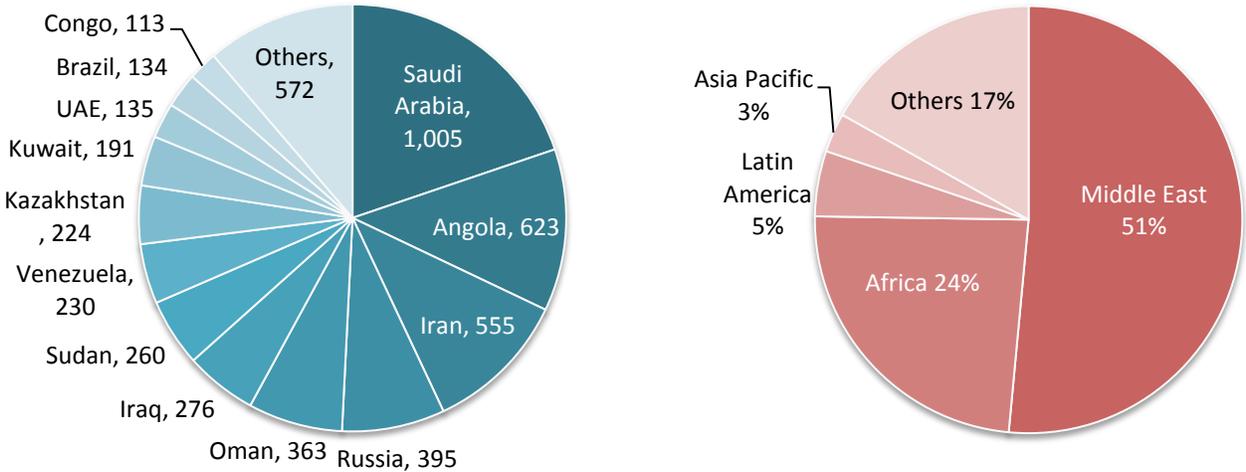
The negative perception of developed countries towards Chinese OFDI however did not hinder the overseas expansion of Chinese SOEs especially in areas the government considers as strategically important. From the findings stipulated in the previous chapter, the Chinese OFDI grew from US\$12.3 billion in 2005 to US\$77.7 billion in 2012. Similarly, the energy-related investments continued to increase valuing US\$386 billion from 2005 to 2012. However, oil-rich countries that have considerable petroleum demand like the Middle East, Russia and Canada remained close to foreign investments, prompting new comers in the market like China to invest in unconventional and riskier FDI destinations like Africa and Latin America. China's foreign policy stipulates non-interference, one of the reasons why autocratic regimes in these regions opened their countries for Chinese capital. Along with the OFDI, petroleum diplomacy also broadened its scope and Chinese leaders embarked on high-level visits around the world, particularly in oil-rich countries. Their visits were accompanied not just with energy experts and NOC executives, but with leverages that can help them ease into forming bilateral agreements with their target countries. These include preferential credits, loans-for-oil, development aid and infrastructure-for-oil loans. Following Hu Jintao's speech in Russia in July, 2006 he subsequently declared in November that year the establishment of a strategic

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<sup>34</sup> Transactions include those of other SOEs. According to The Economist Special Report entitled "Who's Afraid of Huawei", Huawei, a technology based Chinese SOE was blocked from participating to a broadband scheme in Australia, prompting further inquiries on the company's bids especially in the European Union.

alliance between China and Africa<sup>35</sup>. This partnership included eight measures, three of which was the creation of a US\$5 billion China-Africa Development Fund, aimed at encouraging and supporting Chinese enterprises to invest in Africa (Huang & Wilkes, 2011). In March the following year, the China-Africa Development Fund (CADFund) was established to foster strong Sino-African economic relationship and promote Africa’s economic development. The fund will aid Chinese enterprises as they establish businesses in Africa and support partnerships between African and Chinese enterprises.

Figure 6.1. China’s Crude Oil Imports by Source, 2011 (thousand barrels per day)



Source: US Energy Information Administration Counter Energy Profiles: China (April 2013)  
<http://www.eia.gov/countries/analysisbriefs/China/china.pdf>

The focus in Africa comes with an increasing supply of African oil to China. With oil consumption of 9.8 million bbl/day in 2011, and low onshore production of 4.3 million bbl/d, China’s oil imports have increased to 5.5 million bbl/d in 2011 (EIA Full Report: China, 2012). Another energy security issue of the Chinese government is its heavy reliance on Middle Eastern oil imports. To diversify its petroleum sources, new investments have to be made and with the increasing stability of African countries, they have become great destinations for Chinese capital that will secure China of a steady supply of oil (see Table 6.1).

<sup>35</sup> President Hu Jintao’s announcement was at the Beijing Summit of the Forum on China-Africa Cooperation (FOCAC).

Although the Middle East still remains to be China's largest source of oil imports, African countries like Angola, Sudan and Congo have increased their shares in recent years. According to EIA data (2011), the Middle East provided 51% of China's oil imports while Africa accounted for 24%, Asia-Pacific with 3% and another 22% from other countries. This could further explain why China has increased its diplomatic presence in the African continent. Visits from high-level officials including members of the Politburo Standing Committee (PBSC), foreign ministers and China's top leaders sharply increased from 2004. Then President Hu Jintao embarked on the "African safari" three times visiting 14 African countries including Angola and Sudan, China's main oil suppliers in Africa (Kong, 2010). Consequently, current President Xi Jinping just concluded his trip to Congo, South Africa and Tanzania in March 2013. He also visited Angola, Botswana and South Africa in 2010 as the Chinese Vice President at that time. These high level visits do not just entail favorable diplomatic relations in order to secure oil. In recent years, China has become these African countries' biggest trading partner. According to 2012 statistics for instance, Angola exports 45% of its products to China, 95.5% of which is oil, while China accounts for 12.1% of Angolan imports, making it the second largest import source of the country (Nelson, 2013). Similarly, trade between Congo and China increased from US\$ 290 million in 2002 to US\$5 billion in 2012, making the later Congo's largest trading partner. From 2004 to 2012, Zambia, a non-petroleum producing country received six high level visits from Chinese officials, including one with President Hu Jintao in 2010. China is Zambia's major export partner, accounting for 34.9% of Zambia's total exports while similar African countries like Liberia and Ethiopia export 27.6% and 12.2% of their products to China respectively<sup>36</sup>.

## **6.1. Official Visits and Oil Agreements**

One of the most salient features of petroleum diplomacy is the oil-related bilateral agreements that are signed after a high-level visit of Chinese officials. Often referred to as mutually beneficial economic development, the visits are accompanied by energy experts, oil

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<sup>36</sup> Aside from oil and other mineral resources, China's FDI in Africa also includes investments in commodity sectors (South Africa), construction, health and education (Kenya) and access to raw materials (Democratic Republic of Congo).

exploration and development agreements or loans-for-oil. For instance in March 2013, President Xi Jinping's first overseas tour since taking office brought major oil deals and resource agreements to the countries he visited namely, Russia, Tanzania, South Africa and the Republic of Congo. In Russia, a deal was signed between China and Rosneft, securing oil supplies of 1 mb/day starting 2018. Rosneft and CNPC agreed the delivery of 34 million tons to around 50 million tons (1 million barrels per day) by 2018. The deal also included giving CNPC access to Arctic resources. Rosneft also secured a loan of US\$2 billion from China Development Bank, which is backed by 25 years of oil supplies.

At the onset of his African tour, President Xi reaffirmed the US\$20 billion African development fund that will commence in 2013 to 2015. He signed 19 agreements in Tanzania, including a US\$10 billion port development project in Bagamoyo and interest-free loan agreements between the Export-Import Bank of China and the Bank of Tanzania. Tanzania has 45 trillion cubic feet (tcf) of natural gas and the estimated recoverable reserves will be more than double to 100 tcf by the year 2015. CNPC already acquired a 20% stake for US\$4.2 billion of Eni, a gas company in Mozambique, and is looking at opportunities for exploration and production (E&P) in neighboring Tanzania's gas fields. Similarly, during his trip to the Americas in June 2013, President Xi Jinping signed a US\$1 billion loan to Petroleos Mexicanos, a Mexican national oil company (see Table 6.2). On the same tour in Costa Rica, Xi and Costa Rican President Laura Chinchilla signed deals on projects worth nearly US\$2 billion, including upgrades of an oil refinery, infrastructure projects. The US\$1.5 billion deal will be financed with a US\$900 million credit from the China Development Bank, with the remainder put up by the CNPC and the Refinadora Costaricense de Petroleo, a state oil refinery. Consequently, Premier Li Keqiang's first official trip in May 2013 also involved petroleum diplomacy. During his visit in India, the country's Essar Oil signed a US\$1 billion loans-for-oil with China, to be financed by China Development Bank. The deal involves an agreement of Essar's oil supply delivery to PetroChina. Similarly, Premier Li's visit to Pakistan opened up talks for oil pipeline and infrastructure projects what would directly link the country to China.

