DAC Network on Poverty Reduction

THE IMPACT OF CHINA’S ECONOMIC ENGAGEMENT IN AFRICA: AN OVERVIEW AND ISSUES FOR FURTHER DISCUSSION

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This note is for DISCUSSION under item V of the POVNET agenda [DCD/DAC/POVNET/A(2008)13]. It has been prepared by the Secretariat in order to help identify issues which the new China-DAC Study Group may explore further in 2009-10, as part of its work to review jointly selected aspects of China’s development co-operation in Africa and its impact on reducing poverty.

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I. Background and context

1. The development of Africa can no longer be considered without taking account of the influence of China. Economic relations have expanded dramatically and China is now a major and welcome investor and trading partner for Africa, with an increasingly significant foreign aid programme as well.

2. Sino-African exchanges have developed a strong momentum over the last decade, even though the People’s Republic of China has had diplomatic relations with several African countries for more than 50 years. A turning point occurred in 2000 with the establishment of the Forum on China-Africa Co-operation (FOCAC) to promote regular exchanges between China and African countries, including at the highest political levels. Subsequently, China declared 2006 its “Year of Africa” and also published an African Policy that year. In 2007, China hosted the annual meeting of the African Development Bank.

3. China made a number of major announcements at the Third FOCAC Ministerial Conference which took place in Beijing in 2006. President Hu Jintao announced a doubling, by 2009, of the amount of aid given in 2006, the cancellation of RMB 10.5 billion (USD 1.3 billion) of debt from interest-free government loans maturing at the end of 2005 owed by 31 African countries and an expansion in the number of products (from 190 to 440) that the least-developed countries in Africa that recognise China can export tariff free to China. The Fourth FOCAC Ministerial Conference is scheduled to take place in Egypt in 2009.

4. China’s expanding economic engagement in Africa is an expression of a range of political, economic and social objectives. According to its African Policy, “sincerity, equality and mutual benefit, solidarity and common development … are the principles guiding China-Africa exchange and co-operation and the driving force to lasting China-Africa relations.” The need for resources to fuel its rapid economic growth is another motive alongside encouraging political support for its “One China Policy”, developing new markets for Chinese exports and expanding China’s influence internationally.

5. Arguably, China’s role is evolving, from that of a fellow developing country to a donor. This conclusion can be drawn from the statements made by China at the 2006 FOCAC Ministerial Conference, such as the announcement of eight measures “to forge a new type of China-Africa strategic partnership and strengthen [its] co-operation in more areas and at a higher level”. In addition, China is becoming increasingly involved in partnerships with other bilateral and multilateral donors.

6. At the same time, China’s engagement in Africa is raising a number of concerns within the international community. Chinese aid is often tied and provided in kind, which reduces the possible positive impacts on the local economy, including development of the local financial sector. In addition, China is ready to support projects that other donors have rejected due to environmental concerns and some countries to which it is now extending large volumes of loans have only recently benefited from substantial debt relief from many OECD countries and multilateral institutions, raising issues related to debt sustainability.
7. To help promote dialogue and greater mutual understanding between the DAC and China, a China-DAC Study Group is being established to discuss these and other issues related to the impact of China’s development co-operation in Africa and its impact on reducing poverty. The purpose of this note is to help identify some issues which DAC members may be interested in raising in their future dialogue with China. The idea to form a China-DAC Study Group arose from the DAC-POVNET workshop in February 2008 on “China’s experience in rural poverty reduction at home and abroad” as a specific co-operative action to enhance communication between DAC members and China.

II. Forms of engagement

8. China’s economic engagement in Africa takes the form of investments, trade and foreign aid, which often become interlinked in the projects it implements. This makes the attribution of projects and financial flows to each form of engagement difficult to determine, leading to various estimations about the size of China’s engagement in Africa.

a) Aid

9. China’s foreign aid to Africa has increased substantially in recent years. Although China does not publish official data on its aid programme, it is estimated that China’s aid flows to Africa averaged about USD 310 million per year between 1989 to 1992 but rose to around USD 1 billion in 2006 (which is similar in size to the net official development assistance (ODA) disbursed that year by Canada or Italy to Africa). China’s foreign aid takes the form of grants and interest-free or concessional loans, although it is not known how much of this aid would qualify for recording as ODA. In addition, China has provided a significant amount of debt relief to African countries totalling USD 1.3 billion since 2000.

