



CHINA IN AFRICA:
WHAT CAN WESTERN DONORS LEARN?

By Deborah Bräutigam

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A report for Norfund

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China in Africa: What can western donors learn?

Introduction

China is offering a surprising bargain to many African countries today. This bargain says: your country has ample riches, but you're not using them to your advantage. You can leverage what you have and what we want -- oil in Congo-Brazzaville, sesame in Ethiopia, cocoa in Ghana, even tobacco in Zimbabwe -- and use these resources to secure finance to build the hydropower, telecoms, power, and rural electrification projects you believe to be necessary for your country's modernization.

On hearing of a US\$9 billion resource-secured mining and development infrastructure deal in the Democratic Republic of the Congo, an editor at the *Financial Times* wrote: "Beijing has thrown down its most direct challenge yet to the West's architecture for aiding Africa's development."¹

What is that challenge? Western media have focused on the notably lower environmental, social, and labor standards used by Chinese companies abroad (a not unsurprising feature of global engagement from a country with a 2009 per capita income of US\$3,650, less than a tenth of the average income for the Euro area).² They have also highlighted China's pledge not to interfere in the internal affairs of the countries with which it partners. This means that the Chinese government gives some aid and does some business with pariahs and paragons alike, without imposing any governance preconditions, unlike the West which often, but not always, attaches political conditions to its aid (although rarely to its private investment).

However, the biggest challenge presented by China may not actually be these concerns, but the fact that foreign aid and business engagement from the West has not, on the whole, been very successful in raising standards of living in Africa or fostering growth and employment. As the Chinese ambassador to Niger noted, France has been a

significant partner of Niger's for over four decades, and a strategic investor in Niger's uranium industry, "but when one sees that the direct revenues from uranium are more or less equivalent to those derived from the export of onions each year, there's a problem." China, he said, will give African countries "a more profitable option."³

In the West, official bilateral aid for Africa has been almost completely de-linked from business and from job-creating investment by our firms. We can enthusiastically support microfinance and the modest income generation activities of those at the margins, but the idealistic development strategies we envision for Africa tend to forget our own history, and that of the successful countries in Asia.

We ended poverty through investment, not aid. So, unsurprisingly, did China. In the West (and in China) early years of investment in infrastructure (roads, rail, ports, electricity), and a dual focus on modernizing agriculture and creating formal sector manufacturing jobs, soaked up surplus labor, raised incomes, and expanded people's choices. As wages and profits rose, tax revenues kept pace, allowing governments to finance social spending and, eventually, a welfare state.

Is there anything we can learn from the Chinese approach to development partnerships in Africa? This paper outlines the Chinese model of development cooperation, and the implications of this approach for recipient countries (governments, business, and civil society) as well as for western donors and the international financial institutions (IFIs).

A closer look at China's engagement can dispel some myths, and provide some perhaps unexpected food for thought.

Framing China in Africa: Myths vs. Realities

Many Western donors think they know what China is doing in Africa. They've seen the

headlines: the Chinese arrived a few years ago in a desperate search for oil. They set up a huge aid program, propping up governments in resource-rich, pariah states that the West won't touch. Their companies bring in all their own workers and refuse to hire Africans. They're leading the "land grab" in Africa, growing food to ship back to China. It's an alarming story ... but, on closer inspection, *none of it is true*.

A more sober assessment reveals that China is not a new donor, but has been providing aid in Africa since the end of the colonial period, at least as long as the West. But China's official aid is fairly modest, if we use the same categories used by the OECD's Development Assistance Committee (DAC) to categorize flows from governments.

In contrast to most donors, China also spreads its aid relatively evenly across the African continent, in every country where China has official ties. Only two African countries have not been recipients of Chinese aid: oil-rich Libya, and Swaziland, which has always had official diplomatic ties with Taiwan. Chinese companies do bring a larger proportion of their workforce from home than Western firms, but this is the case mainly for construction projects in oil-rich countries like Algeria, Libya, or Angola where local labor is expensive. In other places, with few exceptions, Chinese projects have a majority of Africans in their workforce. Those who do fieldwork regularly report this reality. For example, a researcher who recently visited Cameroon expecting to find large groups of Chinese workers found instead that every construction site she visited had Cameroonian workers under Chinese managers.⁴ It is the *poor conditions* of this employment, and not its absence, that is a constant complaint among African workers.

Although like other investors, Chinese companies have explored commercial agricultural opportunities in Africa, field investigations looking into "land grabs" routinely discover that it is rare to find an actually existing Chinese investment of any significant size.⁵ In countries where Chinese

firms *have* invested in agriculture, we see a pattern of mid-sized commercial farms of 1000 hectares or less, growing food for local markets. This raises issues for farmers in places like Zambia, who object to the competition they now face in their own markets. But, as of now, Chinese investors see little profit in producing crops in Africa and shipping them back to China. This is particularly true for food staples: Chinese government policy is to be self-sufficient in its domestic production of maize, wheat, and rice, and incentives for outward investment follow this policy.

China: Approaches and Financing Models

In figuring out how to react to the rise of China in Africa, the West first needs to understand how Chinese engagement works. For too long we have been trying to force the square pegs of Chinese engagement into the round holes of familiar Western patterns. Because we think of official development assistance (ODA) as the main currency for relations between Africa and the more developed world, we think this is what China is doing, instead of seeing their aid as a relatively small part of a far broader and more strategic engagement.