Table 6.1. Short Overview of the Agreements signed During High Level Visits (2009-2013)

Date & Visits	Person & Position	Country	Agreements Signed
Jun 2013 <i>Mexico, Costa Rica, Trinidad and Tobago</i>	Xi Jinping President	Mexico	US\$1 billion loans-for-oil to Petroleos Mexicanos, joint-CNPC and Pemex (Mexican NOC) technology exchange agreement
		Costa Rica	US\$2 billion upgrade of an oil refinery funds provided by CDB, CNPC and Refinadora Costaricense de Petroleo (Costa Rican NOC)
		Trinidad and Tobago	US\$3 billion in loans of 10 Caribbean countries including oil and gas-rich Trinidad and Tobago
May 2013 <i>India, Pakistan, Germany, Switzerland</i>	Li Keqiang Premier	India	US\$1 billion loans-for-oil provided by CDB to Essar Oil, to secure oil delivery to PetroChina
		Pakistan	Opened talks for Pakistan- China oil pipeline
		Switzerland	Signing of Sino-Swiss bilateral agreement, technology cooperation with Geneva-based Addax Petroleum, a subsidiary of Sinopec
Mar 2013 <i>Russia, Tanzania, South Africa, Gabon</i>	Xi Jinping President	Russia	US\$2 billion from CDB secured by 1mb/day of oil supply starting 2018; CNPC's access Arctic resources
		Tanzania	19 agreements including US\$10 billion port development project, opened potential E&P rights
April 2010 <i>Brazil, Venezuela, Chile</i>	Hu Jintao	Venezuela	US\$ 20 billion CDB loan to BANDES and PDVSA; PDVSA and CNPC signed a joint-venture agreement requiring a US\$16.3 billion investment
Feb 2009 <i>Saudi Arabia, Mali, Senegal, Tanzania, Mauritius</i>	Hu Jintao President	Saudi Arabia	Strengthen economic ties, Chinese company had won a contract to build a \$1.8 billion monorail
		Tanzania	US\$22 million in loans, China's Sonangol International was offered E&P rights to western Tanzania by Tanzania Petroleum Development Corp
Feb 2009 <i>Mexico, Jamaica, Colombia, Venezuela, Brazil, Malta</i>	Xi Jinping Vice President	Brazil	US\$10 billion in loans from CDB to Petrobras, supply of 100,000 barrels of oil per day to Sinopec
		Venezuela	US\$4 billion loan from CDB to BANDES and PDVSA, repayment of 230,000 barrels/day of oil provided to China National Petroleum Corp

Sources: Author's news database

This intensive government support towards petroleum diplomacy and thus towards the global expansion of NOCs has not always been initialized by the state itself. In the mid-1990s, the NOCs themselves embarked on joint E&P projects and M&As, though with less low financing capacity. It is not until the administration of President Hu Jintao and Premier Wen Jiabao that the Going out Policy was jumpstarted and the large-scale diplomatic tours around

the globe commenced, that included signing oil contracts, granting loans-for-oil deals and providing low interest credit to oil-rich countries (see Appendix 6.1). On his first official state visit to Russia as China's president in 2003, Hu was instrumental in establishing a memorandum of agreement between the Russian companies Yukos and Rosneft and CNPC. The agreement was the foundation of an oil pipeline deal connecting Taishet and Nakhodka. This pipeline project served as the reason why Rosneft and Transneft was able to borrow US\$25 billion loan from China, in exchange for a 15 million-ton of oil supply in the next 20 years. President Hu Jintao also actively promoted petroleum diplomacy in Africa. In his 10-year term, he toured the continent four times boosting Sino-African trade from US\$10 billion in 2000 to US\$200 billion in 2012. In his state visits to Egypt, Gabon and Algeria in 2004, President Hu signed important petroleum agreements that included preferential loans to the Egyptian government while CNPC and the Petroleum Ministry of Egypt signed a joint-E&P deal in southern Egypt (Kong, 2010). Similarly in Gabon, the Chinese entourage granted the government a zero-interest loan of US\$6 billion while at the same time, Sinopec sealed a technical evaluation deal with Total Gabon, exploring three onshore oilfields. Unipec, Sinopec's trading arm also secured a delivery of 1 million tons per year delivery of Gabonese oil through Gabon Total. In Algeria, President Hu oversaw the bilateral cooperation agreement between Sonatrach, an Algerian national oil company and CNPC. In 2006, President Hu visited Morocco, Nigeria and Kenya, engaging in similar deals that enabled NOCs to acquire E&P rights in these countries. In Nigeria, CNPC was granted E&P rights to four blocks following a Chinese government funding of US\$4 billion and a US\$5.7 million aid. Kenya also granted CNOOC rights to six blocks after an aid package of around US\$8.7 million.

Although the Chinese government only traditionally deals through bilateral instruments, in recent years, its petroleum diplomacy also extended in multilateral channels. The Forum on China-Africa Co-operation (FOCAC) was created as a platform for ministerial cooperation and to foster Sino-African relations but has become one of the avenues for petroleum diplomacy in Africa. Promoted to a summit level in 2006, it has become a major vehicle for the announcement of preferential loans, credits and aid of the Chinese government to the continent. In 2006, President Hu Jintao announced a US\$5 billion of concessionary loans

for Africa, the creation of the China-Africa Development Fund (CADFund) and the debt cancellations of 150 mature debts of 32 African countries. In 2009 at the Egypt Summit, China announced another US\$10 billion preferential loan, with an additional US\$1 billion loan for small and medium-sized African enterprises. Similarly, the Shanghai Cooperation Organization (SCO) channels multilateral cooperation between oil-rich Eurasian countries. Participated by Kazakhstan, China, Kyrgyzstan, Russia, Tajikistan and Uzbekistan with observers, India, Pakistan and Mongolia, the organization represents half of the world's population. Originally founded for cooperative partnerships in regional security-related concerns, it has increasingly become a vehicle for social and economic intergovernmental projects of the member states. In 2005 at the Moscow summit, SCO issued that it will prioritize joint energy projects including the oil and gas industries, and in 2006, Russia proposed a creation of an "Energy club" within the organization. In 2009 in the China Summit, President Hu Jintao announced that China will provide US\$10 billion preferential loans to SCO member states. According to the China Exim Bank, the accumulative loans it has issued to SCO member countries is US\$13 billion, its net loan in 2011 is around US\$7.4 billion.

Although the direct consequences of China's multilateral relations to its security of oil supply is not as salient as the outcome of its bilateral affairs, evidences of the influence of these regional diplomatic efforts to the country's broader economic development strategy and energy security policy can be observed. The relations between China and the rest of the SCO member states for instance have provided legitimate economic interdependencies in the region that reduces the states' security concerns and elevates their possibilities to enter into win-win agreements between each other. The pipelines deals that have been made between China, Russia and Kazakhstan do not just provide a steady supply of oil to China but also securitized the access for the Chinese market for Russia and Kazakhstan (Andrews-Speed and Dannreuther, 2011). Similarly, the arrangements China has made through FOCAC have facilitated the rapidly expanding Sino-African trade that promotes market expansion for both parties. In 1979, Sino-African trade was just US\$820 million but increased to US\$10 billion and US\$73 billion in 2000 and 2007, respectively (Dent, 2011). In the recent data provided by The

Economist (2013)<sup>37</sup>, Sino-African trade has reached US\$166 billion, making China Africa's biggest trading partner.

