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Seizing Opportunities and Confronting the Challenges of China—Africa Investment Relations: Insights from AERC Scoping Studies

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1. Introduction

Africa continues to lag behind the rest of the world in terms of development despite the recent rise of average annual gross domestic product (GDP) rate. Indeed, the upward trend in average growth rate observed over the 1995–2005 period was sustained through 2007 and was projected to reach 7% in 2008. Whether this will be enough to permit Africa to achieve its objective of poverty reduction and equitable income distribution is not known. However, it is clear that given the current rate of growth and socioeconomic development, Africa will be unable to meet the Millennium Development Goals (MDGs).

In light of the inadequate financial resources to finance long-term development in Africa, foreign direct investments (FDI) are being advocated as a way to bridge the resource gap. This is not a new direction in development policy thinking as such. Indeed, previous reforms embedded in structural adjustments also saw increased FDI as key to sustained economic recovery . Similarly, reforms introduced in the late 1990s were expected to improve the investment climate thereby increasing the flow of FDI which in return would spur economic growth and therefore reduce poverty. Unfortunately this did not occur. A report by OECD (2000) cited by UNCTAD (2005) attributed the failure of African countries to attract FDI to a mix of unsustainable national economic policies. Thus, despite the fact that, in other parts of the world attracting FDI has been a key instrument in boosting economic performance, here again Africa lags behind.

Indeed, recent decades have seen a surge in global flows of FDI, especially to developing countries. However, these flows are highly concentrated in a few countries. Total flows of FDI into developing countries are running at over $200 billion a year compare with under $20 billion in the early 1980s. Approximately 60% of these flows go to only 10 countries located in South America (Brazil, Argentina, Mexico and Chile) and South-East Asia, including China (Thirlwall, 2003).

Although China is still seen as a developing country, it has begun to emerge in the international global scene as an economic power and a FDI alternative, even if this is still small, for other developing countries, especially in Africa. Indeed, from a low $830 million in 1990,[5] post-2000 FDI outflows have been rising, reaching $17.8 billion in 2006. The flows are expected to continue to increase and to reach $72 billion by 2011.

The secrecy around Chinese official data makes it difficult to capture the real importance of Chinese FDI. Indeed some figures of China's FDI flows into Africa are contradictory, confusing and almost certainly understate their true significance. Besada et al. (2008) using various sources estimated Chinese FDI flows into Africa to be just above $500 million in 2006, rising from $400 million in 2005.

This increasing interest in Africa demonstrated by rising Chinese FDI to the continent, presents opportunities and challenges to the development prospects of sub-Saharan African countries. There is therefore a need to carefully identify and analyse these developments if sub-Saharan African countries are to maximize the positive effects of the opportunities and ameliorate the adverse effects of the challenges. The strategies proposed should take account

[5] The reporting mechanism for FDI may have also changed after 2000 and therefore may account for change in reported figures.

