



SEPTEMBER 13-15, 2009 WESTERN CAPE, SOUTH AFRICA

---

# AFRICA EMERGING MARKETS FORUM

---

Looking East:  
Africa's Newest  
Investment  
Partners

---

Deborah Brautigam



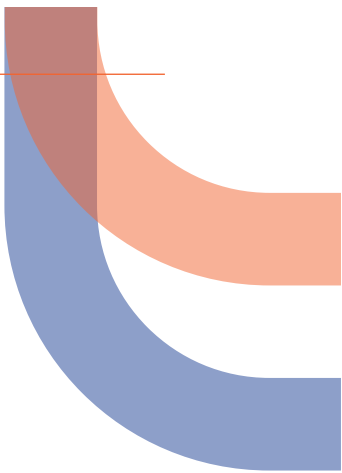
**Emerging  
Markets  
Forum**

A nonprofit initiative of the Centennial Group

Bringing people together to  
accelerate growth and  
well-being in emerging markets



# Table of Contents



|                                              |    |
|----------------------------------------------|----|
| I. Trade Overview                            | 3  |
| II. Investment                               | 4  |
| III. Instruments of Engagement               | 7  |
| Development Finance                          | 7  |
| IV. Export Credits                           | 7  |
| Resource-Backed Infrastructure Finance       | 8  |
| China Africa Development Fund                | 10 |
| Special Economic Zones                       | 10 |
| V. The Economic Crisis and Asian Development | 11 |
| VI. Concluding Comments                      | 12 |



# Looking East: Africa's Newest Investment Partners

Deborah Brautigam

One of the most striking features of the new millennium has been the sharp increase in Asian business engagement in Africa. A surge in trade, investment, and offers of large lines of export credits to finance infrastructure and (sometimes) investment have been accompanied by a rise in more unusual instruments of engagement: natural resource-backed infrastructure loans, government-supported equity funds, and overseas special economic zones.

China, with its "Going Global" strategy of expanding outward, has been a central actor in the Asian embrace of Africa, but India has also increased its ties to the continent, while Malaysia and Korea are following with business deals of their own. In November 2006, China held the highly visible third Forum on China-Africa Cooperation in Beijing, laying out its strategic white paper for its relations with African countries, while India held a large Africa forum in April 2008.

This newly prominent engagement raises many issues for the emerging economies of Africa. Just what are the dimensions of this engagement? Do Asian partners offer anything different from Africa's traditional partners? Are there reasons to be concerned about this new engagement? What is the balance of

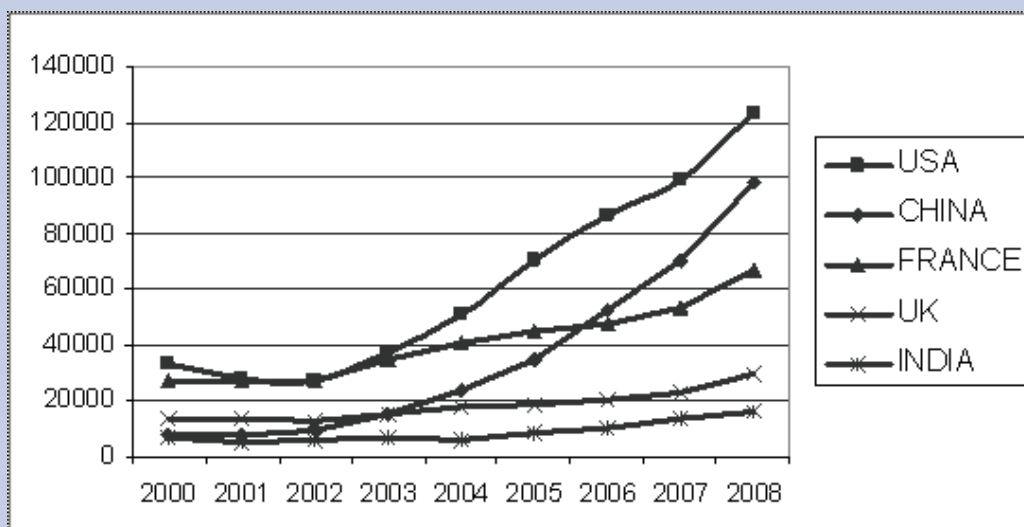
risk and opportunity? This brief paper addresses some of these issues, beginning with the dimensions of engagement.

## I. Trade Overview

Africa's Asian partners have made significant shifts in the continent's traditional trading patterns (Figure 1). In 2003, African trade with China surpassed British trade. In 2006, Chinese trade overtook trade with France, making China second only to the United States in total trade. African trade with India is also growing, although India is still below the UK in importance as a trading partner. India's African trade rose from US\$967 million in 1991 to US\$35 billion in 2008, and India has made it a goal to triple this trade over the next five years, surpassing \$100 billion. Yet as Figures 2 and 3 indicate, these emerging patterns of trade are likely to signal different kinds of risks and opportunities for African countries.

