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China in Africa: Goods Supplier, Service Provider rather than Investor

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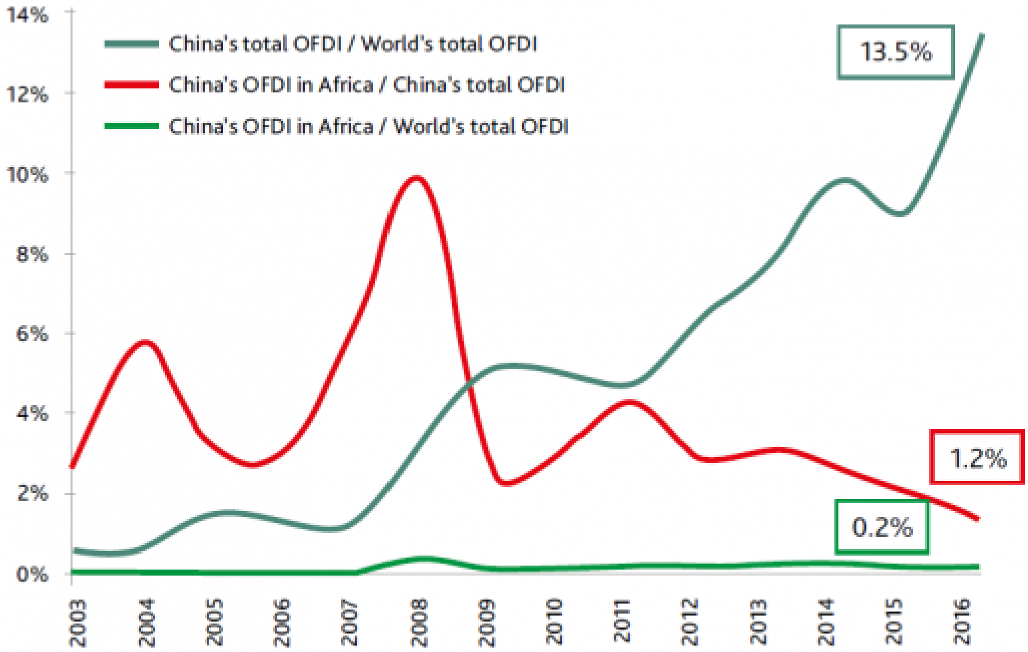
While in the development community and beyond, there is a widespread feeling that China is investing heavily in Africa, factual data shows the precise opposite. How can this be explained, and what is the real nature of China's economic engagement on the continent?

China's official data on outward foreign direct investment (OFDI) are difficult to interpret. Here we will focus on trends and draw comparisons, which are less likely to be impacted by Chinese companies' penchant for offshore financial centres (including Hong Kong) – that attract about three-quarters of their total OFDI. The trends in the data from the Chinese Ministry of Commerce (MofCOM) suggest that Chinese investment in Africa is not only modest, it is falling: the value of Chinese OFDI flows into Africa for 2016 was US$2.4 billion, a decrease of 19 percent compared to 2015 ($2.9 billion), which was a fall of 7 percent compared to $3.2 billion in 2014, itself a fall of 5 percent compared to 2013, which was the second-highest year from 2003 to date.

In 2016, China's OFDI in all of Africa was equal to 14.1 percent of the amount China invests in the United States; 83.6 percent of the amount China invests in Canada; the same as the amount China invests in Germany.

While the share of China's total OFDI flows has increased steadily since 2003 to 13.5 percent of the world's total OFDI, the share of China's OFDI in Africa has declined consistently since 2011 and is now only 1.2 percent of China's total OFDI and 0.2 percent of world's total OFDI (see Figure 1).

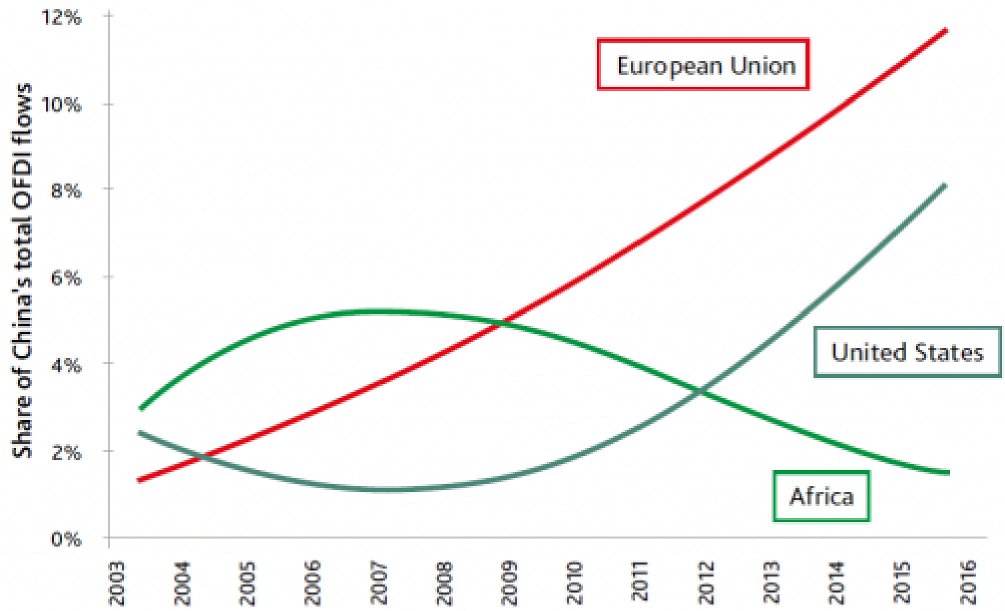
Figure 1: China's annual OFDI flows compared (2003-2016)



