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China, Oil, and Latin America: MYTH VS. REALITY

BY PATRICIA I. VASQUEZ





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FOREWORD

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China's hunger for energy—and oil and gas specifically—will only continue to ramp up in the years to come. The implications are being felt across the globe, including in Latin America, generating new expectations of investment but fear of the potential short and long-term negative implications. And with the Chinese Communist Party's February 2018 announcement of an end to presidential term limits, we should expect not only policy continuity but perhaps a doubling down on the Asian giant's current global strategy.

With China's quest for oil and gas as a major factor driving its worldwide ambitions, the question must be asked: How can Latin American countries with extensive Chinese energy links best position themselves to maximize the upsides—and minimize the downsides—of such Chinese investment?

What is certain is that China's economic and commercial ties with Latin America continue to deepen. Brazil, Chile, and Peru count China as their largest trading partner. A June 2017 Adrienne Arsht Latin America Center report highlights that Chinese foreign direct investment to Latin America has increased by \$70 billion since 2012. Despite growing diversification, oil and mining remain the largest industries for investment.

The economic relationship between China and Latin America, however, has been unbalanced. Capital flows have moved mainly in one direction, with Chinese investment in the region surpassing \$110 billion and lending exceeding \$140 billion through 2017. More than 10 percent of Latin America's exports head to China. The vast majority of regional exports are commodities or natural resource-based manufactured goods, with most countries thereby running a trade deficit with China.

In the eyes of the Trump Administration, China's increasing prominence in Latin America—including of course its energy ambitions—is an issue of concern.

Before his five-country trip to Latin America in February 2018, Secretary of State Rex Tillerson warned of the dangers of China's policy of economic development in the region—a comment that prompted a swift rebuke by Beijing and many in the region itself.

This paints a complex picture of a region in the middle of a global competition between two world powers, but also a diverse region trying to find a sustainable path to prosperity. Certainly, opportunities for complementarity between China and Latin America exist, and cooperation in the energy space can be one of them. China's need for oil and gas to fuel its quickly growing economy provides Latin America producers with a crucial export market. The United States was historically a reliable importer of Latin American energy, but with the US shale oil revolution, this is quickly changing.

On balance, the future is one of greater Chinese energy interests and ambitions in the region. Still, many unanswered questions remain. That is why this publication is so critical. It provides new analysis around China's intentions in the energy space: what is reality and what are myths. The author, Patricia Vasquez, uncovers the facts of Chinese investment and lending deals in the Latin American energy sector, and provides pointed recommendations on how all parties can help shape a better energy cooperation.

This report is part of the Adrienne Arsht Latin America Center's China - Latin America Initiative, which seeks to uncover the geopolitical implications of China's growing influence in Latin America, and inform policymakers and the public of the short and long-term ramifications for Latin America, China, the United States, and the world. At this period of global transition, we believe that greater clarity and nuanced understanding of China's role in the Americas is of critical importance. We thank HSBC for their support of this effort.

Executive Summary

Over the past ten years, Chinese companies and government lenders have quietly but steadily made dozens of investments and loans worth hundreds of billions of US dollars in Latin America's oil and gas industry. In the early 2000s, Chinese leaders, fearing the growth of their economy could be slowed by expensive energy resources, directed their officials to begin securing access to large and diverse oil and gas resources. China's leaders also made attempts to increase domestic energy production, but oil production stagnated, even falling in recent years. Meanwhile, breakneck economic growth has led to skyrocketing oil demand, increasing the pressure on China's oil imports. One result: Chinese investors scouring the globe for worthy investments, with a focus on Latin America—a region that can lay claim to a dramatic rise of proven oil reserves.

In 2013, China became the world's largest net importer of oil. Latin America, like China, has seen oil production stagnate over the past decade. However, proven reserves have gone from 110 billion barrels in 2006 to 320 billion in 2016 as a result of Venezuela making its reserves official. Further, the United States, long a reliable importer of Latin American oil, has begun to reduce imports from the region. This has led to an explosive growth in Chinese-Latin American cooperation on energy.

Latin America now represents more than 13 percent of China's oil imports, up from 2 percent in 2005—the year China began providing Latin American countries with more capital to exploit oil reserves. This capital has come in the form of foreign direct investment (FDI) and government loans, mainly from China's policy banks: the China Development Bank and China's Export-Import Bank. From 2004 to 2016, Chinese companies invested over \$25 billion in oil and gas projects in the region; and from 2007 to 2016, China's policy banks loaned nearly \$140 billion to Latin American governments and state-owned enterprises (SOEs).

The enormous amounts of capital flowing from China, coupled with the opacity of many of the deals associated with Chinese energy investment and lending, have spurred numerous myths that are difficult to distinguish from the truth. For example, one myth portrays these capital flows as China's "secret diplomatic strategy" to gaining increasing control over Latin America's oil and gas industry. But a close look at the data demonstrates that Chinese SOEs and policy banks are driven more

by commercial interests than by central government directives.

Some myths, however, are grounded in reality, like the general mistrust of Chinese operations, an outcome of the secrecy surrounding oil and gas deals. For example, a \$10 billion loan from the China Development Bank to Petrobras in 2009 was negotiated behind closed doors and signed by then-Brazilian President Luiz Inácio Lula da Silva during a visit to China. Similarly, in 2010, Petrobras granted two blocks from the Pará-Maranhão Basin to Sinopec without conducting any public bidding beforehand, causing widespread criticism.

The rise of these myths, whether or not they are based in reality, tends to underscore a critical point in China's dive into the Latin American energy sector: few mechanisms exist to hold Chinese lending and investments accountable and to make them more transparent. To address these concerns, this report puts forward the following recommendations:

- The governments of China and oil-producing Latin American countries should create a multilateral working group to set mutually agreed rules for cooperation in oil and gas.
- At the early stages of an oil or gas project, all stakeholders should adopt mechanisms for permanent and sustained dialogue with the investing institution.
- Development institutions should work with regional governments to design guidelines for Chinese policy banks' engagement with Latin America.
- Latin American governments should promote transparency and accountability for oil and gas operations in their territories with rigid implementation.

There have been widespread benefits from Chinese investment and lending in Latin America's energy sector; however, there have also been mishaps and missed opportunities. This report argues that the responsibility for ensuring efficient, environmentally and socially responsible implementation of deals should fall mainly on Latin American oil-producing nations but also on China.

Introduction

China's seemingly insatiable appetite for energy is reshaping the balance of political and economic power in Latin America as it transforms the global energy landscape. Chinese investments and lending in energy extraction and infrastructure, amounting to over \$125 billion since 2000, have already upended long-standing energy partnerships in the hemisphere. With China's overall demand for oil and gas expected to more than double by 2035, the region's lack of sufficient capital to develop its vast and largely untapped energy resources makes it a continued magnet for excess Chinese capital—promising even more shifts in Latin America's energy map.

