



# China's Engagement with the Nigerian Oil Sector

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## RECOMMENDATIONS

- In countries such as Nigeria, where political power rotates via elections between rent-seeking elites, neither their governments nor potential Chinese investors should attempt 'oil for infrastructure' agreements, but should rather simply trade oil assets for cash.
- Where 'oil for infrastructure' agreements are attempted between African governments and Chinese investors, African governments should anticipate that the cash component of these agreements will be low. Accordingly, if an African government wants a significant up-front cash payment for oil assets, an 'oil for infrastructure' agreement with Chinese investors is unlikely to be appropriate.
- If 'oil for infrastructure' agreements are secured between African governments and Chinese investors, the latter should take into account the possibility of substantive renegotiation or even cancellation in the event of a change of government.

## EXECUTIVE SUMMARY

China used to access Nigerian oil exclusively through long-term contracts and purchases on the spot market, but its economy's rapidly growing demand for oil has led the Chinese government to seek increased Chinese ownership of Nigerian oil reserves. China's interest in Nigerian oil was strongly encouraged by the Nigerian government during the presidency of Olusegun Obasanjo (1999–2007), which demanded of it 'oil for infrastructure'. Obasanjo's government auctioned oil blocs in bidding rounds that required Chinese bidders to commit themselves to providing Nigeria with major infrastructural projects. After initial hesitation, Beijing responded positively, coupling its investments with substantial involvement in Nigerian construction projects.

The Obasanjo government held three bidding rounds under 'oil for infrastructure' rules, with Chinese companies securing oil blocs in return for Chinese commitments to rehabilitate the Kaduna oil refinery, construct a railway from Lagos to Kano, build a hydroelectric power station in Mambilla, and provide the bulk of the finance. But Umaru Musa Yar'Adua, who replaced Obasanjo in 2007, put all these projects on hold. The new government has cited a variety of concerns, but the key issues are that it wants to trade oil blocs for cash and not infrastructure, and that the new political elite will delay infrastructural projects, no matter how important, until its members (rather than its predecessors) receive the bulk of the benefit.

Despite official denials, 'oil for infrastructure' died with the passing of Obasanjo's administration, forcing Chinese oil companies to change tack and acquire Nigerian oil assets for cash instead. The China Petroleum and Chemical Corporation is leading the way, in mid-2009 buying Addax of Canada, which has substantial Nigerian oil assets, for \$7.2 billion.

For future major infrastructural projects for the Nigerian federal government by Chinese companies to succeed, both these companies and the Chinese government need to take greater account of the far-reaching

implications of Nigeria's elite change via the electoral process.

#### THE DEVELOPMENT OF SINO-NIGERIAN RELATIONS UNDER PRESIDENT OLUSEGUN OBASANJO

Nigerian dictator Sani Abacha invited Chinese state-owned companies into the country in the mid-1990s, but it was not until the election of Olusegun Obasanjo as president in 1999 that relations between the two countries began measurably to deepen. 'Oil for infrastructure' was the central element of Obasanjo's economic policy towards China. His government auctioned oil blocs in bidding rounds that required Chinese and other Asian preferred bidders to commit themselves to providing Nigeria with major infrastructural projects.<sup>2</sup> This new approach was motivated by the Nigerian government's disillusionment with the paltry impact on national infrastructure of fifty years of co-operation with the West, impatience with the conditionalities of Western aid, and by Obasanjo being personally so impressed with the infrastructure he saw on visits to China.<sup>3</sup> Following persistent lobbying by the Nigerian government, Beijing opted to engage with Obasanjo's plan, believing it created opportunities both to increase China's presence in Nigeria's oil sector and secure lucrative new Nigerian construction contracts for Chinese companies.

#### OBASANJO'S CHINESE PROJECTS

Obasanjo enticed nervous Chinese companies into Nigeria by offering them the right of first refusal (RFR) on oil blocs at discounted rates or with signature bonus waivers in return for their commitment to invest in downstream and infrastructure projects. The first bidding round held under these rules was in 2005, with 77 blocs on offer and with most Western companies staying away, protesting RFR and the requirement that bidders acquire local partners. Only 44 of the blocs were awarded and, of these, nearly half were withdrawn because the winners defaulted on payments. Worse, Chinese companies failed

to bid, mistakenly believing that they had already secured the blocs during earlier negotiations with the Nigerian government.