One significant pattern that has emerged can be seen in Figures 2 and 3. In 2008, the United States imports from Africa came to nearly \$100 billion, nearly twice the \$51 billion imported from Africa by China. The composition of these imports are

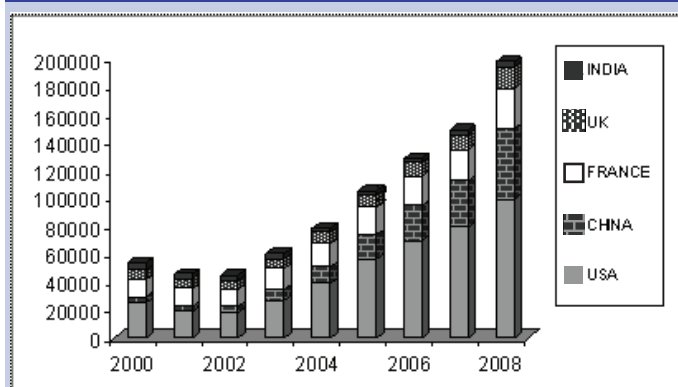
Figure 1. Africa: Trade (\$ mil)



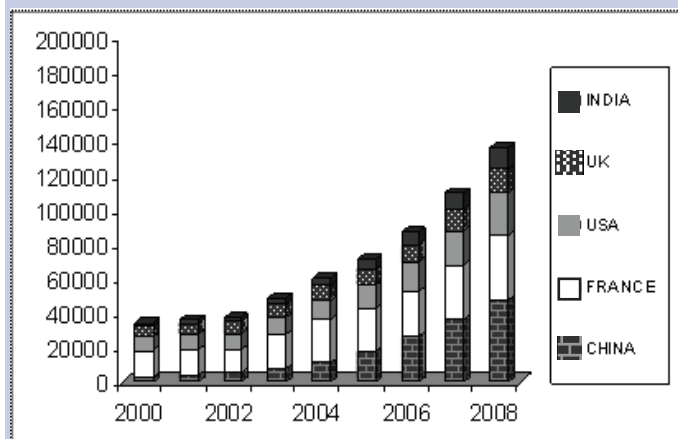
Source: IMF, Direction of Trade Statistics (2009)

This paper draws on the author's forthcoming book: *The Dragon's Gift: the Real Story of China and Africa* (Oxford: Oxford University Press, November 2009). Please do not circulate, and please ask for permission before citing.

**Figure 2. African Exports (\$ mil)**



**Figure 3. African Imports (\$ mil)**



quite similar. In 2008, more than 80 percent of US imports from Africa were oil, very close to the proportion (72 percent) of Chinese imports from Africa (2007 figures). Yet in 2008, Chinese exports to Africa (\$48 billion) were nearly balanced by Chinese imports from Africa (\$51 billion). Exports from the United States to Africa amounted to only \$24 billion in 2008.

This comparison highlights several things. First, since the early 1990s, Chinese leaders have pushed their companies to diversify export markets, seek out investment opportunities, and secure access to natural resources. Africa was a target region. In 1997, for example, with China's trade with Africa resting at only \$4 billion, China's Minister of External Trade, Mrs. Wu Yi, asked Chinese businessmen to "aggressively" seek out African markets and overcome the "monopoly" held by the West.<sup>1</sup>

The Chinese government created a number of instruments to support this trade. Their success in finding markets for Chinese goods is reflected by these trade figures.

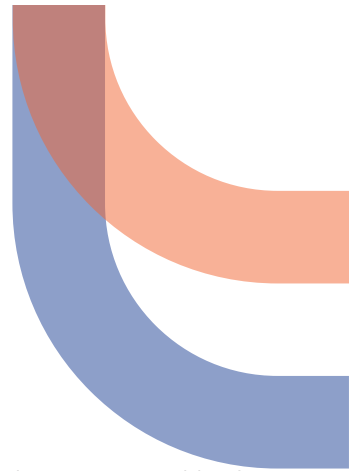
Second, the conventional view is that Chinese goods in Africa are largely cheap consumer goods, textiles and garments that compete with African producers. Some of this is reflected in the trade data. Figures for 2007 report that 25% of Chinese exports to Africa were clothing/textiles, a category that competes with the emerging industries in many African countries, but which in some cases also serves as an input (cloth) into African textile exports: Mauritius, Lesotho, and Swaziland feature in this category. Yet 11 percent were "high-tech products", 8 percent iron and steel products, and 46 percent different electromechanical products.<sup>2</sup>

That last category includes the cheap appliances sold across Africa, but it also includes the machinery increasingly being purchased by African manufacturers for their own production, and equipment sent to supply Chinese mining and manufacturing investments in Africa. In several African countries such as Zambia and Egypt, Chinese firms have established electronics assembly industries, one of the starting sectors on which Asian export prowess built. This category, too, is on the increase. Asian investors and machinery suppliers in some areas are working with African entrepreneurs to solidify African industrial transitions.<sup>3</sup> But on the one hand, Asian exports provide stiff competition for African manufacturing firms.

Agricultural machinery exports are one area in which both Chinese and Indian firms are active. Several Indian firms specialize in small tractors, water pumps, and drilling equipment for wells and irrigation: the Kirloskars in Senegal, Angelique International in Mali and Sudan.<sup>4</sup> Chinese companies have also singled out Africa's agricultural sector as an important market, for agricultural machinery as well as hybrid rice seeds.

## II. Investment

The trend on investment is clear, even if the particulars are somewhat murky. Investment from Asia (China and India in particular) has been growing rapidly. Yet while fairly reliable figures on Asian-African trade are relatively easy to collect from the IMF's Direction of Trade (DOT) database, this is not the case for investment, making it very difficult to provide detailed analysis of investment trends.



Several problems exist with the data on investment. First, much Chinese and Indian foreign investment is routed through offshore tax havens (Mauritius is a favorite of Indian investors who use the island to “round trip” investments back into India, taking advantage of incentives for “foreign” investors). Chinese companies frequently route their investments through Hong Kong (where it shows up in Chinese overseas FDI accounts as investment in Hong Kong), the Channel Islands, the Bahamas, and similar locations, and it is impossible to track where the funds come to rest. In addition, a lot of investment is financed through reinvested profits, which are often not reported as FDI.

Finally, Chinese sources give different figures for the stock of overseas investment in Africa. For example, the Ministry of Commerce Yearbook states that the stock of Chinese direct, non-financial sector investment in Africa at the end of 2005 was \$1.6 billion, and in 2006, \$2.6 billion. In other official statements, Chinese officials have said that Chinese investments reached a stock of \$6.27 billion at the end of 2005, and have given figures ranging between \$11.7 and \$13.6 billion for accumulated investment at the end of 2006. It is not clear why the two sets of figures differ so strikingly.