Setting the Stage – China Learns From Japan

One of the central dilemmas for poor countries that want to build power plants, ports, and railways is: how do we pay for this? In the 1970s, as China emerged from the decade of political struggle we know as the Cultural Revolution, Chinese leaders were well aware that they needed modern technologies and that they would have to increase the export of their natural resources in order to pay for these imports. China's reform leader Deng Xiaoping, already deeply involved in negotiations with Japan, suggested in 1975:

In order to hasten the exploration of our coal and petroleum, it is possible that on the condition of equality and mutual benefit, and in accordance

with accepted practices of international trade such as deferred and installment payments, we may sign long-term contracts with foreign countries and fix several production sites where they will supply complete sets of modern equipment required by us, and we will pay for them with the coal and oil we produce.⁶

Japanese firms negotiated a preliminary agreement in 1977 to export high technology coal and oil extraction equipment to China, with repayment in oil and coal. Japan had earlier used a similar system to finance iron ore mining in the Indian coastal enclave of Goa. “The novel aspect of this so-called Goa formula in economic cooperation,” a study pointed out, “was that in exchange for assured access to important raw materials, Japan would provide the necessary equipment, technical training, and financing.”⁷

In 1978, Japan signed an even larger deal in China. The Japanese government coordinated the offer of a line of export credit, to finance the export of US\$10 billion in equipment and complete plant or turnkey projects. China agreed to pay by exporting US\$10 billion in crude oil (and coal) to Japan.⁸ The model of projects financed by a line of credit with deferred repayment in resources helped China move forward on its modernization program. Later, Japan would offer concessional yen loans (ODA) to China, but this first line of credit was on commercial terms.

China learned from Japan. Today’s system of using commodities as security for a commercial line of credit enables a country to finance a specific investment today, and pay for it later with future earnings. Securing the investment with a resource flow reduces the risk and allows the interest rate to be lower, the loan to be cheaper. In other ways, too, using Chinese government funds (sometimes, but not always, aid) to foster Chinese investment in Africa followed in the footsteps of Japan’s similar moves in Southeast Asia.

Going Out: Institutions and Instruments in China’s Overseas Development Finance

China’s long history in Africa stretches over the Maoist period, (1949-1976), and the reform period, (1978-present). In the early 1980s, Chinese leaders reevaluated their aid program in view of its poor results, their limited funds and the need to focus more on their own development.⁹ They announced to their African partners that China would need to “do more with less”, focusing more on “mutually beneficial” cooperation rather than “one-way” aid.

At home, economist Chen Yun advised China to move toward the market cautiously, experimentally: “feeling for stones while crossing the stream.” For the next decade, the Chinese experimented with ways to combine aid, trade, and investment in Africa. By the mid-1990s, the instruments were largely in place, although new experiments continue to be launched.

One of the changes was institutional. From the 1960s until 1995, Beijing financed its projects in Africa solely through an evolving set of departments and ministries that all focused on foreign economic cooperation (including aid) and trade. In 1994, as China continued to reform its economy in a market direction, Beijing established three policy banks.¹⁰ Today, in the state-directed finance model that is common in East Asia’s “developmental states” (Japan, Korea, Taiwan), China’s Ministry of Commerce directly controls most of the instruments that provide actual government subsidies abroad.

Ministry of Commerce (MOFCOM). China’s traditional aid instruments, **zero-interest loans** and **grants**, are financed directly out of China’s budget for external assistance and are overseen by MOFCOM’s Department of Aid to Foreign Countries, in cooperation with the respective regional departments of the Ministry of Foreign Affairs.

MOFCOM also has a variety of other funds, including the **Special Fund for Foreign Economic and Technical Cooperation** that can be used to support Chinese businesses, as long as they are carrying out the needs of

China's economic diplomacy. One fund, for example, is used to support Chinese companies building six overseas special trade and economic cooperation zones in Africa.¹¹ These funds can be used for the partial reimbursement of pre-investment costs (feasibility studies, documents and consulting services, etc.) and some interest rate subsidies for bank loans.¹² They are *not* financed out of the external assistance budget.

China's Policy Banks. Two of China's policy banks (China Development Bank and China Eximbank) also operate overseas. Loans from policy banks are, as a Chinese analyst put it "heavily influenced by government policies and are not to operate in full compliance with market rules."¹³ This does not mean that CDB and China Eximbank are allowed to be unprofitable or that they are directly subsidized by the government. Rather, as a recent study of CDB explains, with the Chinese government standing behind them, policy banks have the same credit-rating as the Chinese government, can raise funds by issuing bonds with that rating, and can take a longer-term view with their loan investments.¹⁴

In 1995, China Eximbank was given sole responsibility for a new foreign aid instrument -- **concessional loans** (*you hui dai kuan*). These are provided with a fixed interest rate, usually 2 or 3 percent, a grace period of 5 years, and a long repayment term (20 years). China's budget for foreign assistance subsidized the difference between the Eximbank's costs and the fixed interest rate. This allowed the Chinese government to dramatically expand its resources for development assistance, but it also required more careful use of these resources, as the new loans were to be more carefully appraised for their financial feasibility. The Eximbank fully intended to be repaid. As the Eximbank's chief economist told an audience at a World Bank retreat: "it's the new lenders' problem if countries can't repay, not the Paris Club. We know we need a good, strong balance sheet." Although some Eximbank concessional loans have been rescheduled, there are no reports of any being canceled.

