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*Perspectives on Global Development 2010*  
*Shifting Wealth*

## HOW CHINA IS INFLUENCING AFRICA'S DEVELOPMENT

by

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## GLOBAL DEVELOPMENT BACKGROUND PAPERS

This series of background papers was commissioned for the Perspectives on Global Development 2010: Shifting Wealth. These papers have been contributed by the Non-Residential Fellows of the Perspectives on Global Development, eminent scholars from developing and emerging countries, to provide insight and analysis on the areas covered by the main report.

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## TABLE OF CONTENTS

PREFACE .....	4
I. INTRODUCTION .....	5
II. UNSUSTAINABLE DEBT OR A NEW MODEL OF DEVELOPMENTAL FINANCE FROM CHINA? .....	11
III. WILL CHINA'S INFRASTRUCTURE PROJECTS ON THE CONTINENT FACILITATE AFRICAN INTEGRATION?.....	18
IV. WILL CHINA ASSIST AFRICAN INDUSTRIALISATION?.....	24
V. CONCLUSION .....	30
REFERENCES.....	31

## PREFACE

Over the last 20 years, economic and political power has been shifting towards emerging economies. A number of developing countries have become centres of strong growth, raising their shares of global income significantly, which has made them major players in regional and global affairs. Furthermore, flows of trade, aid and investment *between* emerging and developing countries have all intensified.

The *Perspectives on Global Development 2010* presents the evidence which documents these changes, what we call 'Shifting Wealth'. As the world emerges from the crisis, the report clarifies this new global reality and what it means for development. Clearly, it implies that development strategies need to be rethought in the new international environment. The PGD 2010 suggests ways in which developing countries can best take advantage of the new economic landscape and supports calls for global governance to be reformed, making it more inclusive.

The *Perspectives on Global Development* has been guided by and contributed to by eminent scholars from developing and emerging countries, our Non-Residential Fellows. In this paper, Dr. Martyn Davies, from the University of Pretoria, discusses how the global financial crisis is accelerating China's investment in Africa, a region that is becoming more important to Chinese firms that are beginning to venture out into the global economy. In particular, he poses three important questions: What contribution will China have on industrialization efforts in Africa? Does China's concessional finance model offer a new mode of developmental finance for Africa's extractive industries? And will China's investment in infrastructure on the continent assist regional integration of African economies? Combined, these three questions provide an overview of the impact China will have on the long term developmental prospects of Africa.

Javier Santiso  
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February 2010

## I. INTRODUCTION

*“...the Chinese model for stimulating rapid economic development has much to teach Africa.*

**President Abdoulaye Wade, Senegal<sup>1</sup>**

The global financial crisis is accelerating China's investment in Africa, a region that is becoming more important to Chinese firms that are beginning to venture out into the global economy. In the first half of 2009, the bottom point of the global economy during the crisis, investment from China had increased an impressive 81 per cent accounting for USD523 million when compared to the same period the previous year. The very large values of concessional loan finance that is deployed in Africa by Chinese policy banks is excluded from this FDI figure.

China has a long and politically close relationship with Africa, but this does not mean it makes business on the continent any easier for China's emerging multinationals. A number of China Inc.'s investments on the continent have already failed and more will undoubtedly fail in future. But Chinese firms are proving to be rapid learners in foreign markets, including Africa. The ability of Chinese firms to adapt to local African market conditions and operate in sometimes challenging political and economic environments will determine whether Chinese investment in Africa is truly long term strategic, rather than merely short-term mercantilist characterised and enabled by elite political support.

This paper considers what impact China's engagement with Africa is having on the developmental fortunes of the continent. In response, three questions are posed: What contribution will China have on industrialisation efforts in Africa? Does China's concessional finance model offer a new mode of developmental finance for Africa's extractive industries? Will China's investment in infrastructure on the continent assist regional integration of African economies?

Combined, addressing these three questions will lead to an opinion on the impact China will have on the long term developmental prospects of Africa.

### **Over The Last Decade China Has Re-engaged Africa**

A confluence of events, both international and domestic, resulted in the downgrading of Africa in Chinese foreign policy importance from the mid-1970's until the latter part of the century. Africa had been core to China's foreign policy focus in the 1960's, talking the rhetoric of revolution, anti-colonialism and third world solidarity. Political ideology was the priority, but it masked a strategic intent by Beijing to leverage post-

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1. Wade, A. "Time for the west to practice what it preaches", *Financial Times*, 23 January 2008.

colonial African support for the entry of the People's Republic into the international arena. Aid to Africa, despite being hardly affordable for China at the time, became a tool to promote China's foreign policy in pursuit of international recognition and status.

African votes in the UN General Assembly made a weighty contribution to the accession of the People's Republic of China into the United Nations Security Council in October 1971. However, after this internal events in China began to influence the government's foreign policy. A period of introspection and political consolidation followed the end of the Cultural Revolution after the death of Chairman Mao Zedong in September 1976. Following this period of heightened instability and uncertainty over leadership succession, the launch of the economic reform programme at the 11<sup>th</sup> Party Congress of the Chinese Communist Party in December 1978 ensued. China rather focused on managing its own domestic reform rather than expending large amounts of resources and funds to Africa. This period of relative foreign policy neglect lasted for a period of two decades.

The success of China's developmental progress and the unleashing of economic market forces since the early to mid-1980s resulted in the erosion of ideological leanings of the Chinese leadership and society as a whole. With the entrenching of reform, market opening and liberalisation, Chinese state-owned firms - enjoying access to capital from the so-called policy banks most notably China Export-Import Bank and China Development Bank - began to look outward and establish an international footprint over the course of the last decade. Africa quickly became a recipient of outbound Chinese capital in search of securing commodities, most notably oil.

From the late 1990s, the Chinese leadership began to pay far greater attention to Africa. Africa was elevated in priority and this resulted in the conceptualisation and creation of a new vehicle, coordinated by the Ministry of Foreign Affairs, to project Chinese foreign policy objectives toward Africa.

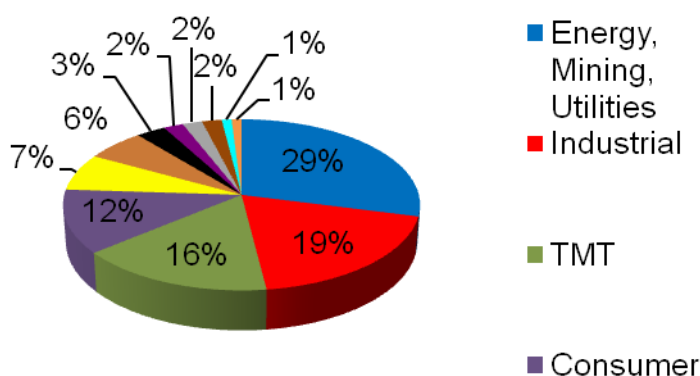
Following its launch in October 2000, the Forum on China-Africa Co-operation (FOCAC) was formed. Since its inception and through four summits held in Beijing (October 2000 and November 2006) Addis Ababa, Ethiopia (December 2003), and Sharm El Sheikh, Egypt, FOCAC has become the institutional mechanism for China-Africa multilateral engagement. Through FOCAC, Beijing has set out three-year engagement plans toward the continent in the form of strategic initiatives and commitments toward the African continent. This "state capitalist" approach by the PRC is unique in that the government is able to make sweeping pronouncements, often on behalf of its business sector, to invest and commit capital to Africa. This is only possible due to the political-economy of China wherein the government is able to maintain direct control over key sectors of its economy and leading companies through state-ownership and therefore influence. This management and provision of capital by the state is now directing China's commercial foray into Africa.

Such political pronouncements form the framework of China's commercial engagement toward Africa. But considering the scrutiny and criticism that China has received from international institutions and non-governmental organisations in its relations with Africa, Beijing will begin to broaden its engagement with Africa to include issues such as environmental matters and utilise phrases such as "sustainable development". But despite the broadening of its engagement, political forces will remain a driving force behind China's corporate presence in the continent.

## China Inc. Goes Global

China's banks are now providing finance to Chinese companies in a manner that can be described as "counter-cyclical" – at least when viewed from the western world. The economy's outbound FDI have increased dramatically in recent years amounting to USD17.6 billion in 2006, USD24.8 billion in 2007 and preliminary figures for 2008 indicate a rise to USD40.7 billion<sup>2</sup>. The bulk of this outward bound investment originates from state-owned enterprises. This is according to the Ministry of Commerce figures that cite 84 per cent of China's outward FDI (including stocks and portfolio investments) to have come from SOEs<sup>3</sup>. The destinations of these investments are hard to accurately verify, but on preliminary data, the majority value will be to developing economies.

