



THE INKERMAN GROUP



Enter the Dragon

The foreign policy implications of China's quest for resources

Executive Summary

- The February 2010 Inkerman Monitor will seek to address the impact that China's record economic growth has had on its quest to obtain resources.
- China in 2010 will continue to be an economic powerhouse, projected to have the largest global economy by 2030 as it takes an ever-increasing role on the world stage.
- The monitor will also seek to address the pattern set by Chinese state owned companies of investing in markets in pursuit of the Government's long-term strategic interests of awarding raw material contracts or defence related deals to countries with questionable human rights records. This paper will address if this strategy is set to continue given that China is looking to promote greater legitimacy in 2010.
- The resource hungry nature of its economy is causing it to seek a more active role in international relations which is in turn increasing its sphere of influence over less developed economies in Africa, Latin America and Central Asia.
- China's strategy is increasingly causing friction with western energy companies, as well as putting pressure on the financial system during the global recession by helping to set off a global commodity boom.
- In 2009, China's trade with Africa surpassed US\$107 billion. The same trade level was reached in Latin America in 2007 after signing deals with Brazil, Venezuela, Bolivia and Argentina amongst others.
- Resource interests are becoming paralleled by strategic and political interests in Central Asia over energy infrastructure and Beijing has spent over US\$50 billion on establishing alternative ways to transport energy out of this region in its bid to lock up resources.

*"When the wind rises, some people build walls. Others build windmills."
- Chinese economic proverb:*

Enter the Dragon - An Overview

The year 2009 will go down in history as a watershed for the epochal expansion of China's global influence. With its economy tipped to grow at 8% despite the global financial crisis, the People's Republic of China (PRC) is widely regarded as a prime locomotive for economic recovery worldwide. The People's Liberation Army (PLA) is building nuclear submarines and aircraft carriers, and the country's first astronaut is expected to set foot on the moon before 2015. Four 500MW coal power plants are continuing to come on line each week across China as well. This exponential growth needs to be sustained, but this currently cannot be done through internally so China is forced to look abroad.

The Inkerman Monitor will contend that China has three explicit strategic imperatives in developing markets: gaining access to resources, increasing its political influence and acquiring preferential access to markets. All of which place business before politics as well as using business to forge a new kind of diplomacy based on necessity for both Beijing and the capital cities with which it makes agreements with. In the past, China has pursued what it considers the most critical of these imperatives, resource extraction, by offering chronically underdeveloped and capital-poor states huge infrastructure loans and favourable lending terms far beyond what Western companies and institutions are willing to provide, in exchange for access to natural resources, particularly oil. Chinese companies have developed a reputation for going where others will not because of political, environmental or ethical concerns, or because profit margins are too slim. State-owned companies in China have the ability to forgo short-term profits in pursuit of the Government's long-term strategic interests and often trade infrastructure improvements explicitly for raw material contracts or defence related deals. Some of Beijing's approaches to the developing world are

generic, such as the use of high-level state visits to cultivate personal relationships between ruling elites, however, the unique aspects include building on extending loans to secure resources, with no conditions attached and also linking future trade linked in at the level of defence deals to countries with questionable human rights records. A unique selling point for Beijing is the fact that countries that sign deals with Chinese companies can benefit diplomatically by securing protection from Beijing as China is a permanent member of the UN Security Council. Beijing can threaten to use its veto power to block sanctions the rest of the world may wish to bring upon states it has negotiated deals with.

Beijing's desire to limit Islamic extremism in its western provinces, quashing rebellious indigenous communities such as the Uighurs in Xinjiang is also of strategic significance in Central Asia. Beijing's priority in the region also includes acting against unrest in order to protect this area for resource security.

Despite much diversification in sources of resources globally, China's partner in its quest for energy, and oil in particular, remains Africa.

Sino-African resource relations

Africa is a continent of fifty-three countries and is host to more than 2,000 languages and cultures. Africa is resource rich in an effort to gain access to these China has sought to establish a common bond with a number of developing countries.

China's state-owned oil giants have been told to secure supplies, at whatever cost, and they have responded by bidding sky-high prices for such equity investments, elbowing out Western oil firms and prompting charges that the Chinese are using Government subsidies to gain valuable oil assets. Arguably, the real beneficiary of China's current strategy is its

state-owned oil companies. Given a blank cheque to improve China's energy security, the three state-owned oil giants - China Petroleum and Chemical, China National Petroleum and China National Offshore Oil - now have practically unlimited financial resources to make overseas acquisitions, regardless of economic viability or geopolitical risks. If their deals go bad, the understanding is that Beijing will foot the bill. The companies will face no responsibility, either, because they are simply implementing the Government's energy security strategy. But if they strike 'black gold', the companies reap the economic benefits.