At the same time, China's rising energy profile in the region, coupled with the air of mystery that sometimes surrounds its activities, has fueled

concerns in Washington and in capitals across Latin America. For example, Venezuela's growing reliance on Chinese energy investment to buttress its dire economic and political situation has contributed to fears that China is exploiting governance weaknesses to bypass environmental and social standards and prop up a corrupt regime. The increase in exports to China from major producers such as Brazil and Colombia has also generated concern about a lack of transparency in the energy contracts negotiated between Chinese state-owned firms and banks, and Latin American firms and governments. But how many of these concerns are well-founded? Separating myth from reality is crucial to understanding the current dynamics of the Latin America-China energy relationship, and what it may mean for the future.



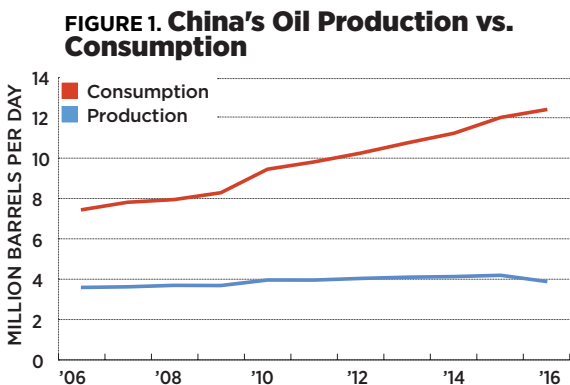
An oil and gas field in Xinjiang, western China. While China's oil consumption surged over the past few decades, its domestic production has plateaued forcing the country to import increasing amounts of oil to satisfy its energy needs.

China's Changing Energy Security Needs

In the early 2000s, China launched its “Going Out” policy, promoting overseas investment by Chinese companies, especially state-owned companies (SOEs). The policy, partly motivated by China’s realization that its increasing energy demand could become a major economic liability, triggered a major effort to significantly increase access to natural resources outside China, and led to major oil- and gas-related deals in Latin American countries like Venezuela, Brazil, and Ecuador.

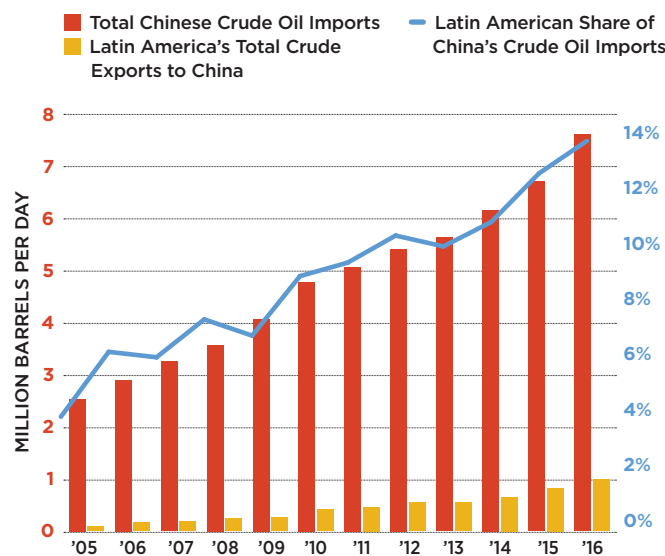
As China’s economy has grown, its demand for commodities has skyrocketed, fueling a quadruple increase in per-capita energy usage since 1980.¹ In 2008, China overtook the United States as the world’s largest consumer of energy, and from 2005 to 2015, it accounted for around 50 percent of global growth in oil consumption.² Nevertheless, although China’s oil consumption has surged, its oil production has plateaued [see figure 1].

Already the world’s largest importer of oil, China is likely to see the gap between oil consumption and production continue to widen. The proportion of domestic oil requirements that China will need to import, compared with its total oil consumption, is estimated to grow from 61 percent in 2015 to 79 percent in 2035.³ The Energy Information Administration’s *International Energy Outlook* expects China’s oil imports to reach more than 10 million barrels per day by 2035, from 7.6 million in 2016 [see figure 2]. Still, at current rates of growth,



Source: BP, BP Statistical Review of World Energy, June 2017.

FIGURE 2. China's Oil—Total Imports and Share from Latin America



Source: “Trade Map,” International Trade Centre, trademap.org.

Note: Calculated assuming a conversion factor of 7.3 barrels per metric ton

that 10 million may be a conservative figure. A normal-sized supertanker holds around two million barrels of oil, so in 2035 China will need the equivalent of five supertankers arriving at its shores per day, or over 1,800 per year. China has made marginal efforts to diversify from oil and other fossil fuels, but these fuels will remain a prominent part of its growth plans.

China’s largest source of oil currently is the Middle East, with Saudi Arabia the largest supplier. But in recent years, China has diversified the sources of its oil imports. Russia accounted for nearly 13 percent in 2016, up from 4 percent in 2006.⁴ And lately, Latin America has become an increasingly crucial player in China’s energy mix, rising above 13 percent of total oil imports, with Venezuela accounting for roughly 40 percent of the region’s supply.

A New Oil and Gas Map

A confluence of changing geopolitical and economic scenarios contributed to the rapid strengthening in the Sino-Latin American oil and gas relationship in recent decades. Throughout the 1990s and into the 2000s, China transitioned from a rural economy that consumed less energy than it produced to an economic giant that needs increasing supplies of oil and gas to keep growing. By 2035, China's demand for oil and natural gas is expected to expand by 61 percent and 185 percent, respectively, from 2015 levels.⁵

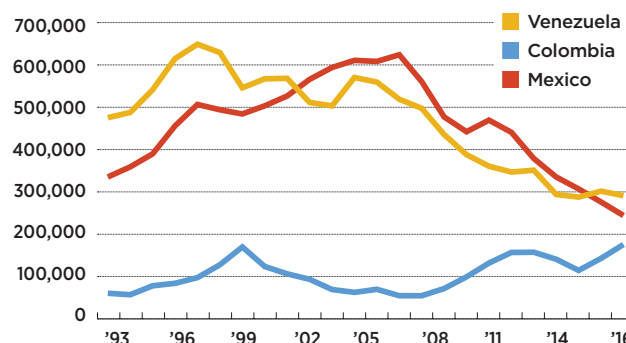
In Latin America, oil and gas output barely grew from 2003 to 2016, inching up from 6.7 million barrels per day to 7.5 million.^{6,7} In Venezuela and Argentina, oil production actually fell during that time. However, proven oil reserves in the region saw a three-fold leap—from 110 billion barrels in 2006 to over 320 billion barrels in 2016.⁸ More than 90 percent of Latin America's proven oil reserves are in Venezuela, which has the largest heavy crude reserves in the world.⁹ By 2016, Latin America's proven oil reserves represented 19 percent of the world total, up from 8 percent in 2006.¹⁰

At the same time, the United States' shale revolution reduced its reliance on imported oil and brought it closer to self-sufficiency, as new discoveries gradually came to market. The United States could even become a net energy exporter by 2026,¹¹ potentially disrupting the global oil market. Venezuela, Mexico, and Colombia continue to be among the top-five petroleum suppliers to the United States—after Canada and Saudi Arabia. But from 1995 to 2015, US-bound export volumes from Venezuela and Mexico fell, and Colombia's remained stagnant and small [see figure 3].