### Sector Split of Cross-border M&A Activity from China 2003-Q3 2009: Volume

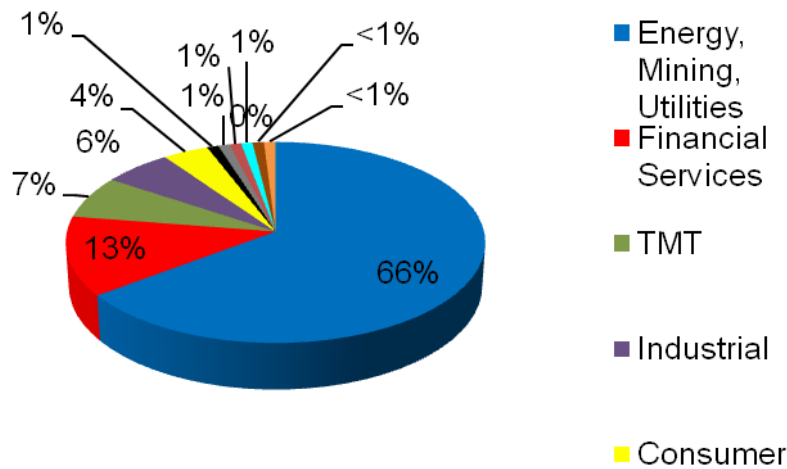


Source: mergermarket (cited in *The Emergence of China: New Frontiers in M&A*, Deloitte, November 2009)

2. Davies, K. "While global FDI falls, China's outward FDI doubles," Columbia FDI Perspectives, No. 5, 26 May 2009.

3. *Ibid.*

### Sector Split of Cross-border M&A Activity from China 2003-Q3 2009: Value



Source: mergermarket (cited in *The Emergence of China: New Frontiers in M&A*, Deloitte, November 2009)

The drivers of China’s going global strategy by leading SOEs are numerous. Key determinants of this force are:

To acquire brands, technologies, distribution and sales channels, Chinese firms have sought to acquire leading global companies that can fast-track their integration and inclusion into the global economy;

To secure energy and resource assets in order to hedge against rising commodity prices and possibly long-term supply shortages, the Chinese Government is encouraging its companies to secure an array of commodity assets;

To offshore manufacturing process in order to offset rising risk of protectionist sentiment that is becoming more prevalent against “Made in China” products;

Due to an inherent distrust of so-called “western” political-economic influence, China seeks to project global political and cultural (soft power) influence through establishing a wide geographic presence of state owned or state aligned firms.

It is reported that Chinese outward FDI in the first quarter of 2009 has already exceeded China’s (then) record FDI outflow from the previous year. The Chinese state through its state-influenced banking sector is in a very strong financial position to acquire foreign assets. According to Davies, China has “...USD1.9 trillion in foreign-exchange reserves, a current-account surplus forecast by the OECD to rise to 11.7 per cent of GDP in 2009 and no credit crunch, China can afford large investments overseas.”<sup>4</sup> According to research carried out by Deloitte, outbound Chinese M&A has “rise rapidly over the first three quarters of the year with Chinese purchases overseas having numbered 61 deals worth USD21.2bn, the majority of them coming to market in Q3 009.”<sup>5</sup> Despite the current global

4. *Ibid.*

5. *The Emergence of China: New Frontiers in M&A*, Deloitte, November 2009.



crisis, Chinese outward investment has remained relatively buoyant with Chinese international acquisitions “falling 28 per cent over the H2-2008 to H1-2009 period” in comparison to the same period a year previously whilst “global M&A volumes fell 36 per cent.”<sup>6</sup>

Rapid acceleration in Chinese GDP performance from the second quarter of 2009 is resulting in a pick-up of Chinese outward investment with Chinese banks having regained their confidence to deploy capital abroad. The willingness of the PRC Government to provide sovereign wealth to Chinese state-owned firms to invest abroad is encouraging this trend.

### China’s Investment in Africa During the Crisis

The global economic crisis has dramatically reduced the value of commodity assets and the resultant impact on Africa’s extractive industries sectors, in particular its emerging “junior mining” sector has been catastrophic.

A PwC report published in February 2009 stated that it is “virtually impossible” for junior mining firms in both exploratory or mine development stages to raise capital for their projects.<sup>7</sup> Many junior mining as well as smaller mining firms have suffered with many going out of business. Similarly the scarcity of capital is also impacting negatively on the development of African infrastructure. According to the Development Bank of Southern Africa (DBSA), prior to the crisis Africa had committed to 2361 such projects. Currently, 1114 projects are going ahead – a massive reduction of 52.8 per cent.<sup>8</sup> This is due largely to the fact that the crisis has made “financing (both debt and equity) more onerous and difficult to secure.”<sup>9</sup>

While capital is being withdrawn from the continent as a result of the global financial crisis, China’s resource investments and further commitments related to the extractive industries sector have been ongoing. The sovereign nature of Chinese capital deployment in the global economy is enabling Chinese financial institutions to allot capital in this so-called “counter-cyclical” fashion.

Bremmer refers to the trend of politically enabled or financed investment as “state capitalism” which he describes as “an economic system in which governments manipulate market outcomes for political purposes.”<sup>10</sup> He asserts that “*China and Russia are leading the way in the strategic deployment of state-owned enterprises*” in the global economy.”<sup>11</sup>

Whilst western (private) investors have been withholding credit due to weak balance sheets and heightened risk aversion, Chinese banking institutions have been expanding their loan portfolios in Africa. This is true for Chinese policy banks as well as to its commercial lenders. The main actors are China EXIM Bank, China Development Bank through its

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6. *Ibid.*

7. Junior Mine Survey, PricewaterHouse Coopers, February 2009.

8. As quoted by Samon Muradzikwa, Chief Economist, Development Bank of Southern Africa, Engineering News, 3 February 2009.

9; Izaguirre, A.K. “New private infrastructure projects in developing countries continue to take place but projects are being affected by the financial crisis”, PPIAF, World Bank, 3 May 2009.

10. Bremmer, I. “State Capitalism and the Crisis” in the McKinsey Quarterly, July 2009.

11. *Ibid.*

recently launched China-Africa Development Fund, China Construction Bank and the Industrial Commercial Bank of China (ICBC).

Jiang Jianqing, Chairman of the state-owned ICBC, said in June 2009 at the World Economic Forum on Africa that Chinese investment in Africa is *“growing and becoming more diversified, even as the global downturn curbs investment by other countries.”*<sup>12</sup> Jiang stated that ICBC through Standard Bank, its banking partner in Africa of which it owns 20 per cent, it is currently evaluating 65 investment projects across the continent<sup>13</sup>. This number may be exaggerated somewhat, but the “commercial corridor” for China-Africa commerce that has been created by ICBC-Standard Bank is indeed important for channelling investment by China Inc. to the continent. As China Inc.’s knowledge and network in Africa deepens, the diversification of China’s investment footprint away from the energy sector in Africa will become an emerging trend in China-Africa commercial ties.

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12. S. Childress, *Foreign Investment Cushions Downturn in Africa* in the Wall Street Journal, 27 June 2009.

13. Stated by Jiang Jianqing at the World Economic Forum, Africa, Cape Town, South Africa, 10-12 June 2009.

## II. UNSUSTAINABLE DEBT OR A NEW MODEL OF DEVELOPMENTAL FINANCE FROM CHINA?

### A New Model of Developmental Finance from China?

The bulk of Chinese capital being deployed in Africa is being channelled through China's "policy banks" – banks that have in the past financed capital investment in the Chinese domestic economy.

A different capital risk model is being constructed that is calculated differently to traditional (western) investors. It is more answerable to political stakeholders pursuing a defined national interest than it is to private shareholders. The state-owned structure of Chinese policy banks allows for an approach where capital is invested in a manner that is arguably more suited to the long term development needs of developing economies and does not chase a short term return on investment.

The sharp end of China Inc.'s move into Africa over the past decade is China Export-Import (EXIM) Bank. Instrumental in financing "strategic" sectors and key state-owned firms in China, the Bank's "concessional finance model" is providing capital for the market entry of Chinese SOEs into African economies. They are receiving large sums of finance from China EXIM Bank to establish a beachhead in the recipient African economy and can be viewed as "first movers" in China's going-global strategy.

The Chinese Government published its foreign policy White Paper on Africa in December 2005 setting out the terms of its engagement with Africa. The policy "encourages and supports Chinese enterprises investment and business in Africa, and will continue to provide preferential loans and buyers credit to this end."<sup>14</sup> The concessional finance model as implemented by China EXIM Bank underwrites this policy.