The first high-level Sino-African meeting occurred at the 2006 China-Africa summit in Beijing, at which China made significant pledges to Africa including US\$5 billion in loans and another US\$5 billion in investment. In the last few years, Chinese companies have signed or attempted to sign exploration contracts in nearly every African country with potential oil resources.

China has secured drilling rights in Chad, Gabon, Kenya, Mauritania, Congo, Ethiopia and Equatorial Guinea and a US\$9 billion investment for copper and cobalt with the DRC to name but a few. In November 2009, China's premier Wen Jiabao announced eight pledges to African nations which included the provision of US\$10 billion in low-cost loans over the next three years, the elimination of tariffs on 60% of exports from least-developed nations, the construction of 100 clean energy projects for Africa, debt forgiveness for several nations and a US\$1 billion loan for small and medium-sized African businesses. In 2010, China may eclipse the US as Africa's biggest trade partner, according to figures from the International Monetary Fund.

Seeking new avenues

As international oil companies from the West have already secured some of the most promising oil fields on the continent, China has primarily looked to places where there

was little competition, either because the fields were not as productive or because the investments were riskier, both in political and security terms. Because of the 'quid pro quo' structure of these deals, China has also frequently been the sole investor in a project, or at least held the majority share. Within this strategy, Beijing has been willing to work with governments that other Western countries prefer to shun for political reasons.

China has major and long-standing projects in Angola, Sudan (6%) and the Democratic Republic of the Congo (2.5%). On the periphery, China National Offshore Oil Corporation (CNOOC) drilled an exploratory well in Kenya in 2009 and gained exploration rights in Somalia in 2007, two countries not known for their oil resources. The Chinese National Petroleum Company (CNPC) is extremely active in Sudan, owning equity in a number of oilfields and has 10,000 Chinese workers involved in country to build refineries and pipelines to the Red Sea. Beijing showers Khartoum with loans to build infrastructure to gain such a foothold in Africa by providing integrated packages of aid that lead to business opportunities and market share for Chinese companies.

China as a 'full on supplier' for Africa

China markets itself well as a 'full-on supplier' that will come in and provide everything that surrounds the development of the country. In Angola, Beijing has secured a major stake in future oil production with a US\$2 billion package of loans and aid that includes funds for Chinese companies to build railways, schools, roads, hospitals, bridges, and offices; lay a fibre-optic network, and also train Angolan telecommunications workers. China's offer of multibillion-dollar credit facilities to Angola was also pivotal for the African nation to negotiate incentives and approval from the International Monetary Fund and the World Bank that it met "serious reform and certain conditions". This could not have occurred without considerable financial assistance and political support from Beijing. In this way China is following a very traditional path

established by Europe, Japan, and the US, in that it is offering less economically developed countries comprehensive and, some might argue, exploitative trade deals combined with aid.

This strategy has served Beijing's political and economic interests as well. China has used infrastructure development through loans and investment in a bid to demonstrate its willingness to contribute to the well-being of its African partners, rather than simply take their resources, a significant point for a country that considers itself the leader of the developing world, not to mention the fact that it also serves as a diplomatic tool. In 2009, the China Development Bank loaned more than US\$420 million to Zambia for Chinese companies to build a power plant and US\$850 million to Nigeria for the construction of a railroad. In return, China also gets political support in international forums like the United Nations from recipient countries. This approach also takes into account Chinese domestic considerations. Chinese companies have invested in telecommunications and other industries in Africa as part of an effort to open up more markets for their export-based economy. Chinese-funded and operated projects also often bring in Chinese workers, providing employment during an economic slowdown. Chinese leaders have visited Tanzania more frequently than other countries in the region, as China sells Tanzania arms and has invested in building up its seaports. Tanzania is an East African power, and maintaining relations there offers China influence throughout the region. China is also heavily invested in the mining industry which lies along Tanzania's western border, and has financed a now ill-kempt railroad connecting the Tanzanian port of Dar es Salaam to Kapiri Mposhi in Zambia, which borders Zambia's copper belt.