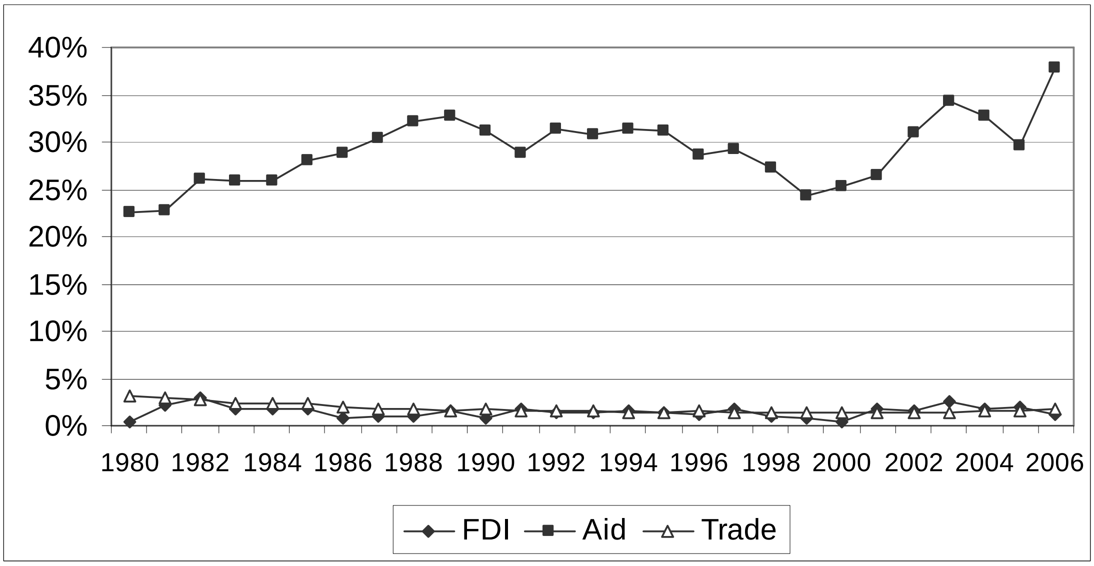
of the changing circumstances of the individual countries and the changing nature of the impact of China.

This paper focuses on China–Africa investment relations drawing insights from the scoping studies. It is organized as follows: Section II analyses the structure of Africa's investment with China; Section III discusses the investment-related gains and losses in China–Africa relations; and Section IV discusses the opportunities and challenges associated with these Chinese interventions. The paper is concluded in Section V.

II. Structure of China–Africa Investment relations: insights from the scoping studies[6]

Although Chinese FDI to sub-Saharan Africa has been increasing, it remains small. Indeed, as Figure 1 shows, whilst sub-Saharan Africa commands the lion's share of global aid flows, its share of global FDI inflows (1.2%) (and also of trade, 1.7%)) is almost "off the map" in global terms.

Figure 1: Africa's share of global FDI



Source: Trade data from COMTRADE (accessed 26 June 2008); Aid data from OECD DAC (accessed 26 June 2008); FDI data from UNCTAD (accessed June 2008).

This is further illustrated in Table 1. Over the period 1991 to 2003, it was only in 2000 that Chinese FDI passed the level of 5% of total FDI inflows in Africa. After that period the Chinese share of FDI dropped to 0.3% of total FDI making 2000 an outlier.

Notwithstanding this, Chinese FDI flows to Africa are geographically dispersed, even if it is not equally distributed. Indeed, as Table 2 illustrates, five countries (Algeria, Nigeria South Africa, Sudan and Zambia,) accounted for 56% of the FDI stock in 2005.

Moreover, from the scoping studies, it appears that Chinese FDI inflows to Africa are sector specific/oriented. These sectors include: oil and minerals, physical infrastructure, agriculture, manufacturing, services and retail (general trade). As reflected in Table 3, oil, minerals and physical infrastructure dominate Chinese investments in sub-Saharan Africa.

6 This and subsequent sections draw freely on the scoping studies with only perfunctory attribution.

Table 1: China's FDI flows to Africa ($ million, 1991–2003)

Year	Total	Africa	Percent share
1991	913	1.5	0.16
1992	4,000	7.7	0.19
1993	4,400	14.5	0.33
1994	2,000	28.0	1.40
1995	2,000	17.7	0.89
1996	2,114	..	..
1997	2,563	..	..
1998	2,634	..	..
1999	1,774	42.3	2.38
2000	916	85.0	9.28
2001	6,885	24.5	0.36
2002	2,518	30.1	1.20
2003	2,855	60.8	2.13

Source: UNCTAD (2007).

Table 2: Distribution of China's outward FDI stock in Africa (1990, 2005)

Country	1990	Country	2005
Zaire	18	Sudan	22
Nigeria	15	Algeria	11
Mauritius	14	Zambia	10
Guinea Bissau	9	South Africa	7
Zambia	7	Nigeria	6
Gabon	6	Tanzania	4
Rwanda	6	Kenya	4
Zimbabwe	6	Madagascar	3
Egypt	4	Guinea	3
Tanzania	4	Zimbabwe	3
Madagascar	4	Others	27
Central African Republic	3		
Sierra Leone	2		
Libya	2		

Source: UNCTAD (2007).

