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China and Africa: An Emerging Partnership for Development?

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Edited by:
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African Development Bank Group

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Foreword

The development landscape in Africa is changing, with new partners from the global South taking on a more important role as providers of much needed finance and know-how for Africa's development. China has been the most prominent emerging partner, and Chinese enterprises have increased their trade and investment relations with African counterparts by a factor of more than ten over the past decade. The growing trade and investment relations are often supported by grants or concessional loans from China's government, as part of the country's "Going Global" strategy. This strongly enhanced engagement is partly the outcome of the increased economic role and power of China on the global stage, and partly the result of China's interest in Africa's rich natural resource base to fuel its surging economy.

Indeed, a large share of China's trade and investment has been linked to extractive industries and related infrastructure. Yet, infrastructure development is a clear priority on the African continent, as progress towards strong, sustained and shared growth depends on private enterprises having access to quality infrastructure services at internationally competitive prices. With an annual infrastructure investment gap in Africa of about USD 50 billion, China's contribution to reducing the transport, power, and telecommunication deficits on the continent is a welcome complement to the efforts by national governments, private investors, and the donor community.

Moreover, China's impact on African economies has started to reach beyond narrow infrastructure-for-resources deals and now touches upon a large array of sectors and development issues. For

example, the creation of Chinese-operated Special Economic Zones in several African countries has the potential to provide a marked boost to the manufacturing capacity of many African countries. In this context, it is timely to take stock of China-Africa relations and discuss in detail the opportunities and challenges for both sides. This publication provides such a comprehensive assessment. The study was supported by a research grant from the United Kingdom's Department for International Development, and it brought together contributions from some of the most distinguished experts in the field of China-Africa relations.

The growing engagement of China on the African continent also challenges the way we at the AfDB and other development partners operate. Some observers are even referring to a "Beijing consensus", in which private sector development and economic growth take center stage and investors do not interfere with the domestic governance structures of African countries. Such sentiment shows that the emergence of China and other new development partners requires us to rethink, and in some cases, gradually adjust our approach. The African Development Bank Group stands ready to engage in this process and help to leverage the financial, technological, entrepreneurial, and knowledge resources from China to the benefit of the African economies.

Mthuli Ncube

Chief Economist and Vice-President,
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Acronyms and Abbreviations

ACFTA	Asian-China Free Trade Area
ACP	African, Caribbean and Pacific
AEC	African Economic Community
AERC	African Economic Research Consortium
ADB	Asian Development Bank Group
AfDB	African Development Bank Group
AFD	Agence Française de Développement
AFTA	Asian Free Trade Zone
AGOA	American Growth and Opportunity Act
AICD	Africa Infrastructure Country Diagnostic
AMU	Arab Maghreb Union
APTA	Asian Pacific Trade Agreement
ATC	Agreement on Textiles and Clothing
AU	African Union
CADF	China-Africa Development Fund
CDB	China Development Bank
CEMAC	Central African Economic and Monetary Community
CIDA	Canadian International Development Agency
CIF	Cost, Insurance and Freight
CIRR	Commercial Interest Rates of Reference
CIS	Commonwealth of Independent States
CNOOC	China National Offshore Oil Company
CNPC	China National Petroleum Corporation
COMESA	Common Market for Eastern and Southern Africa
COMTRADE	United Nations Commodity Trade Statistics Database
CPIA	Country Policy and Institutional Assessment
DAC	Development Assistance Committee
DFID	Department for International Development of the United Kingdom
DFI	Development Finance Institutions
DRC	Democratic Republic of the Congo
DSF	Debt Sustainability Framework
EAC	East African Community
EBA	Everything But Arms
ECCAS	Economic Community of Central African States
ECCCC	European Chamber of Commerce in China
ECOWAS	Economic Community of West African States
ELF	Emergency Liquidity Facility



EPA	European Partnership Agreement
EPZ	Export Processing Zone
EU	European Union
EXIM Bank	Export-Import Bank
EXTI	Extractive Industries Transparency Initiative
FAI	Fixed Asset Investment
FDI	Foreign Direct Investment
FOB	Free on Board
FOCAC	Forum on China-Africa Cooperation
GCI	General Capital Increase
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
ICA	Infrastructure Consortium for Africa
ICBC-SB	Industrial and Commercial Bank of China and Standard Bank Consortium
ICT	Information and Communication Technologies
IDA	International Development Association
IDS	Institute of Development Studies
IFC	International Financial Corporation
IFI	International Financial Institutions
IMF	International Monetary Fund
IMF DOT	International Monetary Fund Direction of Trade
MENA	Middle East and North Africa
LDC	Least Developed Countries
MCC	Millennium Challenge Corporation
MDG	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MFEZ	Multi Facility Economic Zone
MOC	Ministry of Commerce
MOFCOM	Ministry of Commerce of the People's Republic of China
MoU's	Memorandums of Understanding
MVA	Manufacturing Value Added
NAFTA	North America Free Trade Agreement
NEPAD	New Partnership for African Development
NGO	Non-Governmental Organisations
NPV	Net Present Value
ODA	Official Development Assistance



OECD	Organisation for Economic Co-operation and Development
OOF	Other Official Flows
PPP	Public-Private Partnership
PPP	Purchasing Power Parity
RMB	Renminbi
RMC	Regional Member Countries
SACU	Southern African Customs Union
SADC	Southern African Development Community
SEPA	State Environmental Protection Agency
SEZ	Special Economic Zones
SITC	Standard International Trade Classification
SME	Small and Medium Size Enterprises
SOEs	Stated Owned Enterprises
SSA	Sub-Saharan Africa
TA	Technical Assistance
T&C	Textile and Clothing
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNECA	United Nations Economic Commission for Africa
UNIDO	United Nations Industrial Development Organization
US	United States
USD	United States Dollar
VAT	Value Added Tax
WTA	World Trade Atlas
WTO	World Trade Organisation



China and Africa: An Emerging Partnership for Development?

Richard Schiere



I. Introduction

China's phenomenal growth offers an opportunity to boost development in African countries. In 2008, trade between Africa and China reached \$100 billion and FDI flows from China to Africa amounted to \$5.4 billion. Moreover, China's loans and concessional assistance financed a wide range of development projects. China also is reaping significant benefits from this relationship, through access to raw materials, expanded markets for exports of manufactures, the establishment of investment relationships which could generate significant profits over time and diplomatic influence. But leadership from African governments, particularly to strengthen domestic policies and governance and to harmonize regional policies so as to improve the continent's bargaining position with China, are required to ensure that the China-Africa relationship contributes to sustainable growth and poverty reduction. The twin goals of this book are to analyze the economic exchange between China and Africa, and to outline policy recommendations to improve the benefits to both parties.

This overview summarizes the book's key messages and policy recommendations. The next section describes the changing nature of China's development role in Africa over the last six decades, while the third provides a snapshot of relations today. The fourth section analyzes the impact of trade with China on Africa's trade, and the fifth reviews China's investment in African infrastructure. The sixth section highlights the complementary between China and traditional development partners, while the seventh underlines the need to improve governance to ensure that Africa derives the maximum benefit from the development opportunity provided by China. The final section provides a range of recommendations for African countries and China, and considers how the African Development Bank Group can be instrumental in supporting the deepening of China-Africa relationships.

II. An Evolving Partnership

China's history of engagement with Africa can be traced back to the 15th Century when Chinese traders visited East Africa. But the foundation for modern day Sino-African relationships was built in the post colonial period, when China enlarged its cooperation framework with Africa as part of its efforts to demonstrate solidarity with developing countries. The classic example of Chinese support was the \$400 million, interest-free loan provided over 1970-75 for the landmark 1,800 km Tanzania-Zambia railways. This was a large sum for China, which was poorer than most African countries in the 1970s. China also financed several showcase projects, such as football stadiums and public buildings.

Beginning with China's opening to the world under the leadership of Deng Xiaoping in 1978, the Sino-African engagement became less driven by ideological interests and more by commercial viability. Rising living standards and industrialization dramatically increased the consumption of energy and raw materials, raising China's dependence on imports of oil and minerals, in part from Africa. China's trade with African economies boomed, reaching almost 10 percent of Africa's trade in 2008.

Chinese outward FDI is supported by the government's "Going global strategy", which assists Chinese enterprises in becoming global multinationals through providing soft loans and other assistance to foreign investment projects, in particular in emerging markets. Chinese investments in foreign countries are often driven by enterprises with majority ownership by central, provincial or municipal governments. Although these enterprises are officially in the hands of the public sector, they operate frequently as private sector entities and typically seek to maximize profits and set wages of managers and workers at a competitive level.



Chinese banks have been increasingly involved in providing financial services to facilitate trade and investment projects in Africa. Most prominently, the China-Africa Development Fund (CADF) was established in 2007 by the China Development Bank (CDB) as a \$5 billion equity investment fund to assist Chinese companies in expanding into Africa. Beneficiaries have included Sinosteel Corporation, China National Building Material and Hainan Airlines. The CADF also supports companies in the Chinese Economic Processing Zones in Zambia and Mauritius (future zones are currently being discussed in Nigeria, Tanzania, Liberia and Cape Verde.) These investments contribute to African development while helping China to diversify its \$2 trillion external assets, currently mainly invested in foreign Treasury bonds with relatively low yields.

The expansion of Chinese commercial activities in Africa has led to a shift in public policy from a narrow focus on trade and investment relations to a broad range of development issues. China has pledged to expand its zero tariff treatment to 95 percent of the products of African least developed countries, and to provide \$1 billion in loans to small and medium size enterprises. At the 2009 Forum on China-Africa Cooperation (FOCAC), China pledged \$10 billion in concessional loans to Africa and emphasized the need to support Africa's efforts to attain the Millennium Development Goals, address climate change, and overcome challenges in the areas of food security, energy security and epidemic diseases. China provides Africa about \$1.5-2 billion a year in aid (as defined by DAC's criteria for ODA), mainly allocated to countries with longstanding political ties to China (e.g. Egypt, Ethiopia, Mali and Tanzania) and resource-rich countries (e.g. Algeria, Angola, Congo, the Democratic Republic of the Congo, Nigeria, Sudan, and Zambia).

China is also going through a "development cooperation" learning curve with regard to its

various aid, preferential trade access, soft loans and investment instruments. The evolution of Chinese assistance will not mean simply copying the aid modalities of traditional development partners, such as untied aid, conditionality, and budget support. However, it is likely that aid coordination with traditional donors will increase, and that China will pay increasing attention to the implications of its assistance for governance and the environment. It is important for Africa to engage China in its consideration of development cooperation policies, to ensure that China's aid is effective and complements, rather than competes with, aid from traditional donors.

III. An Unbalanced Exchange

China's burgeoning trade and investment relationship with Africa does not benefit all sectors or countries equally. About 70 percent of Africa's exports to China come from Angola, South Africa, Sudan, and the DRC, and are heavily dominated by raw materials (e.g. oil, copper, cobalt, and cotton). And 60 percent of imports from China, largely manufactures, are destined to South Africa, Egypt, Nigeria, Algeria and Morocco. Most other African economies have only a limited trade relationship with China. Chinese outward FDI to Africa shows a similar pattern of concentration, with 50 percent flowing to the mining sectors of just a handful of resource-rich countries (Nigeria, South Africa and Sudan).

The trade and investment relationship between China and Africa is unbalanced, in the sense that Africa is less important to China than other trading partners. China is closely integrated with Asia, in particular through the trade in components, a key element of the export manufacturing sector of this country (whereby components of manufacturing goods are first imported to China from another Asian country, then assembled, and subsequently



re-exported to consumer markets in Europe, North America and Japan). Thus Asia accounts for more than 50 percent of China's trade, compared to only 4 percent for Africa. Fundamentally, however, African exports are limited by domestic constraints, including inadequate infrastructure, burdensome regulatory requirements, and a lack of skilled labor.

Africa also faces substantial competition from other regions in the commodity sector. China has diverse sources for raw materials, including from Africa, Australia (where China has also devoted large minerals-related investment), the Commonwealth of Independent States, and Latin America. China's trade with Latin America reached \$144 billion in 2008 (compared to \$104 billion for Africa), supported by Latin America's abundant raw material and agricultural products, as well its large consumer market. Thus Africa is in competition with regions which are equally endowed with natural resources and with more stable business and political environments and lower investment risks. This interregional competition emphasizes the importance of strengthening competitiveness and addressing structural challenges in Africa.

Taking into consideration trade, investment, and aid, China obviously plays an important role in increasing Africa's development opportunities, but not to the extent of Africa's traditional donors. The European Union and the United States are still the largest trade and investment partners for many African economies. The EU accounts for over 30 percent of Africa's exports, and donors in the Organisation for Economic Co-operation and Development's Development Assistance Committee (DAC) provide \$36 billion in Official Development Assistance (ODA) to Africa (and finance the bulk of the additional \$18 billion from multilateral donors). By comparison, China accounts for about 10 percent of Africa's exports

while China's aid to Africa (defined according to DAC criteria) is about \$1.5-2 billion.

IV. China's impact on African trade

The impact of China varies according to the very diverse size, economic structures, and quality of governance and institutions in African economies. China's impact is probably greatest on resource-rich economies who benefit from China's demand for raw materials, and probably smallest on the more diverse African economies. One approach to measuring the costs and benefits of China's trade with African countries is to compare each country's comparative advantage (what goods the country exports to the world) with the commodity intensity of trade with China. Countries that export primarily oil (e.g. Angola, Gabon, Sudan and new oil producing countries such as Chad and Uganda) benefit from Chinese demand without facing competition from Chinese exports in global markets. On the other hand, African countries that export manufactures, such as tobacco products (Benin), refined oil products (Algeria, Egypt and Kenya), manufactured wood products (Cameroon) and processed food (Mauritius) face Chinese competition on the global market but little demand from China.

China's intense competition in manufacturing and its rising demand for oil underlines the risk that Africa may remain specialized in raw materials and thus remain vulnerable to volatile commodity prices. However, Africa also reaps substantial benefits from its commodity revenues, and China's manufactured exports reduce the price of consumer goods and industrial inputs in Africa.

China is supporting export diversification in Africa through the establishment of Special Economic Zones located in Zambia and Mauritius, with future sites under consideration in North and East Africa. The Special Economic Zones should



attract considerable investments in infrastructure (especially transport and power) and export-oriented production, which could provide some impetus to local manufacturing industries (see box 1). However, for these zones to promote industrialization effectively requires integrating Chinese investments in the national production chain through backward and forward linkages.

Strong domestic policy frameworks, including strong governance, a competitive economic environment, and the availability of skilled workers, are essential to encourage such linkages and enable African economies to move up the value added chain. African governments also need to ensure effective coordination of donor activities to support such efforts.

Box 1: The experience of China's Special Economic Zones in Africa

There is a strong interest by African leaders to replicate the successful experience of China in planning, developing and implementing Special Economic Zones (SEZs) to attract foreign investments and enhance the competitiveness of the manufacturing sector. Consequently, Chinese investments in SEZs have been welcomed by many countries as a means of benefiting from Chinese capital as well as proven experience and expertise in SEZ development and management. Moreover, governments are hoping that the SEZs will generate spillovers in terms of skills and technology that will benefit domestic enterprises and enhance their competitiveness in regional and global markets.

Under the “going out (zou chuqu) policy”, China is actively supporting the establishment of SEZs abroad. The stated objectives are to improve domestic and regional markets for Chinese products and services, leverage trade and preferential market access arrangements, assist domestic industrial restructuring in China by relocating mature labor-intensive manufacturing to other countries, create economies of scale for foreign investments by supporting clusters of Chinese companies and create supply chains, and respond positively to the interest from foreign countries to learn from the Chinese experience with mutual benefits for China and the host countries.

However, Chinese-operated SEZs in Sub-saharan Africa thus far show low levels of investment and exports, and their job creation impacts and integration with the local economy have been limited. This disappointing performance is partly due to the slow pace of implementation of China's SEZs in Africa. A recent study on Chinese-operated zones in Ethiopia, Mauritius, and Nigeria (World Bank, forthcoming) derives several recommendations in order to accelerate and improve the zone development efforts. African governments and zone developers should: (i) strengthen the coordination between political commitments and the business and financial planning of the developers; (ii) address financing gaps which delay the development of the zones; (iii) strengthen legal and regulatory arrangements, including social and environmental safeguards, to more effectively support zone development; (iv) ensure delivery of external infrastructure critical to zone success, such as access roads, energy, water, waste management, ICT and port facilities; (v) improve access of local companies and workers to the zones to ensure linkages to the local economy; (vi) foster integration of the zone master plans into regional urban development plans to enhance economic and social benefits; and (vii) improve communications and outreach strategies to garner public and investor support.

Source: World Bank, “Chinese Investments in Special Economic Zones in Africa: Progress, Challenges and Lessons Learned”, Washington DC, forthcoming



V. African integration and infrastructure

African integration has over time become a priority for policy makers on the African continent. This aspiration was strengthened in the wake of the 2008 financial crisis, when regions that were more integrated in Africa, such as Eastern Africa, suffered a less severe economic downturn compared to other regions. Some of the main challenges for further African integration, and for efficient production, include inadequate transport, telecommunication, and power. The Africa Infrastructure Country Diagnostic (AICD) estimates that infrastructure financing of \$93 billion a year over the next decade, divided equally between investment and maintenance, is required to achieve national development targets.

Total commitments for infrastructure in Africa in 2009 were \$38.4 billion, slightly up by 5.0%, from \$36.6 billion in 2008. The total commitments made by Infrastructure Consortium for Africa (ICA) members for infrastructure in Africa in 2008 were \$19.5 billion, half of the total volume and a significant increase, by 42.5% (\$5.8 billion) compared to the previous year. Private sector support has decreased again, by around 23.7% to about \$11.4 billion, indicating a difficult investment climate and the impact of the financial crisis. Examples of private sector infrastructure investments include the Dakar Container Terminal and the Main One Cable system. The latter will increase internet access at lower cost to West Africa. China typically supports critical sectors that are underfunded by traditional donors.

Chinese investments are mainly channeled through the Export-Import Bank of China (China EXIM Bank), which is the lending arm of the Chinese government. These investments include the 2008 multi-billion dollars resources-for-infrastructure package, which finances much-needed infrastructure (including railway tracks, roads, hydroelectric dams, airports, schools and clinics) in exchange for copper and

cobalt concessions in the Democratic Republic of Congo. The China Exim Bank has extended loans and grants for commercial projects in over 35 African countries, in particular in Nigeria, Angola, Sudan and Ethiopia. The Bank also finances investment projects and partners in Public-Private Partnership (PPP) in the power sector (a key element of regional integration due to economies of scale), including large-scale projects such as the 400MW Bui Dam in Ghana, the 360MW Kariba North Bank hydro project in Zambia, and the 1,250 MW Merowe Dam project in the Sudan. Overall, some 30 African countries have received Chinese funding towards hydropower and power stations.

Moreover, China offers highly competitive prices on goods and services for investment projects, due to lower wages than their Western counterparts and low interest rate loans from public sector banks. Chinese firms also have a good record for on-time completion, compared to projects undertaken by other countries. Africa can thus benefit from Chinese participation through low prices and efficient work.

Similar to many projects from traditional donors, China's investments have at times emphasized the construction of new facilities, while not necessarily addressing long term sustainability issues such as maintenance and capacity building. If this is not addressed it is likely that new investments will not be adequately maintained. For example, the Tanzania-Zambia railway project, which was completed ahead of schedule, was a spectacular engineering achievement, laying over 1800 kilometers of tracks (in part through mountainous terrain) and building 320 bridges. However, due to mismanagement and underinvestment over the last three decades, the railway company fell into financial difficulties and the facilities have been under-utilized.

China's infrastructure investments could be more supportive of African integration. China typically works on a bilateral basis in support of national



infrastructure plans that may not adequately take into account potential benefits from regional cooperation. In exceptional cases, China has supported major regional infrastructure ventures such as the electricity transmission lines between southern African countries. On occasions, China has provided a framework for regional projects, including in the power generation projects, power interconnection, road projects, port projects, railways and ICT networks. However, often regional projects are overlooked.

VI. China's impact on the global aid architecture

China is often called an “emerging donor”, although it has had an aid program since the 1950s. Analyzing the impact of China on the global aid architecture is difficult because several government institutions are involved in concessional finance and China does not report aid according to the definitions adopted by the DAC (which requires for classification as ODA, among other conditions, that the loan or grant is intended for development and has a minimum grant element). Using the OECD-DAC criteria, China's aid program is estimated at between \$1.5 and \$2 billion. Other flows of development finance, such as preferential export credits, or government subsidies for foreign direct investment, may look similar to ODA, but would be classified as “Other Official Flows (OOF)” under the OECD-DAC definition.

There are important differences between OECD-DAC and China development cooperation. China's “ODA” as well as “OOF” are often provided as tied aid, while about 90 percent of ODA from traditional development partners is provided in an untied manner. Within OECD-DAC, only Korea, which only became member of the DAC in November 2009, provides nearly all its assistance in a tied manner. Although Chinese goods and services

are highly competitive compared to those from OECD/DAC members' countries, in some cases the tying of aid could reduce value for money and undermine the recipient countries' ownership of development projects. Also, China does not provide assistance in the form of budget support, which by reducing administrative costs, is highly appreciated by the recipient government, as it can be an effective instrument for aid delivery. In 2008 traditional development partners provided \$5.4 billion in general budget support. More broadly, many traditional development partners tend to be more sensitive to the overall policy framework when determining aid levels. China's focus, by contrast, is to support individual investment projects, while policies to encourage long-term development are viewed as the responsibility of the recipient country.

These differences have become important in the donors' approach to debt sustainability. The Enhanced Heavily-Indebted Poor Countries (HIPC) initiative and Multilateral Debt Relief Initiative (MDRI) have achieved substantial reductions in the debt burden facing poor countries, while supporting policy reform. China has a separate initiative to write off 168 loans owed by 33 African countries, but at the same time continues to provide relatively hard terms on some loans. Some traditional donors are concerned that China's project lending could raise debt levels again, which would be contrary to the debt sustainability objective of the Enhanced HIPC Initiative. The case of the DRC, which had to amend the terms of its financing agreement with China to qualify for debt relief, has been the most publicized. There is something to be said for both perspectives. Traditional donors are understandably unwilling to make financial sacrifices to reduce poor countries' debt burden in the interest of increasing resources to the social sectors, if recipient countries then rebuild their debt levels in order to finance infrastructure



investments. On the other hand, countries like the DRC could benefit from higher investment, even on commercial terms, as long as the return on the project is adequate. Greater coordination between China and traditional donors could help to resolve such issues. Possibilities include China's participation in forums such as the Paris and London Club, in the Debt Management Facility (which coordinates debt sustainability analysis among multinational development institutions), and in consultative group meetings. The China-DAC forum also provides a platform for exchange of best practices in development cooperation.

VII. Governance and African civil society engagement

The ability of African economies to translate the opportunities offered by China into sustainable development and poverty reduction depends critically on strengthening African governance and the business environment. Progress will require not only leadership by African governments, but also participation and oversight by the African private sector and civil society organizations (see box 2). The policy framework that would maximize the benefits from foreign investment will differ, according to the individual circumstances and institutions of each African country. Whatever policies are adopted to improve the development

impact of foreign investment should be applied to all foreign investors, not just Chinese.

Some African countries have implemented policies to increase the local benefits of foreign investment (including from China). For example, Tanzania insisted on the employment of unskilled Tanzanian workers on projects receiving foreign finance, Angola required the use of local construction material, and Senegal emphasized that investors should partner with local firms when submitting bids. However, such requirements need to be accompanied by transparent procurement and effective project management to ensure value for money.

Governance provides a good example of the different perspectives of China and traditional donors, referred to above. China considers intervention in aid recipients' domestic politics as an infringement of sovereignty, while traditional donors emphasize that aid is more effective in countries with good governance. Thus the majority of traditional development partners include good governance criteria, for example as shown in the World Bank's and African Development Bank's Country Policy and Institutional Assessment ratings, in their development cooperation policies. This is the most evident in budget support operations, which often focus on transparency, good governance and budget execution.

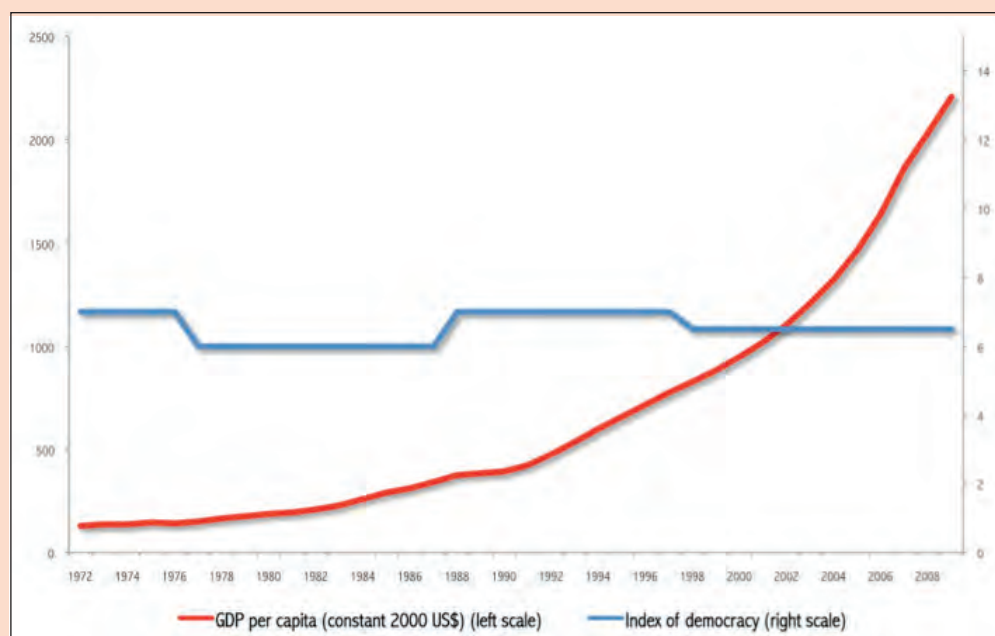


Box 2: Development and Democracy

Few will dispute the tremendous growth performance that China has achieved since the 1970s. A look at official statistics reveals that China has sustained consistently high growth rates, allowing the country to multiply its GDP per capita income by 17 between 1972 and 2009. There is much less evidence, however, on whether democracy in China has improved correspondingly. The Freedom House democracy index has been stagnating around 6-7 for more than three decades.

The literature on the causal link between democracy, development and economic performance has not been conclusive. Competing theoretical and empirical studies have yielded few robust conclusions supporting the different hypotheses: “democracy facilitate development/growth”, “democracy hinders development/growth” and “there is no clear relationship between democracy and development outcomes”.

Income and democracy in China (1972-2009)



Source: adapted from World Development indicators and Freedom House dataset. Note: Index of democracy is the Freedom House average scores of Political Rights and Civil Liberties, negatively ranged from 1 (best) to 7 (worst)

The reverse linkage between democracy and development outcomes, that is the causal effect of the income level on democracy has also failed to operate in China so far. Modernization theory claims that countries will become more democratic as they become richer. The key elements of this hypothesis is that richer countries are more willing to promote democratic values and more receptive to democratic political tolerance norms. A number of studies have followed up this theory by recognizing that the level of



income is an important background condition for democracy although the exact form of the relationship is still a matter of debate. This theory has however received mixed empirical support. While Barro and Helliwell find that improvements in the standard of living (or income level) favor democracy (as measured by a subjective indicator of electoral rights, political rights and civil liberties), Acemoglu highlights with postwar data, that when the factors that simultaneously affect income and democracy are controlled for, the strong cross-country correlation between democracy and a high level of income does not result in a causal effect on income on democracy.

Several institutional factors, which are not related to democracy, have supported China's rapid growth in the last three decades, including gradual economic liberalization, relative political stability since 1979, and the dismantling of the commune system in rural areas. Even though more and more research is focusing on the sustainability of the Chinese economy's success without sound governance-enhancing institutional reforms, China's experience stresses the importance of institutional reforms that are needed to initiate and sustain growth, particularly market reforms.

Source: Kangoye (2008).

Tension is particularly evident in China's support for extractive industries, which are particularly prone to corruption because of the huge revenues involved and often centralized government control. The development impact of investments in the extractive sector could be enhanced through more transparency in the procurement and contracting process and more active engagement of African civil society organizations in oversight. In this regard, there is already a well established role for the Extractive Industries Transparency Initiative, which could be expanded to Chinese companies.

China's concern with the overall policy framework, and particularly the quality of the environment, may be increasing. While problematic relations between Chinese companies and African civil society organizations have involved violent strikes (as in Zambia), recently it appears that Chinese companies are becoming more sensitive to corporate social responsibility and are starting to focus on the "triple bottom line" (profit, social, environmental). Lenders such as China Exim-Bank are already aware of the importance of social responsibility and implementation of social and economic safeguards.

Finally, it is important to strengthen national capacity in negotiating favorable natural resource deals with China. A few decades ago Botswana successfully used international consultants from highly regarded legal firms to negotiate favorable contracts for its natural resources with DeBeers, a South African mining giant. This approach could be emulated by African countries in negotiating long term deals with Chinese companies, in a particular if these include "mortgaging future revenues" for needed development projects.

VIII. Conclusion and recommendations

China is a valuable trading partner, a source of investment financing, and an important complement to traditional development partners. China is investing massively in infrastructure, which helps alleviate supply bottlenecks and improve competitiveness. For China, Africa is not only a source of critical commodities necessary to expand its domestic economy, but also a future investment destination for labor intensive manufacturing, especially given that wages are rising much faster in China than in Africa. The following recommendations for African countries, China and the African Development Bank Group are intended to improve the mutual gains from African-Chinese cooperation.



African Countries should:

- Improve coordination between aid and investments from China and from traditional development partners.
- Enhance technology transfer and maximize the positive spillover effects from foreign investment through local labor and content requirements, as is done in several African countries.
- Achieve greater export diversification by identifying niche markets for African manufacturing products in China, and by expanding preferential trade access to Chinese markets.
- Build negotiation capacity, for example by obtaining specialized legal services, to ensure that large, complex commodity deals with China can be negotiated with favourable terms for the exporting African country.
- Build backward and forward linkages between the domestic economy and the Special Economic Zones supported by Chinese investment.

China should:

- Prioritize the development challenges of Africa within the established FOCAC framework, including addressing issues such as food insecurity, climate change and adaptation technology and infrastructure.
- Integrate “best practices” of traditional development partners, notably through the China-DAC Group, which would share knowledge on development finance.
- Coordinate Chinese aid and investment flows more centrally instead of the current practice where over 20 ministries, public banks and agencies provide support to Africa. A good example might be South Korea, which is also an emerging development partner, where aid is coordinated jointly by the Ministry of Foreign Affairs and Ministry of Strategy and Finance.
- Support additional investment in Africa in labor

intensive manufacturing industries. Currently, as wages are rising in China, labor intensive manufacturing is “relocating” to other Asian countries such as Cambodia and Vietnam.

- Coordinate with multilateral and bilateral institutions on debt sustainability analyses and debt relief.
- Untie aid gradually and open bids to international tender. This approach would enhance transparency, development effectiveness and ownership by the recipient African country.
- Enhance communication between management of Chinese-owned enterprises in Africa and African civil society organizations, including labour unions. Often these tensions reflect different traditions in Africa and China concerning engagement with civil society organizations, as well as cultural and linguistic differences. One way to improve African understanding of Chinese policies is to expand scholarship opportunities for Africans to study in China.
- Expand the implementation of the “Equator principles”, a voluntary set of standards for determining, assessing and managing social and environmental risk in project financing, to Chinese investments. This approach could reduce tensions with local civil society groups as well as improve the sustainability of projects financed by China.
- Elevate China’s status in the Infrastructure Consortium for Africa (ICA) from an observer to full membership. This would enable better coordination between various infrastructure projects financed by China and traditional development partners.

The African Development Bank Group should:

- Support the deepening of the China-Africa development relationship within the FOCAC framework. This could include establishment of a core group of African countries, akin



- to the committee of ten (or C10) financial Ministers and central bank governors, to present regional views on key issues such as regional infrastructure projects, untying of aid, expansion of preferential trade access and coordination of debt relief.
- Leverage the Bank Group's expertise and operational experience in key areas identified in the FOCAC, namely, food security, climate change and adaptation technology, African integration and infrastructure.
 - Implement further the Memorandums of Understanding between the African Development Bank Group, and respectively,

the China EXIM Bank and the China's Development Bank. These Memorandums of Understanding focus on issues such as: (i) exchange of information regarding each other's respective activities in Africa; (ii) sharing of development knowledge and experience; (iii) providing co-financing or guarantee of public and possibly private sector investment projects; (iv) exchange or secondment of professional staff; (v) joint regional, country, economic and sector studies; and (vi) aid harmonization, development policy and strategy coordination.



Chapter 1: Post-crisis prospects for China-Africa relations

Jing Gu and Richard Schiere



I. Introduction

China's rapid growth has transformed its relationship with Africa. Industrialization has boosted China's import demand for oil and minerals (e.g. iron ore, bauxite, nickel, copper), which Africa can satisfy. China is now Africa's third largest trading partner; bilateral trade with Africa reached \$114 billion in 2008, up from \$65.9 billion in 2007. The government's "going global policy", which encouraged Chinese companies to become multinationals, has supported a rise in China's FDI in Africa to \$5.4 billion in 2009, up from a negligible amount just a decade ago. The current China-Africa relationship could be described as "commodities-for-infrastructure", although a shift to broader cooperation on development is now evident.

This chapter discusses how China's relationship with Africa is contributing to development. The first section focuses on the impact of the financial crisis on Africa and China. China was able to recover from the crisis more rapidly than African countries, in part because China was in a better position to undertake expansionary fiscal policies. Going forward, Chinese success in producing more sophisticated manufactures would offer significant opportunities for Africa to break in at the bottom of value-added chain and attract investment into manufacturing. The second section explores how the relationship between China and Africa affects the development challenges they face, emphasizing the central role of the Forum on China-Africa Cooperation (FOCAC). For Africa the major issues include food security and agricultural production, climate change and adaptation technology, regional integration and infrastructure, the need for investment and export diversification, and aid effectiveness and coordination of debt relief. For China, we discuss the impact of Africa on access to hydrocarbon and mineral resources and export markets. A principal conclusion is that

while China is likely to remain engaged with Africa in the medium term, to reap the full benefits, African countries need to transform this engagement into additional development opportunities.

II. Africa and the financial crisis

The 2008 global financial crisis had a severe impact on Africa. The effect of the collapse of financial markets was blunted by Africa's limited access: Africa's international bond issues totalled only \$6 billion in 2007, compared to \$33 billion for Asia and \$19 billion for Latin America (Kasekende, Ndikumana and Rajhi, 2009). Moreover, Africa's trade and investment relationships with Asian countries cushioned the immediate impact of the US recession.

Nevertheless, by the first quarter of 2009 it was clear that economic activity in Africa would be severely depressed. The financial problems confronting Western banks limited their reinvestment of capital (or forced them to withdraw existing capital) in their African subsidiaries (IMF, 2009a, IMF 2009b). The general collapse in trade credit by Western banks and suppliers credit by multinational companies also reduced the supply of finance to African exporters. Portfolio outflows depressed prices in African stock markets. A few countries (e.g. Uganda and Tanzania) postponed plans to issue bonds on the international markets owing to the crisis (Kenya's postponement of its bond issue, however, was also due to post-election violence) and inability to compete with issues by, or guaranteed by, rich country governments.

The impact of the crisis deepened over time as reduced global demand lowered Africa's export volumes and depressed commodity prices, increased unemployment in OECD countries translated into lower remittances to the families of African emigrants, and reduced



incomes in rich countries depressed Africa's tourism revenues. The financial crisis led to the postponement of large investment projects in Africa, as Western multinationals' financial difficulties reduced FDI inflows and domestic companies saw lower profits from both foreign and domestic markets. Comprehensive data are not yet available, but anecdotal evidence shows the scaling back of foreign investment in the extractive industries in Democratic Republic of Congo, and the postponement of large investment projects in Liberia and Tanzania.

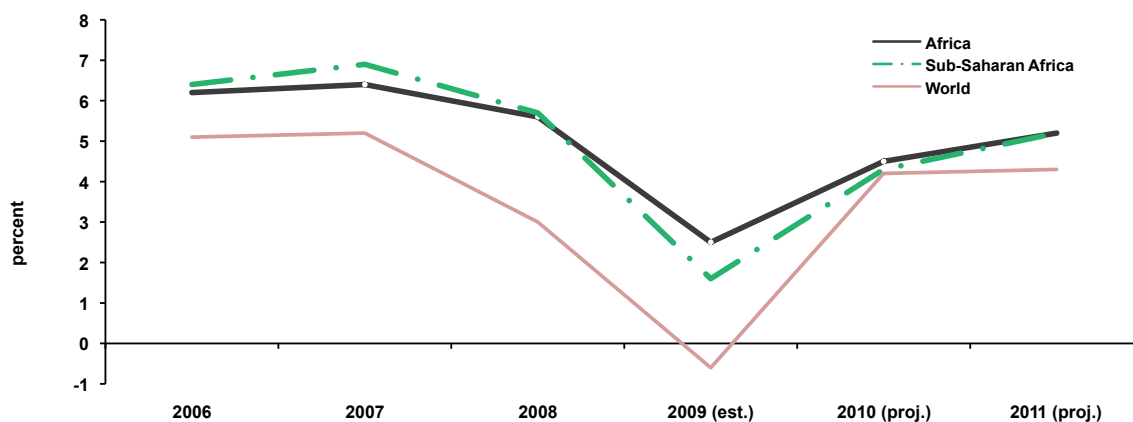
Some African countries have a highly regulated banking system with non-convertible currencies (e.g. Tunisia) before the crisis, which limited the outflow of capital. These regulations reduced the impact of the financial crisis, but current account and fiscal deficits rose (Kamara et al. 2009). Some middle-income African countries (e.g. South Africa, Mauritius, Cape Verde and Seychelles) had the fiscal space to undertake explicit stimulus packages, while many low-income countries had limited policy space.

The global recession has resulted in marked declines in growth rates. Average economic growth fell from an average of about 6% in 2006-

08 to 2.5% in 2009 with per capita Gross Domestic Product (GDP) growth coming to a near standstill. The strongest impacts were felt in Southern Africa, where growth was slashed (from the average over the preceding three years) by almost 8 percentage points to negative growth of around 1%. In contrast, East Africa and North Africa proved to be the most resilient regions. Slower growth has impaired recent development and poverty reduction gains. Indeed, the cyclical downturn might have had adverse long-term effects on poverty through the loss of human capital, as children are pulled out of school to work and unemployed workers see their skills deteriorate.

Going forward, growth is projected to strengthen alongside the recovery in global markets to reach 4.5 percent in 2010 and increase further to 5.2 percent in 2011 (Figure 1). The aggregate outlook masks substantial differences across countries and regions, though. All African regions will achieve higher growth, with commodity exporters, in particular, benefitting from the revived commodity prices and trade, and thus record a relatively sharp upturn. On the other hand, continued weakness in remittances and possibly FDI as well as low aid inflows, leave several low income and fragile countries to grow at relatively sluggish rates.

Figure 1: Africa is recovering in sync with the global economy



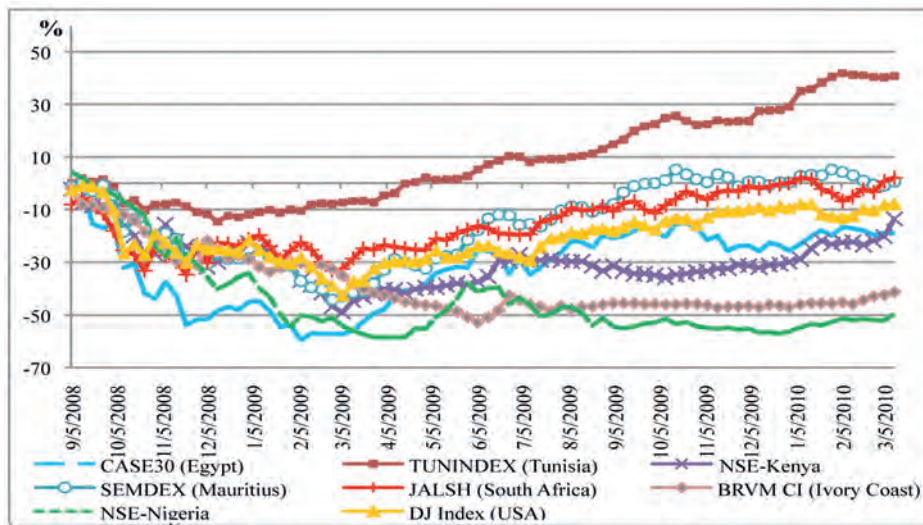
Source: AfDB, OECD, and UNECA: African Economic Outlook, 2010



In early 2010, African stock markets, most of which suffered price declines of between 20 and 40 percent at the height of the crisis, were beginning to recover (figure 2). Commodity prices also are strengthening; cocoa and coffee prices are now higher than at the onset of the crisis, and silver and cotton prices

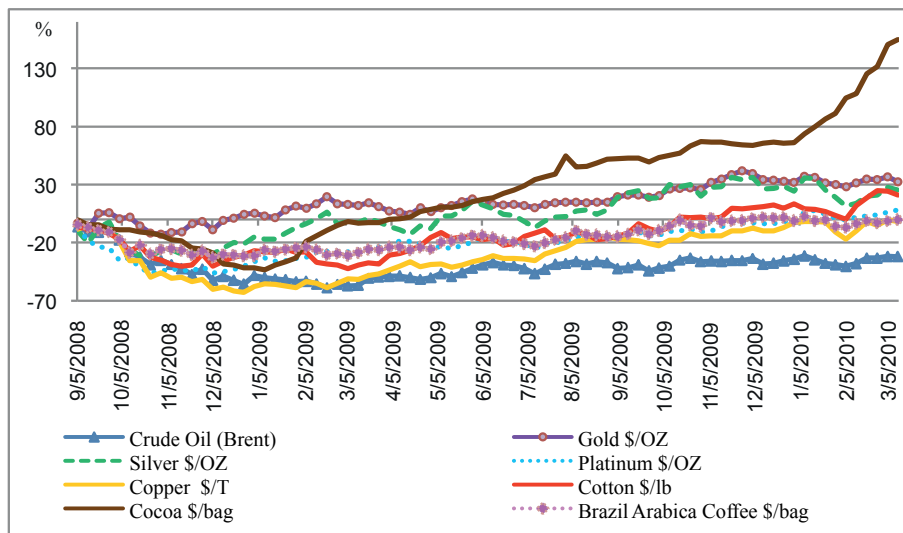
are rising, although others—e.g. platinum—remain depressed (figure 3). The demand for commodities has been supported by relatively strong growth in Asia, particularly in China where fiscal expansion was channelled through large construction projects that use raw materials intensively.

