Africa's Burgeoning Ties

Maximizing the benefits of China's increasing economic engagement with Africa

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AFRICA and China have been trading partners for centuries. But in recent years, the level and intensity of their relationship have increased dramatically. In the early 1990s, official development aid and government ministries dominated the relationship. Now, however, as the relationship has evolved to center on markets for each other's exports and Africa's demand for infrastructure, the Chinese corporate sector and joint ventures have supplanted government agencies. In other words, for Africa, China is now a major market, financier, investor, contractor, and builder—as well as donor.

In general, this tighter economic friendship has been welcomed. After all, reducing poverty tops the global community's Millennium Development Goals for 2015. But concerns are increasingly being voiced about how China's growing presence might affect Africa's development. Many African nations worry about its possible impact on local industries and employment. And major industrial nations worry about the lack of donor coordination and rebuilding of debt burdens in poor countries that have benefited from their recent debt write-offs.

To date, there have been relatively few systematic studies of the growing economic relations between China and Africa. That is why the IMF has undertaken a study to quantify—pulling together available information, which is far from complete—China's economic engagement with Africa. The hope is that through a better understanding of the relationship, we can identify how African countries might best position themselves to reap the biggest possible gains.

Trade is growing

Two-way trade flows between Africa and China have been growing rapidly. Between 2001 and 2006, Africa's exports to and imports from China rose on average by more than 40 percent and 35 percent, respectively, significantly higher than the growth rate of world trade (14 percent) or commodities prices (18 percent). In dollar terms, for both imports and exports, the increase in that period was from about $10 billion to more than $55 billion (see Chart 1). China is now Africa's third largest trading partner after the United States and the European Union. Its share in Africa's annual export growth has almost doubled since 2000 (see Chart 2).

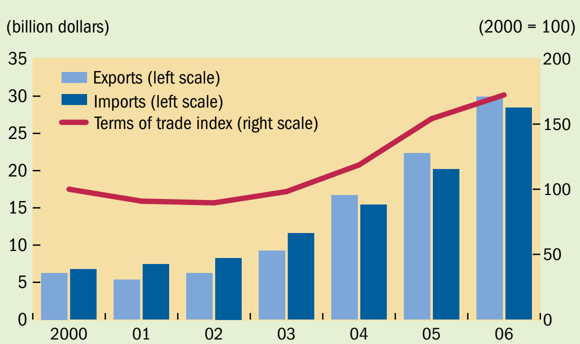
The terms of trade have moved in Africa's favor. It is estimated that Africa's export prices relative to the price of imports from China improved by 80–90 percent between 2001 and 2006, the result of rising world prices for oil and raw materials, Africa's main exports. Those increases have been driven in part by strong demand from China. Bilateral trade, meanwhile, has been fairly balanced. Africa in 2004–06 ran a small, $2 billion a year trade surplus with China.

The composition of goods traded between Africa and China is similar to that between Africa and its other major trading

Chart 1

Surging trade

Africa's exports to China are soaring as its terms of trade improve.

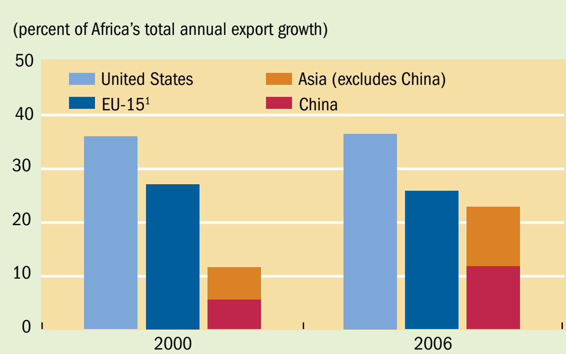


Sources: IMF, *Direction of Trade Statistics*; authors' calculations.
Note: Terms of trade are prices of Africa's exports to China relative to the prices of its imports from China.

