

## The Policy Challenge for Sub-Saharan Africa of Large-Scale Chinese FDI (ARI)

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**Theme<sup>1</sup>:** The existence of large state-owned Chinese firms and private investors engaged in investing primarily, but not exclusively, in resource and infrastructure sectors in SSA (Sub-Saharan Africa) is a major preoccupation in economic and political circles. In order to understand it, Chinese investment has to be differentiated into four different types, and its distinctive characteristic unpacked –ie, the bundling together of aid, trade and FDI (foreign direct investment)–. This has major policy implications for how SSA should relate to Chinese investors in order to maximise available opportunities.

**Summary:** There is widespread economic and political interest in the impact of Chinese investment in Sub-Saharan Africa (SSA). This paper distinguishes between four different types of Chinese foreign direct investment (FDI), primarily focusing on SSA's engagement with large state-owned Chinese firms investing in SSA's resource and infrastructure sectors. Although there is a paucity of published research, it also provides evidence on private Chinese FDI in wholesale/retail, manufacturing, and services. The available evidence drawn from a variety of sources –macro, micro, firm surveys and country reports– on the extent of different types of Chinese investment is discussed. The distinctive character of large-scale state-owned Chinese investors is summed up in the bundling together of aid, trade and FDI, in contrast to traditional western trends which seek to unbundle these factors. The paper concludes that SSA countries should maximise the opportunities opened to them by their resource-base by adopting a similarly integrated and focused response to Chinese (and other large) investors who seek to draw on the continent's natural resources.

### Analysis:

#### *Why Chinese FDI is Important*

Chinese Foreign Direct Investment (FDI) into Sub-Saharan Africa (SSA) has grown rapidly in recent years. After identifying the different streams of FDI, this paper focuses on the family of predominantly state-owned Chinese firms (SOEs) operating in the resource and infrastructure sectors, pointing to their integration with Chinese aid and trade. It is here that Chinese FDI is placed into global context and suggested that it is distinctive when compared to Western FDI in the resource and infrastructure sectors in SSA.

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### *The Dynamics of Chinese FDI Flows to SSA*

China's relations with Africa in the modern era have undergone three phases. The first followed the Bandung Conference of Non-Aligned Nations in 1955, where China, partly driven by its rivalry with the USSR, offered support to decolonising Africa. This analysis covers the second phase, of the mid-1990s and onwards. Following a substantial growth in trade with Africa and a growing need for resources, large and predominantly state-owned Chinese enterprises (SOEs) entered SSA as investors and as contractors to Chinese-aid-funded projects in infrastructure and public buildings. The third phase of Chinese interaction with SSA is one involving small- and medium-sized, predominantly private-sector, enterprises. Some are incorporated in China and have extended their operations to SSA and others have been started *ab initio* in SSA.

The three types of Chinese investors in SSA are shown in Figure 1. 'State-owned' and 'private' are unclear, since one of China's unique characteristics has been the fuzzy lines drawn between the state and private sectors in ownership. Many 'SOEs' function as conduits for private gain, in that profits are appropriated by key individuals who are not formal owners of the firms. Similarly, the returns from many 'private' firms are partial reflections of state decision-making. Thus, ownership in China is a complex amalgam which Nolan characterises as an 'ownership maze' with 'vaguely-defined property rights' (Nolan, 2005, p. 169).

The SOEs, predominantly investing in resource extraction and infrastructure, can be segmented between those owned by the Central Government and those accountable to provincial governments. Central government SOEs tend to operate under formal state-to-state agreements and hence are expected to take the government's strategic objectives into consideration in their African operations. The provincially-owned firms reflect the initiatives of their decentralised state administrations, often built on regional diasporas in SSA (see Gu, 2009), and are under pressure to operate profitably so as to contribute revenue to provincial governments. The private sector firms cover the spectrum of SMEs incorporated in China and investing in SSA, perhaps as a first venture outside their home base. They also include a limited number of very large firms, such as Huawei in telecoms. The large- and medium-sized China-based firms generally operate in the manufacturing and communications sectors, as well as in wholesale trading. The other end of the private spectrum involves small to micro enterprises, either in petty manufacturing or in small-scale retail.

This paper is primarily focused on the Chinese SOE FDI in SSA.

