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SNAPSHOT

Africa’s Eastern Promise

What the West Can Learn From Chinese Investment in Africa

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Last November, in the Egyptian resort town of Sharm el-Sheikh, Chinese Premier Wen Jiabao announced a series of new pledges for Chinese assistance to African countries -- and in the process, made many observers in the West very uneasy. Westerners think they know what Africa needs to do in order to develop: liberalize markets, get prices right, promote democracy. And they think they know what China is doing there: offering huge no-strings-attached aid packages to resource-rich countries that prop up pariah regimes.

But a closer look reveals a somewhat different story. Over the past few decades, China has managed to move hundreds of millions of its people out of poverty by combining state intervention with economic incentives to attract private investment -- the kind of experimentation that the Chinese leader Deng Xiaoping once described as "crossing the river by feeling the stones." Today, China is feeling the stones again but this time in its economic engagement across Africa. Its current experiment in Africa mixes a hard-nosed but clear-eyed self-interest with the lessons of China's own successful development and of decades of its failed aid projects in Africa.

The first prong of Beijing's efforts is to offer African states resource-backed development loans, an initiative inspired by its experience at home. In the late 1970s, eager for modern technology and infrastructure but with almost no foreign exchange, China leveraged its natural resources -- ample supplies of oil, coal, and other minerals -- to attract a market-rate $10 billion loan from Japan. China was to get new infrastructure and technology from Japan and repay it with shipments of oil and coal. In 1980, Japan began to finance six major railway, port, and hydropower projects, the first of many projects that used Japanese firms to help build China's transport corridors, coal mines, and power grids.

Since 2004, China has concluded similar deals in at least seven resource-rich countries in Africa, for a total of nearly $14 billion. Reconstruction in war-battered Angola, for example, has been helped by three oil-backed loans from Beijing, under which Chinese companies have built roads, railways, hospitals, schools, and water systems. Nigeria took out two similar loans to finance projects that use gas to generate electricity. Chinese teams are building one hydropower project in the Republic of the Congo (to be repaid in oil) and another in Ghana (to be repaid in cocoa beans).

So far, most of these loans have been issued by China's export credit agency, the Export-Import Bank of China (China Eximbank). Offered at market rates, they do not qualify as official foreign aid but nonetheless can help development. In poor, resource-rich countries, which are often cursed rather than blessed by their mineral wealth, resource-backed infrastructure loans can act as an "agency of restraint" and ensure that at least some of these countries' natural-resource wealth is spent on development investments.

Of course, China's loans pose some risks for the African recipients, particularly if Chinese firms are awarded infrastructure contracts without competitive bidding or if prices for the resources, the basis of the loan repayments, are fixed in advance. There is always a risk that African governments will not maintain infrastructure investments and that the Chinese projects' environmental and social safeguards will be too lax. Chinese construction companies often bring in Chinese manpower -- on average about 20 percent of the total labor their projects require -- reducing opportunities for Africans. When they do employ locals, Chinese firms often offer low wages and low labor standards.

But there are ways to mitigate these dangers. Under most of the agreements, the earnings from exports of natural resources are deposited directly into escrow accounts and their value is assessed at that moment, not fixed in advanced. This removes the potential for unfair pricing. Moreover, African governments are already driving harder and better-informed bargains. Angola required Chinese companies to subcontract 30 percent of the work to local firms and insisted that the Chinese solicit at least three bids for every project they planned to undertake. The Democratic Republic of the Congo (DRC) will receive a $3 billion copper-backed loan from the Chinese government, which will help finance railways, roads, hospitals, and universities. According to some reports, the Congolese government has stipulated that 10 to 12 percent of all the infrastructure work undertaken under this arrangement must be subcontracted to Congolese firms, that no more than 20 percent of the construction workers involved be Chinese, and that at least one-half of one percent of the costs of each infrastructure project be spent on worker training.