China has not confined itself to sub-Saharan Africa in its search for resources, a point which was confirmed in October 2009, via a leaked letter from the office of Nigerian President Yar'Adua which revealed a US\$50 billion move by the Chinese state-controlled

oil giant CNOOC to acquire concessions in twenty-three prime blocks in the country. Should all CNOOC's bids be accepted, they would double China's oil reserves in Africa and spur conflict with western oil groups such as Shell, Chevron, ExxonMobil and Total, who already possess stakes in the blocks. Beijing was also busy in October 2009, elsewhere in Africa when the military rulers of Guinea announced the creation of a huge mining and oil "strategic partnership" with China after Beijing announced it would invest more than US\$7 billion in infrastructure in the country, including the construction of ports, railway lines, power plants, low-cost housing and a new administrative centre in the capital, Conakry. Guinea has significant deposits of uranium, iron ore, diamonds and many others minerals, and the country is the world's largest exporter of bauxite, making it a prime target for Beijing's strategy of dominating the international raw-mineral supply.

Also in West Africa, Mali signed an economic cooperation agreement with China in 2006, under which Beijing has undertaken development projects in Mali in exchange for opening trade channels. China also re-established ties in 2005 with Senegal, following a rift caused by disagreements over Taiwan's status, which effectively opened the way for a flood of Chinese imports into the country.

Senegal and Mali lie between the western coast of Africa and landlocked Niger, where China is also investing US\$5 billion over the next three years to develop oil reserves. Better ties with each country around Niger would not hamper China's ability to secure that deal and will perhaps more importantly create a 'corridor of influence' in West Africa which is being viewed with envy in the West.

Lack of human rights concerns? – Don't mix business with politics

Beijing's actions must be seen in accordance with China's policy towards the issue of human rights. Beijing officially terms them as "non-interference in domestic affairs" and

Chinese leaders say human rights are relative and that each country should be allowed their own definition of them and timetable for reaching them. They keep the view that they do not wish to mix business with politics. In fact, China has argued that attempts by foreign nations to discuss democracy and human rights violate the rights of a sovereign country. Some experts say China's approach is not significantly different from how any other country pursues its interests. The US is highly selective about its morals, it supports Pakistan, Egypt, Saudi Arabia because it has other strategic interests – notably oil, the war on terror and stability in the Middle East with Muslim nations. In this sense then it could be argued that China is not offering a unique role in cutting deals with questionable governments but is merely acting to achieve their strategic interest: access to natural resources to aid economic growth.

Another way to gain leverage is through the sale of arms. Beijing sees Africa as a growth market for its military hardware and will seek to do business with almost any state as a result if it furthers its own national interest. China's active exploration of oil sources in Africa also leads to a need to ensure security around them. This has led Beijing to send Chinese military trainers to help their African counterparts. In return, China gains important African allies in the UN, including Sudan, Zimbabwe, and Nigeria, for its political goals, including preventing Taiwanese independence and diverting attention from its own human rights record. China has been a significant supplier of jet fighters, military vehicles and guns to Zimbabwe, Sudan and other repressive governments. It is almost a policy of “see no evil, hear no evil” where the thirst for natural resources is concerned. In the case of Zimbabwe, China sold twelve FC-1 fighter jets and one-hundred military vehicles to Harare in late 2004 in a deal worth US\$200 million. Moreover countries that sign deals with Chinese companies also win diplomatic protection. China, as a permanent member of the UN Security Council, has threatened to use its veto power to block sanctions against Sudan, which US officials and others accuse of

committing genocide in its Darfur region. China also resisted efforts by the UN to investigate and punish Zimbabwe for continued human rights violations and reported atrocities. Beijing has also helped the Khartoum Government to evade UN sanctions by assisting in the building of at least three weapons factories in Sudan.

Latin America resource relations

Naturally, the renewal of China's interest in Africa is not taking place in isolation from the country's engagements elsewhere. China has pursued closer relations with Latin America for the past decade as well. In November 2008, Beijing published a policy paper on the region, and President Hu made official visits to Cuba, Costa Rica and Peru, and further state visits featuring business leaders and politicians have continued throughout 2009 across the region including visits to Argentina, Ecuador, Bolivia and Venezuela.

As can be seen by the example of Venezuela below, China has become a major investor in its energy sector and is also investing in the country's transportation infrastructure, including railroads, ports and crude oil tankers. Beijing and Caracas have also recently signed agreements paving the way for Chinese investment in Venezuela's telecom, mining and agricultural sectors. In return for this investment, Venezuela is directing more and more of its oil exports to China. In 2004, Venezuela exported just 12,000 barrels of oil per day to China. At the end of 2009, these exports amounted to approximately 500,000 barrels of oil per day being shipped to China. Moreover, Caracas and Beijing are planning on building a joint refinery in China to process Venezuelan heavy crude oil. China is also investing in Orinoco belt exploration and development through the China National Petroleum Company. In the Venezuelan overall strategy it is essential to sell more oil to China so as to lower its heavy dependence on the US market. According to the existing terms of the China-Venezuela partnership, four tankers and at least two refineries will be built - one in the

immensely oil-rich Orinoco Belt in Venezuela and the other in Guangdong. State-owned Petroleos de Venezuela (PDVSA) will be responsible for shipping the oil to China. The Venezuelan target is to export 1 million barrels per day (bpd) by 2012 and President Hugo Chavez, who in typical colourful manner described himself as a "Maoist" during his last visit to China, wants Venezuela to be no less than China's top oil supplier. China's energy analysts take this partnership extremely seriously and political ties are expected to be strengthened as a result.

