

Sonangol: Angola's Charm Offensive

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SUMMARY

Challenge	To create an efficient national oil company to generate government revenue, despite limited capacity and technical expertise, and during a time of conflict and instability (Precept 6 of the Natural Resource Charter ¹).
Country and period of focus	Angola, 1976-2002
Challenge in country	During Angola's civil war, oil was the government's best chance of obtaining revenue. However, this depended on insulating the national oil company from multiple instabilities in the country.
Core decisions	Emphasizing the importance of a steady flow of revenues by partnering with international oil companies who had superior technical skills, allowing the national oil company to essentially self-regulate and prioritize capacity building and technical expertise.
Implications of decisions	Sonangol met the aims of the government and maximized reliable revenue for the government, without disincentivizing international investment. The cronyism which aligned the interests of the state and Sonangol, however, does not provide a sustainable model for the future Angola's political economy.
Policy decisions, implementation and governance	Sonangol's privilege extends to its de facto role as industry regulator, despite there being a Ministry of Petroleum since 1979. This concentrates the country's limited technical expertise and resources in one, central area. Despite the lack of transparency, it is thought that the close personal ties between Sonangol elites and the government ensure that the company adheres to government policy.
Did it work?	Angola has created an effective national oil company which has been a powerful agent for the state's management of the oil sector, despite its limited capacity and technical expertise, and during a time a conflict and instability. The company, however, has not been accountable to the vast majority of Angola's citizens.
Quantified gains	Angola's oil production increased from 120,000 barrels per day in 1982, to an estimated 2000,000 bpd in 2000. The Angolan government received US \$12,251 million from oil revenue in 2009.
Lessons learned	National oil companies can, and should, be used as a source of government revenue, and they can also be used as a vehicle to drive the domestic industry along the "experience curve" by building-up technical expertise and capacity. However, national oil companies that are effective at accomplishing the revenue-generation goals of the ruling power, are in some cases obstacles to public accountability.

ABOUT THE SERIES

This is one of a series of case studies that illustrates the principles of the Natural Resource Charter. The charter is a tool used by governments and societies seeking to better harness the opportunities created by extractive resources.

¹ Natural Resource Charter <http://www.resourcegovernance.org/approach/natural-resource-charter>

A significant component of Angola's productive oil sector is Sonangol, the national oil company.² Despite the country's history of political instability and lack of technical expertise, Sonangol has managed to maximize revenue for the government and create an investor-friendly environment. The company is well regarded by the international and regional oil industry. However, Sonangol performs functions that may be out of its remit and a complex relationship exists between the government and the company that has ultimately weakened its transparency and created mistrust among the public.

THE CHALLENGE

Establishing a national oil company (NOC) can be a key component in a country's strategy to capture government revenues from hydrocarbons. According to precept 6 of the Natural Resource Charter, national oil companies should be accountable, have well-defined mandates and have the objective of commercial efficiency. Angola has created a strong and effective company, which has been a powerful agent in the state's management of the oil sector. This is despite its limited capacity and technical expertise, and during a time a conflict and instability. The company, however, has not proven to be accountable to the vast majority of Angola's citizens.

Sonangol was established in 1976, the year after Angola gained independence from Portugal. Decades of civil war followed independence and the government recognized that oil would be the primary, if not the only, revenue generating sector of the economy. Sonangol was therefore given responsibility to insulate the oil sector from instability and to create a stable and attractive investment environment for international oil companies (IOCs).

WHAT DID THE COUNTRY/COMPANY DO?

Immediately following independence, the Angolan government, dominated by the Marxist-Leninist Movimento Popular de Libertação de Angola (MPLA), established the National Commission for the Restructuring of the Petroluem Sector (CNRIP) in 1975. The CNRIP formerly supported the nationalist ideology of the MPLA, yet the head of the MPLA recognized that limited indigenous technical capacity precluded a total government takeover of oil. The country therefore prioritized the return of Gulf Oil to ensure that production of domestic oil was relatively reliable.

Sonangol was created in 1976, from the remnants of a Portuguese company ANGOL, which was nationalized at independence. From its early days, Sonangol's managers were from the same small, ethnic-political class as the MPLA government, thus reducing principal-agent conflict. The CNRIP sought to address the limited capacity of the company by improving its technical capabilities. The focus on long-term capacity development continues to this day and is crucial to the company's economic success.