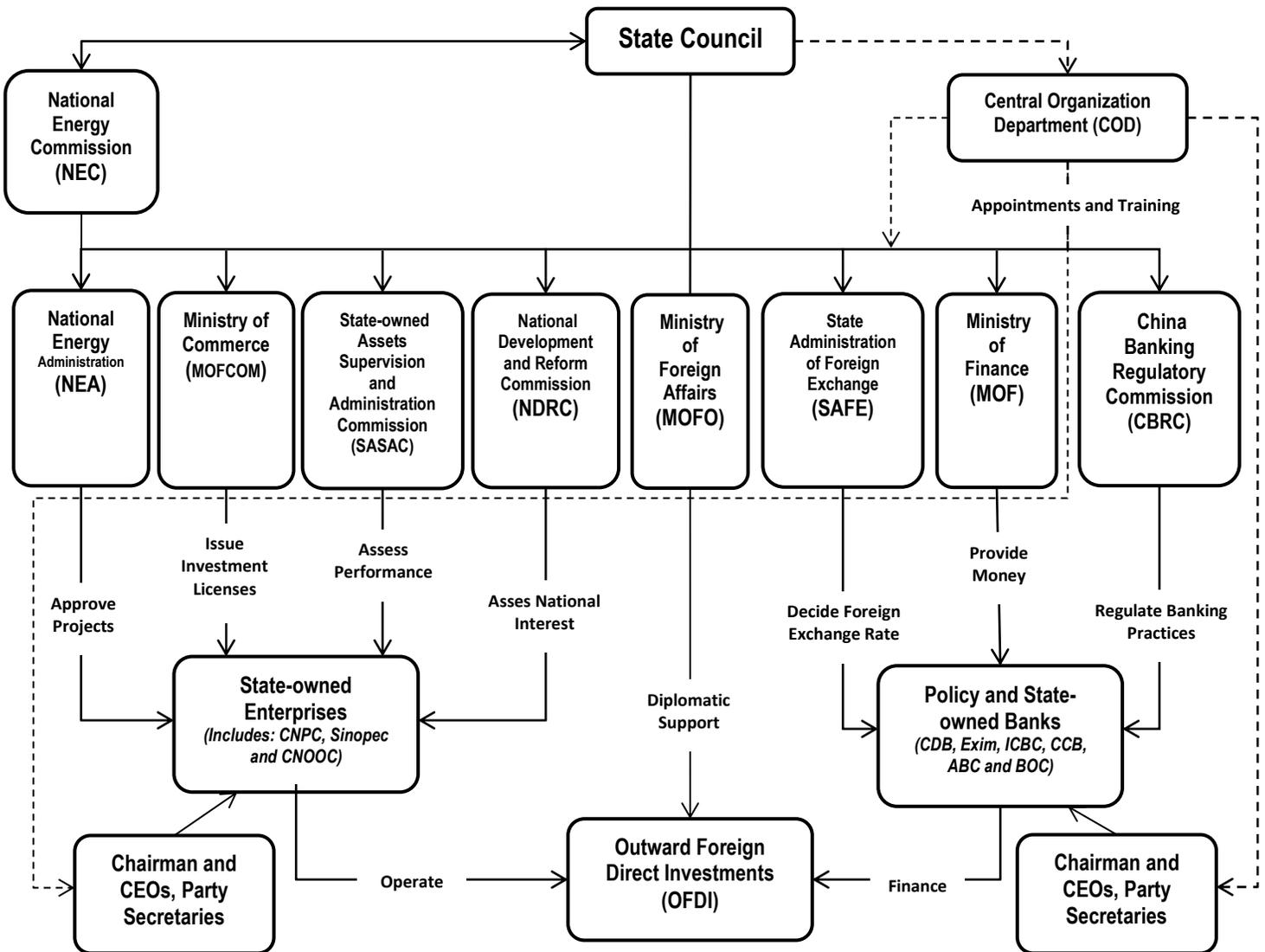
## 6.2. The State's Fundamental Control

The agreements made during high-level visits signify explicit government support to overseas expansion of NOCs. However, the main initiators of investments abroad remain to be the NOCs themselves. Through joint E&P projects, acquiring shares to gain access in a country's supply, participating in biddings and open tenders and M&As with other companies' subsidiaries, the Chinese NOCs' activities are not that different from international oil corporations (IOCs). However, what differentiates them is that the largest deals NOCs have acquired so far were directly negotiated with the host governments, behind closed doors and away from the public (Andrews-Speed and Dannreuther, 2011). This means that these bilateral negotiations entailed explicit state support from the Chinese government and might have included preferential credit offers like infrastructure-for-oil. The deals in Iran, Sudan, Kazakhstan, Russia, Brazil, Syria and Angola just to name a few are case examples of this extensive political assistance by the Chinese government to its NOCs. This is where the coordination of the state-owned companies rallied to support the underlying government energy policy converges. From preferential credits to development aid, loans-for-oil and infrastructure-for-oil, given by the CDB and China Exim Bank, the state has devised an attractive system of financial support to its NOC's expansion, especially in countries that has proved to be challenging for other IOCs to penetrate. By locking some of these loans in Chinese RMB, the recipient governments have no other way to spend their borrowed money but by using Chinese goods and services, enabling other Chinese SOEs to participate in the global expansion. Moreover, the preferential credits NOCs receive domestically, enables them to have an unlimited amount of money to spend in overseas M&As. Often resulting in overbidding, cases in Venezuela, Kazakhstan and Saudi Arabia have been the part of the reasons why developed countries view Chinese investments with an eye of skepticism.

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<sup>37</sup> According to the same report, 80% of Chinese imports from Africa are mineral products while machinery takes up 29% .  
<http://www.economist.com/news/middle-east-and-africa/21574012-chinese-trade-africa-keeps-growing-fears-neocolonialism-are-overdone-more>

Figure 6.2. The Organizational Structure of the Chinese SOE-OFDI System



Sources: Consolidated by the author

Kong (2010) and Downs (2011) argue that as initiators of overseas expansion, the NOCs largely have autonomy in pursuing their own corporate interests. However, the institutional structure of the approval of NOCs international transactions still lean towards a central control mechanism (see Table 6.2). The NOCs may embark on overseas expansion themselves, but the system of government control remains in place. Because they are still fundamentally state-owned, any significant investment of NOCs are subject to the approval of the National

Development and Reform Commission (NDRC). As the main government body tasked for designing, regulating and coordinating national economic and development policies, the NDRC has strong influence in directing NOC policies and pursuing state interests (Huang and Wilkes, 2011). China Exim Bank also needs NDRC's approval if it has to provide preferential loans for NOC transactions and for investments above US\$200 million (Andrews-Speed and Dannreuther, 2011). Moreover, the Ministry of Commerce (MOFCOM) is another government body that plays a significant role in the implementation and supervision of Chinese OFDI. It is the state's representative in bilateral and multilateral investment and trade negotiations and holds the key in issuing investment licenses to the NOCs. Together with the NDRC, the MOFCOM issues a list of countries viable for overseas investments and according to Andrews-Speed and Dannreuther (2011), nearly all rich-countries that are essential to China are on this list. Consequently, the alignment of diplomatic and economic interests is coordinated by the MOFCOM and Ministry of Foreign Affairs (MOFA), the later also being responsible for the organization of high-level visits. The State Council, the highest ranking body of the central government sits on the top of these ministries and agencies. It directs and regulates policy and controls the economic strategy and its implementation. Thus, though might be driven by corporate interests, the policy direction of NOCs are still by far largely influenced by the central government as the State Council holds the policy decision-making process, the coordination and implementation through NDRC and MOFCOM, the diplomatic relations and its alignment with the economic strategy through the MOFA, the financing through the policy banks and the ownership through the SASAC.

## **Chapter 7. Conclusion**

This paper has analyzed the state-NOC relationship in China. It has argued that despite the operational autonomy attained by national oil companies through restructuring and reforms in the oil industry, the underlying policy-making direction is still subject to the central government authority. The NOCs fundamentally remain subjects of the state's political control through traditional ties and ownership, provision of preferential financial support as well as broad diplomatic assistance to the NOCs' international expansion.

To provide a clear picture of the current interaction between the Chinese government and the NOCs, a historical overview of the institutional development of the energy sector was scrutinized. This study found out that along with the gradualist approach to macroeconomic reforms, the Chinese government has devolved its authority over its various entities. The institutional regulatory body of the energy sector was decentralized and remains to be fragmented over different government ministries and entities while the national oil companies have succeeded in centralizing their organizational structures and command centers. However, the devolution of the state's direct control was not a by-product of the NOCs interest in seeking autonomy but by the gradual allotment of authority as orchestrated by the state. Because the NOCs operate in a "strategic industry" the historical context provided a path-dependent view of how the oil sector has received a steady and substantial support from the government and remains to be at the center of energy security policy. Consequently, the corporatization and marketization of these national oil companies do not entail a transfer of ownership, for the state remains to be the majority shareholder and thus able to wield effective corporate control over the NOCs.

To further broaden the scope of the analysis, the issue of ownership and administrative control, organizational theories were employed. The study found out that through its institutional arms, the SASAC and the COD, the state still controls and exercises administrative authority over the NOCs. Through analyzing the political trajectory of executives in the petroleum industry, the paper provided evidences of how the state use official positions to incentivize those who follow its interests. The transference and mobility of executives within

the corporate and the government spheres and the duality of roles of these executives as both corporate chairmen and party secretary provide the central government an effective instrument to issue top-down control. Additionally, the existence of traditional ties such as *guanxi* further delineate the opaque process of executive recruitment that issues from preferential treatment of those who belong in a particular network of influences.

The administrative control over NOCs is not only limited to the oil sector but spread across the SOE system. A closer look at the Chinese banking system revealed that its administrative governance and policy-setting mechanism do not deviate from that of NOCs. As state-owned enterprises, the banks are under a similar control structure although they do not belong to the SASAC. The similarities of the executive appointments and incentive mechanisms within the banking system subsequently confirm the authority of the State Council's institutionalized instruments of vertical control. This centralized level of influence is further employed to establish a horizontal financial support system in between SOEs. As the study shows, the NOCs receive substantial preferential credits and financing from the state-owned banks, a manifestation that a higher coordination and a centralized policy-making body exists and in pursuit of its fundamental interests.

This contention is further exploited in the analysis of the state's outward foreign direct investments and the Going Out Policy. Data evaluation revealed that although the Going Out policy does not explicitly dictate the geographical direction of Chinese OFDI, its energy security interests creates a trend where capital is heavily invested in a certain region at the certain period time. The study also revealed that a substantial portion of this OFDI is specifically allotted to resource-based acquisitions and geared towards NOC expansion. Particular oil-rich regions, especially unconventional sources of petroleum products such as sub-Saharan Africa and Latin America have received extensive FDI from China in recent years. Through the use of policy banks such as the CDB and China Exim, the government has issued an effective means of financial support towards NOC expansion. The loans-for-oil are preferential credits issued by Chinese policy banks to oil-rich countries in exchange for a long-term supply of oil. However, data in the paper also revealed that loans-for-oil also permit access to previously inaccessible countries and create new export markets for Chinese goods and services. Thus, the coordination

of functions between the policy banks and NOCs reveal that the policy direction of state-owned enterprises adheres to the course set by the Going Out Policy. International investments made by Chinese NOCs both follow the commercial objectives of the petroleum industry and the more diversified commercial objectives of the central government.

The internationalization of Chinese NOCs transactions' subsequently required the government to embark on petroleum diplomacy, a state-led diplomatic support for the acquisition of NOC assets in petroleum-rich countries. Taking the Chinese official visits in these countries as a primary sample of diplomatic presence, the assessment of these trips reveal that the state visits often entail loans-for-oil agreements, allotment of preferential credits and other petroleum-based contracts. It has also been observed that the largest NOC acquisitions were done behind bilateral channels and not commercial ones, indicating that NOCs' overseas expansion is one of the agenda of the Chinese diplomatic relations. Consequently, the analysis of the institutional structure of NOC international activities leans towards a central government control. The Ministry of Commerce, National Development and Reform Commission and the Ministry of Foreign Affairs are not just coordinated to further the NOCs expansion, but also to regulate it.

