DEVELOPMENT POLICY RESEARCH UNIT

A DPRU Policy Brief*: **PB 14/36**
Commissioned for the

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HOW THE PRIVATE SECTOR IS CHANGING CHINESE INVESTMENT IN AFRICA

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December 2014

Introduction[1]

In August 2012, US Secretary of the State Hillary Clinton offered a thinly veiled criticism of China's role in Africa, calling upon African leaders to guard against those that "come in, take out natural resources, pay off leaders and leave." [2]The Chinese official news agency, Xinhua, retorted immediately that "Clinton's implication that China has been extracting Africa's wealth for itself is utterly wide of the truth."[3]

Data gathered from China, six African countries[4] and company interviews suggest that neither Clinton nor Xinhua was correct. China's investment in Africa is far from monolithic and is growing increasingly diverse. The driving force behind this evolution is the rising role of China's private sector. Private investors are primarily driven by self-interest, i.e., profits; but profit-based investment can create real economic opportunities for host countries.

The pace of the increase of the Chinese investment in Africa in recent years has, truly, been breathtaking. Until about 15 years ago, China's capital flow to Africa was almost all government-aid related. According to China's Ministry of Commerce, China saw only a negligible amount of $56 million direct investment in the continent by 1996; but the number jumped to $1.5 billion by 2005, and again multiplied 10 times to $15.8 billion by 2012. Most noticeably, just as the world FDI outflow nosedived following the 2008 financial crisis, China's overseas investment more than doubled in 2008, with the part going to Africa actually more than tripled that year and increasing steadily thereafter.

The rise of Chinese private sector's participation in this new wave of "going abroad" is particularly eye-catching. Until 2005, only 52 private investment projects in Africa were registered with the Chinese government.[5] By December 2013, this number had jumped to 1,217, representing 53% of the 2,282 Chinese outward foreign direct investment (OFDI) projects active in Africa.

[1] This short note is an updated version of the note bearing the same title published by Columbia FDI Perspectives, the Vale Center of Columbia University on Sustainable International Investment, No. 93 April 15, 2013. A longer research paper, "Chinese Private Investment in Africa: Myths and Realities" was published by the World Bank as Policy Research Working Paper No. 6311, in 2013; and will be published, with updates, by Development Policy Review (forthcoming, January 2015).

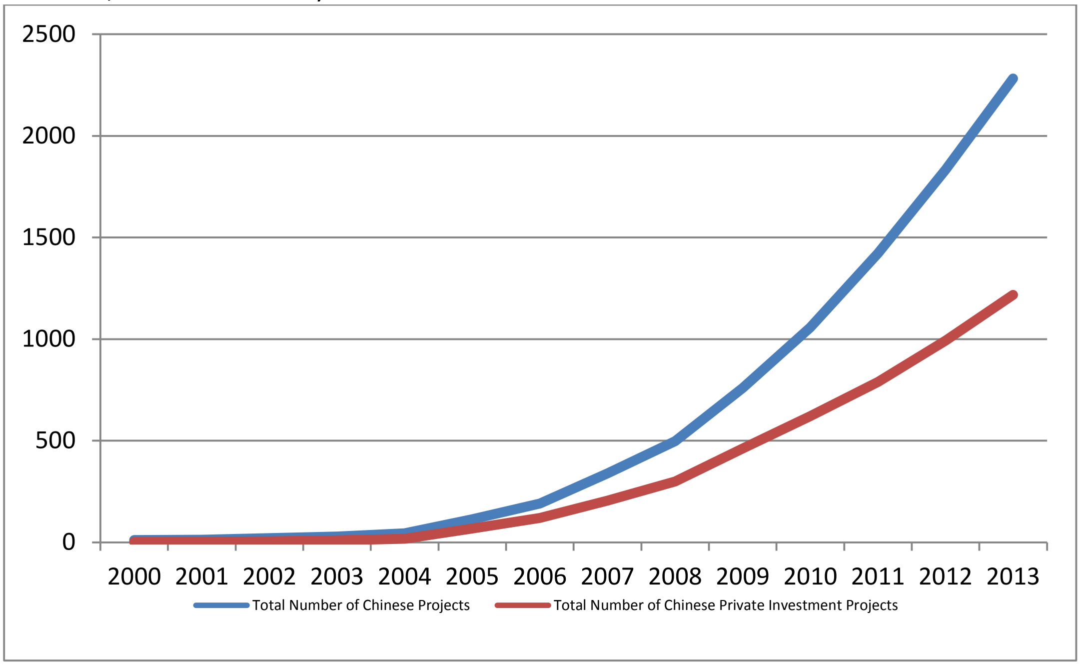
[2] "Hillary Clinton launches African tour with veiled attack on China," The Guardian, August 1, 2012, available at: http://www.guardian.co.uk/world/2012/aug/01/hillary-clinton-africa-china.