Sources: MofCOM, UNCTAD

Other MofCom data further highlight this strategic move of China's OFDI away from Africa: the share of Chinese investment flows in Africa seems to have peaked, while that in the European Union and the United States has been steadily rising (Figure 2).

Figure 2: China's OFDI flows destinations compared (2003-2016)



Source: MofCOM

Nevertheless, beyond these comparisons, one fact can describe even better the actual weight of China's OFDI flows in Africa. In January 2017, after criticism by the newly elected US president, Donald Trump, Ford Motor Company scrapped plans to build a US$1.6 billion plant in Mexico; this was an investment plan for an amount equal to two-thirds of China's investment in Africa in 2016 for just one plant in one country by one company. Then, the question arises: How is one to reconcile the feeling that China is investing heavily in Africa with factual data showing the precise opposite?

China-Africa economic ties: What are they made of?

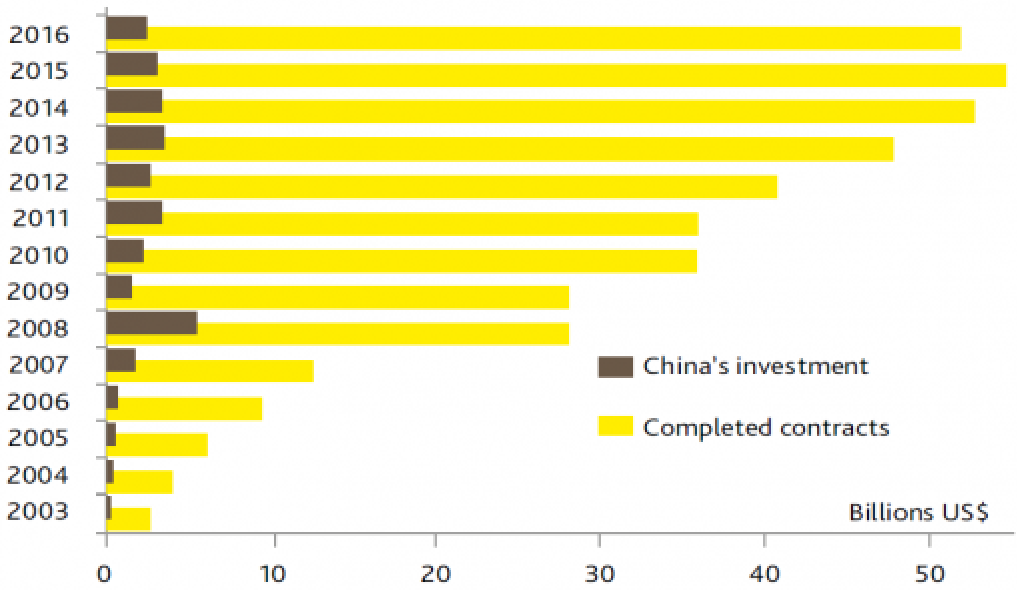
Once again, we are confronted with a classic confusion between investing, financing, and providing services. International bodies (International Monetary Fund, Organisation for Economic Co-operation and Development, and others) have given a clear definition of what should be considered an investment; it is a definition to which China adheres and which is recalled in the MofCOM's last Statistical Bulletin:

"FDI is an activity in which an investor resident in one country obtains a lasting interest in, and a significant influence on the management of, an entity resident in another country. This may involve either creating an entirely new enterprise (so-called "greenfield" investment) or, more typically, changing the ownership of existing enterprises (via mergers and acquisitions). Other types of financial transactions between related enterprises, like reinvesting the earnings of the FDI enterprise or other capital transfers, are also defined as foreign direct investment."[1]

China does not invest in infrastructure in Africa but builds and finances African investments in infrastructure.