Thus, the Chinese government's administrative control mechanism over its NOCs remains to be in place despite the reforms and functional fragmentation of energy policy-making within the energy ministries that have given the NOCs operation autonomy.

### **7.1. Signs of Divergence**

This study has been mainly focused on the Chinese state's interest to pursue energy security. However, over the years, the operational autonomy of the national oil companies and the devolution of central regulatory body in the energy sector have given them incentives to pursue commercial interests. To date, these NOC interests are in still in convergence with the government's interest of global expansion to pursue economic development (Andrews-Speed and Dannreuther, 2011; Houser, 2008). For instance, the government has given the NOCs the responsibility over their profitability and liabilities. This made the NOCs pursue commercial objectives that have proven to be profitable largely because of the increase in world oil prices

but more importantly because of the NOCs ownership structure. Unlike other listed companies that pay dividends to their shareholders, the NOCs do not, for their majority shareholder is the Chinese government. This enables them to retain more revenue and provides leverages for them to pursue other investment opportunities for commercial reasons (see Appendix 7.1). As observed in the study, the NOCs often initialized overseas expansion through mergers and acquisitions and joint E&P projects. This could be a platform divergence of strategic motivations between the government and NOCs and might entail repercussions that could mean more devolution of state control in the future.

The existence of a “new petroleum faction” within the Chinese Communist Party could further enhance the political autonomy of the NOCs and increase their political leverage within the party itself. Prevalent in the 1950s until the 1980s, the petroleum faction was represented by Yu Qiuli (vice premier), Kang Shi'en (vice premier), Song Zhenming (minister of petroleum), and Sun Jingwen (minister of chemical industries) among others (Li, 2001). According to Downs & Meidan (2011), they were all advocates of central planning and proponents of export-based economy, predominantly dependent on oil. However, the new petroleum faction is composed of oil executives who are mostly Western-educated and have gained extensive international working experience (Downs & Meidan, 2011). Recently, these executives have worked their ways up in the political ladder and within the party leadership. The promotion of Jiang Jiemin in March 2013 as the new SASAC chairman is a case point. This rise of the petroleum faction could then lead to more pluralization within the party system as business executives from other sectors have also began taking government positions. This would entail not just a change in the management of the petroleum industry, but within the Chinese political system as a whole.

One of the most fundamental driving forces of Chinese government support in NOC expansion is their belief that retaining equity oil will enhance the country's energy security. However, numerous studies have shown that retaining equity oil does not benefit the security of supply. To date, a large part of oil produced by NOCs abroad is sold in the international market and not transported back to China. Transportation costs, security of transportation and the lack of refining technology in China are one of the main reasons why the Chinese NOCs sell their oil in the international market rather than ship it back to the mainland (see Appendix 7.2).

The amount of oil reserves held overseas or the existence of long-term supply agreements would not provide any benefits in times of crisis or oil disruptions for instance (Downs, 2011). Consequently, onshore pipeline projects planned to mitigate this concern do not decrease the vulnerability of equity oil from security issues that may be coming from the countries where the pipelines pass through. This concern over the significance of equity oil to the overall Chinese economic strategy has increasingly been salient and could influence the future government approach towards its energy policy.

## **7.2. Towards State Capitalism**

This study observed that the reforms of Chinese national oil companies resulted to their corporatization, marketization and internationalization. The diffusion of institutional authority among ministries of the energy sector further enhances the capacity of the NOCs to exercise operational autonomy. However, as previously contended, these reforms follow the overarching plan of the government to gradually integrate its pillar industries in the global market. The traditional ties within the political and economic system could not be easily alienated for they have been ingrained within China's political economy. The CCP will continue to preserve its control and relevance but to do so in an increasingly dynamic political and economic system, it needs to use the "hand of the state" to choreograph the ascent of its national champions in the global arena (Lee, 2011).

Because of its increasing needs for oil, China has changed the dynamics of global political economy. The growing international presence of its NOCs and the continued central government support has caused both comforts and concerns to the countries worldwide. The once criticized role of the state in the political and economic culture is now gaining ground (Andrews-Speed and Dannreuther, 2011). Though the success of it remains undetermined, the role of China in the world's political economy has been cemented.

China's gradual approach to its economic development has brought it to new heights. The devolution of the state's authority over oil industry did not come accidentally but followed a familiar trend of measured reforms. As long as China considers the petroleum sector as its strategic industry, the primacy of authority over it will continue to remain in hands of the state.

## APPENDICES

### *Appendix 2.1. History of China's Petroleum Industry*

Oct 1949	Establishment of the People's Republic of China The Ministry of Fuel Industry was established and given the overall responsibility for petroleum development
Apr 1950	First National Petroleum Congress took place and the Petroleum Administration Department was set up under the Ministry of Fuel Industry was established to trade oil
July 1955	The Ministry of Fuel Industry was abolished The Petroleum Administration Department was upgraded to the rank of Ministry of Petroleum Industry (MPI) which initiated and supervised exploration, oil-field development and construction of refineries The Ministry of Geology was established and charged with petroleum and natural gas exploration
June 1965	China National Import Corporation was renamed China National Import & Export Corporation
June 1970	The Ministry of Coal, Ministry of Petroleum, and Ministry of Chemical Industry were combined together to form the Ministry of Fuels and Chemical Industry
Jan 1975	The Ministry of Fuels and Chemical Industry was abolished and the Ministry of Petroleum and Chemical Industry and the Ministry of Coal Industry were established
Mar 1978	Ministry of Petroleum Industry was established as a separate body from the Ministry of Chemical Industry
1980	The State Energy Commission was established and given administrative power over the Ministry of Petroleum Industry, Ministry of Chemical Industry and the Ministry of Electrical Power
1982	The three ministries were placed under the administration of the State Council after the State Energy Commission was abolished
Feb 1982	The China National Offshore Oil Corporation (CNOOC) was established under the Ministry of Petroleum Industry, responsible for offshore petroleum exploration and development and cooperation with foreign companies
July 1983	China National Petrochemical Corporation (Sinopec) was established from the assets of the Ministry of Petroleum Industry, Ministry of Chemical Industry and Ministry of Textiles
Sept 1988	China National Petroleum Corporation was established under the direct supervision of the State Council
Jan 1996	China National Star Petroleum Corporation (CNSPC) was established based on the exploration functions of the Ministry of Geology and Mineral Resources
Apr 1998	The State Bureau of Petroleum and Chemical Industry was established under the State Economic and Trade Commission and was assigned responsibilities taken from the Ministry of Chemical Industry, CNPC and Sinopec
July 1998	Sinopec and CNPC were restructured into two integrated companies: the China National Petroleum Corporation (CNPC) and China Petrochemical Corporation (Sinopec Group)
Nov 1999	PetroChina Company Limited (PetroChina) was established under the CNPC

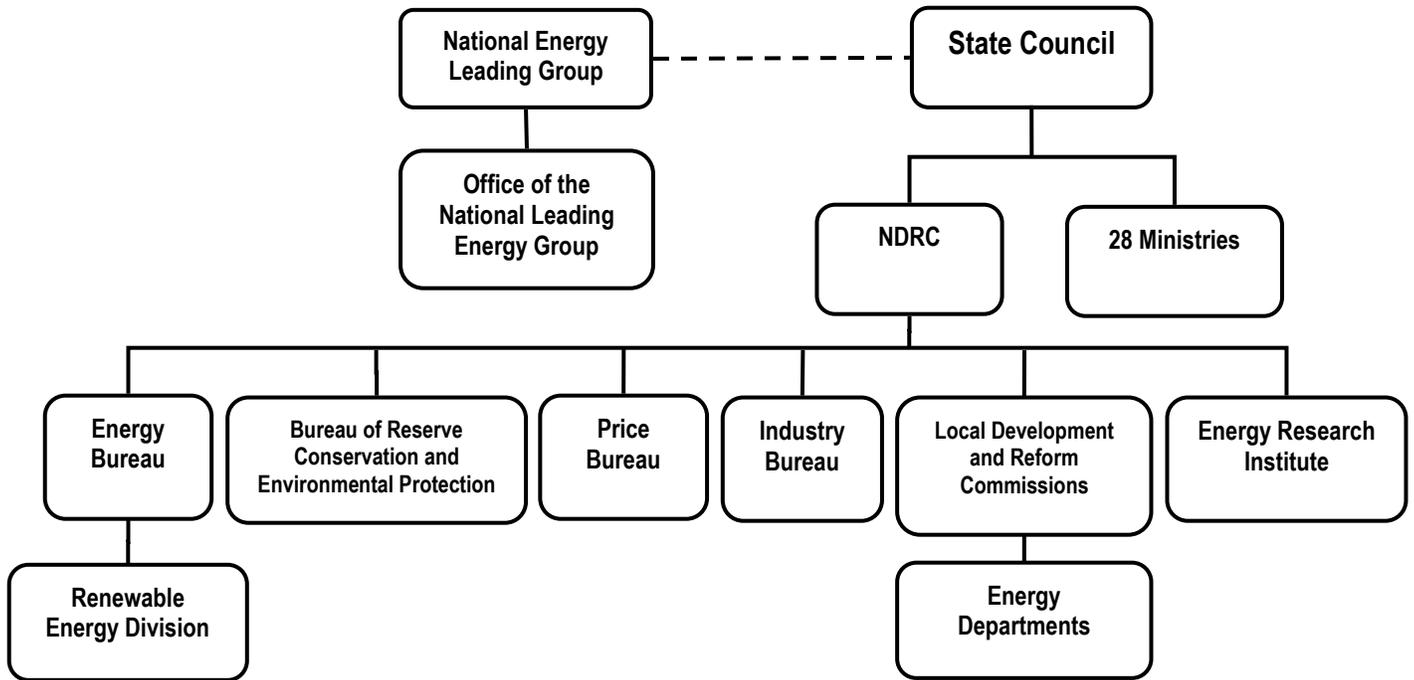
Feb 2000	China Petroleum and Chemical Corporation (Sinopec Corp) was established under the Sinopec Group
Mar 2000	Sinopec Group merged with CNSPC to form Sinopec Star Petroleum Company Ltd
Apr 2000	PetroChina was floated on the Hong Kong and New York Stock Exchanges
Oct 2000	Sinopec Corp was floated on the Hong Kong, New York and London Stock Exchanges
Feb 2001	CNOOC was floated on the Hong Kong and New York Stock Exchanges
2001	The State Bureau of Petroleum and Chemical Industry was abolished
Nov 2003	China National Import & Export Corporation was renamed Sinochem Group
May 2005	The National Energy Leading Group headed by Premier Wen Jiabao was established
Mar 2008	The National Energy Administration and the National Energy Commission were created