Figure 2: First signs of greenshoots - Evolution of stock markets in Africa



Source: Bloomberg

Figure 3: Evolution of main commodity prices



Source: Bloomberg



III. The impact of the global financial crisis on China and the outlook

Prior to the financial crisis, China was highly exposed to fluctuations in global economic activity. Increased reliance on the market and external demand had supported a doubling of per capita GDP and a 20 percent fall in energy consumption per unit of GDP compared to 2005 (Naughton, 2005). However, China's phenomenal growth was heavily reliant on exports, supported by large-scale FDI inflows connecting China to global production chains that ultimately depended on demand from the United States and Europe (Baldwin 2008). This export dependency of China exposes the country to potential risks in international markets (Li Cui, 2007).

Thus the onset of the global economic and financial crisis held dire prospects for the Chinese economy. In December 2008 officials reported 670,000 small firm closures in 2008 with a loss of 6.7 million jobs, many in the export hub of Guangdong (Tan, 2008). The Ministry of Human Resources and Social Security reported a loss of 560,000 urban jobs in the last quarter of 2008 and a rise in the official urban (excluding migrants) unemployment rate to 4.2% (or 8.86 million) (South China Morning Post, 2009). By January 2009, reports of migrant job losses reached 20 million, with 6-7 million new workers expected to enter the migrant labour force during the year (Cook and Gu, 2009). In the first four months of 2009, year on year exports declined by 20%, and imports by 28.7%. Export producers in southern China collapsed, with widespread company closures and bankruptcies among Small-and-Medium Enterprises (SME) in export production supply chains.

Fortunately, other forces helped to limit the full impact of the crisis. First, the health of the financial system had improved, with significant declines in banks' nonperforming loans prior to the crisis (Fan

Gang 2003, Xu GuangJian 2007), and financial institutions' exposure to non-performing assets was manageable, given the degree of state control and the available reserves. Second, prior to the crisis China's leaders had recognised the need for a cooling down and rebalancing of the economy. So initial measures were already in place to address housing and stock market 'bubbles', bring down inflation, boost domestic consumption and promote more equitable and sustainable growth (Xue, 2008).

Finally, China's substantial current account surplus, large international reserves and strong fiscal position provided ample scope for measures to compensate for the fall in external demand. The government implemented a four trillion yuan fiscal stimulus package (Xinhuanet, 2008) that was heavily weighted towards transport and power infrastructure, but also included rural village infrastructure, environmental protection, and capital injections in ten industries (such as textiles) designed to further technological innovation (The Economist, 2009). The government also adopted subsidies for consumer purchases.

These policies contributed to the clear signs of recovery that were evident by July 2009. Chinese Government agencies confirmed a 'V-shaped' recovery of the economy from the global economic downturn (Chinaview, 2009). China's economy grew 8.7% in 2009, retail sales rose 16.9% year on year, while FDI grew 30.1% (Consulate-General of PRC in Cape Town, 2010). China's governmental system facilitated the rapid implementation of Keynesian policies, where money could be disbursed within weeks of the initial policy decisions (Naughton 2009).

China's recovery has been a boon to global markets, and in particular to Africa. The recovery underpinned the rise in price of Africa's raw material exports that took hold in early 2009, and also



contributed to the rebound in global stock markets after 9 March 2009.

IV. Cooperation between Africa and China

China and African countries have much to gain from cooperation to foster mutual support for development. In the past, China-Africa consultations focused on fostering mutually-beneficial trade and investment. More recently, this relationship has expanded to address contemporary development challenges such as climate change, food insecurity and energy insecurity. This engagement has been building on the Forum on China-Africa Cooperation (FOCAC) by identifying key Africa development challenges where China's assistance could be highly useful. The discussion of cooperation through FOCAC is structured around key development challenges facing Africa (food insecurity and agricultural production, climate mitigation and adaptation technology, African integration and infrastructure, additional Chinese investment and export diversification, and aid effectiveness and coordination of debt relief) as well as for China (extraction of resources and expansion of export markets, including Chinese SMEs), emphasizing how cooperation with China could further African development.

1) Food insecurity and agricultural production

Hunger and malnutrition are still prevalent in some African countries and food insecurity remains a challenge for many others. Analysts at the African Development Bank estimate that seven countries, with a population of 38 million (4% of Africa's population) are highly vulnerable¹, while another eleven countries with a population of 330 million

(33% of the total) are vulnerable (Kamara et al, 2009)².

Similarly, UNCTAD has estimated that 21 African countries face food security crises and 300 million Africans are confronted by chronic hunger (UNCTAD, 2009). Historically, food insecurity in Africa was mainly caused by humanitarian disasters (i.e. drought, hurricanes, floods, etc.) and disproportionately affected rural areas, while food in urban areas remained largely available due to food imports.

The nature of the African food security situation worsened after 2003 with the steady rise in global food prices that affected both urban and rural areas. The price of staples spiked in 2008, with rice reaching \$1000 per ton in April (up from \$373 per ton in early January), wheat hitting \$439 per ton in March (more than double the 2007 level), and maize reaching \$288 per ton in June (up 42 percent from November 2007) (Kamara et al, 2009), setting off civil strife in some urban areas. The reasons for the rise in food prices included a jump in the prices of inputs (energy and fertilizer), increased demand (largely owing to diversion of food to biofuel production) and export restrictions.

The vagaries of the international market and food price volatility underline the need for greater domestic investment in food production. The FOCAC Action Plan 2010-2012 emphasizes the commitment to promoting a growth-oriented agricultural agenda by providing technology and contributing to global initiatives and south-south cooperation in agriculture development. However, coordination is required to avoid conflicts over which markets are to be supplied with food during future shortages, and to ensure that Chinese investments contribute to local employment creation rather

1) African countries classified as very high vulnerable are: Zimbabwe, Eritrea, The Gambia, Djibouti, Sao Tome & Principe, Niger and Mauritania.

2) African countries classified as highly vulnerable are: Ghana, Senegal, Mozambique, Cape Verde, Morocco, Burkina Faso, Cameroon, Rwanda, Congo Republic, Kenya and Nigeria.



than replacing large numbers of African farmers by introducing advanced agricultural technology that is capital intensive.

2) Climate change mitigation and adaptation technology

Although the extent and impact of global warming is being intensely debated, there is a growing consensus that the average global temperature will increase by at least 2°C by the end of the 21st Century (World Bank, 2010a). This increase in global temperatures has dire implications for Africa, including the expansion of deserts and additional water stress. North Africa would be exposed to additional droughts, while South and Eastern Africa would be hit by increased flooding and hurricanes. Disruption to the major African rivers, such as the Nile and Congo, will imperil the livelihood of millions of people. The UN Intergovernmental Panel on Climate Change estimated that between 75 and 250 million Africans will be affected by water stress due to global warming. Food insecurity will rise as yields from rain-fed agriculture, still the dominant form of production in sub-Saharan countries, could be reduced by up to 50% (IPCC, 2007). Some research indicates that, over time, staple crops such as maize will even be difficult to grow (Collier, Conway and Venables, 2008).

These challenges highlight the importance of efforts to mitigate the impacts, including more sustainable land and forest management, more efficient use of water resources and, although Africa contributes only a small share of global carbon emissions, cleaner energy (such as geothermal or hydro power) and the creation of sustainable urban transport systems. An investment program in climate mitigation measures could require an additional \$75-100 billion per year (World Bank, 2009). China could make a contribution to this investment program and to building capacity in Africa to mitigate climate change. For example, the FOCAC framework emphasizes that China is willing to contribute to satellite weather monitoring,

clean energy projects, prevention and control of desertification and environmental protection.

3) African integration and infrastructure

Increased infrastructure investment is essential to increase African productivity. The African Infrastructure Country Diagnostic (AICD) estimates that the continent would require \$93 billion a year both for new investment as well as for maintenance over the next decade, in order to achieve national development goals in Africa. The large number of small countries (25 have populations of less than 10 million) underlines the importance of regional projects, where larger investments can generate greater economies of scale. In addition, Africa's 13 landlocked countries require regional transport plans to ensure access to sea ports. While China is an important investor in African infrastructure (\$11 billion in 2008, compared to \$13.7 billion by the G-8 countries---ICA, 2009), Chinese investments are generally determined by bilateral engagements with individual African countries, and often lack a regional perspective. Hence, there is a large untapped potential to leverage China's investments for regional infrastructure projects.

Another important issue for infrastructure development is to ensure adequate maintenance. Too often African governments, with assistance from China or traditional donors, have invested large resources in infrastructure projects without providing the funds required for maintenance. For example, the Chinese-funded flagship Tanzania-Zambia railway project was an amazing engineering achievement, with over 1800 kilometer of tracks laid through mountainous terrain and 320 bridges built. However, financial difficulties, mismanagement, and underinvestment degraded maintenance, with the railroad chronically underutilized due to a lack of functioning locomotives. African governments should, thus, ensure that adequate resources are provided in government budgets for infrastructure financing projects and maintenance.



4) *Chinese investment and export diversification*

The economic relations between China and Africa have often been referred to as being based on “infrastructure for commodities” deals, where Chinese investment in African infrastructure is financed by Africa’s exports of commodities and raw materials. This relationship has indeed been beneficial for Africa, and China’s contribution to global demand for raw materials has increased African export revenues from all

markets. However, many African economies need to diversify their exports to reduce reliance on highly-volatile primary commodities, with adverse implications for macroeconomic stability. China is taking some steps to support African manufactured exports: China is in the process of expanding the zero-tariff treatment to 95% of the products for African LDCs, and is investing in Special Economic Processing Zones, which have been set-up in Mauritius and Zambia, while others are being considered in Egypt, Ethiopia, Liberia and Nigeria.

Box 3: Ethiopia-China: the opportunities and challenges of trade diversification

Ethiopia provides an example of the nature of trade relations between China and African countries. Ethiopia’s trade with China rose from \$100 million in 2002 to \$860 million in 2008. Ethiopia exports to China products like sesame seeds, leather goods, and coffee, and imports from China clothing, machinery, food items, pharmaceuticals and electronics. Ethiopia’s trade deficit with China equalled \$470 million in 2007. China supports Ethiopian exports through a zero tariff policy, leading to a rise in Ethiopia’s exports to China (primarily driven by sesame seed products) from \$14 million in 2004 to \$85 million in 2005. Chinese exports of textiles and footwear reduced the income, assets and property of small-scale Ethiopian producers, leading many to turn towards production in the informal sector. On the other hand, medium-size Ethiopian firms have attempted to improve designs, quality, delivery time and invest in newer machineries as part of a broader strategy to cope with Chinese competition. Due to the poor quality of certain Chinese goods, such as shoes, blankets, toys and plastic products, the government has established a Joint Committee on quality control, which certifies quality before they can be imported in Ethiopia. Moreover, the Ethiopian government is attempting to support local industries, and has listed a number of areas of investment reserved for domestic investors only, including: export of raw coffee, qat, oil seeds, pulses, leather hides and skins; grinding mills; saw milling and timber-making products; and printing industries

Source: Chris Alden, SAIIA

Africa’s desire to diversify its exports could fit well with China’s goals of structural transformation (see box 3). As manufacturing wages have risen in China, labour-intensive industry has moved to low-income countries such as Vietnam and Cambodia. While these Asian countries have an advantage in terms of cultural and geographical proximity, Africa also has a vibrant labour force and an increasingly stable and attractive business environment. For example, Tunisia is ranked 40th in the global competitiveness

report, i.e., higher than Vietnam and Cambodia, ranked 75th and 110th respectively on the same index (World Economic Forum, 2010). Rwanda is another country that has achieved rapid improvement in its international standing, from 143rd to 67th in the latest World Bank’s Doing Business Report, ahead of India, Italy and Turkey (World Bank, 2010b). Therefore, Africa could be considered a destination for further Chinese investments in manufacturing, which would benefit both parties.



5) *Aid effectiveness and coordination of debt relief*

China is sometimes referred to as an emerging development partner, although this country has had an aid program since the 1950s. ODA (as defined by the DAC) amounts to about \$1.5 billion (Brautigam 2008), and is mainly allocated to “all weather friends” such as Egypt, Ethiopia, Mali and Tanzania. However, it is difficult to estimate the size of Chinese aid, as China does not make the DAC’s distinction between Official Development Assistance (ODA) and Other Official Flows (OOF); credit and aid data on African countries are fragmented over more than 20 line ministries, public banks and other agencies; and China’s assistance includes a wide range of activities such as providing grants, scholarships, and building infrastructure projects.

Although Chinese investments are often highly effective in terms of cost and implementation, their development impact remain frequently limited. It could be enhanced by encouraging increased reliance on local suppliers, that is, employing more African labour and subcontracting project components to African companies. African governments have increased local content requirements governing foreign investments. For example, Nigeria recently tightened requirements governing local firms’ participation in oil contracts and Angola has in the past required the use of local construction materials.³ Such national regulations can, however, only be effective if there is an adequate governance framework, transparency and engagement of African civil society.

Coordination between China and traditional development partners on debt relief could also be improved. China announced at the latest FOCAC event that it would write off 168 debts

owed by 33 African countries. This could be an area which would be relatively easy to work together with traditional development partners under the frameworks of Enhanced Heavily Indebted Poor Countries (HIPC) Initiative. Closer coordination could prevent situations like that faced by the DRC, which could not qualify for the completion of its \$6.3 billion debt relief unless the terms of the Chinese investment package were amended. Although the DRC case was resolved by amending the China investment deal, coordination and information sharing between China and other development partners could have avoided delays and controversy. Closer coordination could be achieved through Chinese participation in the Paris Club and consultative group meetings, and by inviting traditional development partners as observers in the FOCAC meetings.

6) *Chinese SME development in Africa: Evidence from an enterprise survey*

While China’s investment in mining and infrastructure is dominated by public companies, small- and medium-sized enterprises from China’s private sector are also making significant investments. Many textile producers are already shifting from China to Africa, and there is considerable potential to relocate the whole range of consumer durables, automobile and other transport manufactures, and electronics. Survey research undertaken for this study points to the main drivers of investment in Africa by China’s SMEs.

The survey data reveal that Chinese managers have a strong work ethic and entrepreneurial spirit, and are willing to engage in markets where profit margins are low (at least initially) and supply chains are weak. They take a long-term perspective on

3) For Angola, see <http://www.internationallawoffice.com/newsletters/detail.aspx?g=96305c12-67af-49e1-b7c5-edca2a2043e1>; for Nigeria, see <http://www.petroleumafrika.com/en/newsarticle.php?NewsID=9856&format=print&PHPSESSID=1f4ac81a5a1ecf0dcaaf8ca60f5ccbe>

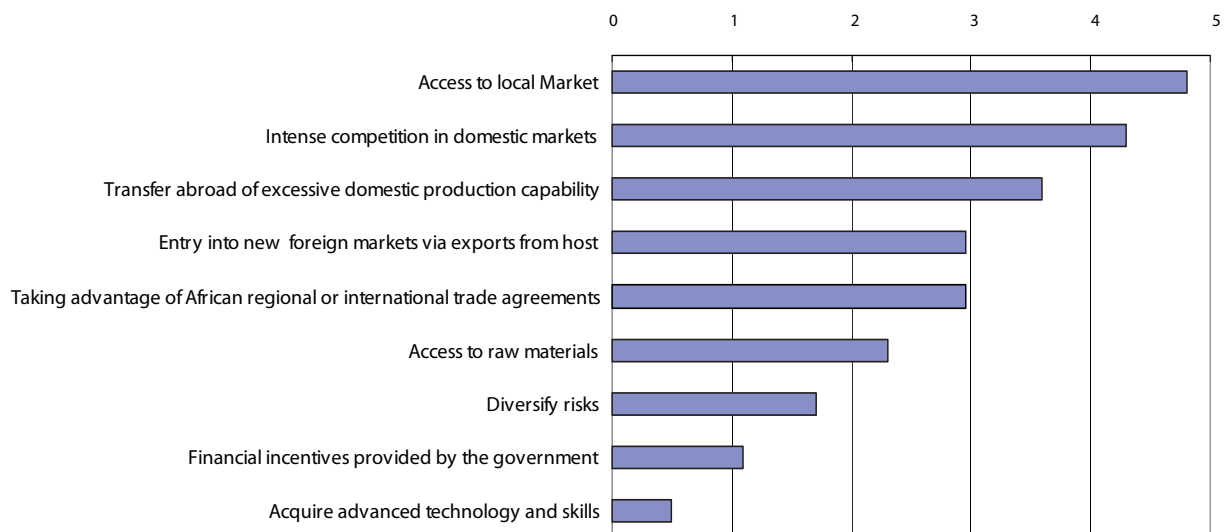


the value of markets, and hope to reap strategic advantage by entering at an early stage (in terms of profitability and size). For example, in describing their business strategy over the next three years, Chinese managers emphasized consolidation of their position in existing markets, increasing investment in these markets, and expanding into new markets. Thus they are more willing than many Western entrepreneurs to accept the uncertainties and risks of operating in an African environment in the interest of their long-term strategic position. Chinese managers emphasize the need for flexibility and adaptability to changes in the market, and the importance of seizing opportunities. This view of Chinese managers is corroborated by African perceptions; for example a senior Ghana Investment Promotion Centre officer commented: 'They [the Chinese] are hard-working, very adventurous and innovative».

Push Factors in the Domestic Chinese Economy

The survey responses also provided insight into the determinants of Chinese investment. Each corporate respondent was asked to indicate, and rank in order of importance, those factors that were decisive in its investment decision. The top five motives for investing identified by these firms were: (1) Access to local African market; (2) Intense competition in domestic Chinese markets; (3) Transfer abroad of excessive domestic production capability; (4) Entry into new foreign markets via exports from host; and (5) Taking advantage of African regional or international trade agreements (Figure 4). Motives that typically would be considered as important in foreign investment, such as access to raw materials and to diversify risks, were mentioned less frequently. One implication is that more intense competition in China, either owing to slower growth or rising wages, would accelerate the process of Chinese investment in Africa.

Figure 4: Reasons for investing in Africa



Source: China-Africa Project Survey

The survey results also emphasize Chinese managers' confidence in the African market, which is listed as the most important reason for investing in Africa. For example, Chinese investors in Nigeria noted that it was the second largest economy in sub-Saharan Africa, and could also improve access to West Africa in general. A view widely shared among Chinese entrepreneurs in Nigeria is that: 'This part of Africa is like the 1980s and 1990s in China; it is full of commercial opportunities.' Regarding the investment climate in Africa in general, Chinese investors have the saying: 'Despite the strong wind and wild waves, the deepwater still has fish to be found.'

Another important dimension that should be highlighted is the intention of SMEs in China to move 'upwards' from low value-added products towards middle-to-high value-added goods that they believe have a sustainable demand in African and other markets. According to a Ministry of Commerce (MOC) spokesman, Yao Jian, many companies have shifted from labor-intensive sectors to technology-intensive industries, such as electric power, oil refining, telecommunications and metallurgy.

The enthusiasm for investing in Africa does not appear to have been dimmed by the global crisis. Surveys undertaken in early 2009 in Beijing indicate that entrepreneurs would continue to invest in, and trade more, with Africa. Chinese companies that have tended to invest more in the North would be looking to diversify their investments in the light of the current financial crisis. In fact, in our study, we found that Chinese companies exporting to Europe and America have adjusted rapidly to the slowdown in these markets by finding new markets, such as in Africa. Also, many Chinese private investors are now increasingly looking to Africa in sharp contrast to their dark outlook with respect to investment opportunities in China, and have expanded their

target markets from the European Union and the United States to developing countries in Africa and Latin America. Chinese companies are also taking advantage of opportunities created by the financial crisis to increase mergers and acquisitions. Overall, many Chinese firms concur with Craig Bond, Chief Executive of South Africa Standard Bank China who notes that: "Now is the best time for Chinese firms to invest in Africa... Some developed countries have withdrawn their investment in Africa following the worsening global financial crisis. There are more opportunities for Chinese firms."

V. Conclusion

As a Chinese scholar puts it, "Relations with Africa are still the most important and reliable part of China's foreign relations with developing countries" (Zhang, 2007). If there was anxiety in Africa that the global financial crisis might reduce China's interest in the continent, Chinese President Hu Jintao provided some political reassurance during his visit in February 2009, as he committed to 'fully and punctually implement measures agreed at the Beijing Summit of the Forum on China-Africa Cooperation, seek China-Africa pragmatic relations and promote the further development of our new strategic partnership' (Ministry of Foreign Affairs, 2009). At the November 2009 FOCAC meeting China reaffirmed its commitment to maintain the level of ODA and investment flows to Africa in the wake of the financial crisis, and pledged \$10 billion in concessional loans to Africa, as well as a loan of \$1 billion for small- and medium-sized African businesses. As noted above, China also is providing substantial debt relief to 33 African countries (FOCAC 2009). China's commitment to maintaining development assistance is particularly welcome, as there is a risk that ODA flows might be reduced by traditional development partners due to the deterioration of their national budgets.



Also, in what it called “a major step for Sino-African co-operation”, the China-Africa Development Fund (CADFund) opened its first representative office in Africa on 16th March 2010. According to the CEO of the fund, “The fund will boost economic development in Africa by encouraging investment by Chinese enterprises.”

Finally, the growing importance of China should not mask the continuing importance of Africa’s

traditional development partners among the industrial countries, who still provide the lion’s share of ODA and investment. Moreover, traditional development partners provide some forms of aid, such as general budget support, which are highly effective and efficient and are not provided by China or other emerging developing countries, underlining the complementarity of traditional development partners with emerging development partners such as China.



Chapter 2: China's trade and FDI in Africa

Mary-Françoise Renard



I. Introduction

China's growth and its capacity to move in thirty years from under-development and extreme poverty to an emerging global power and one of the largest exporter of manufactured goods has attracted the attention of many developing countries. China has served as a development model for Africa and an alternative source of trade and finance from Africa's traditional development partners. The impact of China on African economies has been diverse, depending in part on the sectoral composition of each country's production. Overall, China's increased engagement with Africa could generate important gains for African economies. However, analysis is required to quantify the advantages and disadvantages, and to design the policies necessary to maximize the development impact of China. One overriding consideration is that reaping the full benefits from Chinese trade and investment will require substantial improvements in governance in African economies.

This chapter presents a historical and comparative perspective of the trade and FDI relationship between China and Africa. The next section provides an historical overview of Sino-Africa trade and investment relationships. The third section discusses China's overall international economic policies, while the fourth section highlights the evolution of China's engagement in Africa through trade and investment. The fifth section presents a quantitative approach to evaluating the potential benefits of Africa's trade with China. A final section emphasizes the importance of governance in ensuring that African benefits from China's engagement.

II. China's Engagement in Africa: A Historical Perspective

Historically, trade relations between China and Africa date back to the first Han emperors of the

Second Century B.C. The best example is the Chinese navigator, Zheng He, who reached the coast of Africa four times, disembarking in Somalia and Kenya, in the early 15th century. However, the period of explorations was followed by several centuries of disengagement from the world. Only with the establishment of the Peoples Republic of China in 1949 did China take renewed interest in other developing countries, in particular after the Bandung Conference. This conference aimed at promoting Afro-Asian economic and cultural cooperation and opposition to colonialism. China also supported independence movements in various countries (Burma, Malaysia and Vietnam) as well as provided economic assistance (Mongolia, North Korea) (Richer, 2008).

In the post colonial period, China sought to extend its influence in other developing countries and export the communist revolution. The newly independent countries looked to China as an alternative to domination by the former colonial powers. For example, China signed an economic and technical cooperation agreement with Guinea in 1960, a year after independence; subsequently provided an interest-free loan of \$20 million to Ghana, the first African country to establish diplomatic relations with China; and recognised Mali upon independence and sent a trade mission the following year. These three countries were close to China politically. However, China also established relationships with other countries, for example in North Africa, with Algeria, Morocco and Tunisia. China signed an economic and technical cooperation agreement with Algeria and granted it a \$50 million loan in the 1950s, although Algeria did not renounce its relations with the Soviet Union.

Sino-African relations were maintained in the 1960s, and China was present at various Afro-Asian Conferences held in Africa. Gradually, such conferences became strongly marked by Sino-



Soviet differences. The Cultural Revolution in China and various Chinese interventions had a detrimental effect on Sino-African relationships, although they did improve in the late 1970s. Relations with China offered a number of advantages compared to western countries, as China: (i) demanded fewer conditions on providing assistance; (ii) granted assistance at very low rates, repayable over a very long period; and (iii) offered training to professional and technical personnel. “The west’s employment of conditionalities, merely the latest in the decades of humiliating experiences at the hands of former colonial powers and the United States, echoes the humiliations of the “inequal treaties” foisted on China by the west in the nineteenth century. Indeed, China’s ability to recognize this is part of the genius of its foreign policy endeavours toward Africa” (Alden, 2008, p.20).

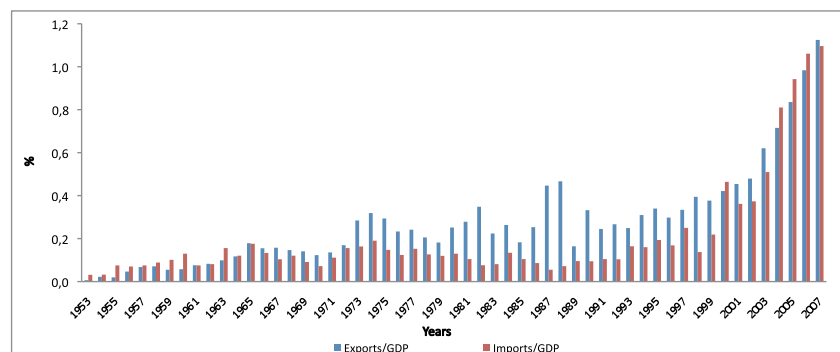
From a political perspective, China gave priority to highly-visible, prestige projects such as stadiums and hospitals. China also financed the construction of a railway line between Zambia and Tanzania between 1973 and 1976, and dispatched 15,000 Chinese for the project, although this investment was earlier turned down by the British Government and the World Bank (Chaponnière, 2008). China’s role in providing development assistance, as well as some military support, was striking, in

that China was even poorer than some African countries. These activities probably contributed to the backing by most newly independent countries of China’s efforts to obtain a permanent seat on the United Nations Security Council in 1971.

China’s relationship with Africa changed following the opening up of China’s economy initiated by Deng Xiaoping, a dramatic shift from policies followed under Mao. Relations were no longer dominated by ideological concerns, except for the sensitive issue of Chinese Taiwan. However, the official principles of engagement, including equality among partners, mutual benefit, respect for sovereignty, use of interest-free grants and loans, beneficiary capacity building, compliance with obligations, provision of equipment made in China and the same living conditions for both Chinese and local experts, did not change (Larkin, 1971, Chaponnière, 2009). More recently, China’s growing dependence on energy has led to Africa gaining prominence on China’s agenda.

Trade between China and Africa has increased dramatically (Figure 5). China’s trade with Africa was minimal until 1954. Trade then grew steadily, but did not rise significantly until 1974, before China’s opening up. The gradual liberalization of the Chinese economy from 1978 was accompanied by strong growth in trade with Africa.

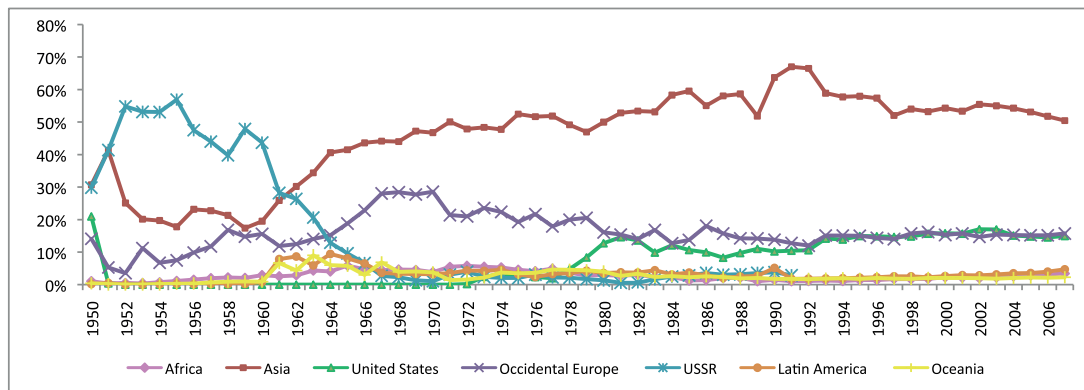
Figure 5: Trend of Chinese imports and exports with Africa, 1953-2007
(In percentage of GDP)



Source: Author’s calculations using data from “Almanac of China’s Foreign Economic Relations and Trade”, 1984



Figure 6: Share of regional trade with China (1950-2007, X+M in percentage)



Source: Author's calculations using data from "Almanac of China's Foreign Economic Relations and Trade", 1984 and "China Statistical Yearbook", 1985-2008

Nevertheless, Africa remains a marginal trading partner compared to China's trade with other regions (Figure 6). China's trading relationships have reflected its political ties: the Soviet Union was China's principal trading partner until the early sixties but bilateral trade then plummeted, and China had no trade with the United States from 1951 until President Nixon's visit in 1972. Western Europe's trade shares have been volatile, but since the mid-sixties Europe has ranked second among China's partners, mainly due to Germany. Asia has had a growing share since the early 1960s, and now accounts for more than half of China's trade.

III. China's International Cooperation Strategy

Until the end of the 1970s China's trade largely reflected government to government relations rather than comparative advantage. However, following Mao's death and two years of political uncertainty, Deng Xiaoping took power and embarked on a spectacularly successful reform program to transform China into a market economy open to international competition.

The opening was gradual, beginning with the establishment of four Special Economic Zones in the southern provinces (Guangdong and Fujian) in 1978-1979. China's trade increased rapidly, notably with support from the local Chinese governments that were given very strong incentives to promote exports. The spread of trade liberalisation to the rest of the country resulted in a marked increase in imports. Despite criticisms from conservatives in China, the essence of the process was no longer challenged. Trade became responsive to market forces, although protection of the domestic market remained very strong, with extensive use of tariffs, quotas, and licenses (Lardy, 2002). WTO accession further motivated China to lower its protectionist barriers.

Trade developed rapidly following the 1987 exemption from customs duties of raw materials and components destined for re-export. China has drawn heavily on the Southeast Asian development model, where components are first imported, then assembled, and finally re-exported, either for further processing or directly to markets in developed countries. This trade was boosted by increases

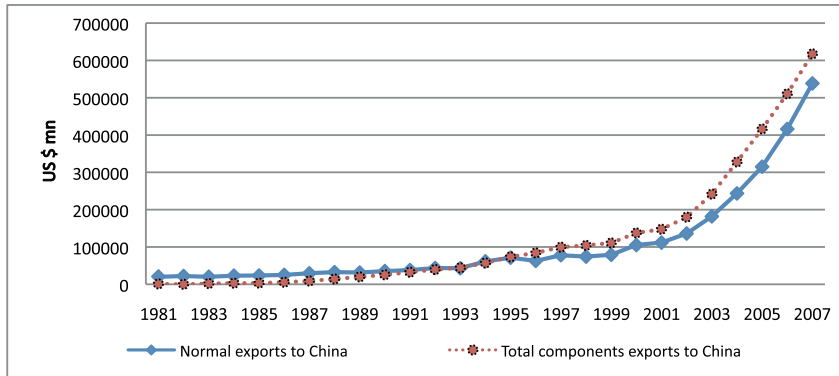


in foreign investment in the 1990s, aided by the establishment of Special Economic Zones and the role of Hong Kong and the Chinese Diaspora.

The importance of the components trade helps to explain the high level of China's trade with other Asian countries (figure 7). The trade in components has increased the interdependency of Asian countries, and was assisted by policies designed to further integration, as reflected

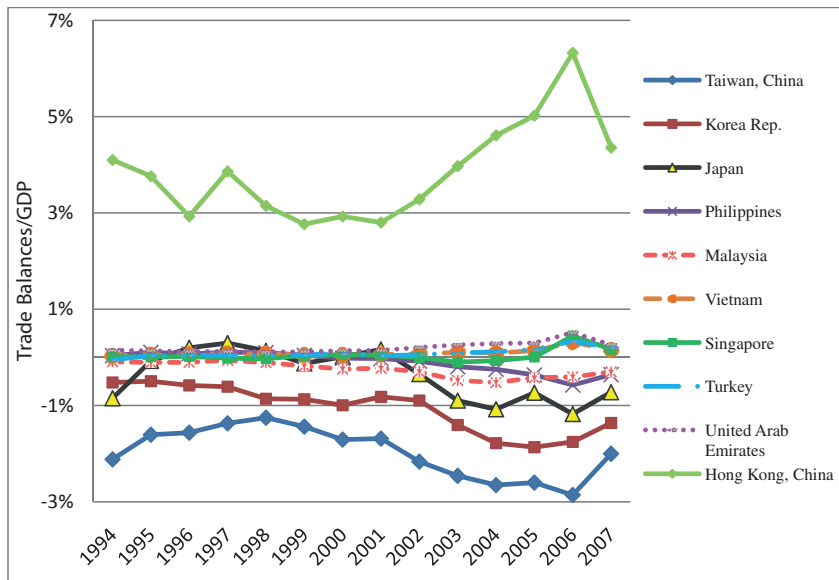
in the establishment of the Asian Free Trade Area (AFTA). China's trade balances also demonstrated the intermediary role this country plays in the component trade (see Figure 8). China's increasing trade deficit with Taiwan, Korea and Japan, and, to a lesser degree, Malaysia and Philippines, in part reflects the import of components that are then transformed into exports to other markets, such as the United States.

Figure 7: Trend of Chinese total exports and imports for component manufacturing sector, 1981-2007



Source: Author's calculations using data from "China Yearbook" (2008)

Figure 8: China's five largest trade surpluses and five largest trade deficits, 1994-2007



Source: Author's calculations using data from "China Yearbook" (1995-2008)



The trade in components also explains why China is sometimes considered (Rodrik, 2006) as exporting more sophisticated products than countries with the same factor endowments and at lower prices than products exported by countries with similar per capita income (Schott, 2008). These trends reflect the re-export of sophisticated goods that were initially imported, and not produced in China (Branstetter and Lardy 2008). Apart from the trade in components, China's principal imports are energy and primary products (fertilizers, grains, ores, etc), and exports are mainly consumer products with low capital intensity, although it is endeavouring to move towards more technology-intensive products. Thus it appears that China does specialize in labour-intensive products (or in the case of the trade in components, labour-intensive services embodied in products), reflecting the country's relatively low labour costs.

China's opening to the outside world has also transformed the global organisation of trade. China has outpaced a number of Asian countries, including Chinese Taiwan and South Korea, in exports to the rest of the world, particularly the United States (Branstetter and Lardy, 2008). In addition, the growth of foreign trade and investment over the past decade has been guided by the desire to secure energy resources, leading to increased relations with Australia, Latin America and Africa. A key question is whether China's growing interest in Africa fits this global trend, or whether Africa presents a unique case in China's strategy?

IV. China's Presence in Africa

China's relations with African countries, and indeed its global economic strategy, have been shaped by the need to obtain energy resources to support economic development. However, political considerations have also played an important role. In 1971, African countries were instrumental in preventing Chinese Taiwan from obtaining a seat

at the United Nations Security Council. And while Taipei had until recently retained the support of numerous African countries, China's diplomatic interventions, financial incentives, aid proposals, and military assistance to Africa have been premised on receiving countries' abandoning diplomatic relations with Chinese Taiwan. This strategy has proven successful.

Chinese diplomacy in Africa, in particular that carried out by the Ministries of Foreign Affairs and Trade, has focused on bilateral relationships with African governments. In addition, several State-owned banks have backed China's presence in Africa. Exim Bank (China Export-Import Bank) was established in 1994 to promote Chinese exports and foreign direct investment (FDI) specifically in the infrastructure sector: roads, power plants, pipelines, telecommunications, etc. (Wang, 2007). This bank has a less risk-sensitive profile compared to private banks, but is still more willing to support some investment projects than Western counterparts. China Development Bank (CDB), also established in 1994, provides loans to Chinese firms and has launched the China-Africa Development Fund to support Chinese FDI in Africa. SINOSURE (China Export and Credit Insurance Corporation) has since 2001 provided insurance against the risks involved in Chinese exports and foreign investment. China's presence in Africa also involves a broad range of private-sector actors, including multinationals, small businesses, traders, and migrants, as well as Chinese local governments which at times act directly, mainly through the firms they own (Chen and Jian, 2009). In the following section, we will present the main features of the reciprocal trade and investment flows between China and Africa.

IV.1 Major China-Africa Trade Trends

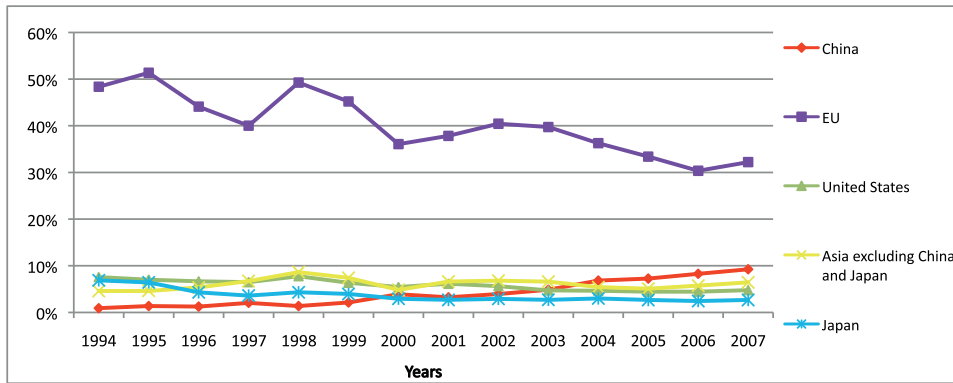
China has emerged as a major trading partner for Africa. While European countries remain



Africa's leading trade partners, Europe's share of Africa's exports has fallen steadily (figure 9). China's importance as an importer of African goods also has risen (figure 10), while the share of the United States continues to increase and Europe's share declines. Africa's share

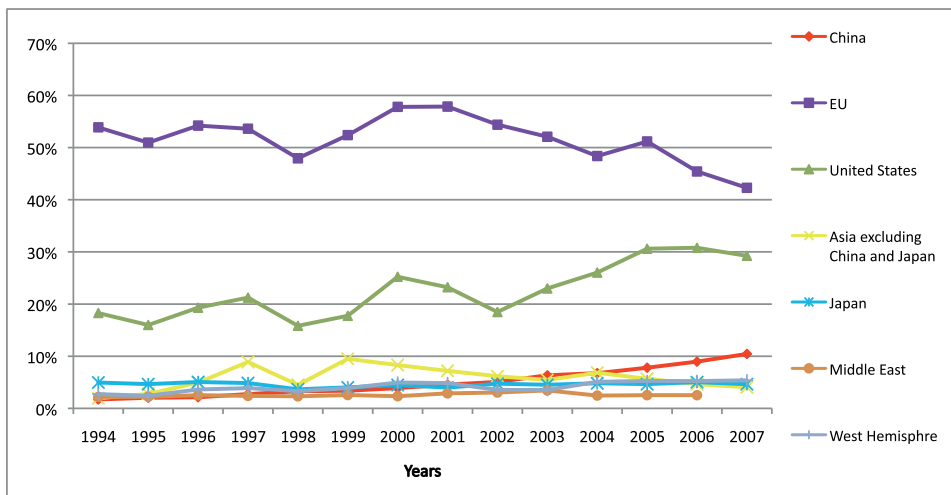
of China's total exports and imports - despite recent increases - remains less than 4 percent (figure 11), and is even smaller for manufactured goods (table 1). Trade with China is somewhat more important for Africa, representing almost 10 percent of exports and imports.