The terms of Chinese loans also tend to be better than those of deals from Western companies. As Congolese President Joseph Kabila has pointed out, a $3 billion joint mining venture in the DRC gives his government a 32 percent share, compared with the 7 to 25 percent that is typical for mining deals with other companies. Former Angolan Finance Minister José Pedro de Morais has said that by setting "a new benchmark," a $2 billion loan from China Eximbank in 2004 helped Angola negotiate better terms for other commercial loans. Thanks to its trillions in foreign exchange reserves, China can offer loans at highly competitive interest rates. Eximbank gave the Angolan government three loans at interest rates ranging from LIBOR (the London Interbank Offered Rate, the rate banks charge each other on loans) plus 1.25 percent to LIBOR plus 1.75 percent, as well as generous grace periods and long repayment terms. Commercial lenders, such as Standard Chartered Bank, have charged Angola LIBOR plus 2.5 percent or more, without any grace period and while requiring faster repayment.

In its second major experiment, China is helping to build special trade and economic cooperation zones in Africa. Seven such zones are in the works: two in Nigeria; the others in Egypt, Ethiopia, Mauritius, Zambia, and, possibly, Algeria. Special economic zones were an important feature of China's early development; today, China has more than one hundred such areas. The economists Paul Collier, author of The Bottom Billion, and John Page, of the Brookings Institution, argue in a recent report for the United Nations Industrial Development Organization that special economic zones can be a very promising strategy for industrialization and employment in Africa's least developed countries. It allows countries to improve poor infrastructure, inadequate services, and weak institutions by focusing efforts on a limited geographical area. And a targeted focus on boosting manufactured exports can help countries overcome the exchange-rate appreciation and the weakening of local non-energy industries that often accompany natural-resource exports.

The Chinese government is mindful that these zones must be sustainable in the long term. For decades, Chinese teams in Africa constructed agricultural projects or built factories only to turn them over to inexperienced and sometimes uninterested host governments. Once the Chinese left, the benefits of the projects declined, prompting the host governments to ask the Chinese to return. Now, Chinese companies are taking responsibility for both designing and building the zones and then managing them as businesses. Beijing will subsidize part of the start-up costs, including some of the expenses that Chinese companies incur by moving operations overseas. Several of the agencies involved in China's own successful zones are advising -- and in some cases, investing in -- the projects in Africa. China's venture-capital fund for Africa, the $5 billion China-Africa Development Fund, has taken equity shares in three of the seven planned zones. A new $1 billion fund for small and medium enterprises in Africa, which was announced at the November summit in Egypt, will help African entrepreneurs set up businesses in the zones.

Why would the Chinese government push some of its labor- and energy-intensive industries to move to special economic zones in Africa, even as the U.S. Congress bans the U.S. Agency for International Development from financing any activities that could relocate the jobs of Americans overseas? Because Chinese planners want industrialists at home to move up the value chain. Polluting industries such as leather tanneries and metal smelters are no longer tolerated in many Chinese cities. And as the world economy recovers from the recent economic recession, wages and benefits will resume rising in China's coastal belt, as they had been before the crisis. Some factories will move further inland, but others will go offshore, closer to both the sources of and the markets for raw materials.

The early stages of industrialization might bring pollution, low wages, and long workdays, especially if the Chinese zones are successful. But like China's resource-backed loans, the planned economic zones promise to provide African countries with some things they very much want: employment opportunities, new technologies, and badly needed infrastructure. This is an opportunity for African states to ride into the global economy on China's shirttails rather than remain natural-resource suppliers to the world.

While the West supports microfinance for the poor in Africa, China is setting up a $5 billion equity fund to foster investment there. The West advocates trade liberalization to open African markets; China constructs special economic zones to draw Chinese firms to the continent. Westerners support government and democracy; the Chinese build roads and dams. In so doing, China may wind up supporting some dictatorial and corrupt regimes, but -- and this is an inconvenient truth -- the West also supports such regimes when it advances its interests. And given the limits of the West's success in promoting development in Africa so far, perhaps Westerners should be less judgmental and more open-minded in assessing China's initiatives there.

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