The trend toward US energy self-sufficiency and the simultaneous growth in China's energy needs have changed Latin America's energy outlook. Three factors have led to the region accounting for 13 percent of China's oil imports as of 2016 (from 2 percent in 2005): a decline in sales by producers like Mexico and Venezuela to the US market; major Chinese efforts to grow and diversify its energy imports; and a hunger for

Latin America has become an increasingly crucial player in China's energy mix, rising above 13 percent of total oil imports, with Venezuela accounting for roughly 40 percent of the region's supply.

FIGURE 3. Top US Oil Imports from Latin America (barrels of oil per day)



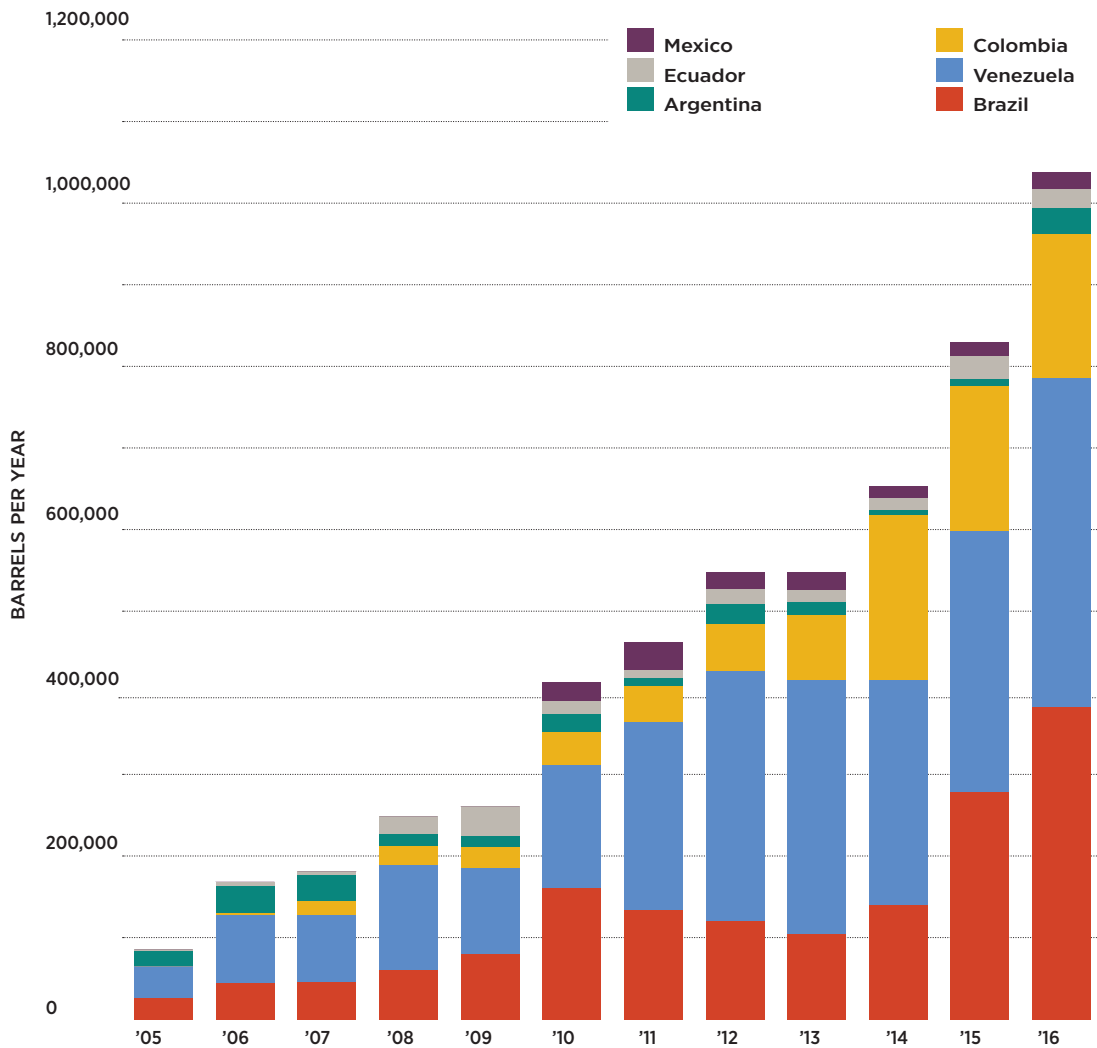
Source: US Energy Information Administration

capital in countries like Venezuela.

The bulk of the increase in Chinese-bound oil exports has come from Venezuela, Brazil, and Colombia. In 2013, for the first time, Venezuela exported more oil to China and India combined than to the United States.¹² Since 2015, China has been the top destination for Latin American crude oil, surpassing the United States. And in 2016, Latin America exported more than one million barrels of oil per day to China, a major milestone [see figure 4]. Importantly, Brazil has caught up to Venezuela in crude oil exports to China.

In exchange for money, China obtains political and strategic relationships that can aid its goal of developing a diverse supply of energy sources.

FIGURE 4. Chinese Crude Oil Imports from Latin America, by Country



Source: "Trade Map," International Trade Centre, trademap.org.
 Note: Calculated assuming a conversion factor of 7.3 barrels per metric ton

What Is in It for Latin America?

Latin America is sitting on vast reserves of oil. But state-owned oil firms like *Petróleos de Venezuela, SA (PDVSA)* have been ineffective at maximizing the potential. Effective use of these resources could place Latin America in a geopolitically advantageous position, but these countries cannot do it alone.

This is where China comes in. In exchange for money, China obtains political and strategic relationships that can aid its goal of developing a diverse supply of energy sources. Chinese energy firms especially, with large amounts of capital coupled with a lack of energy reserves at home, are eager to partner with private and state-owned energy firms in Latin America.

Chinese presence is not new in Latin America's hydrocarbons sector. It goes back to the 1990s, when the state-controlled *China National Petroleum Corporation (CNPC)* started drilling in Peru in 1994 and in Venezuela in 1998. But it was not until the mid-2000s, as part of its *Going Out* strategy, that China began to significantly invest in oil and gas projects in the region.