Table 3: Sub-Saharan African country ranking and distribution of China's investment[7]

Country	Rank[8]	Oil	Mining	Agriculture	Services	Retail	Physical infrastructure	Manufacturing
Angola	1	X			Telecoms	Small-scale traders	Construction, infrastructure	
Cameroon	3	X		Rice, timber, fish		Small-scale traders	Construction, infrastructure	
Chad	3							
Côte d'Ivoire	3							
Congo, Brazzaville	2				Health, telecoms		Energy, Construction	
Ethiopia	1		X		Telecoms, electricity, water	Small-scale traders	Construction	Garments, shoes/leather
Gambia	3							

[7] Only 20 countries are included as the data in the Zimbabwe scoping paper were regarded as too unreliable.
[8] Countries were ranked in terms of the significance of Chinese FDI in selected sectors:
1 = very significant (size and impact), 2 = significant, 3 = insignificant.

Ghana	1			Poultry		Small-scale traders, import/export		Garments, shoes/leather
Guinea	3							
Kenya	2		X	Coffee		Small-scale traders, import/export		Garments, shoes, general spread
Madagascar	1			Sugar	Financial, telecoms	Small-scale traders, import/export		Garments, general spread
Mali	2			Cotton	Electricity, water		Construction, Infrastructure	Food processing
Mauritius	1					Small-scale traders, import/export		Textiles, garments, general spread
Namibia	3					Small-scale traders	Construction	
Nigeria	1	X			Telecoms, technical services	Small-scale traders	Construction, infrastructure,	Agro-processing
S. Africa	1		X		Financial	Small-scale traders	Constructions, infrastructure,	Electronic goods
Sudan	1	X	X			Small-scale traders		
Tanzania	3			Cotton			Construction	
Uganda	2		X	Cotton	Telecoms, electricity	Small-scale traders	Construction, infrastructure,	Agro-processing, general spread
Zambia	1		X	Cotton			Construction	Agro-processing

Source: AERC Scoping Studies 2008.

Oil and minerals

China’s FDI in oil and minerals has been in Angola, Cameroon, Ethiopia, Nigeria, South Africa, Sudan, Uganda and Zambia. In 2006, China’s investment in oil/gas in Angola was valued at $2.4 billion (investment on 3 oil blocks (blocks No. 15; 17 and 18); at $757 million in Sudanese oil and $ 2.7 billion in Nigerian oil fields.

Infrastructure

In terms of physical infrastructure a fair proportion of investment is involved in show-piece construction—government buildings and sport stadiums. This is the case in countries like Cameroon, Congo, Côte d’Ivoire, Ethiopia, Nigeria, Uganda and Namibia. In Nigeria for instance, the Chinese are involved in the modernization of the country’s one track rail to standard gauge rail with an investment of $8.3 billion for the first phase. In Uganda, 5.85% of investment in construction is Chinese but represents also 5.65% of Chinese FDI in the country.

Agriculture

Agricultural investments are beginning to play a more significant role in Chinese investment in Africa. This is seen in Ghana where in 2001 Chinese firms invested $4.3 million in this sector and the investment represented 71.3% of all investment in agriculture that year. In Kenya, Chinese are involved in coffee growing. In Cameroon, they are interested in rice, timber and fisheries. In Mali, Uganda, Tanzania and Zambia their interest is in cotton farming.

Manufacturing

Manufacturing investment is primarily in labour intensive activities—garments dominate. Much of Chinese manufacturing investment was in the clothing sector, taking advantage of

Africa's preferential access to US markets under the African Growth and Opportunity Act (AGOA) scheme. This is the case in Ethiopia, Ghana (where 20% of Chinese investment went to that sector in 2005); Kenya (where they are involved in the production and distribution of textile), Madagascar and Mauritius.