Figure 9: Distribution of African exports among the major blocs (1994-2007)



Source: IMF, Dots, different years

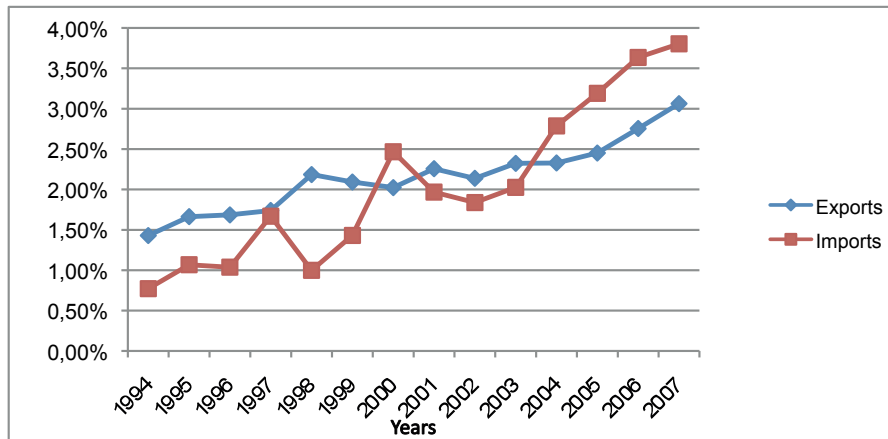
Figure 10: Distribution of African imports among the major blocs (1994-2007)



Source: IMF, Dots, different years.



Figure 11: Africa's share in total Chinese exports and imports



Source: Statistical Yearbook, different years, NBS.

Table 1: Chinese trade in manufactured goods by origin and destination

	Exports			Imports		
	Share		Annual percentage change	Share		Annual percentage change
	2000	2007	2007	2000	2007	2007
World	100	100	27	100	100	17
North America	31.9	27.6	15	11.8	8.7	16
South and central America	2.5	3.3	15	0.3	0.8	16
Europe	21.5	26.6	30	17.5	15.5	21
CIS	1.3	4.0	74	1.9	0.7	23
Africa	2.0	3.0	41	0.2	0.4	40
Middle East	2.5	3.7	51	0.7	1.0	19
Asia	38.3	31.7	25	67.6	72.9	16

Source: WTO International Trade Statistics, 2008.

China's trade with Africa is highly concentrated (figure 12). About 60% of Chinese exports are destined for only six countries: South Africa (21%), Egypt (12%), Nigeria (10%), Algeria

(7%), Morocco (6%) and Benin (5%)⁴, while over 70% of Chinese imports originate from four countries: Angola (34%), South Africa (20%), Sudan (11%) and Republic of Congo (8%)⁵.

4) China Exports to Africa: South Africa, 20.95%; Egypt, 11.75%; Nigeria, 10.18%; Algeria, 6.96%; Morocco, 5.76%; Benin, 5.14%; Sudan, 3.95%; Togo, 3.55; Angola, 3.25%; Ghana, 3.18%; Kenya, 2.58%; Libya, 2.21%; Liberia, 2.06%; Others, 18.48%.

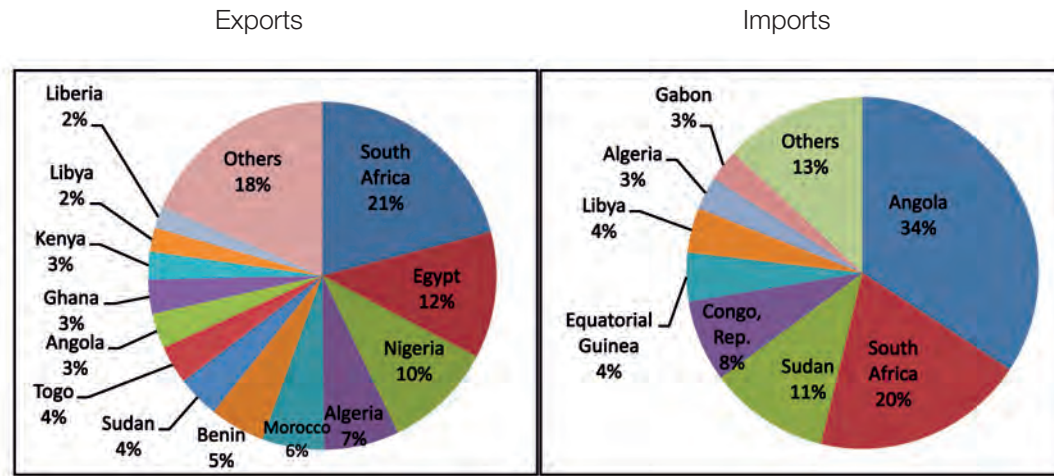
5) China Imports from Africa: Angola, 34.25%; South Africa, 19.55%; Sudan, 11.05%; Rep. Congo, 7.52%; Equatorial Guinea, 4.49%; Libya, 4.10%; Algeria, 3.08%; Gabon, 2.91%; Others, 13.05



The high country concentration of China's imports in part reflects the importance of crude oil (70 percent of imports from Africa—figure 13), which accounts for almost all of China's

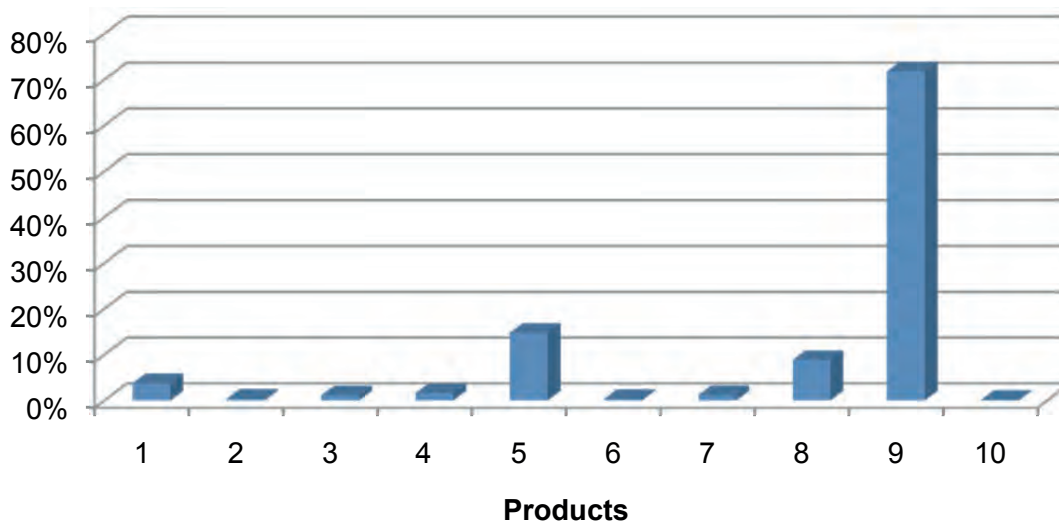
imports from Angola and the Sudan. China's agricultural imports have a modest share, although they constitute the bulk of imports from several African countries.

Figure 12: Breakdown by country of Chinese exports and imports in Africa (2007)



Source: COMTRADE, UNCTAD (2008)

Figure 13: African exports to China by product, 2007



Source: COMTRADE

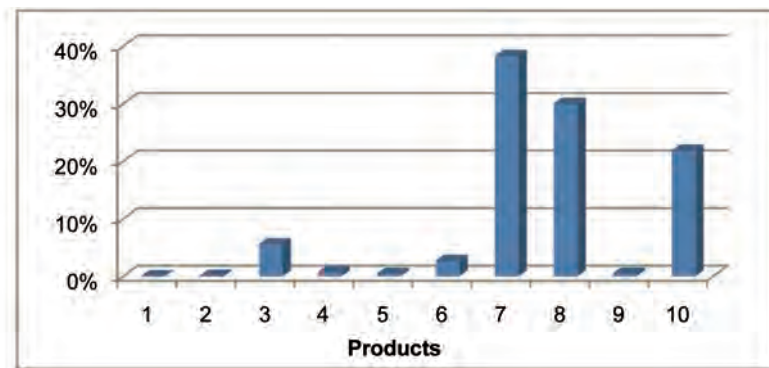
1: Animal and vegetable oils and fats – 2: Beverages and tobacco – 3: Chemicals 4: Commodities and transactions, n.e.s – 5: Non-edible crude materials - 6. Food and live animals - 7: Machinery and transport equipment – 8: Manufactured goods mainly classified per raw material – 9: Mineral fuels, lubricants and related materials – 10: Miscellaneous articles.



African imports from China are somewhat more diversified, although machinery and transport equipment, manufactured goods and handicrafts account for the bulk of imports (figure 14). Chemicals and food products account for less than 10% of the total. Chinese manufactures (e.g. electronic toys, textiles) have relatively low

prices, making the products accessible to a larger number of people and enabling African consumers to expand their range of products. Machinery and transport equipment imports are linked to the strong presence of Chinese firms in the infrastructure sector, specifically in telecommunications, road construction and construction of public buildings.

Figure 14: African imports from China by product, 2007 (% of total)



Source: COMTRADE

1: Animal and vegetable oils and fats- 2: Beverages and tobacco- 3: Chemicals 4: Commodities and transactions, n.e.s -5: Non-edible crude materials- 6: Food and live animals- 7: Machinery and transport equipment- 8: Manufactured goods classified mainly per raw material- 9: Mineral fuels, lubricants and related materials- 10: Miscellaneous articles.

The structure of imports from China is similar among leading African trading partners, with machinery and transport equipment, as well as manufactured goods, accounting for large shares (figure 15). Exports to China from the major African exporters (except South Africa) consist mostly of crude oil (figure 16).

Africa's bilateral trade deficit with China amounted to \$10 billion in 2008 (\$52 billion in exports and \$62 billion in imports), with the oil and gas exporters (except Algeria and Nigeria) running surpluses with China and other countries deficits (figure 17).

Figure 15: Key African imports from China (by country and by product)

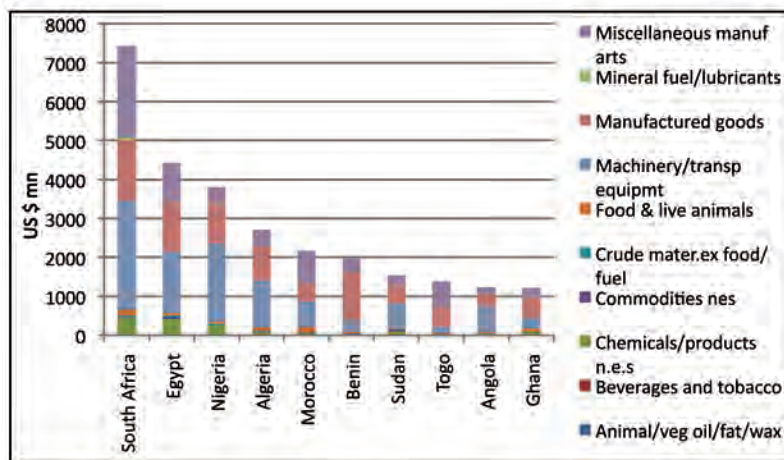




Figure 16: Key African exports by country and by product

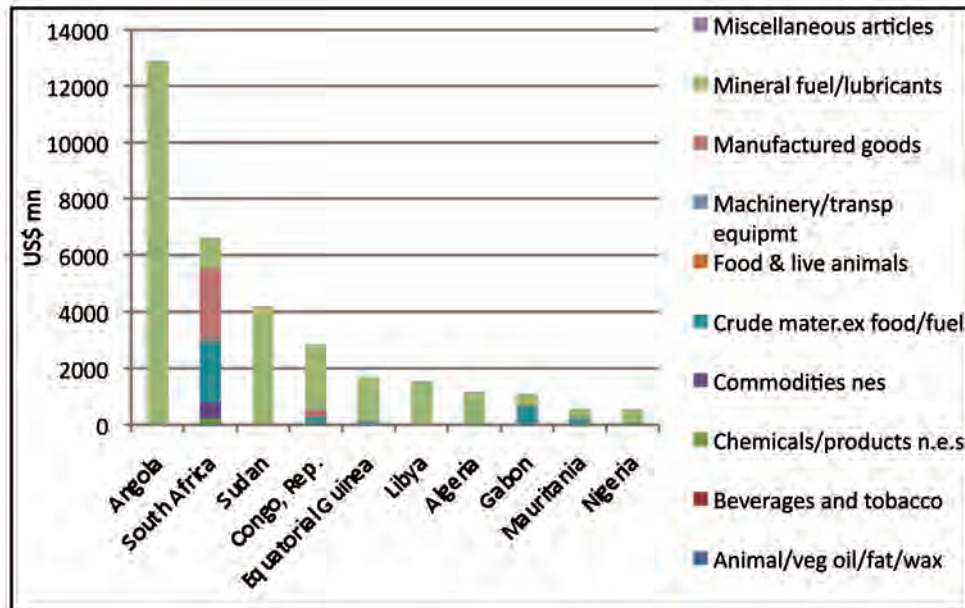
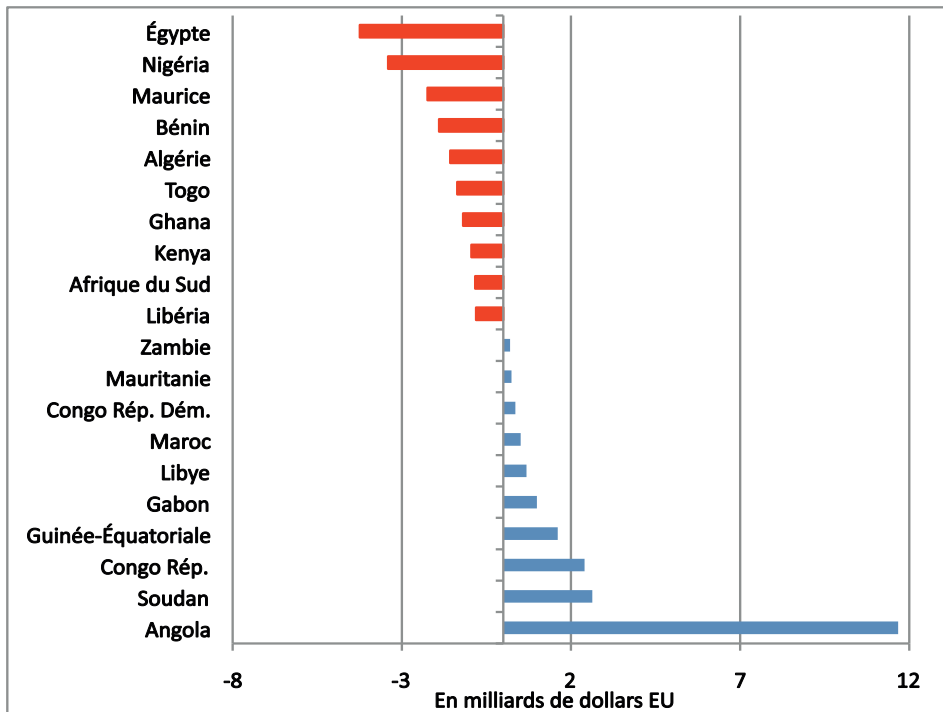


Figure 17: Africa-China balance of trade (10 leading surpluses and 10 leading deficits)





IV.2 China's Foreign Direct Investment in Africa

As previously highlighted, China's FDI in Africa is closely linked to trade and development assistance. Thus FDI has increased over the past 10 years in tandem with increased Sino-African trade, although China's FDI to Africa remains marginal in terms of China's total outward FDI flows (0.2% in 1991 and 5.9% in 2007—Kaplinsky and Morris, 2009) and total FDI received by Africa from the rest of the world (3% in 2007⁶). According to the Chinese Ministry of Commerce, China's FDI in Africa has increased by 46% per year over the last decade. The stock of foreign investment stood at \$4.46 billion in 2007 compared to \$56 million in 1996.⁷ During the first half of 2009, Chinese FDI flows into Africa increased by 81% compared to the same period in 2008, reaching over \$0.5 billion. However, it is difficult to be certain about the level of China's

FDI outflows, as estimates from different sources vary widely and Chinese investments are often channeled through off-shore entities registered in places such as Hong Kong, Cayman Island and others.

Similarly to trade patterns, China's outward FDI to Africa is dominated by a few resource-rich countries, plus South Africa (figures 18 and 19). From 2003-07, over half of Chinese FDI flows into Africa were absorbed by three countries: Nigeria (20.2%), South Africa (19.8%) and Sudan (12.3%). Algeria (oil) and Zambia (minerals) came 4th and 5th, respectively. FDI to Nigeria is set to rise: according to the Financial Times, China National Offshore Oil Company (CNOOC), a State-owned enterprise and one of the three major energy players in China, is negotiating the acquisition of rights to 1/6th of Nigeria's oil reserves.⁸

Figure 18: China's FDI flows into Africa by destination (2003-2007)

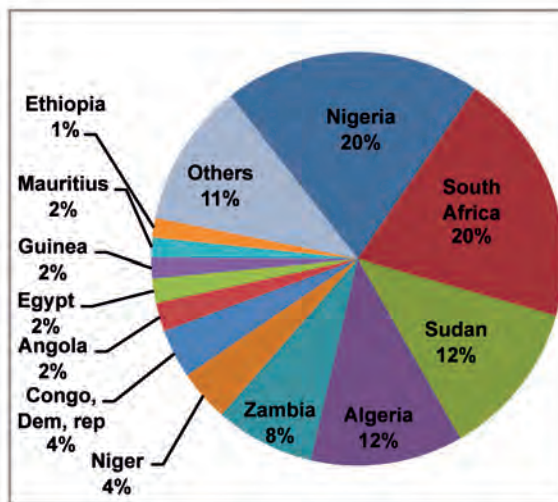
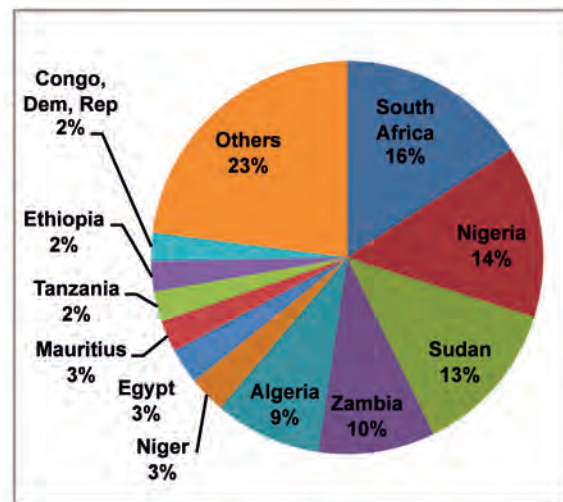


Figure 19: China's FDI stocks in Africa by location (2007)



Source: China Ministry of Commerce, 2008

6) Calculated using UNCTAD basic FDI data and "2007 Statistical Bulletin of China's Outward Foreign Direct Investment" of the PRC Ministry of Commerce.

7) "Statistical Bulletin of China's Outward Foreign Direct Investment", 2003-2007, PRC Ministry of Commerce.

8) Burgis Tom, 29 September 2009, "Chinese Seek Huge Stake in Nigeria Oil", Financial Times.



Most Chinese enterprises investing in strategic sectors, such as oil, minerals or infrastructure, are state-owned (by either the central government or local governments-- Chen and Jian, 2009) and receive government grants or loans from State-owned banks. These enterprises often manage large investment projects (Kaplinsky and Morris, 2009). For instance, the State-owned China National Petroleum Corp is the leading foreign investor in Sudan. Chinese medium- to large-sized enterprises are found mainly in the manufactured goods, telecommunications and wholesale trade sectors. Small firms are found mostly in the light industry and retail sectors. Although the small firms certainly play an important role and are present in most African countries, they are not properly captured in official statistics.

In 2006, the bulk of FDI flows involved the mining sector (40.74%), business services (21.58%), finance (16.4%), transport and telecommunications (6.57%), wholesale and retail trade (6.57%) and manufactured goods (4.33%), with the other sectors being only slightly represented. For instance, agriculture, forestry and fisheries attracted less than 1% of Chinese FDI (Kiggundu, 2008). In terms of stocks, the three leading investors in Africa are State-owned oil companies: China Petrochemical Corp., China National Petroleum Corp. and China National Offshore Oil Corp. (Kiggundu, 2008)⁹.

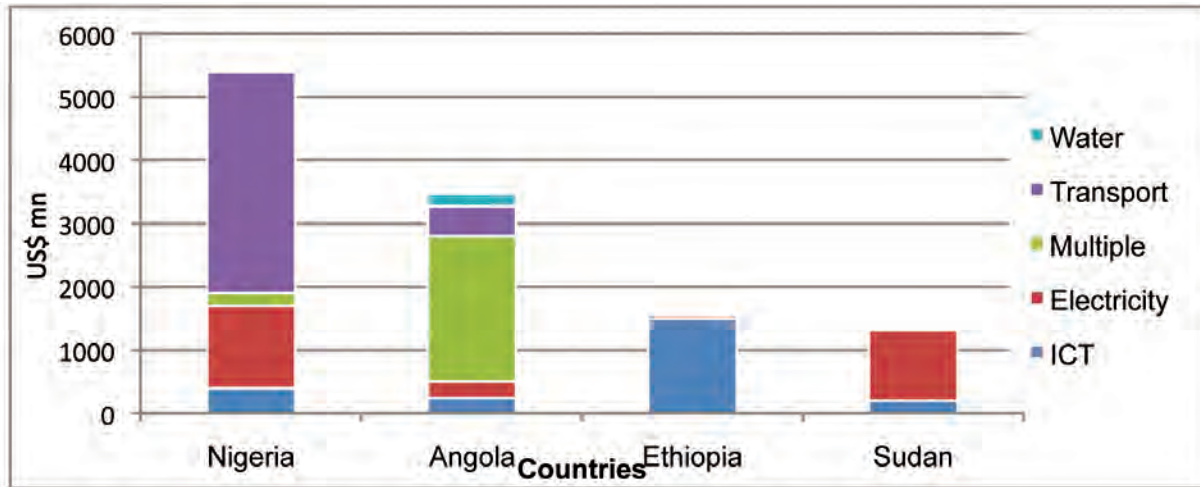
The case of infrastructure is particularly important because the sector is a driver of economic growth; the Africa Infrastructure Diagnostic (AICD) study estimated that Africa needs \$93 billion per year to address the deficit in this sector. Historically, infrastructure was one of the first sectors in which China invested in Africa. China has developed industries and competitive services with special expertise in the execution of public works, based on constructing large infrastructure projects in China. Over 35 African countries are engaged with China in infrastructure financing arrangements; the largest recipients are Nigeria, Angola, Sudan and Ethiopia (see Figure 20 & 21). China's commitments to infrastructure in Africa rose from \$1 billion annually between 2001 and 2003 to \$1.5 billion between 2004 and 2005, and reached \$7.5 billion in 2006.¹⁰ For example, China financed 10 hydroelectric power projects in 2007, to the tune of \$3.3 billion, which increased Africa's hydroelectric power production capacity by 30%. China also has financed \$4 billion in investments in road and railway network projects, including the rehabilitation of existing railway lines and the construction of new lines. The main beneficiaries of such projects are Nigeria, Gabon and Mauritania. China also contributes to Africa's information and communications infrastructure (nearly \$3 billion in total), generally in the form of supplying equipment to national firms. Ethiopia, Sudan and Ghana have been major beneficiaries.

9) It is worth noting that State-owned enterprises or collective enterprises from the Chinese provinces are increasingly investing in Africa and, in 2007, accounted for 21% of Chinese investment in Africa; for example, TCL, owner of Huizhou City, has invested in electronics in cooperation with Philips and Toshiba.

10) Chinese commitments do not cover FDI only, but also loans, concessional loans and grants.

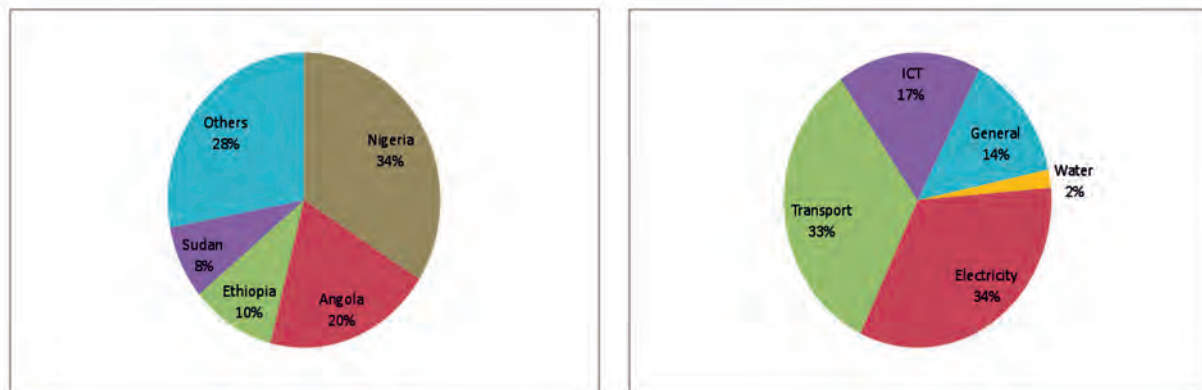


Figure 20: China's financial Commitments in infrastructure projects in major countries (2001-2007)



Source: World Bank, 2009

Figure 21: Confirmed Chinese infrastructure financing in Sub-Saharan Africa per country (2001-2007)



Source: World Bank, 2009

While China's FDI in Africa is likely to continue to be linked to trade, Kapinski and Morris (2009) consider that future FDI will focus more on the private sector and the development of small and medium size enterprises (SMEs) in sectors such as telecommunications, business services and manufactured goods. China is also using some African countries as a platform for re-exports, largely in the apparel industry and focusing on countries that benefit from a non-reciprocal trade agreement,

such as the "Everything but Arms Agreement" of the European Union and "American Growth and Opportunity Act" of the United States.

Kapinski and Morris (2009) stress that with the exception of SMEs in search of quick, short-term profit, Chinese firms are less averse to risk than their Western counterparts (see also chapter 1), and less constrained by environmental and social concerns. Similarly, Besada and others



(2008) emphasize that FDI from Western countries is dominated by private firms with limited risk appetite and little long-term commitment, while Chinese investments are made with the intention of establishing long-term relationships with governments. Given that China's presence in trade and investment is becoming increasingly important for African countries, the next section reviews the effects of China's presence for economic growth and poverty reduction as well as governance and the environment.

V. Potential Impact of China's Presence in Africa

The impact of China's trade with and investment in Africa is difficult to determine, in part because China's increased presence is relatively recent and a valid assessment will take several years. Moreover, the Africa continent consists of 53 individual countries, with different histories, development models and political regimes. For example, Alden (2007) emphasizes the distinction between democracies with diversified economies, weak democracies specialised in primary products and "pariah" regimes. African countries differ significantly in the extent of economic diversification, with Egypt and South Africa the most diversified (and thus probably the least vulnerable), and some of the oil exporters totally dependent on oil revenues. The extent of dependence on China's trade, FDI and development assistance differs greatly. African countries also differ according to the importance of China compared to that of European countries or the United States.

China's success has encouraged a number of African countries to imitate China's policies. However, the Chinese development model is the result of the interaction between a restrictive political system, which developed internally, and economic actors largely dependent on that system (cf. for

example, Naughton, 2008). This experience is not necessarily transferable. Nonetheless, an economic relationship with China does provide an alternative to dependence on Western countries. A distinction is sometimes made between the "Beijing Consensus" and the "Washington Consensus", as many Africans seek engagement with China along lines less restrictive than those imposed by European and American partners or international organisations. This freedom, however, may also be risky. China may be willing to finance projects, for example in infrastructure, that more traditional partners refuse to support because they are not sustainable.

Many African economies have reaped enormous benefits from China's rapid growth and increasingly important trade links with the continent, although other African countries have suffered from increased competition. Thus trade can generate both gains and losses (Ajakaiye et al., 2008, Ademola et al., 2009). An analysis of the effect of China's growth should take into account: (i) increased demand for Africa's exports; (ii) rising commodity prices owing to China's demand for commodities from the global market; (iii) reduced prices on consumer and investment goods in African economies; and (iv) reduced demand for African production due to competition from China, in both domestic and third markets.

Thus the impact of China will depend on the commodity specialization of each country. Countries exporting labour-intensive goods have reason to fear competition from China, while those exporting primary commodities or capital-intensive and technologically advanced goods will gain (Eichengreen and Hui, 2006). Countries that export oil, metals, and certain industrial inputs (for example, cotton) will enjoy increases in export volumes and prices. Various AERC studies (cf. Ademola et al., 2009) conclude that the countries that gain from exporting to China are: (i) Oil exporters: Angola, Chad, Congo, Cameroon, Nigeria and Sudan;



(ii) Ore and metal exporters: Angola, Cameroon, Ethiopia, Ghana, South Africa, Tanzania, Zambia and Zimbabwe; (iii) Cotton exporters: Cameroon, Chad, Cote d'Ivoire, Mali, South Africa, Sudan, Tanzania, Zambia and Zimbabwe; and (iv) log timber exporters: Cameroon, Congo, Cote d'Ivoire, Nigeria and South Africa.

China also has an important impact on African countries' import prices. African economies benefit from the expanded availability and lower prices of consumer goods, for example: transport vehicles (South Africa, Kenya, Mauritius, Ethiopia and Nigeria), motor vehicles (South Africa, Nigeria, Kenya, Ghana), textiles and apparel (South Africa, Mauritius, Nigeria and Gambia) and rice (Nigeria, South Africa, Côte d'Ivoire and Kenya) (Ademola et al., 2009). The purchase of capital goods and transport equipment at lower prices than products imported from Europe has significantly lowered investment costs. This has particularly benefited Africa's infrastructure sector, where the strong Chinese presence relates to both trade and FDI. By contrast, countries importing primary commodities, particularly raw materials and energy, suffer from higher prices. An IMF study covering 21 African countries concludes that the increase in primary commodity prices between 2003 and 2004 resulted in a neutral trade balance for 14 of the countries. For those countries, the gains from the non-oil primary commodity price increase roughly balanced the loss arising from higher oil prices (IMF, 2004).

Some African sectors suffer from reduced production and employment owing to competition from China, both domestically and in third markets. Ademola (et al. 2009) cites several examples of countries with industries that are threatened by Chinese imports, leading to numerous factory closings. For example, in the textile industry, South Africa apparently lost between 23 000 and 85 000 jobs. Ghana also had to close down businesses.

Furthermore, competition in this sector accounts for declining trade between African countries, with nations such as South Africa, Cameroon, Kenya and Madagascar losing market share in neighbouring countries due to the penetration of Chinese apparel. A study on the crowding-out effect of Chinese exports highlights the link between rising Chinese textile exports and declining African exports (Giovannetti and Sanfilippo, 2009). On the whole, in the sectors where China and Africa compete, increased Chinese exports translate into reduced African production.

For some countries, the effects of China trade are mixed. For example, Benin, Burkina Faso and Mali, which are cotton exporters, have gained from the rising price of this commodity, but have seen higher prices on their oil imports (Zafar, 2007).

Moreover, there are distributional impacts within African economies: consumers have greater access to labour-intensive goods, firms may enjoy lower input costs, while some firms will see demand for their production decline. The impact on poverty may also be mixed: the poor may benefit from increased access to low-cost consumer goods, although with the exception of Uganda, Ghana, Tanzania and Ethiopia, basic consumer products imported from China account for less than 10% of total imports. Poor agricultural labourers working in the production of tradable commodities could see a rise in wages and/or employment, while poor urban workers producing consumer goods may see a decline.

A more detailed empirical analysis can provide more insight into the impact of China's trade on African economies, including how China may influence the development of Africa's exports going forward. One important issue is the extent to which trade with China will encourage further specialization in primary commodities, or can help African economies diversify their production



structure and benefit from the economies of scale, productivity improvements, and more stable prices that can accompany increased production of manufactures.

A first approach to this question is to compare the intensity of trade between selected African countries and China and the African economies' comparative advantage in particular commodities. The intensity of trade¹¹ between two countries, i and j , during year t can be calculated as follows (see Calderon et al., 2007):

$$(1) T_{ij,t} = 100 \times f_{ij,t} / (F_{i,t} + F_{j,t})$$

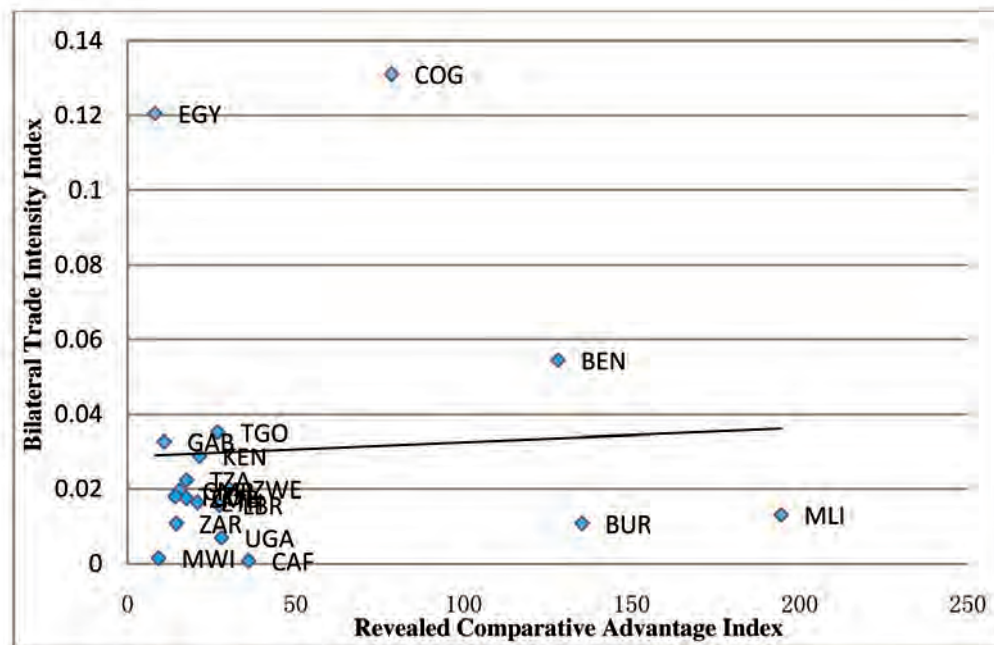
Where $f_{ij,t}$ represents the amount of bilateral trade flows between countries i and j . $F_{i,t}$ and $F_{j,t}$ represent the total trade between countries i and j . This indicator was calculated based on United Nations COMTRADE data. The comparative advantage by commodity group was calculated using a widely used World Bank index (see Annex 1). The comparative advantage index was calculated for each type of product in 2004, based on data from several sources: the World Bank for manufactured goods (Nicita and Ollareaga, 2006), and UNCTAD for unprocessed agricultural and petroleum products. The goal of this analysis is to see whether sectors in which African countries have a comparative advantage are also sectors with a high intensity of trade with China. As the intensity

of trade varies widely, we restricted the analysis to products that are included in the top 25% ranked according to Africa's comparative advantage (by value), Africa has a substantial comparative advantage in unprocessed agricultural products, and the correlation between country indices of comparative advantage and Africa-China trade intensity is low, but positive (figure 22). Chinese agriculture is not competitive, China has reduced import barriers significantly since joining the WTO, and China has entered into trade agreements providing for zero tariffs with many African countries (Fan 2007). Thus there should be considerable potential for African economies to benefit from exporting agricultural products to China. However, agricultural exports to China are only about 3% of Africa's total agricultural exports (Brazil, the United States and Canada dominate China's agricultural imports), and these exports are concentrated in a few products from a limited number of countries. As noted above, China's increased demand for agricultural products has pushed up prices, with implications for African economies depending on whether they are net exporters or net importers. For instance, there is limited coincidence between China's agricultural import demand and Southern African countries' export supply: "In particular, none of the top exports of Tanzania appears as top imports of China [...] So, on the surface, it looks as though the effects of China on SA's exports due to direct demand are negligible". (Villoria, 2009, p.5).

11) This indicator is more difficult to interpret when the two countries are of very different sizes. For some African countries with a modest economic size, the denominator is almost entirely made up of Chinese trade.



Figure 22: Comparative advantage and trade intensity: agricultural sector



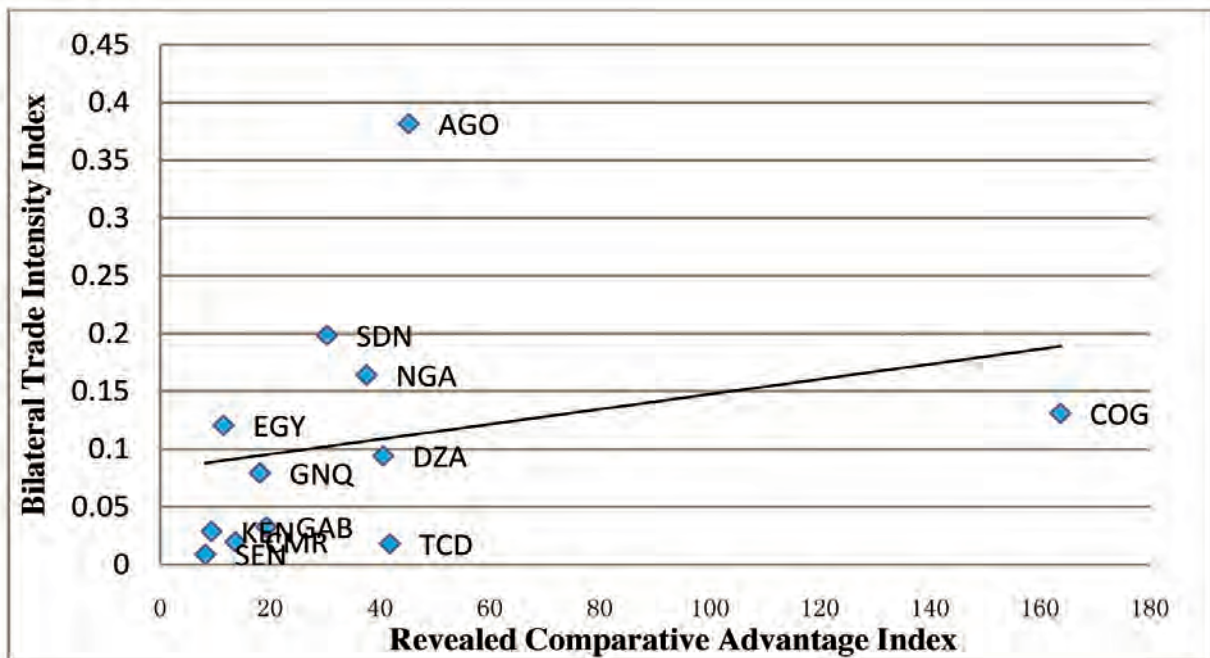
MLI=Mali, BUR=Burkina-Faso, BEN=Benin, COG=Rep. of Congo, CAF=Central Africa, ZWE=Zimbabwe, UGA=Uganda, LBR=Liberia, TGO=Togo, KEN=Kenya, ETH=Ethiopia, SOM=Somalia, TZA=Tanzania, ZMB=Zambia, CMR=Cameroon, ZAR=D.R. Congo, TCD=Chad, GAB=Gabon, MWI=Malawi, EGY=Egypt.

With regard to oil, Congo has the highest comparative advantage, followed by Chad and Angola (figure 23). The correlation between countries' revealed comparative advantage and the intensity of trade with China is positive (0.26); it is the most significant of the three sector groups. China's desire to obtain secure energy supplies is well known, and it is likely that Chinese demand for oil will continue to rise, while Africa has significant reserves. This amounts to a relationship of complementarity. Moreover, Africa offers better quality oil than that of the Middle Eastern countries and represents a source of diversification of supply for China. "The African oil and gas markets hold a number of attractions for the Chinese. First, China prefers sweet crude

oil which is low in sulphur contents to blend with more sour variables that they import from the Middle East. There is therefore fierce competition over the existing supplies of sweet crude from Africa. Second, for energy security, China is trying to diversify supply sources from Middle East countries to more stable African countries. Third, among all SSA oil producing countries, Nigeria is the only member of OPEC. Hence, fears about production quota and other controls by the cartel will have little impact on [Asian Drivers countries] quest for oil and gas from the continent". (Adenikinju and Bamou, 2006). Rising oil prices and profit margins have made it possible to undertake more costly explorations in the Gulf of Guinea, Sudan and Nigeria.



Figure 23: Comparative advantage and trade intensity: oil sector



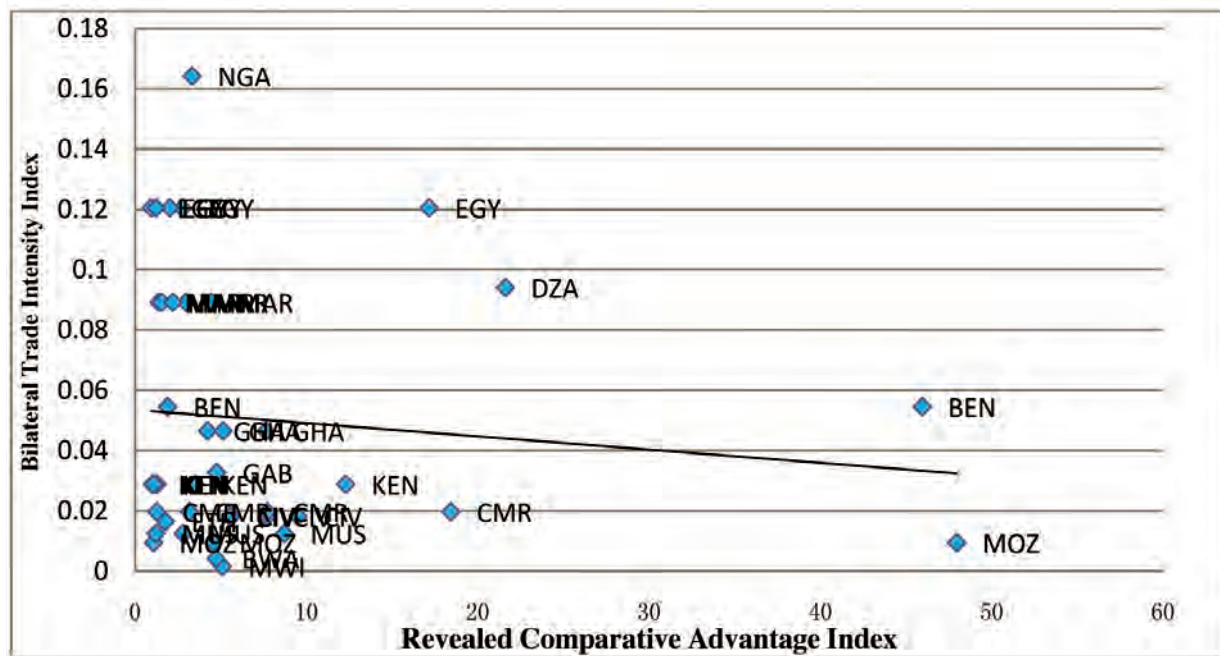
COG=Rep. of Congo, AGO=Angola, TCD=Chad, DZA=Algeria, NGA=Nigeria, SDN=Sudan, LBY=Libya, GAB=Gabon, GNQ=Equatorial Guinea, CMR=Cameroon, EGY=Egypt, KEN=Kenya, SEN=Senegal.