The Chinese Government's strategy in Africa is starting to mimic the approach adopted in the home market itself, one that channels sizeable amounts of capital through a state-owned (policy) banks at key sectors. At the FOCAC IV summit held in Sharm El Sheikh, Egypt in November 2009, the PRC committed to spend USD10 billion in concessional loan finance to Africa over the course of the next three years<sup>15</sup>.

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14. China's Africa Policy, 2006, Government of the People's Republic of China

15. On 9 November 2009 at the Sharm El Sheikh FOCAC meeting, Premier Wen Jiabao set out eight commitments that the PRC would fulfill over a three-year period. The third commitment stated that: "China will help Africa build up financing capacity. China would provide 10 billion US dollars in concessional loans to African countries, and support Chinese financial institutions in setting up a special loan of 1 billion dollars for small- and medium-sized African businesses. For the heavily indebted countries and least developed countries in Africa having diplomatic relations with China, China would cancel their debts associated with interest-free government loans due to mature by the end of 2009."

Despite the large amount of interest and uptake by African Governments of China EXIM's commodities-for-infrastructure concessional finance deals, the financing model employed is coming under a great deal of scrutiny and suspicion by external stakeholders. Do China's concessional package-deal projects undermine the debt sustainability efforts in highly indebted poor African countries or does the concessional structure offer a new model of development capital in Africa?

### China EXIM Bank as the Lead Actor

The Export-Import Bank of China (China EXIM Bank), established in 1994, is a government policy bank that is exclusively overseen by the PRC State Council. It is the third largest export credit agency (ECA) in the world and has been a vital cog in the rapid expansion of Chinese global trade and investment.

China EXIM Bank carries out three major functions: 1) it is the official export agency looking after trade and investment guarantees, 2) it provides aid administration (i.e. evaluating projects) and 3) it acts as the policy bank that deals with foreign aid that comes to China. There are two divisions within the bank that oversee financial outflows: a commercial as well as concessional arm. The bank is the sole provider of the Chinese Government's concessional loans and as such is playing a major role in financing China's going global strategy. It has been stated that the Bank's policy loans are influenced by the PRC Government and do not "operate in full compliance with market rules."<sup>16</sup> The Bank has extended loans to over forty states, all of which have provided a sovereign guarantee to the loans, mostly in Africa and Asia.

Key countries in Africa that have been recipients of China EXIM Bank's concessional financing include Angola, Equatorial Guinea, Congo Brazzaville, Ethiopia, Guinea, Nigeria, Sudan and Zimbabwe – countries that have questionable governance regimes and some of which may not qualify for funding from traditional developmental finance institutions. In June 2007 at the World Economic Forum's Africa meeting held in Cape Town, China EXIM Bank's CEO Li Ruogu stated that as much as 40 per cent of the bank's loan book is now held in Africa – such is the political commitment of the PRC toward its commercial driver toward Africa.

The Bank provides credit lines to client SOEs that focus on infrastructure (roads, power plants, oil and gas pipelines, telecommunications, and water projects) and its investment loans target the energy, mining, and industrial sectors. The bank's main source of funding is the bond market<sup>17</sup>.

Besides extending concessional funding the Bank finances export buyer's credits, and overseas construction and investment projects. The latter project assistance is extended to Chinese SOE companies investing in oil and gas, mining, infrastructure and telecom projects abroad. Funding goes to Chinese corporate behemoths that dominate strategic sectors in the Chinese economy itself and many are destined – at least intended as such by the PRC Government's national planning agency the National Development Reform Council – for

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16. Institute of Economic and Resource Management, *A Report on the Development of China's Market Economy*, Beijing: China Foreign Economic Relations and Trade Publishing House, 2003, p. 129.

17. Wang, J.Y. "What Drives China's Growing Role in Africa?," International Monetary Fund Working Paper, August 2007.

Fortune 500 status. Client firms include the national oil corporations CNOOC, CNPC, Sinopec, telecom players Huawei Technologies, ZTE, and construction and engineering firms China Harbour, CSCEC and CEIEC.

According to EXIM Bank's concessional loan requirements, Chinese contractors must be awarded the infrastructure contract financed by the loan. This is similar to concessionary finance of traditional donors and provides these companies with an entry point to set up a presence in host markets where they can bid for commercial contracts, independent of projects under the concessional loan agreements.

In principle, concessional loans are used for procuring equipment, materials, technology and services, with no less than 50 per cent of the contract's procurement coming from China. The loan is denominated in Chinese Renminbi (RMB) and has a maximum maturity of 20 years. A grace period of 3-7 years may be granted to the borrower, during which the borrower will only repay interest payments and not the principal. The interest rate is subsidised and underwritten by Chinese Government finances. China EXIM Bank's loan programme to foreign states also taps into funding from the Ministry of Commerce's aid budget to subsidise its concessional lending.

Donald Kaberuka, President of the African Development Bank, said at the bank's annual general meeting in Shanghai in May 2007 that *"what the Chinese are doing is taking a long-term perspective of the ability to repay debts."*<sup>18</sup>

### **Aid as Part of the Package**

The Chinese Government's brazen corporatist approach to engaging Africa is being actively downplayed through political rhetoric that appeals to a political solidarity that China has with Africa as well as the ramping up of aid to African states. Regularly included in the concessional finance packages provided to many African states is an aid component. Aid is not the basis upon which Beijing engages with Africa, but is increasing the disbursement of aid to the continent in order to reduce the starkness of its commercial ambitions and to connect with Africa on terms with which it is more familiar.

In November 2006 at the FOCAC Summit in Beijing, President Hu Jintao promised to "double aid to Africa by 2009". Due to the inclusion of aid commitments by China into the large financial loan packages as disbursed by China EXIM Bank in Africa, it is impossible to accurately calculate the value of these aid disbursements. Aid pronouncements are clearly included to sweeten the deal for recipient governments.

The Government of the People's Republic of China has a broad and, at times, vague definition of what constitutes foreign aid. China's position on the definition of "aid" does have some parallels with the official OECD-Development Assistance Committee (DAC) definition of Overseas Development Assistance (ODA). According to the DAC definition, grants or loans that are extended to developing countries constitute ODA when they are undertaken by government or government bodies, with the promotion of economic development and welfare as their main objectives, at concessional financial terms.

China's interpretation of what the term "aid" encompasses can be viewed to correspond to the DAC definition, as applied by traditional donors. However, despite some

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18. Wallis, W. and Dyer, G. "Lending rattles the traditional donors" in Africa-China Trade Special Report, *Financial Times*, January 2008.

broad correlations between these interpretations, China's foreign aid policy has a wider, more ambiguous scope. It can be argued that the PRC Government, in particular, the Ministry of Commerce, is itself in the process of defining what constitutes "aid". There is apparently no official definition of aid within Chinese Government circles at present.

Under the November FOCAC 2006 commitments, foreign aid disbursements to Africa in the political, economic, social and cultural spheres are growing rapidly. The monitoring of these commitments and their implementation, as well as delivery to Africa is proving difficult for Chinese Government authorities and state-aligned think-tanks to track, not to mention African institutions themselves. Many of these Chinese aid projects in Africa have not succeeded and are currently undergoing a review by the Chinese government with a view toward making its aid projects more impactful and sustainable.

### **China's so-called "Angola Model"**

China EXIM Bank's financing arrangement that ties a commodity off-take agreement with the provision of infrastructure in the contracting African country are commonly referred to as the "Angola Model". The Bank's first such major deal was concluded with Angola's Ministry of Finance in March 2004 when the first USD2 billion financing package was agreed to. This funding has been financing construction of Angolan infrastructure in the areas of energy, water, health, education, fisheries, road, rail and airport public works projects<sup>19</sup>.

In May 2007, an extension to the original loan was negotiated to the value of USD500 million from China EXIM Bank to add to existing infrastructure spending. In September 2007 a further oil-backed loan of USD2 billion was signed between Angola and the Bank to finance an additional 100 projects that have been prioritised by Angola's Council of Ministers in November 2007.<sup>20</sup>

The total USD4.5 billion loan disbursed is providing Angola with the reconstruction of vital infrastructure in Angola whilst guaranteeing a minimum daily supply of oil to China's national oil corporation Sinopec - in a joint venture arrangement with Angola's Sonangol.