The majority of China Eximbank's lending instruments do not qualify as foreign aid. In 1998, they began offering export sellers credits (usually short to medium term) to Chinese firms to boost their ability to invest overseas and finance construction contracts.¹⁵ In 2000, the bank launched **export buyer's credits**, rolling them out in Africa in 2005. These are usually issued in dollars, at London Interbank Offered Rate (LIBOR) or the Commercial Interest Rate of Reference (CIRR) rates prevailing in global markets. **Preferential export buyer's credits** (*you hui mai fan xin dai*) also exist. These are very similar to concessional loans, but are subsidized from a different budget.

Commercial Banks. In the past decade, several Chinese commercial banks – China Construction Bank, Industrial and Commercial Bank of China (ICBC), and Bank of China – have also set up offices in Africa to support Chinese companies' business. One, ICBC, purchased 20 percent of South Africa's Standard Bank for around US\$5 billion, and has since embarked on a number of joint projects across the continent.

China Africa Development Fund. The China Africa Development Fund (CAD Fund), overseen by CDB, provides equity capital. CDB provided the initial US\$1 billion investment, and the CAD Fund was expected to raise finance for successive phases from other investors, with the goal of reaching US\$5 billion. The fund's managers have stressed that this equity finance is not aid, and not loans, but medium-term investment that expects a return.¹⁶ A similar instrument, China Asia Fund, was set up by China Eximbank in Asia.

A Closer Look at China's Aid and Non-Aid Development Finance

How large is China's aid program? Some believe that China is a bigger donor than the World Bank. This is far from the case. In 2010 alone, according to its annual report, the World Bank committed US\$14.5 billion to 66

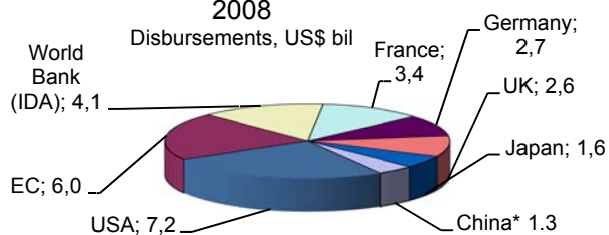
countries in IDA grants and soft loans, with cumulative commitments of US\$222 billion since 1960.

In April 2011 the Chinese provided some of the first official figures on China's aid program: cumulative commitments of close to US\$38 billion since the early 1950s and the end of 2009, broken down as follows:¹⁷

- MOFCOM: cumulative US\$16 bn in **grants** (not including debt relief), and US\$11 bn in **interest-free loans**, some of which have been cancelled;
- China Eximbank: cumulative US\$11 bn in **concessional foreign aid loans**

Africa has traditionally received between 40 and 50 percent of China's total aid annually. My estimates of Chinese aid disbursements suggest that on an annual basis, (Figure 1) China disbursed about US\$1.3 billion in 2008, making it a mid-sized donor in Africa. (Chinese aid to Africa is growing rapidly; annual commitments could be more than 30% higher than disbursements).

Figure 1: Major Donors, ODA to Africa, 2008



How much finance has China provided through other, non-concessional instruments? The figures here are very approximate:

China Development Bank. In September 2010, China Development Bank said that it had made commitments of over US\$10 billion to projects in Africa, and already disbursed US\$5.6 billion to 35 projects in more than 30 African countries (People's Daily, 2010). This can be compared with an earlier announcement in March 2007, when CDB

reported that it had financed 30 projects in Africa, for a total of about US\$1 billion (Xinhua 2007).

China Eximbank. At the end of 2010, China Eximbank's outstanding loans in support of China's "Going Global" program totaled some US\$41 bn.¹⁸ In 2010, China Eximbank disbursed about US\$7.6 bn in export sellers' credits for Chinese overseas investment and about US\$1.3 bn to finance construction projects being implemented by Chinese firms. It is not clear how much of this was directed to Africa. China Eximbank president Li Ruogu said that his bank had committed over US\$13 bn to Africa as of June 2007, and planned to extend up to US\$20 bn in loans to Africa over the next three years.¹⁹

One of the major misconceptions of Chinese engagement in Africa is that it is largely financed by "concessional" loans, implying that it is a type of ODA (official development assistance). A 2010 background paper written for the OECD, for example, used the adjective "concessional" at least 27 times while writing in often general terms about the Chinese financing model in Africa.²⁰ Yet loose terminology like this is unhelpful for our understanding of how China operates overseas.

Most Chinese finance in Africa is *not* concessional. Indeed, Chinese banks reserve the term "concessional loan" only for the foreign aid loans issued by China Eximbank, with, as noted, a cumulative total of US\$11 billion committed between 1995 and 2009. The term "concessional financing" should be reserved for "loans made by a government at an interest rate below the market rate as an indirect method of providing a subsidy".²¹

China's Approach to Financing Development in Africa

Here's the conventional wisdom: *China offers concessional loans to gain access to resources, or China offers "gifts" like stadiums in return for resource concessions.* This is a misreading of the evidence. Beijing uses its different

instruments for different purposes. It's not "all about resources".

