China's Oil Diplomacy and State-Backed Investments in the Partition of Sudan

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Abstract
This paper examines the evolving role the People's Republic of China has played in breaking the oil deadlock between Sudan and South Sudan. By offering a historical overview of the Sudanese conflict in the context of China's oil development, this paper first outlines the conflicting nature of China's economic and political interests when conducting oil diplomacy between both states. Then, it details the options and strategies available to China's leaders as they mediate the deadlock, while finally providing a prediction as to how they might proceed in the years to come.

Introduction

Western countries often associate narratives of Sudan with the well-known humanitarian situation in Darfur: The genocide, poverty, and tragic history of civil wars and internal conflict that have plagued the region since its independence in 1956. However, from a Chinese perspective, Sudan is not a developmental backwater, but a significant strategic partner for increasing its presence in Africa, and the site of major projects to secure China’s future energy security. As only the fourth country to recognize the legitimacy of Communist China, Sudan has generally maintained friendly relations ever since. The alliance was greatly strengthened when, in the mid-1990s, China invested around $4 billion towards tapping Sudan's oil reserves. By 2008, it “import[ed] 60 percent of Sudan's oil output” (Taylor 2009, 50).

However, the Sino-Sudanese bilateral relationship has come at huge political and economic costs. Since 1995, China has been subject to intense international...
criticism pertaining to its complicity in Sudan’s human rights records and failure to play a greater role in deterring the atrocities of Darfur. In addition, the discontinuation of Sudanese oil production resulting from the succession of South Sudan has jeopardized China’s energy security within the region, drawing China into a larger conflict between North and South Sudan.

Chinese efforts to resume oil production have become increasingly difficult because its oil assets remain in the South while its traditional diplomatic ties are aligned with the North, forcing China to mediate the conflict while attempting to retain neutrality. However, the lack of progress among Chinese diplomats presents Beijing with the question of intervention: “Should China intervene on behalf of one party to resume oil production in the Sudan?” The answer lies between the trade-off of China’s short-term and long-term energy security interest. While intervening would restart oil production in the short term, it would discredit China’s “no-strings-attached” foreign investment policy, preventing China from gaining access in other developing nations in the future. Additionally, Sudan is gradually losing its significance in China’s grand strategy for global energy security. By diversifying supply sources abroad, China can mitigate the effect of volatile oil production from Sudan and indirectly increase its soft power elsewhere – without the added costs of intervention.

To that end, this case study offers a historical overview of Chinese state oil investments in Sudan divided into three pivotal periods throughout the Sudanese conflict: China’s initial oil investment from 1995-2005, Sudan’s Comprehensive Peace Agreement from 2005-2011, and South Sudan’s independence after 2011. Then, it proceeds to analyse how the independence of South Sudan and evolving conflicts along the Sudan-South Sudan border will impact these investments and influence Chinese energy policy.

1995-2005: China Invests in Sudan

China’s interest in developing Sudan’s reserves began in September 1995, when Sudan’s President, Omar al-Bashir offered China oil concessions in exchange for access to credit at reduced interest rates (Large 2008, 278). After Chevron suspended oil development due to security concerns, the Sudanese government needed new partners to finance the country’s oil development. Since Sudan at the time was sanctioned by the United States and hence closed off to Western companies, China proved an appealing alternative (Jakobson and Zha 2006, 65-66). Sudan’s interest in foreign direct investment coincided with China’s “Go Out” policy. Initiated at the end of the 20th century, this policy was intended to reinvest China’s amassing foreign reserves in oil and gas assets abroad in order to meet the country’s rapidly expanding energy consumption rates as domestic energy sources began to mature. The “Go Out” policy would not only provide future energy security for China’s growing consumer base, but also indirectly improved
domestic products and enterprise, thereby extending Chinese soft power globally. In addition, Sudan's historical friendly relations with China, its political isolation, and “its economic potential” made Sudan “an attractive investment prospect” (Large 2008, 280).