In order to shed more light on the confusion and give investment its exact role, one approach is to compare the amount of investment to the value of services provided, taking the turnover of overseas construction contracts completed in one year as a proxy for services.[2] Figure 3 shows that the turnover achieved by Chinese construction companies in 2016 was more than 25 times higher than the amount invested by China in Africa. This was not an exception but the rule.

Figure 3: China in Africa – investment vs completed contracts



Sources: MofCOM, National Bureau of Statistics

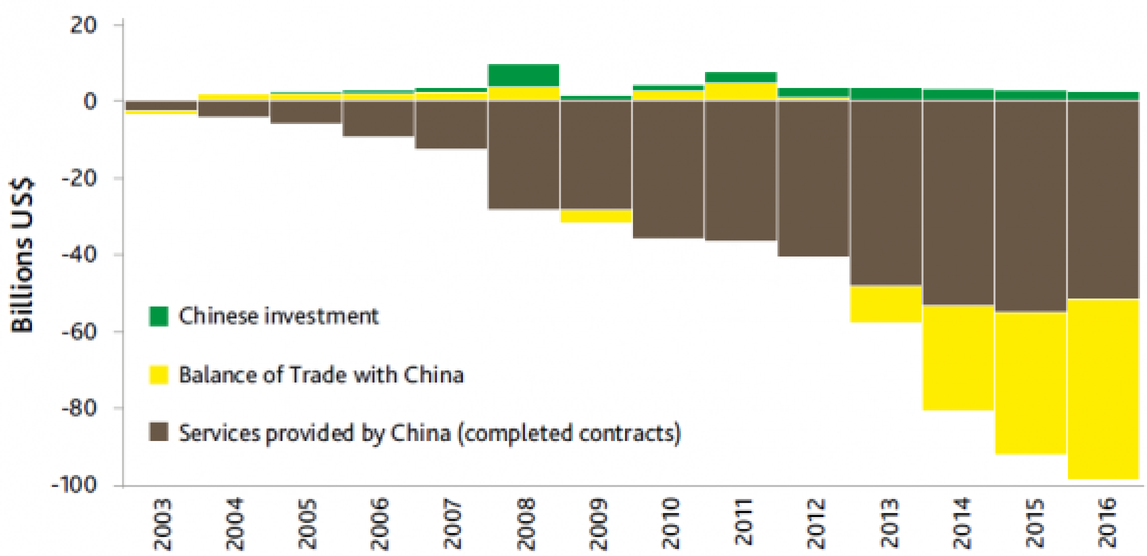
It must be perfectly clear that China's investment in Africa is an expense for China, but not an income for the hosting African country. On the other hand, payment for services is an expense (and at the same time an investment) for the client African country and a revenue for China. Keeping in mind this difference, these two activities each illustrate, in their own way, China's presence in Africa. They show clearly that China is a service provider rather than an investor, that Africa is more a customer than a partner. This conclusion would be even more evident if the services were to be added to the Chinese goods bought by African countries or, more accurately, to the growing African merchandise trade deficit with China.

Some African countries are engaged in major infrastructure projects which they finance through loans, thus at the price of an *a priori* legitimate debt, but one which is increasingly burdened by the appearance of growing trade deficits. Over a long period from roughly 1995 to 2012, Africa's trade balance was in its favour and it was even largely in surplus from 2003 to 2012 (except in 2009). In contrast, the four years from 2013 to 2016 were marked by large and growing trade deficits. During an initial period from 1995 to 2010, Africa's trade balance with China was either slightly in deficit or slightly in surplus, while from 2013 onwards, the trade deficit increased so significantly that it reached US$46 billion in 2016, equivalent to Africa's trade deficit with the rest of the world.

This situation is largely due to the composition of African exports and imports in the context of a global economic downturn and the resulting fall in commodity prices. From 2012, African exports of ores, minerals, metals, and fuels[3] fell by two-thirds, both to China and the rest of the world. At the same time, African imports of manufactured goods increased considerably until 2015 (+29 percent when they were Chinese products), before starting to fall sharply the following year.[4] This same category of products from other countries experienced a significant drop (-15 percent) over the same period compared to 2012. All these developments together led to the situation where, in 2016, the African deficit vis-à-vis China was equal to its deficit vis-à-vis other countries taken as a whole, while the volume of Africa's trade with China represented only 15 percent of Africa's volume with the rest of the world.

What do the three categories of statistics (investment, services, and balance of trade) show? In Figure 4, for a given year, the amount of Chinese investment in Africa and Africa's trade surpluses with China appear on the positive side of the axis. On the negative side are the costs of the Chinese services provided in a given year – for African governments to pay either all at once or in instalments (loans from China's Exim Bank, for example) – and Africa's trade deficits with China.