Diplomacy. Projects funded by grants and zero-interest loans are used primarily for diplomatic purposes, and are not used for resource-linked packages. Diplomatic goals are behind the dozens of Chinese-built stadiums, government office buildings, conference halls and other "prestige projects" found across the continent. These projects, which often have the word "Friendship" in their name, can be found equally in resource-poor countries and those with resources. Like the teams of Chinese doctors, rural primary school construction program, and hospital construction program, projects funded by these instruments serve Chinese "soft power" goals. They are initiated at the political level, and are primarily tools of diplomacy, not business.²²

Mixed Purpose. Projects funded by concessional loans and preferential export credits mix diplomacy and business. Because they are subsidized by China's budget for external assistance or by the budget for international cooperation, they need to be approved by the Ministry of Foreign Affairs and MOFCOM. But they are also more restricted: they can only be given to credit-worthy countries (Mauritius or Namibia, for example) or for credit-worthy projects, usually with an income stream: rural telecom networks, or scanners for the customs bureau. Projects funded through these instruments are often initiated by a Chinese company seeking business, not by China's diplomats, although host governments can also take the lead in requesting finance.

Business. China Eximbank's export buyer's credits and strategic packages, development finance loans from China Development Bank, and the equity finance instruments (CAD Fund) are all about business. These lines of credit and equity take advantage of low global interest rates and China's large foreign exchange reserves to offer competitive, but market-based financing for Chinese companies and African governments. As with other banks and export credit agencies, a lot

of the business is initiated by Chinese companies and host governments who apply for finance, but the banks also send out teams to drum up projects.

On occasion, concessional loans are combined with market-based loans and zero interest loans or even grants, in a package. Ghana's Bui Dam was financed in this manner.

Patterns and Approaches

The most common pattern is to negotiate an Economic and Technical Cooperation Agreement (MOFCOM) or a Framework Agreement (China Eximbank) which involves a grant, or a line of credit with specific terms. Each project financed out of the line of credit will have a separate loan agreement. The Chinese and the African government sit down together and negotiate a list of development infrastructure projects that will be financed out of the agreement and (usually) built by Chinese companies. Most official aid projects are financed through grants, zero-interest, or concessional loans.

Commodity-backed Loans. Chinese banks offer several varieties of commodity-backed infrastructure loans; these are almost always on commercial terms. Some use existing resources marketed through an African state-owned company as security to repay a loan. In this model, the Chinese firm imports the resource but does not itself have a concession. Ghana is using its cocoa exports to secure a line of credit for the Bui Dam, for example. In Angola, China Eximbank has offered a series of oil-backed lines of credit since 2004.

These commodity-secured loans are not unique to China. In Angola, dozens of international bank consortia have provided oil-secured loans to the government. The Chinese loans to Angola – like the large package in the DRC -- were different, in that they were never given in cash, but tied to development infrastructure constructed by Chinese companies (with 30 percent reserved for Angolan subcontractors).

Hundreds of projects have been financed under these credits. Most are listed on the Angolan Ministry of Finance website: hospitals repaired, secondary, poly-technical and vocational schools built, water systems and bridges repaired, electricity extended across Luanda, and so on.

The war-torn Democratic Republic of the Congo represents yet another model, where two Chinese construction companies have joined with Gécamines, the Congolese state-owned minerals company, to develop an abandoned copper mine. In an off-take arrangement, profits from the mine will be used to repay US\$3 billion in infrastructure construction unrelated to the mining, as well as the costs of developing the mine.

Loans for the Angolan projects, and those in the Congo, were signed at an interest spread above LIBOR, the London Interbank Offered Rate. The spread has been from one to two percent better than loans from a European banking consortium, and with a longer grace and repayment period. Still, this rate, while very good, is not discounted enough to qualify as ODA.

As these financing models indicate, Beijing appears to have many more instruments with which to foster economic engagement. Official aid is a small subset of these funds, as are funds that offer rebates and subsidies to Chinese companies for their overseas investments, and even preferential (subsidized) export credits. Far greater are equity funds for investment, and market-rate export credits.

The Chinese approach – and its business as opposed to “aid” mentality – was outlined well by a senior Chinese official in 2007 who described China’s key areas of cooperation with Africa as:

...upgrade agriculture, improve infrastructure, develop energy and mineral resources, accelerate industrialization and train qualified personnel ... Exploring new ideas on cooperation between Chinese and

Africa businesses and developing new ways to cooperate is an important issue facing us. ... We throw our support behind a number of large projects that are capable of pulling along the entire situation so as to [assist] the development of small and medium-sized businesses. We should concentrate on cooperative projects in economic and trade zones and industrial parks in order to form an industrial chain. These projects would then be a leader for the rest with their spillover effects.²³

Implications of China’s Approach for Recipient Countries

China’s approach to development cooperation clearly offers opportunities, but also entails some risks. The benefits include greater ownership, and more equal partnerships, lower transaction costs, a new emphasis on infrastructure and productive activities, “agency of restraint”, and policy space. The risks include the potential for higher costs when contracts are signed without competitive tenders, as well as the lower labor, social, and environmental standards that come with a middle-income developing country partner, as opposed to one at a high level of development.