**Figure 1. Four types of Chinese investors in SSA**

	<b>Central State</b>	<b>Provincial State</b>
<b>Predominantly State-owned</b>	Normally accountable to State Council	Often loyal to Provincial rather than Central Government objectives
	Tender for Central Government funded EXIM Bank financing	Tender for Central Government funded EXIM Bank financing
	Predominantly in resource sector, infrastructure projects and construction	Predominantly in resource sector infrastructure projects and construction
	Involves formal State-to-State (ie, China host government) agreements	Generally some form of twinning between China provinces and SSA governments
	<b>Incorporated in China and SSA</b>	<b>Incorporated in SSA only</b>
<b>Predominantly private-owned</b>	Predominantly in manufacturing and services	Predominantly in trading and services
	Largely self-financed	Self-financed
	Act independently of Chinese central government	Act independently of Chinese central and provincial governments
	May be supported by Chinese provincial government	May not be legally incorporated
		Familial contacts important

Source: adapted from Corkin (2009) and Gu (2009).

### *Chinese FDI in SSA*

Estimates of FDI flows are notoriously inaccurate. The weak recording practices in SSA increase the unreliability of data on Chinese investment flows there. There are four sets of estimates of the extent and nature of these flows: (1) official and public-domain estimates of the extent and distribution of Chinese FDI in SSA; (2) AERC study estimates of the extent and distribution of Chinese FDI in SSA; (3) UNIDO's survey of FDI in SSA; and (4) primary studies of small private-sector Chinese FDI.

- (1) Official and public-domain estimates of the extent and distribution of Chinese FDI in SSA. Official estimates of China's FDI flows to SSA are contradictory and understate their true significance. Drawing on a variety of official sources, Besada *et al.* estimate that Chinese FDI flows into Africa exceeded US\$500 million in 2006, rising from US\$400 million in 2005 (Besada *et al.*, 2008). UNCTAD data suggest inflows rising from US\$1.5 million in 1991 to US\$61 million in 2003 and US\$1.6 billion in 2005. In terms of relative shares, Gelb (2010) draws on the Chinese Ministry of Commerce database (MOFCOM) to differentiate real Chinese FDI from flows and holdings in the Cayman Islands (CI) and British Virgin Islands (BVI) as well as round-tripping through Hong Kong (HK). Africa then accounts for 40% (the largest share) of Chinese FDI in 2008. Chinese FDI is concentrated in the Sudan, Algeria, Zambia, Nigeria and South Africa, accounting for 71% of Chinese FDI in Africa.

Between 1979 and 2000, 46% of Chinese FDI was in the manufacturing sector (mostly clothing), while services, mainly construction, accounted for 18% and resource extraction accounting for 28%. China's FDI in oil and gas exploration has been concentrated in Nigeria, Angola, Equatorial Guinea, the Sudan and Gabon. In 2007 the State-owned Industrial and Commercial Bank of China invested US\$5.4 billion acquiring a 20% strategic stake in Standard Bank of South Africa.

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- (2) AERC Study estimates of the extent and distribution of Chinese FDI in SSA. In 2006-07 the African Economic Research Consortium (AERC) undertook studies in 21 SSA countries to assess their trade, aid and investment relations with China. In 2009-10 a further 20 studies in 14 countries were completed.

The research ([www.aercafrica.org/publications/category.asp](http://www.aercafrica.org/publications/category.asp)) outlines three groups: those in which Chinese FDI plays a relatively significant role, a moderate role and a low-significance role. They show that oil-gas and mining investments are of considerable significance in some economies. In agriculture, the primary sector of Chinese involvement is cotton, but only in Zambia. Chinese FDI in telecoms is widespread throughout the 20 economies. There are significant investments in utilities. It is the construction and infrastructure sector where Chinese FDI is most pervasive, some of it in show-piece construction –government buildings and sport stadiums–. FDI in manufacturing is primarily in labour intensive activities –garments dominate–. There is also a spread of investments in small-scale manufacturing enterprises, which do not surface in official statistics but, like Chinese retail traders, may have a more substantial socio-economic impact. Small-scale petty-trading by Chinese migrants is widespread in almost every economy, but is often unrecorded. The AERC studies reveal limited gains in local employment creation and a significant use of an expatriate labour force.

- (3) UNIDO's survey of FDI in SSA. In 2005 UNIDO conducted a survey of 1,216 foreign enterprises operating in 15 African economies. Comparing Chinese, Indian and South African and Western investors, Chinese firms were younger, had lower sales per worker (but with higher sales growth), were more export-oriented and had low investment rates and low annual wages. Chinese respondent firms were clustered in low value-added export-oriented low-wage assembly operations (eg, garments).
- (4) Primary studies of small private sector Chinese FDI. Chinese FDI that is much harder to track, but with increasingly significant socio-economic impact, is in the private sector. Gu (2009) reports Chinese EXIM Bank estimates of around 800 China-incorporated firms that have established operations in SSA as a whole. However, she estimates the number of private firms to be more than 2,000. Although no numbers are provided on employment, most of these firms appear to be small- or medium-sized. A second set of primary research on Chinese private sector firms is Brautigam (2008) on small-scale investments in Mauritius arising from a history of Chinese immigration –reinforcing the importance of diasporas in private-sector FDI–.