China's more recent push into Latin America's oil and gas sector has materialized in two ways, each explained in greater detail below:

■ **Foreign direct investments (FDI)**—mainly mergers and acquisitions (M&A), joint ventures, and a handful of greenfield projects. China invested over \$25 billion in oil and gas FDI in Latin America from 2004 to 2016.¹³

■ **Massive government loans**—China's policy banks, like the *China Development Bank (CDB)* and the *Export-Import Bank of China (Ex-Im Bank)*, loaned about \$100 billion — 70 percent of total lending — to the oil and gas industry in Latin America from 2007 to 2016.¹⁴

FOREIGN DIRECT INVESTMENT

Foreign direct investment in the hydrocarbons sector is dominated by China's three state-owned oil companies—*CNPC*, *Sinopec*, and *China National Offshore Oil Corporation (CNOOC)*—and, to a lesser extent, petrochemical company *Sinochem*. These companies are frequently supported by several Chinese oil service and engineering businesses.¹⁵ Chinese FDI in oil and gas in Latin America saw a remarkable increase after the 2007-08 global financial crisis, when oil prices dropped. As economically strained Western companies sold their assets to cut down costs, Chinese companies jumped in to buy assets in key oil and gas-producing regions at competitive prices.

Chinese FDI in hydrocarbons is concentrated—by order of magnitude—in three countries: Brazil, Argentina, and Venezuela. Colombia, Ecuador, Peru, and Bolivia have also benefited from Chinese FDI,



Then-President Lula speaks at a ceremony inaugurating a new offshore platform for Petrobras. The *China Development Bank* has loaned billions to Petrobras in funding agreements related to oil and gas development.

FIGURE 5. CHINESE COMPANIES' MAIN INVESTMENTS IN LATIN AMERICA'S OIL AND GAS SECTOR(2010-16)

Year	Country	Amount	Transaction
2010	Brazil	\$7.1 billion	Sinopec acquires 40 percent of Repsol-YPF and becomes one of the largest energy companies in Latin America. Enters pre-salt. Estimated recoverable reserves: 1.2 billion barrels of oil equivalent.
	Brazil	Unkown	Sinopec buys 20 percent stake in two blocks from Petrobras: BM-PAMA-3/ BM-PAMA-8, located in Pará-Maranhão Basin.
	Brazil	\$3 billion	Sinochem acquires 40 percent of Peregrino block from Statoil, located in Campos Basin. Production capacity 100,000 barrels per day. Statoil's biggest operated field outside Norway. Estimated recoverable reserves: 300-600 million barrels of heavy crude.
	Argentina	\$2.5 billion	Sinopec buys Occidental Petroleum.
	Argentina	\$3.1 billion	CNOOC acquires 50 percent of Bidas, which owns 40 percent of Pan American Energy (PAE) with BP (60 percent). Largest private producer in Argentina.
	Colombia	\$280 million	Sinopec buys Huepecol and created a new company: New Granada Energy.
	Venezuela	\$900 million	Joint venture between CNPC (40 percent) & PDVSA (60 percent). CNPC buys 40 percent rights to Orinoco block Junin-4. Estimated projected output: 400,000 barrels per day.
2011	Brazil	\$5.2 billion	Sinopec buys 30 percent of Galp Energia. Owns stakes in 26 areas, including the pre-salt largest block, Lula, (estimated reserves: 8.3 billion barrels of oil equivalent). ¹⁶
	Argentina	\$800 million (est.)	CNOOC-Bidas acquires the Campana refinery and retail from ExxonMobil.
2013	Peru	\$2.6 billion	CNPC purchased Petrobras Energía Perú. Assets in Block 58: estimated reserves 3.6 trillion cubic feet of natural gas.
	Brazil	\$1.4 billion	CNPC/CNOOC bids and obtains (10 percent each) stakes in Libra field. Expected to invest \$20 billion in 35 years. Libra: one of world's largest recent oil discoveries. Estimated recoverable reserves: 8-12 billion barrels.
	Argentina	\$120 million	Joint venture: Total (37.5 percent) -Wintershal-(37.5 percent)-PAE (25 percent). Government awards licenses to explore for natural gas in offshore Cuenca Marina Austral. Production started in 2016. Estimated production capacity: 70,000 barrels per day.
	Venezuela	\$1.4 billion	Sinopec-PDVSA. Obtains Junin-1 block in Orinoco. Estimated output 200,000 barrels per day.
2016	Venezuela	\$550 million	Created Petrolera Sinovensa, a private subsidiary of CNPC. To expand Sinovensa plant to boost output: from 170,000 barrels per day to 275,000 barrels per day.

Source: Compiled by the author with data from Gallagher and Myers 2016; AEI and The Heritage Foundation;¹⁷ Alves 2013; de Almeida and Consoli 2014;¹⁸ Chen and Ludueña 2013;¹⁹ China National Petroleum Corporation;²⁰ Hook 2011;²¹ Repsol;⁶ Koch-Weser 2015;²³ CNOOC;²⁴ and Sinochem.^{25,26,27}

although at a smaller level. Brazil received \$17 billion in FDI from 2004 to 2016 while Argentina received \$7 billion and Venezuela an estimated \$3 billion. From 2010 to 2016, Chinese oil companies finalized approximately fourteen M&A deals and entered into some of Latin America's most valuable oil and gas areas [see figure 5].

Chinese oil and gas investments in Latin America

reached a record high of \$17 billion in 2010 [see figure 6, page 9]. That year, as oil prices recovered from their pre-global financial crisis levels, Sinopec, CNOOC, and Sinochem made their first large investments in Latin America's oil and gas sector, in Brazil and Argentina. CNPC, in 2010, acquired assets in Venezuela's oil-rich Orinoco belt for the first time.

Through large asset acquisitions in recent years,

Chinese oil companies have become important players in some of the most promising oil and gas areas in Latin America. In Brazil, Sinopec's 2010 purchase of a stake in the Brazilian subsidiary Repsol-YPF marked its entry into the promising giant ultra-deep pre-salt oil reserves, where total production jumped from just 41,000 barrels per day in 2010 to one million in 2016.³¹ In 2013, CNPC also entered Brazil's pre-salt operations with the purchase of a stake in one of the area's most prolific blocks, containing the Libra field.

In Argentina, CNOOC acquired 50 percent of the largest private producer in the country, Bidas, which holds promising shale reserves. In Peru, one of CNPC's most important investments in the region was its 2013 purchase of Petrobras Energía. The deal enabled CNPC to enter Peru's—and some of the region's—largest natural gas reserves, worth approximately \$5 billion at today's prices. These deals give China a stake in unexplored and potentially very

lucrative reserves, basically placing strategic bets on future oil extraction.