Chinese investment in manufacturing also has to do with agro-food processing (this is the case in Kenya, Nigeria, Mali, Uganda and Zambia), assembly plants (Kenya, Mali and South Africa) and electronic goods (in Kenya, South Africa and Mali). There is also a spread of investments in small-scale manufacturing enterprises, which are not significant in terms of official statistics but may have a more substantial socioeconomic impact. This includes manufacturing of candles from wax, intravenous fluids, cigarettes, mosquito nets, optical lenses, TVs, DVDs, VCDs, glass, aluminium, electric machines etc. in Kenya; and electric bulbs, farm equipment in Mali. In Uganda for instance, Chinese investment in manufacturing represented 63% of total investment in that sector over the period 1991–2007 and was worth $98 million.

Services

In 2007 this sector was dominated by the move of the state-owned Industrial and Commercial Bank of China to acquire a 20% stake in Standard Bank, a South Africa based bank with extensive operations across the Continent.[9]The stake was worth $5.4 billion; this acquisition is an example of strategic investment. The aim is not to exercise control over the bank but rather to use its equity base in two strategic forms. First, the intention is to use it as a learning operational experience for Chinese financial interests. Second, and more importantly, the aim is to use Standard Bank of South Africa's independent status and financial reputation as a strategic guarantee backing Chinese financial aid and loan operations in sub-Saharan Africa. Other Chinese interventions in the service sector concern tourism (in Ghana), transport (Kenya), finance (Madagascar and Uganda), telecom (Angola, Congo, Ethiopia, Nigeria, South Africa and Uganda).

Retail and general trade

The retail sector is complicated as it involves a large number of individual small-scale Chinese operators and often does not show up as FDI investment in official statistics. In Ghana, it is captured under general trade and it has been growing over the years from 3.75% in 2001 to 26% in 2006.

This source of Chinese investment is much harder to track, but has significant socioeconomic impact. Indeed, the increase in Chinese migration to sub-Saharan Africa and the large number of Chinese individuals operating as small-scale entrepreneurs in selected countries , for example in Angola, Namibia and Madagascar, raises some social concerns. Chinese families are usually engaged in small-scale retail activities or import-export operations. A significant, but minor, tendency is that of Chinese retail entrepreneurs in Kenya and Uganda using their base to spread their retailing activities into neighbouring countries.

III. Investment-related gains and losses

FDI flows to developing counties in general and specifically in sub-Saharan Africa have been on the increase in recent years. Recipient countries should be aware that these flows can

[9]http://www.moneymorning.com/2007/12/04/china-drills-into-africa-with-54-billion-investment/.

affect their economy both positively and negatively. Indeed, FDI brings many advantages to recipient countries. These include:

- Raising the investment ratio above the domestic savings ratio thereby closing the savings gap. This is good for growth if nothing adverse happens to the productivity of the investments.

- Bringing additional knowledge, technology and management skills which can have positive externalities on the rest of the economy. This requires training of the labour force.

- Being a catalyst for domestic investment in the same or related fields which can promote upstream as well as downstream economic activities.

- Enhancing export performance given their orientation towards tradable goods sector, thereby easing pressures on balance of payments through foreign exchange earnings.

These gains related to FDI have been indicated by empirical work that showed positive relations between FDI, domestic investments and GDP growth. Indeed, Bosworth and Collins (1999) found that FDI brings about a one-to-one increase in domestic investment thereby contributing to growth. Borensztein et al. (1995) showed that a one percentage point increase in the ratio of FDI to GDP in developing countries over the period 1971–1989 was associated with a 0.4 to 0.7 percentage point increase in the GDP per capita growth, with the impact varying positively with educational attainment as an indicator of a country's ability to absorb technology.

Despite the above gains related to FDI, international experience, including the experience of sub-Saharan economies in previous decades, has shown that FDI can also have negative impacts on the local economy because:

- They could introduce inappropriate technology and delay the development of an indigenous capital goods industry.