In fact, African countries remain minor players in Chinese overseas investment. By the end of 2007, Chinese companies had invested in more than 173 countries worldwide. Around 7000 Chinese firms had established at least 10,000 overseas enterprises.<sup>5</sup> Only around 1000 of these were in Africa, however. It is true that the proportion of Chinese investment going to Africa has increased. Data provided by China’s Ministry of Commerce show that Chinese investment in Africa was only 2.6 percent of China’s total overseas investment flows in 2003. As Figure 4 indicates, by 2007, the figure for Africa had risen to 6 percent. In other words, Africa’s share of Chinese investment more than doubled, but from a relatively low base.

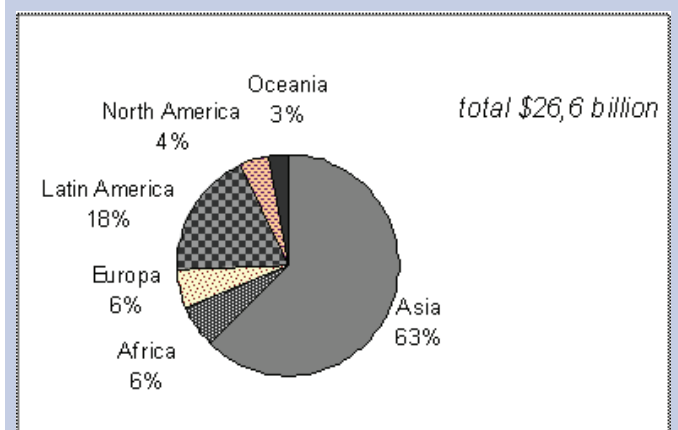
Which countries are winners of this investment? Table 1 provides data from the China Commerce Yearbook on Chinese direct investment in non-financial sectors in the top 15 African recipients (cumulative stocks). Even with the qualifications about the data expressed above, it is not surprising that the top five recipients of Chinese investment are resource-rich countries. However, five countries among the top ten destinations of Chinese investment (Egypt, Mauritius, Tanzania, Ethiopia and Madagascar) are not among the countries traditionally labeled as “resource-rich”.<sup>6</sup> This reflects the fact that Chinese

investment is diversified, embracing sectors outside of raw materials. As a recent report by the OECD noted, Chinese overseas foreign direct investment in Africa “has not been particularly skewed towards the natural resources sector in international comparison.”<sup>7</sup>

One of the areas in which both Chinese and Indian companies are investing in Africa is pharmaceuticals. China has budding pharmaceutical multinationals, companies like Holley, a manufacturer of anti-malarial drugs. India is already well known as the home of generic pharmaceutical manufacturer Cipla, known for its anti-retrovirals, as well as Ranbaxy. Pharmaceutical firms from both countries are setting up production bases in Africa. At the same time, lines of credit and aid programs are supplying Chinese and Indian pharmaceuticals to African governments, helping populations to grow accustomed to the new brands.

Another key area of investment is telecommunications. Chinese companies Huawei and Zhongxing Telecommunication Equipments Company Limited (ZTE) are taking market share away from Swiss Ericsson, Finnish Nokia and French Alcatel, and growing fast in Africa. Huawei is said to have more than 30 branch offices in Africa. Indian telecom firms such as Bharti Airtel have been buying into African telecoms markets. Bharti Airtel recently made a \$23 billion bid to join with South Africa’s MTN Group. ZTE purchased over half of the privatized Niger Telecommunications, and has a joint telecoms venture

**Figure 4. Chinese FDI Flows 2007**



Source: 2007 Statistical Bulletin of China's Outward Foreign Direct Investments

**Table 1: Major Recipients of Chinese Non-financial Direct Investment in Africa  
(Cumulative Stocks) \$ mil**

|              | 2003 | 2004 | 2005 | 2006 | 2007 |
|--------------|------|------|------|------|------|
| Total Africa | 491  | 900  | 1595 | 2557 | 4462 |
| South Africa | 45   | 59   | 112  | 168  | 702  |
| Nigeria      | 32   | 76   | 94   | 216  | 630  |
| Sudan        | 1    | 172  | 352  | 497  | 575  |
| Zambia       | 144  | 148  | 160  | 268  | 429  |
| Algeria      | 6    | 34   | 171  | 247  | 394  |
| Egypt        | 14   | 14   | 40   | 100  | 132  |
| Mauritius    | 13   | 13   | 27   | 51   | 116  |
| Tanzania     | 7    | 54   | 62   | 112  | 111  |
| Ethiopia     | 5    | 8    | 30   | 96   | 109  |
| Madagascar   | 28   | 41   | 50   | 54   | 76   |
| Guinea       | 14   | 26   | 44   | 55   | 70   |
| Congo        | --   | 6    | 13   | 63   | 65   |
| Zimbabwe     | 37   | 38   | 42   | 46   | 59   |
| Gabon        | 24   | 31   | 35   | 51   | 56   |
| Kenya        | 26   | 28   | 58   | 46   | 55   |

in the Congo. (Interestingly, the Chinese companies have won contracts in India, where in 2007 Reliance Communications, the country's leading private mobile phone service operator, awarded a \$200 million dollar contract to Huawei to expand its Indian network.)