Ownership. Countries across the developing world have been pressing for more ownership over their aid and development finance. The Chinese have neither the expertise, nor the inclination, nor the personnel to engage in development strategy planning or write country assistance strategies, for any of the countries where they engage. In fact, such an activity would probably never occur to them.

For the Chinese, ownership starts (and sometimes ends) at the top. In cases where leaders do not coordinate with ministries, this can cause problems, as in Liberia where a president asked the Chinese to build a hospital upcountry, leaving the Liberian health ministry scrambling to figure out staffing for the remote location. But governments who do

have well thought out development plans appreciate the Chinese willingness to follow their lead. They also appreciate that the Chinese principle of non-interference in internal affairs allows them to maintain sovereignty over their development strategy.

Partnership. The language of “donor” and “recipient” remains widespread in the West, despite the efforts of the Paris Declaration to shift to partnership. As the West has found, it is difficult to have real partnerships when one partner is wealthy and autonomous and the other is poor and dependent. As a Chinese researcher once asked me, “how can you fight poverty and stay in a five star hotel?”

Skilled Africans can’t help but wonder why foreign experts who work beside them are earning ten or twenty times their salaries, all paid out of a foreign aid budget (or even worse, financed by a loan that will later be paid out of African government workers’ taxes). The Chinese live far more simply in Africa, often in group housing or compounds, and share a frugal mentality. The managing director of the Bank of China branch in Lusaka is authorized to fly business class, his assistant told me, but he flies economy class instead “to save the bank money.” It is hard to imagine a similar gesture from a World Bank employee.

Lower Transaction Costs. China’s tiny aid bureaucracy (70 professionals in MOFCOM’s Department of Aid to Foreign Countries, 100 in China Eximbank’s Concessional Loan Department) means that the Chinese rarely participate in the stream of donor missions that occupy the time of so many African ministries. China’s aid program offers a relatively limited menu of turnkey projects, mainly focused on infrastructure: roads and bridges, telecoms and power plants, sanitation and water systems. Once a project is initiated or requested, all important decisions are made in Beijing, not by the Chinese mission in the host country. Contrary to conventional wisdom, Chinese banks do require environmental impact assessments, but will often accept those prepared by their borrowers. In recent years Chinese banks have begun to require more elaborate

environmental impact appraisals for loans. Increasingly, these are contracted out to European firms.

New Emphasis on Infrastructure and Production. Chinese companies and banks appear to be far more open to financing and investing in infrastructure, resource processing activities and industrial projects than their peers coming from Western countries. “Donors have neglected power since the 1990s,” a recent study noted, pointing to an infrastructure financing gap of some US\$93 billion in Africa.²⁴ African countries themselves spend some US\$45 billion a year on infrastructure; and Chinese companies have been building much of this, earning revenues of over US\$20 billion annually from construction and engineering contracts on the continent. Worldwide, over 60 percent of China Eximbank’s concessional loans have been committed to infrastructure projects.²⁵

After Liberia’s war ended, President Johnson Sirleaf repeatedly said that her number one priority was getting roads financed. According to adviser Steven Radelet, “No one was doing it. They all said ‘we don’t do roads. But the Chinese ambassador said: ‘we’ll do roads.’ And things changed.”²⁶

In Ghana, the China Africa Development Fund is one of the equity investors in a joint venture with the Government of Ghana and Bosai Minerals Group in a Sekondi industrial estate that will be anchored by a proposed alumina refinery. Ghana has long been a producer of bauxite, mined by large western firms -- Rio Tinto (now merged with Canada-based Alcan), and the US company Alcoa -- who refined the bauxite into aluminum ingots which were then shipped out. But none of these partners was willing to invest in building an aluminium industry.

As Ghana’s Minister of Trade and Industry put it, the Chinese project “will allow our country to finally achieve our long term objective of establishing an integrated aluminium industry and make the most of our resources.”²⁷ Business Monitor International predicted that

the Sekondi Industrial Freezone would “create a major growth area in West Ghana.”²⁸

Another Chinese company is building Chad’s first petroleum refinery in a 60:40 joint venture. The Chadian government applied for a preferential export credit to help finance its share of the venture. Although the famous Chad-Cameroon pipeline project supported by the World Bank originally envisaged building a small refinery, this did not happen, and the pipeline instead transferred Chad’s crude oil outside, while Chad continued to import all its refined petroleum products. Ngata Ngoulou, Chadian Finance and Budget Minister, said: “If we had made this request to our traditional partners, they would have certainly told us to give up the idea.”²⁹

Likewise, in Niger, the Chinese approach contrasted with that of earlier Western companies. Some Africans believe that “China’s efforts offer opportunity for industrialization on a scale never countenanced by the colonizers of old.”³⁰ Ibrahim Ango, president of Niger’s chamber of commerce, told a reporter that French oil firm Total and the US firm ExxonMobil both held oil concessions in Niger’s Agadem region, but refused to consider refining oil. “East time the government said, ‘build a refinery’, they said: ‘it’s impossible’. The Chinese came and said: ‘A refinery? What size?’”³¹

Agency of Restraint. China’s system of resource-backed infrastructure loans is a way for countries with weak governance, unable to access global finance, and prone to the “resource curse”, to opt for an **agency of restraint**. With multiple competing demands for access to the revenue streams from their natural resources, leaders find it hard to say no. Commodity-backed loans are a pre-commitment technique. They allow a government to have public works expenditures today, paying for them with future exports. In weak governments, rather than trying directly to improve the host government’s accountability mechanisms, or forcing improvements through conditionality, the Chinese accept that institutional development is a long term process. They

manage their fiduciary responsibility by keeping control over the finances and almost never giving cash. As one African official told me: “with China you never see that money.”