Chart 2

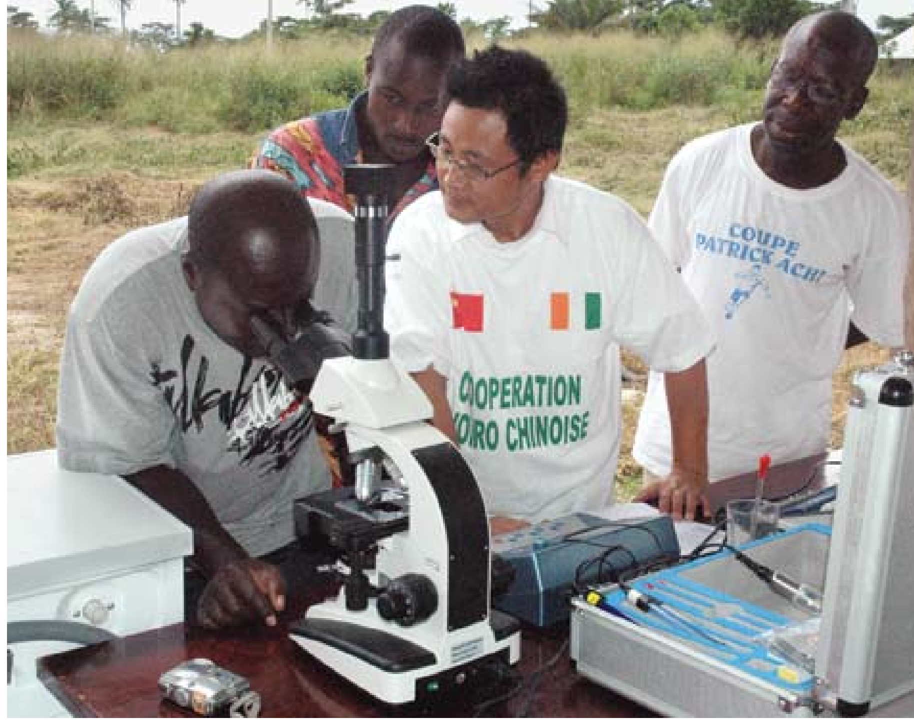
The partnership deepens

China is increasingly contributing to Africa's export growth.



Sources: IMF; authors' calculations.
[1]Original EU members before the 2004 expansion: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and United Kingdom.

with **China**



A Chinese expert helps local fishermen monitor water quality in Andé, Côte d'Ivoire.

partners (see Chart 3). In 2006, oil and gas accounted for over 60 percent of Africa's exports to China, followed by nonpetroleum minerals and metals at 13 percent. Africa's imports from China comprised mainly manufactured products and machinery and transport equipment, which together accounted for about three-fourths of total imports. The similar composition of goods traded between Africa and its main trading partners suggests that the recent surge in Africa-China trade largely reflects the comparative advantages of each partner, given their stage of economic development, rather than any unilateral interest by China in exploiting natural resources.

Commerce dominating aid

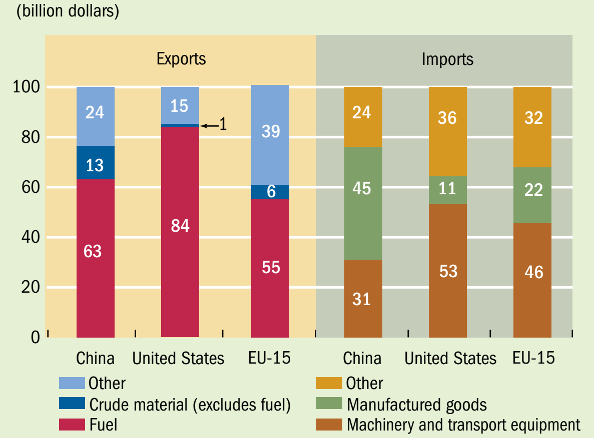
Merchandise trade is only one aspect of the booming economic relations between Africa and China. There are fewer reliable data on the other important factors in the relationship—such as aid, debt, and direct investment. But on the basis of the information available, it appears that China has played a variety of roles in Africa—trading partner, donor, financier and investor, and contractor and builder. The data also show that trade, investment, and other commercial activities combined have outpaced official development assistance (ODA) and become dominant in financial terms (see Table 1).

Chart 3

Familiar trade pattern

Africa's trade with China in 2006 was similar in composition to its trade with other partners.

(billion dollars)



Source: UNCOMTRADE.

Historically, ***aid*** was of major importance in China's economic engagement with Africa. Aid flows relative to trade were about 20 percent in the early 1990s. That ratio declined to 3–4 percent in 2004–05, even though China has stepped up its ODA to Africa since the first China-Africa Cooperation Forum was held in 2000. Indeed, in dollar terms, annual ODA flows from China to Africa increased from about $310 million in 1989–92 to an estimated $1–1.5 billion in 2004–05 (Wang, 2007; Taylor, 1998). However, there are major difficulties in estimating Chinese aid disbursements because of a lack of official time series and problems in valuing Chinese technical assistance and in-kind aid.