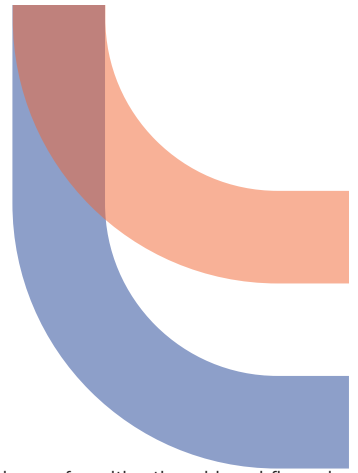
Asian foreign direct investment (FDI) into Africa takes a number of forms. Particularly common is the construction of new (greenfield) assets (a new factory, for example) or the purchase of existing productive assets that have been "given up" by their previous owners, whether through bankruptcy or privatization. For example, China's Zonghui Mining Group agreed to purchase a bankrupt copper mine in Zambia for a reported \$3.6 billion, while other Chinese companies have opted for concessions that remain to be developed. A number of Chinese companies are also operating firms originally built under Chinese foreign aid between the 1960s and 1980s. For example, COVEC (China Overseas Engineering Group) has for several decades operated COMATEX Malienne des Textiles, a large textile complex in Mali, while China Light Industrial Corporation for Foreign Economic and Technical Cooperation operates a large sugar complex in a joint venture with the

government of Mali. Both ventures came about as a result of privatization programs in Mali.

Share purchases and more "arms-length" acquisitions of companies with African assets or expertise is another set of investment strategies for Asian companies. For example, it has become increasingly common for Chinese companies to purchase shareholdings in respectable existing companies with African holdings, but where the Chinese firm will not hold controlling interest. To date, the largest such investment by a Chinese company in Africa was the 2007 purchase of 20 percent of the shares of Standard Chartered Bank by the Industrial and Commercial Bank of China for \$5.4 billion.

This acquisition reflects a Chinese strategy of *partnering* with more experienced companies in new areas. Chinalco, a state-owned aluminum company, owns the largest block of shares (9.3 percent) of the global minerals firm Rio Tinto, which has extensive African assets. In another version of this strategy, a Chinese firm purchases an existing company but keeps the operating structure intact. Chinese oil firm Sinopec has offered to purchase Toronto-listed Addax for \$7.2 billion (Addax has large holdings in Iraq, Nigeria, and Gabon, and the deal must





be approved by the Chinese government). Addax's expertise in deepwater exploration was a major draw for Sinopec, which lacks such expertise. Sinopec planned to keep Addax's management and technical staff.

Both Chinese and other Asian companies are frequently supported by their governments in their investment strategies. Following in the time-honored path of the East Asian developmental state, these governments have developed a number of instruments to support the investment and business success of their companies.

### III. Instruments of Engagement

#### *Development Finance*

In the pattern followed by Japan, Korea, and Taiwan, the Chinese use bank finance far more than stock markets to provide capital to their companies. This allows for the guiding hand of government to provide an extra boost to companies' overseas efforts. Given high domestic savings rates and the accumulation of dollar reserves, China's large state-owned banks, and in particular, China Development Bank, can provide large lines of credit to their companies to foster their efforts to "go global." In April 2009, for example, the telecoms firm ZTE announced that it was working with China Development Bank on a five year, \$15 billion investment and financing platform to help ZTE expand overseas. The credit line will allow ZTE to expand its offers of suppliers' credits to potential customers, a practice highlighted in the companies winning of Ethiopia's Millennium Telecommunication Project contracts. Other large Chinese multinationals have received similar lines of credit from China Development Bank, and from China Export Import Bank (Eximbank).<sup>8</sup>

These strategic cooperative agreements should not be seen themselves as loans. They are rather lines of credit that can be drawn on to support the particular company in its overseas business. The credits can be used by the company directly, by other institutions authorized by the company, or any corporation or institution that purchases equipment or engineering services from the company. In each specific project launched under the credit line, however, (i.e. each specific loan) China Development Bank or China Export Import Bank will apply its own internal evaluation and approval process. The Chinese

banks increasingly use the services of multinational legal firms in evaluating the financing packages for large projects.

Some of the loans fostered by these large lines of credit may be taken out by African companies or countries. For example, in December 2005 Sinomach, a large state-owned group comprising at least 50 companies involved in engineering, project contracting, equipment and machinery, signed a cooperative agreement with China Eximbank involving a promise of \$3 billion in support. Over the next three-plus years, Sinomach subsidiaries were able to sign agreements ranging from MOUs to hard contracts for business in a number of African countries, including:

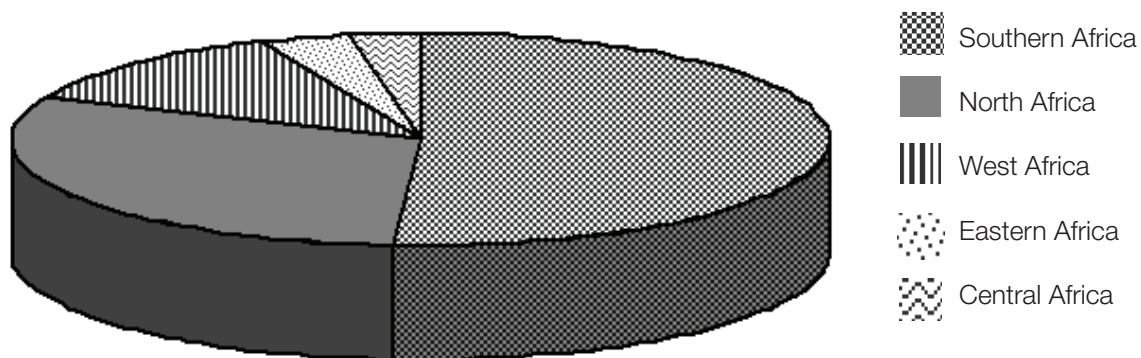
- a €240 million set of sports facilities in Cameroon
- a medium and low voltage power grid modernization program in Malabo, Equatorial Guinea
- a city electricity network reconstruction project in Kenya
- the \$970 million Morupule Power Plant in Botswana
- the RMB 976 million Ambodiroka Hydropower Plant in Madagascar
- the power transmission lines for the Imboulu Hydropower Station in Congo-Brazzaville
- a \$647 million power transmission and distribution system for 25 cities to be supplied by Djiploho Hydropower Station in Equatorial Guinea
- a \$298 million electrification project in Luanda, Angola
- a \$669 million engineering, procurement and construction project for two privately-financed hydropower stations on the Kalungwishi River in Zambia.