The AERC studies provide a third window into China's small scale investors through their links as suppliers to large-scale SOEs in the infrastructure and resource sectors. The Sudan is a particularly illuminating case. Between 2000 and 2007, 97 Chinese SMEs provided inputs for 13 SOEs in the oil sector.

Finally, we have research looking at small-scale firms operating predominantly in manufacturing and services, small construction firms and petty manufacturing. A large and unrecorded number of Chinese individuals operate as small scale entrepreneurs (Mohan & Kale, 2007; Mohan & Power, 2008; Dobler, 2008). A relatively new set of trading entrepreneurs are Chinese wholesalers who act as a platform for associated retailing activities in neighbouring countries by other small-scale migrant entrepreneurs ('platform economies'). These, too, are observed but are not systematically recorded.

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*How Distinctive is Chinese FDI in SSA?*

The SOE category of Chinese FDI in SSA is predominantly clustered in large-scale resource-oriented ventures (Burke & Corkin, 2006; Broadman, 2007, p. 275; Ajakaiye *et al.*, 2008) and predominantly bundled with Chinese aid in projects designed to meet China resource needs.

- (1) Terms of trade reversal and the growing importance of resources. Since at least the 1870s there has been a trend for the terms of trade to turn against the commodities export sector. Prices of manufactures have usually risen faster. However, between 2002 and 2008 prices boomed across the spectrum of commodities. This 'super-cycle' comprised a longer period than previous spikes. There are sound reasons to believe that it will last, despite the financial-sector induced bust after August 2008. Unlike previous periods, the current boom is fuelled by a massive demand in the Asian driver economies which have a high income-elasticity of demand for commodities (IMF, 2007; Farooki, 2009). This affects the demand for energy (with spin-offs into agriculture for bio-fuels), minerals and food crops (FAO, 2007; Freeman, Holslag & Weil, 2009). Primary commodities are therefore likely to remain in short supply globally, and prices are likely to be sustained.

Africa is especially well favoured by these developments, not so much in terms of its existing commodities, but for its potential exports. It is the primary base for the future of many mineral commodities. In many mineral commodities, Africa is the primary resource base for the future. In energy, it is not so much Africa's share of global reserves which is so strategically important, but its reserves of unallocated reserves.

According to McKinsey, nearly one-quarter of Chinese FDI in the extractive industry is also involved in infrastructure development and resource processing, (McKinsey Global Institute, 2010). A large part of these investments are focused on providing transport routes for the export of resources. Since 2005, Chinese total infrastructure commitments to SSA have exceeded those of the World Bank (McKinsey Global Institute, 2010).

- (2) The strategic integration of Chinese operations in SSA. With the exception of small-scale copper mining smelters in Zambia and the DRC, all of these resource-based Chinese investments have been large in scale and have involved Chinese SOE (both Central-State SOEs and Provincial-Government SOEs). In all these sectors, particularly in infrastructure for trade (Foster *et al.*, 2008), Chinese aid has complemented these trade and FDI flows.

The close link between trade, FDI and financial flows has historical precedents. In the colonial era these three vectors were fused and the imperial powers' interests in SSA were closely coordinated. As Africa was decolonised, the aid, trade and FDI vectors were increasingly separated because of an increasing opposition from SSA countries, who saw the integration as too costly since tied aid generally led to much higher-cost inputs. New economic actors were emerging (notably the US) and the integration of vectors locked them out of markets. There was growing public opposition in the OECD economies against what was seen as an exploitative framework and multilateral aid was growing in importance, so that the International Financial Institutions insisted on the delinking of aid, trade and FDI.



China's presence in SSA departs from this recent orthodoxy and represents a reversion to the patterns of historical colonial links between mother countries and SSA colonies. Particularly in the case of large-scale infrastructural and mining projects, this takes the form of the strategic integration of various inputs from China. It is therefore impossible to unbundle what constitutes Chinese 'aid' and 'FDI' (Ajakaiye *et al.*, 2008). The so-called 'Angola-model' has become a framework for much of China's SOE activity in SSA. It describes an integrated package in which China's EXIM Bank provides a line of credit at subsidised interest rates. Chinese firms then tender for infrastructural projects, tied to the use of Chinese inputs with intensive use of Chinese skills. The bulk of these 'aid' funds never leave China but are transferred from the EXIM Bank to the firms which have won the tenders. These funds are repaid by the recipient country as a drawdown on commodity exports back to China. Not all aid follows the 'Angola-model'. China also provides for politically sensitive and prestigious projects but often where it has a direct resource interest and where it seeks to build a long-term presence.