10. China’s foreign aid is mostly provided as concessional or “preferential” loans. These are medium to long-term loans (of up to 20 years) provided at a low interest rate usually to the government of the African country. Loans are provided both to countries which have not benefited from recent debt initiatives (e.g. Angola, Sudan and Zimbabwe) as well as to countries that have received substantial debt relief. For some countries, the value of recent loans now contracted to China represents a significant share of the face value of their former debt – e.g. 40% for Mauritania, 55% for Nigeria and 115% for Guinea.

11. China’s foreign aid is mostly tied. One of the basic criteria for concessional loans is that “Equipments, materials, technology or services needed for the project should be procured from China ahead of other countries. In principle, no less than 50% of the procurements shall come from China.” In some contexts, this 50% limit is exceeded by a substantial margin. In Angola, for example, 70% of a Chinese loan in 2006 was tied.

b) Investment

12. Although only a small share of its overall foreign direct investment (FDI), China’s FDI flows to Africa have also been increasing substantially. Estimates vary dramatically and range from a cumulative total of USD 1.6 billion by the end of 2005 to USD 6.3 billion. These investments are often realised through joint-ventures with African enterprises, predominantly in the resource sector but more recently in other sectors as well including infrastructure and textiles. It is estimated that about 800 Chinese firms are currently operating on the African continent.

c) Trade

13. China is now Africa’s third largest trading partner, behind the United States and France. Its trade volume reached about USD 73 billion in 2007. This 700% increase over its 2000 level was partly driven by the implementation of a number of tax exemption agreements. Chinese imports from Africa are
predominantly natural resources, with oil representing about three-quarters of imports. China’s exports to Africa are mostly manufactured products, such as electronic equipment and textiles. It is forecast that China-Africa trade will continue expanding to around USD 100 billion in 2010, which will make China the continent’s most important trading partner.

III. Main sectors and main partner countries

14. The sectors China is especially engaged in Africa are infrastructure, construction, agriculture, education and health. Chinese aid is project-based and predominantly provided in kind. Aid activities often form part of a larger project, combining, for example, private investment with the provision of infrastructure such as roads or a power plant (see Boxes 1 and 2 for some examples).

Box 1. China's engagement in Gabon

Gabon counts itself among the resource rich countries in Africa, with substantial reserves of resources that can fuel China’s growth such as petroleum, diamonds, manganese, uranium, gold, timber and iron ore. On the other hand, as a relatively small country with a population of only 1.4 million people, the Gabonese market offers only limited opportunities for expanding Chinese exports.

Bilateral trade between China and Gabon has increased tremendously in recent years, from a value of USD 237 million in 2002 to USD 880 million in 2006. Exports to China, mainly oil, manganese ore, wood and rubber, accounted for more than 90% of their two-way trade.

China’s investment profile in Gabon is also focused on the resources sector (mining, oil and timber). The largest investment is the exploitation of the Belinga iron ore mine by a consortium of Chinese state-owned firms and the Gabonese government. This investment will be accompanied by the development of the surrounding infrastructure including two hydroelectric power plants, the building of a 560 km railway to the coast and the construction of a deep water port. This project, of about USD 3 billion, is being financed by the China ExIm Bank.

China’s foreign aid to Gabon also shows the range of other sectors in which China is now active:

- **Construction**: National Assembly, Senate building, National TV and radio stations.
- **Agriculture**: Rice production, support for small-scale projects and capacity development.
- **Health**: Sending medical missions, construction, renovation and providing some staff for two hospitals.
- **Education**: 31 higher education scholarships to study in China per year, sending teachers.