Recently China has twice provided ***debt relief*** on its own terms to African countries. In 2000–02, it wrote off overdue obligations totaling 10.5 billion yuan ($1.3 billion), and in 2006 it announced that it would cancel another 10 billion yuan in debt owed by 33 heavily indebted and least developed African countries that have diplomatic relations with China. Incomplete data make it hard to compare the terms on which China provided debt relief with the terms of the Heavily Indebted Poor Countries Initiative—the debt relief program jointly run by the IMF and the World Bank.

Trade credits, including medium and long term, are an important part of the financial flows from China to Africa. Here the Export-Import Bank of China (China Exim Bank) is a major player. Though China Exim Bank does not report annual activities by region, there is clear evidence that it is expanding its operations in Africa. Based on information collected by Moss and Rose (2006) and Broadman (2007), China Exim Bank supports mainly infrastructure projects in Africa, the financing for which is surely much larger than ODA flows.

China's Ministry of Commerce puts China's ***direct investment*** to Africa for 2000–06 at $6.6 billion, but the official statistics may not fully capture foreign direct investment (FDI) by Chinese enterprises, which tend to rely on retained earnings and, in the case of private enterprises, informal arrangements to finance investments. Chinese FDI has increased sharply in the past year. In October 2007, for instance, the Industrial and Commercial Bank of China agreed to purchase 20 percent of Standard Bank Group of South Africa, the largest bank in Africa, spending $5.6 billion on that one investment. FDI between Africa and China flows both ways; there are indications that African FDI to China has also expanded significantly in recent years.

> **"In services, Africa is quickly becoming a key market for Chinese construction and engineering enterprises."**

In *services*, Africa is quickly becoming a key market for Chinese construction and engineering enterprises. Official Chinese statistics show the sum of "contracted projects," "labor cooperation," and "design consultation" in Africa as being less than $2 billion in 2001. In 2006 the turnover on contract labor went up to $9.5 billion, representing 31 percent of China's offshore contracted projects (PBC and CDB, 2007). Within trade in services, two-way traffic is growing particularly fast in tourism.

The ascending private sector

It was two decades ago that China dismantled the state's monopoly on foreign trade. Since then, Chinese private and joint-venture firms have become dominant forces in exports and imports. That has been the case in Africa, where China's private sector is at the forefront of trade, direct investment, and the contracted construction business (Wang, 2007). In recent years, when China's state-owned oil companies struck large deals, Chinese private enterprises were also investing millions of dollars in Africa, most obviously in textiles and mining but also in services, agriculture, and processing and manufacturing. The number of private Chinese construction companies is growing rapidly, as are their size and capacity. They compete actively for construction contracts in Africa.

The increasing influence of the private sector is supported by both government policies and state financial institutions. China's new commitments to Africa for 2007–09, announced by President Hu Jintao in November 2006 during the Beijing Summit of the Forum on China-Africa Cooperation, emphasize trade and investment to achieve "win-win" outcomes. China is extending the list of African exports that China will admit duty free, providing preferential trade credits, and establishing a large fund to support Chinese FDI in Africa. The last two components are being implemented by China Exim Bank and the China Development Bank. The new package is consistent with China's Going Global strategy, which encourages Chinese enterprises to compete for resources and markets outside the country. The Beijing Summit of November 2006 also set a goal of doubling two-way trade between Africa and China to $100 billion by 2010.

Table 1

Aid, trade, and investment

The level of transactions between Africa and China has burgeoned since the turn of the century.

(billion dollars)

	2001	2006
Total trade	10.8	55.5
African exports	4.8	28.8
African imports	6.0	26.7
Official development assistance (ODA)	...	2.3
Chinese ODA	...	1.0
Chinese debt relief	1.3	1.3
Foreign direct investment (FDI)		
Chinese FDI to Africa	...	0.9
African FDI to China	0.3	1.1
Contracted projects		
Chinese projects in Africa	1.8	9.5

Sources: Trade data are from China customs statistics. All other data are from Wang (2007).
Note: ... denotes not available.

Reaping the benefits

As economic relations between China and Africa become increasingly commercial rather than aid driven, future relations between the two will be shaped more and more by shifts in comparative advantages and changes in global supply chains. How can African countries benefit from these developments? The key will be to leverage expanded foreign trade and investment to achieve sustainable private sector–led growth. Several domestic policy areas will need particular attention.