At the same time as Sonangol, the National Petroleum Directorate (later the Ministry of Petroleum) was created, with the official remit of sector oversight. In practice however, the resources and authority of the oil sector are concentrated within Sonangol. The intention was to avoid overextending the limited resources of the country.

2 Unless otherwise stated, content is abridged from Heller, P. "Angola's Sonangol: dextrous right hand of the state", in *Oil and Governance: State Owned Enterprises and the World Energy Supply*, Victor, D., Huilts, D. and Thurber, M. eds. (2012).

Steward of the sector, responsible for delivering maximum revenue to the state

As an agent of the state Sonangol does not operate in the same way as a traditional commercial company. The company's long-term aims are consistent with those of the state — i.e., to maximize government revenues from the sector, without undercutting the incentive for outsiders to invest.

The company uses three distinct contractual regimes to deliver fiscal benefits to the state, but production sharing agreements (PSAs) apply to the majority of Angola's major fields.³ The production sharing formula used enables Sonangol and the government to capture a heavy share of the benefits during boom times, without being confiscatory during periods of low price or production.

Sonangol's share of profit oil (the oil split by the parties after private partners have reimbursed their costs) has been reported to range from as low as 20 percent (for rates of return under 25 percent) to 85-90 percent (for rates of return above 40 percent). Once the profit oil has been divided and the operating group has sold its share, Sonangol pays the government 50 percent income tax.

These agreements generate the majority of the government's share of production and revenue from the sector. This share has increased in recent years and will represent a growing share of the total in the future as deep-water oil production comes to have greater significance.

Furthermore, Sonangol is the lead authority for monitoring contracts and has a reputation for being one of the toughest regulators in sub-Saharan Africa. Operating costs are the most common sticking point in negotiations; Sonangol must approve operating expenditures in excess of a relatively low threshold, and it frequently rejects operating group proposals on a variety of issues. The company may also override operating-group preferences based on the broader strategic interests of the Angolan oil sector. For example, the company has at times refused the requests of private partners to pump oil as rapidly as possible, on the grounds that this would damage the reservoir. This example shows how the structure of Sonangol has allowed it to pursue its own — and the Angolan state's — longer-term objectives of maximizing recoverable reserves, rather than the implementing their partners' short-term profit objectives.

Driver of Angolanization

Sonangol is also an engine of growth for local private businesses, thus supporting the "Angolanization" policies of the government. "Angolanization" policies serve two purposes. First, they develop a local private sector and technocratic class. The country's economy is heavily oil dependent, and the government intend to use the finite oil resources to provide capital for other businesses and exploit an "experience curve." This will strengthen the entrepreneurial and technical base and overtime, reduce the country's reliance on foreign contractors.

The second purpose of Angolanization policies concerns the distribution of oil rents among key clients that the government seeks to placate. Relatedly, the allocation of local partnership contracts is not as transparent as the allocation of operating contracts.

³ For certain partnerships set up in the 1960s and 1970s a tax-and-royalty model applies. In 2013, Angola also introduced Risk Service Contracts. See, Ernst and Young, *Global Oil and Gas Tax Guide*, (2015).

One way in which Sonangol manages the ancillary economy is through its network of subsidiaries and joint ventures. There is limited information available about the extent of this network, but given its reputation as the most technically competent organization in the country, Sonangol is perceived by government to be the most appropriate manager of this network. Subsidiaries include the exploration and production vehicle Sonangol Pesquisa e Produção (Sonangol P&P) which is the largest shareholder in Block 0 offshore of Cabinda and a smaller shareholder in other projects; the overseas offices responsible for the marketing of the company's share of Angolan oil; the supervisor of the country's natural gas industry (Sonangas); and a range of other support service and logistical companies involved in Sonangol activities, as well as investments in some non-oil-related industries.

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Some key Sonangol joint ventures and subsidiaries

Core oil development and marketing

- Sonangol Pesquisa e Produção (P&P), exploration and production
- Sonangol Ltr., Sonusa, and Sonangol Asia, trading offices in London, Houston, and Singapore
- Sonangol Starfish Brasil P&P, oil exploration and production in Brazil
- Sonangol Distribuidora, downstream unit, including domestic gas stations
- Sonamet and Petromar, construction of offshore platforms and other equipment
- Sonamer, oil recovery and deep drilling
- Sonagas, development and distribution of natural gas
- Sanawest, seismic data survey and analysis
- SonAir, oil and gas industry air transport service

Non-core subsidiaries

Sonangol Logística, SONILS, Sonangol Shipping, Sonasurf, Kwanda Logistical Support and Sonatide (logistical support and other technical services)

Beyond this, Sonangol officials maintain informal ties with other Angolan companies. They afford a range of benefits including shares in operating groups and also encourage IOC officials to engage with local companies.