With the encouragement of the Chinese government and financial support of several state-backed institutions, China's major national oil companies (NOC’s) invested heavily in Sudan. Between 1995 and 1996, the China National Petroleum Corporation (CNPC) began unilateral operations in block 6,1 and purchased a 40 percent share in the newly formed the Greater Nile Petroleum Operating Company (GNPOC), which developed blocks 1, 2, and 4. In 2001, the CNPC increased its market share in Sudan by acquiring a 41% stake in PetroDar, a new consortium operating on blocks 3 and 7. Furthermore, CNPC helped construct two crucial pipelines operated by GNPOC and PetroDar, as well as an oil terminal at Port Sudan that “connect[ed] oil production with the international market” (Large 2008, 281). To that end, the CNPC’s acquisitions in conjunction its unilateral actions played a major role in turning Sudan into a net oil exporter in 1999 (Downs 2007, 58). However, the CNPC’s transformation of the Sudanese oil resources would later become the center of dispute, sabotage, and conflict leading up to the partition of Sudan.


The Comprehensive Peace Agreement (CPA) between North and South Sudan set the stage for China's entanglement in Sudan's broader civil war. Signed on January 9th, 2005, the CPA formed a negotiated settlement between the Bashir administration representing Northern Sudan and the Sudan People's Liberation Movement/Army (SPLM/A) representing Southern Sudan. This settlement reached an agreement to share oil revenues, and set a future referendum date for South Sudan independence in 2011. During this period of relative peace, China became Sudan's most important trade partner, accounting for a massive 75 percent of Sudan's total exports in 2006 (Large 2008, 285). The CNPC “shipped back home most of its Sudanese equity oil,” although when oil prices were high they were also sold on the international market (Downs 2007, 47). In the same year, the combined production total of CNPC and the Chinese Petroleum and Chemical Corporation (Sinopec) in Sudan reached 81% of China’s total NOC oil productions in Africa (Downs 2007, 46).

However, as the violent killings in Darfur drew increasing foreign media attention, Beijing's close ties with Bashir's regime in Khartoum became detrimental to China's reputation. Heavy international criticism was centered on

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1 See Exhibit 1, noting that the map was compiled in 2007 before the independence of South Sudan
China’s sale of small arms to Sudan, its opposition to anti-Darfur resolutions in the United Nations, and Beijing’s general failure to leverage its influence on the Bashir administration to foster peace. Eventually, as the International Criminal Court indicted President al-Bashir for genocide, the Darfur advocacy campaign culminated in massive protests against the Beijing Olympics in 2008. Moreover, rebel forces within Sudan have also reacted to Beijing’s role in Darfur. A senior leader in the northern opposition commented that while he welcomed China’s ability “to balance Khartoum’s relations with the West,” he also criticized “that China is insensitive to human rights issues and the people of Darfur blame China for protecting the al-Bashir regime” (Shinn and Eisenman 2012, 254).

As the conflict in Darfur gradually drew to a close, media discourse and widespread criticism of China have softened correspondingly. Moreover, both the international community and domestic players in Sudan have come to appreciate the role China could play in mediating the Sudanese referendum. Nevertheless, the negative press these campaigns created during the Beijing Olympics and physical threats to Chinese investment in the region will certainly enter Chinese policymakers’ calculations as they choose to consider whether the costs of its relationship with Sudan outweighs the benefits.

2011-today: South Sudan Independence and Onwards

On July 9th, 2011, the security of China’s Sudanese oil assets was further complicated when South Sudan passed a referendum in support of independence from the North, thereby splitting Sudan in half. This partition of Sudan created a dilemma for oil exploitation: “Roughly three quarters of the remaining oil now belong[ed] to the South, but the infrastructure to exploit it – pipelines, refineries and export terminals – [were] in the North” (International Crisis Group 2012, 26). As a result, the CNPC built pipelines that enabled Khartoum to extol high transit fees in order to compensate for its lost oil revenue. Following a series of disagreements over these fees, Khartoum began to block shipments of Southern oil by the end of 2011. Beijing was hard pressed by both sides to mediate the conflict, and sent a special envoy for African affairs to reconcile the deadlock. However, the engagement proved shallow as China was reluctant to take a side and simply “continued to appeal for restraint and dialogue.” In January 2012, preferring “to fully exercise its economic sovereignty than be held financially hostage by Khartoum,” Juba chose to completely shut down oil production (International Crisis Group 2012, 30).