Debt Sustainability. China’s new ability to offer large-scale finance arrived just as African countries were finally successful in getting multilateral debt relief through the Highly Indebted Poor Countries (HIPC) program. Paris Club and multilateral creditors have worried about a new debt burden. In the DRC, for example, China’s initial offer of a credit line of US\$6 billion for infrastructure and another US\$3 billion or so to finance the copper mine appeared certain to sink the war-ravaged country beneath towering waves of debt just when the government was negotiating with the Paris Club for debt forgiveness on the Cold War era loans racked up under Mobutu.

Yet a different way of looking at this package suggests that while the Chinese financing model involves large sums of credit, it also frequently *creates new cash flows to finance the investments*.

When asked about Western criticism of China’s African engagement during a press conference at the World Bank/IMF Spring Meetings in April 2011, Ngata Ngoulou, Chad’s Finance and Budget Minister, said, regarding debt: “it is more important that the debt burden of African countries is manageable. For us, this is a big difference. Even if some of the Western critique of China makes sense, I still do not think it is a bad thing for Africa. We borrow for our industrialization projects and the debt will be repaid from their profits.”³² This also creates incentives for the Chinese companies and banks to do what they can to ensure that their investments are financially sustainable, an incentive that was often missing in past multilateral debt.

Impact on Local Firms. Chinese imports, particularly of textiles, have been devastating competition for African firms using outdated technologies to produce for local markets. At the same time, some African entrepreneurs are partnering with Chinese companies or

using new Chinese machinery and technical assistance, and competing successfully with Chinese imports into their regions.³³ Indeed, World Bank data shows that between 2004 and 2009, although Chinese imports were rising dramatically, Sub-Saharan African countries experienced average annual increases of three to five percent in manufacturing for every year except 2008, the first year of the global financial crisis.³⁴ In Ethiopia, Senegal, Sudan, Tanzania, Uganda, Zambia and Zimbabwe, all large importers of Chinese goods, manufacturing grew by an average of nine percent in 2009.

In the construction industry, Chinese companies clearly benefit from contracts tied to Chinese finance. When these contracts are delivered without competitive bidding, as in many export credit arrangements, countries may find themselves paying higher costs than would otherwise be the case. Yet even when they have no financial support, Chinese companies are winning a large share of the small and medium construction contracts that might have gone to local firms in the past.

Chinese companies do have low costs but construction firms in Zambia and Namibia have documented unfair Chinese business practices: collusive bidding, low wages, and a tendency to hire contract workers in order to get around mandated labor benefits (paid holidays, sick leave, etc.) for permanent staff. A study by Namibian labor unions pointed out that the Chinese were following the same practices as local African firms. European-owned firms that adhered to local labor laws and regulations suffered most.³⁵

Policy Space. Decades of advice and conditionality imposed by the West have pushed African governments to rely on the magic of the marketplace, develop by opening their markets and exporting according to their comparative advantage in raw commodities. While the Washington Consensus usefully stressed key macroeconomic fundamentals – low inflation and adequate foreign reserves – it was skeptical of the kind of industrial policy and targeted intervention practiced across

East Asia, and it had little to say about strategic *development* policy.

The achievements of the Chinese in moving millions out of poverty are recognized as a significant success. But like other East Asian countries, although China moved toward the market, they did it gradually, and in particular, they did not begin by liberalizing trade, as recommended by the Washington Consensus. Their model emphasizes fiscal stability and macroeconomic balance, but also learning and experimentation. The enormity of this example provides policy space for African governments to experiment with other approaches to fostering development.

African Reactions to China's Business Model

Africans have reacted to China's business model in different ways. Government officials and leaders have largely been very positive. Civil society, trade unions, and some sectors of local business have been more wary. This is particularly the case with regard to the influx of small scale traders, the impact of Chinese goods on local manufacturing, and the fact that by engaging primarily with governments, Chinese aid and export credits reinforce incumbent leaders. Concerns have also been raised about the high levels of counterfeiting and substandard goods coming into Africa from China.

Opposition politicians have sometimes found that Chinese engagement can provide ample fodder for political capital. Writing an op-ed about a large Chinese economic zone planned for Mauritius, Anil Gayan, an opposition member of parliament, wrote: "It is a voluntary colonization...a danger for our security."³⁶ Michael Sata, a perennial presidential candidate in Zambia, famously dismissed the Chinese in his country as "infesters" not investors. Public opinion polls in Africa show that populations there are generally even handed about Chinese engagement. In Cameroon, for example:

...70% of the respondents in one poll were 'disturbed by the Chinese influx' while at the same time 92% in the same survey admitted that China is good for Cameroon's economy. Also, 81% welcomed Chinese products, which benefited poorer parts of the population.³⁷