[3] Ibid.

[4] Including four top recipients: Nigeria, Ethiopia, Zambia, and Ghana, plus two minor recipients: Liberia and Rwanda.

[5] Depending on the size and nature of the projects, Chinese firms are required to obtain Ministry of Commerce (MoC) approval/registry/filing when making outbound investments.

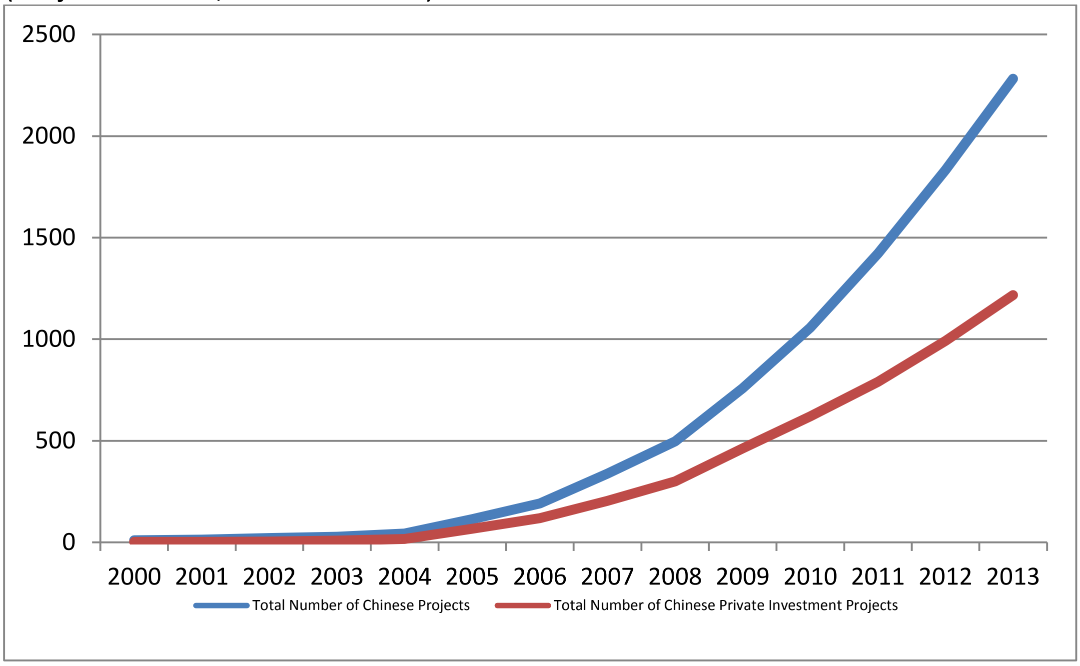
Figure 1. Chinese investment in Africa, comparing private and government ownership (Project number, as of end-2013)



Source: Xioafang Shen, op. cit., calculated on the basis of data from Ministry of Commerce, China as well as data from each of the six examined host countries.

However, China's data provide only a partial picture. Host country data consistently show the number of Chinese companies operating in their countries to be 3-4 times higher.

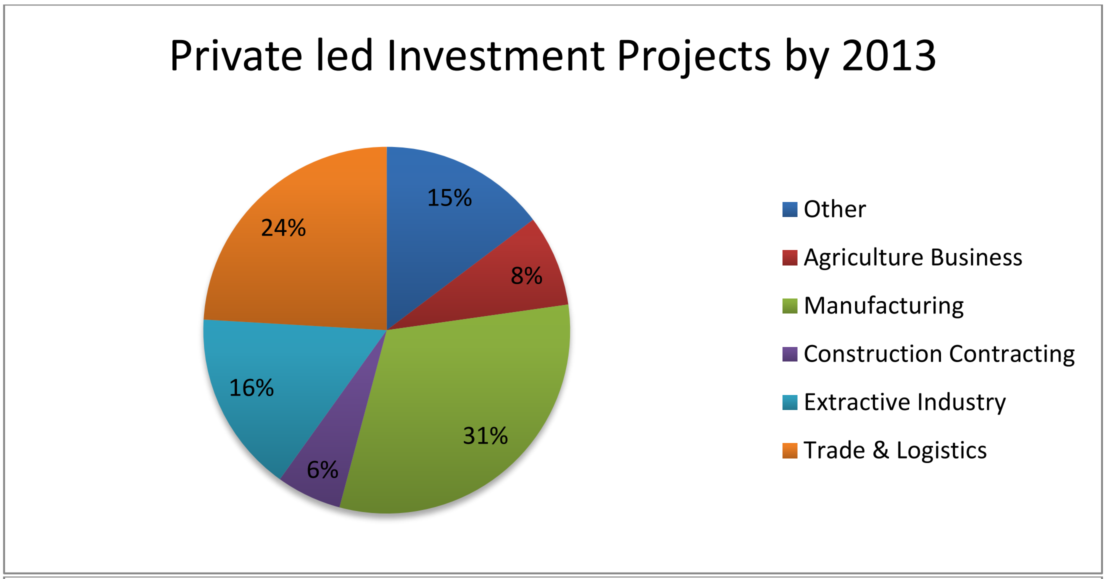
Figure 2. Chinese investment in six African countries, comparing home and host country data (Project number, as of end-2011)