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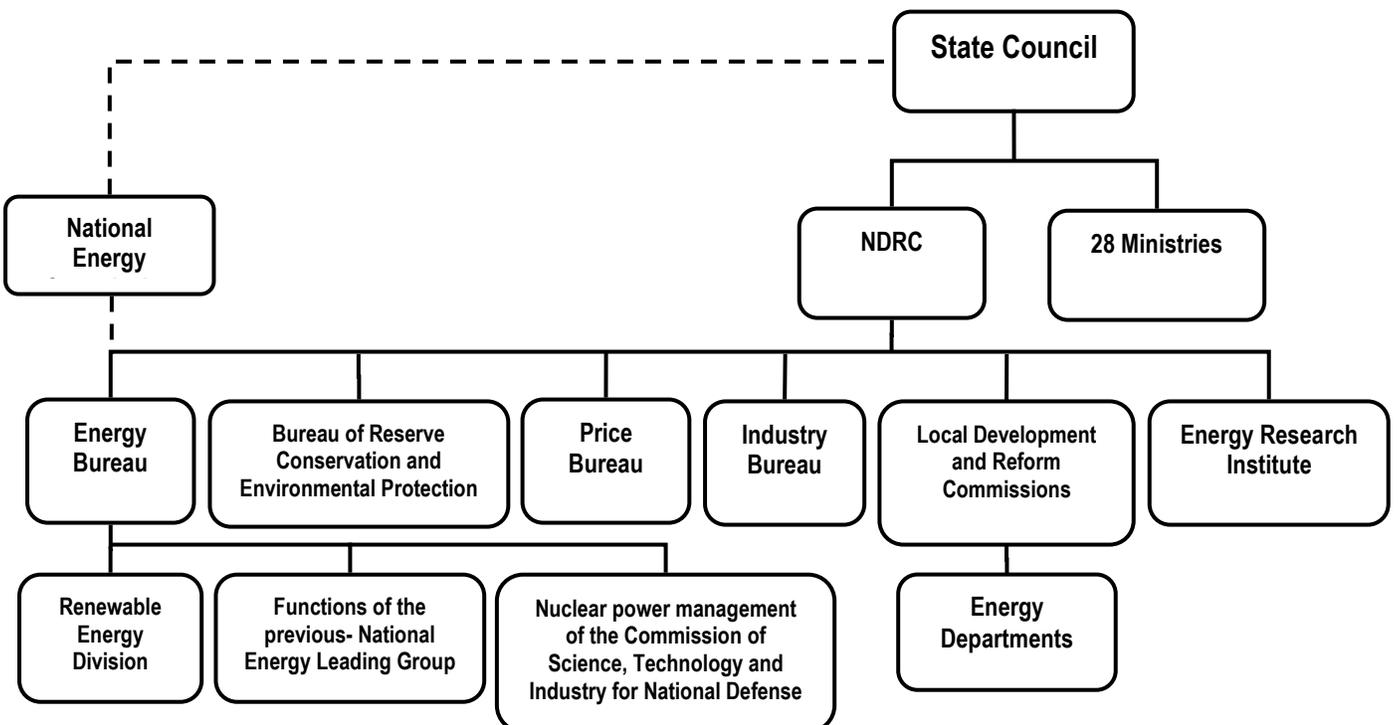
*Source: Zhang (2004), Bo (2010) and author's database*

Appendix 2.2. Chinese Energy Policy Making Bodies

A. Chinese Policymaking Bodies before March 2008 Reforms



B. Chinese Policymaking Bodies after March 2008 Reforms



Appendix 2.3. National Energy Commission Members (As of January 2010)

Name	State Energy Commission	17th CC	Current Position
Wen Jiabao	Chairman	PBSC	Premier
Li Keqiang	Vice Chairman	PBSC	Executive Vice Premier
You Quan	Member	Alternate	Deputy Secretary General of the State Council
Zhu Zhixin	Member	Full	Director of Central Finance General Office
Yang Jiechi	Member	Full	Minister of Foreign Affairs
Zhang Ping	Member Director of the General Office	Full	Chairman of National Development and Reform Commission
Wan Gang	Member	Non-CC	Minister of Science and Technology
Li Yizhong	Member	Full	Minister of Industry and Information
Geng Huichang	Member	Full	Minister of State Security
Xie Xuren	Member	Full	Minister of Finance
Xu Shaoshi	Member	Full	Minister of Land and Resources
Zhou Shengxian	Member	Full	Minister of Environmental Protection
Li Shenglin	Member	Full	Minister of Communication and Transport
Chen Lei	Member	Full	Minister of Water Resources
Chen Deming	Member	Alternate	Minister of Commerce
Zhou Xiaochuan	Member	Full	Governor of People's Bank of China
Li Rongrong	Member	Full	Chairman of State-Owned Assets Supervision and Administration Commission
Xiao Jie	Member	Full	Chief of State Administration of Taxation
Luo Lin	Member	Alternate	State Administration of Work Safety
Liu Mingkang	Member	Full	Chairman of China Banking Regulatory Commission
Wang Xudong	Member	Full	Chairman of National Electricity Regulatory Commission
Zhang Qinsheng	Member	Full	Deputy Chief of the General Staff Department
Zhang Guobao	Member and Deputy Director of the General Office	Non-CC	Vice Chairman of National Development and Reform Commission and Director of the State Energy Administration

Source: Bo (2010), EAI Background Brief No. 504

Appendix 5.1: Foreign Investments by Chinese National Oil Companies (2005-2012)

**North America**

Year	Month	Investor	US\$ millions	Share	Partner	Country
2005	April	CNOOC	\$130	17%	MEG Energy	Canada
2005	June	Sinopec	\$120	40%	Synenco	Canada
2007	February	Sinopec	\$100		Syntroleum	USA
2009	May	CNOOC and Sinopec	\$320		Talisman Energy	Trinidad-Tobago
2009	August	CNPC	\$1,740	60%	Athabasca Oil Sands	Canada
2010	August	China Communications Construction	\$130		Friede Goldman United	USA
2010	May	CIC	\$1,220	5%	Penn West Energy	Canada
2010	March	CNPC	\$180	51%	INOVA Geophysical Equipment	USA
2010	November	CNPC	\$4,500		Cuvenpetrol	Cuba
2010	April	Sinopec	\$4,650	9%	ConocoPhillip	Canada
2011	July	CNOOC	\$2,040		Opti Canada	Canada
2011	October	Sinopec	\$2,100		Daylight Energy	Canada
2012	February	CIC and Sinopec	\$300		Sunshine Oilsands	Canada
2012	December	CNOOC	15100		Nexen	Canada
2012	January	CNPC	\$670	40%	Athabasca Oil Sands	Canada
2012	October	CNPC	1510		TransCanada	Canada
2012	September	Sinopec	\$1,020		Summit Power	USA
2012	November	Sinopec	\$1,980		DKRW	USA
Total Investments			<b>\$37,810</b>			

**South America**

Year	Month	Investor	US\$ millions	Share	Partner	Country
2005	September	CNPC and Sinopec	\$1,420		EnCana	Ecuador
2006	September	Sinopec	\$430	50%	Omimex	Colombia
2009	November	CNPC	\$700	50%	Recope	Costa Rica
2010	March	CNOOC	\$3,100	50%	Bridas	Argentina
2010	April	CNPC	\$900		PDVSA	Venezuela
2010	November	CNPC and Sinopec	\$610			Ecuador
2010	May	Sinochem	\$3,070	40%	Statoil	Brazil
2010	October	Sinopec	\$7,100	40%	Repsol	Brazil
2010	December	Sinopec	\$2,470		Occidental Petroleum	Argentina
2011	February	CNOOC	\$330		ExxonMobil	Argentina
2011	November	Sinopec	\$4,800	30%	Galp Energia	Brazil
2012	April	Sinomach	\$230		Albanisa	Nicaragua
2012	June	Wison	\$1,470		Hyundai	Venezuela
Total Investments:			<b>\$26,630</b>			