This agreement was not just developmentally but also politically significant for Luanda considering Angola's difficulties in recent years in securing capital from western-aligned international financial institutions, such as the Paris Club and the International Monetary Fund (IMF) due to their concerns over financial governance and political accountability. Kose Pedro de Morais of Angola's Ministry of Finance states that "The fact that we secured a loan from China EXIM Bank has set a new benchmark with which new loans are now being aligned". Other lenders to Angola, including international commercial banks are now lending to Angola on more favourable terms to compete with China EXIM Bank's loan structure.

Rising oil prices in recent years have emboldened the Angolan Government to eschew "traditional" sources of finance when the prospect of financing from Beijing

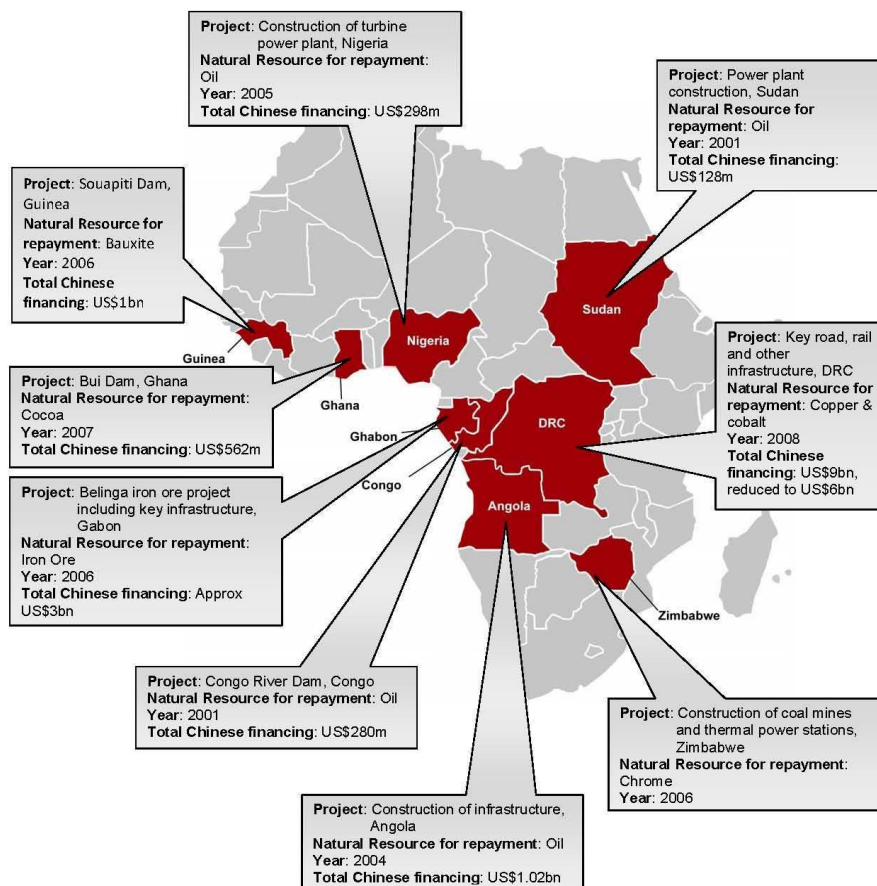
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19. Campos, I. and Vines, A. "Angola and China – A Pragmatic Partnership", Working Paper presented at a CSIS Conference, "Prospects for Improving US-China-Africa Cooperation" in December 2007, March 2008.

20. *Ibid.*

emerged<sup>21</sup>. Other African governments, fatigued by the continuing but apparently developmentally ineffective aid disbursements from traditional actors, are starting to incline toward China’s concessional finance model that is transactional rather than contributory.

### Selected Chinese Concessional Finance Deals in Africa



Source: Frontier Advisory analysis

### Sustainability of the Deals

Much debate exists over the “political motivation” of the loans originating from Beijing. One can attempt to delve into the strategic thinking of policy-makers in Beijing and drivers of China’s foreign policy toward the African continent, but this is not the scope of this paper. Rather the focus is through a “developmental lens” for recipient African economies.

It is argued that China EXIM Bank’s unique long-term financing structure is more suited to Africa’s extractive industries that are the mainstay of the continent’s economy that are both difficult to extract and require very long lead times to commercialise. Most African recipient economies of China EXIM Bank’s concessional loans are endowed, however, with

21. Corkin, L. *Scoping Exercise on China-Africa Relations: Angola Country Case Study*, African Economic Research Consortium, Centre for Chinese Studies, October 2007.

rich oil reserves. It is in these economies where the concessional deals tied to an off-take agreement are seemingly functioning best, led by the Angolan example.

However, considering the recent dramatic drop in commodity prices following the onset of the financial crisis, the question over the sustainability of the sovereign backed debt arises. The question over sustainability of this financing mechanism has come to the fore in the case of China EXIM's Bank's deal with the DRC<sup>22</sup>.

Undoubtedly, one of the most well known deals struck between China and an African country during

2008 was the barter deal signed in April 2008 between the DRC government and the Chinese companies China Railway Engineering Corporation (CREC) and Sinohydro. The deal agreed that a Sino-Congolese joint venture named Sicominex would provide the DRC with China Export-Import (EXIM) Bank financed infrastructure in exchange for copper and cobalt mining concessions. It is planned that mining of these deposits will begin in 2013. In return, Chinese firms will build infrastructure to a total value of USD6 billion. Another USD3 billion will be invested in mining infrastructure through a joint venture between Congolese mining parastatal Gécamines and a Chinese consortium.<sup>23</sup>

The Sicominex deal has been subject to a great deal of controversy. Congolese opposition groups along with international institutions, in particular the International Monetary Fund (IMF), have criticized the deal around the issue of debt sustainability. The DRC is heavily indebted with USD11 billion external debt. Debt relief would reduce the country's debt by up to 90 per cent<sup>24</sup>. Judgment for the granting of debt relief by means of the World Bank Group's Highly Indebted Poor Country (HIPC) debt relief programme is made on the basis of the policy conditions and targets of the Poverty Reduction and Growth Facility (PRGF)<sup>25</sup>. The DRC currently has interim status in the HIPC programme (the country is between decision and completion point). Thus, in order to qualify for debt relief, the DRC has to start a new three-year PRGF programme.

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22. Refer to Jansson, J. Patterns of Chinese investment, aid and trade in Central Africa (Cameroon, DRC and Gabon) A briefing paper by the Centre for Chinese Studies, Stellenbosch University, Prepared for World Wide Fund for Nature (WWF), June 2009.

23. Further details on the agreement can be found in "Convention de Collaboration entre La République Démocratique du Congo et le Groupement d'Entreprises Chinoises relative au Développement d'un Projet Minier et d'un projet d'Infrastructures en République Démocratique du Congo", signed 22.04.2008. See also: Democratic Republic of the Congo, Ministry of Infrastructures, Public Works and Reconstruction (2008), "Contribution by the Minister on the occasion of the Presentation of the Accords signed between the Government of the Democratic Republic of the Congo and the People's Republic of China" Published 09-05-2008, accessed on 04-01-2009 from <http://www.infomine.com/publications/docs/Lumbi2008.pdf>. - See also Jansson, Johanna (2009). "Sino-Congolese barter deal – an update" in Mining Weekly, 3-10 April edition. Available on <http://www.miningweekly.com/article/whither-the-9bn-sino-congolese-deal-in-times-of-crisis-2009-04-03>

24. Citibank (2009). "Citinews", 23 April 2009.

25. International Monetary Fund (2008). "The Poverty Reduction and Growth Facility (PRGF)". Accessed 01.12.2008 from <http://www.imf.org/external/np/exr/facts/prgf.htm>. For more info on the HIPC programme, please see [www.worldbank.org/hipc](http://www.worldbank.org/hipc)



The World Bank writes that “[t]his financial agreement, although [it] has the potential to strengthen the country’s prospects for growth, could hamper DRC’s chances of reaching the HIPC completion point to alleviate sustainably the debt burden, if the following issues it raises are not quickly addressed: the state guarantee for the loan, the concessionality of the loan, as well as the debt viability with respect to the parameters of the debt sustainability analysis”<sup>26</sup>. A breach of the guidelines set by the IMF could result in sanctions against the offending state.

As a result of the pressure imposed by the IMF, the deal has been re-structured downwards to the value of USD6 billion taking into consideration some of these concerns and pressure from the IMF placed upon the DRC Government. According to DRC Central Bank Governor Jean Claude Masangu, “Concerning the mining project, there was a guarantee from the state. The Chinese partners are no longer demanding a guarantee from the state. We are left with a purely commercial contract.”<sup>27</sup> The IMF has responded by saying that “When the IMF services confirm that the revised agreement is compatible with the viability of the debt, the Congolese authorities will be in measure to solicit financial assurances for (a new IMF) programme from the lenders of the Paris Club.”<sup>28</sup>

Within the Sino-Congolese contract Chinese infrastructure projects are already being built to the value of USD750 million in 2009 in the DRC.