- (3) China's investment in SSA: a departure from trend? The most-used framework for assessing the drivers of FDI was developed by Dunning (2000) who identified three primary explanatory factors, the so-called OLI framework: ownership, location and internalisation. The 'ownership' factor describes special competences, motivations and power to control foreign affiliates, which reflect the nature of the firms involved. 'Location' explains why they operate in a particular country. This may be because of market possibilities ('market-seeking FDI'), resource-seeking FDI or because the country has low operating costs ('cost-reducing FDI'). 'Internalisation' explains why foreign firms prefer to own their operations as opposed to licensing or selling their technologies.

Mathews (2002) has suggested a fourth factor, the 'linkages' driver, to explain FDI from the Asian Tigers, especially in relation to their investments in high-income economies insofar as firms invest abroad not to exploit their firm-competences, but in order to augment these competences by learning from their overseas operations. While it is debated whether this 'leveraging' is really new (since it arguably reflects firm-competences in business strategy and technology acquisition –Dunning, 2006; Narula, 2006–), there does seem to be a new flow of FDI from low- and middle-income economies like China, India and Brazil.

Utilising the Dunning framework (as augmented by Mathews), is it possible to compare the investments by Chinese SOEs with those of the historically-dominant Western firms? With respect to the strategic integration of aid, Chinese SOE FDI in SSA is distinctive and differs markedly from the global trend to unbundle investment from aid. Most FDI from China has reflected a relatively tight bundling of investment with tied aid, designed to facilitate the export of natural resources, predominantly directly to China.

In terms of ownership characteristics, Western firms investing in SSA are usually funded through stock markets. The emphasis on 'shareholder value' means that they have a short-term profit objective and are very risk-averse. By contrast, with cheap (and often subsidised) long-term capital, Chinese SOEs operate with long-term time-horizons and are less risk-averse (Tull, 2006; Zeng & Williamson, 2007). The exception to this has been small investments by Chinese private firms, for example in Zambian and DRC copper smelting. Finally, most Western firms are constrained by

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accords like the Paris Declaration, affecting labour rights and general practices. By contrast, Chinese SOEs operate in a relatively unfettered environment.

In terms of location-specific factors, resource-seeking investments are found in both Western and Chinese FDI. However, many Western TNCs have operations in SSA to meet the needs of domestic consumers and many of these investments are long-lived. By contrast, a small component of Chinese FDI has been market-seeking. The use of SSA as a low-cost export platform is largely confined to the garments sector, and reflects tariff preferences in major Western markets.

Learning factors also play a more important role for Chinese firms using SSA as a test-bed for overseas investments. Finally, although some Chinese garment exporters incorporate their SSA garments operations in their clothing exports, these are only very isolated examples of their integration of SSA subsidiaries in global value chains. Some Western firms integrate their African subsidiaries in their global value chains.

## Conclusion

### *Policy Implications for Engaging with Large Chinese Dragons*

What are the optimal responses to ensure that the entrance of Chinese FDI is turned into developmental opportunity? This requires a focus on the development of strategic capabilities and the roles played by key developmental actors.

- (a) Developing strategic capabilities: SSA is not without its attractions to Chinese investors. The key, therefore, is for it to use its commodities to its best advantage and use this power to leverage advantageous terms in agreements with China. In developing a strategic agenda, they can benefit from integrating the aid, trade and FDI. Meeting China's trade needs should be conditional upon their providing aid to exploit these commodities, as well as meeting SSA's developmental and infrastructural needs.
- (b) Policy actors: who in SSA is going to drive this strategic agenda? It will necessarily involve individual governments as they hold the levers which determine access to their economies. They each need to coordinate an integrated strategic response to offer access to their resources in a way which meets their country's needs. Formal written strategies which are not implemented effectively are much less use than dynamic and active coalitions of local interests interacting effectively amongst themselves and with emerging country partners.

Another arena for integrated response is in regional forums –SADC, ECOWAS and the AU–. These multi-country organisations are important in their aggregation of African countries in the bargaining process and in the protection of countries with fewer commodities, so as to develop intra-regional trade capacity.

In conclusion, although we have pointed to the distinctive character of Chinese SOE-driven FDI in SSA, and the opening this creates to negotiating aid and economic assistance with China, this only partially addresses the problem. Undertaking the necessary research and developing policies is not enough. The question is how can it ensure that such policy and strategies stick? The real issue is whether SSA countries have the human resource capacity and institutional capability to negotiate these agreements effectively, as well as the political will and legitimacy to enforce, and gain

maximum advantage from them. Institutional governance is one of SSA's greatest challenges. Without this implementing capacity, the agreements are likely to be notional, nothing more than granting advantage to China in its interaction with Africa and its global diplomatic strategic initiatives under the cloak of a developmental agenda.

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