After 2010, Chinese oil and gas FDI in Latin America dropped considerably, most likely related to higher oil prices. The decrease in investment also coincided with President Xi Jinping assuming power in March 2013, his adoption of government spending austerity, and his relentless anticorruption campaign directly affecting the oil industry, particularly CNPC.³²

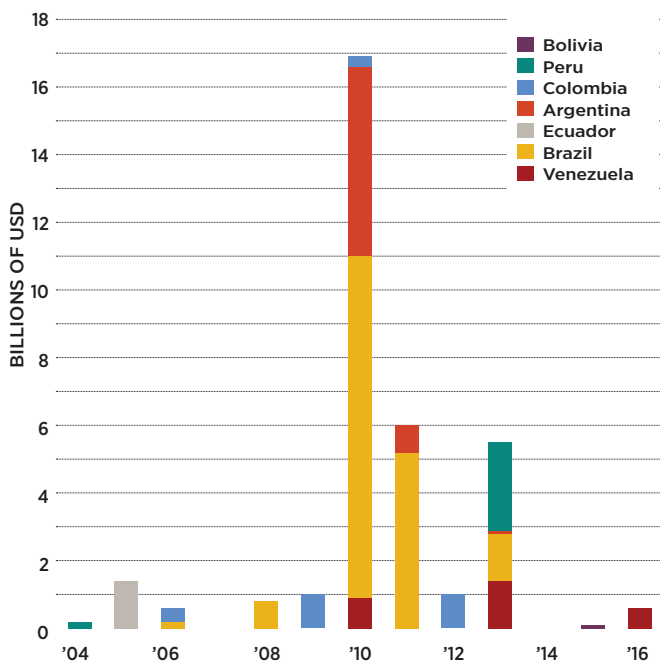
Nevertheless, 2011 and 2013 showed some important investments by Chinese oil companies. Most notable was Sinopec's expansion of its Brazilian ultra-deepwater acreage through the acquisition of a stake in one of Brazil's largest pre-salt blocks—containing the Lula field.

LOANS AND CREDIT LINES

China has begun to reshape the landscape of development finance by using some of its vast foreign exchange reserves as loans to sovereign nations. Many of these loans are tied to the infrastructure or energy sector, and are made in conjunction with Chinese companies. China's policy banks, including China Development Bank and the Export-Import Bank of China, have now lent around \$140 billion since 2007 in development finance, 70 percent of which went to the energy sector.³³

Most Chinese lending earmarked for the oil and gas sector from 2007 to 2016 went to three countries: \$55 billion to Venezuela, \$37 billion to Brazil, and \$5.5 billion to Ecuador.³⁴ These countries' relatively low market credit ratings reduced access to conventional international financing. In all three cases, China provided a financial lifesaver, as part of its strategy to strengthen commercial relationships

FIGURE 6. Chinese Oil and Gas FDI in Latin America by Country (2004-2016)



Source: Compiled by the author with data from Ray and Gallagher 2013;²⁸ Red ALC-China 2017;²⁹ AEI and The Heritage Foundation; Alves 2013; de Almeida and Consoli 2014; Gallagher and Myers 2016; Yacimientos Petroliferos de Bolivia.³⁰

*Includes mergers and acquisitions; joint ventures; greenfield projects.

[Oil and gas] deals give China a stake in unexplored and potentially very lucrative reserves, basically placing strategic bets on future oil extraction.

Future Chinese engagement may target more cutting-edge areas such as ultra-deep offshore drilling in Brazil and shale reserves in Argentina.

in Latin America and diversify energy sources.

By comparison, Chinese lending was much lower to other oil and gas-producing countries, namely Colombia and Peru, whose comparatively higher credit ratings enabled them to access alternative sources of international funding at competitive interest rates.³⁵ The hydrocarbons sector in Mexico and Brazil also received some Chinese lending but at a much lower scale.

In addition to direct loans, China established bilateral and regional development funds with Latin American and Caribbean countries amounting to some \$37 billion.^{36,37} In Venezuela, the China-Venezuela Joint Investment Fund aimed at financing infrastructure and social projects.

Chinese lending to Venezuela was particularly large [see figure 7]. From 2007 to 2016, Venezuela likely received \$60 billion in loans, including thirteen oil-related loans primarily from CDB. The largest Chinese loan in the region was for \$20 billion and it was granted by CDB to Venezuela in 2010. Other typical loans to Venezuela averaged \$5 billion.

Along with mismanagement of economic policy, low oil prices amplified Venezuela's need for heavy borrowing. The country depends on oil revenues for more than 90 percent of its export earnings, which explains in part why Chinese lending was especially strong when oil prices were low [see figure 8].

China's loans to Venezuela are guaranteed by obligating Caracas to allocate oil income to China until the estimated \$20 billion in outstanding loans are paid back, a practice known as loan-for-oil.^{44,45} Loans are paid back to Chinese oil companies by Venezuela's state-owned oil

FIGURE 7. ESTIMATED CHINESE HYDROCARBON LOANS PER COUNTRY (2007-16)³⁸

Year	Country	Amount	Awarded to/for	Lender
2007	Venezuela	\$4 Billion	Joint Fund Tranche A	CDB
2008	Brazil	\$750 Million	Petrobras. Gasene 2nd phase.	CDB
2009	Venezuela	\$4 Billion	Joint Fund Tranche B	CDB
	Venezuela	\$500 Million	Not specified	ExImBk
	Brazil	\$10 Billion	Petrobras. Loan in exchange for 10 years of oil supply.	CDB
	Bolivia	\$60 Million	Home gas network/ drilling rigs	Ex-Im Bank
	Peru	\$50 Million	Transport/ Infrastructure/ Environment/Energy	CDB
2010	Venezuela	\$20.3 Billion	Joint Fund Long-Term Facility	CDB
	Ecuador	\$1 Billion	80% discretionary/20% oil	CDB
2011	Venezuela	\$4 Billion	Joint Fund Tranche A renewal	CDB
	Venezuela	\$1.5 Billion	Abreu e Lima refinery*	CDB
2012	Venezuela	\$500 Million	Purchase of oil-related products	CDB
	Venezuela	\$5 Billion	Joint Fund Tranche B renewal	CDB
	Venezuela	\$500 Million	Purchase of oil-related products	CDB
	Ecuador	\$3 Billion	CNPC buys share of Refineria del Pacifico*	ICBC
2013	Venezuela	\$4 Billion	CNPC-PDVSA. Increase output at Sinovensa.	CDB
	Venezuela	\$5 Billion	Joint Fund Tranche C	CDB
	Mexico	\$1 Billion	Pemex. To buy offshore drilling equipment.	ExImBk
2015	Venezuela	\$5 Billion	Joint Fund Tranche B renewal.	CDB
	Brazil	\$5 Billion	Petrobras-CDB. Bilateral Coopereative Agreement	CDB
	Brazil	\$5 Billion	Petrobras	ICBC
2016	Venezuela	\$2.2 Billion	PDVSA. Oil sector development	CDB
	Brazil	\$10 Billion	Petrobras. Debt financing.	CDB
	Brazil	\$5 Billion	Petrobras. Debt financing.	CDB
	Brazil	\$1 Billion	Petrobras. Debt financing. Conditionality: Buy equipment/services from China.	Ex-Im Bank
	Ecuador	\$1.5 Billion	Discretionary Spending	ICBC

Source: Compiled by the author with data from Gallagher and Myers 2016, Yacimientos Petrolíferos Fiscales de Bolivia, Alves 2013, Chen and Ludueña 2013, de Almeida and Consoli 2014.