- Their brand power and their competences, which are a source of their competitive advantage, may exclude nascent domestic producers. This can also cause the recipient countries to lose aspects of their national sovereignty and control over economic policy. Indeed, they can avoid tax by shifting profits abroad.

- They often have few linkages with the local economy and when these occur, they are often linkages with subsidiaries of other foreign investors or with large firms.

- They may utilize Africa's scarce resources poorly, exploiting resources more quickly than is desirable; shipping out unprocessed minerals and agricultural products (rather than processing these and adding value); and exploiting consumers and workers through exercise of monopoly and monopsony power.

- In the manufacturing sector, even when foreign investors do export, they have very low levels of domestic value added, focusing on simple assembly rather than complex products and importing most of their key inputs.

- The lifestyles which they promote and which are embodied in their operations contribute to growing inequality on the continent. Indeed, they tend to manipulate consumption by catering for the taste of the already well to do and often encourage forms of consumption among the mass of people that could be inappropriate and often nutritionally damaging. These tendencies encourage acquisitiveness, reduce domestic savings and can worsen balance of payments difficulties.

- Thirlwall (2003) showed that if profits are repatriated, the impact of continuous FDI on balance of payments must be negative unless the gross inflow of FDI grows substantially from year to year with all the implications that this may have for the pattern of development in the future.

None of these positive or negative outcomes is inevitable. They depend on how sub-Saharan African economies react to incoming FDI. This has long been known. But now countries in the region face new policy challenges and opportunities arising from the growing Chinese FDI.

It is important to understand the drivers of FDI if sub-Saharan Africa is to make the most of new investment inflows from China. The most widely-used framework for assessing these drivers is that developed over the years by Dunning (see, for example, Dunning, 2000; see also Cantwell and Noonan, 2000). Most of these approaches towards FDI determine three primary explanatory factors, the so-called OLI (ownership, location and internalization) framework which was later augmented to four with the linkage factor.

- The “ownership” factor describes motivations which reflect the nature of the firms involved, analysing their particular special competences which provide them with a global reach, the power to control their foreign affiliates and the capabilities which they possess which make them an attractive source of finance and technology to other countries.

- The “location” factor explains why foreign firms operate in a particular country. This may be because of market possibilities for the output of the foreign ventures, because the country has scarce natural resources or because the country has low operating costs which make it an attractive export platform.

- The “internalization” factor explains why foreign firms prefer to own their operations in other countries, as opposed to licensing out or selling their technologies and skills to domestic firms or other foreign firms.

- In the “linkages” factor (Mathews, 2002) firms invest abroad not so much to exploit their firm-competences (as in the OLI explanation), but to augment these competences by learning from their overseas operations. Thus India’s Tata Steel purchased Corus Steel in Europe, and China’s Lenovo acquired IBM’s laptop computer division.

Sub-Saharan Africa, as we have seen, is not without its attractions to the Chinese, particularly with regard to its potential as a provider of commodities. The key question is how Africa can use this power in commodities to seize opportunities and confront challenges arising from its relations with the new emerging powers, particularly in the exploitation of mineral resources and in the provision of related infrastructure. The agreement which the Democratic Republic of Congo (DRC) reached with China in 2007 and 2008 shows the potential for using this power to leverage advantageous terms, particularly as China and other emerging economies seek to muscle their way into territories which were previously the domain of Western economic powers (Jiang, 2009).

However, the real issue that lies behind negotiating such agreements is whether sub-Saharan African countries have the capacity and capability to enforce and gain maximum advantage from them. In the absence of ensuring capacity and capability such agreements are likely to be nothing more than granting strategic advantage to China in its interaction with Africa and its global diplomatic strategic initiatives. The policy conclusion that flows from this is the urgent need for policy dialogue with senior SSA government officials and training of government trade and industry personnel and the staff of private sector organizations to facilitate their abilities to take advantage of these new opportunities.