Despite the substantive efforts to cosy up to Caracas throughout 2009, Brazil remains the largest trading partner in the region for China, due to its iron ore supply which contributes massively to a trade figure of about US\$29.7 billion. Also because it is one of the world's top developing countries Beijing sees the relationship with Brazil as one which it is keen to strengthen. Mexico and China have linkages involving trade, manufacturing and energy to the tune of US\$14.9 billion, while Chinese interest in Colombia (US\$3.4 billion) and Ecuador (US\$1 billion) is mostly about access to oil supplies. Beijing hopes that by increasing trade with Latin America, it can take a bite out of US trade with the region, gaining new destinations for its exports.

Pipeline politics and the militant threat in Central Asia

In Central Asia, resource interests are paralleled by strategic and political interests of a different kind. The concern over the management of the potential for unrest in the Muslim Uighur population in China's north-western province of Xinjiang, which borders to its west Kazakhstan, Kyrgyzstan, Tajikistan, Afghanistan and Pakistan-administered Kashmir, is paramount to energy security for Beijing.

The global imperative to assuage the hunger for natural resources has propelled Central Asia into the international spotlight in recent months, and several concurrent shifts in what previously were disparate vectors of

international policy resulted in a situation where influence in the region is strategically imperative not only for the neighbouring countries, but also the US. China's sway over the Central Asian energy infrastructure became most evident after the creation of the Shanghai Cooperation Organisation provided it with a regular forum for exploring and deepening contacts and cooperation with the Central Asian states. In recent years, China has spent over US\$50 billion on establishing alternative ways to transport energy resources out of the Central Asian states.

The China-Central Asia pipeline

An oil pipeline from eastern Kazakhstan into western China, which bypassed Russia and was completed on 14 December 2009, tightens the Asian giant's grip on energy resources needed to fuel a burgeoning economy. The China-Central Asia natural gas pipeline is 1,833 kilometres in length and is estimated to be able to transport forty billion cubic meters of natural gas to China yearly up to 2040. Aside from the increasing economic ties exemplified by the grand opening of the pipeline, China seems keen to intensify its already substantial charm offensive on the Central Asian states. In particular, Chinese President Hu appears to be singling out Kazakhstan as a potential privileged partner for cooperation, and purposefully highlighted prominent fields the two nations should pursue together. These include enhancing political mutual trust and deepening cooperation in the security sector, as well as expanding financial and cultural cooperation. The two sides also agreed to speed up the implementation of a US\$10 billion loan agreement from China to Kazakhstan. Such a project could also tap sources of natural gas in Turkmenistan, illustrating the overlapping energy interests at play in Central Asia. The pipeline is the first major export corridor for natural gas out of the region that does not pass through Russia and the Chinese success is all the more notable, given that Europe and the US have been jousting with Russia for years to break its natural gas pipeline monopoly. It seems that China succeeded

where the West failed because it did not blend energy ventures with support for democratic change in the region, or demands for access to the military bases the allies need to help fight the war in Afghanistan.

The pipeline was the final piece of Beijing's jigsaw puzzle for Central Asia, as it had been methodically collecting other strategically important energy assets since CNPC International paid almost US\$4 billion for a 33% stake in PetroKazakhstan in 2005. The following year China bought up Kazakh oil assets worth nearly US\$2 billion in the Karazhanba oil and gas fields (which has proven reserves of more than 340 million barrels), agreed to purchase 30 bcm gas from Turkmenistan (later increasing this to 40 bcm), and committed US\$210 million to look for oil and gas in Uzbekistan over the next five years. In April 2009, China also agreed to issue a US\$3 billion loan to Kazakhstan to developing the Central Asian state's largest gas field, South Iolotan, which is estimated to contain anywhere between 4 trillion and 14 trillion cubic meters of gas, making it one of the world's five largest gas deposits. China's relations with Uzbekistan have also been noticeably deepening and pro-Chinese lobbies are increasingly active in the parliaments of Tajikistan, Kyrgyzstan and Turkmenistan.