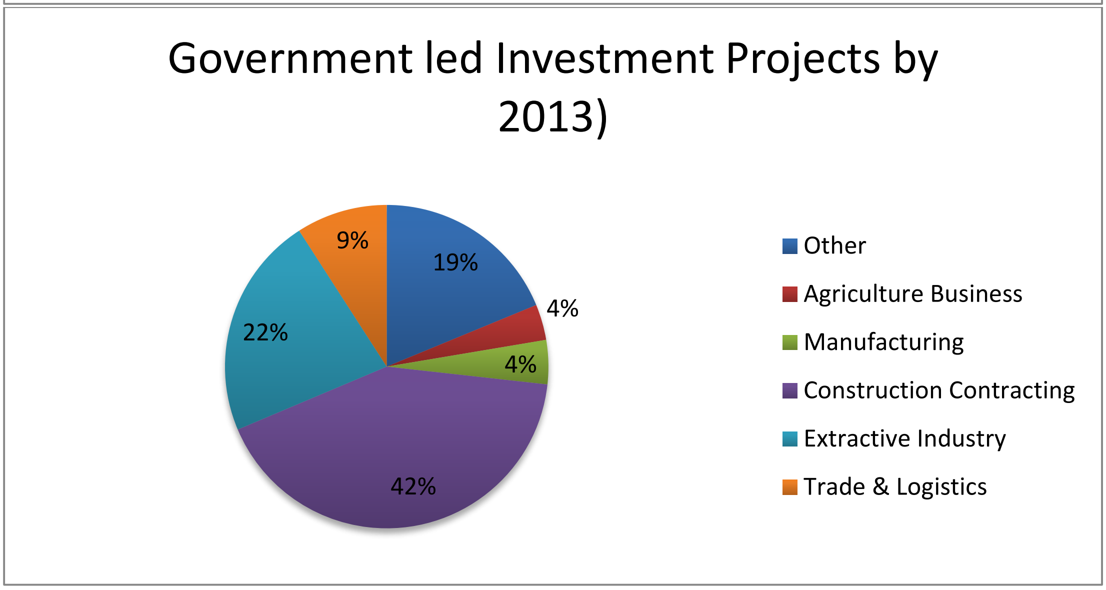


Source: Xioafang Shen, op. cit., calculated on the basis of data from Ministry of Commerce, China as well as data from each of the six examined host countries.

Moreover, there are stark differences between private and state-led investment in Africa in terms of sectors. The former mostly involve manufacturing (33%) and trade/logistics services (24%); in contrast, state-led projects focus heavily on construction (42%) and resource-extraction (22%).

Figure 3. Sector spread of Chinese OFDI in Africa, comparing government and private-led projects, 2011.





Source: Xioafang Shen, op. cit., calculated on the basis of data from Ministry of Commerce, China.