In April the following year the Chinese president, Hu Jintao, visited Nigeria and signed a memorandum of understanding (MOU) that committed Chinese companies to playing a role in the planned rehabilitation of Nigeria's much decayed rail network in the expectation of receiving oil blocs in future bidding rounds. Chinese companies were given responsibility for the 1 315-kilometre Lagos-Kano section, the plan being to install a double-track, standard gauge railway line.

The next oil bidding round a month later allowed only companies prepared to make significant downstream or infrastructural investments in Nigeria to take part. The China National Petroleum Corporation (CNPC), using RFR, won two blocs (OPLs<sup>4</sup> 471 and 298) in the Niger Delta and two (OPLs 732 and 721) in the Chad basin. In return, CNPC promised to invest \$2 billion to rehabilitate the northern Nigerian city of Kaduna's failing oil refinery.

However, in May 2006 the Nigerian Senate rejected government-backed constitutional amendment that would have allowed Obasanjo a third presidential term. This was despite Obasanjo's backers spending millions of US dollars trying to persuade Senate members to back the change.

In October 2006 the Nigerian government awarded the Lagos-Kano railway construction contract without tender to the China Civil Engineering and Construction Corporation (CCECC). CCECC's initial quote was \$15.4 billion, which was eventually reduced to \$8.3 billion, but was still double World Bank estimates of the job. While the bulk of it was to be financed by the Export-Import Bank of China (Exim Bank), with the loan backed by Nigerian oil blocs, there was also a cash requirement from the Nigerian government and a down payment of \$250 million was made to CCECC in January 2007.

In his next major 'oil for infrastructure' project, in November 2006 Obasanjo secured the agreement of the Chinese government to build a huge 2 600-megawatt hydroelectric power station

at Mambilla in Taraba State. Obasanjo explicitly linked the Mambilla project to China National Offshore Oil Corporation (CNOOC) acquiring oil blocs in a promised new bidding round the following year. In November 2006 the Nigerian government signed an agreement with Exim Bank for a \$2.5 billion loan to finance both the Lagos–Kano railway and Mambilla. In early 2007 Obasanjo unilaterally awarded a \$1.5 billion contract for Mambilla to China Gezhouba Group Corporation, despite never signing the required documentation to activate the Exim Bank loan.

Presidential elections were held in Nigeria in late April 2007, which were won by Umaru Musa Yar'Adua. Although from the same party as Obasanjo, Yar'Adua comes from a different ethnic group (Fulani/Hausa) from the Muslim north, with the result that a sea change in personnel and policies ensued. Two weeks before Yar'Adua took office, Obasanjo's administration held its next oil bloc bidding round. A total of 45 blocs were placed on offer, with 24 pre-assigned to 12 companies on RFR terms. Among the 12, CNPC was given RFR on one bloc, again in return for its promised Kaduna refinery investment. CNOOC was given RFR on four blocs as settlement for the anticipated \$2.5 billion loan from Exim Bank for the Lagos–Kano railway and the Mambilla power station. The closeness of this round to a far-reaching change of government, however, proved to be too much for CNPC and CNOOC, which declined to bid.<sup>5</sup>

Meanwhile, outside the three formal bidding rounds, in 2006 the China Petroleum and Chemical Corporation (Sinopec) bought a 29% stake in bloc 2 of the Nigeria–São Tomé Joint Development Zone and CNOOC paid \$2.3 billion for a 45% stake in OML<sup>6</sup> 130 in the Akpo offshore field, financed by Exim Bank.

#### THE DEATH OF 'OIL FOR INFRASTRUCTURE'

It had been audacious for Obasanjo to hold an oil bloc bidding round so near to Yar'Adua's inauguration and few were surprised when the new president demanded a formal investigation. Thereafter, the agreements for the rehabilitation of

the Lagos–Kano railway and the construction of the Mambilla power station were placed on hold, and so too was the rehabilitation of the Kaduna refinery.<sup>7</sup>

In addition, Yar'Adua has still not signed the required MOU to activate Exim Bank's promised \$2.5 billion loan and his government has said that while it still wants the Mambilla project to proceed, it must be with entirely different funding arrangements.