Not all of these projects will come to fruition, but the range of business shows the ambition of companies like Sinomach in Africa, and the assistance they can get from the Chinese government.

### IV. Export Credits

A related instrument of support for Asian investment and business in Africa is the system of export credits. India's export credit agency is already nearly twenty-five years old. China's Export Import Bank was established only in 1994. Yet the Chinese bank is already the world's largest export credit agency. China Eximbank offers export suppliers' credits, export buyers'

**Figure 5: Regional Distribution of Outstanding Loans Extended to African Countries by China Eximbank, as of 2006**



credits (market rate and preferential), and guarantees, and it also operates China's concessional foreign aid program, one of several aid instruments used by the Chinese government. (Most Chinese export credits are not concessional, however, but are based on LIBOR-plus interest rates.)

Both India and China have ratcheted up their offers of export credits for Africa. In 2005, Chinese leaders pledged that "within the next three years, China will provide US\$10 billion in concessional loans and preferential export buyer's credit to developing countries to improve their infrastructure and promote cooperation between enterprises on both sides."<sup>9</sup> Half of these turned out to be targeted to Africa. In 2006, Chinese leaders made this more specific with the pledge of \$2 billion in preferential export buyer's credits for African buyers over the next three years, along with \$3 billion in concessional foreign aid loans for African governments. In 2007, the head of the China Eximbank said that his bank planned to make \$20 billion in export finance available to African countries over the next three years (this would mainly be market rate, but at very attractive market rates).

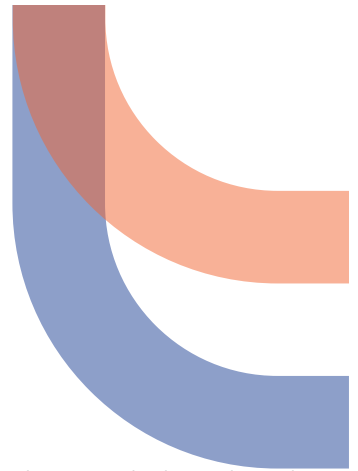
Likewise, Indian officials made a similar announcement at their April 2008 summit: a doubling of export credits for Africa over five years, from \$2.15 billion in 2003-4 to \$5.4 billion in 2008-9. Export credits from China (or India) can be used for

infrastructure investments by African countries, as long as they use goods and services exported by China (or India). Chinese export seller's credits can also be used for foreign direct investment by Chinese companies.

China Eximbank does not usually give figures for its African portfolio separate from its overall portfolio. However, in 2007, a China Eximbank official announced that it had authorized RMB 92.5 billion (\$12.3 billion) in export credits and other loans to Africa between 1995 and 2006, for more than 259 projects (not all of this has been disbursed). Figure 4 below shows the regional distribution of outstanding loans extended to African countries (mainly to governments) by China as of 2006. Then, Southern Africa accounted for more than half of the portfolio.

#### *Resource-Backed Infrastructure Finance*

Chinese finance for large-scale infrastructure is one of the most frequently noted elements of Beijing's economic embrace of Africa. As credit markets dried up in the global financial crisis that began in 2008, some observers hailed China's apparent ability to continue financing large scale infrastructure projects in Africa. China Eximbank has financed nearly 300 projects across Africa since 1995, but, surprisingly, only about half a dozen are in the category of large, natural-resource backed infrastructure loans.<sup>10</sup>



Although they are relatively rare, these lines of credit, usually large and often somewhat complicated, epitomize what the Chinese mean when they talk about “win-win” cooperation. A country uses its natural resources to guarantee infrastructure loans from China. The loans are used to build infrastructure and sometimes (but not always) to develop a block of natural resources so that the loans can be repaid.<sup>11</sup> The offer of a line of credit usually must be used within two, sometimes three, years, but can be extended.

Other Asian countries have followed suit. In November 2006, for example, it was reported that Korea’s minister of commerce, industry and energy had signed a \$10 billion preliminary deal to provide low interest loans for Korean companies to build the Port Harcourt - Maiduguri railroad in Nigeria in exchange for preferential access to several blocks of Nigeria’s offshore oil reserves. “This is a win-win project where South Korea’s technology and Nigeria’s resources are swapped,” the Korean government commented. As with many such announcements, the project appeared to go no further, but it was an indication of Korean interest in the same kind of resource-backed infrastructure model.

It is likely that these complicated packages are more about having a secure backing for a loan than they are about gaining secure supplies of resources. They rarely seem to be done as an initiative of China’s oil or minerals firms. There are far more examples of China’s oil or mineral companies simply bidding in auctions or purchasing shares of existing oil/mineral companies directly without an infrastructure component. Indeed, the Chinese state-owned mining firm (China Metallurgical Group) brought as a third partner into the massive copper and cobalt-backed infrastructure project in the DRC, initiated by two large Chinese state-owned construction companies (China Railway Engineering Corporation and Sinohydro) and backed by China Eximbank, later pulled out.