Appendix 5.1 (continuation): Foreign Investments by Chinese National Oil Companies (2005-2012)

**Sub-Saharan Africa**

Year	Month	Investor	US\$ millions	Share	Partner	Country
2005	May	CNPC	\$390		SONATRACH	Algeria
2006	January	CNOOC	\$2,270	45%	South African Petroleum	Nigeria
2006	May	Sinopec	\$730	75%	Sonangol	Angola
2007	January	CNPC	\$200	50%	EnCana	Chad
2008	June	CNPC	\$4,990			Niger
2011	March	CNOOC	\$1,450	33%	Tullow	Uganda
2011	December	CNPC	\$150	51%	Varun Industries	Madagascar
2011	May	Sinopec	\$540	80%	Shell	Cameroon
2012	November	Sinopec	2500	20%	Total	Nigeria
Total Investments			<b>\$13,220</b>			

**Middle East and North Africa**

Year	Month	Investor	US\$ millions	Share	Partner	Country
2005	December	CNPC	\$290	16%	Petro-Canada	Syria
2008	December	CNPC	\$3,290		International Petroleum Investment	UAE
2008	February	Sinochem	\$470	17%	Soco	Yemen
2008	September	Sinopec	\$1,990		Tanganyika Oil	Syria
2009	April	Sinopec	\$350		Kuwait Oil	Kuwait
2010	May	Rongsheng Holding & Sinochem	\$1,990			Egypt
2010	May	CNPC	\$1,480	35%	Shell	Syria
2011	March	Sinopec	\$3,300	38%	SABC	Saudi Arabia
Total Investments			<b>\$13,160</b>			

**Europe**

Year	Month	Investor	US\$ millions	Share	Partner	Country
2008	July	CNOOC	\$2,490		Awilco Offshore	Norway
2009	June	Sinopec	\$7,200		Addax Petroleum, the largest overseas takeover ever by a Chinese company	Switzerland
2011	January	CNPC	\$510	50%	INEOS Britain	Britain
2011	January	CNPC	\$510	50%	INEOS France	France
2012	February	Sinochem	\$260	35%	Siat	Belgium
2012	October	Sinopec	170	50%	Mercuria	Switzerland
2012	July	Sinopec	1500	49%	Talisman Energy	Britain
Total Investments			<b>\$12,640</b>			

Appendix 5.1 (continuation): Foreign Investments by Chinese National Oil Companies (2005-2012)

**Asia and Oceania**

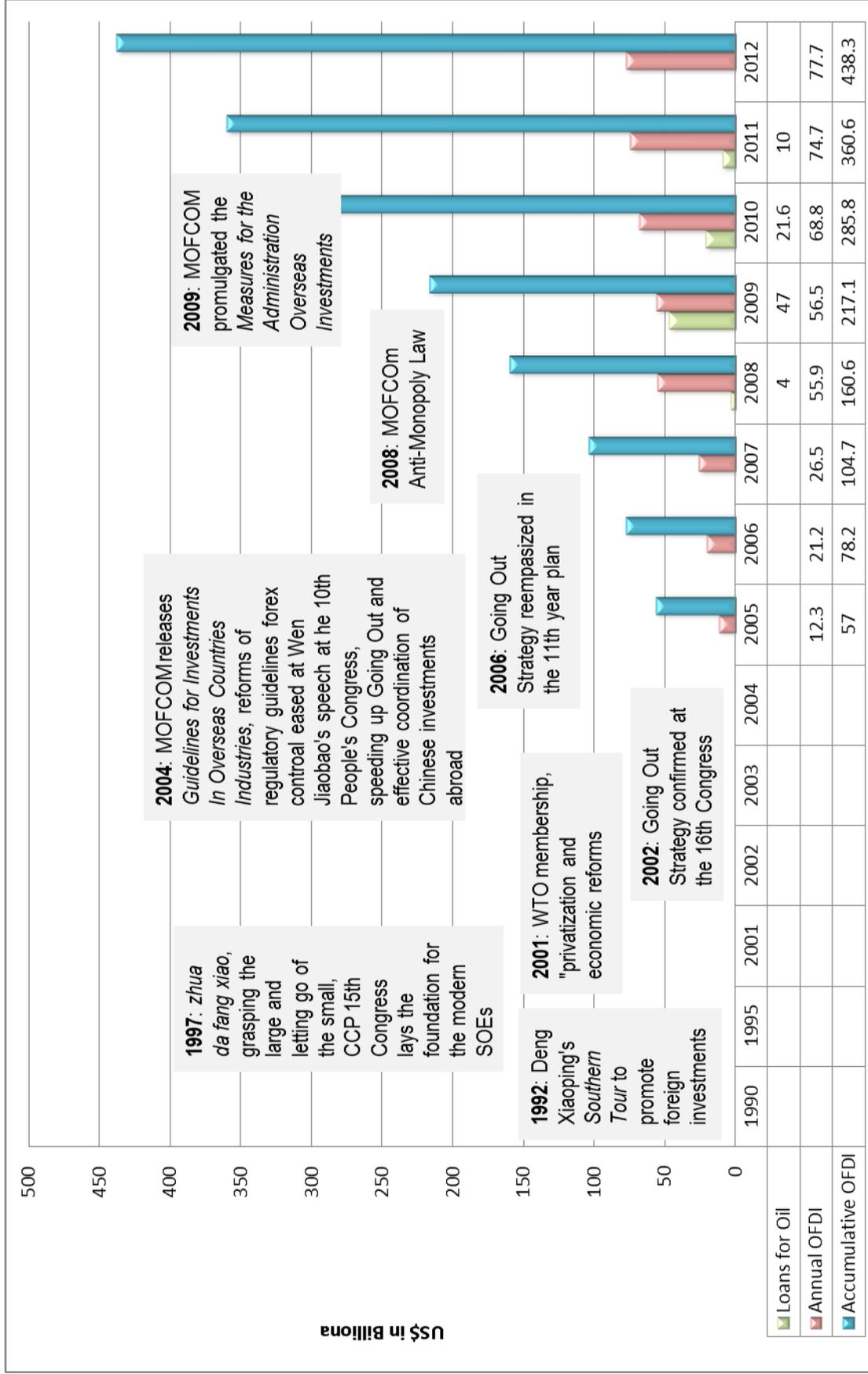
Year	Month	Investor	US\$ millions	Share	Partner	Country
2006	July	CITIC	\$100	51%	Kuwait Petroleum	Indonesia
2009	May	CNPC	\$1,020	46%	Keppel	Singapore
2009	September	CNPC	\$1,160	96%	Singapore Petroleum	Singapore
2009	June	CNPC	\$1,240			Myanmar
2010	May	CNPC	\$150			Indonesia
2012	December	Sinomach	\$2,300		Cambodia Petrochemical	Cambodia
2012	October	Sinopec	\$850			Indonesia
2011	July	Zhejiang Hengyi and Sinopec	\$2,500			Brunei
2008	March	Sinopec	\$560	60%	AED	Australia
Total Investments			<b>\$9,880</b>			

**West Asia**

Year	Month	Investor	US\$ millions	Share	Partner	Country
2005	August	CNPC	\$4,200	67%	PetroKazakhstan	Kazakhstan
2006	July	CNPC	\$500		Rosneft	Russian Federation
2006	July	Sinopec	\$2,800		North West Shelf Partners	Iran
2006	June	Sinopec	\$3,490	97%	Rosneft	Russian Federation
2007	December	Sinopec	\$2,010	51%	National Iranian Oil	Iran
2008	August	CNPC	\$3,010			Iraq
2009	October	CIC	\$300	45%	Nobel Holdings	Russian Federation
2009	January	CNPC	\$1,760		National Iranian Oil	Iran
2009	September	CNPC	\$2,250	70%	National Iranian Oil	Iran
2009	December	CNPC	\$240		State Oil Marketing Organization and South Oil Company	Iraq
2011	October	CNPC	\$400		Watan	Afghanistan
2011	June	CNPC	\$170		Maysan Oil	Iraq
2011	December	Sinopec	\$850		Marubeni	Kazakhstan
Total Investments			<b>\$21,980</b>			

Source: The Heritage Foundation, China Global Investment Tracker dataset (2013)  
<http://www.heritage.org/research/projects/china-global-investment-tracker-interactive-map>