African economies' highest comparative advantage in manufactures and processed goods is in metals (Mozambique), tobacco (Benin), refined oil (Algeria, Egypt and Kenya), timber and manufacture of wood and cork products (Cameroon) and food processing (Mauritius).

Morocco enjoys a comparative advantage in several manufactured products, various food processing industries, chemicals, etc. Thus there is potential for Africa to compete with China in selected manufactures. China also provides an opportunity to build industrial linkages.



Figure 24: Comparative advantage and trade intensity: manufactured sector



MUS=Mauritius, CIV=Cote d'Ivoire, MWI=Malawi, GHA=Ghana, ETH=Ethiopia, CMR=Cameroon, EGY=Egypt, KEN=Kenya, GAB=Gabon, MAR, DZA=Algeria, MOZ=Mozambique, NGA=Nigeria, BEN=Benin, BWA=Botswana.

There is a negative correlation between the intensity of trade with China and the degree of an African economies' comparative advantage in manufactures and processed goods (figure 24). This suggests that trade with China does not, on balance, encourage the expansion of Africa's manufactures and processed goods industries. Thus trade with China could encourage African economies to remain specialised in raw materials, which implies high vulnerability to commodity prices and a higher probability of corruption. It also limits the opportunity for the development of agricultural and industrial production towards higher value added products.

FDI by China can also generate important benefits for Africa. There is some evidence that China's investments in Africa have encouraged similar steps by other emerging economies, although the official statistics do not yet show this. For example, India's engagement with Africa has increased with the Africa-India summit in April 2008.

Investment in agriculture is very important for African governments due to food security needs. China is committed to supporting research and innovation in Africa through building technology centres, sending scientists to transfer technology to African countries, and helping to upgrade African products, as emphasized at the 2009 Forum on China-Africa Cooperation (FOCAC). Chinese support has made it possible for several African countries to boost their production and exports (Besada et al., 2008). For example, China provided Zimbabwe technical assistance (including training in irrigation and developing smallholdings) to improve the value added of its exports by developing cigarette manufacturing instead of exporting tobacco.

The oil and natural resource sectors attract the majority of Chinese investment, which have been accompanied by the establishment of service businesses that are highly competitive in terms



of salaries, costs and expertise. This could have a negative effect on local employment and have implications on host government local content policies (Adenikinju and Bamou, 2006). There are also positive effects because Chinese investments in services could reduce the price of services facing African firms, and high-priced and inefficient services are an important constraint on development in Africa. However, the energy sector in many countries has lacked transparency, has encouraged extensive rent-seeking, and has been connected with government corruption, to the detriment of improving the income levels of the population.

The Chinese presence has also permitted the building of a local industry. “Chinese investments “have helped to build local capacity, transfer technology and raise exports levels to several African states. In Zimbabwe, for instance, where tobacco has been among its top exports, Chinese investors have helped Zimbabwe process tobacco into cigarettes and export these as finished value-added products. Chinese investors and local companies have also formed joint ventures to establish a large cement factory in Gweru to meet national demand. These Chinese investments can be found in a wide variety of sectors, including so-called fragile states and projects that western investors have seemingly deemed too risky” (cf. Besada et al., 2008, p.11). Such efforts need to be tied to a national development strategy (Ajakaiye et al., 2009) to encourage the development of backward and forward linkages to African firms. Moreover, certain works have shown that Chinese FDI and trade in Africa are complementary (Mo and Liu, 2008). Lastly, the services sector has benefited from Chinese investments in telecommunications and banks. Again, it is the strategy of each African country that must serve as the basis for investment negotiations.

VI. Governance and Economic Policy

Despite various definitions, there is a consensus that governance encompasses institutions with the capacity to ensure the rule of law, respect for individual freedoms and a democratic political regime (Kaufman and Kraay, 2008). In recent years, international organisations and bilateral aid agencies from traditional donors have made their assistance conditional on good governance. China, on the contrary, makes a clear distinction between economics and politics in its interventions in Africa. This position has led China to support undemocratic regimes, raising concerns about its contribution to the development of governance in African countries. Africa cannot expect assistance from China to improve governance, which can only result from internal choices and consultations between the State and its citizens. However, a number of recommendations can be suggested to limit the negative effects on governance of China’s presence in Africa:

1. Trade and FDI in the natural resource sector tend to impair governance and efficiency, have harmed the environment, and often failed to lead to a reduction of poverty. Moreover, the oil sector’s demand for resources has often reduced manufacturing production (due to the Dutch disease effect) and has been associated with imprudent macroeconomic policies resulting in high levels of volatility. The weak impact of oil or mineral exports on poverty reduction has often been highlighted in the literature (Adenikinju and Bamou, 2006).¹² Countries with substantial oil reserves need to be particularly careful to ensure strong, democratic institutions, to pursue prudent fiscal policies (ensuring efficient

12) This situation is facilitated by the lax practices of some Chinese partners, but it also stems primarily from internal institutional weaknesses. For example, Congo-Kinshasa with its vast mineral reserves of copper, cobalt, etc. is very poor, because of the State’s inability to collect tax revenue from thousands of companies that are beyond its control.



public expenditures and avoiding excessive monetary expansion), and to allocate a portion of oil revenues towards investment in the non-tradable sectors (Iimi, 2006).

2. The sharp increase in revenues resulting from Chinese demand must be managed by increasing savings in times of economic boom and making provisions for social assistance, particularly for the unemployed, during downturns. The OECD (Goldstein et al., 2006) cites the example of Chile's countercyclical policies and recommends the application of Hartwick's rule (1977). This rule states that a constant level of consumption can be maintained in a rent-based economy if the amount of investment is equal to the value of rent accrued from the natural resource, at all times. Funds have been set up to save the rents from oil windfalls in Nigeria and Botswana, and could be recommended more broadly to stabilize expenditures over the commodity price cycle (absorbing resources when commodity prices rise and spending resources when they fall).
3. African countries need to increase the value added of their production and exports, irrespective of their partner countries. This implies developing specialisations that may justify limited protectionist measures (Geda, 2006). For example, local content requirements, not only for Chinese investors, but for all investors could be expanded to increase the demand for unskilled African labour and local construction material for investment projects.
4. Trade growth can be associated with increasing inequality. Zafar (2007) emphasizes that trade with China contributes to an improvement in the terms of trade for resource-rich countries and a deterioration for resource-poor countries.

The same distributional effects can be seen within a country, where workers and firms in the oil and mineral sectors see increasing incomes while agriculture and manufactures sectors see reductions. Such changes in income distribution can increase the risk of social unrest, particularly where oil or minerals production is concentrated in particular regions.

5. As described above, China enjoys significant benefits from its integration in the Asian region. Similarly, African countries may be able to reap significant benefits from furthering regional integration in respect to the rules governing Chinese investment. For example, collaboration among African governments could be useful in stipulating minimum levels of local employment in Chinese-owned firms.

Economic policy suggestions can only be envisaged by taking into consideration the specific nature of individual countries. The influx of financial and human resources from China generate short-term mutual benefits and can enhance complementarities between China and Africa. However, reaping the full benefits of this collaboration will require that African governments strengthen their governance institutions. This would require stronger interaction between African civil society organizations and their respective governments. Stronger governance institutions would have a beneficial impact on implementation of social and environmental safeguards as well as encourage the use of African labour and local construction companies to support major investment projects. Such regulations would not only apply to Chinese investors, but to all investors from other countries as per the WTO agreement. Many of these issues have been highlighted at the November 2009 FOCAC meeting.





Annex 1: Revealed Comparative Advantage (RCA)

“The concept of RCA pertains to the relative trade performances of individual countries in particular commodities. On the assumption that the commodity pattern of trade reflects inter-country differences in relative costs as well as in non-price factors, this is assumed to reveal the comparative advantage of trading countries”, B.Balassa, 1977.

$$RCA_{ij} = (x_{ij}/X_{it}) / (x_{wj}/X_{wt})$$

Where:

x_{ij} represents exports of country i in product j

X_{it} represents total exports of country i in year t

x_{wj} represents exports of country w (China) in product j

X_{wt} represents total exports of country w in year t





Annex 2: Nomenclature of Manufactured and Processed Goods

Description of manufactured products/industrially processed products

Manufactured products used in this paper were disaggregated according to International

Standard Industrial Classification (ISIC)-3-digit, Rev 2. The list of industrial products, according to this classification and as found in the Nicita and Olareaga database (2006) is:

- Food	- Paper	- Processed and Cast Iron
- Beverages	- Printing Work	- Metallic Structures
- Tobacco	- Chemicals	-Machines and Machinery
- Textile	- Refined Petroleum and Petroleum Derivatives	- Electrical
- Apparel	- Rubber	- Transport Equipment
- Leather	- Plastics	- Medical and Surgical Equipment
- Shoes	- Stoneware and Porcelain	- Other precision Equipment
- Articles of wood	- Glass	



Chapter 3: China's manufacturing and industrialization in Africa



Ron Sandrey and Hannah Edinger

I. Introduction

China, as well as several other Asian economies, has achieved spectacular growth rates through opening markets to facilitate sensible price signals, operating trade and exchange rate policies that favour exports over imports in at least the initial stages, providing a sound incentives framework for investment, and developing large-scale physical infrastructure. These policies have fostered dynamic gains from increased production and export of manufactures. In Africa, by contrast, the acceleration of growth from 2001 until the global recession was based on higher primary commodity prices, while diversification into manufactures production has been limited.

The objective of this chapter is to examine the state of industrialization in Africa and to discuss the interactions between China's growth and African development. African nations are linked to China through that country's importance in determining the prices of raw materials, China's demand for Africa's raw materials exports, substantial investments in Africa, and exports of low-cost investment and consumer goods. However, there is concern that these exports are damaging Africa's industrial base, while reliance on commodity exports will not support poverty reduction as commodity production generates limited demand for unskilled labour and increasing scope for reliance on rent-seeking rather than productive activities. Goldstein et al. (2006) conclude that China can have a net positive impact on Africa, but only with improvements in governance and policies that support diversification, backward and forward linkages between sector enclaves and the rest of the economy, increased demand for labour, and skills upgrading.

We begin with an analysis of Africa's export performance and diversification. The next section considers how China has affected African growth over the past decade or so, focusing on the

implications of China's manufactured exports, Chinese investment in Africa's resource sector, and China's encouragement of export processing zones. A key question is whether China's rapid growth in manufacturing combined with Africa's exports of natural resources is effectively blocking off Africa's ability to follow a manufacturing-led growth path. The final section offers some policy recommendations.

II. The State of Industrialization in Africa

II.1 The Background

Given its natural resource wealth, it is only natural that Africa exports a considerable share of its oil and mineral commodities. This is consistent with general trade theory. But most African states import many goods that require a large semi-skilled and unskilled labour base to produce. This is not so consistent with theory, as these African countries, with a large pool of unskilled labour, should be producing and exporting these goods.

Most African countries have achieved only limited diversification from primary commodity exports to manufactures, and often small gains in diversification have been reversed quickly (Hammouda and others, 2006). The United Nations Economic Commission for Africa (UNECA, 2007) describes Africa's progress in diversification over the last few decades as "slow and volatile". Progress has differed across regions. North Africa recently has achieved the most gains, and SADC and COMESA also have made progress, led by structural transformation in key economies (in the case of SADC, South Africa) (UNECA, 2007).

The production of manufactures (value added as a share of GDP) in Africa remained constant from 1995 to 2004, and has remained far below the average of its developing country peers (Table 2). Manufactures accounted for only 10.9 percent



of the GDP of the 20 largest African economies in 2006 (9.6 percent if South Africa is excluded).¹³ Fukunishi (2004) finds that manufactured exports equalled only 6 percent of Sub-Saharan Africa's GDP—a little over half of the 11 percent average for all low income countries—and the value of manufactured exports equalled 50 percent of value added in manufacturing, compared to 59 percent for all low-income countries. He concludes that the poor export performance is the key reason for the stagnation of the manufacturing sector in Sub-Saharan Africa.

Table 2: Share of manufacturing value add (MVA) as a % of GDP (at constant 1995 prices)

	1995	2000	2004
Africa	12.1	12.3	12.1
China	34.7	36.7	39.0
India	16.3	15.7	15.0
Developing Group excluding China	19.2	20.0	20.4
WORLD	19.8	20.1	19.9

Source: UNIDO International Year Book 2006, reported in Kaplinsky (2008)

Fukunishi (2004) and Kaplinsky and Morris (2008) show that SSA's productivity is lower and that labour costs are higher than in other low-income economies (and in Asia in particular), and that

these factors are accentuated by over-valued exchange rates, low FDI levels and small firm sizes in Africa. Although there are differences among African countries, in general high indirect costs and business-environment related losses impair the productivity of African firms. African gross productivity¹⁴ is only 40-80 percent of China's.¹⁵

The creation of competitive industrial capacity has been hindered by: (i) low investment; (ii) poor infrastructure services, resulting in higher production and transaction costs; (iii) high sovereign risk, poor governance and weak institutions; (iv) ill-advised industrial policies; and (v) generally rigid macroeconomic frameworks (UNECA, 2007). Africa's problems are accentuated by the small size and ethnic fragmentation of many countries that too often results in internal conflict, by the geographical nature of many landlocked resource-scarce states, and by the implications of letting Asia "get too far ahead". Soderbom and Teal (2001) caution that improved macroeconomic policies alone may not be sufficient to boost economic growth. Policies that target improvements in the operational efficiency of firms, coupled with macroeconomic reforms, would help firms become successful exporters and substantially improve countries' economic performance. In general, political leadership is required to eliminate constraints on infrastructure, skills development, and entrepreneurship.

II.2 What Should Africa Produce?

The desirable structure of African production is a matter of some controversy. Wood and Mayer

13) This calculation is based on data from UNIDO. The average weighted MVA for 2000 was 11.6 for the top twenty economies with South Africa and 10.2 without South Africa, as South Africa's MVA declined from 17.25 in 2000 to 16.33 in 2006. Of the top twenty economies in 2006 the MVA was below 5 for seven, between 5 and 9.9 for six, between 10 and 14.9 for two and over 15 for the remaining five (South Africa, Egypt, Tunisia, Cote d'Ivoire and Senegal). Of the twenty, twelve saw a decline in MVA ratios between 2000 and 2006.

14) Where gross productivity relates to the usual concept of total factor productivity, while net total factor productivity takes out the indirect costs that are outside of the control of the individual firms but contribute to higher operating costs.

15) This range depends upon how the productivity estimate is calculated and falls even further when net productivity is analysed, to only 20-40 percent of China's productivity.



(2001) argue that Africa should follow a land-abundant development path similar to that followed by the United States, rather than the model followed by the land-scarce Asian economies.¹⁶ The highest priority should be to raise exports, relying on Africa's abundant natural resources. They argue that even if Africa were to eliminate the policy constraints on manufactures production, so that manufactures export performance achieved its estimated potential, manufactures would still make up less than 30 percent of total exports, marginally above Latin America's 28 percent but significantly below the 60 to 70 percent levels in East and South Asia. The limited potential for manufactures implies that substantial increases in SSA's output and exports must depend on the expansion of natural resource-based activities. Eifert et al. (2005) confirm that African manufacturing and manufactured exports are high-cost relative to the continent's levels of income and productivity. And Lederman and Maloney (2007) state that raw materials should be seen as "neither a curse nor destiny", and can contribute to development when coupled with policies that support innovation. Knowledge, the availability of infrastructure, and the quality of governance together determine what countries produce and how they produce it.¹⁷

Other observers find that Africa's dependence on natural resources must be overcome because it limits development. Natural resource dependence has often been accompanied by widespread

corruption, weak institutions, and rent seeking. Volatile primary commodity prices have imposed high levels of volatility on resource-dependent African economies, while these economies have only limited ability to protect the vulnerable. Investments in natural resources contribute little to the employment of the unskilled, and thus often have a limited role in reducing poverty. And resource-rich developing countries have often experienced slower growth than their non resource-rich developing country peers since the 1960s.

II.3 Where is Africa Competitive?

Determining what goods Africa is most suited to produce, given its resource endowments and input costs, is a difficult exercise. Export performance can indicate what products are competitive in global markets, although the level and commodity composition of exports are influenced by distorted trading regimes in many African countries, as well as import preferences offered by trading partners. Given the general problem of reliability and timeliness of African data, our analysis of the competitiveness of African manufactures will use US import data, as the United States is the world's main export destination for manufactured goods.¹⁸

Several aspects of African exports are worth highlighting, in terms of country breakdown, commodity composition, and in comparison to Asian exports (Table 3 & 4).¹⁹ The bulk (89 percent)

16) By now, of course, the US has moved towards a service economy.

17) For most sectors, the patterns of comparative advantage are better explained by the set of new endowments (what one does) than by traditional endowments (what one has). Only in the raw materials and forestry sectors do the traditional endowments predominate over the new endowments that are affected by public policies such as knowledge, schooling, infrastructure, ICT and institutions¹⁵ This range depends upon how the productivity estimate is calculated and falls even further when net productivity is analysed, to only 20-40 percent of China's productivity.

18) We have omitted an analysis of African trade with the EU, although this trade is more important than the US trade for several North African and West African economies. We use the US as the benchmark manufacturing market as this market has been the final manufacturing market for successive waves of Asian growth economies.

19) The data were selected for table 4 to show exports by: (i) The 20 largest African economies (South Africa, Egypt, Nigeria, Algeria, Morocco, Angola, Libya, Sudan, Tunisia, Ethiopia, Kenya, Tanzania, Cameroon, Ivory Coast, Ghana, Uganda, Botswana, Senegal, Gabon and the Congo), broken down by North Africa and Sub-Saharan Africa; (ii) the six largest African economies shown separately; (iii) countries where exports of clothing are important (Kenya, Mauritius and Lesotho); and (iv) some Asian comparators. Total exports are broken down by fuels and minerals (codes 27 and 71 of the Harmonized System (HS)), textile and clothing (HS codes 50 to 63 of Section XI), and within T&C, apparel (HS codes 61 and 62).



of Africa's exports to the United States are fuels or minerals, which account for more than 99 percent of exports from Nigeria, Algeria and Angola, and about 40 percent of exports from Egypt and South Africa. Fuels also dominated the only significant exporters among the medium-sized African economies. Textiles and clothing made up only 2 percent of exports (about \$1 billion each from Sub-Saharan Africa and North Africa) to the United States, three-quarters of this supplied by Egypt, Kenya, Mauritius and Lesotho. Nevertheless, textiles and clothing accounted for a significant share of Africa's manufactured exports to the United States, with other major products including transport-related goods (1.7 percent of total exports), base metals (1.5 percent), chemicals (1.3 percent), prepared foods (0.9 percent), and machinery and electrical equipment (0.6 percent).²⁰

Apparel plays an important role in African manufactured exports. Ninety percent of textile and clothing exports to the United States were classified as apparel, which increased by 6 percent per year from 2000-08. In addition (not shown in the table), imports into the US from AGOA²¹ countries during 2008 were some \$1,151 million, with all but \$13 million qualifying for AGOA preferences. Kaplinsky and Morris (2006) report that the nominal rate of tariff protection on apparel imports ranges between 16 and 32 percent, but with the exception of South Africa the AGOA suppliers to the US can incorporate duty-free imports of materials. They

calculate that this raises the effective rate of the subsidy (the subsidy level that takes all factors into account and not just the tariff) to between 27 and 84 percent. Furthermore, they state that "this rate of subsidy is required for AGOA clothing producers to compete in the US market. This is because scales of production are low in SSA plants, and many producers suffer from poor bureaucratic and physical infrastructure". Collier (2007) goes further and states that "What Africa needs is temporary protection from Asia in OECD markets".

Finally, the European Union was an important market for North African apparel exporters, with EU apparel imports from Tunisia totalling €219.5 million, from Morocco as €111.3 million and from Egypt as €52.3 million. Imports from other African countries included those from South Africa (€12.4 million), Madagascar (€2.4 million) and Kenya (€1.3 million). Tellingly, while most African countries had tariff preferences into the EU under the old Cotonou Agreement (with these to be replaced by the Economic Partnership Agreements – EPAs), and South Africa has preferences under the Trade, Development and Cooperation Agreement (TDCA), these preferences are undermined by rules of origin constraints that are much more rigid than the AGOA rules offered by the US to African exporters (Naumann, 2004). Europe's imports from Lesotho, Swaziland and Mauritius were negligible, showing these countries to be entirely focused on the US market.

20) Other African exports to the United States included a 'Special' category reserved by the US for classification purposes (0.5%), fruit and vegetables (0.4%) and plastics and rubber products (0.3%), with only the latter minor category being of traditional manufacturing interest. Wood and fats and oils reached individual shares of 0.1 percent, while "miscellaneous manufacturing", pulp and paper products, instruments (surgical etc), hides and leather, stones/glass/ceramics, footwear and arms/ammunition did not register significantly.

21) The African Growth and Opportunity Act (AGOA) is a United States Trade Act that significantly enhances US market access for (currently) 39 SSA countries. The Act originally covered the period from October 2000 to September 2008, but was recently extended to 2015. A special dispensation relating to apparel also applies.



Table 3: US imports from selected African and Asian countries (\$ billion/million and %)

Region country	\$ billion total imports	% HS 27 & 71 fuels & minerals	T&C \$ million	T&C %	HS 61-62 % of T&C	Growth 61&62
Africa	113.5	89.1	2,266	2.0	90.6	6.0
North Africa	27.4	89.9	1,080	3.9	83.5	6.7
SSA	86.1	88.8	1,186	1.4	97.1	5.4
RSA	10.0	42.2	50	0.5	36.4	
Egypt	2.4	40.3	915	38.6	81.1	7.5
Nigeria	38.1	99.4	00	0.0	73.3	
Algeria	19.4	99.7	0	0.0		
Morocco	0.9	1.9	94	10.7	97.2	-0.6
Angola	18.9	100	0	0.0		
Kenya	0.7	0.5	247	71.9	99.9	
Mauritius	0.2	14.4	102	57.6	99.7	-11.0
Lesotho	0.4	8.2	340	90.8	100	11.1
Asian countries						
China	337.8	1.4	31,489	9.3	76.2	16.9
Vietnam	12.9	8.7	5,271	40.9	97.7	58.7
Cambodia	2.4	0.0	2,382	98.8	99.6	13.6

Note: Country composition and commodity definitions are given in footnote 21.

Source: US Department of Commerce, Trade Stats Express at <http://tse.export.gov/>



Table 4: US imports from selected Africa countries, 2008

Country	\$ million imports	% HS 27 & 71 fuel, minerals	T&C \$ million	Other main trade lines		
Libya	4,179	95.6	0	Special	Fertiliser	Org chem.
Sudan	5	0.0	0	Gums etc	-	-
Tunisia	644	58.0	71	Olive oil	Electrical	Fertiliser
Ethiopia	152	0.0	10	Coffee	Oil seeds	Special
Tanzania	56	29.7	2	Coffee	Fruit	Gums etc
Cameroon	614	88.6	1	Wood	Rubber	Cocoa
Cote d'Ivoire	1,092	35.6	0	Cocoa	Wood	Rubber
Ghana	222	58.3	1	Wood	Cocoa	Fish
Uganda	53	0.0	0	Special	Coffee	Other metal
Senegal	18	57.0	0	Special	Fish	Feathers
Gabon	2,279	95.9	0	Ores	Wood	Rubber
DRC	266	96.7	0	Wood	Unclassified	Milling prod

Source: US Department of Commerce, Trade Stats Express at <http://tse.export.gov/>

II.4 The Apparel Sector

It can be expected that the labour-intensive apparel sector would play an important role in Africa's manufactured exports, given the continent's abundant low-skilled labour and preferential access to the United States and the European Union. Production of wearing apparel (SITC 84) is being transferred rapidly to developing countries in general, which accounted for only 28.2 percent of global production in 1995 but 57.5 percent in 2006; some two-thirds of this change took place during the 2000 to 2006 period, when the global value added in manufacturing declined by an annual average of 1.6 percent but the

developing country value added increased by 5.9 percent annually. China has accounted for a large share of the developing world's apparel exports (see above for comparison with Africa), assisted recently by the expiration of the WTO's Agreement on Textiles and Clothing (ATC), although the US and other WTO members have retained the option of imposing restrictions on Chinese imports. The productivity and importance of apparel sectors also vary, with apparel making important contributions to growth in Egypt and Mauritius, but facing major impediments in South Africa (Box 4).



Box 4: Comparing major apparel sectors in African economies

The apparel sectors of Egypt, South Africa and Mauritius illustrate some of the diversity in apparel production in Africa.

The apparel industry is one of the most dynamic industrial sectors in **Egypt**, comprising some 1,500 private sector apparel and intermediate manufacturers. It accounts for 20 percent of all of Egypt's exports, 3.5 percent of GDP, and nearly 30 percent of manufacturing employment (more than half a million workers). The latest technologies are adopted in all phases of production²². The industry covers the entire spectrum of cotton processing operations and is growing at an average rate of 6.5 percent annually. While the sector has relative advantages, Egyptian companies have not fully succeeded in leveraging the country's cotton into building a superior manufacturing industry (Magder, 2005).

In contrast to Egypt, the **South African** clothing sector faces severe structural problems. During 2008 R1 billion of the industry's contribution to GDP and 10 percent of the industry's workforce were lost (Bisseker, 2009). The industry has battled unsuccessfully for many years to attract capital and investment, reducing firms' ability to compete with low-cost producers, and leaving them vulnerable to Chinese imports. South Africa began applying quota restrictions to many lines of Chinese C&T imports from January 2007. These quotas were designed to protect the domestic sector, a sector already sheltered behind tariffs of 40 percent to imports from most sources outside of the Southern African Development Community (SADC); and a sector struggling to keep up with fashion trends and thus shorter product lifecycles, and to compete with speed-to-market of Asian producers.

In Mauritius²³ the textile and apparel sector accounted for about 66% of total manufacturing employment in 2004 (Joomun, 2006). Observers have feared that competition from China would hurt the sector, which declined by 12.5 percent in 2006. However, the sector grew by 8 percent in 2007 (Ackbarally, 2008), and the island imported more foreign labour from India, China and Bangladesh. Some studies have concluded that while resource-rich countries stand to gain from China's demand for oil and minerals, economies like Mauritius, with no commodity base and which compete with China in export markets, are likely to lose. However, Ancharaz (2008) argues that the economic impact of China on Mauritius has not been so negative, due to: the Mauritian economy's resilience and ability to adjust to global developments; and structural upgrading in the clothing industry, which has shielded it from Chinese competition in third markets; and export market diversification, which has partly made up for the loss of share in the US market, where Chinese competition has been most acute.

22) See Infomat Inc (2009).

23) It should be acknowledged that Mauritius, with its geographical location and relatively high income is not representative of a typical African country.



In summary, based upon exports to the US, the clothing sector is the only manufacturing sector in Africa that displays international competitiveness. However, the performance of the clothing sector varies considerably among African economies, and only a few are significant exporters. Moreover, the success achieved is built upon the rather unstable foundations of tariff preferences, and in particular tariff preferences that curtail the Chinese competition in the US market.

III. Challenges Facing Africa in the Age of the Chinese Dragon

China affects African economic performance through several channels. China is an increasingly important market for African exports, while increased demand from Asia has played a significant role in the rise in the international prices of Africa's resource exports (Kaplinsky and others, 2007). Chinese export expansion has benefited African firms and consumers by reducing the price and increasing the availability of manufactures. At the same time, competition from Chinese manufactures in both domestic and third markets has reduced the demand for African manufactures and perhaps undermined Africa's manufacturing capacity. Finally, Africa has benefited from an inflow of Chinese aid, financing and investment, which in itself is coupled to trade flows. Beijing sees itself as a "partner in development" to the African continent, as reiterated in numerous state visits and the Forum on China-Africa Cooperation (FOCAC) summits (Davies et al, 2008). While China's financial support is often seen as a longer-term strategy for its own development and benefit, direct and indirect assistance has resulted in economic benefits to Africa, spurring activity in the commercial corridor between China and Africa. The net impact of all of these influences

varies greatly among African economies, depending on the commodity composition of their trade and their resource endowment, among other factors.

III.1 China trade with Africa versus other regions

Africa is hardly the most important trading partner for China: in 2008, Africa ranked 7th as an export destination and 8th as a source of imports. Nevertheless, China's trade with Africa is expanding more rapidly than with most other trade partners. From 1995-2008 China's exports to Africa rose by 23 percent per year, more rapidly than exports to Europe, the United States, or ASEAN countries (Table 5). Similarly, China's imports from Africa increased by 28 percent per year from 1995-2008, more than twice the rate of increase of imports from Europe or the United States.²⁴

Table 5: Chinese export destination and import

Country/region	Exports – percentage annual change		Imports – percentage annual change	
	From 1995	From 2004	From 1995	From 2004
World	17.4	22.0	16.5	17.5
Africa	23.2	32.6	28.2	31.8
EU -27	20.5	24.8	13.9	15.9
US	17.9	17.6	12.5	15.0
Hong Kong	12.8	15.9	3.2	2.3
Japan	10.8	11.4	10.8	11.4
ASEAN	18.4	24.5	19.0	15.5
Korea	18.5	24.4	18.4	14.8

Source: World Trade Atlas data, authors' calculations

24) Had we extended the table to the top 20 export destinations and import sources we would have found that there were seven export destinations that saw annual increases greater than Africa's over the full period (India, United Arab Emirates, Brazil, Mexico, Saudi Arabia, Kazakhstan and Kyrgyzstan) but only three (Saudi Arabia, India and Iran) that had greater import increases.



Comparing Africa's trade with China and the United States, Africa's exports are dominated by oil and minerals (84 percent of Africa's exports to China and 86 percent of Africa's exports to the United States—Table 6). Exports from China to the world,

to Africa and to the United States show greater diversity, with the largest category machinery and electrical equipment, followed by textiles. By contrast, the share of textiles in Africa's exports to China and to the United States is marginal.

Table 6: Africa-China trade comparisons, 2008 data, \$billion & % shares

HS Sections	China from Africa	China to Africa	China to World	US from China	US from Africa
Total \$ billion	55,883	50,869	1,428,869	337,790	113,520
Mineral fuels	83.9%	1.6%	2.5%	0.8%	86.1%
Precious metal	3.2%	0.1%	0.6%	0.8%	4.2%
Textiles & articles	0.8%	17.5%	12.5%	9.3%	2.0%
Transport	0.0%	11.0%	5.0%	2.1%	1.7%
Base metals	4.6%	13.9%	10.1%	7.1%	1.5%
Chemicals	0.7%	4.6%	4.8%	2.9%	1.3%
Prepared food	0.5%	1.2%	1.3%	0.7%	0.9%
Machinery & elect	0.7%	31.8%	42.7%	43.1%	0.6%
Special	2.8%	0.0%	0.1%	1.3%	0.5%
Vegetable fruit	0.3%	1.5%	0.8%	0.3%	0.4%
Plastics & rubber	0.3%	4.3%	2.9%	3.6%	0.3%
Wood	1.8%	0.7%	0.8%	0.9%	0.1%
Animal prod	0.1%	0.3%	0.6%	0.6%	0.1%
Misc man	0.0%	3.2%	5.8%	14.3%	0.0%
Footwear etc	0.0%	3.2%	2.5%	5.1%	0.0%
Stone/glass/ceramics	0.0%	2.3%	1.6%	1.3%	0.0%
Pulp & paper	0.1%	0.7%	0.7%	1.2%	0.0%
Instruments	0.0%	1.2%	3.3%	2.2%	0.0%

Source: US Department of Commerce and World Trade Atlas data, authors' calculations



In 2008, China's total exports to Africa equal \$50.9 billion versus \$55.9 billion in imports from Africa. However, in these data China's import valuation includes freight and insurance costs while the valuation of exports is f.o.b. (excluding freight and insurance). It is likely that (accurate) Africa data would similarly show a trade deficit with China.

III.2 Competition from China in manufactures

In little more than 25 years China has evolved from an internationally isolated, centrally planned communist state into one of the world's fastest-growing economies, increasingly outwardly-oriented and market-driven. A "package" of reinforcing macroeconomic and political policies, fostering FDI inflows, as well as an export-led development strategy has positioned the country as a leading global manufacturing powerhouse and seen hundreds of millions of people move out of abject poverty. Thus Africa's adoption of outward-looking policies has come at a time when excess capacity in China and other Asian exporters has limited the continent's access to markets (Kaplinsky and Morris, 2008).

China's manufacturing sector is likely to continue to expand, supported by low wages and an enormous potential labour pool with high levels of innovation. The surplus labour force in China is possibly in the order of 100 to 200 million, in contrast to the earlier Asian growth economies (Japan and Korea) that quickly ran up against labour shortages and hence rising

wage levels as their economies expanded (Bannister, 2005). Rapid growth in China's manufactured exports has reduced African manufacturers' market share in both domestic and third markets, as confirmed by Villoria (2009b) for the clothing industries in Kenya, Mauritius and SACU members. At the same time, Chinese manufactured exports have reduced the prices of both consumer goods and industrial inputs in African economies. However, estimations of their terms-of-trade effects suggest that the reductions in export prices outweigh the decrease in import prices, and these countries were net losers from Chinese manufactures export expansion.

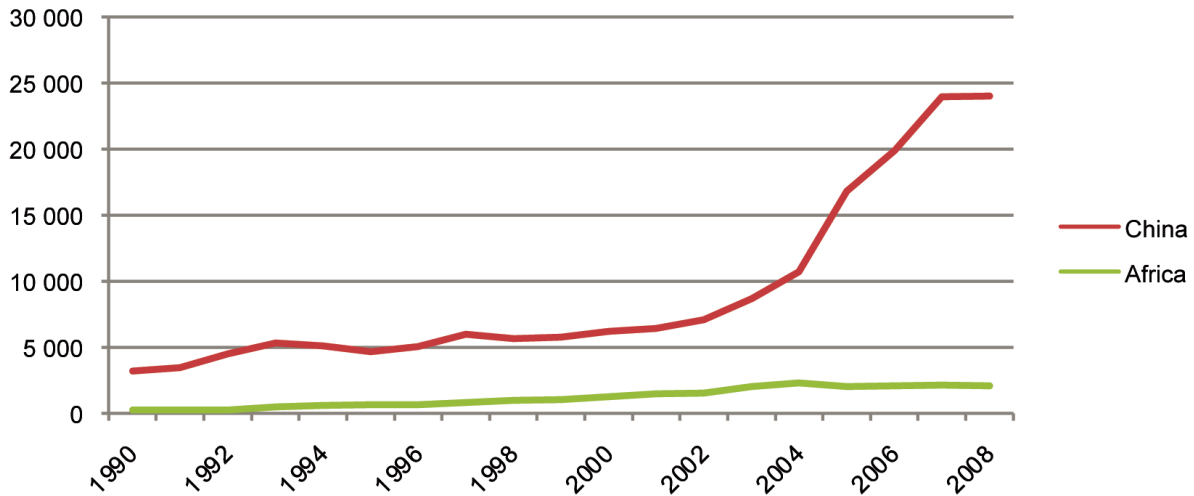
Chinese competition is perhaps most important for Africa in the clothing sector. US imports of apparel (HS 61 and 62) from China increased spectacularly from 2003 to 2007 (figure 25), before levelling off and then declining with the 2009 recession.²⁵ By contrast, US clothing imports from Africa, after increasing in the first few years of the last decade, stagnated after 2004. Looking at the data by SITC category,²⁶ total US imports of apparel and clothing (SITC 84) from Africa increased by 6.6 percent from 2000-08, somewhat more rapidly than US imports from India but less than half the rate achieved by China. US imports of apparel and clothing from all of Africa totalled about \$2 billion in 2008, or about 7 percent of imports from China and less than imports from Thailand or Cambodia alone (Table 7). The main African suppliers included Egypt (\$742m), followed by Lesotho (\$340m), Madagascar (\$280m), Kenya (\$247m), Swaziland (\$125m) and Mauritius (\$102m).

25) Analysis of Chinese export data of HS codes 61 and 62 (apparel) for the first three months of 2009 shows that overall exports were down by 5.1 percent in US dollar terms over the first quarter of 2008, with exports to the US actually up by 6.2 percent. Exports to Africa were down by 7.2 percent. Complicating this analysis is the impact of the global financial crisis, currency realignments and perhaps some uncertainty associated with restrictions and the threat of restrictions on Chinese exports to both the US and Africa. We note that first quarter 2009 Chinese exports of HS 61 and 62 to the EU (their main market) were down by 8.9 percent over first quarter 2008, while those to the second market of Japan were up by 9.2 percent.

26) This SITC data is only roughly comparable with the HS data presented to date, as the SITC classification is related to type of manufacture rather than the HS which is trade-based.



Figure 25: US apparel imports from China and Africa (\$ millions)



Source: US Department of Commerce data

Table 7: US imports of SITC 84, Articles of apparel and clothing

	Imports 2008		Percentage change (log annual change)	
	\$ million	% share	From 1990	From 2000
World Total	78,893	100.0%	6.3%	2.6%
China	27,205	34.5%	11.4%	14.6%
Vietnam	5,253	6.7%	-	58.9%
Mexico	4,213	5.3%	9.9%	-9.1%
Indonesia	4,158	5.3%	10.4%	8.0%
Bangladesh	3,443	4.4%	11.6%	6.1%
India	3,213	4.1%	9.0%	5.9%
Honduras	2,676	3.4%	17.6%	1.3%
Cambodia	2,376	3.0%	58.5%	13.5%
Thailand	2,133	2.7%	8.3%	0.0%
Africa	1,965	2.5%	11.9%	6.6%

Source: US Department of Commerce

An open question remains as to why Africa, with a modest presence in the US market at the start of the period, was not able to enhance that presence at a time when African economies were expanding and enjoyed a significant tariff preference over China through the AGOA scheme. Asia, and particularly China, have dominated apparel imports by OECD countries despite somewhat higher wages than in many African economies: Cadot and Nasir (2001) calculate that wage costs, adjusted for productivity differences, per shirt produced in Madagascar, Kenya, Ghana, Mozambique, Lesotho ranged from \$0.12 to \$0.19 (in South Africa it was \$0.65), compared to \$0.17 for India and \$0.29 for Chinese export processing zones. Competitive environments differ enormously within Africa; wages vary from relatively high levels of \$3,355 per year in Morocco, \$2,834 in Mauritius and \$2,669 in Tunisia, to the medium level of \$1,611 in South Africa, to a lower level of \$897 in Egypt and only \$429 in Lesotho. And wages are only one factor in the determination of per unit costs of production (although an important one in a low-skilled operation such as garment manufacture), so that



China's success in apparel exports is due to other competitive advantages.²⁷ He (2009) reports that the total cost of a pair of pants made in China is about \$1 while a similar product produced in South Africa costs ten times as much.

China's rapid productivity gains and huge capacity indicate that Africa requires continued trade preferences to develop (Collier and Venables 2007a and Collier 2007). Kaplinsky and Morris (2006) also demonstrate that current trade preferences are needed to maintain the ability of AGOA clothing producers to compete in the US market. However, while trade preferences offer windows of opportunity, they are not lasting solutions. African economies need to use the space offered by trade preferences to improve their ability to compete in global markets.

III.3 China exports and manufactures prices

China has significantly reduced world prices for manufactures, and especially for wearing apparel and footwear (Villoria, 2009b), thus reducing African import prices. Some evidence for China's impact can be seen in data from South Africa. The average import values for a selection of South Africa's clothing imports dominated by Chinese products (and covering 59 percent of total clothing imports) shows: (i) an increase of 25 percent or higher for all import lines from 1996-2005; and (ii) for most imports, either very modest increases or declines in import prices in both rand and US dollar terms from 1996-2005 (Table 8). While who benefited from these limited increases or actual declines in prices is unknown, there is a strong case that price reductions of Chinese clothing imports have resulted in cheaper clothing for consumers.

27) This success is arguably beyond wage or exchange rate-related advantages, but largely a function of productivity as a main driver of competitiveness; supported by low energy costs and consistent government spending on infrastructure, which has lowered the cost of logistics for enterprises; as well as economies of scale and integration into regional and global product supply chains. One controversial aspect of Chinese manufacturing is the blurring of lines between government and the private sector which makes it hard to determine the actual cost of production, although we note that China is moving towards a more open market-orientated approach to export manufacturing.