In a few cases (Angola 2004, possibly again in 2006 and 2007; Nigeria 2006, Equatorial Guinea 2006) these oil-backed infrastructure loans seem to have been offered as a pure swap: a line of credit at an attractive, yet still commercial interest rate, for infrastructure, in exchange for a Chinese company or joint venture gaining preferential rights to oil blocks (the Nigeria deal was not consummated; the Angolan and Equatorial Guinea deals have not been confirmed as direct swaps). In the DRC copper-cobalt swap, the loans will pay jointly for public

infrastructure and for mining development, the latter through the joint venture with Gécamines. When the copper-cobalt joint venture comes into production, it will repay the initial loan. In other cases, (Nigeria in 2005, Ghana in 2007, and possibly in Angola in 2006 and 2007) existing natural resources owned or marketed by the borrowing government were simply used to repay the loan.

The finance that accompanies these projects usually comes from the China Eximbank (occasionally, and increasingly, the China Development Bank is involved). It may combine export buyer’s credits, and export seller’s credits (which could be on-lent as a supplier’s credit), but does not seem to involve concessional aid loans. In all cases, the financing stays within China, being used to pay a Chinese exporter of goods or construction services. (The Chinese supplier may draw on the money for local expenses, labor, or local subcontractors, as in Angola). It operates as a line of credit, not as a blank check deposited into the borrower’s bank account. Each project is managed, designed, implemented and evaluated as a separate loan.

The benefits of this kind of package are obvious. The country is able to use its natural resource exports for infrastructure, construction of which usually begins almost immediately. For projects that also finance the development of a natural resource, the project (usually a joint venture with the local government) begins to repay the infrastructure loan, and the costs of developing the resource, with the proceeds from the mine or oil wells. The downside is equally obvious.<sup>12</sup> When the same companies develop the resource and do the infrastructure projects without competitive bidding (Angola does require that three pre-approved Chinese companies bid on each project), there is a huge risk that the country might not get value for money on the infrastructure projects. In addition, infrastructure, in general, is notorious for kick-backs.

The largest of these resource-backed infrastructure packages is currently underway in the Democratic Republic of Congo. The package involves three separate loans from China Eximbank which will finance (1) Sicomines, the proposed \$3 billion copper and cobalt mining joint venture between several Chinese companies and state-owned Gécamines in the Democratic Republic of Congo (DRC) where the Congolese will hold 32 percent of the shares; (2) at least one, and possibly two, \$3 billion commercial rate lines of credit from China Eximbank

that will finance Chinese companies to build roads, hospitals, railways and schools in the war-ravaged country. Another in a series of package deals brokered by China Eximbank, some of the output of the mining venture, estimated to be worth up to \$50 billion, is slated to repay the \$3 billion investment loan, and the infrastructure loan(s).

The International Monetary Fund and several of the DRC's creditors oppose China Eximbank's huge infrastructure-credits-mining as risky, believing that low commodity prices or unexpected difficulties with extracting the ores could impair the ability of the venture to repay the infrastructure loans, forcing the DRC to borrow to repay the Chinese. An underlying issue is the structure of the credit framework agreement, which gives the China Eximbank first claim to the export resources generated by the mining venture, and provides a government guarantee should the resources in the mine fall short of the infrastructure expenditures. Traditionally, countries that borrow from the IMF and the World Bank agree to make them preferred creditors with a priority claim to any foreign exchange generated by the country's exports. In addition, as is the case with most mining investments no matter the nationality, the still-evolving contracts were not made public, raising concerns about transparency. On the other hand, the DRC government has publicized extensive details on the terms of the loans, and the projects they are expected to finance.<sup>13</sup>

At the end of the day, the system might be seen as an improvement over the current system in many weak states, where natural resources are exported, and the proceeds disappear into off-budget accounts, and from there, often, to off-shore accounts. In the case of Equatorial Guinea, foreign architects were brought in to evaluate the work to ensure quality control.<sup>14</sup> The DRC contract also involves an independent third party to oversee the work. In Angola, the Ministry of Finance was allowed to publish on the internet details about costs and status of the infrastructure projects being completed under the loan. More moves like these should ameliorate some of the risks.

#### *China Africa Development Fund*

Announced at the November 2006 Beijing Summit, this \$5 billion equity fund will be open to Chinese companies and their joint venture partners for investment in agriculture, manufacturing, industrial parks, mining, and infrastructure (power, telecommunications, water, transportation). Managed

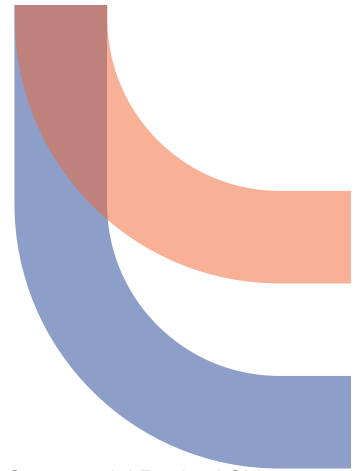
by the China Development Bank, the fund will have a lifespan of 50 years and make equity investments of between \$5 and \$50 million in each project. The focus on joint ventures provides an opportunity for African governments and entrepreneurs to collaborate with Chinese entrepreneurs on manufacturing and other productive ventures.

The fund started with an initial capital allocation of \$1 billion. By the end of 2008, it had invested in some 20 projects (about \$400 million in CADF equity, with Chinese partners investing an additional \$2 billion).<sup>15</sup> Projects funded under this fund include a glass factory and leather processing factories in Ethiopia, a cotton outgrower and processing project in Malawi, a commercial power station in Ghana, assembly plants in South Africa and Algeria (with China YTO Group, a subsidiary of SINOMACH), and three of the seven special economic zones being set up by Chinese companies in Africa.

#### *Special Economic Zones*

China's current prosperity can be traced in part to Shenzhen and the other three special economic zones opened along the coastal regions in the 1980s. Drawing on this model, the Chinese government decided in the 11th Five-Year Plan (2006-2011) to establish at least ten industrial zones abroad as part of the "Going Global" strategy. In 2006, the Chinese announced that three to five of these would be located in Africa.