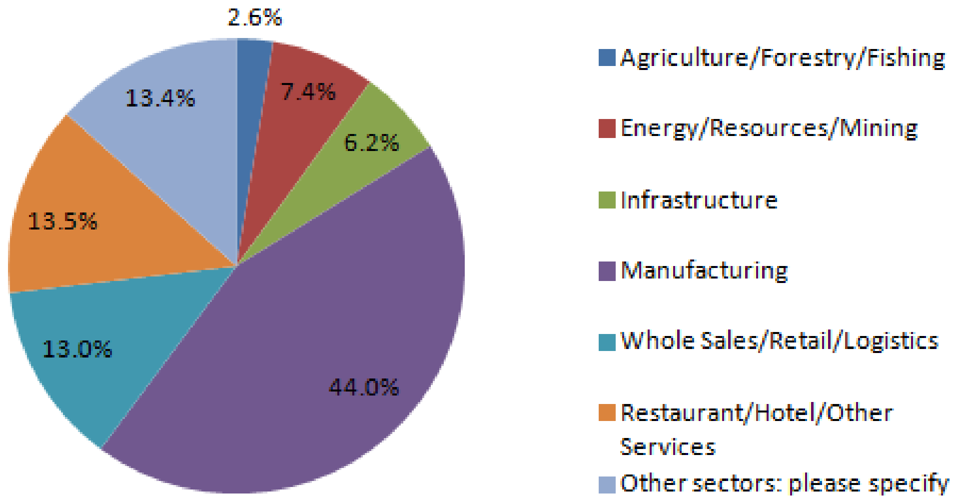
Table 1. Spread of Chinese manufacturing investment in Africa, by sub-sector (number and percentage of investment projects, by end-2013).

Subsector	Number of Projects	Percentage
Equipment & Machinery	79	18%
Metal, Plastic and Rubber Parts	50	12%
Medicine and Medical Instrument	21	5%
Construction Material	82	19%
Food & Drinks	21	5%
Textile, Apparel & Footwear	82	19%
Tennary & Hair Products	17	4%
Pulp, Paper & Packaging Materials	15	3%
Wood Processing & Furniture	30	7%
Other Industry	32	7%
Total	429	100%

Source: Xioafang Shen, op. cit., calculated on the basis of data from Ministry of Commerce, China.

Six host countries confirm the concentration of Chinese investment projects in manufacturing (44%) and service sectors grouped together (40%). Unsurprisingly, host governments' feedback on job-creation is positive in all six countries surveyed.

Figure 4: Chinese investment by Sectors (project numbers)



Source: Xioafang Shen, op. cit., calculated on the basis of data from Ministry of Commerce, China.

However, host governments' views regarding the impact on local industrialization are somewhat mixed. While the injected Chinese capital and technology are appreciated, there are worries about competition hurting domestic firms. Host governments are also generally disappointed by the lack of technology transfer. Some are further concerned about labor and environmental standards.

Interviews with firms shed light on their motives. Most manufacturers moving to Africa belong to "sunset industries" that are labor-intensive and low-tech. These firms had their heyday as the world's factories in the past two decades but are in danger of losing their competitiveness due to the rapid rise of wages at home. Relocating to distant, foreign countries is risky and laborious, but almost inevitable for some looking to survive and grow.

This suggests that the surge of private investment in Africa is at least partly due to the challenge China must meet in the next decade. To maintain productivity and stay competitive in a globalized market, Chinese firms must move up the value chain through strategic industrial upgrading, innovation and, sometimes, relocation.

That is good news for Africa. Countries looking to transform resource-based economies into industrialized ones face a time-bound opportunity. Industrialization is a process involving many steps. The labor-intensive and low-tech manufacturing brought in by Chinese firms provides a desirable first step in this process. Such manufacturing activities are easy for low-income countries to absorb and adapt, while allowing the latter to realized their comparative advantages.

Dynamic global industrial relocation is nothing new. China itself benefited tremendously from the "flying-geese paradigm" in its economic take-off. The first wave of FDI to China, which lasted throughout the 1980s, was led not by large western multinationals enterprises, but a host of small and medium-sized manufactures from Hong Kong, Taiwan and other Asian emerging markets, making labor-intensive and technologically simple products for the world market. It was these "second-class" investors who brought China initial foreign capital and technology, which helped China tap into its comparative advantages and enter the global economy.

Africa faces a similar opportunity as China did twenty years ago, but benefits will not materialize without special efforts. Despite the rising interest in Africa, Africa receives only 2.2% of China's total dollar amount of outbound investment, including private and state-led investment. If anything, Africa still carries a negative image as a distant, poor and unstable investment destination among the majority of Chinese firms, resulting from both real problems and misperceptions.

To enlarge its share of the Chinese investment pie, African governments must forcefully address concerns expressed by investors regarding infrastructure, policy stability and administrative efficiency. They should also improve regulatory transparency to make compliance easy and abuse difficult. When promoting themselves to Chinese investors, governments should give priority to servicing those "first comers." The "word of mouth" effect is strong among Chinese firms – one happy business could help bring 5-10 new ones.

Finally, improving technology transfer and business linkages with local firms are critical areas in which host governments should be active promoters. Chinese and local firms should collaborate for their self-interests. After all, better business integration helps sustain business successes while rendering long-term benefits for host economies. It is a win-win solution.