## Summary

The loans have become to be perceived as a Chinese foreign policy tool, particularly in Africa’s cash-strapped, but resource-rich countries, and especially those with major infrastructure needs and those which can securitise their proven resources as collateral. Despite the relatively scant numbers of these large projects they have attracted enormous attention in the media. The nature of these financing structures can be described as a potential “game changer” in developmental finance in Africa’s commodities sector. These “coalition arrangements” linking commodity extraction with the construction of infrastructure in recipient African countries is inventive and may have implications for existing interpretations of what constitutes debt sustainability.

China EXIM Bank President and CEO Li Ruogu has argued that the bank takes into consideration both debt sustainability as well as development sustainability<sup>29</sup>. The resources-for-infrastructure lending practice spans both private sector lending and donor lending that is most often de-linked from commercial pursuits.

China’s developmental finance approach with its higher tolerance (due to its political underpinning) of investment risk than traditional funding mechanisms is increasingly appealing to African states over models that may not always cater for the developmental needs of resource rich but developmentally poor African economies.

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26. World Bank (2008). “Democratic Republic of Congo Economic Report: Fall 2008”. Available on : [http://siteresources.worldbank.org/CONGODEMOCRATICEXTN/Resources/DRC\\_Fall\\_Econ\\_Report\\_08.pdf?resourceurlname=DRC\\_Fall\\_Econ\\_Report\\_08.pdf](http://siteresources.worldbank.org/CONGODEMOCRATICEXTN/Resources/DRC_Fall_Econ_Report_08.pdf?resourceurlname=DRC_Fall_Econ_Report_08.pdf)

27. Bavier, J. “Congo to downsize Chinese deal in debt relief bid”, 18 August 2009.

28. IMF Mission Chief in the DRC, Brian Ames. Quoted in *Ibid*.

29. Li Ruogu, “Debt Sustainability & Sustainable Development” Presentation at the OECD, Paris, November 2006. and Li Ruogu, “A Proper Understanding of Debt Sustainability of Developing Countries” in *World Economics and Politics*, v.4: 63-73, 2007.

### III. WILL CHINA'S INFRASTRUCTURE PROJECTS ON THE CONTINENT FACILITATE AFRICAN INTEGRATION?

A significant development in Africa over the past decade has been the trend of Chinese construction firms building infrastructure on the continent. The market entries of large Chinese state-owned or state aligned construction enterprises have largely been underwritten by the Chinese Government through financing provided by the China Export-Import Bank, the *de facto* project finance arm of China Inc. in Africa. Although relatively few in number relative to its overall project funding on the continent, the Bank's new commodities-for-infrastructure financing model is rapidly gaining in appeal to cash strapped African Governments that are willing to part exchange commodity resources for the building of infrastructure.

Will China's infrastructure projects on the continent assist the process of regional integration of African economies?

#### Africa's Wanting Infrastructure

According to the World Bank, China's investment commitments to infrastructure build in sub-Saharan Africa was more than USD7 billion in 2006 – China's declared "Year of Africa". In the following year it committed a further USD4.5 billion<sup>30</sup>. China's investment in African infrastructure is often described as being purely extractive in nature and tied to China interests that pertain to resource security. However, this assertion is overly simplistic. As China's investment in Africa both broadens geographically and deepens in financial commitment, China itself will increasingly have a vested interest in Africa's long-term developmental success.

While Africa's GDP performance has been robust in recent years, a major constraint on sustainable development has been the very poor state of the continent's infrastructure system. The inability of economies to integrate themselves with neighbouring countries to promote wider markets continues to be a serious obstacle to trade. This reality has constricted the development of all sectors in Africa – both primary and secondary. The logistical challenges that are imposed due to this serve to constrain the ability to transport products within the region and ultimately frustrate the formation of value chains for production. It is estimated that Africa requires at least USD40 billion per annum to fund and

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30. Foster, V. Zutterfield, W. Chen, C. Pushak, N. "China's Emerging Role in Africa" in Gridlines, Public-Private Infrastructure Advisory Facility, World Bank, October 2008.

maintain its existing core infrastructure capacity<sup>31</sup>. This undoubtedly has a detrimental impact on the lack of competitiveness of African economies<sup>32</sup>.

A recent report by the Infrastructure Consortium for Africa (ICA) states that "In most African countries, particularly the lower-income countries, infrastructure emerges as a major constraint on doing business, depressing firm productivity by about 40 per cent<sup>33</sup>.

Costs of transportation are higher overall in Africa than other developing economies. According to the United Nations Conference on Trade and Development (UNCTAD), freight costs on average account for 5.4 per cent of imports for the global economy, in Africa this figure is up to five times higher<sup>34</sup>. A World Bank study shows that the average transportation cost to export a container from Africa in 2007 amounted to USD1649 which was almost double the OECD average of USD889<sup>35</sup>.

Deficient infrastructure has thus stifled trade both regionally and internationally and further isolates Africa from the global economy. Currently Africa accounts for less than 3 per cent of both exports and imports in world trade<sup>36</sup>.

Intra-regional trade in Africa is also a lowly 9 per cent of overall African trade – the lowest of any region in the global economy. In addition, the energy infrastructure deficit is estimated to have resulted in up to 6 per cent in yearly industrial production losses.<sup>37</sup>

### China's Financing of African Infrastructure

According to the World Bank, China provided USD4.5 billion in 2007 towards infrastructure projects, in many cases very sizeable scale projects. This is a major increase from USD1 billion annually from 2001-2003, but down from a peak of USD7 billion in 2007 (World Bank, 2008).

Chinese involvement in Africa's infrastructure is also on the increase. Whilst Africa-specific data is not supplied, China's Ministry of Commerce reports that its international construction projects stood at a value of USD7.96 billion in the first two months of 2009, up 24.8 per cent year-on-year despite the financial crisis<sup>38</sup>.

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31. Sandrey, R. and Edinger, H., 2009. "China's manufacturing sector and industrialization efforts in Africa", prepared for the African Development Bank, October
  32. "The foregone income due to extended waiting times and delays at borders on these cargos is huge. A week's delay of a trainload of copper can cost up to USD16000 only for the interest charged. Trucks transporting goods can take up to 10 days to pass through border posts, significantly increasing economic costs" (see Edinger, H., 2009. "Lack of cross-border infrastructure will stifle trade". SA Exporter, Business Day. [Online]. Available: [www.businessday.co.za](http://www.businessday.co.za), May.).
  33. Cropley, E. "Africa needs \$93 billion a year for infrastructure: report", Reuters, 12 November 2009.
  34. Hanouz, M.D. and Lawrence, R. "Enhancing Trade in Africa: Lessons from the Enabling Trade Index" in The Africa Competitiveness Report 2009, World Economic Forum.
  35. *Ibid.*
  36. Hanouz, M.D. and Lawrence, R. *op.cit.*
  37. Edinger, H. and Herman, H., 2009. "Beijing's investment muscle could lighten SA's load". SA Exporter, Business Day. [Online]. Available: [www.businessday.co.za](http://www.businessday.co.za)
  38. [http://news.xinhuanet/english2009-03-16/content\\_11021374.htm](http://news.xinhuanet/english2009-03-16/content_11021374.htm)

China's financing commitments have intersected largely with China's foreign policy objectives on the continent. Funding has been provided through so-called concessional financing channelled through China's EXIM Bank. The combination of loans and grants for commercially driven projects has taken place in over 35 African countries with noteworthy recipient including Angola, Ethiopia, Nigeria and Sudan<sup>39</sup>.

In terms of the power sector, "research into Chinese policy bank financing in Africa reveals that great focus is placed on hydropower projects, with approximately USD5.3 billion being invested in this sector"<sup>40</sup>. For example, China EXIM Bank has financed the construction of the large-scale Bui Dam project in Ghana. The project valued at USD660 million is to provide 400 MW of power to be distributed nationally and to neighbouring countries. It is estimated that almost two-thirds of Africa states have received finance from China – mostly through China EXIM Bank – for thermal and hydro power projects in Africa<sup>41</sup>. The World Bank states that Chinese funded projects will generate a power capacity of more than 6000 megawatts – over a third of Africa's currently existing hydropower generating capacity<sup>42</sup>.