In Chinese eyes, these zones are unlike the ill-fated export processing zones established by many African governments in the past. Instead, major Chinese companies bid for the opportunity to win state support as they take the risks in proposing, establishing and promoting the zones to their compatriots, while hoping to profit from selling services to investors located in the zones. The plan is to create a supportive environment for small and medium Chinese companies to venture overseas, particularly those that are no longer competitive in China but might be competitive by moving closer to their markets. Local firms and other foreign companies will also be able to invest in the zones, subject to approval by African governments. Seven African zones have been approved for Chinese support: Zambia, Mauritius, Nigeria (Ogun and Lekki), Egypt, Ethiopia, and Algeria. All are still in the early stages, and some (such as Mauritius) have been stalled by the recent economic crisis.



## V. The Economic Crisis and Asian Investment

A widely read article in *The New York Times* with the gloomy title “As Chinese Investment in Africa Drops, Hope Sinks,” shaped many peoples’ perceptions that the plans of the Chinese and other Asian investors for a new economic partnership with the African continent were sinking fast. The reporter was writing from Conakry, Guinea, where a recent coup and political instability had put all investment plans on hold, not just those of the Chinese. Does the evidence elsewhere back this pessimism?

The economic crisis could affect Asian commercial engagement in trade and investment. The first quarter of trade figures for 2009 showed significant declines from levels prevailing in 2008, the year when Sino-African trade reached \$108 billion. In the second quarter of 2009, imports from Africa increased 67 percent.<sup>16</sup> But this was not enough to make up for the slump in African demand for imports, nor the fact that trade values are very sensitive to changes in the prices of commodities that make up the bulk of Chinese imports from Africa. Overall, China-Africa trade fell 30.5 percent, amounting to only \$37.07 billion in the first six months of 2009, but investment has risen.<sup>17</sup> China’s Ministry of Commerce reported that foreign direct investment in Africa rose by 81 percent in the first six months of 2009 compared with the same period of 2008, reaching \$552 million.<sup>18</sup> Across the continent, there are cases of continued countercyclical interest in African business by Asian banks and firms, as well as deals that have slowed because of the crisis.

With regard to China, three areas stand out. First, Chinese industries facing increased competition at home due to market slowdowns in China are looking hard for new markets. Some are setting up factories in Egypt, Ethiopia, Nigeria, and other countries, both to supply those markets and to export to the region and beyond. Second, Chinese natural resource companies are expanding in a counter-cyclical fashion, using China’s still massive foreign reserves to buy up assets at bargain prices from companies unable to wait out today’s lower prices. Third, Chinese banks continue to team up with Chinese construction companies to finance and build infrastructure projects.

Energy projects for the power-hungry African continent are a central feature of this interest. In June this year, China’s

largest bank, the Industrial and Commercial Bank of China (ICBC) and South Africa’s Standard Bank signed an agreement to co-finance just over half of Botswana’s \$1.6 billion Morupule B coal-fired power station expansion project. Chinese co-financing is likely in a second mega-project being developed by Canadian-listed CIC Energy: the \$3-billion Mmamabula coal-fired power station in Botswana. CIC Energy has already signed an engineering, procurement and construction contract with Shanghai Electric Power Generation Group. Power from Botswana’s ample reserves of coal will find a ready market in South Africa, where shortages have recently led to power cuts. These co-financing examples are signs of the increasing maturity of Chinese banks as global players.

Chinese interest remains strong in mining. Although many small, private companies owned by ethnic Chinese closed their doors in places like the DRC when prices fell in the global recession, larger, well-capitalized companies are holding firm, and even expanding. For example, Chinese copper companies in Zambia have increased their investments, and a Chinese firm recently agreed to purchase a large nickel mine in Zambia. At least one other large project has also been signed since the global financial crisis began. In January this year, the Liberian government announced a contract with a Hong Kong company, China Union, for a \$2.6 billion project to develop the dormant Bong iron ore mines. However, details on the financing for the project have not been released, casting some doubt on the project’s viability.

The Chinese companies behind the \$9 billion loan-infrastructure-mining package in the DRC have shown every intention of going forward.

A final geological study of the project commissioned by the Sino-DRC joint venture Sicominex was concluded only at the end of August 2009, but the Chinese construction companies had already begun work on the first installment of infrastructure projects.<sup>19</sup> Reports from Zimbabwe suggest that a large, resource-backed Eximbank line of credit is being negotiated for that country as well, while the China Development Bank has been developing a platform for economic engagement with Zimbabwe over the past several years.

On the other hand, the financial crisis has affected some of the other large infrastructure projects often mentioned in the media. A case in point is the \$8.3 billion Lagos-Kano railway construction contract awarded to China Civil Engineering

Construction Corporation (CCECC) by the Nigerian government, in 2006. The contract was suspended in late 2008 after CCECC had begun work. Low oil prices caused by the global recession cast doubt on the Nigerian government's ability to finance the project out of its oil windfall account. A newly elected government also took issue with the non-transparent award of the contract by the previous government. A \$2 billion line of credit from China Eximbank for infrastructure projects in Nigeria -- some of which was expected to be used for this project -- expired without being used.

Chinese banks have access to the country's still-ample foreign currency reserves. This gives them a comparative advantage in providing low-cost financing during the global financial crisis when many of the other global banks are under stress. People's Daily reported that ICBC, which owns 20 percent of Standard Bank, now is working with Standard Bank on more than 60 projects in Africa. China Development Bank has also increased its exposure in Africa, and is reportedly close to concluding a \$1 billion loan to Angola, which may finance agriculture projects. Chinese banks continue to scrutinize proposed projects with a close eye to their repayment capacity. Still, Chinese interest in using the global crisis as a countercyclical opportunity remains high.