Table 8: Average changes in import values for main lines of clothing into South Africa, 1996-2005

HS code	2005		China %		Ave Change period %	
	\$m	Description	RSA imp	US\$ Ave price	Rand	Imports
6103.4	13.4	Men's knit trousers	77	-4.0	1.0	42.3
6104.6	10.8	Women's knit trousers	82	7.1	-4.4	53.4
6105	12.4	Men's shirts	53	0.7	5.2	25.7
6106	17.9	Women's blouses	69	1.8	5.9	55.5
6111	29.9	Babies knit garments	96	-2.6	2.4	29.8
6203.3	10.8	Men's woven jackets	77	4.8	9.5	27.0
6203.4	70.2	Men's woven trousers	83	-1.3	3.1	27.6
6204.3	12.6	Women woven jackets	80	-2.7	1.3	53.0
6204.5	26.1	Women woven skirts	67	-7.3	-2.9	62.0
6204.6	62.1	Women woven trouser	86	-6.5	-1.5	53.6
6205	27.8	Men's woven shirts	61	1.1	5.6	34.5
6206	25.1	Women woven blouses	60	-15.6	-10.9	28.4
6212.1	10.3	Bras	81	-7.5	-3.0	42.9

Source: Sandrey, 2006

The South African government imposed quotas on clothing and textile imports from China from January 2007. The objective was to protect the South African sector, a sector that hides behind 40 percent tariff barriers but was still unable to compete against burgeoning imports from China and others. Sandrey and Fundira (2008) examine the impact of the first full year of these quotas and find that average prices increased by between 16 percent (cotton fabrics) and 50 percent (female blouses). Thus the quotas were reversing the stable or declining prices previously enjoyed by South African consumers over the previous decade.

China's impact on African manufactures prices (and industrial competition) would be all the more significant if China tends to 'price to market', that is, charge less on its exports to poor countries than it does on exports to rich countries. The data show a mixed story.²⁸ Sandrey (2008) finds that the average price of China's exports to the United States was some 13 percent above the global average for 2007 and 16 percent above for 2006, indicating that China may have charged higher prices in that developed market. However, higher average prices could also result if the United States were importing higher-quality goods within these HS 6 lines. By

28) The data examined were the commercially obtainable World Trade Atlas (WTA) data for Chinese exports to the world at the HS 6 detailed level.



contrast, the average price of Chinese exports at the HS 6 level to South Africa were approximately equal to the world average (for 2007 the figure was slightly above, and for 2006 slightly below), indicating that China was not lowering its export prices, on average, in that developing market. Considering just the clothing exports in HS 61 and 62 and using the more disaggregated HS 8 lines rather than the HS 6 lines, the average price of China's exports to South Africa was nearly three percent below the global average in 2005, perhaps indicating some tendency towards pricing to market. Interestingly, the average price of China's exports to South Africa increased to one percent above the global average for 2007, the first year of the South African quotas, perhaps reflecting increases in prices by Chinese exporters to gain some of the excess profits resulting from trade restrictions.

III.4 The impact of China's growth on Africa's commodity sector

Rapid growth in China has boosted global demand for oil and minerals. China consumes about 20% of global aluminium and copper resources, 30% of steel and coal, about half of globally traded iron ore, and is the second largest consumer of oil after the US, importing about one quarter to one fifth of its oil needs from Africa. Rising demand from China helped fuel the boom in commodity prices prior to the global recession. Oil prices peaked at almost \$150 per barrel in mid-2008, and copper prices more than tripled during 2002-08. The rise in prices greatly increased the export revenues of Africa's oil and minerals exporters, and attracted large inflows of capital into resource-rich but also undeveloped regions across Africa.

Table 9: Select Chinese investment and financing packages into Africa's commodities

Year	Country	Resource	Description
2005	Angola	Oil	\$1bn concessional financing initially which has been extended several times; estimated by now to be between \$5.5bn and \$8bn.
2006	Gabon	Iron ore	\$3.5bn total investment in Belinga iron ore deposit: \$790m for mine development; construction of key mining and transport infrastructure; environmental and transparency concerns delaying project
2007	Zambia	Copper	\$800m-\$1bn investment in Chambishi Copperbelt, including copper mine, smelter and Special Economic Zone; investment ongoing
2008	DRC	Copper & cobalt	\$9bn investment in Katanga province: \$3bn mining related and \$6bn transport and social infrastructure; in August 2009 restructured on request of IMF to \$6bn
2008	Liberia	Iron ore	\$2.6bn investment announced in development of Bong iron ore deposit

Source: Authors' research, 2009

Chinese investments in Africa's resource sector have been significant. According to UNCTAD, between 1979 and 2000 China's cumulative resource extraction investments on the continent amounted to only \$188 million, but in recent years China has announced mega-investments amounting to several billions of dollars (Table 9).

Large amounts of capital for mining infrastructure development and refurbishments (and social projects) have been extended, in return for mining rights and concessions in mineral and energy reserves. Cash-flush China, in combination with the right policies from host African countries, could be the source of much-needed investment



and the generation of substantial benefits from Africa's natural resources.

Resource producers should now position themselves to best harvest and extract the highest returns from the next "wave" of Chinese demand. Unfortunately the nature of resource booms and the nature of resource-rich states' governments is that there is little incentive to promote diversification, little reinvestment of resource rents into other sectors and

generally no proper management of new wealth. Poor governance and rampant rent-seeking have meant that resource producers have been unable to progress up the value chain by exporting more processed goods based on their primary commodity resources (Eifert et al., 2005). South Africa could be an exception, as the country has outlined a strategy for engaging China which features policies to promote greater processing of the country's primary commodity exports (see Box 5).

Box 5: Current account imbalances and competitive devaluations

The trade relationship between many African countries, including South Africa, and China is characterized by exports of raw materials and imports of manufactured good. China thereby directly competes with the domestic manufacturing sector, with adverse implications for the employment of low skilled workers. Moreover, it is often perceived that China is unfairly competing as this Asian country has an undervalued currency which supports its own exported oriented development strategy.

This trade and exchange rate relationship has a direct impact on the economic policy process. For example, in South Africa - a country with an abundant unskilled laborforce and unemployment of over 25% - there has been political pressures to introduce tariffs on some labor intensive manufacturing products. Indeed, the Congress of SA Trade Unions (Cosatu) has welcomed the recent increase from 40% to 45% in textile tariff as this move is seen as helping to protect local jobs against cheap imports. Some policymakers have even argued that South Africa should follow the Asian countries example and also devalue its currency so as to strengthen the competitiveness of its own manufacturing sector, thereby contributing to a string of competitive devaluations.

More generally, China's pursuit of an undervalued exchange rate has negative impacts on Africa's efforts to promote economic diversification particularly through manufacturing and moving-up the value-added chain. In these circumstances many policymakers fear that Africa will remain "trapped" in the extractive industries sector which are capital, and not labour intensive, even if China's investment is welcome as a contribution to alleviate structural infrastructure bottlenecks.

III.5 Chinese support for African infrastructure

Greater Chinese investments in Africa's infrastructure should further private sector development. Chinese funding has been directed largely at hydropower and transport projects, with important benefits for industrial productivity, cross-border trade and connectivity to global markets.

These investments could play a pivotal role in the promotion of economic diversification in African countries, by facilitating market access and reducing transactions costs. In Zambia, for example, major infrastructure investments are linked to China's strategic interests in copper supplies. Direct investment in the Zambian resources sector by Chinese investors will further boost employment,



raise the profits of firms in the resource sector, and increase opportunities in related industries. Inroads into economies like Zambia through investment and the promises of skills and technologies transfers will ensure that China can access vital resources such as copper at the consent of the producing country (Carmody, 2009).

III.6 The potential for Chinese support for African manufactures

Another potential benefit of China's involvement in Africa is its support for export processing zones. Eifert et al (2005) argue that a critical mass of firms is necessary to generate the scale economies, network effects, and spread of technology required for structural change and diversification to manufactures production. Successful industrialisation efforts of countries such as South Korea and Taiwan were based on "surges of investment" coupled with export promotion strategies (Trindade, 2005). But implementing economy-wide reforms to attract greater FDI into manufacturing industries and more value-added exports can be difficult. Thus several countries have chosen to create special geographic regions, known as Export Processing Zones (EPZ), Special Economic Zones (SEZ), industrial zones, or free trade zones, with more liberal policies towards trade and investment and (usually) with significant investments in infrastructure. These zones provide a favourable economic environment for investment in manufacturing and foster the clustering of production facilities of domestic and foreign investors (Din, 1994; Ge, 1999). Many countries in East Asia, Latin America, and the Caribbean have achieved substantial success in promoting manufactured exports through such policies (Graham, 2004). China, for example, established five major SEZs and opened a further

14 coastal cities and three coastal areas to foreign investors between 1979 and 1988 (Ge, 1999).²⁹

Unfortunately, attempts by African countries (except Mauritius) to develop such export and investment zones, including the wave of EPZ regulations in southern Africa initiated during the early 1990s (Jauch, 2002), have not been successful. These failures were due to several causes, including a lack of adequate infrastructure, insufficient entrepreneurial capacity, institutional challenges, socio-political aspects such as attitudes and culture, and even investor ignorance (World Bank, 2001).

China has initiated efforts (announced at the third FOCAC summit) to set up five special economic zones in Africa, with more on the drawing board (Edinger, 2008; Davies, 2008), which could make a substantial contribution to industrial development on the continent. The policies governing the zones are likely to differ across countries, although most should offer a more liberal environment for both Chinese and other investors, including tax breaks, customs duty waivers, less strict labour laws, discounted land, and various services; and significant infrastructure investments, particularly transport and power within the zones and tied into ports and regional markets. In some zones, joint venture partnerships between Chinese and other foreign investors with local counterparts is encouraged. While these zones will assist China with its "going global" policy and create safe havens for Chinese capital³⁰, they also represent a great opportunity for African industry to gain access to capital, infrastructure services, and skills and technology transfers, as well as backward (to the country's hinterland) and forward (to third markets) linkages. Most importantly, the zones are

29) While no direct comparison between China's economic growth miracle and Africa's point of departure and industrialization efforts should be drawn, the rollout of SEZs along coastal provinces and cities of China played a significant role in the structural transformation of the country (Davies, 2008). The country experienced with market liberalization through promoting such zones (Interview in Beijing, April 2008)

30) See Davies (2008) for more details on this.



anticipated to boost employment and generate higher and more diversified sources of foreign exchange earnings (World Bank, 2001). Some

African economies have more experience with the establishment of EPZ and attracting capital into these zones³¹ (see Box 6).

Box 6: African Special Economic Zones supported by China

The first zone, announced in February 2007 and referred to as the Multi Facility Economic Zone (MFEZ), is located in the mining area of Chambishi, Kalulushi, in Zambia (Edinger, 2007). The main objective of the MFEZ is to catalyse “industrial and economic development in the manufacturing sector for the purpose of enhancing both domestic and export orientated business”. It is designed to “operate on the principal of value-addition”.³² The second SEZ is located in Mauritius, near Port Luis. Construction was said to have commenced in October 2007, although progress has been slow. Unlike other Chinese-initiated SEZs in Africa, the zone will focus on the service industry. The Mauritius SEZ is intended to host the regional headquarters of companies in southern and eastern Africa, provide a commodity trade and transit route to markets in East Asia, and serve as a springboard and gateway for Chinese companies to invest on the continent. The limited focus on value-added manufacturing of this zone is likely planned because Mauritius already has achieved considerable success in exporting manufactures.³³

Most foreign investment in Egypt takes place under the laws which define incentives in SEZs. China’s investment in the Egyptian SEZ in Port of Sokhna (near Suez) began in early 2007. It is hoped that a clustering of Chinese enterprises in the SEZ will encourage integration with global supply chains.³⁴ The zone is expected to focus on infrastructure, logistics, electronics, ICT, construction, car components and chemicals investments and production. It will also serve as a key bridge between the Middle East and North Africa (MENA) region and SSA, providing access to markets in the MENA region and the EU. Similarly, SEZ developments in Nigeria, Uganda, and potentially also Angola, Algeria, Mozambique, Tanzania and Ethiopia, are expected. The zones in Mauritius, Egypt and Nigeria are partially supported by the China-Africa Development Fund (CADFund) (Teng, 2009), which is assisting with zone construction and infrastructure rollouts and supporting investment by Chinese companies.

Limiting reforms designed to attract investment and promote exports to dedicated zones is not a first-best solution to development (Madani, 1999; and Jenkins et al., 1998). Such zones can raise employment and foreign exchange earnings, and where infrastructure and other government services are weak, expanding services in a limited geographical area may be easier and more

productive than attempting to expand services throughout the country (World Bank, 2001). Thus such zones may help initiate the process of industrialization, but generally do not result in massive increases in industrialization and growth. Also, the easing of rules that protect workers and limit negative externalities from investment may cause neighbouring countries to lower their own

31) Kenya, Egypt and Mauritius are probably the most proactive countries in Africa establishing such zones (Edinger, 2008).

32) See Ministry of Commerce, Trade & Industry website

33) The manufactured exports sector has been dominated by T&C but spans across the whole value chain, with focus on vertical integration within this industry. Significant investment in the industry was channeled previously through mainly Taiwanese firms (Ancharaz, 2008).

34) See People’s Daily Online (2007)



standards, referred to as the “race to the bottom” (Jauch 2002). Such effects were seen in the series of zones established in southern Africa and more recently in some countries attempting to attract Chinese SEZ investment, for example Cape Verde.³⁵ A focus on SEZs also could limit progress towards regional integration, as countries compete for foreign investment from outside the region.

Another area where China could assist in the diversification of African manufacturing is in tariff preferences. Sandrey (2009) estimates that the average duty assessed on Chinese imports from Africa was 0.83 percent in 2008 (0.64 percent if imports from South Africa are excluded). Combined with Africa’s current commodity-dominated export profile this highlights that the continent already has almost duty-free access to China.³⁶ However, across the broader spectrum of non-commodity goods, duties on some imports remain high. Importantly, imports of cotton valued at \$315.6 million attracted duties of \$126.2 million (40%), and this means that raw cotton, a crucial input into the Chinese clothing export sector, is contributing 42.5 percent of the total duties assessed against African imports. This highlights the importance of expanding zero-tariff treatment to 95 percent of the products for African Least Developed Countries (LDC), part of the FOCAC engagement, with the result of the continent enjoying additional stimulus to access the Chinese market for manufactured products in particular.³⁷

IV. Conclusion

Why has Africa failed to emulate the rapid growth of Asian economies, supported by spectacular

increases in manufactured exports? One problem is that Africa’s economic policies, governance, and institutions have been far weaker than in many of the successful Asian economies. Moreover, Africa’s abundance of natural resources has starved manufacturing sectors of resources, while resource-rich economies (not only in Africa) have generally failed to achieve rapid growth, in part because of weak linkages between the natural resource sector and abundant unskilled labour, and in part because government control of natural resources has encouraged rent-seeking activities rather than productive investment. Africa’s limited diversification poses grave threats to development, owing to the volatility of primary commodity prices and the failure to reap the potential gains from economies of scale and productivity advances available in manufactures.

Africa needs to strengthen ‘the policy umbrella’ through more stable macroeconomic policies, more dependable provision of government services, and expanded infrastructure investments, including support for regional trade (e.g. improved roads and border post management). Regional and multilateral negotiations should address ‘tariff escalation’, whereby imports of processed goods incur higher tariffs than imports of primary commodities, and should improve the value of tariff preferences by eliminating onerous and unworkable rules of origin. Dedicated geographic zones with less restrictive rules facing investment could support manufactured exports, although the extent to which such zones will further African development is uncertain. Finally, linkages need to be established between tariff and trade policies on the one side, and industrial policies on the other.

35) See Afrol News (2007)

36) This is based on the value of imports from Africa assessed against the Chinese tariff schedule as downloaded from the WTO website.

37) However, supply-side constraints in Africa and restrictive Chinese non-tariff barriers such as rules of origin may well undermine the full potential of such an agreement for Africa.



In some cases (South Africa is the outstanding example), a combination of earlier unilateral liberalisation and bilateral, regional and multilateral agreements have limited the policy space to nurture industrial development.

An examination of many Asian success stories demonstrates that the coordination of trade and industrial policies can be an effective means of promoting development. Many African economies tried to promote industrialization during the 1970s and 1980s with import protection and government subsidies, but with extraordinary dismal results. Perhaps the critical difference between many of

the interventionist regimes pursued in Asia and African policies was that the former ensured that favoured industries were exposed to international competition, often by setting export targets, and furthermore the successful Asian economies were (a) more successful in getting the appropriate 'basket' of policies in place and (b) willing to recognise mistakes earlier and sacrifice poorly performing sectors. Whether such Asian-type policies, which involved inter-alia tariff protection and subsidies, are possible now with WTO disciplines and greater sensitivity in industrial economies to competition from developing countries is an open question.



Chapter 4: China's engagement and aid effectiveness in Africa

Jean Claude Berthelemy



I. Introduction

Engagement with China is an important phenomenon for the African continent. Beyond the quantitative impact of growing aid, finance, trade and investment flows, this engagement may have significant qualitative impacts on African development, positive and negative. It is often alleged that the heavy role played by extractive industries in Africa's engagement with China will impede diversification. More generally it is stated that China's engagement in Africa could undermine African development, implying an adverse impact on aid effectiveness. However, too often such discussions are based on informed opinion, rather than on hard data and research results. This chapter approaches these debates using as much as possible a quantified framework, in an attempt to go beyond the common wisdom. The issues addressed include aid effectiveness, trade creation, and diversification.

Chinese assistance (defined by the turnover of economic cooperation) has traditionally focused on countries with which it has good political relations and countries with oil and mineral resources. However, recent trends have seen some broadening of Chinese assistance. Chinese assistance has traditionally provided support for poverty reduction, has focused on sectors that have been relatively untouched by Africa's traditional development partners, and does not appear to have impaired debt sustainability. Thus Chinese assistance has overall played a positive role in supporting African development.

UN Comtrade data reveal that China's involvement in Africa has contributed to a sharp increase in Africa's trade and welfare, in part related to China's financial assistance. And so far, China's engagement with Africa has not affected African economic diversification, although China's support

for special economic zones and tariff preferences may help increase African diversification.

The rest of the chapter is organized as follows. The next section provides a brief review of China's past engagement in Africa, based on the existing literature and on data describing stylised facts on China-Africa trade, FDI and aid flows. The third section considers the debate over the effectiveness of China's development assistance. The fourth section examines trade, FDI and diversification in detail. And the final section considers the way forward in the context of the global financial crisis.

II. Background information

II.1 Literature review on China's engagement in Africa

As background to the research in this chapter, the following is a non-exhaustive review of the recent literature on China's engagement in Africa through aid, finance, trade flows, trade policy, and FDI.

A few authors (Wang 2007, Brautigam 2008, and Kragelund 2008) have developed estimates of aid flows to Africa, which remain relatively small compared to aid flows from DAC members. Foster and others (2009), using a new database based on information released by the press, estimate that Chinese infrastructure finance commitments to sub-Saharan Africa totalled \$16 billion from 2001-07. While some of this finance has an element of concessionality, most of it does not meet the DAC definition for aid.

Several studies, many critical of Chinese policy, focus on the nature and "quality" of Chinese aid to Africa. For example, McCormick (2008) and Penhelt (2007) are concerned that China does not take into account the quality of governance in recipients when allocating aid. Thus according to Penhelt, China is



willing to provide aid to “unstable and problematic regions and rogue States” that DAC members are more reluctant to support. Kaplinsky, McCormick and Morris (2006) also point to several examples of China’s significant involvement in fragile states. However, none of these papers provide statistical evidence to support the claim that China provides aid regardless of the quality of governance.

Some studies point to positive aspects of Chinese aid. While Davis et al. (2008) acknowledge the debatable role that China has played in resource-rich countries like Angola and the Sudan, they find that “China’s approach has been one of mutual respect, also awarding small African countries with relatively little economic and political significance, with aid and investment support.” Wang (2007) and Foster and others (2009) point out that China provides substantial funds for infrastructure, for example in power (mainly hydropower), transport (mainly railroads), and information and communications technology (mainly equipment supply), where traditional donors allocate relatively little assistance.

It does not appear that China’s engagement in Africa has substantially impaired efforts to ease Africa’s debt burden. Reisen (2008) concludes that Chinese lending has not endangered the positive outcome of the HIPC initiative, and several papers point to the significant amounts of debt relief granted or promised by China (e.g., Wang, 2007, and Penhelt, 2007).

The determinants and impact of China’s trade with Africa are discussed extensively in the literature. It is often considered that China’s engagement in Africa is driven primarily by its strategic search for raw materials (e.g., Kaplinsky, McCormick and Morris, 2006; Asche and Schüller, 2008).

China’s trade with Africa has been supported by trade liberalization in both Africa and China, including Chinese tariff exemptions on a number of products exported by eligible African countries (Zafar 2007). However, both Zafar (2007) and Broadman (2007) point to the persistence of tariff escalation and tariff peaks that may limit increases in the value added content of Africa’s exports to China. Minson (2008) concludes that, while the benefits for Africa of China’s preferential trade policy are likely to be modest, the preferences have been thoughtfully tailored to African export capacities. China’s trade and investment in Africa also has been supported by implicit subsidies provided by Government support programmes with low cost loans (Asche and Schüller 2008), while Kernen (2007) emphasizes the importance of multiple private sector networks and the increasingly significant role of Chinese privatized companies and the Chinese diaspora.³⁸

Broadman (2007) is one of the few studies based on microeconomic data, using a survey of both Chinese and non-Chinese firms in South Africa, Ghana, Senegal and Tanzania. He finds that China’s trade with and investment in Africa tend to reinforce each other, and notes significant investments in non-primary industries such as clothing, food industry, transport, building, tourism, power plants, and telecommunications. He finds that Chinese investment in Africa has had a limited role (largely in apparel) in integrating African countries in the global decomposition of the value chain, and that Chinese enterprises have played a positive role through transferring technology and are more active than other enterprises in regional trade. Thus trade with China could contribute to the product and geographic diversification of African exports.

38) On the role of the Chinese diaspora, see also the February 2008 issue of the China Monitor published by the Centre for Chinese Studies, University of Stellenbosch



Henley et al. (2008) survey firms involved in FDI outside of the extractive sector. Chinese firms within this sample are overwhelmingly concentrated in the manufacturing sector (particularly in the textile and apparel industry) and (consistent with Broadman 2007) many have set up export platforms in East Africa to take advantage of the trade preferential regimes granted by the US and EU to African countries.

Chen et al (2007) survey Chinese firms involved in the African construction sector, and find that the success of Chinese firms was due both to cost competitiveness, derived from access to cheap capital, low-cost labour, and cheap building materials, and to political support from the Chinese government. However, the political support enjoyed by Chinese construction firms does not exempt them from the challenges faced by other construction firms in terms of economic

and political instability, poor quality of local inputs and weak infrastructure.

II.2 Recent Trends in Trade between China and Africa

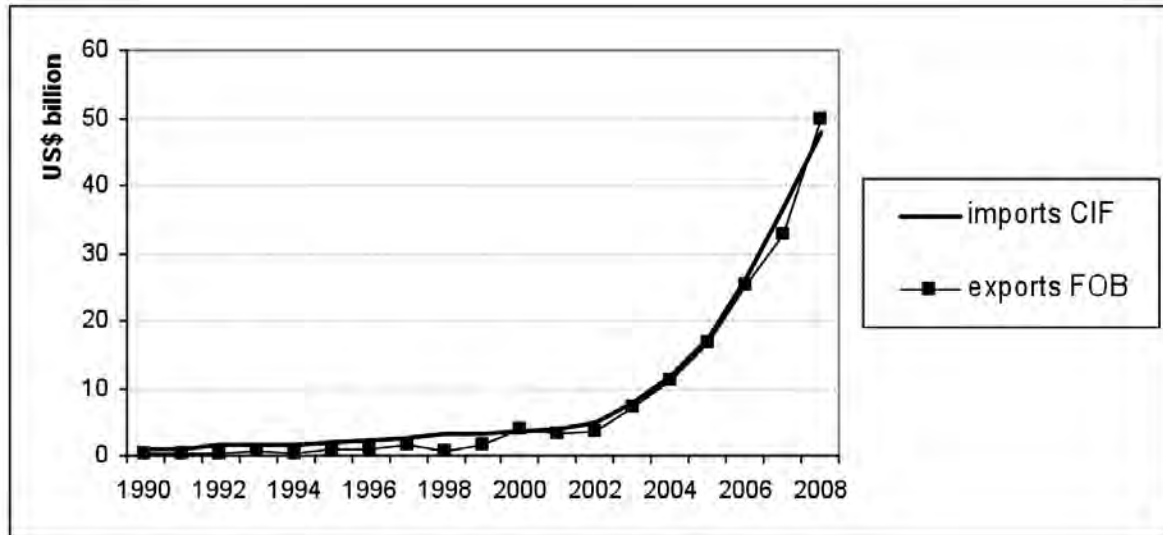
While the analysis of African trade data confronts significant issues (Box 7), it is clear that Africa's trade with China has increased sharply since the late 1990s (figure 26). African exports to China increased from close to zero in 1998 to about \$50 billion in 2008, while China's exports to Africa have risen 15-fold. China accounted for only 0.9% of African exports and 3% of African imports in 1998, rising to 11.1% of exports and 9.1% of imports in 2008. The CIF/FOB trade balance of African countries vis-à-vis China shows an average deficit of \$ 1.3 billion from 1998 to 2007, but exhibited a surplus of US\$ 1.9 billion in 2008, thanks to the oil and mineral price boom.

Box 7: Data on African trade with China

We have at our disposal different sources of data on Africa's trade with China: Chinese official data provided by MOFCOM, and data from international organizations, including UN COMTRADE data and IMF DOT. We prefer using international sources, so as to include data on African trade with countries other than China. UN COMTRADE data have the merit of being a primary source, being based on statistics reported by the governments to the UN system, and of including details on the commodity composition of trade that are necessary for our analysis. Since not all African countries report to this system, regional aggregations are generally based on "mirror" data, i.e. estimates of African trade based on data reported by African partner countries. However, the partner data report African imports in FOB terms and African exports in CIF terms, so that estimates of the trade balance are not accurate. Also, UN COMTRADE data are available only until 2006 or 2007, depending on the country. IMF DOT is a secondary source, and provides only aggregates, but it provides data up until 2008. Hence we will use IMF DOT data when recent data will be needed and UN COMTRADE data otherwise. IMF DOT data have also the merit of providing directly a correct assessment of the CIF/FOB trade balance. We have checked that the overall trends of China-Africa trade in the two sources are consistent.



Figure 26: China-Africa trade flows



Source: IMF DOT

The rise in African exports is heavily concentrated in a few oil-exporting countries, although other countries that are dependent on the China market provide minerals (copper, cobalt, coltan) or beginning with 2003, agricultural raw materials (cotton, sesame). By contrast, a diverse set of countries import substantial amounts from China, including relatively rich countries (e.g. Botswana, Namibia) and relatively poor ones (e.g. Eritrea, Niger). Only six countries (Benin, DR Congo, Ethiopia, Mauritania, Sudan and Tanzania) that have large imports from China also have significant exports. As we will see below, the rise in imports from China is not closely correlated with exports and cannot easily be explained by a gravity model, but appears to be related to other aspects of Africa's engagement with China, notably investment and financial flows.

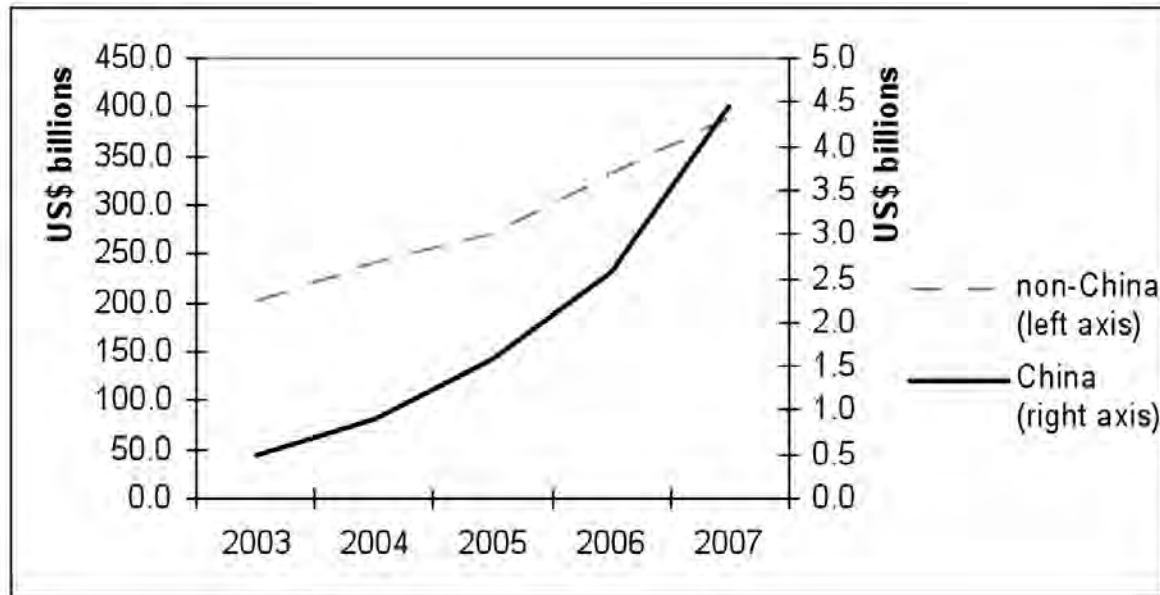
II.3 Foreign Direct Investment

Chinese investment in Africa has increased rapidly since 1996, stimulated by incentives from the Chinese government and by the economic recovery of African countries. By 2005, China had already established more than 800 enterprises in Africa, covering 49 countries. Nevertheless, the stock of China's FDI to Africa amounted to only 1.1% of total FDI to Africa in 2007, up from 0.2% in 2003. Still, this estimate (based on MOFCOM data) omits many Chinese foreign investments that go through offshore financial investment centers such as Hong Kong or the Virgin Islands. And China's FDI to Africa is growing much more rapidly than FDI from other countries (figure 27).³⁹

39) These data are based on definitions comparable to UNCTAD definition and can therefore be compared to total FDI received by African countries reported by UNCTAD for the same period.



Figure 27: China and non-China FDI stocks in Africa



Source: based on MOFCOM and UNCTAD data

The destination of Chinese and non-Chinese investments in Africa have become more similar over time: the correlation between the country distribution of Chinese and non-Chinese FDI in Africa rose from 0.25 in 2003 (not statistically significant at the 5% level) to 0.71 in 2007 (and highly significant). Nevertheless, striking differences remain. For example, Algeria, Sudan, Zambia, Mauritius and Niger account for 37% of Chinese FDI to Africa, but only 8% of non-Chinese FDI to Africa.

II.4 Development assistance and financial flows

It is difficult to give a clear picture of China's development assistance to African countries. Such assistance is administered by no less than 23 line ministries and agencies (Kragelund, 2008). It is almost impossible to disentangle what would be development assistance in the OECD/DAC definition and what would be merely financial flows. Chinese development assistance can take different forms: grants extended for social projects (health,

education, housing) in the form of material assistance, technical assistance and personnel training; interest-free loans given notably for infrastructure projects; concessional loans provided by China EXIM Bank; and debt relief. Kragelund (2008) finds that Chinese aid flows to Africa in 2005 substantially exceeded the \$731 million reported by official sources, and may have reached \$8.1 billion. Wang (2007) estimates that China's ODA to sub-Saharan Africa averaged between \$1.0 billion and \$1.5 billion per year in 2004-2005. Brautigam (2008), using the Chinese definition (which excludes the face value of concessional loans from the external assistance budget), finds that China's external assistance to Africa was about \$525 million in 2007 and close to \$1 billion in 2009.

By all of these estimates Chinese aid to Africa is growing rapidly, but remains small compared to assistance from OECD/DAC members. In January 2009, Chinese Minister of Commerce Chen Deming announced that in 2009 China would meet its commitment to double aid made



at the 2006 Beijing Summit of the China-African Cooperation Forum, and that “168 debts” due by 33 African countries by the end of 2005 will have been cancelled.⁴⁰ In addition, China EXIM Bank’s Vice President Li Jun stated at the 2007 African Development Bank Annual Meetings in Shanghai that it would provide \$20 billion over the next three years in infrastructure and trade financing on commercial terms. Following this meeting, the Chinese State Council approved the creation of a \$5 billion China-Africa Development Fund, to be administered by the China Development Bank.⁴¹

Given the close linkages between Chinese development aid and financing, an indirect estimate of the size of China’s aid flows can be based on contracted projects under the turnover of economic cooperation data published in the China statistical yearbook.⁴² According to this admittedly imperfect indicator, China’s financial engagement with Africa was relatively stable at around \$2 billion per year from 1998 to 2002, rising to \$12.7 billion in 2007. Foster et al. (2009) finds that about 90% of the turnover of economic cooperation flows was related to Chinese (as opposed to multilateral) financing from 2002-05, so these data may provide a relatively accurate picture of China’s financial engagement with Africa. Since China’s assistance is tied to the purchase of Chinese goods, data on Africa’s imports from China also may provide information on the size of China’s assistance, an issue addressed in the next section.

III. Aid and Official Financial Flows from China to Africa and the Aid Effectiveness Debate

III.1 Geographical allocation of aid and Official Financial Flows

The country allocation of Chinese aid provides important information on aid effectiveness. For example, is Chinese aid channelled largely to countries with poor governance, high rates of poverty, or with close diplomatic ties with China (to the possible detriment of countries that could use aid more effectively)? Here we undertake econometric tests of what has driven the country allocation of China’s financial assistance. The dependent variable is the data on turnover of economic cooperation (divided by population) described above. The independent variables include: (i) governance indicators published by the World Bank; (ii) per capita income; (iii) size, defined by population; (iv) alternative specifications of political ties, including the number of years with continuous diplomatic relations, a dummy variable for the existence of diplomatic relations in each year, and dummy variables for the existence of at least 5 or 10 years of diplomatic relations; and (v) in order to control for the existence of opportunities for economic cooperation of Chinese companies related to privately funded projects, the stock of inward FDI (divided by population) and a dummy variable for oil rich countries.

40) Source: Xinhua news agency, 20 January 2009.

41) Source: Lucy Corkin, Christopher Burke and Martyn Davies, China’s Role in the Development of Africa’s Infrastructure, SAIS Working Papers in African Studies n°04-08.

42) We include the estimates of projects under Turnover of Economic Cooperation with Foreign Countries or Regions”, which reflects: (1) overseas civil engineering construction projects financed by foreign investors; (2) overseas projects financed by the Chinese government through its foreign aid programs; (3) construction projects of Chinese diplomatic missions, trade offices and other institutions stationed abroad; (4) construction projects in China financed by foreign investment; (5) sub-contracted projects to be taken by Chinese contractors through a joint umbrella project with foreign contractor(s); and (6) housing development projects. We add also to these labour services (activities of providing technology and labour services to employers or contractors in the forms of receiving salaries and wages) and design consultation (projects with income for technical services provided to overseas operators).



We find that our explanatory variables are reasonably good predictors of the turnover of economic cooperation only in recent years, but that none of them can explain it in previous years. The results obtained for the period 2004-2007 are summarized in Table 10.

Table 10: Determinants of turnover of economic cooperation (2004-2007): OLS regression

	[1]	[2]	[3]	[4]
GDP per capita	0.07 (0.28)	0.09 (0.42)	-0.02 (0.08)	0.06 (0.27)
population	-0.38*** (3.01)	-0.37*** (3.25)	-0.35*** (3.03)	-0.33*** (2.72)
stock of FDI per capita	0.44*** (2.61)	0.43*** (2.72)	0.51*** (3.08)	0.45** (2.65)
dummy for oil rich country	1.54** (2.24)	1.64** (2.57)	1.69** (2.58)	1.60** (2.34)
number of years diplomatic ties	0.03** (2.24)			
dummy for diplomatic ties		2.21*** (3.50)		
dummy for 5 years diplomatic ties			1.59*** (3.02)	
dummy for 10 years diplomatic ties				1.00*** (2.20)
intercept	-3.66 (1.05)	-5.34 (1.66)	-3.54 (1.06)	-4.41 (1.28)
R2	0.551	0.606	0.584	0.549
Number of countries	52	52	52	52

Note: *** (resp **, *) significant at 1% (resp. 5%, 10%) level. Student-t statistics within brackets. Method of estimation: between countries. All variable in logs except the dummy variables for diplomatic ties and the control of corruption qualitative indicator.

The regression results provide some useful insight into the determinants of Chinese assistance. The stock of FDI per capita and the dummy for oil-rich

countries are significantly related to the turnover of economic cooperation, indicating that Chinese financing is closely related to its foreign investment. All of the indicators of diplomatic ties are significant as well, indicating that Chinese aid, like that of the traditional donors (see Alesina and Dollar 2000), is closely related to political relationships. And we observe a bias towards small countries, as in analyses of DAC donors' aid.

Two negative results should be highlighted. The coefficient on per capita GDP is not significant. And while China's engagement in Africa (unlike that of traditional donors—see e.g. Berthelemy 2006) is usually described as focused on countries with governance issues, none of the governance indicators' coefficients were significant (result not reported).

The non-significant coefficient on per capita GDP may result because the turnover of economic cooperation can be financed both by development assistance (in which case it is expected to be decreasing with GDP per capita of the partner country) and by profitable investment (in which case it is expected to be increasing with GDP per capita). Another test of this relationship is to define a dummy variable for countries where the engagement with China (the ratio of economic turnover to GDP) was above the median. This dummy variable is the dependent variable in a probit model, where the explanatory variables are the same as before, averaged over the 2004-2007 period. The results of these probit regressions are reported in Table 11. The main difference with previous regressions is that this time GDP per capita has the expected negative and significant parameter. Attempts at introducing governance indicators failed as previously and are not reported. Alternative thresholds at 60% and 40% of the sample generated roughly the same results.⁴³

43) For the 60% threshold, the oil dummy is dropped because it perfectly predict being among the largest beneficiaries of China engagement.

Table 11: Determinants of turnover of economic cooperation (2004-2007): probit regressions

	Dummy variable for China engagement among 50% highest	Dummy variable for China engagement among 40% highest	Dummy variable for China engagement among 60% highest
	Equation 1	Equation 2	Equation 3
GDP per capita	-0,92*** (2,78)	-1,20*** (3,29)	-1,08*** (2,91)
population	-0,37** (2,31)	-0,41** (2,48)	-0,61*** (3,16)
stock of FDI	0,53** (2,35)	0,72*** (2,94)	0,58*** (2,32)
dummy for oil rich country	0,85 (1,09)	1,19 (1,51)	0,68 (0,76)
number of years of diplomatic ties	0,03* (1,93)		0,05** (2,39)
Dummy for 5 years of diplomatic ties		2,91*** (2,55)	
intercept	15,54*** (3,13)	17,91*** (3,42)	20,01*** (3,48)
pseudo R2	0,196	0,293	0,305
nb of countries	52	52	48

Note: *** (resp **, *) significant at 1% (resp. 5%, 10%) level. Student-t statistics within brackets. All variable are in logs except the dummy variables for diplomatic ties and the control of corruption qualitative indicator.

Another issue which could be subjected to econometric tests is whether Chinese aid is directed at the same countries as that of traditional donors, which in the absence of adequate donor coordination would increase the administrative burden on recipient governments. In general, Chinese development and financial assistance is poorly coordinated with other donors' assistance. There is no coordination with other bilateral donors,

although some very preliminary discussions have been initiated by China with bilateral donors, towards co-financing of projects (e.g. the French AFD). There have been some efforts at coordination with multilateral donors, including agreements between China EXIM Bank and both the World Bank and the African Development Bank, and an agreement between China's Development Bank and the African Development Bank.⁴⁴ It is too early

44) These Memorandums of Understanding focus on (i) Exchange of information regarding each other's respective activities in Africa; (ii) Sharing of development knowledge and experience; (iii) Providing co-financing or guarantee of public and possibly private sector investment projects; (iv) Exchange or secondment of professional staff; (v) Joint regional, country, economic and sector studies; (vi) Aid harmonization, development policy and strategy coordination; and (vii) any other areas as may be agreed upon between the parties from time to time.



to judge the effectiveness of these agreements, although joint financing of infrastructure projects is underway between China EXIM Bank and the two multilateral institutions. However, the low level of donor coordination may not have a substantial impact on recipient countries, because the geographical distribution of the turnover of economic cooperation is not significantly correlated with the geographical distribution of total ODA and other financial flows received from DAC and/or multilateral donors (results not reported). Thus Chinese assistance does not appear to increase aid fragmentation in recipient countries.

III.2 The tying of aid

Most Chinese development and financial assistance is tied. Development assistance is usually granted in kind, while financial assistance is given to finance contracts that are implemented by Chinese companies. The only part of Chinese assistance that may be considered as untied is debt relief. By contrast, about 90% of OECD/DAC member country assistance is untied, and only Korea (which only became DAC member in November 2009), still provides mostly tied assistance.

Tying reduces the effectiveness of aid only if it leads to higher prices of goods financed by aid, or less efficient or suitable goods not fully compensated by lower prices. Goods and services procured by China are highly competitive compared to the same goods and services that would be procured by OECD/DAC member countries. Hence its practice of tying of aid may not create a significant

distortion of competition. In addition, Chinese aid tying is comparable to the Korean practice, and to common practice in OECD/DAC countries up until 15-20 years ago. However, the tying aid may reduce opportunities for domestic producers (see Brautigam 2008 and chapter 6 of this volume).