A study analyzing Afrobarometer's public opinion surveys in 20 countries found that while most Africans expressed positive views of China's role, Africans who rank human rights as high in importance were more likely to have an unfavorable opinion. Views on the importance of democracy were not correlated with negative opinions of China, however.³⁸

Government officials generally express positive views. Speaking at the World Bank/IMF Annual Meeting in April 2011, Dr. Situmbeko Musokotwane, the Zambian minister of finance, compared China's business and aid model with that of the West. China used aid and other tools vigorously to encourage its companies to invest in Africa, he said, but that did not seem to be the case for Europe and America, whose aid programs were more paternalistic, and seemed to be designed as charity: "at least help them not to suffer, we can't do much more than that. They're not ready for investment."³⁹

Mthuli Ncube, chief economist at the Africa Development Bank, commented in Tunis that the Chinese model "is a fascinating and new model in terms of how aid is flowing into Africa and how infrastructure investment is being conducted and supported." China, he said, is "posing a challenge and making us think about aid architecture, this kind of governance-neutral approach to aid engagement and investment in Africa." China's approach might even be more sustainable, he said. "We can talk forever about Millennium Development Goals but my view is you can only pay for MDGs targets and progress not through aid but through growth."⁴⁰

A survey of African stakeholders carried out in 40 African countries by the OECD for the

African Economic Outlook 2011 found that emerging partners such as China were ranked as having a comparative advantage for cooperation in infrastructure, innovation, and even health compared with Africa's traditional bilateral and multilateral partners. Economist Helmut Reisen, head of research at the OECD's Development Center commented: "these results are striking considering all the effort traditional donors have put into these sectors."⁴¹

Lessons for Western Donors and the IFIs

The Chinese have six decades of experience with aid in Africa. They've spent time analyzing their own past failed aid projects, and they've come up with a different model of engagement, much of which does not actually involve official development aid. It's much closer to Japan's pattern of engagement with other Asian countries.

Through diplomatic processes like the Forum on China-Africa Cooperation (FOCAC), initiated in 2000, China's has increasingly coordinated its development engagement with Africa on a "whole of government" basis, with involvement by the line ministries (agriculture, health, education, science and technology), universities and think-tanks, policy banks, as well as the ministries of commerce and foreign affairs. This synergy has led to practical experiments based on China's own experience:

- **Resource-backed infrastructure loans.** Credits that allow countries with poor credit ratings to borrow today and pay with tomorrow's exports.
- **Overseas economic zones** that encourage Chinese companies to move their labor, energy, and resource-intensive manufacturing offshore.
- **A US\$5 billion equity fund** provides additional capital investment options for suitable Chinese companies in Africa who plan invest in public-private partnerships, joint ventures, and manufacturing.

- **A US\$1 billion fund** to provide loans to African small and medium enterprises, channeled through African countries' national development banks.
- **20 agro-technology demonstration centers** that ask Chinese institutes and agribusinesses to build sustainable business models that can cross-subsidize development outreach with profitable income opportunities.

These tools are for the most part not funded by China's official aid, but they *are* about development. More importantly, they respond to the requests of Africans for assistance that will help in building infrastructure and creating new jobs. The Chinese approach to development finance in poorer countries demands that we reconsider our assumptions and our neat categories that separate "aid" from business support.

This overview of China's aid and development cooperation suggests five lessons for Africa's Western partners.

(1) Africa Is Open for Business. Western governments and their firms have long seen Africa as a continent of collapsed states, danger, pathos: "the heart of darkness." Africa is seen as a place that deserves our pity and our charity, but not (except for raw materials) our investment. China saw much earlier than Western governments that Africa was turning the corner. They began to actively encourage Chinese investment across all sectors. Yet even when prospects in Africa are looking particularly bright, the response by Africa's Western partners does not always reflect this. The US has increased grant aid for health programs in Africa, but at the same time the US Department of Commerce has closed all of its offices in Francophone Africa, shelved plans to open one in Angola, and planned to close its office in Ghana, one of Africa's fastest growing economies.⁴²

We need to think harder about how we can combine our limited aid funds with private money not just as socially responsible charity, but in strategically coordinated ways that boost business for our own companies and

that encourage them to invest in economically sustainable ventures that foster not just growth, but structural transformation and employment.

These ideas are not alien to the West and there is growing support for them on both sides of the Atlantic. A Brookings Blum Roundtable argued in 2010 that donors should be more strategic about "leveraging multinational corporate interest in developing countries" and "incorporating useful business mentalities in approaches to development aid."⁴³ In June 2011, the Confederation of Netherlands Industry and Employers answered the question "Should the business sector be allowed to make a profit from development assistance?" with a resounding affirmative.⁴⁴

(2) True Ownership and Partnership: We Can Do Better. Where the West regularly changes its development advice, programs, and approach in Africa (integrated rural development in the 1970s, policy reform in the 1980s, governance in the 1990s, the MDGs this past decade, and so on) China does not claim to know what Africa must do to develop. Their "request-based" funding approach relies on African borrowers to figure out what they need, rather than requiring them to import often unwanted consultants to draft proposals. These days, African laws frequently require loans to be approved by parliaments. In theory, this puts the people's stamp on a project.