Reducing the cost of investing and doing business. African countries can attract and use more capital only if they significantly reduce red tape and other regulatory impediments to private activity. Although progress has been made in recent years, sub-Saharan Africa lags other parts of the world in terms of investment and business climate (see Table 2). According to the latest assessment of the International Finance Corporation—which tracks indicators of the time and cost to meet government requirements in business start-ups, operation, trade, taxation, and closure—24 of the 30 countries with the most costly business environment are in sub-Saharan Africa. A business-friendly environment would also incorporate nondiscriminatory taxation, customs regimes that facilitate the movement of goods and services, and regulations that make the labor market more flexible while safeguarding the rights of labor. Because the poor quality of its infrastructure—particularly energy and transportation—is one of the major constraints to doing business in Africa (World Economic Forum, 2007), improving infrastructure is critical if African countries are to benefit from the globalization of business and industry.

Leveling the playing field. During the 2006 Forum on China-Africa Cooperation, African and Chinese leaders reiterated their intention to forge a new type of strategic partnership based on equality and mutual benefit. It is thus important for African countries to ensure that competition for their projects is fair and to treat all foreign investors equally. Increasing the transparency of all state-sponsored transactions by implementing the Extractive Industry Transparency Initiative and similar international initiatives will be particularly helpful in fostering sound governance and ensuring more efficient use of Africa's valuable resources.

Managing public finances efficiently. This would include prioritizing all infrastructure projects—including those proposed by others—using best practice cost-benefit analysis, separating project development from financing, ensuring that bidding on tenders for projects is truly competitive, and making financing decisions on the basis of a careful assessment of the most favorable terms. Favorable terms means, among other things, avoiding the use of side transactions that make it difficult to compare financing options.

Preventing the accumulation of unsustainable debt. African countries face a dilemma: they need major financing to build their infrastructure and productive capacity, but their inadequate production and export bases limit the amount of external financing they can handle. Addressing this constraint will require prudent debt management and closely linking debt finance to the potential for productive, possibly foreign-exchange-generating, capacity. Clearly, both debtor and creditor countries have a responsibility to minimize the vulnerabilities arising from debt-creating capital flows to African countries.

Safeguarding the environment. The international trade of many African countries is based on rich but largely nonrenewable natural resources. As illustrated by China's own development path, a country may pay a heavy price unless the environmental impact of exploiting resources is dealt with early on and is mitigated by good planning, high standards, and firm regulatory oversight (World Bank, 2007).

Table 2

Investment climate

Sub-Saharan Africa is the most difficult region in the world in which to do business.

Economy	Ease of doing business rank
Top-ranked countries	
Mauritius	27
South Africa	35
Namibia	43
Botswana	51
Kenya	72
Ghana	87
Bottom-ranked countries	
Burundi	174
Republic of Congo	175
Guinea-Bissau	176
Central African Republic	177
Democratic Republic of Congo	178
Average by region	
East Asia and Pacific	77
Latin America and Caribbean	87
South Asia	107
Sub-Saharan Africa	136

Source: *Doing Business 2008*, International Finance Corporation.

Note: The higher the ranking, the higher the cost of doing business in the 178 economies covered. The rankings do not take account of such variables as quality of infrastructure or crime rates.

Moving up the value chain. Achieving sustained growth will require African countries, particularly in sub-Saharan Africa, to diversify exports and move from being pure exporters of raw materials to processing or otherwise adding value to those raw materials. There are no substitutes for reforms to reduce domestic barriers to entry and exit and to address critical supply constraints. Many Chinese enterprises have fresh experiences in moving up the value ladder in their own fields of business. Partnerships between African and Chinese firms may facilitate technology transfer, add value to African exports, and help African firms position themselves to benefit from world markets, not least the rapidly expanding Chinese market.

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At the same time that Africa has a responsibility to maximize the benefits of its economic relationship with China and other nations, China has an important role to play in ensuring that its economic partnership with African countries is mutually beneficial. After all, China's spectacular growth has made it an increasingly important player in global commerce and finance, and responsibilities come with influence. In particular, increasing disclosure about aid flows would help African countries harmonize donor activities. Aligning assistance with the priorities those countries have identified in their poverty reduction strategies would also make aid to them more effective. Lending terms and volume need to be consistent with the low-income country debt sustainability framework many African countries now use. Finally, increasing local sourcing of parts, equipment, and labor to promote effective technology transfer would help boost income growth in sub-Saharan Africa and hence the size of that market, benefiting both China and Africa. ■

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