*Projects that never materialized (in red).

**ICBC stands for the Industrial and Commercial Bank of China.

company, PDVSA, on twenty- to thirty-year contractual agreements.⁴⁶ The loan-for-oil deals became a source of development funding for Venezuela, when other—more conventional—channels of financing became unavailable due to the country’s dire economic situation.

The granting of fewer loans to Venezuela after 2013 may suggest concern by the Chinese that Venezuela is becoming a riskier recipient of financing. Nonetheless, given that its lending is guaranteed by oil, China has an intrinsic interest in granting loans specifically assigned to boosting Venezuela’s oil production capacity—such as the 2013 loan to increase output at the CNPC-PDVSA Sinovensa joint venture, or the 2016 loan to PDVSA for developing the oil sector.

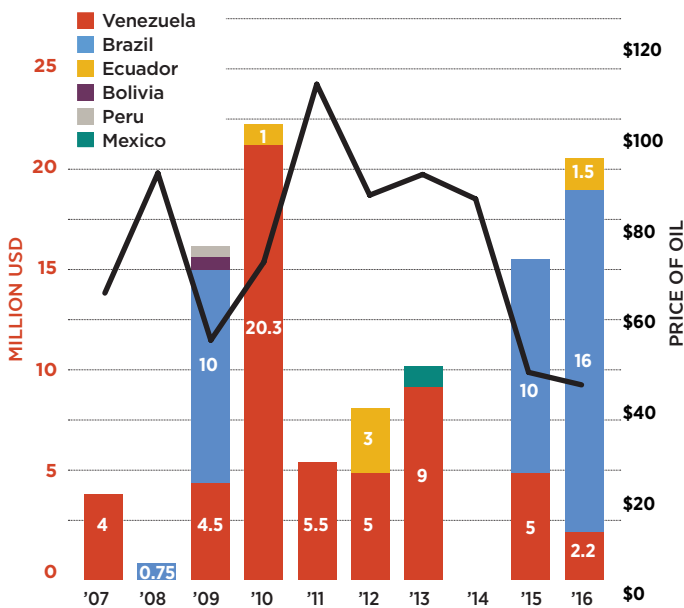
Brazil’s state-controlled oil company, Petrobras, was granted seven loans by Chinese banks from 2007 to 2016 under the loan-for-oil mechanism. Petrobras’s connection to a huge corruption scandal resulted in the company losing its investment grade rating while its shares plummeted. This significantly hindered its

ability to access international financing. Petrobras, with debts of \$24 billion and facing low oil prices, turned to China for financial help. Between 2009 and 2016, Petrobras borrowed close to \$40 billion from Chinese banks in exchange for oil shipments.^{47,48} One example is Petrobras borrowing \$10 billion from CDB in 2009, in exchange for committing to sell oil to Sinopec’s trading company, China International United Petroleum & Chemicals Co. (UNIPEC), for ten years.⁴⁹

Ecuador, too, engaged in borrowing from China’s policy banks, though to a smaller degree than Brazil and Venezuela. This lending was often discretionary, making it more difficult to track the specific purpose of the loans. During then-President Rafael Correa’s tenure, China was the main source of international financing, as other investors remained wary following the country’s 2008 default. Some of the loans from China were loan-for-oil deals, with the money going to infrastructure projects like a hydroelectric dam. Another \$3 billion deal in 2012 was for Ecuador’s Pacifico refinery, though the project never materialized. Notably, China’s loans had the unexpected effect of helping to lift Ecuador’s credit rating, in part as a result of the country’s ability to secure external funding from China.⁵⁰

Chinese activity in Latin America’s oil and gas industry is expected to continue to be strong in the near future. Some barriers stand in the way, like China’s lower long-term economic trajectory and a deep restructuring of China’s oil industry that includes the sale of some of its oil businesses overseas.⁵¹ Future Chinese engagement may target more cutting-edge areas such as ultra-deep offshore drilling in Brazil and shale reserves in Argentina.⁵² Venezuela’s extra heavy oil reserves continue to be of interest to China. But Caracas’s deteriorating economic and political situation and apparent delays in PDVSA’s oil shipment repayments to China will most likely continue to put new loans to Venezuela on hold.^{53,54}

FIGURE 8. Chinese Lending in Latin America’s Oil/Gas Industry and Average Annual Price of Oil (2007-2016)³⁹



Source: Author estimations with data from Myers, Gallagher, and Yuan 2016;⁴⁰ Petrobras 2016;⁴¹ Gallagher, Kamal, Wang, and Chen 2016; Gallagher and Myers 2016; Ray and Gallagher 2013; Ray and Gallagher 2018;⁴² Red ALC-China 2017; and Downs 2011.⁴³
³⁹Includes loans by public and private banks, and fund allocations.

Separating Myth from Reality

The Chinese presence in Latin America's oil and gas industry has sometimes been criticized and the source of much concern. But on closer examination, many assumptions about China's activities in the region are grounded more on assumption than reality.

Here are some of the prevailing myths, and the facts that belie them:

MYTH

China is pursuing a "secret diplomatic strategy" to control a large portion of Latin America's oil and gas industry, thereby strengthening its political and economic presence in the region. According to this theory, the Chinese government is using its state-owned oil companies and banks, which act as policy agents of the state, in attempts to exert its power in the sector.

REALITY

Some evidence has begun to emerge that Chinese SOEs and policy banks are in fact driven more by their own commercial interests, and do not necessarily respond to top-down decision-making from the central government.^{55,56,57,58} While China's SOEs and policy banks do operate within the framework of China's overall policy strategy toward Latin America, which identifies "energy and resources" as a cooperation priority, there is little evidence to suggest a clandestine plan for dominating the region's energy sector.⁵⁹

MYTH

Contrary to other multilateral institution lending, Chinese loans to Latin America are devoid of conditionality.