III.3 Official financial flows and debt sustainability

The availability of loans from China has been viewed as threatening concerted efforts to improve debt sustainability in poor African countries. Chinese loans to African countries could represent free riding by a new lender who takes advantage of the increased payment capacities of HIPC countries resulting from debt relief granted under the HIPC and MDRI (multilateral debt relief initiative) from Africa's traditional donors. Chinese loans also could undermine these efforts to restore poor country solvency. However, Reisen (2008) concludes that there is little risk of new excess indebtedness in HIPC countries due to borrowing from China. We expand his analysis by including all countries that reached the HIPC decision point by 2007, and by including a larger number of countries with high engagement with China.⁴⁵ The ratio of the net present value of debt to exports of goods and services of countries with high China engagement (with a turnover of economic cooperation to GDP ratio above the African median from 2004-07) is not significantly higher than the ratio for countries with low China engagement (Table 12). In addition, the change in the debt ratios between 2004 and 2007 are not significantly different between the two groups.

45) Among HIPC countries, Reisen (2008) assumes that Ethiopia, Mozambique and Zambia may have borrowed significant money from China. However the turnover of economic cooperation to GDP ratio of these three countries is only just above the median of African countries. Several HIPC or interim HIPC countries have turnover of economic cooperation to GDP ratio higher than the median: Central African Republic, Congo, Gambia, Guinea, Mali, Mauritania and Sierra Leone.



Table 12: Comparison of debt ratios for HIPC countries with high vs. low China engagement

	Large China engagement		Small China engagement		Diffe- rence mean	
	n. obs.	mean	n. obs.	mean		
NPV of debt/GDP ratio 2004	9	70.7	9	30.7	40.0	*
NPV of debt/GDP ratio 2007	14	47.6	13	15.3	32.4	*
(NPV of debt/GDP ratio 2007-2004)	9	-16.2	9	-21.8	5.5	
NPV of debt/Exports ratio 2004	9	272.5	9	199.7	72.8	
NPV of debt/Exports ratio 2007	13	159.6	13	109.7	50.0	
(NPV of debt/Exports ratio 2007-2004)	9	-83.6	9	-144.7	61.1	

Note: *** (resp **, *) significant at 1% (resp. 5%, 10%) level.

Similarly, more recent data (including estimates for 2007) reinforce Reisen's conclusion that resource rich, non-HIPC IDA-only countries with substantial engagement with China (Angola, Congo—included in our previous analysis—Nigeria, Sudan and Zimbabwe) have experienced a decline in debt ratios in recent years. However, the small number of observations does not allow tests of differences with a control group of non-HIPC IDA-only countries with

low Chinese engagement. Hence this conclusion is not necessarily robust. We conclude that loans from China have not impaired debt sustainability in poor African countries, although this may become a problem as China becomes more involved with Africa. For example, the Democratic Republic of Congo had to modify the terms of its assistance package from China (which involves \$9 billion in mining and infrastructure projects) to qualify for completion of its US\$ 6.3 billion (in NPV terms) HIPC debt relief.

IV. Trade, FDI and diversification

IV.1 Primary commodity exports: the “Dutch disease” argument

Increased demand for oil and minerals by China and other big emerging countries have boosted prices on international markets. The resulting booms in African oil and minerals exporters could divert capital and labour from tradable sectors (the Dutch disease), potentially limiting diversification. Investment in the mining sectors of African economies are often financed by FDI (Box 8 shows the example of Angola), so that it is not obvious that a commodity boom in a poor African economy will reduce capital available for investment in manufactures or agriculture. And while the commodity boom may also divert skilled labour, much of the skilled labour required in mining is sector specific, and is often imported. Goldstein and others (2006) conclude that higher raw materials prices do not appear to have greatly impeded diversification in African economies.



Box 8: China's FDI in extractive industries in Angola

In a relatively short period of time China has become Angola's second largest trade partner, after the United States (40% of Angola's exports). In 2006, Angola's exports to China represented 35.6% of its total exports, up from 13.6% in 2002. Total bilateral trade increased seven fold between 2002 and 2005, from US\$ 1 billion to almost US\$ 7 billion, and doubled to US\$14 billion in 2007. This rapid rise in Chinese imports is mostly explained by the sharp increase in China's oil imports from Angola since 2002. In the first trimester of 2008, Angola overtook Saudi Arabia for a second time as China's main oil supplier (the first time was in the first trimester of 2006). Timber, fisheries and marble have only a minimal share of Angolan exports to China. In 2006 Angola became China's top trading partner in the African continent surpassing South Africa, a status it continues to hold.

With the sector dominated by the Western oil majors, Luanda has been seeking to diversify its partnerships, having launched two licensing rounds recently (2005/2006 and 2007/2008), which attracted large and small contenders from all over the world, including companies from China, India and Japan. Following the signing of the ExIm Bank credit line in March 2004, Sinopec acquired its first stake in an Angolan oil block. The stake in question was 50% of oil block 18 that previously belonged to Shell (the other 50% belong to BP) and was initially to be sold to an Indian company (Videsh). Allegedly, in face of a bigger offer from the Chinese, Sonangol handed over the stake to Sinopec. In the bid round of 2005/2006, China claimed important stakes in the exploration of three important blocks: 40% stake in another part of block 18, 20% in block 15 and 27.5% in block 17. At US\$2 billion, Chinese bids were reported to be the highest ever offered for exploration acreage in the world. In 2006 Sinopec established a joint venture with the Angolan national oil company (Sonangol) under the name of Sonangol Sinopec International in which it holds a 55% stake. The purpose was to jointly operate stakes in offshore oil blocks and to build a US\$3 billion refinery at Lobito. Business, however, did not go as expected and in March 2007 Sonangol and Sinopec's negotiations over the refinery in Lobito collapsed, supposedly over a disagreement on the technology to be used, which would favour the supply of the Chinese market, while Angola mainly wanted to supply its own domestic market. In the end, the Angolan government decided to proceed alone with the project.

In the construction sector, Chinese companies have made impressive inroads, especially in the last four years. Excluding oil and diamonds, over half of Chinese FDI in Angola is directed to the construction sector, followed by light industry, retail and transport. According to Angola's private investment national agency Chinese investment in construction rose at a fast pace in recent years but still pales in comparison to traditional investors such as Brazil and Portugal. A large number of Chinese companies, mostly parastatals, entered the Angolan market in the framework of the first ExIm Bank loan in early 2004. Encouraged by political stability, fast economic growth and improved investment and legal frameworks, some have established headquarters in Luanda and started venturing outside the areas covered by the Chinese credit lines. Among these are: China Road and Bridge Corporation, China State Construction Engineering Corporation, China Guangxi International Construction Engineering Company and China Jiangsu International Group. Like in the rest of the continent, China seems to be particularly keen on delivering high prestige buildings such as the Ministry of Finance, the High Court, various Congress halls, as well as edifices for the masses, like hospitals, schools and stadiums. All of these works are wrapped up in quick and cheap delivery packages, with the aim of enhancing China visibility and political capital within the country and maximising goodwill amongst the Angolan government and the general population. Chinese reputation is, however, being threatened by the alleged poor quality of their work.

Source: Chris Alden, SAIIA.



IV.2 Trade Liberalization between China and Africa

China engagement in Africa has led to major increases in trade flows. Development and financial assistance granted by China to African partner countries, which is generally tied, reduces the opportunity cost of imports from China. This acts the same way as a subsidy on China exports to African countries. The trade effect of this implicit subsidy is equivalent to a partial liberalization of imports of Chinese products in African countries, which could lead to trade creation and diversion: African countries import more Chinese products (trade creation) and could, as a counterpart, import less products from other partners (trade diversion). Measuring the size of trade creation versus diversion would be necessary to understand the net impact on welfare of the African importing countries.

We estimate the size of these creation and diversion effects in a standard gravity model, in which imports of African countries are explained by GDP and GDP per capita of the importer and of its partner, as well as by geographical and historical variables such as distance, common borders, common languages, and former colonial ties. We also include dummy variables for bilateral relations with China and with non-China partners. Each of these dummy variables is made time specific, so that trade creation and diversion effects can be observed in the pattern of the parameters of such variables over time.

This estimation is performed on all imports flows reported by African countries in the UN COMTRADE database, with all possible partners.

We report here estimates using the fixed effects method, which collapses the effect of all the geographical and historical bilateral dummies in the fixed effect parameters (Table 13). Estimates for the parameters associated to GDP and GDP per capita have reasonable values (both GDP and population have a positive influence on trade flows). We find that the parameters associated with the dummy variables for bilateral relations with China increase over time, suggesting a clear trade creation effect over the period 1996-2007. On the other hand, the parameters associated with bilateral relations with non-China partners have no significant trend. We conclude from these estimates that there is no significant trade diversion effect.

Part of the explanation of the increase of imports from China could be due to imports of parts of products newly exported to the United States under the AGOA scheme, which provides generous rules of origin treatment in the apparel industry. As stated in the previous chapter, several African countries have started exporting apparels to the United States market having a high content of Chinese textile. In order to check that this AGOA effect does not explain the aggregate patterns that we observe, we have re-estimated our equations with a sub-sample excluding African countries that have exported significant quantities of apparels with high content on non-AGOA/non-US textiles to the United States under the AGOA scheme. These countries are Kenya, Lesotho, Madagascar and Swaziland. Results reported in Table 13 do not change significantly. Hence our results do not result from an indirect effect of the AGOA.

**Table 13: Estimation of trade creation and diversion effects using a gravity model**

	All African reporters			Sample excluding countries importing textile to export apparels under AGOA		
	Unilateral variables	Dummies for China partner	Dummies for non-China partner	Unilateral variables	Dummies for China partner	Dummies for non-China partner
GDP reporter	1,07*** (4,14)			0,88*** (3,38)		
GDP partner	0,62*** (3,32)			0,41** (2,18)		
GDP per cap. reporter	-0,50* (1,94)			-0,30 (1,13)		
GDP per cap. partner	-0,51*** (2,74)			-0,30 (1,61)		
intercept	-25,64*** (5,01)			-19,36*** (3,74)		
year 1996		-0,14 (0,36)	-0,12*** (3,02)		-0,13 (0,33)	-0,12*** (2,90)
year 1997		-0,11 (0,29)	0,01 (0,29)		-0,11 (0,27)	0,02 (0,53)
year 1998		0,00 (0,01)	-0,01 (0,13)		0,02 (0,04)	0,01 (0,20)
year 1999		0,12** (0,32)	-0,13*** (2,72)		0,15*** (0,38)	-0,11*** (2,32)
year 2000		0,24 (0,65)	-0,19*** (3,66)		0,25 (0,65)	0,17*** (-3,24****)
year 2001		0,30 (0,82)	-0,20*** (3,55)		0,37 (0,98)	-0,16 (-2,90)
year 2002		0,35 (0,95)	-0,08 (1,37)		0,37 (0,96)	-0,04 (-0,73)
year 2003		0,60 (1,62)	-0,03 (0,46)		0,60 (1,56)	0,00 (0,00)
year 2004		0,79** (2,12)	-0,02 (0,24)		** (2,04)	0,01 (0,14)
year 2005		1,11** (2,91)	0,01 (0,07)		1,13*** (2,87)	0,04 (0,48)
year 2006		1,39** (3,53)	0,08 (0,86)		1,41*** (3,48)	0,10 (1,12)
year 2007		1,39*** (3,21)	0,10 (1,03)		1,52*** (3,42)	0,15 (1,55)

Note: *** (resp ** , *) significant at 1% (resp. 5%, 10%) level, Student-t statistics within brackets. Method of estimation: within countries. All variable in logs except the dummy variables.



On the export side, China offers significant preferential tariff treatment to a number of African countries. In recent years, it has significantly expanded the list of products that it imports duty-free from eligible African countries. This list covers now more than 250 products, and it has been announced that the list will be expanded to more than 440 items, possibly by the end of 2009 (Minson 2008). Current preferences are equivalent on average to a 10% tariff preference, which is quite significant. Minson has estimated the overall economic value of such preferences as \$10 million per year.

Products for which China grants tariff exemption are principally raw materials, while transformed products face higher tariffs. This is not favourable to diversification of African exports. However, China grants also tariff exemption for some semi-finished or finished products that several African countries are able to export, such as products made of plastic, leather products, and textile and apparel products.

Comparing the AGOA and EBA trade preferential regimes, Collier and Venables (2007b) have found that rules of origin are a major determinant of the impact of trade preferences on diversification: the AGOA has a positive impact in some countries due to its loose rules of origin in the apparel industry, contrary to the EBA scheme. Given that the rules of origin imposed by China are also relatively generous, with a minimum of 40% value added in the exporting countries, these tariff exemptions can have a positive effect on African industrialization, insofar as it would help some African countries to develop export diversification based on decomposition of the value chain. This effect would be possibly lower than the effect of the AGOA rule of origin system in the apparel industry, but probably more significant than that of the EBA provision of the European Union.

Up to now, African countries have been little involved in global networks of manufacturing based on decomposition of the value chain, except in

the apparel industry thanks to the AGOA. But the Chinese industrial companies have a long experience of this. The success of African countries in creating such production networks with Chinese partners will however be conditioned by their capacity to be competitive in particular segments of production. As the experience of the AGOA shows, only a few African countries are currently able to reach this stage.

IV.3 Synthesis on Chinese Engagement in Africa and Diversification

There is little evidence that Chinese engagement in Africa is adverse to economic diversification there. The most serious argument, about the Dutch disease, is about the influence of China on world markets rather than specifically about engagement of China in Africa. Nevertheless, it is worth testing this hypothesis. Through its investment, its aid policy and its trade policy, China's engagement in Africa is becoming large, and could have an impact on economic diversification in countries where China is particularly engaged. For example, the sectoral orientation of Chinese FDI could be more (or less) oriented towards natural resource extraction than that of non-Chinese firms. African partner countries receiving assistance from China may also have policies more favourable to the extraction of natural resources (or not). In order to test these ideas, we start by building a standard diversification equation, based on ideas developed notably by Imbs and Wacziarg (2003) and UNECA (2007).

Imbs and Wacziarg (2003) have shown that economic diversification of a country can be related to its economic development, measured by GDP per capita, through an inverted-U shaped curve. Diversification is also positively related to the size of the country, measured by its population size. Diversification can be influenced also by policies. We introduce two policy variables: the first, the time required to register a new business, provides information on the costs of starting a business; the second is the existence in the country of an export processing zone (EPZ). The objective of



creation of EPZ is mainly to diversify the economy, through fiscal and regulatory exemptions granted to companies that export manufactured goods. In previous literature, the success of EPZs in helping diversification has been debated. Nevertheless, there are examples of EPZ successes (the EPZ schemes of Mauritius and more recently Madagascar). Finally, we introduce a dummy variable for oil rich countries, to take account of the possibility of a severe Dutch disease effect in such countries.

Our dependent variable is the inverse of a Herfindhal index computed on exports disaggregated at the HS 6 digit level. We use all data reported by African countries in the UN COMTRADE database. We report here regressions computed using a between estimator, as the period covered (2003 to 2007) is not long enough for a time-series analysis. Our benchmark equation is reported in the first column of Table 14 (all variables are in logarithms, except the oil dummy).

Table 14: Determinants of diversification

	Equation 1	Equation 2	Equation 3
GDP per capita	0,45*** (2,99)	0,47*** (6,40)	0,43*** (2,97)
population	0,36*** (3,73)	0,36*** (6,19)	0,38*** (4,03)
time to start a business	-0,60*** (2,71)	-0,57*** (5,67)	-0,14* (1,74)
EPZ dummy	0,62** (2,37)	0,66*** (5,13)	0,58** (2,21)
oil rich country dummy	-2,47*** (6,07)	-2,58*** (10,31)	-2,45*** (5,97)
intercept	-5,31** (2,05)	-5,58*** (3,91)	-7,09*** (3,08)
estimation method	Between	MCO	
R2	0,657	0,610	0,570
number of observations	35	130	130

Note: *** (resp ** , *) significant at 1% (resp. 5%, 10%) level. Student-t statistics within brackets. All variable in logs except the dummy variables.

Attempts at estimating an inverted-U relation with GDP per capita failed. Given that all African countries are below the threshold point above which diversification declines with GDP per capita, as estimated by Imbs and Wacziarg (about US\$ 16 000, converted in 2007 PPP terms), this result is not surprising. Hence we introduce here the GDP per capita in linear form, instead of the usual quadratic form. All parameters are highly significant, and this regression explains a large part of the between variance of the dependent variable. In order to check the robustness of this estimation, we have also performed OLS and random effect estimations, with very similar results (equations 2 and 3).

In Table 15 we use this benchmark equation to test the impact of diversification of variables measuring engagement with China (the share of exports to China in total exports, the share of imports from China in total imports, the share of the stock of FDI from China in total FDI received, and the ratio of turnover of economic cooperation with China over GDP). It is clear from these results that China engagement in African countries has had so far no significant influence, whether negative or positive, on economic diversification. We find the same results whatever the estimation method (between, OLS or random effect – results not reported).



Table 15: Test of the impact of China's engagement on export diversification

	Équation 1	Équation 2	Équation 3	Équation 4
GDP per capita	0,46*** (2,93)	0,47** (2,94)	0,40** (2,40)	0,49*** (3,03)
population	0,36*** (3,33)	0,35*** (3,30)	0,37*** (3,50)	0,33*** (3,18)
time to start a business	-0,61** (2,66)	-0,58** (2,41)	-0,61** (2,51)	-0,60** (2,69)
EPZ dummy	0,59** (2,11)	0,56* (1,92)	0,66** (2,27)	0,64** (2,40)
oil rich country dummy	-2,50*** (5,90)	-2,53*** (5,87)	-2,41*** (5,44)	-2,36*** (5,42)
share of exports to China	0,01 (0,25)			
share of imports from China		0,10 (0,44)		
share of FDI from China			-0,03 (0,39)	
turnover of economic coop. with China/GDP				-0,06 (0,72)
intercept	-5,27* (1,88)	-5,13* (1,84)	-5,20* (1,81)	-5,98** (2,15)
estimation method	Between	Between	Between	Between
R2	0,66	0,662	0,688	0,663
number of observations	35	35	32	35

Note: *** (resp **, *) significant at 1% (resp. 5%, 10%) level. Student-t statistics within brackets.
Method of estimation: within countries. All variable in logs except the dummy variables.



V. Special Economic Zones and Diversification

While China appears to have had no significant impact on African diversification so far, China's support for the creation of Special Economic Zones (SEZ) in Africa could change this. Special Economic Zones have similarities with economic processing zones, insofar as their aim is to stimulate the agglomeration of new economic activities in a given area by providing infrastructure and other facilities.⁴⁶ In both cases, it is expected that this agglomeration will create positive externalities among businesses that will promote a sustainable diversification process. China has a long and fruitful experience at home with SEZs, which have formed the backbone of its industrial development in the 1980s. Nevertheless, the development impact of such projects is uncertain, given the enclave nature of SEZs and potential limitations such as lack of infrastructure and institutional governance issues.

The information on SEZ projects is scattered and sometimes inconsistent. According to Davies et al. (2008), the Chinese government has announced in the context of the FOCAC the development of 3 to 5 SEZs in Africa, in Zambia, Mauritius, Nigeria, Egypt and Tanzania. In January 2009, the Chinese Minister for Commerce Chen Deminz confirmed that five SEZs have been initiated as follows: the Zambia–China Economic and Trade Cooperation Zone, the Guangdong Economic and Trade Cooperation Zone and the Lekki Duty Free Trade Zone in Lagos, Nigeria, the Egypt-Suez Economic and Trade Zone and the Ethiopian Orient Industrial Park. In April 2009, Chinese press indicated that China was building 7 economic and trade cooperation zones.⁴⁷ Table 16 below summarizes information available on several SEZs. Time will be required to see if these zones make a significant contribution to diversification in Africa.

Table 16: Chinese SEZs in Africa

Country	Name	Planned investment (US\$ million)	Principal sectors
Planned in FOCAC			
Zambia	ZCCZ	800	Copper products
Nigeria	Lekki FTZ	200	
	Ogun State FTZ		
Egypt	Suez SETZ	800	textile, petroleum, automotive and electrical appliance
Ethiopia	Dukem Industrial Park	713	textile, leather and construction equipment
Others			
Mauritius	Tianli ETCZ	625	
Algeria	Mostaganem ETZ	550	automotive industry, construction materials, electronic industry and textiles
Botswana	Phakalane Industrial Park	52	

Source: various press reports

46) We prefer however keeping the term SEZ for these Chinese projects in Africa, instead of using the term EPZ, given that the building of an EPZ is a domestic policy, and may entail specific measures such as tax exemptions.

47) Source Xinhua News Agency, April 19, 2009.



VI. Conclusion

This chapter has considered the consequences of China's engagement in Africa for African economic development. Due to a lack of good information, we have attempted to analyze this engagement using indirect methods. Given the fact that Chinese assistance to Africa is essentially tied, we interpreted the fast growing imports from China and turnover of economic cooperation with China as relevant signals of this engagement. By doing so, we cannot disentangle the effect of true aid flows (in the sense of DAC definitions) from the effect of other financial flows, but in any case no data source provides accurate data on aid flows compatible with the DAC definition.

The usual suspicion is that China provides assistance to a few natural resource rich countries and does not pay attention to criteria advocated by the DAC donor community, notably good governance.

Our findings suggest that the core of the Chinese financial engagement in Africa is either in countries with which it has good political relations, notably its "all weather friends" such as Egypt, Ethiopia, Mali and Tanzania, or in countries that represent strategic interests for the Chinese economy due to their oil and mineral resources, such as Algeria, Angola, Congo, the Democratic Republic of Congo, Nigeria, Sudan and Zambia. Thus China, like other bilateral donors, does pursue its own economic interests in its engagement with Africa. However, in recent years China's engagement with Africa has expanded to cover most countries in the continent and beyond natural resources to light manufacturing and services. Clear examples are China's projects in Mauritius and Botswana. China is also significantly involved in some countries that are "aid darlings" of the international donor community, such as Ghana.

Moreover, China's development assistance policy has had from its very beginning an orientation

towards poverty reduction, with significant cooperation and technical assistance in the health sector and agriculture. In recent years, we observe also, insofar as data permit, some influence of poverty on Chinese geographical aid allocation. Recently, China's financial engagement in Africa has supported sectors that are under-financed by the international donor community, notably infrastructure. This is an area in which there is room for cooperation between China and multilateral financial institutions such as the World Bank and the African Development Bank, although so far such cooperation has been limited. It should also be noted that Chinese financing, including loans, has not had an adverse effect on the reduction of African over-indebtedness under the HIPC initiative, although a risk of excessive debt still exists in some countries. Mitigating this risk is another important reason for increased cooperation between China and multilateral financial institutions. On balance, China's engagement in Africa can be beneficial both to China and to African countries.

This engagement can be helpful in assisting African economies through the current global financial crisis. Since the end of 2008, Chinese leaders have repeated that the crisis will not affect their assistance to Africa. Keeping this commitment would help Africa mitigate the adverse consequences of the global financial crisis, and will be a good test of China's desire to maintain its support for African development.

Engagement with Africa can also help support China's growth through the current economic environment. As China's financial sector is insulated from international financial markets, the main impact of the financial crisis on China has come through reduced demand for its exports (for example, China's exports fell by 25.7% in February 2009 below the February 2008 level). While Africa receives only a small share of China's exports, nevertheless continued growth in Africa will contribute to the recovery of China's exports.



And lending to resource-rich African countries in RMB may not turn out to be a poor investment, particularly if the RMB continues its appreciation against the dollar.

Finally, the global financial crisis gives China an opportunity to consolidate its role in Africa as a major partner, and hence strengthen its diplomatic ties with a continent that will become in future decades an increasingly significant player in the global economy due to its demographic trends and its natural resource endowment. Continued assistance to Africa will serve China's long term strategic and political interests.

There is some anecdotal evidence of a recent slowdown of China engagement in some African countries, such as Guinea and the Democratic Republic of Congo, perhaps reflecting the plunge of prices of commodities in global markets. But China's disengagement may also signal China's unwillingness to continue pouring billions of dollars into countries with extreme levels of political instability and government mismanagement. Steps by China to be more selective in choosing the partner countries where it increases its engagement may be bad news for the governments of countries where it adopts a more cautious attitude, but may be good news for the development of the African continent as a whole.

China's trade and investment flows to Africa have increased exponentially. These flows still may be described as exports of African raw materials to China and imports of Chinese manufactured goods by Africa, reinforced by significant FDI flows from China into Africa's natural resource industries. This pattern is not different from the pattern of Africa's trade and investment relations with developed market economies, and simply corresponds to Africa's comparative advantages. The assumption that there would be a specific "Dutch disease"

effect attributable only to increased trade with China does not make much sense, given the similarity of Chinese and non-Chinese imports of African commodities.

Two more interesting questions are (1) whether trade with China leads to a trade diversion effect and (2) whether the growing trade and investment relations between Africa and China will help or hinder the necessary diversification of African economies from a purely resource based structure. Our answer to the first question is definitely negative. The impressive growth of imports of Chinese products in Africa corresponds to a trade creation rather than a trade diversion effect. This trade creation may be related to growing financial assistance given by China to Africa, which can be interpreted as the equivalent of an export subsidy. The absence of a trade diversion effect supports the conclusion that such new trade flows are welfare improving for African countries.

As to the second question, China's engagement in Africa, however defined, has not had any impact on African economic diversification. However, China could help some African countries diversify their economies in the future. First, the numerous SEZ projects that have been initiated in the past few years in several African countries will promote diversification, if they succeed. Some of them may fail, as in other regions, because countries with poor governance and infrastructure are not good candidates for successful development of SEZs. Second, China has reduced tariffs on manufactured exports from some of its trading partners, with relatively flexible rules of origin. Such preferences may help at least a few African countries where there is some potential for developing manufacturing production integrate into the global decomposition of the value chain, in the same way as AGOA has been beneficial for a few African countries.



Chapter 5: Chinese Infrastructure Investments and African Integration



Richard Schiere and Alex Rugamba

I. Introduction

Regional integration in Africa is important in a globalized world for African countries to reap benefits from economies of scale and to strengthen their position in international negotiations. Yet, this process has been hampered by overlapping mandates and memberships from various regional organizations. At the same time, the rise of China as a global economic power has created additional opportunities and challenges for African integration. On the one hand, Chinese investment in infrastructure is alleviating major supply side bottlenecks for further integration. On the other hand, the bilateral approach of China with individual African countries limits the possibility of addressing regional issues.

This chapter discusses the establishment of a core group of African countries within the China-Africa Cooperation Forum (FOCAC) to promote regional integration. In the short term, this core group of African countries would pursue initiatives which are relatively easy to achieve, such as improving access to the Chinese market and advancing regional infrastructure projects. In the long term, this group could focus on more challenging tasks such as establishing a coordinated approach to debt relief and untying of development assistance. The core group of Africa countries would thus strengthen FOCAC implementation, thereby deepening China-Africa relationships and creating win-win situations for all stakeholders.

The outline of the chapter is the following: The next section highlights the challenges of African integration as well as the structural issues (such as high transportation costs and a weak regulatory environment) that must be overcome if the continent is to seize the opportunities provided by a globalized world. The third section describes inefficiencies due to the overlapping mandates and membership of various regional organizations in Africa. The fourth section discusses the growth of Chinese trade disaggregated by regional groupings. The fifth

section highlights how infrastructure investments support intra-African trade and alleviate bottlenecks for African integration. The sixth section underlines the importance of deepening African collaboration within FOCAC and argues for the establishment of a core group of African countries in the forum. The conclusion highlights the most important recommendations.

II. African Integration and Structural Challenges

Although historically African integration has enjoyed strong political support, implementation has been hampered by individual countries' desire to protect their national sovereignty (Kühnhardt, 2008), as well as by regional agreements that provide preferential market access to developed country markets, such as through the African, Caribbean and Pacific (ACP) Group of States. Although bilateral trade treaties with European and North American countries provided access to large markets, duty free access was often limited to primary commodities, while exports of higher value added industrial products were discouraged through tariffs. This tariff structure limited spillovers and "learning by doing", thus leaving African countries "trapped" in producing commodities manufacturing, as predicted by "center-periphery" dependency theory (Cramer, 1999, Liu, 2007).

In contrast to African countries, the first group of Asian tigers (i.e. Japan, South Korea and Chinese Taiwan) have achieved high economic growth rates and dramatically reduced poverty since the 1970s by pursuing export-oriented development strategies (Hiratsuka, 2005). The success of the Asian tigers underlined the importance of promoting private sector development and competitiveness in export markets (Schiere, 2010), thus encouraging the expansion and deepening of various regional trading blocks, including the European Economic Community, the North America Free Trade Agreement (NAFTA) and the ASEAN-China Free



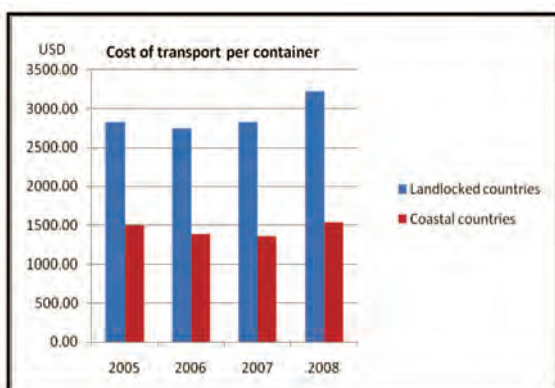
Trade Area (ACFTA). More recently, lack of progress in the multilateral trade negotiations has further increased emphasis on regional trade blocks. The failure to conclude the Doha Development Round (WTO, 2001), originally scheduled for the end of 2005, is particularly important for Africa, as the market access provisions under this agreement could lead to substantial increases and greater diversification of the continent's exports.

The lack of progress in multilateral trade negotiations also has encouraged the growth of non-reciprocal free trade agreements, such as the American Growth and Opportunity Act (AGOA) and the European Union's Everything But Arms agreement. The European Union also has a reciprocal trade agreement with African countries under the Economic Partnership Agreements (EPAs), the successor of the Lomé accord. The implementation of the EPAs is still being negotiated by several African countries and it will be gradually phased-in over a 12 year period (Olumuyiwa, 2006). These agreements provide poor exporting countries with temporary price advantages, to help them develop their new export industries. Ideally, over time these exports would become sufficiently competitive to survive without preferential terms. The non-reciprocal free trade agreements could help promote sustained export-led growth, if

accompanied by the establishment of an appropriate enabling environment. In some African countries, these agreements have encouraged investment in export industries. For example, in Lesotho access to the US and European markets lead to Chinese textile investments and thereby increased job opportunities, although the sustainability of these investments is uncertain if the preferential access were limited or abolished.

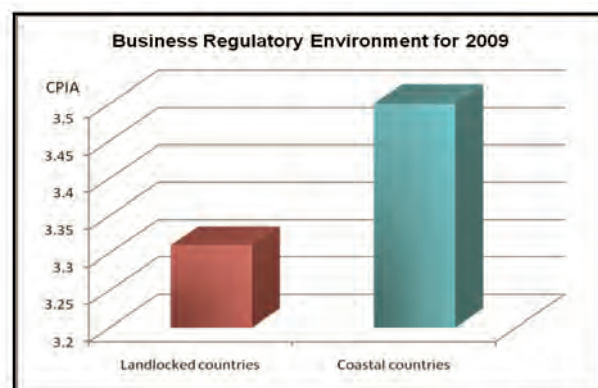
In many African countries, the positive impact of preferential trade agreements has been limited by structural challenges, including high transportation costs and institutional weaknesses. Thus access to export markets does not necessarily lead to higher economic growth rates and poverty reduction in Africa. Landlocked countries in particular tend to have higher transport costs and weaker business environments than coastal countries (see figures 28 & 29). Given the overall reduction in global transport costs over the last few decades (Yang and Gupta 2005), these high costs seriously undermine African countries' ability to compete, for example with Asia. And landlocked countries are particularly disadvantaged: it costs \$1,500 to transport a container from Japan to Abidjan (UNECA, 2004), while the average cost for container transport to landlocked countries in Africa is \$3,000.

Figure 28: Average transports cost per container



Source: African Development Bank Group (Data platform)

Figure 29: Business regulatory environment





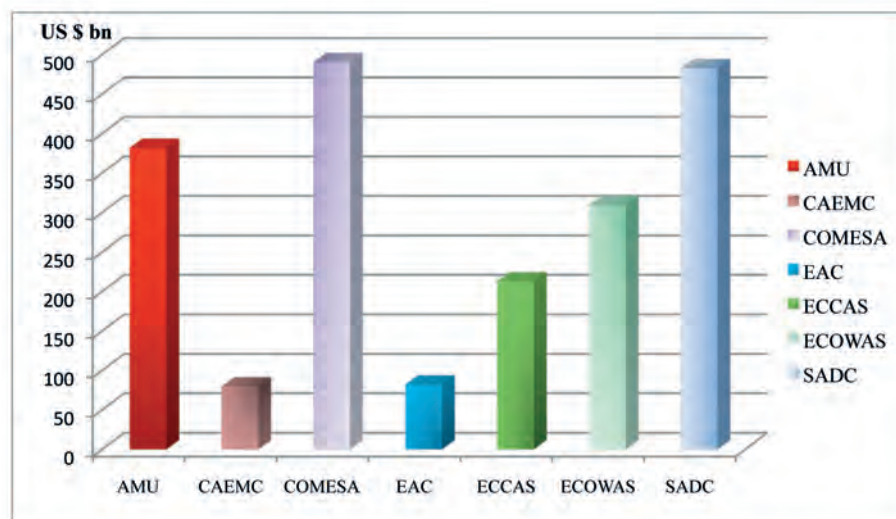
The high costs of transport are driven by both the lack of adequate physical infrastructure (i.e. poor roads, slow port operations and poor storage facilities, etc), and institutional weaknesses such as unnecessary bureaucracy, slow customs procedures, transport cartels, and corruption (World Bank, 2001 and WTO 2005). These weaknesses must be addressed to ensure that Africa can benefit from preferential market access. Another challenge, at least on the import side, is that customs revenues are often a main source of government revenues; thus internal revenue sources (VAT, income tax, profit tax, etc.) should be strengthened before tariffs are reduced. Eliminating import prohibitions, for example those that Nigeria maintains on some products from ECOWAS Member States (Olumuyiwa, 2006) and addressing logistical and regulatory barriers could facilitate trade without reducing customs revenues (World Bank, 2005).

III. The multitude of African organizations

Africa has numerous sub-regional organizations with various mandates for promoting deeper

integration, for example facilitating trade flows and reducing the costs of circulation of individuals (e.g. issuing a common passport).⁴⁸ These organizations include the African Economic Community (AEC), Arab Maghreb Union (AMU, headquartered in Rabat), Central African Economic and Monetary Community (CEMAC, headquartered in Libreville), Common Market for East and Southern Africa (COMESA, headquartered in Lusaka), the East African Community (EAC, headquartered in Arusha), the Economic Community of West African States (ECOWAS, headquartered in Abuja), the Economic Community of Central African States (ECCAS, headquartered in Libreville) and the Southern African Development Community (SADC, headquartered in Botswana). In general, these regional organizations pursue their own mandates; there is a lack of an overarching pan-African integration initiative, although the African Union is encouraging some coherency. Note that even achieving full African integration would still leave a relatively small market in global terms (see figure 30)—Africa's GDP (nominal in 2009) is only about \$1.18 trillion, compared to \$16.4 trillion for the European Union, \$14.2 trillion for the United States, and \$4.9 trillion for China.

Figure 30: GDP of regional organizations in 2008



Source: African Development Bank Group

48) There are also African organizations that deal with peace and security issues, however, in this chapter the focus is on trade and investment integration among African countries.



One key impediment to coordination across regional organizations is that several African countries are members of more than one. Of the 53 African countries, 26 are members of two regional economic communities, and 20 are members of three regional groups. Only 6 countries maintain membership in just one regional economic community (UNECA, 2004). This overlap wastes scarce administrative and financial resources and complicates the negotiation of bilateral trade treaties with the European Union and the United States. This is particularly a challenge for African regional groups which include both Least Developed Countries (LDCs) and non-LDCs, as the latter are involved in reciprocal trade negotiations, while the former receive access through non-reciprocal trade negotiations. These tensions were evident in the EPA negotiations. Several members of the Southern African Development Community (SADC) signed temporary EPA agreements with the EU, while South Africa could not reach an agreement with the EU due to requests for additional safeguard provisions to protect key manufacturing sectors, which other SADC countries lack (Mbatha & Charalambides, 2008). These tensions among SADC members could have serious repercussions for the regional organization.

The proliferation of regional organizations also affects African integration. On the one hand, it can be easier to achieve trade integration agreements within small regional organizations than within large blocs. Trade integration can have strong distributive effects (Verdier 2005, Hoekman 2005); domestic constituencies that lose from lower tariffs are likely to organize to oppose reform, while potential beneficiaries are

often difficult to identify and organize. Managing the complicated political economy of trade reform is easier if the number of parties to the agreement is limited. On the other hand, various small organizations can become a stumbling block to African integration, as each regional organization seeks to achieve its members' interests at the expense of promoting trade liberalization at the continental level.

IV. African trade within regions and with China

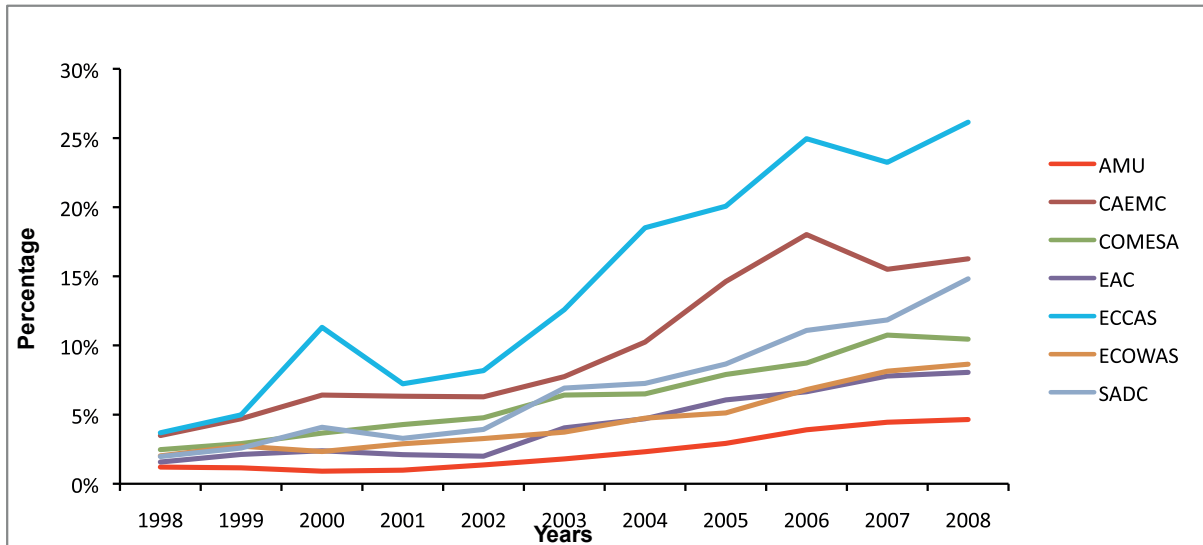
The relative small market size of regional trade groupings contributes to the limited amount of intra-African trade, which has not significantly increased within nearly all regional groups in the last decade.

Intra-Africa trade will likely continue to decline with the deepening of the European Union Neighborhood Policy and the Mediterranean Union (European Commission, 2004).⁴⁹ Other regional groupings' intra-African trade equalled from 4 to 13 percent of their total trade from 1998 to 2008. By contrast, China's share of each regional groups' trade increased steadily from 1998 to 2008, most notably for the Economic Community of Central African States (ECCAS), where trade with China in 2008 reached 25% of total trade (figure 31). Expanding trade with China was led by the strong rise in commodity exports from three ECCAS members (Angola, Republic of Congo and Cameroon). Data for the other regional organizations show a steady growth of overall trade with China, largely dominated by commodity exports.

49) The European Neighborhood Policy Strategic Paper deals with a wide range of issues including human rights and migration. This policy also highlights the need for infrastructure investment to transport energy to Europe from North African and therefore will increase European-North African trade.



Figure 31: Share of China-Africa trade by regional organization



Source: IMF trade statistics & SADC trade statistics

But for Africa to reap substantial benefits from trade integration will require addressing structural challenges, such as improving trade facilitation, establishing an appropriate environment for private sector development (e.g. reducing impediments to opening a business), and improving the skills of the labour force. Such improvements would enhance intra-African trade, as well as attract foreign investors. Strengthening domestic institutions in the context of an outward-oriented development strategy would win cooperation from development partners and thus further market access. By contrast, pursuing a closed development strategy by creating an African customs zone with high external tariffs would boost trade diversion and reduce consumer welfare owing to high prices, as production costs within Africa for many essential manufactures are higher than in the rest of the world.

V. The impact of Chinese infrastructure investment in Africa

Investment in infrastructure, including in transportation (e.g. roads and rails), power generation, and telecommunications (e.g. Internet) is essential to alleviate supply-side impediments to African integration. The small population and market size of the majority of African countries limits opportunities for economies of scale and increases border stop-related transportation costs, so that regional cooperation can contribute to reduced trade transactions costs. The 12th African Union (AU) summit held in February 2009 identified infrastructure development, cheap energy and regional transport networks as priorities (African Union, 2009)⁵⁰.