On 26 March 2012, South Sudanese forces attacked a GNPOC operated oil field called Heglig. After occupying the field for 10 days in April, South Sudan’s troops were defeated by the Sudanese Arm Forces, and control of the field returned to the north. The fighting caused a fire in the company’s oil processing facilities and also damaged the crucial Greater Nile Oil Pipeline. These damages halted oil
production in the entire region, restricting “roughly half the national production, 50,000-55,000 barrels a day” (Timberlake 2012). The conflict between Sudan and South Sudan continued throughout the summer as negotiations took place in the background. The deadlock was finally broken on August 5 when Sudan and South Sudan both announced that they had reached a profit sharing agreement (“Sudan and South Sudan Oil Deal Applauded” 2012). Despite the signing of the agreement in September, Sudanese security concerns inhibited Heglig from resuming production. As the oil dispute between Sudan and South Sudan raged on, both economies slowed and by November, “Sudan’s currency fell to a historic low against the dollar” (Holland and Laessing 2012).

While headlines mostly cited the mediation efforts of an African Union task-force led by former President of South Africa, Thabo Mbeki, the United States and China also played important roles in the negotiations. Diplomatic pressure from Beijing led South Sudan’s Foreign Minister, Nhial Deng, to comment: “We strongly believe that this deal would not have been possible without China in the background basically pushing for such an agreement” (Lynch 2012). While Deng refused to elaborate on what exactly Chinese officials did during the negotiations, they refused to take a political position. Acting solely on protecting its financial interests, China pressured both sides to move the agreement forward while showing disinterest in the resulting political implications.

Managing Security Risk: The Challenge for Chinese NOC’s

The investment of Chinese oil companies into unstable regions provided access to additional African markets but also carried an obligation to manage much higher levels of security risk. Initially, resentment about China’s negligence in Darfur fuelled many of the violent attacks against Chinese NOC’s. In 2007, the Justice and Equality Movement (JEM), a Darfur rebel group, “briefly seized Chinese oil facilities at Defra in [South] Kordofan Province,” and then “attacked the Heglig oil facility run by the Great Wall Drilling Company.” The violence escalated the following year, when JEM “kidnapped nine Chinese CNPC employees,” eventually “kill[ing]…four of them while security forces rescued four others and one went missing” (Shinn and Eisenman 2012, 253). More recently, NOC’s seem to have been drawn into the broader tug-of-war of the North-South civil war. In January 2012, 29 Chinese workers were kidnapped while working on a construction project along the North-South borders by, rebel remnants of the SPLM who remained in the North after secession. This incident represented “the third case of abduction of Chinese working in Sudan since 2004,” as Chinese workers became increasingly attractive targets for Sudanese rebels hoping to leverage China to put pressure on Bashir’s administration (Wee 2012).

In response to the additional violence caused by the North-South rift, the management of Chinese companies has been compelled to adjust accordingly.
Following its independence, the South Sudan government ordered major oil companies to move their headquarters from Khartoum to Juba, but Chinese companies, for fear of alienating Sudan, have only selectively implemented the order. Perhaps in response to perceived Chinese non-compliance, the South Sudan government ejected the Chinese chief of PetroDar on oil theft accusations on February 2012 (Bariyo 2012).