In May 2009 the Nigerian minister of transport declared that it was wrong for CCECC alone to be responsible for the design, construction and supervision of the Lagos–Kano railway. He suggested that if the CCECC deal is to survive at all, it will require substantial renegotiation.<sup>8</sup> CCECC has apparently diverted much of the equipment it was going to use on the railway to other projects in Nigeria and elsewhere.<sup>9</sup>

Just as the main Chinese infrastructural projects agreed under Obasanjo's 'oil for infrastructure' terms have been stalled by Yar'Adua's government, so too have the oil blocs won by Chinese companies in the 'oil for infrastructure' bidding rounds come under threat. In early 2009 an Ad Hoc Committee of the House of Representatives recommended that OPL 298 be taken away from CNPC, although it appeared to be prepared to allow CNPC to retain OPLs 471, 721 and 732.

#### THE TRIUMPH OF 'OIL FOR CASH'

In a dramatic new development that dwarfed CNOOC's 2006 purchase, in June 2009 it was announced that Sinopec would purchase Canada's Addax Petroleum for CAD<sup>10</sup> \$8.3 billion (\$7.2 billion). Addax has two offshore and one onshore oil operations in production in Nigeria and two in Gabon, plus exploration rights across the Gulf of Guinea, as well as in Iraq.<sup>11</sup> Sinopec was badly affected by the suspension of the 'oil for infrastructure' agreements, and the proposed agreement, if all proceeds as planned, will hugely increase the company's and China's exposure to the Nigerian oil sector. The move clearly signals that China has accepted that to gain access to Nigerian oil, it must buy reserves rather than offer

to finance and construct national infrastructure, and there may be more similar deals to come.

## CONCLUSION

The Yar'Adua government's policy, as Sinopec's Addax deal underscores, is 'oil for cash'. In future, it seems, oil blocs will be awarded to the highest bidders.<sup>12</sup> According to one seasoned Western diplomat:

When it comes to 'oil for infrastructure', I think the Angolans understood the point that you either get the infrastructure or the money. The Nigerians thought you got both .... But it turns out that, forced to choose, in the end the Nigerians want the cash. ... The political elite works on a short-term, four-year basis, dictated by the electoral cycle. I don't think the Chinese fully understood this. But they do now.<sup>13</sup>

According to one senior Nigerian government source, while some of China's stalled 'oil for infrastructure' contracts may eventually be revived, this will only happen if the contracts are restructured to take account of the changed political realities since Yar'Adua became president. Yar'Adua's northern supporters will not let Obasanjo's deals proceed unless they, rather than Obasanjo's cronies, are included.<sup>14</sup> Beijing has discovered the hard way that in contemporary Nigeria the electoral cycle trumps any business deal and that when state power is transferred via an election from one elite to another, and specifically from a southern, Christian elite to a northern, Muslim one, the spoils of state come up for renegotiation.

It is this cycle that makes 'oil for infrastructure' deals of the kind that China has negotiated in other African countries unworkable in Nigeria, dictating instead that Chinese companies

acquire their oil assets there with cash. And even then, it may not always be that simple. Chinese companies purchasing oil assets would also be wise to factor in the possibility that they may have to pay extra for their acquisitions when the next elite assumes control of the Nigerian state and begins a new round of rent collection.

## ENDNOTES

- 1 Gregory Mthembu-Salter is a researcher, author and journalist on Africa's political economy, and has served on the UN Panel of Experts on the Democratic Republic of Congo.
- 2 Wong L, *The Impact of Asian National Oil Companies in Nigeria*. London: Chatham House, 2008, p. 1.
- 3 Interview with Sir Elvis Emecheta, head of the Nigerian–Chinese Chamber of Commerce, Lagos, April 2009.
- 4 Oil production licences.
- 5 Most of the information here comes from Wong L, *op. cit.*
- 6 Oil mining licence.
- 7 Interview with Igo Aguma, chair of the Ad Hoc Committee on Oil and Gas Deals of the Obasanjo Presidency, House of Representatives, Abuja, March 2009.
- 8 <<http://h2.punchng.com/Articl.aspx?heartic=Art200905034171287>>.
- 9 Interview with Chinese journalist, Lagos, April 2009.
- 10 Canadian dollars.
- 11 <<http://www.addaxpetroleum.com/operations>>, accessed 23 July 2009.
- 12 Wong L, *op. cit.*, p. 2.
- 13 Interview with Western diplomat, Abuja, March 2009.
- 14 Interview with senior Nigerian government official, Abuja, April 2009.

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