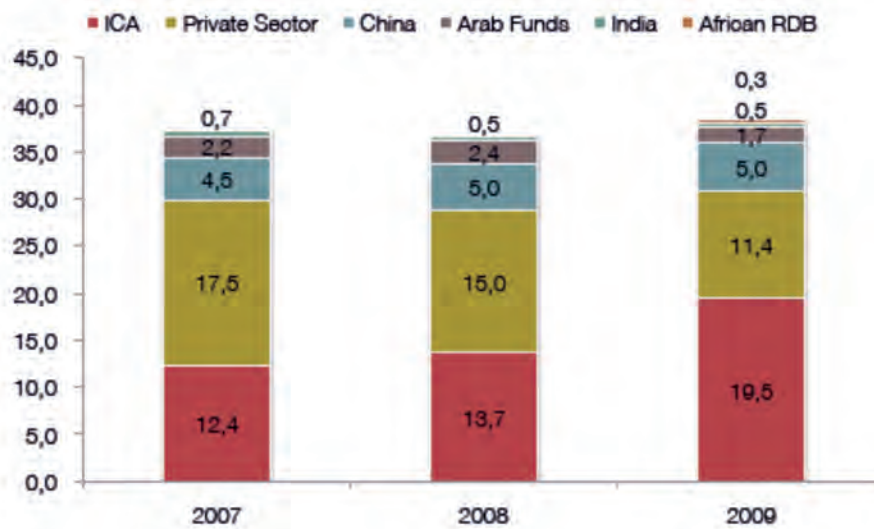
50) The theme of the Summit was "Infrastructure Development in Africa, with emphasis on Transport, Energy and Investment".



The Africa Infrastructure Diagnostic (AICD) estimates that \$93 billion in annual spending over the next 10 years is required to meet the Millennium Development Goals (MDG) and achieve national development targets in Africa (IBRD/World Bank, 2010). Almost half

of this amount is needed to address the continent's current power supply crisis that is hindering Africa's growth potential. It is estimated that the increase in power supply could add 2% of GDP per year and raise business productivity by 40%.

Figure 32: External support to the infrastructure sector (2007-2009)



Source: ICA 2010 (RDB = Regional Development Banks)

Total commitments for infrastructure in Africa in 2009 were \$38.4 billion – slightly up, by 5.0%, from \$36.6 billion in 2008 (figure 32). The total commitments made by ICA members for infrastructure in Africa in 2009 were \$19.5 billion, half of the total volume and a significant increase, by 42.5% (\$5.8 billion), from 2008. Private sector support has decreased again, by around 23.7% to about \$11.4 billion, indicating a difficult investment climate and the impact of the financial crisis. Examples of private sector infrastructure investment include the Dakar Container Terminal and the Main One Cable system. The latter would increase internet access at lower cost to West Africa.

China's investment in infrastructure in Africa remained stable at around \$ 5 billion per year.

These investments from China to Africa do not appear to have declined due to the international financial crisis. This is in part because of the limited impact of the crisis on the financial sector in China as well as the country's \$2 trillion in foreign currency reserves, but mostly because Chinese investments are intended as a long-term commitment.

Chinese investment can make an important contribution to improving African infrastructure. Recent examples are roads and bridges in Democratic Republic of Congo (DRC), railways in Angola, and power stations in Zambia. Chinese investments are often structured around oil and mineral resources, including in fragile states (Box 9). China is building high-voltage power transmission lines to interconnect countries in Southern Africa, thereby strengthening



African integration. In the rail sector China's largest deals include the construction of mass transit systems as in Nigeria, and the construction of new lines linked to mining developments in Gabon and Mauritania. The largest ICT project with Chinese involvement comprises the rollout of a national communications network in Ethiopia.

Chinese investment is beneficial to Africa also through competitive pricing, as shown by China's

receiving 21% of the AfDB's total procurement contracts and 35% of its civil engineering projects in 2008. China's comparative advantage is particularly evident in hydropower project construction. By the end of 2007 China had committed at least \$3.3 billion towards 10 major hydropower projects (World Bank and PPIAF, 2008). Once completed, these projects will provide a combined generating capacity of more than 6,000 megawatts.

Box 9: China's engagement in Mozambique

Unlike its activities in other African countries, China's engagement with Mozambique can be characterized as being guided by caution and compromise. Maputo's established relationship with traditional donors and their presence in the country (foreign aid from traditional donors financed 51% of the 2008 national budget of \$3.2 billion), the relatively strong Western NGO presence and concomitant fostering of a local civil society, and the proven ability of FRELIMO (the governing party since independence) to manage an array of external actors makes Beijing's and the Mozambican government's bilateral relations very different from China's ties with other resource-rich countries. Thus China's approach in Mozambique, while as usual emphasizing resources and infrastructure, nonetheless has been far less significant than in Beijing's aspirations.

China has funded several public infrastructure projects in Mozambique since 1999, beginning with the construction of the parliament buildings. From 2001-04 concessional loans amounting to \$15.6 million (to be repaid between 2013 and 2025) financed several public works projects, including construction of the Joaquim Chissano Conference Centre, the new Foreign Ministry, and low income housing in Zimpeto in the outskirts of Maputo, as well as the purchase of police equipment. A new national stadium is also being built by the Chinese ahead of the 2010 FIFA World Cup held in South Africa. A third of all road construction, amounting to 600km of roads, in Mozambique is being carried out by Chinese road contractors. Chinese construction companies are also involved in rehabilitating urban water supply systems in Maputo (\$30 million), and Beira and Quelimane (\$25 million in total), through international tender procedures, and are looking at further tender opportunities in the road and bridge construction sectors.

The Ministry of Public Works and Housing is finalizing details with China's Exim Bank on the construction of a \$300 million hydro-electric dam in Maputo that will supply both water and electricity. The Moamba Major dam will provide the city with crucial infrastructure, destroyed during the civil war, which will extend drinking water to 60% of the population by 2015 and will also decrease Maputo's reliance of Cahora Bassa dam for its power supply. Exim Bank is set to become the largest financier of Mozambique's biggest infrastructure project, the construction of the Mpanda Nkua dam, worth \$2.3 billion, and a 1.5 Megawatt hydro-electric plant. Chinese construction companies are normally awarded projects financed by Chinese funds, but in this case the construction of the dam has been awarded to Camargo Correia, a Brazilian engineering company, and to their Mozambican partner group Insitec.

Source: Chris Alden, SAIIA.



One of the key challenges in analyzing China's infrastructure investment in Africa is that Chinese investments are fragmented across several government institutions, including the China Development Bank, China EXIM Bank, and the Ministry of Commerce. In addition, the China-Africa Development Fund (CADF) is supporting business partnerships between Chinese and African entrepreneurs, and has participated in 20 projects and invested over \$500 million of its own resources while promoting investment of more than \$20 billion by Chinese companies (Businessday, 2009), including Sinosteel Corporation, China National Building Material, and Hainan Airlines. China has also acquired African banks, which could extend financial services, such as trade finance, to Chinese companies. The most prominent example is the acquisition of 20 percent of South Africa's Standard Bank for \$5.6 billion by the Industrial and Commercial Bank of China, China's largest lending institution (Centre for Chinese Studies, 2007). Other Chinese banks that are active in Africa include the China Construction Bank, which has entered into a strategic partnership with FirstRand of South Africa. However, benefiting from Chinese acquisitions will require addressing key structural challenges for the banking sector in African, including the lack of property rights, slow bankruptcy procedures and weak rule of law.

China's engagement, based on developing win-win outcomes within the framework of south-south cooperation, has provided very substantial resources for critically-needed infrastructure. China's assistance to Africa has changed from grants and soft loans to commercial loans at competitive rates for projects viewed as financially viable, which has raised concerns that Chinese involvement could impair debt sustainability. The most well publicized example is the case of the DRC, which had to amend the terms of its Chinese assistance package to qualify for completion of its \$6.3 billion HIPC debt relief. To ensure that

Chinese investments have a positive impact, African governments need to establish an adequate regulatory framework to ensure transparency in decision-making and the implementation of environmental and social safeguard policies, to encourage the transfer of skills and technology, and to require foreign investors to use local labour and construction materials. These regulations should be applied to all investors, whether from China or traditional development partners.

Maximizing the development impact of China's investments will also require coordination with other investors and development partners, through, for example, co-financing projects. For example, Botswana will receive a loan of \$225 million from the African Development Bank Group to finance the Morupule B Power Project, which involves the construction of a 600 MW coal-fired power plant and associated transmission infrastructure, with the goal of achieving energy self-sufficiency. The project is to be co-financed by the World Bank, plus \$825 million from the Industrial and Commercial Bank of China and Standard Bank Consortium (ICBC-SB).

Chinese investments have mainly supported infrastructure projects through direct bilateral relationships with individual African countries. However, China has demonstrated that it can participate in regional projects so as to benefit from economies of scale. Regional African entities could provide a framework for such projects, including in power generation, power interconnections, roads, ports, railways and ICT networks. One major regional infrastructure venture is the planned construction of electricity transmission lines between South Africa and Mozambique, South Africa and Zambia, and Botswana, Namibia and Zimbabwe. Other positive developments include joint infrastructure programs (with strong trade facilitation components) such as the North-South Corridor, designed to support the Tripartite Arrangement that has been set up



between SADC, COMESA, and EAC to create a grand free trade area in East and Southern Africa (Swazi Observer, 2009).

Overall, China's engagement in Africa is positive and will be critical to meet the growing needs of the continent and promote regional economic development. However, it is important for national governments to ensure that China's assistance and investments are aligned to national and regional strategies. Addressing these issues within the FOCAC framework would provide an opportunity to create win-win situations.

VI. Strengthening FOCAC Implementation

The increasing importance of economic ties between China and Africa (Sino-African trade exceeded \$100 billion in 2008) led to the organization of the Ministerial China-Africa Cooperation (FOCAC) forums, which bring together heads of states of China and of 53 individual African countries. The initial FOCAC event was held in Beijing in 2000, and subsequently was organized every three years, in Addis Ababa (2003), Beijing (2006) and Cairo (2009).

China's engagement with Africa is being carried out under the strategic objective of the "Going global strategy" which seeks to create multinational companies, in particular in the infrastructure and extractive (oil, iron ore and timber) sectors. Often these Chinese enterprises thrive in Africa, while Western companies have limited presence due to perceived high business and political risks. By contrast, Africa lacks a strategic vision for engagement with China, despite the considerable development opportunities that China offers.

Experience with other regional economic entities, such as the European Union and the United States, has demonstrated that Africa needs to have a strategic vision to reap the full benefits of economic

cooperation. This vision could be elaborated within the FOCAC, the established institutional framework for Sino-African relationships. Regional organizations could have an observer status, but due to the overlapping mandates and memberships, Sino-Africa engagements might best be dealt with within the existing institutional framework of FOCAC. Establishing a core group of African countries to follow-up on regional issues, including the achievement of greater access to the Chinese market, coordinating regional infrastructure projects, increasing debt relief and reducing the share of development assistance tied to donor suppliers, would strengthen the FOCAC's implementation framework.

This core group of African countries could build on the experience of the African Development Bank Group, which created a network among 10 African countries, or C-10, to negotiate a common position for Africa during the global economic and financial crisis. The C-10 has representation from ten different African entities, including representatives from five government ministries (Tanzania, South Africa, Nigeria, Cameroon and Egypt) and five central banks (Algeria, Kenya, Botswana, Central Banks of West African States and Central Banks of Central African states). The C-10 held regular meetings to discuss the evolution of the financial crisis and measures to strengthen the "African voice" on reforming the global financial architecture, such as the Bretton Woods Institutions as well as banking regulatory standards. In this process the C-10 assisted in negotiating a common African position, which subsequently fed into the G-20 negotiations.

Building on the experience of the C-10, the possible members of the core group of African countries within FOCAC could include states that export raw commodities to China (e.g. Sudan, Angola, Democratic Republic of Congo, etc.) as well as countries which import manufacturing goods from



China (e.g. Nigeria, Egypt, South Africa, etc.)⁵¹. This group could focus on the following issues in the context of the FOCAC:

1. **Improving market access to the Chinese market.** This initiative would be in line with the FOCAC statement which announced a “zero-tariff treatment to 95 percent of the products from the least developed African countries having diplomatic relations with China, starting with 60 percent of the products within 2010” (FOCAC, 2009). However, two issues still have to be addressed. First, it is important to address non-tariff barriers. For example, eligibility for tariff preferences under China’s rules of origin require that 40% of the value added are produced in the exporting African country, which is stricter than requirements by the EU (33%) and AGOA (35%) (Minson, 2008). Secondly, although there is some evidence that China is moving-up the value chain (Cui and Syed, 2007), African countries still have to compete with Asian imports, which are more competitive and also enjoy preferential access to the Chinese markets.
2. **Advocating regional infrastructure projects.** Although Chinese investment projects are highly competitive, the preferred model of engagement is bilateral. The advantage of a bilateral approach is that projects can be approved rapidly and required consultations during implementation are limited. The disadvantage is that regional infrastructure projects are often overlooked, including various trade initiatives in the Eastern and Southern Africa and the North South Corridor. The core group of African countries could emphasize the importance of funding regional infrastructure projects to address one

of the major bottlenecks to regional integration. It should be emphasized that China is already funding some regional projects, but that there is a lack of capacity of African institutions to prepare a pipeline of projects that are ready for investment.

3. **Coordinating debt relief.** Although there is an established framework for debt management under HIPC and MDRI, it might be beneficial for China, as a creditor country, to interact with other development partners and multilateral institutions. China’s debt relief initiative which, as announced at the 2009 FOCAC meetings, focuses on writing off 168 debts owed by 33 African countries, could be coordinated with multilateral institutions and international lenders. Such cooperation could avoid tensions such as those that arose in the case in the Democratic Republic of Congo. However, any debt sustainability analysis is first and foremost the responsibility of the individual African countries, and, only as part of due diligence, is there a role for multilateral institutions.
4. **Untying of development assistance.** This issue is the most difficult to address, as the objective of Chinese development assistance is not only to support development in the recipient African country, but also to support Chinese companies in their going global strategy. However, in the long term, untying of development assistance would provide the opportunity for African companies to participate in tender projects, improve their technology and labour force skills through learning by doing, and enhance national ownership. Moreover, participation of local industries is important for sustainability: local companies should have the

51) This group of countries is chosen because 60% of the Chinese exports are to 6 countries: South Africa (19, 92%), Egypt (11,88%), Nigeria (10,18%), Algeria (7,25%), Morocco (5,80%) and Benin (5,28%), while more than 70% of the Chinese imports are from 4 countries: Angola (35,45%), South Africa (18,20%), Sudan (11,47%) and Republic of Congo (7,80%).



capacity to maintain infrastructure projects, irrespective if these projects are built by the Chinese or by other development partners.

The first two initiatives (improving access to Chinese markets and advocating regional infrastructure projects) could be addressed by the core group of African countries within the FOCAC framework. However, the two latter initiatives (coordinating of debt relief and untying of development assistance) are politically sensitive and may require a shift in the political economy in China before progress can be made.

VII. Conclusion

China can provide an important development opportunity for the continent and can assist African integration by alleviating infrastructure bottlenecks and expanding trade. However, for Africa to thrive in a globalized world will require not only addressing the infrastructure gap, but also improving business regulations and customs procedures, as well as broader reforms to strengthen the rule of law. These

reforms are the responsibility of African countries, and are essential to diversifying African exports and to economic growth and poverty reduction on the continent.

One of the drawbacks of China's support to Africa is its bilateral approach with individual African countries, which leads to regional issues not being adequately addressed. In this context, this chapter has argued in favour of establishing a core group of African countries within the China-Africa Cooperation Forum (FOCAC) which would advocate issues of common concern. In the short term, this group could focus on improving access to the Chinese market and advocating regional infrastructure projects, while in the long term, this group could emphasize the importance of coordinating debt relief and untying of development assistance. In this manner, the core group of Africa countries would strengthen the FOCAC implementation, thereby deepening China-Africa relationships and creating win-win situations for all stakeholders.



Chapter 6: China, Africa and the International Aid Architecture

Deborah Bräutigam



I. Introduction

The rising prominence of Chinese aid, export credits, and bank finance has aroused both enthusiasm and concern within development circles. Some believe that Chinese practices in official aid, preferential export credits, and other forms of development finance pose a significant challenge to the norms governing the international aid architecture. Others welcome the rise of a new development partner, one with seemingly deep pockets, and suggest that the Chinese might provide new leverage to countries faced with conditionality-based aid advocated by traditional donors. Yet despite the intense interest, debates over the impact of China as a donor and financier have largely taken place with very little information.

China's rise is taking place within a set of rules, norms, and sometimes competing institutions that make up what is known as the global aid architecture. The purpose of this paper is to investigate the potential impact of Chinese aid and development finance on the dynamics of this aid system, particularly in Africa. The chapter uses the OECD Development Assistance Committee's standardised definition of aid as "official development assistance" (ODA), which is official financing given at concessional rates to developing countries, primarily to promote economic development and normal welfare in the recipient. We also consider other official flows (OOF), such as preferential export credits. While they are not "ODA", it can be argued that these forms of development finance are in principal part of the aid architecture.

The chapter is organised as follows. The next section provides a brief overview of the rise in China's development assistance and other forms of official finance. This is followed by Section III, which defines what is meant by the "international aid architecture". Following this, Section IV provides explanations of several forms taken by Chinese aid and development finance. Section V focuses on

China's impact on the global aid architecture, while the last several sections conclude and offer some recommendations.

II. The Rise in Chinese Aid and Other Official Finance

Although often called an "emerging donor," China has in fact had an aid programme since the 1950s. Egypt was the first African recipient of aid from China in 1956. Chinese aid is almost automatic for African countries with formal diplomatic ties with Beijing. Every country in Africa, with the exception of Swaziland, has been a recipient of Chinese aid. Countries such as Chad, Burkina Faso, and The Gambia, have switched diplomatic recognition back and forth between Beijing and Chinese Taipei (Bräutigam 2008, p. 12-13).

In the peak period of the mid 1970s, after Beijing had won back its United Nations seat from Chinese Taipei, China had aid programmes in more African countries than did the United States (Bräutigam 1998, p. 4). Although the quantity of funding dipped during the 1980s, Chinese aid programmes were maintained, with a focus on sustaining and consolidating the results of aid investments made during the 1970s. Some knew that China continued to support its flagship project -- the Tanzania-Zambia Railway -- but it was less known that in the 1980s and 1990s, China sent teams to dozens of African countries to repair, rebuild, and consolidate many of their earlier infrastructure and production projects (Bräutigam 1998; 2009).

It is widely said that China does not have a central aid agency, but in fact, China's aid programme is organised by the Department of Foreign Aid in the Ministry of Commerce (MOFCOM), which cooperates with the Ministry of Foreign Affairs (Bräutigam 2009b). The Department of Foreign Aid operates China's grant programme, zero-interest aid loans, youth volunteer programme, and technical assistance. Under direction from



the Ministry of Commerce, China's Export-Import Bank (Eximbank) administers China's concessional foreign aid loan programme using subsidies from the foreign aid budget to soften the terms of its concessional loans.

China Eximbank is one of three "policy banks" (along with China Development Bank, and China Agricultural Development Bank) set up in 1994 to better enable the government to directly finance its development goals as it transitioned to a market economy. As a Chinese analyst put it, "policy loans are heavily influenced by government policies and are not to operate in full compliance with market rules" (Institute of Economic and Resource Management, 2003, p. 129).

Policy banks may offer subsidies for export credits or foreign investment, but these do not qualify as aid. In 2008, the China Development Bank's plan to transition to "commercial" status was approved. In time, only two policy banks will remain.

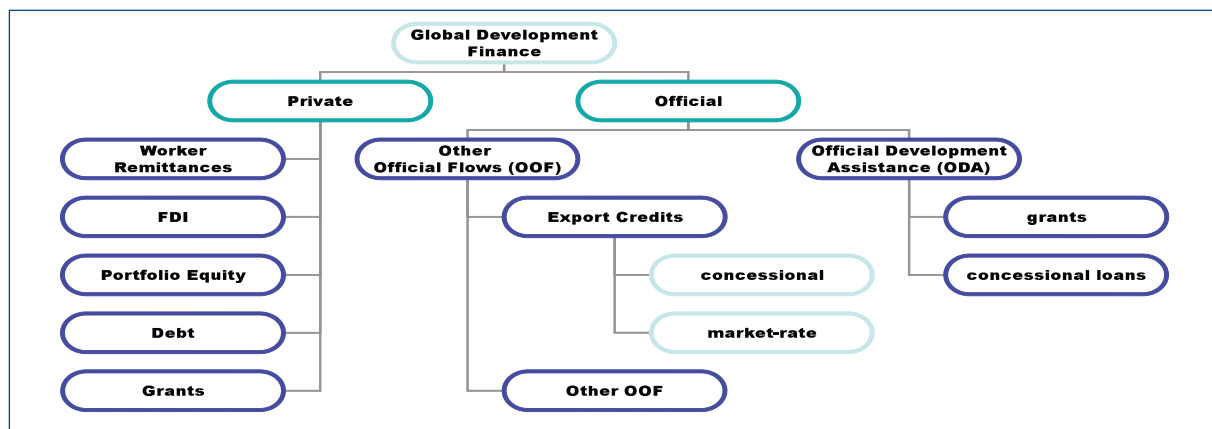
Since 1994, China has developed other sources of official finance: Equity funds (the China-Africa Development Fund, managed by China Development Bank, for example); non-concessional loans from the China Development Bank; and a growing mix of market-rate and preferential export buyer's credits offered by the China Eximbank and frequently mistaken by outsider observers as official aid.

The Bank of China has a branch in Lusaka, Zambia, and another in Johannesburg, where the China Construction Bank also has a branch. These banks now operate largely on commercial principles. The Ministry of Commerce, through its "going global" policies, has other funds that enable companies to apply for interest rate subsidies for commercial bank loans undertaken to support their overseas activities. These various vehicles create considerable confusion among some observers over which of the financial flows coming from China should be called "aid".

III. The International Aid Architecture: Institutions, Rules and Norms

The international aid architecture can be defined as the system of institutions, rules, norms, and practices that govern the transfer of concessional resources for development (Figure 33). It comprises four major areas: (1) Institutions and actors; (2) volumes and composition; (4) instruments and modalities, and (4) rules and standards. As Figure 34 points out, only a small subset of global financial flows qualify as "foreign aid", classified as private grants (funding from individuals, foundations, NGOs, and the new "global funds" such as the Gates Foundation) and official development assistance (bilateral and multilateral donors).

Figure 33: Global development finance





III.1 Institutions and Actors

These comprise the players -- bilateral and multilateral donors, as well as non-governmental organisations (NGOs), global funds, and private foundations -- that provide assistance to developing countries, and the agencies within developing countries that receive the aid. By one estimate, more than 1000 financing mechanisms currently exist in the global aid architecture (Hammad and Morton 2009). The traditional bilateral donors have been joined by up to 18,000 international NGOs, and up to 233 multilateral agencies (Kharas 2007). Included here as well are forums such as the Paris Club (an informal group of mainly OECD creditor governments), the G-8, the Commonwealth, the OECD's Development Assistance Committee (DAC), and the United Nations' Development Cooperation Forum, all of whose members contribute to the rules and norms that try to regulate aid practices.

III.2 Definitions, Volume and Composition

While organisations make up the skeleton of the aid architecture, aid flows make up its circulatory system. The definition of "official development assistance" is central to the aid architecture, and to any discussion of China as a donor country. As agreed by the members of the DAC of the OECD in 1969, and revised in 1972, official development assistance comprises concessional funding with a grant element of at least 25 percent, given to developing countries (those with a per capita income below a regularly adjusted threshold), and to multilateral institutions primarily for the purpose of promoting welfare and economic development in the recipient country. In 2009, for example, all countries with per capita incomes in 2007 of \$11,455 or less were counted as "developing countries"⁵².

The DAC members agreed to define "other official flows" (or OOF) as money that comes from governments but does not meet the ODA criteria. These could be loans with a grant element of less than 25 percent, or they could be "official bilateral transactions, whatever their grant element, that are *primarily export facilitating in purpose*" (emphasis added). Thus, for the DAC, ODA excludes, by definition, export credits given by state-supported (official) export credit agencies primarily to promote exports. It also excludes government funds that support equity or portfolio investment in developing countries, and military aid.

The volume of aid and the sectors supported by aid change over time. Public commitments to change the volume of aid are another important element of the global aid system. In 1970, at the United Nations General Assembly, "economically advanced" countries agreed to an official development assistance target of 0.7 percent of gross national income by the middle of the 1970s (United Nations 1970, para 43). Other more recent pledges made separately by both the OECD donors and by the Chinese, have focused on "doubling aid" to Africa. The changing sectoral composition of aid, and specifically the proportion directed to social sectors, infrastructure, productive activities, or debt relief, fit in this central component of the aid architecture.

III.3 Instruments and Modalities

Aid instruments and modalities comprise the ways in which aid is programmed and delivered. Concrete instruments of aid include projects and programmes, technical assistance, food aid, budget support, debt relief (for example, the Highly Indebted Poor Countries or HIPC programme), humanitarian assistance, and so on. Modalities for the use of aid include agreed codes of "best

52) "DAC List of Aid Recipients", <http://www.oecd.org/dataoecd/32/40/43540882.pdf> [accessed September 2, 2009]



practice”, such as those embodied in the 2005 Paris Declaration on Aid Effectiveness, with its emphasis on ownership, harmonisation, alignment, results, and mutual accountability. But modalities would also include practices such as the project cycle, the use of cost-benefit analysis and other methods of appraisal, the application of conditionality or measures for greater selectivity. Economic and political conditions imposed on aid are a central feature of the aid architecture. Sometimes, but not always, conditionality is backed by clear rules and standards.

III.4 Rules and Standards

Compared with regimes that govern international trade (codified in the World Trade Organisation), the rules of the international aid architecture are much less universal. Many were agreed upon by the DAC, founded in 1960 with eight member countries, and since expanded to include 23 members. Others originated in the Bretton Woods institutions – the World Bank and the International Monetary Fund – while still other rules have come via the informal “Paris Club” of official creditors. Few of these rules have sanctions or other built-in enforcement mechanisms. Most depend on informal practices, expectations, and public opinion for their enforcement. Of these rules and standards, the most codified and concrete involve norms, agreements, or conventions in five areas: (a) Transparency; (b) tied aid and export credits; (c) social and environmental protections; (d) corruption and governance, and (e) the management of debt.

a) Transparency

The members of the DAC agreed long ago to transparently report their financial flows (particularly ODA and OOF) to developing countries using

standardised categories and definitions. The strength of the norm of transparency is apparent in that 18 donors that are not members of the DAC nevertheless report their official development assistance through the DAC⁵³. However, Russia, China, India, and Brazil, four of the countries believed to be among the most important of the non-DAC donors, do not report their aid. While ODA is usually very transparent in the traditional donor countries, officially supported export credits are much less so. While the amount of the credit is usually available, it was long common practice for export credit agencies to treat almost all other information about officially supported export buyers’ credits and official guarantees as confidential due to its commercial nature (Hawley 2002). In the past decade, this secrecy has begun to change, but by and large, it remains the norm.

b) Tied Aid and Export Credits

Aid tying is the requirement that recipients use aid to purchase goods and services from the donor country. Evolving rules and principles address both the tying of ODA and subsidies (“aid”, but not “ODA”) used to make export credits more concessional. In 1978, DAC members developed “Recommendations” (or norms) on aid tying, but until recently, the process of untying aid was quite slow.

In 2001, DAC members agreed in principle to untie financial aid and investment-related technical cooperation for the Least Developed Countries, although they did not reach an agreement on untying other forms of technical assistance or food aid (Manning 2006, p. 378). In 2008, they agreed to completely untie ODA to the 39 most highly indebted countries, although food aid

53) As of May 2009, these included Chinese Taipei, Czech Republic, Estonia, Hungary, Iceland, Israel, Korea, Kuwait, Latvia, Liechtenstein, Lithuania, Poland, Romania, Saudi Arabia, Slovak Republic, Slovenia, Thailand, Turkey, United Arab Emirates. http://www.oecd.org/document/2/0,3343,en_2649_34447_41513218_1_1_1_1,00.html [accessed May 6, 2009].



and technical assistance were again omitted (OECD 2009). These agreements have no built-in sanctions. Nevertheless, the level of tying has dropped substantially since the late 1990s⁵⁴.

A related component of the international aid regime is the separation of ODA from export credits, and the level playing field for export finance agreed upon by the OECD members. In the early years of official development assistance, donor countries commonly competed with each other in part by drawing on their ODA to subsidise attractive financing packages for their exports. Concessional financial support linked to the procurement of capital goods or construction services could involve heavily subsidised export credits, or mixing official development aid with other kinds of credits. Led by the United States, OECD members negotiated a more level playing field through the voluntary 1978 Arrangement on Guidelines for Officially Supported Export Credits, and the 1992 Helsinki Package, which specified minimum levels of concessionality, based on current market rates (CIRR) rather than the standard 10 percent used to calculate ODA. They also stipulated transparency via required notification to other members of one's own offers of concessional export credits. These voluntary norms have been quite effective in policing this second area of subsidised export credits⁵⁵.

c) Environmental and Social Protections

Development finance and aid now take place within a framework that emphasises the protection of people and the environment. Most major funding agencies require social and environmental impact studies for their major projects. A variety of voluntary guidelines also exist. For example, the World Commission on Dams developed standard

guidelines for the implementation of hydropower projects in 2000, based on five core values, these being equity, efficiency, participatory decision-making, sustainability, and accountability. Standards in the oil and mineral extractive industries have developed rapidly in the last few years, including those embedded in the Extractive Industries Transparency Initiative (EITI). Codes of conduct are being established for industry groups in forestry. Many of these are based on the pioneering Code of Conduct of the UK Timber Traders' Federation, published in 2002.

In December 2003, OECD members agreed to adopt voluntary "Recommendations on Common Approaches on Environment and Officially Supported Export Credits." However, although these "Common Approaches" were revised several times, their voluntary nature and measured coverage led them to be critiqued by advocacy groups (ECA Watch 2007) as "weak" and "non-transparent".

Similar standards are also increasingly applied in private sector finance. In 2003, with the assistance of the World Bank's International Finance Corporation, a group of private banks agreed on a set of voluntary standards for socially and environmentally responsible lending called the Equator Principles. For example, hydropower or other infrastructure projects must have environmental assessments as well as consultation, compensation, and funded resettlement for people affected by the project. Yet there appears to be no overarching convention or agreed set of rules on environmental and social protections similar to the rules on officially supported export credits, or the standard definition of ODA.

54) Between 1999/2000 and 2005/2007 untied aid rose from 51% (but with the tying status of 38% of aid not reported) to 73% (with only 6 percent not reported). Edward J. Clay, Matthew Geddes and Luisa Natali, "Untying Aid: Is it working? An Evaluation of the Implementation of the Paris Declaration and of the 2001 DAC Recommendation of Untying ODA to the LDCs," Copenhagen, December 2009.

55) Email communication, Janet West, TAD/XCR, Export Credit Secretariat, OECD, Paris, March 18, 2008.



d) **Corruption and Governance**

What kind of rules govern corruption, democracy, and the protection of human rights when it comes to aid and development finance? The global rules on corruption rest on binding international treaties, particularly the 1997 OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. This convention enjoys the status of law. It made it mandatory for OECD members to make bribery of foreign officials (i.e. kickbacks or corrupt “facilitation payments”) a domestic crime in their countries. The United Nations Convention against Corruption, which came into force in 2005, lifts many of the OECD agreements to the level of international law.

In practice, however, it is a challenge to create a framework for detecting these crimes and punishing offenders. For example, as Transparency International (TI) has noted, OECD members have resisted calls for companies receiving officially supported export credits to name agents receiving commissions; to make the size of commissions public; or to bring facilitation payments (“greasing the wheels”) into the remit of these conventions (Wiehen 2002). A 2009 analysis by TI also pointed out that only four of the 38 countries that had signed the OECD Convention were actively enforcing it. There was “little or no” enforcement by 21 signatories (Heimann and Dell 2009, p. 6).

Further, the Convention itself focuses on combating specific practices by companies. It does not contain broadly agreed rules or standards for engaging with countries whose governments are thought to be highly corrupt. Individual donors, or even agencies within a donor government, might withhold aid from corrupt countries. In the United States, for example, the Millennium Challenge Corporation uses levels of corruption as one of the parameters for assessing whether a country qualifies for assistance or not, but the United States Agency for International Development does

not have such a specific criterion. Furthermore, practices in areas outside of aid suggest problems with application of the convention. As an obvious example, few export credit agencies, if any, have mandated international competitive bidding for the projects they finance.

How solid is the aid and development finance architecture in terms of democracy and human rights? Since the end of the cold war, most donor country governments have embraced the idea that wealthy governments should not provide aid to governments that have come to power by force or through flawed elections, or those that tolerate extensive corruption or human rights abuses. The United States has been a leader in this regard.

In 1975, an amendment to the 1961 Foreign Assistance Act of the United States (Section 116) required the suspension of US aid to countries with a “consistent pattern of gross violations of internationally recognised human rights ... unless such assistance will directly benefit the needy people in such country”. Section 7008 of the Foreign Operations Bill requires the termination of aid to countries whose governments have been overthrown by a military coup or decree. Many other donors have similar provisions.

These principles are also reflected in many regional organisations. For example, Article 30 of the Constitution of the African Union, which entered into force in 2001, states that “Governments which shall come to power through unconstitutional means shall not be allowed to participate in the activities of the Union”. While one of the core principles of the constitution remains “non-interference in the internal affairs” of other member countries, the AU reserves the right to intervene in “grave circumstances, namely, war crimes, genocide, and crimes against humanity”. But the rules for how it should act in the area of foreign aid and development finance are a work in progress.



The European Parliament has accused the European Council of having “double standards” in the application of conditionality based on human rights violations (Bartels 2008). Even in the United States, security concerns and other political and economic ties frequently trump up concerns about election abuses or generalised repression. Defining terms such as “consistent pattern” or “gross violations” or sometimes even “military coup” can be more an art than a science.

Further, the Bretton Woods institutions, which are among the largest sources of development finance, have a much narrower concern with governance. The World Bank has allocated aid to the 78 low income countries eligible for its concessional loans, in part on the basis of their rank on the Country Policy and Institutional Assessment (CPIA). This tool has 16 broad indicators (World Bank 2008). They include “property rights and rule-based governance” as well as “transparency, accountability, and corruption in the public sector.” The CPIA indicators include some protection of human rights (particularly equal rights for women) but there is no reference to democracy, elections, or general political freedoms. This is because World Bank’s Articles of Agreement ban it from interfering in a country’s political affairs or making decisions based on the political character of the member country. The International Monetary Fund has similar restrictions.

In short, although few donors ignore issues of human rights, democracy, and corruption in recipient countries in their allocations of aid, in many cases, the criteria for the allocations are not clear or standardised. No conventions or international agreements provide global rules for how donor countries should act in such situations.

e) Debt

The global architecture for the management of foreign aid debt has four main parts: (1) An agreed

forum for negotiation and rule-making at the Paris Club; (2) specific rules for conditional debt relief for highly indebted poor countries or HIPC; (3) agreement that the World Bank and the IMF are to be “preferred creditors”; and (4) new rules for poor countries regarding the taking on of new debt (the 2005 Debt Sustainability Framework, or DSF).

The debt regime is most formalised for low income countries – those with few alternative sources of capital or political leverage. For these countries, debt relief is normally granted only after countries follow a schedule of conditions that usually include good macroeconomic management (certified by the IMF), some form of economic liberalisation, and, frequently, good governance practices such as budget transparency.

In 1996, the process to further institutionalise these conditions and procedures for HIPC countries began. It was in that year that these countries became eligible to have their multilateral debts reduced or cancelled through an intricate system of rules and benchmarks. The majority of countries in Africa qualify as HIPCs. The DSF imposes sanctions on HIPC countries that take on new debts that do not meet its guidelines on concessionality.

IV. Unpacking Chinese Development Assistance and Other Official Funds

China’s official development assistance is provided through grants and zero-interest loans issued by the Ministry of Commerce, and concessional loans issued by China Eximbank. Several other instruments do not qualify as official development assistance: preferential export buyer’s credits, mixed credits, and commodity-backed infrastructure credits.

IV.1 Official Development Assistance

China has financed more than 900 foreign aid projects in Africa since the early 1960s. In 2007



alone, the Chinese signed 154 aid contracts in 48 African countries (Coordination Office of Department of Western Asian and African Affairs 2008: 488). Most of these have been simple turnkey projects: a building, a bridge, or a health clinic, financed through grants or zero-interest loans offered by the Ministry of Commerce.

China's foreign aid grants and zero-interest loans usually promote broad diplomacy objectives, while the concessional foreign aid loans operated by China Eximbank mix diplomacy, development, and business objectives. Because of the significance of aid as an instrument of diplomacy, Chinese aid is spread across every country in Africa with which China has diplomatic ties, including those that are wealthier, such as Botswana, Namibia, Mauritius, and South Africa (Brautigam 2008). At the same time, China uses concessional lines of credit to promote exports of goods or turn-key projects in creditworthy countries that can repay the loans, or for bankable projects in less creditworthy countries.

China has its own definition of what constitutes "external assistance". Its definition has evolved separately from the one used by the OECD's DAC. In several instances, items that the OECD/DAC count as "official development assistance" (ODA) are not included as foreign aid in Chinese practice, and vice-versa. China's budget for external assistance includes military aid and loans for some joint venture investments. It excludes scholarships for students studying in China. DAC rules do not count assistance in support of private investment, or military aid, as ODA, but scholarships count.

On the other hand, the concessional loan programme operated by China Eximbank has clearly been designed to reflect the norms of the OECD/DAC for official development assistance.

As the website of China Eximbank explains, concessional loans are "...medium and long-term, low interest rate credit extended by the China Eximbank under the designation of the Chinese government, to the government of the borrowing country with the nature of official assistance" (i.e. ODA). The objective of these loans is to "promote economic development and improve living standards in developing countries," and to "boost economic cooperation between developing countries and China." Examples of areas that can be financed by concessional loans are energy, transportation, telecommunication, manufacturing, mining, health care, and housing. Projects need to have "good social benefits" and use Chinese enterprises as contractors or exporters⁵⁶. These loans are always denominated in Chinese currency, and they would qualify as ODA.

However, three other instruments of development finance offered by China Eximbank have created some confusion about what should be termed as "aid" or official development assistance (ODA), and what should not: (1) Preferential export buyer's credits; (2) mixed credits; and (3) commodity-backed lines of credit. From what we know about the terms of these instruments, none would qualify as ODA. As the discussion below explains, much of what is believed by outside observers to be aid from China is actually a market-rate line of export credit.

IV.2 Preferential Export Buyer's Credits

Preferential export buyer's credits are export credits that are negotiated to have a better-than-market rate. They are subsidised, but their primary purpose, as the name suggests, is to promote Chinese exports. Therefore, they would not qualify as ODA under the DAC rules (China also does not classify them as "external assistance"). Preferential export credits can be offered at lower than market

56) China Eximbank, "Chinese Government Concessional Loans," <http://english.eximbank.gov.cn/business/government.jsp> [accessed May 5, 2009].



(usually two or three percent), to support specific deals such as the purchase of Chinese commercial airplanes (Zambia) or a Chinese satellite (Nigeria). These loans are always denominated in foreign currency, (usually, US dollars).

In 2006, China Eximbank provided a preferential export credit for US\$200 million to finance Nigeria's purchase of a Chinese satellite. This loan was made at 3 percent interest, with a management fee of 0.2 percent, and a commitment fee of 0.3 percent per annum. With a grace period of four years, the loan was scheduled to be repaid by 2014⁵⁷. In 2007, Chinese leaders offered Namibia US\$100 million in a preferential export buyer's credit along with a RMB 1 billion concessional loan, RMB 30 million grant, and RMB 30 million interest-free loan. These instruments were later used separately in Namibia, although in other countries, such as Pakistan, they have been combined into a mixed credit for a single project.

IV.3 Mixed Credits

In 2006, the Chinese Eximbank announced that it had developed a "package financing mode" that would combine lines of export buyer's credits (given to a borrowing country), export seller's credit (short-term credits given to a Chinese company), and concessional loans (foreign aid), to be offered together, but not always, for a specific

project. In 2006, the Eximbank signed preliminary agreements on package financing with Congo-Brazzaville, Ethiopia, Equatorial Guinea, Nigeria, and Mauritania. Not all of these packages were used. The bank was also negotiating packages with Ghana, Namibia, and Eritrea. This model of package financing parallels the mixed credits used by OECD countries.

IV.4 Commodity-Backed Loans and Lines of Credit

A third model of market-rate finance involves the issue of a line of credit, or a single loan for infrastructure, with repayment arranged through commodity exports. These commodity-backed loans are believed to be widespread, when in fact they are relatively rare. As of late 2009, only seven African countries had actually used large, commodity-backed lines of credit from China Eximbank for infrastructure projects, while three other countries were still negotiating packages⁵⁸. Almost all of the commodity-backed loans and lines of credit have been on market-terms.

Four models of commodity-backed finance exist. In the first model, a single project is secured by commodity exports. Ghana's Bui Dam, Congo-Brazzaville's Imboulou Dam, and Nigeria's Papalanto gas-fired power plant are examples⁵⁹.