Prior to the Sudanese split, Chinese NOC’s had relied on support from the Chinese state to manage these security risks. Taking lessons from prior companies like Chevron, which was forced to withdraw due to a lack of adequate security, the Chinese government ensured the protection of their workers through small arms agreements. As a result, military expenditure by Bashir’s new Sudanese government increased dramatically after 1997 soon after oil began flowing out of Sudan (SIPRI 2012). However, this agreement collapsed following the partition of Sudan. While most of the oil fields in the partition went to South Sudan, the Chinese government remained politically aligned with the North. This created a problem as South Sudan’s army was drastically underequipped to provide any kind of reliable security for these oil fields as China could not employ its prior method of simply arming the government forces without politically infuriating the North.

Facing increased interference from both Sudanese governments, security threats against company personnel and facilities, and even the possibility of war, China’s NOC’s must now re-weigh the current operational success with the spectre of future complications. CNPC’s operation in Sudan has been regarded as “the single most outstanding success” of Chinese oil investments overseas (Jakobson and Zha 2006, 67). Divestment would not only cause the company to ‘lose face,’ but also cast doubt on the entire Chinese model of investing in resource-rich, but politically unstable regions. Moreover, the energy industry requires a large initial investment in both oilfield exploration and the construction of upstream and downstream infrastructure. Returns, on the other hand, come in much smaller portions over a longer trajectory as oil is gradually extracted, distributed, and exported out of the country. This business model, in effect, prevents companies from divesting their assets until they recoup the costs of their initial investments. While Chevron exited Sudan in the early stages of oil development, CNPC and Sinopec’s prolonged investment in upstream and downstream assets may prevent them from divesting their assets without suffering heavy financial losses.

Nevertheless, Chinese NOC’s enjoy many alternative investment options. While Sudan is an important oil producer, its proven reserves still constitute only 5% of the total in Africa (Downs 2007, 46). Financing new alternatives would allow China to diversify its investment portfolio and avoid reliance on a single country for energy security. Taking the first steps to do so, Sinopec purchased its “first…overseas upstream assets” from Angola for $2.46 billion in 2010 (Lee
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Worldwide, Chinese NOC’s have increased their acquisitions “from almost negligible in 2007 to 15% of the total [Asian NOC acquisition spending] in 2010,” including ventures in Brazil, Canada, Australia, and, the United States (Atmakuri 2012). As these endeavors extend China’s reputation and foster a more diversified energy supply, it may actually be a logical choice to abandon Sudan in search of more secure and reliable partners.

Political Manoeuvring: Should Beijing Continue Intervention?

All else aside, the ultimate future of Chinese NOC investments in Sudan remains in the hands of the Chinese government. The international community retain high hopes that China will continue to use its trading partner status to mediate the conflict in Sudan and thus take on greater responsibilities in global governance. However, China’s presence in Africa was welcomed by local governments precisely because of its “no strings attached” policy that was willing to overlook corruption, instability, and human rights violations, while helping the, “host country build up an entire chain of oil industry” (Jakobson and Zha 2006, 67-68). This has left China in a precarious position as it faces the dilemma of choosing between its historic political alliances with the North and protecting the commercial assets now in the South, while retaining neutrality.

The question of whether or not to forego the “non-intervention” strategy in pursuit of greater regional security will dictate China’s future strategy in Sudan, and likely have significant implications on the country’s presence all over Africa. In the short term, the benefits of Chinese intervention outweigh the costs of insecurity resulting from the status-quo. Long-term infrastructure investments from NOC’s are already in place and complete shutdown of production in southern oilfields would be a financially catastrophic result for the Sudan operations of these state-funded companies. Additionally, Sudan’s role as one of China’s first and closest African allies also gives political significance for continued Chinese involvement, as Beijing needs to leverage this relationship to expand its influence, and its potential allies in Africa may look to the Beijing-Khartoum relationship as an indicator of China’s credibility as a strategic partner.