The Paris Declaration on Aid Effectiveness uses the language of partnership. Yet true partnership is not something forged between "the generous and the grateful".⁴⁵ The Chinese believe that Africans will accept that development finance (aid and non-aid) can be offered in a frank exchange, as part of a relationship of mutual benefit, rather than a one-way transfer from donor to recipient.

(3) Governance and Economic Conditionality May Be Over-Rated. While donors have clear fiduciary responsibilities for the use of their taxpayers' funds, the imposition of economic and political conditions has gone far beyond this, and has usually been selective, focused

on the weakest countries who, it has been said, pretended to reform while the donors pretended to believe them. As a Nigerian civil society activist said, some who admire China's approach are "physically and intellectually exhausted by two decades of economic 'reform' supposedly adopted by African government but driven by Western governments, donors and the IFIs."⁴⁶

Li Ruogu, president of China Eximbank, stated his views on governance conditions bluntly at a meeting of the World Economic Forum in South Africa: "We spend most of the time discussing issues such as transparency and good governance. And that would not help because they are part of a development process. I do not think that Britain was as transparent as it is today some 200 years ago, let alone the United States a hundred years ago."⁴⁷

Obviously, it is not only Chinese officials who hold this view. The chairman of the board of DIIS (Danish Institute of International Studies) wrote recently that "Good governance is not a good development strategy ... [it is] a consequence of, rather than a condition for, economic development."⁴⁸

The West needs to do harder thinking about how best to engage in troubled countries, even in pariah states where our policy of isolation means we have little leverage. Are there ways that we can still support development in addition to disaster relief and modest humanitarian assistance? After all, China under Mao was seen as a "pariah state" for decades after 1949 and remains a communist authoritarian state with human rights challenges today. Yet engaging rather than isolating Beijing has been enormously fruitful for the West, and for 1.3 billion Chinese.

(4) Infrastructure, Infrastructure, Infrastructure. Ngozi Okonjo-Iweala, vice-president of the World Bank and former finance minister in Nigeria, said that when she asked the Chinese how Nigeria could have 10% growth like China's, they answered: "Infrastructure – infrastructure and

discipline."⁴⁹ It is clear that when African governments truly have ownership, as in the US Millennium Challenge Corporation program, they opt for infrastructure spending. Shenggen Fan, director general of the International Food Policy Research Institute, recalled how Norman Borlaug, the father of the green revolution, told him that Africa needed "three things – rural roads, number one; number two, rural roads; number three, rural roads."⁵⁰ But it isn't just roads that Africa lacks. As John Briscoe -- a South African professor of environmental engineering at Harvard and former World Bank official -- has emphasized, the wealthy world has developed 80% of its hydropower resources, but Africa only about 3%. Dams are an "emotive issue" he acknowledged, but the moratorium on Western finance for dam construction was long overdue for re-evaluation.⁵¹

(5) Policy Space for Experimentation. Beijing has argued that countries should be free to find their own pathways out of poverty. This is not the way the West thinks. The "one size fits all" approach adopted in the Washington Consensus is the most stark example, but even the Millennium Development Goals (which emphasize important social areas, but neglect the equally important underpinnings of rural electricity, telecoms, transport, and other infrastructure as well as economic development) are a softer kind of hegemony in development thought.

Economists used to understand that developing countries were different from rich countries, and that they needed different things at different stages. China, with its emphasis on strategic planning, still thinks this way. For too long we in the West have thought we knew what was best for Africa and the rest of the developing world. Perhaps it is time we stepped back and allowed them the policy space to experiment and learn on their own.

Conclusion

The Chinese approach is different than ours for at least four reasons.

1. Core Ideas. China's core ideas about development are different than our changing recipes: they derive from China's own development experience. The Chinese say at home: "to get rich, build a road." And so they focus their aid on infrastructure. They believe "agriculture is the foundation and industry the leading edge" and so agriculture and industry have always been a big component of their aid and now their economic engagement.

2. Past Experience. China's experience as a developing country and recipient of aid and loans, particularly from Japan, influenced their thinking about how countries can use aid and development finance for mutual benefit.

3. Foreign Policy. China's five core foreign policy principles include *non-interference* in internal affairs of other countries, and the idea that relations between nations should be based on *mutual benefit*. This provides a powerful check on paternalism, while endorsing the use of multiple instruments, including business, to bolster cooperation that benefits both sides.

4. Regional Model. China is becoming an East Asian developmental state, along the lines of Taiwan, Korea, and Japan. We know what this looks like: state intervention to promote economic prosperity. We just haven't seen a country working like this in Africa, on this scale.

The West still tends to see Africa's development as dependent on our foreign aid. Yet with budget woes in the West, and healthier bottom lines across much of the continent, we are at a turning point where most development financing is not going to come from official development assistance, but from banks, private companies, and even export credit agencies in the BRICS.

We need a better understanding of just how countries like China are engaging in Africa.

And once we have that understanding, we may be better positioned to accept the recommendations of thoughtful African officials like Ngozi Okonjo-Iweala: "China should be left alone to forge its unique partnership with African countries and the West must simply learn to compete."⁵²

Implicit here is a warning: we in the West no longer have a monopoly over development ideas, practice, and finance. China is rising, and with them, India, Brazil and others. If we don't learn how to have "a new conversation" as African Development Bank president Donald Kaberuka put it,⁵³ we risk finding that Africans are no longer interested in listening.

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