57) Personal communication, Debt Management Office, Federal Government of Nigeria, May 2009.

58) Angola (2004, 2007: \$4.5 billion in infrastructure lines of credit at market rates/backed by oil. Additional lines of oil-backed infrastructure credits were offered by a private, Hong Kong based company, China International Fund); Equatorial Guinea (2006: \$2 billion infrastructure line of credit/backed by oil; terms unknown); Democratic Republic of the Congo (2008): \$6 - 9 billion line of credit at market rates, infrastructure & mining/backed by copper-cobalt; Nigeria (2002: Omotosho and Papalanto gas power plants/secured by one year of oil exports; 2006 \$2 billion line of credit at market rates, and \$500 million at preferential rates; both expired without being used); Congo-Brazzaville (2001: hydropower dam/backed by oil); Sudan (various infrastructure/oil secured); Ghana (2007: dam/backed by cocoa). According to the World Bank study, two other projects were at various stages of discussion that would build infrastructure to facilitate export of a resource, possibly to China (Botswana coal/railroad; Mauritania phosphates/railroad). It was not clear whether or not these involved natural resources as security for the loans. Three other large loan packages remain at various stages of negotiation, hampered both by the financial crisis and by crises individual to each country: Gabon (infrastructure & mining/iron ore); Guinea (infrastructure & mining/bauxite); Zimbabwe (chromium/platinum). World Bank, *Building Bridges* (2008).

59) Foster, Butterfield, Chen, and Pushak 2008, pp. 26; 57.



In the second model, a line of credit is offered for development infrastructure (schools, water systems, housing) and repayment is secured by a country's export commodities. Lines of credit for at least \$4.5 billion in Angola (below), and \$2 billion in Equatorial Guinea are examples. These lines of credit parallel oil-secured loans offered by Western Bank consortia. There is no hard evidence that Chinese (or Western) companies received preferential access to a resource concession because of these particular lines of credit. A third type does involve a Chinese company gaining preferential access to a concession, usually in a joint venture with the host government. Chinese banks provide finance to develop the resource, including associated energy and transport links. The Belinga iron ore mine under negotiation in Gabon is this type of project. In a fourth model, a variation of model three, the preferential access is combined with a different line of credit that can be used for general development-related infrastructure unconnected to exploitation of the resource (as in the DRC case discussed below, for example). This credit is also repaid from the resources produced by the concession.

Although they do not qualify as official aid, these commodity-backed infrastructure lines of credit and loans, though relatively rare, epitomise what the Chinese mean when they talk about “win-win” cooperation. A country uses its export commodities to attract and guarantee an infrastructure loan from China on better commercial terms than it is likely to get from commercial banks (see below). The business for Chinese contractors engendered by these packages may be as important as the ties to natural resources. For example, Chinese

contractors signed construction contracts in Africa worth \$40 billion in 2008 (Ministry of Commerce 2009). In fact, these complicated packages seem often to be initiated by either the China Eximbank, or the Chinese engineering contractor that wants to win the business. China's petroleum companies and state-owned mineral firms which have been investing across Africa generally seem to shy away from these complicated packages, preferring to bid in auctions, obtain concessions directly, or purchase shares of existing oil/mineral companies.

Although there is much speculation that the practice is widespread, the existing evidence suggests that China does not use its official foreign aid to support bids for oil investments or natural resource concessions⁶⁰. Three of most highly publicised examples (described below) are part of the confusion over this issue. Each was widely believed to involve Chinese official aid, but actually involved market-based export credits, signing bonuses, and other commercial transactions.

Angola: Several rounds of oil-backed infrastructure loans used in Angola were issued by China Eximbank at market rates: London Interbank Offer Rate (LIBOR) plus a margin (usually 1.5 percent). The first of these infrastructure framework agreements was signed in late 2003, and the first package of projects approved in March 2004 (Campos and Vines 2008, p. 6). Although financed at non-concessional rates, the loans paid for the rehabilitation of Angola's war-ravaged infrastructure – electricity, railways, telecommunications, hospitals, secondary schools, polytechnics, water treatment plants, and irrigation. They also financed

60) This issue is discussed further in Deborah Brautigam, *The Dragon's Gift* (Oxford University Press, 2009), pp. 277-281, which presents evidence from a large database that maps Chinese official aid commitments across Africa. The pattern of aid commitments was fairly evenly spread across resource-rich and resource-poor countries, suggesting a general goal of building diplomatic good will. It would be difficult to document unofficial tying of aid to a special resource deal for a Chinese company. Yet despite much speculation in the media, there exists no smoking gun of a “quid pro quo” of official aid being conditional upon a resource concession for a Chinese company. We identified one case, in 1995, of a joint venture in Sudan's oil fields being supported directly by a Chinese Eximbank foreign aid concessional loan.



imports of Chinese agricultural machinery, fishing boats, and coast guard vessels.

DRC: In 2007, the DRC signed initial agreements on a very large package project initiated by two Chinese construction firms, China Railway Engineering Corporation (CREC) and Sinohydro, with partial finance from the China Eximbank. Two successive tranches of Eximbank finance, \$3 billion each, were originally slated to pay for post-conflict reconstruction infrastructure: 3402 km of paved roads, 3213 km of railway construction or rehabilitation, 145 health centers, 31 hospitals, 5000 units of low-cost housing, and 2 universities (République Démocratique du Congo 2007). The infrastructure loans were to be secured by a copper-cobalt mining venture, of which the Chinese would own 68 percent. The Chinese companies agreed to pay a signing bonus of \$350 million, of which \$250 million would go directly to the Congolese state. The companies also arranged financing for the mining investment, estimated at \$3.25 billion. The post-conflict infrastructure construction loans were to be made at LIBOR plus 1%, while the mining venture was financed through a combination of shareholder equity and loans, with the majority at a fixed interest rate of 6.1% (Lumbi 2008). Negotiations between the International Monetary Fund, the World Bank, and the Congolese government succeeded in reducing the commitment to finance infrastructure from two \$3 billion tranches to one, and removed the government guarantees from the loans for the mining venture.

Nigeria. In 2007, China Eximbank made an offer to Nigeria of a \$2 billion line of credit at a very competitive commercial rate to finance infrastructure projects in

connection with preferential access to oil blocks⁶¹. Separately, the Chinese government offered Nigeria a \$500 million preferential line of export credit for uses to be determined between the two sides. There was no ODA involved in the discussions or in the package. Some sources have stated that the \$2 billion was offered on concessional terms (Vines, Wong, Weimar and Campos, 2009: 23). However, other sources disagree. An exclusive April 2009 interview with Nigerian president Yar'Adua printed in *The Guardian* (Lagos) commented that he had also believed it to be concessional. However, "[w]hen I visited China and we discussed, I was told this 500 million dollars was given on concessionary rate from the Chinese government but the \$2 billion dollars was given at commercial rate from the Chinese Exim Bank."⁶² The proposed "infrastructure-for-oil" deal fell through. The framework agreements and memoranda of understanding on both lines of credit would normally have expired after two years, although the Chinese government later extended the \$500 million preferential export credit offer until 2010⁶³.

As this brief discussion indicates, none of these offers of credit or actual loans appear to involve China's official foreign aid (ODA). They should be viewed as examples of credit for investment, or for trade. Nevertheless, although they do not involve ODA, the benefits of resource-secured loans are obvious as an instrument for development. The country is able to use its natural resource exports for infrastructure, construction of which usually begins almost immediately. For projects that also finance the development of a natural resource, as in the DRC, the venture, usually a joint mission

61) Author interviews, Nigeria, May 2009.

62) "Umaru Yar'Adua: President ... on a mission incredible," *The Guardian* (Lagos) April 29, 2009. The proposed exchange of the line of credit for preferential access was also confirmed in author's interviews with Chinese authorities in Nigeria, May 2009, as well as the failure of the proposed package.

63) Interview, Chinese embassy, Abuja, Nigeria, June 2009. This was possibly to assist in the effort to restore the suspension of a large contract awarded to a Chinese construction company to rebuild the Lagos-Kano railway



with the local government, begins to repay the infrastructure loan and the costs of developing the resource using the proceeds from the mine or oil wells. The practice also helps as an “agency of restraint” against embezzlement. The financing essentially stays within China, being used to pay a Chinese exporter of goods or for construction services. It operates as a line of credit, not as a blank cheque deposited into the borrower’s bank account. In addition, the signing of a memorandum of understanding or even a framework agreement for a line of credit, should not itself be an indication of a formal loan commitment. Loans must be signed individually for individual projects, each of which should be appraised separately.

The downside is that when the same companies develop the resource and do the infrastructure projects without competitive bidding (Angola does require that three pre-approved Chinese companies bid on each project), there is a huge risk that the country might not get value for money on the infrastructure projects. Without safeguards, the selection of projects might be made on the basis of political patronage rather than need. Marketing of the resource needs to be transparent to ensure correct pricing. Little is transparent in the few projects that already exist. In some cases, leaders ran these systems directly out of their own offices by-passing existing institutions.

At the end of the day, the structure might be seen as an improvement over the current system in many weak states, where natural resources are exported and the proceeds disappear into off-budget accounts, from where they are eventually transferred to off-shore accounts.

Further, some steps have been taken to address concerns raised above. In the case of Equatorial Guinea, for example, foreign architects were brought in to evaluate the work to ensure quality control (Esteban 2009). In Angola, the Ministry of Finance published details on the internet about the budget for infrastructure projects being completed under the loan, and used an independent third party to oversee construction. The president’s office and executive branch in the DRC has engaged extensively in discussions with the DRC parliament to answer their questions about the package there⁶⁴. More of moves like these should ameliorate some of the risks engendered by lack of transparency.

V. Chinese Aid and The International Aid Architecture

A few studies have begun to address the possible impact of China’s engagement on the international aid architecture. Humphrey and Messner (2006) note that China’s rise could challenge the priorities and agenda-setting success of the industrialised countries, and undermine the credibility of their advice and message. Particular areas in which China’s influence might be felt include the power and governance structure of the Bretton Woods institutions; the dominant ideologies and prescriptions that currently shape recommended development policies and strategies; and the evolving standards in arenas such as human rights and the environment. They also point to many unknowns. “Just how China’s development diplomacy will work out is far from clear (2006, ii).”

Bräutigam (2008; 2009b), Davies (2008) and the Centre for Chinese Studies (2008) all provide

64) See, for example, documents on the DRC presidential website, including «La Communication officielle du Gouvernement présentée par le Ministre des Infrastructures, Travaux Publics et Reconstruction sur les critiques et observations des Députés lors de la présentation de ces accords à l’Assemblée Nationale,» http://www.presidentrdc.cd/chinois_et_nous.html [accessed September 3, 2009].



overviews of China's African aid programme. All three studies outline the general concerns raised by Chinese aid practices, particularly the issues of governance and corruption, debt sustainability, and aid effectiveness. In an article focusing on China and the international aid architecture, Stähle (2008, p. 130) picks up the issue of Chinese competition, noting concerns about competition between China's development ideas (called by some the "Beijing Consensus") and those known as the Washington Consensus. Stähle contrasts aid from China with those from the traditional donors, who, he contends, have agreed in principle that the goal of aid should be to reduce poverty, foster good governance, liberal democracy, and market economies, without harming the environment. On the other hand, some observers argue that finance from China may help to counter the "power of the World Bank and the International Monetary Fund to impose strict and often ill-suited economic policy conditions on their borrowers" (Bosshard and Brewer 2008, p. 3).

A study by the Centre for Chinese Studies (2008) notes that China has increasingly aligned its statements on partnerships with Goal 8 of the United Nations' Millennium Development Goals (pledging better partnerships between aid donors and recipients). The study recommends that China should practice greater transparency in its aid and finance agreements.

Below, we look more deeply into the different principles that inform China's approach to aid in seeking to elaborate how it compares and contrasts with the global aid architecture.

V.1 Institutions and Actors

China is in an unusual position, being both a recipient of aid within the global aid architecture,

and a donor. The institutional structure of China's aid and export credit system resemble several others in the OECD system, in particular, the aid/export credit systems prevailing in two other powerful exporting countries: Germany and Japan.

V.2 Definitions, Volume, and Composition

Aid figures for donors that are members of the DAC are reported and published annually. In 2007, the United States was the largest DAC-reporting donor to Africa. In that year, the country gave out \$7.6 billion in official development assistance. The World Bank was second, with \$6.9 billion, followed by the EC with \$5.4 billion, France was ranked fourth that year after donating \$4.9 billion.

China does not report its aid to the DAC, and estimates of its ODA are often vastly exaggerated. For example, some reporters have written, mistakenly, that China's loans to Africa were "three times" larger than *all* aid to the continent from OECD countries (Harman 2007). In fact, although all areas of Chinese external economic relations (trade, investment, finance) with other developing countries have risen sharply (trade declined in the wake of the global financial crisis of 2008-2009), official *aid* figures remain relatively modest⁶⁵.

In 2008, Chinese Premier, Wen Jiabao, announced that over more than 50 years, China had provided a total of \$30 billion in official aid to other developing countries, including grants worth approximately \$13.3 billion. Historically, Asian countries, particularly North Korea and Vietnam, have received the bulk of aid from China. African countries received about \$5.7 billion (RMB 44 billion) in aid from China (Zhang 2006). These figures, however, are not very useful as they simply add the aid year after year without accounting for inflation.

65) Researchers at the World Bank with access to internal data on debt reporting concluded that Chinese loans made to Zimbabwe were non-concessional, and the total of loans and grants was relatively modest (Foster, Butterfield, Chen, and Pushak 2008, p. 46).



The aid figures reported by the Chinese are not calculated using the standard reporting categories applied by the members of the Development Assistance Committee (DAC) of the OECD and thus they are not truly comparable. Most importantly, the Chinese aid figures include only the Ministry of Finance's interest subsidy for concessional foreign aid loans from China's Eximbank rather than the full face value of the loans, as is the practice for the DAC. However, we can estimate China's assistance as it would be if China reported it using the DAC's ODA categories⁶⁶. Relying on Chinese sources for figures on concessional loans and other external assistance, it can be estimated that China's official aid to Africa, not including debt relief, was approximately US\$850 million in 2007, \$1.2 billion in 2008, and \$1.4 billion in 2009, making China one of Africa's main bilateral donors, but by no means the largest.

There are no breakdowns for the composition of Chinese aid by value, but reports from China on the country's aid make it clear that the primary sector financed through aid is infrastructure, ranging from bridges, roads, and water systems, to the so-called "prestige" projects, such as stadiums, conference halls, and Ministry of Foreign Affairs buildings. Productive activities such as agriculture have also been important areas for aid. Both of

these sectors have received relatively little aid in recent decades from the DAC donors, although the trend has recently begun to reverse.

V.3 Instruments and Modalities

The main financing instruments for Chinese aid and export credits are already outlined in earlier pages. Aid from China and the OECD countries are programmed in similar ways, including technical assistance, food aid, debt relief, humanitarian assistance, and so on. The Chinese rarely give budget support, and they do not contribute to common pool "basket financing" of sectors, which is a growing trend among the OECD donors.

Principles governing the modalities of how aid is delivered include those embodied in the 2005 Paris Declaration on Aid Effectiveness, which emphasised that aid should be given in ways that support ownership, harmonisation, alignment, results, and mutual accountability. Since 1964, the delivery of aid from China has been governed by eight principles (Box 10), which emphasise some of the same ideals enshrined in the Paris Declaration. In many ways, Chinese aid supports country ownership well, financing projects desired by governments, but which other donors have declined to finance. An example is the Bui Dam in Ghana.

Box 10: Eight Principles for China's Aid to Foreign Countries (1964)

1. The Chinese Government always bases itself on the principle of equality and mutual benefit in providing aid to other countries. It never regards such aid as a kind of unilateral alms but as something mutual.
2. In providing aid to other countries, the Chinese Government strictly respects the sovereignty of the recipient countries, and never attaches any conditions or asks for any privileges.
3. China provides economic aid in the form of interest-free or low-interest loans and extends the time limit for repayment when necessary so as to lighten the burden of the recipient countries as far as possible.
4. In providing aid to other countries, the purpose of the Chinese Government is not to make the recipient countries dependent on China but to help them embark step by step on the road of self-reliance and

66) For an explanation of the methodology used in estimating China's ODA, see Brautigam 2009b, pp. 162-188.



independent economic development.

5. The Chinese Government tries its best to help the recipient countries build projects which require less investment while yielding quicker results, so that the recipient governments may increase their income and accumulate capital.
6. The Chinese Government provides the best-quality equipment and material of its own manufacture at international market prices. If the equipment and material provided by the Chinese Government are not up to the agreed specifications and quality, the Chinese Government undertakes to replace them.
7. In providing any technical assistance, the Chinese Government will see to it that the personnel of the recipient country fully master such technique.
8. The experts dispatched by China to help in construction in the recipient countries will have the same standard of living as the experts of the recipient country. The Chinese experts are not allowed to make any special demands or enjoy any special amenities.

Source: Speech by Chinese premier Zhou Enlai, Accra, Ghana, January 15, 1964.

Although not enshrined in the Paris Declaration, it has been common practice among DAC donors to attach extensive political and economic conditions to their aid. As noted in Box 10, the Chinese promise that they give aid without requiring political or economic conditions, and that they will not intervene in the internal affairs of other countries. On the other hand, some conditions do apply. Aid and bank credits from China are largely tied to goods and services from the country, and are only given to nations with whom China has diplomatic ties.

V.4 Rules and Standards

This section discusses in deeper detail, several of the rules and norms of aid as earlier identified, considering the impact China could have (or is already having) on these aspects of the global aid architecture. For reasons of space, the chapter analyses only a subset of these emerging rules and principles.⁶⁷

a) China and the OECD Arrangement on Officially Supported Export Credits

OECD donors have a long history of using ODA to support exports. As recently as the mid-

1990s, Germany directed 85 percent of its ODA to infrastructure projects, rail, and ships that used German firms and technologies (Evans and Oye 2000, p. 129). However, although the OECD norms on the use of foreign aid in officially supported export credits are voluntary, they have been successful in gradually bringing conformity into a contentious area.

As noted above, links between aid and exports began to be reduced when, after long negotiations, the OECD members agreed to the 1978 Arrangement on Officially Supported Export Credits, and its extension in the 1992 “Helsinki Package”. Today, the revised Arrangement, a “gentleman’s agreements”, stipulates:

- (1) No concessional export credits for wealthier countries above a certain income level (such as Botswana, Gabon, or Brazil);
- (2) No concessional export credits for “commercially viable” projects, which must be at specific Commercial Interest Rates of Reference (CIRR);
- (3) When allowed, concessional export credits must be given at least 35 percent as a grant, calculated

67) These three topics were selected by the directors of this project from a longer list.



using the relevant commercial interest rate in the exporting country (CIRR) as comparison. Sometimes referred to as “tied aid”, this definition of “aid” is different from the definition of “official development assistance” used for the DAC. Thus, only commercially non-viable projects in lower income countries are eligible for concessional export credits (“tied aid”).

In 2005, at a UN meeting on financing the Millennium Development Goals, China’s president, Hu Jintao, announced that the country would provide developing nations with \$10 billion in concessional loans and preferential export credits. A year later, Africans learned that their countries would receive half of this: \$3 billion in concessional loans, and \$2 billion in preferential export buyer’s credits. This offer of what looked like “tied aid” heightened concerns that the Chinese might not play by the rules developed for concessional export credits by the OECD countries.

Many years ago, Europe, the US, Canada, and Japan regularly had trade disputes concerning tied aid. In the context of export credits, tied aid is considered somewhat separate from the issue of general tying of aid to domestic goods and services. It is defined as “aid credits for which the motivation is significantly connected to promoting the sale of goods from the donor government’s country” (Export-Import Bank of the United States 2003, p. 112). In one account:

These are big-ticket items, important for job creation and economic growth, [creating] strong economic and political incentives for governments to sweeten export credits to improve their export competitiveness. In the past, this was done subsidising interest rates and prices charged for credit risk or by combining development aid with export credits to create “mixed credits”. These soft

loans are often tied to purchases from the donors (Evans and Oye 2000, p. 116).

As noted above, for OECD countries today, no tied aid is allowed for exports to middle income countries. Low-income countries can only get concessional loans for commercially nonviable projects. Although the Arrangement’s limit of tied aid to commercially nonviable projects might seem to mean that concessional loans can only be used for projects like the construction of primary schools or health clinics, in the real sense, many kinds of projects are considered commercially nonviable, including power transmission lines, telecommunications systems in rural areas, roads and bridges, airport terminals, water treatment and sanitation, housing, and urban rail and metro systems. Tied aid is allowed for these, but at controlled rates that must be reported to the OECD, but not to the public.

In much of Africa, OECD countries are limited to offering only standard commercial rate export credits for power plants, urban telephone systems, and manufacturing equipment. The Arrangement is supposed to ensure that exporting countries compete for business on the basis of the merits of their goods and projects, rather than on the financing package. Aid for capital goods and construction services was supposed to be limited to projects and countries that could not attract commercial loans.

These reforms seem to benefit exporters rather than recipient countries, which quite likely ended up paying more for the commercially viable projects like power plants, once the Arrangement eliminated tied aid for projects such as these. But advocates of the system also saw it as a way to reduce “white elephant” projects (those entered into not because of local needs, but because of an exporter’s promotion or even kickbacks to government officials), and inject more competition.



China Eximbank is clearly well aware of the evolving norms for export credits. Several years ago, the text of the Arrangement was translated into Chinese. China Eximbank's website stresses that even though China is not a member of the OECD, its export buyers' credits "generally" follow the Arrangement. At the same time, the Chinese believe that companies in wealthier countries got a head start with assistance from their governments, under rules that were changed before Chinese firms became global players. For example, the United States' Eximbank was established in 1934, and China's Eximbank sixty years later. The Chinese are unlikely to agree to put their new multinational companies on a level playing field without spending a few more years learning how to manage their drive to "go global".

This issue will continue to be a bone of contention between China and the OECD countries. But it need not be a loss for developing countries, which could enjoy the benefits of more competition for the power projects and other infrastructure, and the possible lower prices. To ensure that developing countries win, their governments need to insist that all procurement be subject to competitive bidding. Chinese bids could follow current OECD practice by including pledges or guarantees of official export credits. If procurement is not done through international bidding, government officials should take the time to investigate comparable products and services in order to ensure that an offer is actually good value for money.

b) China, HIPC, and the Rules on Debt

The most frequently expressed concerns over China's role in the system of debt management come from the OECD countries. They involve fears over debt sustainability, "free-riding", China's lack of conditionality for debt relief, and the problem posed by the country's commodity-backed loans for the IFI's preferred creditor status. None of these

concerns have been central to African critics of China's role. However, should Chinese lending, combined with the weaknesses generated by the 2007/2008 global financial setback provoke a "new debt crisis", all countries' access to credit would suffer.

The free-riding issue arose from concerns that China was "taking advantage" of debt cancellation by giving loans to countries whose balance sheets were lightened by cancellation of debts paid for by the OECD states.

Debt sustainability is also an issue. In 2005, after nearly a decade of HIPC debt relief, the World Bank and the IMF jointly adopted a "Debt Sustainability Framework" that aimed to protect low income countries from taking on new loans (like those from China) without being able to properly manage the debt. A second goal of the policies was to forestall the possibility of grants and debt relief from the World Bank being used to subsidise less concessional borrowing (World Bank 2006). All multilateral development banks, export credit agencies, bilateral donors, and commercial creditors were asked to "adhere to the framework", making it a powerful norm. Countries breaching the concessionality guidelines would be sanctioned by either reduced access to concessional finance through the World Bank, or by harder terms, such as higher interest rates and/or shorter repayment periods. No sanctions were proposed for lenders who violated the guidelines.

While the debt management issue is an important point, critics of this policy note that one of the roles of the World Bank as a subsidised public institution, has traditionally been to catalyse investment and finance from other sources. They also note that the DSF may push some low income countries to conceal their borrowing from countries like China so as to avoid a sensitive topic with the World Bank (Reisen and Ndoye 2008).



The principles of Chinese aid (Box 9) note that Beijing will reschedule aid debt on request, although there is no such principle for commercial debt or export credits. Rescheduling aid debt was done multiple times in some countries. Starting in the 1980s, the Chinese dealt with the unpaid debts for some productive ventures (mainly factories) by swapping them for equity shares in the projects. But although China lacked any leverage to compel repayment, the debt was almost never cancelled outright. Rescheduling, even for a year, has involved the signing of formal agreements.

Starting in 2000, this changed. By 2009, China had either cancelled or pledged to cancel about \$2.7 billion in overdue debt from African countries – about 60 percent of the amount owed (Qi 2007). China's debt relief resembles the Paris Club HIPC norm in that it is targeted at low income and least developed countries. Mauritius, for example, with an excellent record of repaying its debts, received no debt relief. Zimbabwe, which is not a HIPC, also received no debt relief. Highly indebted Zambia reportedly received \$211 million. There are no HIPC-style conditions imposed for debt cancellation, however. Countries have to request it. The process is not automatic, and it is only available for countries that have continued to have diplomatic relations with Beijing. Chinese announcements make it clear that only overdue debt is cancelled, and the debts are those linked to loans proffered for specific foreign aid projects. Announcements of 156 “debts” cancelled by 2002, 172 debts by 2005, and 154 in 33 African countries by the end of 2007 make this very specific (Wu 2007).

With regard to debt sustainability, China Eximbank president, Li Ruoguo, has argued that his bank takes debt sustainability into account when making loans. But he has also emphasised that his bank's lending is based on development sustainability

(Li 2007). He has argued that the IFI's debt sustainability analytical framework is too static, a concern shared by some African borrowers who believe that investments in infrastructure such as power, even if financed at a commercial rate, will increase their ability to repay loans, changing the assumptions under which sustainability is calculated.

An OECD study pointed out that in Angola and Sudan, Chinese investment and the higher prices stimulated by China's demand for raw materials seem to have contributed to the considerable improvement seen in debt-distress indicators in both countries (Reisen and Ndoye 2008, p. 30). In Angola, total debt dropped from 100 percent of GDP in 2000 to 30 percent in 2006. In Sudan, it dropped from 162 percent to 75 percent, even when actual debt numbers were rising. In late 2009, Angola announced that it was seeking its first bond rating from Standard & Poors in preparation for a Eurobond issue of between \$500 and \$4 billion. This was another sign that Angola's large Chinese loans may not have unduly impaired its debt position (Mendez 2010).

c) China, Conditionality, and Standards

It is widely believed that official finance from the OECD countries and multilateral development banks conforms to an agreed set of standards on governance, good economic policy, and social and environmental protections. As one report puts it, China's engagement in Africa “may unpick the carefully knitted deal between the West and key African players for economic liberalisation accompanied by ‘good governance’, leading to stability” (*Africa Research Bulletin* in Taylor 2007, p. 959). The Chinese position was summarised by Liu Guijin, China's special envoy for Africa, in 2008. He said (in Morris 2008): “We don't attach political conditions. We have to realise the political



and economic environments are not ideal. But we don't have to wait for everything to be satisfactory or human rights to be perfect."

We can disaggregate the issue of standards into two areas. The first would be standards applied to specific loans, such as the protection of environmental and social rights in an irrigation, hydropower, or road project, that might involve resettlement, and so on. The second would be country-level conditionality in which decisions to lend (or not) might be made on the basis of quality of governance or economic policy in a country. In both areas, standards are informal and work in progress.

Social and Environmental Standards

As noted above, the standards for socially and environmentally responsible project appraisal are becoming more concrete. They are supported by the Equator Principles as well as lending guidelines in use by all the traditional donors. Extending beyond aid into private finance, they have broadened into principles that can be regarded as widely shared, even if their application in areas such as private lending or official export credits are still far from perfect.

There is some evidence that as Chinese domestic awareness has been raised on environmental issues, China's overseas financing may also raise its standards. At present, Chinese projects overseas use either China's own standards, or those of the borrowing country, not the standards that have evolved over time in the richer countries. However, standards on the environment are rapidly changing within China. China's State Environmental Protection Agency (SEPA) adopted the Equator Principles in January 2008. In March 2008, China's State Council established a new "super ministry" of Environmental Protection, reflecting leaders' growing concerns

about the impact of pollution, energy consumption, and global warming on China, as well as concerns about pressure on China to reduce its share of the problem.

These are now being reflected in China's development finance. The Chinese Academy for Environmental Planning has drafted environmental guidelines for Chinese companies involved in aid and overseas investment (Li 2008). According to one report, China Development Bank (CDB) had pledged to apply the "highest standards, including social and environmental impact assessments to companies benefiting from its funding" (Wissenbach 2007, p. 7).

Although CDB does not give foreign aid loans, this may be reflective of current thinking in the Chinese government. In July 2008, China Eximbank published new guidelines for social and environmental impact assessments, aligning the bank's approach with the central government's "Green Credit" policy, and including land rights and resettlement as new concerns (Matisoff and Chan 2008, p. 47). The Exim-bank's new guidelines are the strongest signal yet that China's largest providers of development finance understand the standards at work in shaping development finance in more socially and environmentally responsible ways, and that in principle, at least, they agree. Yet, as critics have noted with other export credit agencies, there can be a wide gap between guidelines and actual project funding. Without considerable more transparency, it will be difficult to know the extent to which these guidelines are actually applied by China.

Governance Standards

There is a concern that the rise of China as a significant source of finance presents a threat to improved governance in Africa. These concerns center on two issues: (1) Chinese finance may fuel



corruption directly through the transfer of large funds to poorly governed regimes (the resource curse); (2) it could provide a financial lifeline to repressive, authoritarian governments that might otherwise be forced to bow to sanctions or governance conditionality.

It is well known that the Chinese do not impose any conditions on governance or human rights before financing projects in other countries, regarding this as interference in the internal affairs of others. China is not an OECD member, and is therefore not a signatory to the OECD Corruption Convention. Even though, it has ratified the UN Convention against Corruption that requires similar legal reforms (Bräutigam 2009a). Chinese aid projects organised by MOFCOM use competitive bidding to select Chinese companies, but there is a different system for the concessional loans provided by the China Eximbank. These tend to work either as lines of credit or as finance provided to a single project, usually proposed by a Chinese company.

In the case of the former, a good example would be the \$58 million credit offered to Zimbabwe and channelled through a company called Farmer's World. The company's officials then travelled to China to select agricultural equipment and machinery to be imported under the loan, with all payments going from the Chinese bank to the Chinese exporters. An example to support the latter case would be the rural telecoms project proposed by a Chinese company in Sierra Leone and later financed by a concessional aid loan.

While Farmer's World was able to do comparison shopping in China, the Sierra Leone project ran the risk of not receiving the best value for money, as there was no competitive bidding. On the other hand, the Chinese almost never transfer any actual money through their loans, and only rarely give aid as cash grants. Keeping the money in China

through payments to Chinese companies and their subcontractors authorised by the borrowing government actually aids in avoiding large-scale embezzlement of funds, although kickbacks might still take place.

With regard to democracy and human rights abuses in countries such as Sudan and Zimbabwe, the Chinese position is generally that once development is achieved, standards, rights and rules would fall into place. They also argue that "standards need to be worked out by Africans, not imposed by outsiders" (Liu Guijin in Wissenbach 2007, p. 4).

The Chinese position is far from consistent with the norms that have evolved in Europe and North America, even if those norms are unevenly applied in practice. Yet the Chinese respect for sovereignty, while also convenient for Chinese companies, appears to be closer to the African norm. For example, the Chinese have generally followed the lead of prominent countries in Africa (South Africa) and African organisations, particularly the African Union, in their positions on governance issues, in the United Nations. Despite the problems in Zimbabwe, no government has actually imposed sanctions that would impede their companies from trading with or investing in that troubled country. A limited arms embargo is an exception.

Legal sanctions and embargoes have been more restrictive for Sudan, where the government has been accused of brutally suppressing a rebellion in Darfur. Yet there is also nothing like a global set of rules regarding Sudan. A limited UN-sanctioned arms embargo and a full EU arms embargo are in place. The United States is nearly alone in imposing a full trade embargo on Sudan, and has also prohibited US firms from participating in the petroleum and petrochemical industry in the country. In general, other western companies



that have left Sudan have done so not because of sanctions but because of effective pressure from advocacy groups or their own concerns about security, stability, and justice.

V.5 Chinese Cooperation with Other Donors

So far, the Chinese have been reluctant to participate in established donor-led groups (such as the Paris Club, or the Consultative Groups) in part because they generally do not see aid from the West as having been very effective in reducing poverty in Africa. But there have been a number of cases of tripartite cooperation, including the South-South Cooperation Programme run through the Food and Agriculture Organisation's Food Security Programme.

China contributed 514 experts and technicians to Nigeria under the first five-year phase of this programme. That was from 2003 to 2007. Sierra Leone has also hosted Chinese teams under the FAO tripartite programme. The Chinese have a history of working cooperatively under the UN umbrella. This may offer a more promising way to engage them.

The OECD's DAC has a China-DAC study group with participants from China and the major donor agencies. The China-DAC Study Group and the International Poverty Reduction Center of China have sponsored several mutual learning events focused on China and Africa, in Paris, in Beijing, and in Bamako, Mali. The British aid agency, the Department for International Development (DfID) has taken the lead among bilateral donors in engaging the Chinese. For example, DFID has asked its Africa missions to try to "build relationships" with Chinese counterparts (DFID 2007). It has also invited the Chinese Ministry of Commerce's Department of Foreign Aid to send an observer to participate in a peer review of the DFID aid programme being undertaken by the OECD-DAC. The Chinese ministry has obliged.

DFID has sponsored several research projects in order to learn more about the subject. In that respect, they have held several workshops. In March 2008, for example, together with Canadian International Development Agency (CIDA), the World Bank Institute, and the International Poverty Reduction Centre in China, DFID co-sponsored a workshop to share aid experiences. Several other donor countries, Chinese officials, and senior government representatives from Malawi and Mozambique participated. The representative from China's Ministry of Commerce "encouraged the other donors to find out where China has comparative advantage and start building partnerships and joint action" (CIDA/DFID/WBI/IPRCC 2008, p. 8).

On the multilateral front, China contributed \$30 million to the Asian Development Bank's Asian Development Fund in 2005, and set up a \$20 million PRC Regional Cooperation and Poverty Reduction Fund, also with the ADB (the first developing country to establish a fund like this). China also pledged to contribute to the World Bank's concessional loan operations (IDA) for the first time in 2007, with the IDA15 replenishment (\$30 million). An MoU signed between the World Bank and the China Eximbank in July 2007 was intended to lead to "joint action", but has so far had little concrete result aside from the secondment of some Eximbank staff to Washington. The idea of staff exchanges is one with a great deal of potential for mutual learning, and might be adopted by other multilateral banks. The Chinese have reportedly been enthusiastic partners with the World Bank's IFC and its social responsibility team in trainings on the Equator Principles.

China has concluded a bilateral agreement on technical co-operation with the African Development Bank (AfDB), and set up a China Trust Fund of \$2



million.⁶⁸ In addition, the AfDB has two MoUs with China Exim-Bank and China Development Bank. African officials have pointedly urged the Chinese government to “vigorously” move forward on parallel and co-financing with Africa’s regional banks. China Development Bank has responded with offers of lines of credit to the East African Development Bank (\$30 million) and the Eastern and Southern African Trade and Development Bank (\$50 million). Also China Eximbank has provided a line of credit to the African Eximbank (\$100 million).

Chinese officials have also attended Consultative Group meetings in some countries. Sierra Leone is one of them. These Consultative Group meetings are efforts to share information and coordinate donor activities. They have traditionally been chaired by the World Bank. Even if they do not attend at first, Chinese representatives should continue to be regularly invited to attend donor coordination meetings. When the host government takes the lead on donor coordination, the Chinese will be more likely to attend.

V.6 African Countries: Engaging China

The evidence suggests that Chinese finance will be a significant, continuing source of capital for African countries. In 2009, the Chinese pledged to commit \$10 billion in new preferential loans (a mix of export credits and concessional aid loans) to Africa by 2012. This finance will be complemented by new commercial credits for Chinese exports of capital goods (including oil refineries, copper smelters, and power plants), Chinese construction companies, and Chinese investment (including joint ventures). This finance is likely to be at very attractive rates, given China’s own very low cost of capital and enormous foreign reserves. This is particularly relevant, as the opportunity cost for this

Chinese capital is the very low rates offered by US Treasury Bonds.

Countries that propose bankable projects will likely be able to access some of this finance, whether or not they have natural resources. For the most part, however, it is not being made *available as ODA*. In some cases, such as in Angola and the DRC, China Eximbank has agreed that a percentage of the contracts financed by these loans can be subcontracted to local companies, something that can spur local development. Export credits from the OECD countries have been declining since 1995 (Wang et al. 2005, p. 8-9). Even in the current global financial crisis, China’s Eximbank continues to insist that it is more than ready to fill the gap.

How can African countries position themselves to get the best from this newly important partnership? To what extent should they encourage China to play by the rules set up by the OECD countries in the international aid and export credit regime?

Transparency is an important norm, but African governments themselves already know how much aid and development finance they are getting from China. Transparency is not an issue for individual country governments, which could supply this information if they so wished, but it would be helpful for their citizens. It is not clear whether or not African countries would benefit if China strictly followed the OECD Arrangement on Officially Supported Export Credits, as their financing costs would likely rise. However, to ensure value for money, it is critical that African governments insist on competitive tenders for their procurement requirements, no matter how concessional the associated export credit is. If a competitive tender is not possible, officials can still do comparison shopping by soliciting estimates

68) Forum on China-Africa Cooperation, “Programme for China-Africa Cooperation in Economic and Social Development,” September 20, 2006, <http://www.focac.org/eng/wjih/t404122.htm>



from comparable companies for the goods and services offered under Chinese finance.

The AU has developed a workable compromise between the well-entrenched sovereignty norm, and the evolving norm of the human right to protection. This gives the African Union an opening to firmly condemn military coups and other violations of democratic norms. It could move further and signal that engagement with abusive regimes would place companies or banks at a disadvantage with other African Union members. This would be welcomed by those seeking peaceful resolution of these conflicts, and would help pressure countries that have used African inaction as a justification for their own active engagement with abusive regimes.

Corporate social responsibility is a new area in China, but one that is gaining popularity as Chinese companies begin to understand that they have a “triple bottom line” (profit, social, environmental).

Lenders such as China Eximbank are already aware of the importance of being seen to be responsive to these issues, but continued pressure on the bank (along with other export credit agencies) to be “responsible partners” is not out of place. Nonetheless, countries can do more themselves. For example, African governments worried about technology transfer and training can demand that Chinese (and other) companies partner with local firms when submitting bids. Senegal does that. African governments can also insist on subcontracting to local firms, like Angola and DRC do. They can further put a ceiling on imports of expatriate labour, as do Tanzania and many countries.

Building up local capacity to negotiate favourable natural resource deals with China Eximbank and Chinese companies should also be a priority. Decades ago, Botswana showed how the use

of strategic international consultants from highly regarded legal firms could enable the country to negotiate very favourable contracts for its natural resources with DeBeers, a South African mining giant. An international presence from a highly respected firm could provide a form of credibility that is lacking in some of the deals presently on the table. A high-level closed-door workshop where African officials who have worked on these deals can meet to exchange experiences and information would be useful.

Continued engagement with Chinese working in the area of foreign aid and export finance will build relationships and increase knowledge on both sides. Workshops should involve Chinese officials from the Ministry of Commerce and the China Eximbank, and driven by experience sharing rather than pure academics. The invitation of Chinese officials to join project and programme evaluations of other non-DAC donors and financiers would also be a useful way to exchange ideas.

VI. Conclusion

The Chinese have built an economic development success with relatively little outside aid. As the Chinese ambassador to Malawi reportedly said in 2008: “No country in the world can develop itself through foreign aid ... To develop your economy is your job. You have to do it yourselves.” (quoted in Masina 2008). Yet China provides aid and development finance through a not very transparent and poorly understood approach.

This paper analysed China’s growing foreign aid and export credit programme as an element of the changing international aid architecture. The study finds that practices governing Chinese aid and development finance generally diverge from clear OECD standards and norms on transparency and definitions, the management of concessional



export credits, and the management of sovereign debt. In the area of environmental and social protections, corruption, and governance, we find mixed results. Rules in these areas are less clearly spelled out, and their enforcement and monitoring less well-developed. Although guidelines exist, the traditional donors and financiers do not always have clear, unambiguous rules to apply. Chinese norms on environmental and social safeguards are evolving rapidly. There is some evidence that their framework for development loans has begun to take these higher standards into account.

Both China and the traditional sources of development finance have rules that discourage corruption in the procurement of aid. But neither (with some exceptions, such as the US Millennium Challenge Corporation (MCC) and the World Bank's CPIA) seems to have rules for when or how aid or development finance should be restricted when a pattern of corruption characterises an entire recipient government.

Many countries have not done enough to put in place rules that would help ensure that businesses supported by their export credits are free from corruption. With regard to democracy and human rights, the global aid regime is not well-institutionalised, although it has improved over the past several decades.

Neither the IMF nor the World Bank (nor the Chinese) apply conditionality over democracy or human rights. Many bilateral donors apply such conditions, but sometimes inconsistently or without well-defined objective triggers or standards. Export credit agencies are only slowly being brought into compliance with expectations for transparency, social and environmental impact, or the protection of human rights.

In sum, China's practice as a provider of aid and development finance is not as different from the practice of others as is commonly believed. Across the board, there is much room for improvement from all the major players in the global aid and development finance regime.



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