In the rail sector, Chinese financing commitments in Africa are reportedly standing at no less than USD4 billion for rehabilitation of both old lines that were mostly damaged through conflict as well as new line construction. Large deals have been announced in Nigeria, Gabon and Mauritania<sup>43</sup>. The Nigeria deal was out on hold after its change in government two years ago, but in October 2009 an agreement was signed to construct a railway line from the capital Abuja to Kaduna valued at USD850 million and to be constructed over a three year period. The largest rail project planned to date is the potential rehabilitation of over 3200km of rail in the DRC – an infrastructure development commitment that forms part of the commodity for infrastructure deal being implemented by a consortia of Chinese firms.

In the realm of ICT, China EXM Bank is providing finance for the supply of equipment hardware from leading firms such as ZTE and Huawei Technologies. Another World Bank estimate in 2008 finds that Chinese telecom firms have supplied over USD3.2 billion worth of telecoms equipment to Africa with particular reference to Ethiopia, Ghana, South Africa and Sudan<sup>44</sup>.

For the construction of roads, it is estimated that project finance for road rehabilitation and building stands at approx. \$550 million, but with many more projects in the planning stages. Deserving particular mention once again is the DRC case where it is

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39. World Bank, 2008. "Building Bridges: China's growing role as infrastructure financier for Sub-Saharan Africa".

40. Sandrey, R. and Edinger, H., 2009. "China's manufacturing sector and industrialization efforts in Africa", prepared for the African Development Bank, October

41. *Ibid.*

42. Foster, V. Zutterfield, W. Chen, C. Pushak, N. *op. cit.*

43. *Ibid.*

44. *Ibid.*

reported that over 7000km of road rehabilitation and construction is to be carried out by Chinese contractor companies<sup>45</sup>.

A key facilitator and contributor to these infrastructure projects has been China EXIM Bank. As the lending arm of the Chinese Government, the policy bank has financed specifically infrastructure developments on the continent. Reportedly, China EXIM Bank alone has also financed more than the combined total investment from official development assistance (ODA) and private participation in infrastructure (PPI) in the African power sector between 2001 and 2006 according to a survey carried out by the IMF.

Given the desperate state of Africa's infrastructure, the continent needs to embrace China as a new large-scale infrastructure financier, specifically in light of the current global recession and withdrawal of capital out of emerging markets and Africa. For China, its involvement in Africa's construction and infrastructure sectors has proved most effective in building relations with African governments, increasing influence and expanding and facilitating transportation access within and between African economies.

Senegalese President Abdoulaye Wade states that *"With direct aid, credit lines and reasonable contracts, China has helped African nations build infrastructure projects in record time – bridges, roads, schools, hospitals, dams, legislative buildings, stadiums and airports. In many African nations, including Senegal, improvements in infrastructure have played important roles in stimulating economic growth."*<sup>46</sup>

However, it is claimed by many international observers infrastructure projects funded by Chinese financial institutions in Africa are tied to the extraction of raw resources. This however, is a simplistic assertion as Chinese financiers largely finance projects that are proposed by the recipient governments themselves. Decisions on the choice of infrastructure project are thus taken in African capitals and not Beijing.

Chinese financing could potentially make a not insignificant contribution to efforts toward economic diversification in African countries. First, infrastructure development can promote and attract further investment in all related sectors in the economy, in particular the extractive industries which contribute toward the bulk of most sub-Saharan African economies' GDPs.

Second, local beneficiation through production can be supported through the access to enabling infrastructure. Both local productivity and international investment will be enhanced as the cost of doing business and other transaction costs will decrease through the greater capacity resulting from increased infrastructure provision.

Chinese state-owned and state-aligned companies have, however, made strategic inroads into the construction and infrastructure sectors in many African economies often at the expense of the existing market presence of European and even recently arrived South African construction and project engineering companies. Criticism from the private sector as well as non-governmental organisations has been levied against the market entry and operational practices of Chinese construction firms in the region. Some of the criticisms may be valid especially around the widespread usage of expatriate Chinese labour where local labour could often be utilised.

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45. Field research carried out in the DRC, through 2008 and 2009 by the Centre for Chinese Studies, Stellenbosch University.

46. Wade, A. "Time for the west to practice what it preaches" in the Financial Times, 23 January 2008.

Criticism is common of Chinese firms that often operate as “insulated actors” in recipient African economies. Construction firms that utilise only Chinese labour for their contracts do so in the interests of rapid completion of their projects. The desire to deliver the infrastructure on time often takes precedence over the inclusion of the local community – projects which have delivery dates often determined by government seeking the political kudos from their completion.

### **China and Regional Infrastructure Co-ordination?**

“China has a plan for Africa but Africa does not have a plan for China.” This is comment that has been repeated at numerous conferences pertaining to China-Africa relations in recent years. Beijing is often criticised for not engaging Africa at a more multilateral level - coordinating its infrastructure investment activities at a regional rather than a national level. But is this criticism fair?

With respect to African integration, the finding of a conference hosted by the Development Bank of Southern Africa in 2008 found that “As China’s role in the provision of infrastructure has broadened throughout Africa, it has become clear that the continent needs to coordinate a regional response to the potential advantages China could bring in this regard in the future.... While the potential benefits from China’s engagement on the continent, specifically in the provision of infrastructure, was great, it could only be harnessed once African governments realised these benefits and the advantages that regional actions could bring to their country, as well as its neighbours.”

The lack of adequate cross-border infrastructure within African regions undoubtedly hampers attempts to promote intra-regional trade and economic cooperation. Exacerbating the obstacle is blockages and delays experienced when traversing African countries’ borders. Regional efforts to alleviate these bottlenecks and inefficiencies are beginning, but a great deal of work has to be done to improve regional coordination. Collaboration within regions is thus weak and aggravated by weak and under-resourced institutions within African countries at the multilateral level that in many cases have had little interaction with Chinese policy-makers or financial actors.

An organisation such as the NEPAD Business Foundation (NBF), a private sector body spun out from the NEPAD Secretariat, is working to prioritise and coordinate infrastructure development around key development corridors, but its efforts are largely applicable to the southern African region only. The NEPAD Secretariat and NBF have engaged with the Chinese Government around the FOCAC Forum in November 2006, but neither has the mandate to negotiate project investment on behalf of African governments or other private sector stakeholders. Rather its role appears to be is marketing and coordination of prioritised corridors or so-named spatial development initiatives.

It could be argued that the sheer geographic enormity and great diversity of Africa will most often prevent common African positions being found especially in relation to infrastructure where its economic benefits are largely localised. The bureaucratic processes involved in seeking common regional positions amongst states that have – despite geographic proximity – greatly varying interests has also discouraged Chinese commercial actors in Africa from engaging multilateral institutions rather than at the preferred bilateral level.

## Summary

In comparison to many peer economies in Asia, most African economies have been unable to establish substantive and competitive manufacturing sectors, the development of which has been hampered by a lack of economically enabling infrastructure. Given the desperate state of the continent's infrastructure, Africa can undoubtedly not afford to disregard China as a large-scale financier of infrastructure, specifically in light of the current global recession where large values of capital from traditional investors have been withdrawn due to the crisis.

Whilst traditional western donors have shifted their aid emphasis toward so-called "softer" spending seeking to influence policy or to disseminate information to populations, China remains heavily focused on "hard" spend especially on infrastructure. This approach reflects China's own model toward development that has focused on massive infrastructure development and industrialization. The method in which Chinese state-owned and so-called "policy banks" direct capital towards key sectors in China has accelerated this process in China.

## IV. WILL CHINA ASSIST AFRICAN INDUSTRIALISATION?

The trend of China's "counter-cyclical" investments abroad is becoming increasingly apparent in Africa. It extends beyond the sizeable concessional deals signed between Chinese policy banks with African governments and investments by Chinese companies into Africa's resource and infrastructure sectors.

China's Go-Global strategy announced in 2002 to encourage Chinese firms to establish an international investment presence is gaining in momentum following the onset of the global crisis. The state-inspired policy formulated by the Ministry of Commerce (MOFCOM) includes the encouragement of Chinese enterprises to establish offshore operations in designated Chinese special economic zones in the global economy. This strategy forms an integral part of the PRC's Eleventh Five Year Plan (2006-2010). According to MOFCOM, manufacturing accounts for just 8 per cent or USD9.52 billion of its total outbound FDI stock of USD118 billion by the end of 2007<sup>47</sup>. This figure is likely to rise as Chinese firms seek to offset protectionist sentiment that is rising during the global economic crisis.