REALITY

It is true that Chinese loans are not subject to the stringent conditions that other global financial institutions demand, such as requirements that loans be allocated within a framework of transparency and efficiency; that the highest environmental and social standards be applied; and that there be strong checks on corruption.

But most Chinese loans *do* carry other types of conditions. For example, a portion of the funds of some Chinese loans to Venezuela, namely the \$20 billion credit line of 2010, must be used for contracting with Chinese companies or for financing joint projects.⁶⁰ Critics of this type of conditionality see it as a form of interventionism that negatively affects domestic employment and the expansion of local or regional companies.⁶¹ In Brazil, where institutions are relatively strong and workers' unions very active, some conditions on Chinese loans became unsustainable and had to be weakened. Loans to Petrobras, for example, initially required the purchase of equipment and services from Chinese companies for up to as much as 60 percent of its credit lines.⁶² This requirement was then relaxed due to Brazil's strict local content legislation and following strong opposition from workers' unions.⁶³

MYTH

Many critics argue that loan-for-oil deals are detrimental to Latin American countries, on the grounds that locking in future oil shipments for delivery to China restrains producing countries' ability to negotiate more-favorable-term contracts with other buyers. Adding more weight to this argument is the belief that a large portion of the oil that Chinese SOEs obtain from Latin America never physically arrives in China. The oil is instead sold in the US market by traders working for China's SOEs.⁶⁴ If true, this would support the idea that loan-for-oil agreements are harmful to Latin America, because it would mean Chinese traders, and not producing countries, get more favorable deals.

REALITY

The terms of the loan-for-oil contracts between China and Latin American producers are typically not made public. That indeed makes such assumptions hard to disprove. However, a few experts argue that the financing terms under China's loan-for-oil deals may be beneficial for Latin American oil-producing countries.⁶⁵ Selling the physical oil in the United States may actually make sense, because it is cheaper than shipping it all the way to China. In the case of Venezuela, many refineries in the United States are specially equipped to process Venezuelan heavy crude, its most common petroleum export. Venezuela's state-owned oil company, PDVSA, even owns a refining arm in the United States, Citgo Petroleum, to process its crude. Though these analyses are based on assumptions that the loan-for-oil deals are made at market prices for oil. In truth, the public has not seen the contracts thus the terms of the deals are not known, this problem of secrecy and opacity leads to widespread skepticism and rumors.

MYTH

China prefers to lend to countries with a poor record of governance—those with a weak rule of law, widespread political instability, or corruption. As mentioned earlier, Venezuela is the largest recipient of Chinese oil lending, followed by Brazil and Ecuador. It is true that Venezuela ranks at the bottom of the World Bank's latest Worldwide Governance Indicators, which measure perceptions of governance.⁶⁶ A few notches higher on the indicators, but not too far, are Ecuador, Brazil, Colombia, and Peru. This, particularly in the cases of Venezuela and Ecuador, partially supports the argument that China prefers to lend to countries with weak institutions and high economic and political volatility.

REALITY

China typically has an indifferent attitude—rather than an outright preference—toward the governance performance of countries where it invests. There is a lack of convincing evidence of a deliberate Chinese policy to target weak governments for its oil deals. Such allegations appear to be based more on preconceptions about Chinese behavior than on reality.⁶⁷ It could be argued that China's decision to invest and lend to governments seen as unstable, autocratic, or corrupt, where authorities are less accountable, while not the primary cause of the governance weakness, contributes to its perpetuation, and may even lead to conflict.⁶⁸


MYTH

Chinese oil companies are indifferent to environmental and social standards.

REALITY

Although Chinese oil companies have a mixed record, they have in fact adhered to stricter standards when environmental and social policies are rigorously enforced by host governments. But the onus falls on the host country. Unlike US or European oil companies, Chinese firms are not bound by rigorous standards from either their government or from internal corporate practices.

In Ecuador, Sinopec's subsidiary, Tip Top Energy, is



A crude oil tanker on Maracaibo lake in Venezuela. Venezuela has the world's largest proven oil reserves.

a partner with Repsol in the development of Amazon Oil Block 16, an extremely socially and environmentally sensitive area. Sinopec has adhered to an oil development technique known as “offshore inland,” aimed at leaving minimal footprints in the Amazon. Repsol had been implementing this technique for several years with relative success before the Chinese company joined.⁶⁹ In Peru, which subscribes to the Extractive Industries Transparency Initiative (EITI) Resource Governance Index, CNPC adheres to strict operational transparency, disclosing all payments.⁷⁰

When enforcement by the host country is weak, some Chinese firms tend to sustain the myth by overlooking social or environmental issues. In Ecuador, a scandal broke out in 2014 following press reports about then-President Rafael Correa’s secret deal to commit the oil-rich Yasuni National Park to drilling, while seeking international donations for keeping the oil underground in the biodiversity-rich Amazon region.⁷¹ CNPC-owned PetroChina and Andes Petroleum Ecuador (owned by a consortium

of CNPC-Sinopec) received licenses for operating in Yasuni, with financial support from CDB. In Colombia, the operations of Sinochem’s Emerald Energy in Caquetá ran into serious conflict with the local population. Communities in the producing area opposed oil developments in general, but in particular they criticized the company’s handling of legally mandatory consultations with them. The armed forces had to intervene several times to break up demonstrations that blocked operations.

Recently, China’s central government has tried to promote better social and environmental standards among its companies.⁷² China’s Ministry of Commerce (MOFCOM) has also recently started to promote environmental and social safeguards for Chinese companies operating overseas and Chinese banks with international operations—mainly CDB and China’s Ex-Im-Bank—by adopting similar safeguards for their lending abroad. In addition, China incorporated “Green Credit Guidelines” for all financial institutions operating internationally.⁷³

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China's engagement in the promotion of sound environmental and social safeguards abroad is a step in the right direction; in practice, however, it is not enough. Chinese firms and banks are basically required to adhere to the social and environmental rules of the host country. Unfortunately, safeguard enforcement in producing areas is often weak or not properly enforced. Instances of noncompliance on the part of Chinese firms operating in Latin America are often a mix of company mistakes and government inability or reluctance to enforce the standards.⁶⁸ In Peru, for example, foreign companies must make public their revenue contributions to the government as required by the EITI, of which Lima is a member. CNPC started to comply with this requirement in 2014. By contrast, Sinochem-owned Emerald Energy's operations in Colombia have been mired by recurrent conflicts with local communities that complain of company noncompliance with social and environmental safeguards and of government failure to exercise its monitoring duties.⁷⁵

MYTH (AND REALITY)

The lack of transparency in Sino-Latin American hydrocarbons deals, from Chinese contracts to operations, is a major cause for concern about these agreements. Here, the arguments are grounded in reality. Secrecy surrounding Chinese oil and gas deals in the region, and companies' relatively weak adoption of participatory mechanisms, have been among the chief sources of public distrust of Chinese intentions.