Xinjiang worries and resource security

Despite this historic achievement for Beijing, widespread scepticism exists among observers as to whether the fallout from the July 2009 ethnic violence between Uighurs, Han Chinese and security forces in Urumqi, in north-western Xinjiang region which killed 156 people in the bloodiest protests in China for twenty-years, would put the project at risk. China is putting a lot of its energy security in one project as large quantities of oil and gas will now come through a small region. China's Central Asian pipeline could potentially become a sitting duck for terrorists as has been seen in Nigeria and Iraq. Security could be impossible if the pipelines become targets as they pass through vast stretches of sparsely populated areas in Central Asia and

Xinjiang as there is no way the pipeline can be protected along its entire length. To address this fear, the Xinjiang Uygur autonomous region government issued plans on 13 January 2010 to increase its spending on public security by almost 90% to 2.89 billion Yuan (US\$423 million) to further maintain social stability and combat terrorism, separatism and extremism.

Western experts often speak in a dismissive tone that the Central Asians prefer the Chinese because they never raise difficult issues such as democracy and human rights. But this is far too simplistic a reading. Central Asian countries see Western discourse on democracy and human rights as doublespeak from countries that pander to authoritarian regimes without scruples when it suits their business interests. China's track record in Turkmenistan displays its new standards. China-Turkmenistan trade has jumped forty times since 2000; thirty-five enterprises are working in Turkmenistan today with Chinese capital. Chinese companies are active in sectors of the Turkmen economy as diverse as oil and gas, telecommunications, transport, agriculture, textile, chemical and food industries, healthcare and construction. China is pursuing diversification of energy imports, while the Central Asian countries are pursuing diversification of exports. A trend which is expected to develop and flourish in the future. In other words, China's cooperation with Central Asia rests on a convergence of mutual interests. Chinese commentaries have stressed that "export diversification" as a strategic option has become necessary for Central Asian countries especially after the financial crisis and as European countries' demand for the region's natural gas has decreased.

Conclusion

The motivation for China's engagements in less economically developed arenas globally is not unreasonable, and these engagements should come as no surprise to observers of these dynamics. Where China's leaders had previously judged that the country's

development was best served by focusing inwards and keeping foreign engagements to a minimum, a new reality is emerging to which both China's leaders and the international community are having to adjust: China's need for foreign resources and markets to protect the country's impressive - and politically indispensable - rates of growth is unquestionable.

Chinese diplomacy has clearly moved onto a more active footing in the pursuit of a clearer set of interests that lie beyond China's borders. This is expected to continue throughout 2010 and beyond even bucking the trend of other states experiencing the same global recession.

China continues to fulfil its necessity to 'lock in' supplies from relatively low-cost sources like Africa, as Beijing actively seeks to diversify its supply lines away from Middle Eastern crude. China has achieved this through adopting an 'aid-for-resource' strategy that has resulted in increasing supplies from developing countries globally. China's need to find resources can now be referred to as a driving component in Chinese foreign policy. China's manufacturing sector has created enormous demand for aluminium, copper, nickel, iron ore, and oil. China has been able to adapt its foreign policy to its domestic development strategy by encouraging state-controlled companies to seek out exploration and supply contracts with countries that produce oil, gas, and other resources. At the same time, Beijing aggressively courts governments through diplomacy, trade deals, debt forgiveness, and aid packages. Chinese companies have developed a reputation for going where others will not, without political, environmental or ethical concerns, or because profit margins are too slim. State-owned companies in China have the ability to forgo short-term profits in pursuit of the Government's long-term strategic interests and often trade infrastructure improvements explicitly for raw material contracts.

This monitor has argued that while China's trade with Africa, Latin America and Central

Asia is undergoing huge investment and dramatic development, the political framework within which this trade has taken place is still being fashioned. There does not have to be an inherent conflict between China's interests in Africa and development, good governance and democracy on the continent. Indeed stronger partners from Africa, Latin America and Central Asia would offer more stable environment for Chinese investments as well as further the economies of those states it partners with. Moreover, emerging Chinese relationships with states and international responses to tactics used will offer an opportunity to encourage Beijing's development as a player within the global order, rather than an aloof and restless power that has any plans to pursue its own arrangements to the detriment of others. The prospect of a relative eastward shift of the balance of power, following Asia's economic rise, is often viewed as a potential impediment to the development of western exploration firms and the flourishing of democracy to the states in question, but it must also be viewed in the sense of China playing an important role of progressing the development of these states under terms not experienced before.

**PREVIEW OF INKERMEN MONITOR
MARCH 2010**

With fossil fuel supplies dwindling, and clean energy alternatives gaining increased prominence, February 2010's monitor will examine the future of global energy provision – the possibilities of which have the potential to redraw the geopolitical map.

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