To reiterate, the emphasis on local content is evidence of the consistency between Sonangol's aims and those of the government.

Quasi-sovereign responsibilities

Sonangol has occasionally acted on behalf of the government on issues beyond the traditional remit of a traditional national oil company. For example, during the civil war Sonangol allowed the government to access credit by negotiating oil-backed loans. This was despite the government's tendency to default on debt and the perception that the regime was corrupt; in comparison Sonangol has never defaulted on a loan. The company negotiated loans with international banks and channeled the funds to government accounts in Angola and abroad. The country's oil served as collateral, Sonangol repaid the loans with the delivery of oil shipments to international trading companies that channeled the proceeds into offshore accounts.

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In addition, the company has been a significant player in Angola's oil-based diplomacy. This has been particularly important with regards to Angola's relationship with China. Angola is a major supplier of crude oil to China and the Chinese government has provided a massive amount of credit (totaling US \$7.5 billion as of 2011⁴) to finance infrastructure reconstruction. Much of this credit is oil-backed, and so Sonangol is responsible for servicing the repayments. The company formed a joint venture with a Chinese company to form Sonangol Sinopec International (SSI). This saw a record signature bonus of more than US \$1 billion for a non-operating 40 percent stake in relinquished deep water Block 18/06 and also controls non-operating stakes ranging from 20 percent to 50 percent in four other Angolan blocks.⁵ In its role as concessionaire Sonangol was responsible for the granting of these shares.

Sonangol also plays an important role in Angola's outreach to other African countries, with representatives frequently serving as advisors to current or would-be allies on the development of nascent petroleum sectors, thus boosting Angola's influence across the continent.

There are however indications that Sonangol's loosely defined, quasi-sovereign status has allowed for dubious financial management. In 2014 the International Monetary Fund (IMF) uncovered an "unexplained residual" in state accounts initially calculated at more than US \$31 billion between 2007 and 2010 (equivalent to one fourth of annual GDP) that had not been managed via ordinary rules of public financial management.⁶ A reconciliation of these discrepancies revealed that a large proportion of these expenditures were attributable to quasi-fiscal activities by Sonangol and the transfer of oil revenues "to external accounts to service external credit lines."

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DID IT WORK?

Sonangol has been a highly effective agent of the state and maximized revenue for the government by creating a highly productive oil sector. The company has also created an investor-friendly environment without sacrificing government interests. Furthermore, the company has driven the development of the Angolan private sector and pursued the country's diplomatic aims with effective oil diplomacy. On the other hand, there are concerns over Sonangol's lack of transparency and accountability, and the tight control exercised over it by an autocratic elite, which has enriched itself while leaving most of the country desperately poor.

4 Alves, A. C. "Chinese Economic Statecraft: A Comparative Study of China's Oil-backed Loans in Angola and Brazil", *Journal of Current Chinese Affairs*, 42:1, (2013).

5 Vines, A. R., Wong, L., Weimer, M. and Campos, I., *Thirst for African Oil: Asian National Oil Companies in Nigeria and Angola*. Chatham House: London. (2009).

6 International Monetary Fund, *Angola: Second Post-Program Monitoring: Press Release and Statement by the Executive Director for Angola*, IMF Country Report No. 14/81, (March 2014) <http://www.imf.org/external/pubs/ft/scr/2014/cr1481.pdf>

WHAT ARE THE LESSONS FOR OTHER COUNTRIES?

A nationally owned resource company can be a useful tool to harness the developmental potential of a country's natural resources. A key remit of the company is collection of revenue. Sonangol is a good example of how to maximize government revenue without disincentivizing international investors and all the while in a significantly challenging context. In particular, the emphasis on building and maximizing capacity has allowed the company and the country to make the most of limited technical skills. This is most appropriate in the early stages of an NOC's development.

There is also a cautionary aspect to the Sonangol story: without transparency and accountability an NOC can become a powerful state-within-state, used to facilitate crony-driven politics and obscure public accountability.

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