These designated zones are being set up in an array of very diverse countries that include Cambodia, Egypt, Mauritius, Nigeria, Pakistan, Russia, Tanzania, Thailand and Zambia. MOFCOM is coordinating the planning of these zones in conjunction with host governments that have already themselves initiated domestic development zones to promote industrialisation and/or exports.

The zones are intended to promote China's foreign commercial interests and create safe-havens for Chinese capital, and similarly offset risk against increasing protectionist trade practices against Chinese companies<sup>48</sup>. The zones are thus expected to assist Chinese companies to secure new markets on the African continent through investment in industrial clustered zones. Whilst these industrial zones may begin to serve as catalysts for broader industrial activity in their host economies, the broader impact of China's rapidly rising exports of manufactured products to African economies may be to undermine African states already weak manufacturing sectors. The general lack of success to add downstream beneficiating industry in African economies may be further exacerbated as they increase their imports from China.

But in addition to the economic rationale exists a political motivation. The establishment of these light industrial manufacturing zones creating job for local citizens will also serve to offset criticism that trade with China erodes the industrial base of its Africa

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47. Davies, K. *op cit*.

48. Davies, M. J., 2008. "Special Economic Zones: China's Developmental Model Comes to Africa", in Rotberg, R. I. (ed), 2008. "China into Africa: Trade, Aid and Influence", March, pp. 137-154.



trading partner and also that Chinese firms only seek to invest in the extractive industries, especially in Africa.

What are the strategies behind the establishment of Chinese special economic zones in Africa and what contribution will they have toward industrialisation efforts in Africa?

### Clustering for Competitiveness

African economies' share of manufacturing value added as a share of their GDPs is very low compared to other emerging market peer economies<sup>49</sup>. Many Asian economies' industrial success over the past four decades originates from the creation of manufacturing and export processing zones with incentives provided to investors to set up industrial clusters. Successful manufacturing and export oriented economies in Asia have regularly benefited from a critical mass of industries. Other economies, not least in Africa, implemented import substituting industrialisation policies, which served to restrict economic openness and resulted in protectionist tendencies.

According to Porter, the global economy is characterized by these clusters – critical masses in one place of linked industries and institutions. They are “geographic concentrations of interconnected companies and institutions around particular sectors”. The trend of clustering contributes to competitiveness in three ways: It increases the productivity of companies that are located in or around the cluster; they promote the direction and pace of innovation; and they lead to the creation of new businesses within the cluster.

Porter states that clusters regularly “extend downstream to channels and customers and laterally to manufacturers of complementary products and to companies in industries related by skills, technologies, or common inputs”. Clustering is most often underdeveloped or absent in poor or developing countries. These economies are unable to compete beyond supplying non-beneficiated raw resources. Porter states that to move beyond this lowly state of economic development, the development of well-functioning clusters is essential.

Following the political change and the resultant dramatic shift in economic policy that took place in China in the late 1970s, the country's leadership thereafter created dedicated geographical zones on the eastern seaboard of the country that would serve as experiments for market liberalization to attract Chinese diaspora and foreign capital. These zones increased in number as Chinese reform efforts gained economic traction.

Four SEZs were introduced two years after the party's Eleventh National Congress in December 1978. The conference recognized the need for the country to implement economic reform, promoting a market-led policy to encourage higher levels of foreign capital, trade, technology, and growth in an economy that had until then been insular and based on the premise of self-sufficiency. The state acted as the primary funding agency of the SEZs in their initial growth stages.

The new “open door policy” and the SEZs were mechanisms to open the country's economy gradually to the rest of the world. SEZs in Shenzhen, Zhuhai, and Shantou in Guangdong Province and in Xiamen – including Xiamen Island and Gulangyu Islet – in Fujian Province were announced in 1980.

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49. Kaplinsky, R., 2008. “What does the Rise of China Do for Industrialisation in Sub-Saharan Africa?” *Review of African Political Economy*, Vol. 35: 115, p. 7-22

A fifth zone in Hainan Province was created in 1988, after the passage of a resolution to establish Hainan Province and Hainan SEZ. The Hainan SEZ was the largest of the zones, including 6 cities and 13 counties with a total population of 7.4 million. The zones were located along China's east coast, taking advantage of potential links between Shenzhen and its neighbour Hong Kong, Zhuhai and nearby Macao, Xiamen and Taiwan, while also providing easier access to foreign markets<sup>50</sup>.

Similar attempts of launching dedicated zones to attract capital investment on the African continent have, however, enjoyed considerably less success. Except for the case of Mauritius, Africa generally has largely failed to achieve tangible gains from the establishment of these liberalised investment zones<sup>51</sup>.

### Chinese Clusters in Africa

China could potentially be a catalyst for the promotion of industrial activity in selected African economies where Chinese funded zones are established. The SEZ investment proposal originated at the FOCAC summit in Beijing in November 2006. Under the Beijing Action Plan, it was stated that "China is ready to encourage, in the next three years, well-established Chinese companies to set up three to five overseas economic and trade cooperation zones in African countries where conditions permit." This commitment was to be fulfilled before the following FOCAC Summit hosted by the Egyptian Government in November 2009.

In the planning eyes of Beijing, the zones are expected to improve the investment climate and thus attract foreign private investment into dedicated investment clusters. The terms of these zones are being negotiated between Beijing and targeted African governments that are willing to offer the requested policy concessions in order to receive committed Chinese investment. These potentially include investment incentives such as tax breaks, customs duty waivers, discounted land and other such services.

The zones are becoming more attractive to African states which seek to promote the clustering effect in their economies and to move away from simple resource extraction. A sizeable capital injection from Chinese financiers or investors could provide a good base from which to expand. The emergence of a Chinese funded cluster zone could contribute to the backward (to the country's hinterland) and forward (to export markets) linkages in the economy. Most importantly the zones are seen as facilitators to creating employment opportunities and generating greater foreign exchange reserves through more diversified sources of income<sup>52</sup>.

To date, positive interest and uptake in the establishment of such zones has been shown by both Chinese anchor investor companies and African recipient states. Six official

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50. Davies, M. J., 2008. "Special Economic Zones: China's Developmental Model Comes to Africa", in Rotberg, R. I. (ed), 2008. "China into Africa: Trade, Aid and Influence", March, pp. 137-154.

51. Jauch, H. "Export processing zones and the quest for sustainable development: a Southern African perspective" *Environment & Urbanization*, Vol 14 (1), April, pp. 101-113, in Sandrey, R. and Edinger, H., 2009. "China's manufacturing sector and industrialization efforts in Africa", prepared for the African Development Bank, October 2002.

52. Sandrey, R. and Edinger, H.. "China's manufacturing sector and industrialization efforts in Africa", prepared for the African Development Bank, October 2009.

zones have been announced thus far by the PRC Government, but as it is very early in the roll-out of these zones, their operational successful remains to be seen.

### China's Special Economic Zones in Africa

It is expected that these proposed SEZs will focus on value-added industries and provide liberalised investment environments for investors. Furthermore, the zones will not exclusively provide for Chinese investors but seek to attract capital from other domestic or foreign investors.

A number of African economies are more familiar and versed with the establishment of EPZs and attracting capital into these zones. Kenya, Egypt and Mauritius are probably the most proactive economies on the continent in establishing such zones<sup>53</sup>.

The first zone announced in February 2007 during President Hu Jintao's 2007 eight-country Africa visit is located in Chambishi in the heart of Zambia's copperbelt region. Characterised as a Multi Facility Economic Zone (MFEZ), its main objective is to catalyse "industrial and economic development in the manufacturing sector for the purpose of enhancing both domestic and export orientated business" and will "operate on the principal of value-addition"<sup>54</sup>. The anchor investment is a copper smelter project with a project value of USD250-\$300 million and built by China Nonferrous Metal Mining Group. Total investment in the zone is expected to reach between USD800 million and USD1 billion. By early 2009 it was reported that more than ten Chinese firms had established operations in the zone, creating over 3500 local jobs<sup>55</sup>. Contracts across a number of industries including mining, smelting and chemical engineering have been inked and more than USD300 million in contracts is expected to be reached for local procurement<sup>56</sup>.

Altogether, more than 50 Chinese businesses are expected to invest in the zone over the medium term with between 6000-7500 job opportunities directly created and up to 15000 indirectly in the Zambian economy.

International commentators have, however, expressed caution against Chinese investment in Africa due to the common usage of large numbers of expatriate Chinese labour utilised on construction projects and exclusively Chinese procurement practices. Concern has also been expressed over the Zambian Government offering special tax concessions to Chinese investor firms may possibly erode the country's fiscal revenue base if not monitored cautiously and effectively<sup>57</sup>.