As mentioned, the \$10 billion CDB loan in 2009 to Petrobras was negotiated behind closed doors and signed during a visit to China by then-Brazilian President Luiz Inácio Lula da Silva. As well, no public bidding preceded Petrobras's granting of two blocks to

Sinopec in the Pará-Maranhão Basin in 2010. The deal was made public as a *fait accompli* when Chinese officials visited Brazil. Low levels of transparency constrain accountability, which, in turn, provides incentives for rent seeking, as evidenced by the corruption scandal involving the China-Venezuela Fund (Fondo Chino-Venezolano).⁷⁶ The corruption and secrecy regarding China's presence in Latin America understandably contribute to increased suspicion of Chinese oil operations among local communities and the civil society. Adding fuel to the fire: Venezuela has little to show for its position as the number one borrower of Chinese oil funds. Oil output fell dramatically, by as much as 930,000 barrels per day, from 2006 to 2016.⁷⁷

The contrasts between myth and reality (except for the last example) underscore a critical point in analyzing China's growing inroads in Latin America's oil and gas industry: the willingness of host countries to demand accountability and transparency mechanisms from Chinese investors and lending institutions—and adopt them—is in the long run more important than the source of those investments. Investor behavior in hydrocarbons—from China or elsewhere—responds to the capacity and readiness of national and local leaders to enforce the rules, regulations, and practices that apply to their country. To be sure, some Chinese institutions lag behind their peers in other countries in the priority they attach to environmental or social standards in foreign investments. However, a significant share of the responsibility for ensuring that Chinese oil and gas investments respond to the region's larger interests rests with Latin American governments themselves.

In that spirit, below are policy recommendations to guide governments and leading stakeholders in negotiations with Chinese firms.

Policy Recommendations

These recommendations are aimed at improving the capacity of host countries to monitor Chinese oil and gas investments and lending. Most of these recommendations involve all stakeholders, not just governments, to ensure high levels of transparency and accountability. Some recommendations are applicable at the national level, others at the local level.

AT THE REGIONAL LEVEL

The government of China and a group of Latin American producing countries, for example, Brazil, Peru, Argentina, Colombia, and Venezuela, should establish a multilateral working group to set mutually agreed rules for cooperation in oil and natural gas development and lending. Doing so would increase China's credibility as a "win-win" partner, and give the Chinese an opportunity to dispel many of the myths associated with their oil and gas investments. For Latin American stakeholders, this would offer a platform to voice their concerns and ideas.

The working group should clarify the legal and socio-environmental safeguards required by each host country, and the level of compliance expected from the investor. Chinese-Latin American chambers of commerce and Chinese embassies should be part of this effort, as well as Latin American government officials and civil society groups.

Discussions within this working group should establish a baseline for corporate social responsibility, emphasizing best practices that address the specific concerns of oil-rich areas in Latin America, which are typically characterized by the presence of indigenous populations and by high biodiversity. Indigenous peoples are protected by laws and have particular cultural expectations, and environmentally sensitive areas also have varying degrees of legal protection. More concretely, local content requirements and realistic assessments of local employment availability should be agreed upon during working

group discussions. The working group should meet regularly with representatives from the permanent dialogue recommended below.

Development institutions—such as the Inter-American Development Bank, the Development Bank of Latin America, and the United Nations Economic Commission for Latin America and the Caribbean—should work with regional governments to design guidelines for policy banks' engagement in Latin America, with a view of ensuring environmentally and socially sustainable long-term growth. The guidelines could be in the form of (binding or nonbinding) principles and standards in areas such as information disclosure, anti-corruption, money laundering, environmental protection, investment reciprocity, and consumer protection, among others. With those guidelines in place, Latin American governments could then hold foreign investment banks, including those from China, to local standards.

IN THE PRODUCTION AREAS

At the very early stages of an oil or gas project, all stakeholders—including local civil society, community members, local authorities, churches (or local religious leaders), and energy companies—should adopt mechanisms for permanent and sustained dialogue with the investing institution.

This periodic stakeholder engagement can serve to adopt participatory development-planning

mechanisms early on to identify and prioritize local investment projects that could be potentially financed with oil or gas revenues. A permanent stakeholder exchange mechanism could also help assess local capacities and define possible linkages with the local economy for generating employment, transferring knowledge, and outsourcing inputs locally. An active local stakeholder engagement could serve to ensure that oil and gas developments are transparent and that grievances are addressed. It would also provide a useful tool for civil societies and local populations in general to hold the authorities and the oil companies accountable.⁷⁸

For Chinese oil companies, participating in a periodic dialogue with local stakeholders could help dissipate the companies' generalized reputation as nontransparent and nonengaging, and help reduce the cultural divide.⁸⁰ In Latin America, prior consultation with local communities affected by hydrocarbons development is often required by law. Where the consultation process is poor or nonexistent, oil companies typically face major conflicts with local communities and the civil society, which can freeze oil and gas projects. As mentioned earlier, lack of transparency and weak consultation efforts fueled Energy Emerald's persistent problems in its Colombian Amazon operations. By contrast, CNPC resorted to stakeholder dialogue and successfully contained a series of conflicts with local communities that it had inherited from its predecessor, Petrobras, in Peru's Talara Province.⁷⁹

AT THE NATIONAL LEVEL

Latin American governments should explore the possibility of promoting transparency and accountability of oil and gas operations in their territories, using the EITI as a model. The voluntary initiative for improving natural resource governance and the accountability of public officials rests on the notion that transparency and knowledge about oil and gas revenues will empower citizens and institutions to hold authorities accountable. The EITI framework could be adapted to each national context with the ultimate goal of improving transparency and accountability throughout the hydro-

carbons value chain. For Chinese oil operators, an EITI-like transparency initiative in the countries where they operate could help improve mutual trust with local stakeholders.

These recommendations are by no means intended to be comprehensive. But they can form the basis for policy decisions that can assure that all Latin Americans share the benefits of what promises to be a transformative moment in the region's energy economy. China's energy needs and its economic might go hand-in-hand with Latin America's search for investments to develop oil and gas resources. For the relationship to be a win-win deal it is the responsibility of both parties to ensure that hydrocarbons are developed in a way that is mutually beneficial, not only economically but also from an environmental and social perspective. China's willingness to accept a share of the responsibility for addressing those concerns is crucial; however, governments in Latin America should take a leading role in steering the process and ensuring it meets long-term economic, environmental, and social sustainability goals.

For the relationship to be a win-win deal it is the responsibility of both parties to ensure that hydrocarbons are developed in a way that is mutually beneficial, not only economically but also from an environmental and social perspective.

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