15. As of October 2008, China had diplomatic relations with 50 African states and delivers foreign aid to all of them (the three remaining African countries - Burkina Faso, Gambia and Swaziland - do not officially recognise the People’s Republic of China). According to one source, the 10 African countries receiving the highest amounts of Chinese aid are: Angola, Republic of Congo, Congo-Brazzaville, Ethiopia, Equatorial Guinea, Ghana, Mozambique, Sudan, Zambia and Zimbabwe, although the exact amounts provided are unknown. The major beneficiaries of China’s debt relief have been Zambia, Ethiopia, Angola, Tanzania, Republic of Congo, Uganda, Ghana and Guinea.
Box 2. China’s support for hydro-electric power plants

Power plants, especially hydro driven, often form part of China’s large infrastructure projects. By the end of 2007, China was providing loans with a total value of about USD 3.3 billion for the construction of ten hydro-electric power plants across Africa. These plants will increase existing hydro-electric capacity by 30%. These projects are located in Benin/Togo, Ethiopia, Gabon, Ghana, Guinea, Mozambique, Nigeria, Republic of Congo, Sudan and Uganda.

Apart from the positive effect of countering one of Africa’s main weaknesses to expanding its productive capacities, namely the lack of electricity, hydro-electric plants can also have negative social and environmental effects. These include the need to resettle affected populations, destruction of wildlife habitat, water pollution and the elimination of sources of income for local populations (such as fisheries). Due to such negative impacts, the World Bank, the European Investment Bank and France have withdrawn their support for some of the projects now being financed by China.


IV. Institutional arrangements

16. China does not have a single agency or ministry responsible for managing its foreign aid programme. Its system of aid delivery is therefore somewhat complex, involving a variety of actors:

- The **State Council** is the highest political body. It announces new agreements.

- The **Ministry of Finance and Commerce (MOFCOM)** is the central implementing body in the Chinese aid system. It has a department for foreign aid with its own small budget. It is responsible for strategy formulation and as well as the supervision and evaluation of Chinese aid projects.

- The **Ministry of Foreign Affairs** plays an advisory role to MOFCOM on political and diplomatic topics and on the formulation of development policies.

- China’s embassies in Africa help to implement and monitor projects.

- The **China ExIm Bank** extends concessional loans.

V. Issues for further discussion

17. It is in the interest of both DAC members and China that the totality of aid to Africa is effective and well-co-ordinated. Formation of the China-DAC Study Group will help enhance communications and so provide a basis for greater co-ordination in the future. Both sides will have issues they will want to raise, in order to promote greater understanding. For DAC members who have now reached consensus on a large body of standards and principles on managing and delivering development co-operation, a number of issues could potentially be discussed with their Chinese counterparts regarding the impact of its economic engagement in Africa:

i) **Capacity Development.** China has a long experience of helping to develop capacities in Africa through training programmes and scholarships. As capacity development is now a priority area for the DAC, as recently emphasised in the Accra Agenda of Action, exchanges and dialogue with China about its experience in this field would be valuable.
ii) Benefits to the local economy. Increased investment raises the competitive environment of an economy. This can increase welfare through more efficient production, better quality products and lower prices. Knowledge spill over and broader diversification of the economy can be additional positive effects, leading to stronger and more sustained growth. However, China’s concessional loans are provided on condition that Chinese firms are used. Furthermore, material, equipment and labour from China are used to a high degree. This tying of aid reduces the benefits to the local economy by undermining competition and reducing the transfer of knowledge. For the DAC, the untying of aid increases aid effectiveness, promotes developing country ownership and helps to stimulate local economic activity. DAC members now untie most of their ODA to least-developed countries and recently extended this provision to Highly Indebted Poor Countries (HIPCs) that are not also classified least developed countries.

iii) Environmental impact. The way that natural resources are exploited has an impact on the environment, as has been shown in China in recent years. For some of China’s current infrastructure projects, similar negative environmental effects have been predicted. China’s increasing engagement in the resources sector and infrastructure projects in Africa is consequently raising some concerns about the environmental impact and sustainability of its investments.

iv) Debt sustainability. In recent years, many African countries have benefitted from debt relief operations, including through the HIPC initiative. Some of the large projects which China is now supporting in Africa through the extension of new loans could lead again to countries building up an unsustainable level of indebtedness.

NOTES

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