However, China’s ability to intervene is anchored down by its own strategy of “non-intervention” and laissez-faire relationships with local governments. Since the first signs of a deadlock in negotiations with the North, South Sudan has actively explored the possibility of constructing a new pipeline that would circumvent Port Sudan, thereby eliminating Khartoum’s ability to extort the south for oil money. South Sudan President Salva Kiir visited China in April of 2012 to request funding for a new pipeline through Kenya and Ethiopia, but his trip was cut short when Beijing rejected his proposal. Observers suggest that the Chinese government fears the move would, “antagonise the [North] Sudanese government and further inflame an already incendiary situation” (Deng 2012).
While China’s historic relationship with Khartoum has prevented China from backing the South, Southern control of Chinese oil investments means that Beijing must also avoid disenfranchising the Kiir administration. As such, Beijing promised to send humanitarian aid to South Sudan, and dispatched a new special envoy lead by China’s top diplomat in the Africa province, Zhong Jianhua, to facilitate peace. Characterized by observers as “friendly, [and] media-canny,” Zhong’s appointment further testifies to Beijing’s intention to urge restraint and end hostilities without explicitly taking a side (H.E. Zhong 2012).

Ultimately, China’s question over intervention will become increasing insignificant in the long run as the divided Sudan’s play a diminishing role in Beijing’s core interests in energy security. While China remains the overwhelming principal trading partner to Sudan, the share of Sudanese oil in China’s overall oil imports has declined after reaching “the high water mark of 2001-2” (Large 2008, 285). Chinese academics Jiang and Zhao contend that this trend is, “due to the overall effects of factors such as the mediocre quality of crude oil in Sudan, the emergence of more and more replacement oil suppliers in Africa, and the increasing attention towards oil reserves in Sudan domestically” (Jiang and Xiao 2011, 48). On average, Sudanese oil only accounted for merely 6% of China’s total imports through 2008-09 (ChinaOilWeb 2012). After South Sudan’s oil shutdown in the first quarter of 2012, the rate withered to a mere 3% (China Petroleum and Chemical Industry Association 2012). Despite the decrease in Sudanese imports over this period, however, China has located effective alternatives, and its overall oil import actually increased by 11.35% relative to the previous year. The losses from both the Sudanese situation and a separate incident in Iran were supplanted by increased imports from alternative sources such as Russia and Venezuela (“2012 First Quarter” 2012). Meanwhile, analysts have suggested that China will benefit from the increasingly cheaper and widely available oil in Iraq, “90% of… [which] are going to go to Asia – mostly China” (Whelan 2012).

As Chinese NOC’s gradually expand their assets further in Africa and other developing regions, it seems possible and even logical that they may choose to forfeit the politically unpredictable Sudan’s. Awareness of this emerging trend may provide an alternative explanation as to why Beijing refused to fund the alternative pipeline for Juba, a costly investment that promises to entangle them further in Sudan and South Sudan’s future.

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In the end, China’s future strategy in Sudan faces two opposing directions. In the short term, Beijing will continue to advocate purely for its commercial interests and the physical security of its NOC’s workers and oil assets. Yet, as China tries to establish its global reputation, maintaining ties with a notorious Khartoum may pose reputational risks increasingly difficult to ignore. On the other hand, it would
be equally difficult for China to shift their alliance entirely towards South Sudan, since the SPLM government in Juba remains unstable, and its relationship with Beijing lacks the same level of trust. Meanwhile, the commercial significance of Sudanese oil as a whole continues diminish as China better manages its energy security by diversifying its African oil interests with trading partners such as Angola, Uganda, and Nigeria.

Hence, the costs of continuing support for Khartoum and involvement in Sudan seem to outweigh the gains. In the long term, barring some dramatic improvement in the security and stability of the Sudan’s, China may opt out of the North-South power struggle, and establish an exit strategy to withdraw from Sudan. This may be a sign that China is becoming more selective of its trading partners, thereby distancing itself from regimes with questionable records and unstable business environments. As Chinese foreign investments better represent this selectivity, Beijing's goals in maintaining both the profitability and security of its investment may successfully converge.

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