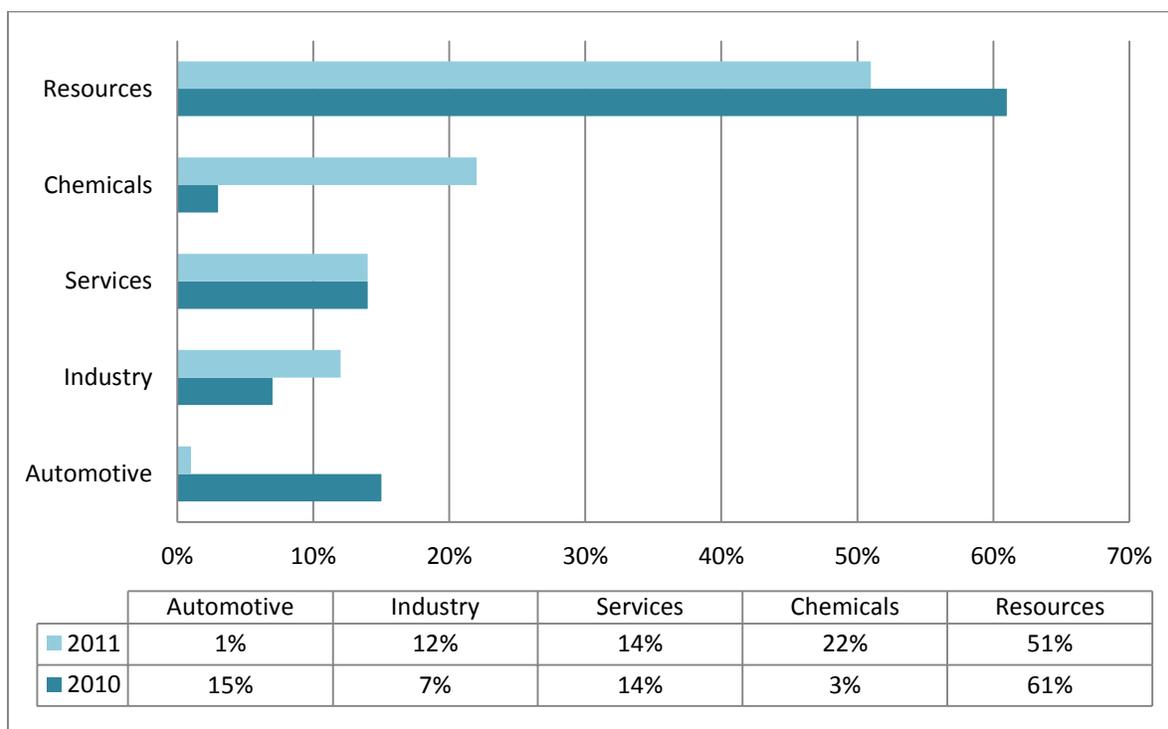
Appendix 5.2. China's Outward Foreign Direct Investments and Policies



Sources: Tan (2011), Mofcom Statistics

Appendix 5.3. Perspectives in China's Outward Mergers and Acquisitions by Sector

Figure 5.3.1. Chinese OFDI by Sector, 2010 and 2011



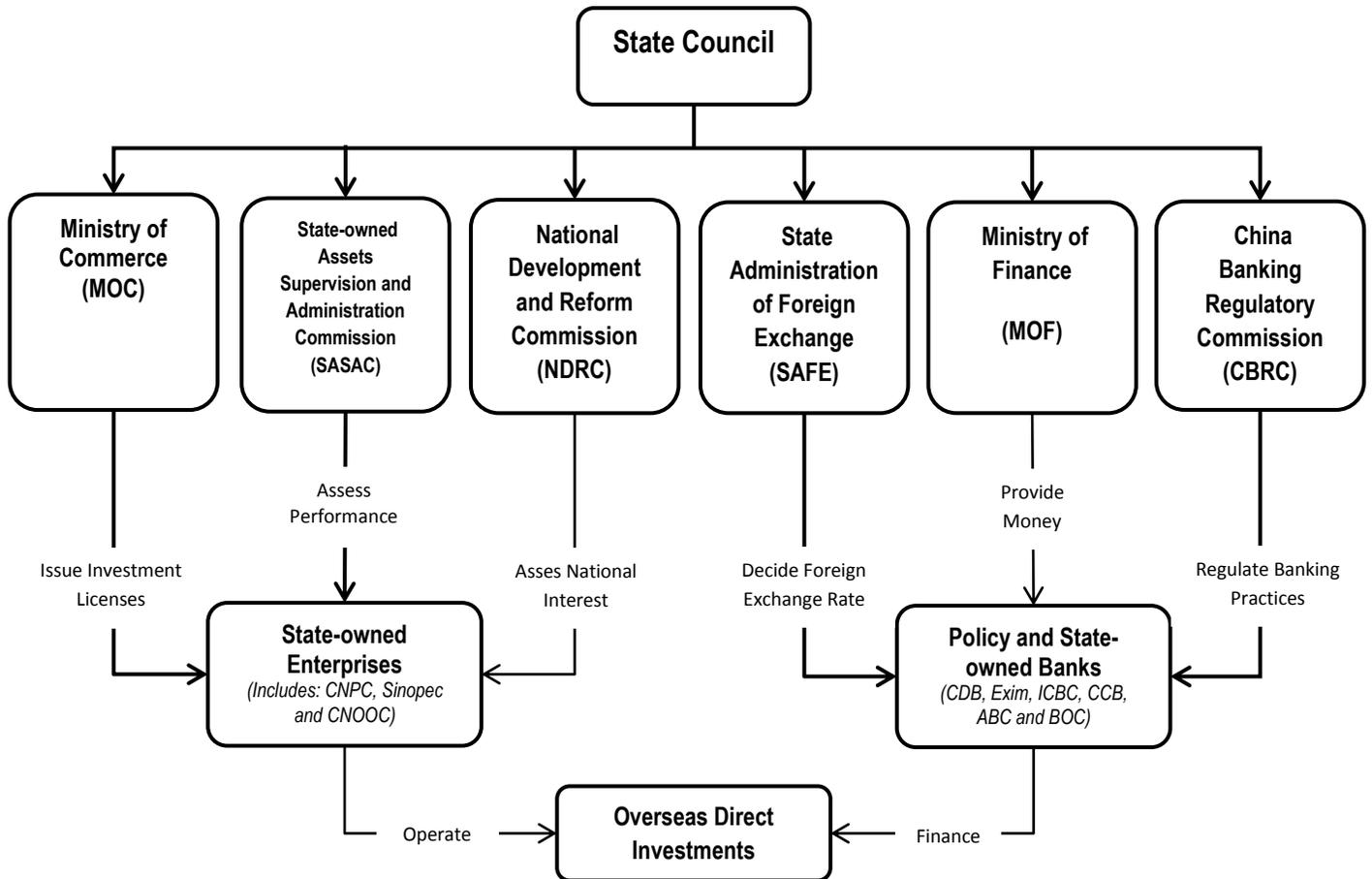
Source: Beijing Axis Report (2010): <http://www.thebeijingaxis.com/tca/editions/the-china-analyst-apr-2012/115>

Figure 5.3.2. Chinese Sector Patterns from mid-2009 to mid- 2012 (in US\$ billions)

Sector	Investment	Engineering Contracts	Troubled
Energy and power- total	98.7	58.4	24.0
Energy and power- oil only	35.8	18.7	2.5
Metals	36.0	0	18.8
Real Estate and Construction	18.1	12.0	3.6
Transport	9.2	38.5	7.1
Agriculture	9.2	2.1	2.4
Finance	6.9	n/a	0.8
Technology	5.6	1.8	6.8
Chemicals	5.2	1.7	0
Other	4.9	0	0
<b>Total</b>	<b>193.8</b>	<b>114.5</b>	<b>63.5</b>

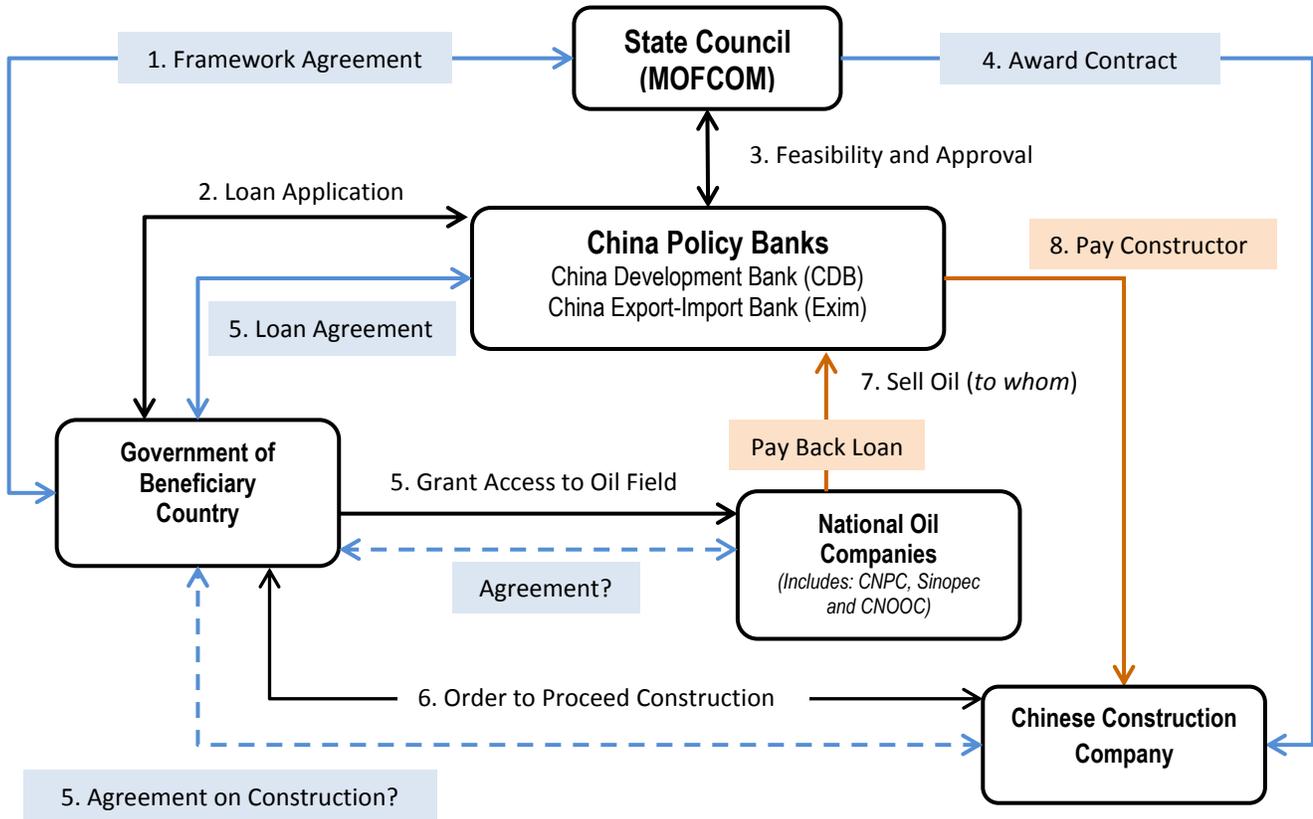
Source: The Heritage Foundation, China Global Investment Tracker data set (2012).  
<http://www.heritage.org/research/reports/2012/07/chinese-foreign-investment-outward-investment-acceleration-features-the-us>