## **VI. Concluding Comments**

This brief discussion is unable to address many of the concerns raised by the rise of Asian finance and investment, some of which are listed below:

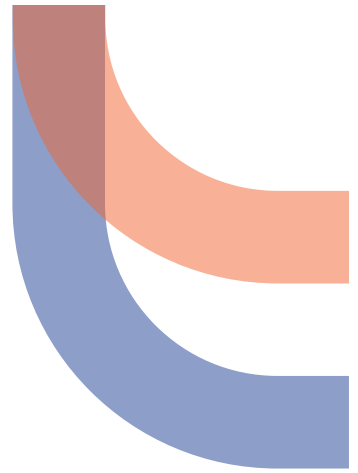
- "Asian tsunami": Will Asian imports swamp African manufacturing?
- Debt sustainability: Will these large loans lead to a new debt crisis?
- Governance: does "no strings attached" financing worsen efforts to improve governance?
- Standards: Do Asia's lower standards for labor and the environment pose a threat to development in Africa?
- Employment: Do Asian contractors tend to use their own compatriots as labor on their projects?

Much of what is known about these issues is gleaned from somewhat sensational media accounts. However, evolving research suggests a more nuanced set of conclusions.<sup>20</sup> This

research, and participants' own experiences, can be discussed further at the Cape Town Forum.

The rise of Asian business partners presents an opportunity to African countries to diversify their sources of trade, investment, and finance. There is much that can be gained from this, and risks that will need to be ameliorated through wise negotiation and safeguards. At the end of the day, the extent to which this opportunity bears fruit will be up to the actions of African leaders and government officials.





## ENDNOTES

- 1 China Daily, as reported in Africa Research Bulletin, v. 34, n. 8, 1997, p. 13138.
- 2 China Commerce Yearbook 2008, p. 487.
- 3 For an analysis of this issue, and case studies of Chinese investment in manufacturing, see Deborah Brautigam, *The Dragon's Gift: the Real Story of China in Africa* (Oxford: Oxford University Press, forthcoming November 2009).
- 4 Renu Modi, "Africa-India: An Ideal Partner?" Pambazuku News, July 31, 2009.
- 5 China Business Network, "Support Chinese Investing Overseas," <http://www.chinabn.org/invest/index.htm> [accessed August 28, 2009].
- 6 For a list of the "resource-rich" countries, see John Page, "Rowing Against the Current: The Diversification Challenge in Africa's Resource-Rich Economies," Brookings Institution, Global Economic and Development Working Paper No. 29, December 2008, p. 26.
- 7 OECD Investment Policy Reviews: China 2008, p. 67.
- 8 These include many companies active in Africa's emerging markets, including China National Machinery Import Export Corporation, Sinopec, Chalco, China State Construction Engineering Corporation, Chery Auto, TCL Group, China Minmetals Group, China Machinery Group, Sinomach (China National Machinery Industry Corporation),
- 9 Hu Jintao, "Promote Universal Development to Achieve Common Prosperity," New York, September 14, 2005.
- 10 Congo-Brazzaville 2001: dam/oil; Sudan 2001: power plant/oil; Nigeria 2002: power plants/oil; Angola 2004: infrastructure/oil; Equatorial Guinea 2006: infrastructure/oil; Ghana 2007: dam/cocoa. Three additional cases are being negotiated or under discussion: Gabon (Belinga iron ore), Guinea (bauxite), Zimbabwe (chromium), DRC (copper). Two other projects were also under discussion that would build infrastructure to facilitate export of a resource, probably to China (Botswana coal/railroad; Mauritania phosphates/railroad).
- 11 Choe Sang-Hun, "South Korea and Nigeria Negotiate an Oil-rail deal," International Herald Tribune, November 6, 2006. This arrangement has apparently come to naught.
- 12 According to the IMF, resource-backed loans in general "are ripe for exploitation and misuse" since they are usually non-transparent, often contain exorbitant fees, and tend to be associated with corrupt behavior and weak states. IMF "Guide on Resource Revenue Transparency," June 2005.
- 13 Democratic Republic Of The Congo, Ministry Of Infrastructures, Public Works And Reconstruction,
- 14 Contribution By The Minister On The Occasion Of The Presentation Of The Accords Signed Between The Government Of The Democratic Republic Of The Congo And The People's Republic Of China, Kinshasa, DRC, May 9, 2008
- 15 Mario Esteban, China Quarterly, forthcoming.
- 16 "Africa: Investment Fund Strengthens Sino-African Partnership," TradeInvest Africa (Cape Town), August 9, 2009.
- 17 Ding Qingfen, "Crude, iron ore imports up in July," China Daily, August 12, 2009.
- 18 "China's Direct Investment in Africa Up 81 Pct in 1H," Xinhua, August 18, 2009.
- 19 Franz Wild, "Congo's Sicominex Confirms Extent of Copper Find," Bloomberg.com, August 27, 2009.
- 20 For extensive discussion of all of these issues, see Deborah Brautigam, *The Dragon's Gift*.







---

The Emerging Markets Forum is a non-profit venture of the Centennial Group, a Washington-based strategic advisory firm specializing in emerging market economies. The Forum was created to allow senior political and corporate leaders and public servants reach actionable conclusions on economic, political, and social issues facing emerging market economies.



Further details on the Forum and its meetings may be seen on our website at <http://www.emergingmarketsforum.org>

The Watergate Office Building, 2600 Virginia Avenue, NW, Suite 201  
Washington, DC 20037, USA. Tel:(1) 202 393 6663 Fax: (1) 202 393 6556

Email: [info@emergingmarketsforum.org](mailto:info@emergingmarketsforum.org)