In developing this strategic agenda, African countries need to adopt a similar strategy of integrating the aid, trade and FDI vectors to that which is being pursued most clearly by China, but increasingly also by India. Meeting the trade needs of China—Africa as a source of primary commodities and, to a lesser extent, as a market for its exports—should be conditional upon China providing aid to exploit these commodities, and to meet Africa's complementary development and infrastructural needs. Where appropriate, it should also incorporate FDI from the Chinese and participation in Chinese firms' value chains which serve global markets.

IV. Seizing the Opportunities and Confronting the Challenges

Chinese FDI flows in Africa contain both opportunities and challenges that African countries need to consider in dealing with China in each of the sectors of the economy.

Oil and minerals

Opportunities

Chinese FDI flows in the oil and minerals sector enable the transformation of passive (dormant) assets into active assets. This transformation will not have been possible (to some extent) without Chinese investment. With the additional resources harnessed from investment in this sector, the recipient countries are better equipped (financially) to finance their development strategies. It is important to underline that the recipient country can also insist that no raw minerals be exported without prior local value addition thus encouraging the partner countries to invest in some stages of processing thereby adding value to the minerals before export just like the Congolese government did in 2007 (Jiang, 2009).

Challenges

The above additional resources generated by FDI flows in the sector should be used cautiously. Indeed, if revenues generated are used for balance of payments support (including debt service payment) for example, the sector will lack sufficient resources to maintain its competitiveness which is essential for the sector's survival. The speed of extraction of the minerals, if not controlled, can deplete these natural resources faster than is desirable. Moreover, FDI should not be limited to extraction and shipping out of unprocessed minerals and raw agricultural product. Rather, FDI should include processing these minerals and agricultural products locally to add value before shipping out. In so doing, they will develop local skills, create jobs and diversify the economic base away from primary production towards higher value adding activities.

Infrastructure

Opportunities

Investment in the infrastructure sector helps the recipient countries build or rebuild the needed physical infrastructure. This infrastructure is essential for moving production from one part of the country to the other. For example, Chinese FDI flow in infrastructure has changed the face of Addis Ababa with its ultra-modern highways.

Challenges

Although this physical infrastructure can help boost the recipient country's competitiveness, the question that arises is whether the development of infrastructure is enshrined in a development strategy. Other challenges include ascertaining that there is adequate transfer of technology to ensure that the recipient country can maintain the infrastructure; ensuring that the local workers are adequately trained to undertake future infrastructure building projects; and ascertaining that the infrastructure, especially transport infrastructure, is geared towards linking the local markets as opposed to exclusively facilitating evacuation of primary products to the ports. These challenges must be addressed in order for the infrastructure to support inclusive and sustainable growth, economic transformation and poverty reduction.

Agriculture

Opportunities

Chinese investments in agriculture will without doubt increase the recipient country's agricultural production and thereby increase its agricultural revenues through increased export of agricultural output as well as agricultural output for the local market (if they are involved in non-cash crop production).

Challenges

The question that arises here is to determine the purpose of these Chinese investments in the agricultural sector assuming that the FDI is not for charity. Is it to supply China-based manufacturers with needed raw agricultural inputs? If so, then the recipient country will not benefit from any value addition. Moreover, it runs the risk of dependency on low and volatile agricultural product prices. In any case, the recipient country needs to ensure that agricultural products are not shipped out unprocessed and that value is added locally to the product so as to contribute to the development of local nascent industry.

Manufacturing and Services

Opportunities

Chinese FDI flows in the manufacturing and service sectors have helped African private sector growth to a great extent, especially in the telecom, transport, tourism and banking sectors.

Indeed, with Chinese FDI flows in the banking sector, for instance, fresh and increased financial resources are made available to the sector that could be used to avail loans to private/individuals or corporate investors. Chinese intervention in the telecom sector has brought competition and significantly reduced the cost of communication to the benefit of local consumers and businesses.