Appendix 5.4. Chinese Regulatory Bodies for Overseas Investments



Source: Tan (2011)

Appendix 5.5. Structure for Oil-for-Resources Deal



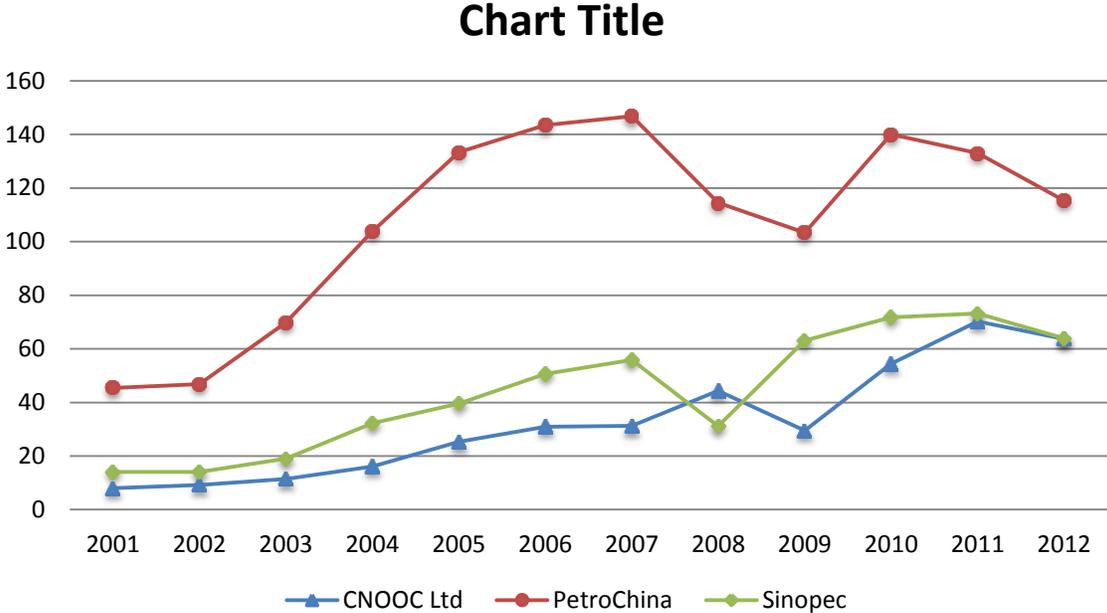
Source: Asche and Schuller, *China's Engagement in Africa*, p.36.

*Appendix 6.1. High Level Chinese Official Visits to Africa (2004-2008)*

<b>Year</b>	<b>Date</b>	<b>Person</b>	<b>Official Title and Position</b>	<b>Countries Visits</b>
2004	Jan 29 – Feb 4	Hu Jintao	President	Egypt, Gabon and Algeria
	June 20-29	Zeng Qinghong	Vice President , PBSC member	Tunisia, Togo, Benin and South Africa
2005	Jan 6-14	Li Zhaoxing	Foreign Minister	Seychelles, Madagascar and Mauritius
	Nov 14-24	Huang Ju	Vice Premier, PBSC member	Madagascar, Botswana and Guinea
	Nov 12-24	Li Changcun	Propaganda Chief of the CPC, PBSC member	Sudan, Namibia, South Africa and Tanzania
2006	Jan 11-19	Li Zhaoxing	Foreign Minister	Cape Verde, Senegal, Mali, Liberia, Nigeria and Libya
	Apr 25-29	Hu Jintao	President	Morocco, Nigeria and Libya
	June 17-24	Wen Jiabao	Premier	Egypt, Ghana, Congo-Brazzaville, Angola, South Africa, Tanzania and Uganda
	Aug 27 - Sept 10	Wu Guanzheng	Head of the Central Commission for Discipline Inspection of the CPC, PBSC member	Rwanda, Madagascar, Botswana and Gabon
2007	Jan 30 – Feb 10	Hu Jintao	President	Cameroon, Liberia, Sudan, Zambia, Namibia, South Africa, Mozambique and Seychelles
	Apr 15- 26	Jia Qinglin	Chairman of the People’s Political Consultative Conference, PBSC member	Tunisia, Ghana, Zimbabwe and Kenya
	Jan 7-11	Yang Jiechi	Foreign Minister	South Africa, Burundi, DR Congo and Ethiopia
	Mar 21- Apr 4	Li Changchun	Propaganda Chief of the CPC, PBSC member	Algeria, Mauritania, Morocco and Tunisia

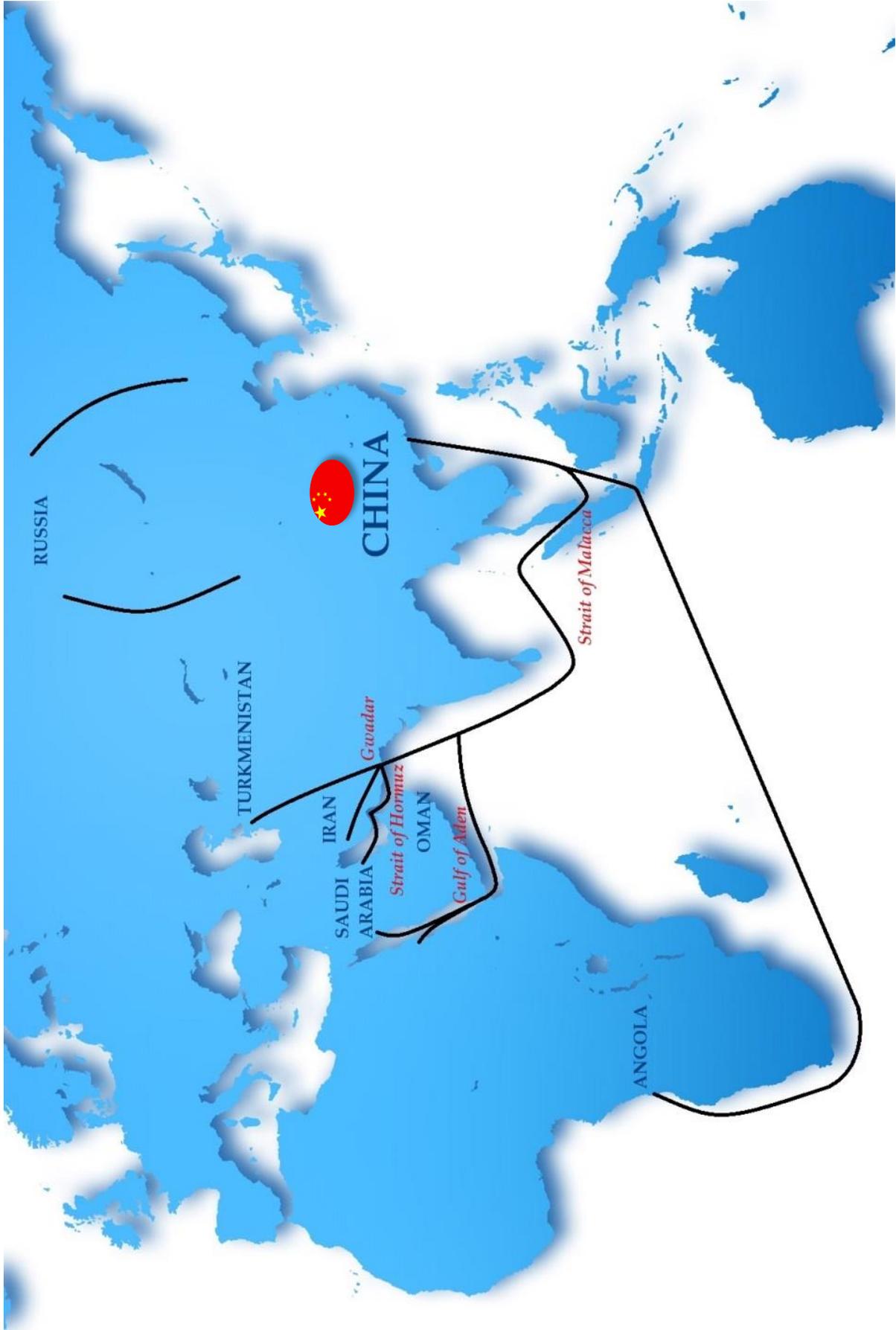
*Source: Kong (2010)*

Appendix 7.1. NOC Net Profits from 2001-2012 (in billions of RMB)



Sources: Compiled by the author, data based on companies' annual reports

Appendix 7.2. Major Oil Supply Routes to China



Source: Consolidated by the author

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