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53. Edinger, H. "China's Commercial Relationship with Africa: Evaluating Special Economic Zones", presented at the Institute for West Asian and African Studies (IWAAS), Chinese Academy of Social Sciences, Beijing, China, 15 April 2008.

54. See Ministry of Commerce, Trade & Industry website at: [http://www.mcti.gov.zm/index.php?option=com\\_content&task=view&id=50&Itemid=9&limit=1&limitstart=2](http://www.mcti.gov.zm/index.php?option=com_content&task=view&id=50&Itemid=9&limit=1&limitstart=2)

55. See "Zambia-China Economic Zone launches sub-unit in Lusaka", 16 January 2009, [http://en.ce.cn/Business/Macro-economic/200901/16/t20090116\\_17983718.shtml](http://en.ce.cn/Business/Macro-economic/200901/16/t20090116_17983718.shtml)

56. See Construction of China-Africa economic and trade cooperation zones proceeds smoothly, 21 January 2009, People's Daily, <http://english.peopledaily.com.cn/90001/90776/90883/6578752.html>

57. See IMF, "Statement by the IMF Staff Mission at the Conclusion of a Visit to Zambia", 2 April 2007. <http://www.imf.org/external/np/sec/pr/2007/pr0762.htm> and see Sandrey, R. and Edinger, H.,

In Mauritius, the second SEZ was announced in mid-2007. The zone is strategically located in the Indian Ocean Rim region. Located near Port Luis construction of the zone was due to commence in October 2007. Called the Mauritius Tianli Economic and Trade Cooperation Zone, the zone is subject to investment of USD500 million by Shanxi Tianli Enterprise Group over the next five years. The zone will focus on the service industry, servicing Chinese enterprises operating and investing in mainland Africa.

Mauritius provides a strategic destination for Chinese investment. It is well situated on the Indian Ocean Rim; it is an offshore financial centre with attractive investment laws; its economy is well integrated into the economies of South Asia; the country is a member of the Southern African Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA) and thus enjoys preferential market access into the African region; and Mauritius has a sizable ethnic Chinese community that is active in trading with the Chinese economy. The zone is expected to earn about USD200 million in export earnings per annum once fully operational<sup>58</sup> contributing to the island's economic diversification process. According to Mauritian Prime Minister Navinchandra Ramgoolam, China will utilise Mauritius as "*a springboard for entry into Africa.*"<sup>59</sup>

The third "official" zone is intended to be located in Egypt. Most foreign investment in Egypt already takes place under the laws which define incentives around SEZs, promoting both public and privately managed investment zones. In early 2007, Chinese investment in Egypt's SEZ near Suez was announced and twinned with the very successful cluster development in the northeast Chinese city of Tianjin. Tianjin Economic and Technological Development Area Suez International Cooperation Company is the major shareholder of the Egypt-Teda zone initiative - a Sino-Egyptian joint venture overseeing the development of the zone<sup>60</sup>. The first phase of the zone is expected to be completed by 2011, with an initial capital investment of USD100 million. This phase is forecast to create 10000 jobs mainly for local workers<sup>61</sup>. Construction of the entire zone will take up to 2018 to be completed<sup>62</sup> and up to USD2.5 billion in investment is expected to be invested from China into this zone, mainly targeting the automotive components, electronics, logistics, clothing and textiles sectors<sup>63</sup>. The zone is strategically positioned to expand market access into the Middle East and North Africa (MENA) region and sub-Saharan Africa. It also provides to an extent market access into the EU as well as to the US market.

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2009. "China's manufacturing sector and industrialization efforts in Africa", prepared for the African Development Bank, October

58. See: [www.afrol.com/articles/26135](http://www.afrol.com/articles/26135)

59. In mid-July 2007, Prime Minister Ramgoolam led an official mission and business delegation to China to motivate Chinese investment to the island economy. Cities visited include Beijing, Shanghai, and Qingdao.

60. See: [www.entrancechina.org/news.php?id=85460](http://www.entrancechina.org/news.php?id=85460)<http://www.entrancechina.org/news.php?id=85460>

61. See: [www.entrancechina.org/news.php?id=85460](http://www.entrancechina.org/news.php?id=85460)<http://www.entrancechina.org/news.php?id=85460>

62. See: [www.itnewsafrika.com/?p=57](http://www.itnewsafrika.com/?p=57)

63. See: [www.entrancechina.org/news.php?id=85460](http://www.entrancechina.org/news.php?id=85460)<http://www.entrancechina.org/news.php?id=85460>

A zone in West Africa is being established in Nigeria - the Lekki Free Trade Zone which is to be developed in three phases and seeks to attract more than USD5 billion in investments. The Vice President of the Chinese anchor investor in the zone - Guangdong Xinguang International Group - Sun Jianxiong, stated that Nigeria was chosen to host one of the official SEZs due to its large domestic market and accessibility to the West African and European marketplaces<sup>64</sup>.

Other potential Chinese-invested zones are being mooted in Angola, Ethiopia, Mozambique, Tanzania and Uganda. The zones in Mauritius, Egypt and Nigeria are partially supported by the CADFund<sup>65</sup>, which is assisting both with zone construction, infrastructure rollouts and supporting Chinese companies looking to expand into these zones. While these developments are still in an early stage, there could be potential benefits to the industrial development of these economies through these Chinese invested SEZs.

## Summary

China's strategy of establishing clusters in Africa is lifted from its own developmental experience at the onset of its economic reform drive in 1980's. The zones within which these clusters were formed, contributed to attract the required capital, technology, skills and management process into China's domestic economy. The lure of China's sizeable and growing domestic market along with the attractive policy incentives on offer contributed to the success of these zones.

The alignment of Africa's economies to China's going global strategy is resulting in the establishment of Chinese initiated zones on the continent that have the potential to develop into economic clusters. If successful, they may encourage further liberalisation by the host African governments to attract capital both international and local into their economies. Centred around the Chinese zones, clustering type arrangements will be a new trend of Chinese investment on the continent.

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64. *This Day*, 21 September 2007.

65. Teng, L., 2009. "China's First Equity Investment to facilitate the African Continent". Presentation by the Southern African Representative of the China-Africa Development Fund (CADFund) at the opening of the Asian Business Centre at the Gordon Institute of Business Science (GIBS), Johannesburg, South Africa, 26 March

## V. CONCLUSION

Africa is proving receptive to Chinese investment with political resistance to Chinese investment in the continent's "strategic assets" absent. Whilst debate and political opposition to Chinese investment has been increasing as the pace of China Inc. moving abroad has increased in the developed western world, no such political resistance from African governments has been forthcoming. The political obstruction – however real or perceived – of Chinese SOE acquisitions in western economies is likely to further encourage these firms to seek out investments in Africa centred largely on commodities.

But beyond the impressive growth numbers of Chinese investment in Africa, the question remains as to whether the politically conceived investment drive will prove sustainable. China's current government is clearly intent on expanding and deepening its investment commitment to the continent using the state-owned vehicles that it has at its disposal. Spearheaded financially by China EXIM and China Development banks with leading SOE firms in tow, it is apparent that commercial intent reinforces the political rhetoric from Beijing. A review of China's foreign policy approach toward Africa may be in store when China's new government is installed after the 17<sup>th</sup> Chinese Communist Party congress due in March 2013. Over the medium, China's commercial presence in Africa will continue to gain traction and this has been reinforced by Beijing's financial commitments to the continent outlined at FOCAC IV in Sharm El Sheikh.

The challenge for China Inc. however, will be less political and more operational. A disconnect is becoming apparent between the vision held toward Africa by Chinese politicians and Chinese firms that are serving to act upon and implement the "going global" policy in Africa. The operational environment in most African states is challenging and not conducive toward promoting private sector growth. The operational difficulties facing Chinese firms are no different to other foreign firms and their ability to manage and overcome challenges and investment risk in Africa is not yet proven.

Inter-cultural challenges are also an obstacle facing Chinese firms operating in Africa. Chinese firms are used to dealing with tough and competitive conditions, but are far less adept at these early stages of their internationalisation at understanding local cultural circumstances. African societies also have a relatively low understanding of China and the Chinese. It is imperative that African organisations and governments build their knowledge, networks and experience in dealing with Chinese commercial institutions.

I do not believe that we as Africans have even begun to comprehend the long-term strategic implications of China's growing commercial presence in Africa. A shift in Africa's economic relations is occurring – away from traditional economies toward the east and China. This force has not been created by the current crisis that is inflicting western economies, but it has definitely accelerated it. The developmental impact of this shift in Africa will begin to become clearer as the depth of China's commercial penetration becomes greater.

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