Challenges

Chinese FDI flows in the service sector may harm the recipient countries. Indeed, Chinese intervention in the banking sector, for example (by taking stakes in the companies), could be a strategy which in the long run could lead to the control of the entire sector and therefore influence the way in which the banking sector provides support to businesses (providing preference to Chinese-owned firms and activities) thereby crowding out local firms and entrepreneurs by restraining their access to credit. Other concerns are whether capacities are being built and technologies being transferred with these Chinese interventions in the service sector. If not, then, the recipient countries face the risk of encouraging enclaves with limited linkages to the local economy.

Retail and general trade

Opportunities

In the retail and general trade sector, Chinese FDI flows provide access to cheap products to the poor, and with suitable revenue collection efforts, increase government tax revenues.

Challenges

Despite the above opportunities, these Chinese interventions present challenges. Indeed, local entrepreneurship may suffer due to Chinese invasion of the local market, making it difficult for these local entrepreneurs to operate thereby hurting local small- and medium-scale enterprises. This can lead surely in the long run to the loss of government revenues and increased unemployment. Furthermore, the safety of Chinese products is not always guaranteed.

V. Concluding Remarks

The upsurge of Chinese FDI to sub-Saharan Africa has provided the continent with alternative sources of financial resources to finance its development strategy. However, these additional financial resources are not without costs and thus require African authorities to devise strategies to seize opportunities arising from these alternatives and confront the potential and possible challenges.

Looking at Chinese interventions (FDI), we observe that: i) they are bundled more tightly than those emanating from Western countries; ii) they have much longer time horizons and are more prepared to work in insecure environments than western firms; iii) Chinese firms do not use their sub-Saharan African subsidiaries as part of their global value chain operations serving markets in other countries; and iv) many Chinese firms use sub-Saharan Africa as an easy learning environment, honing their skills before venturing into more taxing conditions (for example, with regard to banking, telecoms and oil exploration).

The issue is who in Africa is going to drive this strategic agenda towards FDI inflows from China? At the most basic level, this must necessarily involve individual African governments. Although they do not generally directly control inward FDI and trade flows, they hold the key levers which determine access to their economies. Each country needs to make an informed assessment of its specific attractions to the Chinese (and, indeed, any other emerging economies) and then coordinate an integrated strategic response to the opportunities and challenges presented by China in a way which is complementary to each country's own development agenda and aspirations. This will involve extensive background analysis, but also the convening of appropriate stakeholder groups to ensure an integrated approach that provides clear signals to China and any other emerging country partners.

Another arena for integrated response is in regional and African fora such as the Southern African Development Community (SADC), the Economic Community of West African States (ECOWAS), the New Partnership for Africa's Development (NEPAD) and the African Union (AU). These multi-country organizations are important for three major and related reasons. First, by aggregating African countries in the bargaining process, they help to avoid contradictory bargaining positions and wars of incentives. As has been evident for many decades in the diamonds sector, there is enormous power in cartelized bargaining. This is not just a matter of achieving the best price for Africa's resources, but also to ensure that wider objectives can be met, such as the construction of regional infrastructure networks to provide access for non-commodity exporters. Second, as observed earlier, not all African countries have extensive commodity deposits or are significant commodity producers. Their interests need to be protected by those economies that do have primary resources and markets of interest to the Chinese. Including these marginalized economies is not just a matter of altruism for the commodity exporters. As we have seen, intra-regional trade may be a primary area for the development of the capabilities which are required for long term and sustainable growth so that it is in the interests of all parties—commodity exporters and non-commodity exporters alike—that these intra-regional links are strengthened as a consequence of engaging with the Chinese. The final reason why the multi-country organizations are important is that the emerging economies themselves see these as important organizations for bargaining access to Africa's resources and markets. This is most evident in the case of the FOCAC (Forum for China African Cooperation), but it is also relevant for other emerging economies.

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APPENDIX: LIST OF AERC SCOPING STUDIES ON THE IMPACT OF AFRICA-CHINA ECONOMIC RELATIONS

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