Figure 4: China in Africa – investment, completed contracts and trade compared (2003-2016)



Sources: MofCOM, UNCTAD

Figure 4 unequivocally substantiates the nature of China's economic relations with Africa as a whole. China in Africa is not primarily an investor but a provider of services and also a supplier to which Africa is indebted as a result: in 2016, the amount of Chinese investment in Africa was equivalent to 2 percent of the debt generated in the same year by both the completion of services by China's companies and the trade deficit with China.

Adjusting expectations

African countries should look at the facts – just the raw facts, without asking whether the Chinese presence in Africa is appropriate or not, efficient or not, desirable or not – and first take into account what China is actually doing and expecting to do. China is not a magic wand that will solve Africa's development conundrum. Like many other African experts and decision-makers, Lamido Sanusi, Emir of Nigeria's Kano state and former governor of the country's central bank, says just that; he urges African countries to be proactive and make China work for their development strategy so that "the romance must be replaced by hard-nosed economic thinking."[5]

Dreaming that China could invest and create tens of millions of industrial jobs in Africa is unrealistic. "If only it were so easy," sighs Ambassador Shinn in a post berating the speech by Helen Hai, CEO of the Made in Africa Initiative, at the Africa 2017 Summit in Sharm El Sheikh and the injudicious enthusiasm it aroused.

Take, first, the findings of a report published in December 2017 by the Peking University Center for New Structural Economics and the Overseas Development Institute, which made it clear that very few Chinese light manufacturing firms (garments, footwear, household appliances, toys, etc.) struggling with rising costs are considering relocating. For those that do, moreover, the report finds that Africa does not appear to be a likely destination. Hence the report's recommendation: "The first, and most important [policy implication for potential host country governments], is the need for realism about the overall potential for jobs transfer – the numbers of 'outbound' jobs are not large."

Second, there are the figures disclosed by the MofCOM. According to them, Chinese companies located in one of the 99 industrial parks approved by MofCOM in 44 countries around the world created an average of 59 local jobs each. It would therefore require a huge number of Chinese companies to create the tens of millions of jobs that some are dreaming about.

Thirdly, there is automation and the political commitment to make systematic use of artificial intelligence. The relative cost of automation is expected to be modest compared with the value it can create, thus making work relocation uncompetitive even if it is done in countries where labour costs are very low.[6] The Made in China 2025 strategy does not actually support the relocation of production lines that have become unprofitable, but effectively advocates their replacement by automated lines that reshape the entire structure of production, or even the whole industrial sector to which this production belongs.

The plan is ambitious and its philosophy straightforward. Accordingly, if China were to sell its outdated and inefficient production lines to some African countries, there would be a risk that they would very soon face competition from China's new production lines, since the conditions today in Africa for relocation and marketing are by no means comparable to those prevailing in China in the years 1980-2000. Hence the issue of Chinese special economic zones (SEZs), the second strand of the African dream narrative. In fact, several types of SEZ should be considered.

First, there are the ordinary SEZs: these are the free zones also called free-trade zones, export-processing zones, industrial free zones, etc. These are zones defined by the government of one country to host companies from other (preferably developed) countries under favourable tax, legal, administrative, and migration conditions. Their objectives are twofold. One is to attract selected foreign investors as part of a development strategy. The other is to promote industrial and commercial exports. Most of these SEZs are located in developing countries, including China.

A second type are the "Chinese SEZs": these are the Foreign Economic Cooperation Zones registered by the Chinese Ministry of Commerce. Unlike the ordinary SEZs, they are Chinese enclaves on foreign territory, subsidised and financed by the Chinese government to host Chinese companies that will manufacture under privileged conditions for the local market. Today, there are three of these in Africa that are performing more or less well according to available reports. A fourth should have emerged in Algeria, but it was an obvious failure. From the outset, there was a contradiction between Algerian and Chinese aspirations, since there is no rationale for equating the development objectives of any African government with those of the Chinese government. Moreover, from an African point of view, there is no reason why such enclaves should cater to the internationalisation of Chinese enterprises – as proclaimed by MofCom – instead of having as a priority the economic development of the host African country.

Third, there are the "contracted-out SEZs": these are free zones whose management is contracted out (a concession) to a foreign company. [7] When the grantee is a Chinese company, the resulting situation is quite similar to the previous case but with one important exception: the grantor is not the Chinese government but an African government. But even in this case, nothing guarantees the final compatibility of objectives. Djibouti has bitterly experienced this after granting the management of its port and free zone to DP World. Today, China Merchants Port has taken up the torch more or less on a trial basis and should encourage Chinese companies to set up in the free zone it manages now. Such a move could bring a boost to Djibouti's economy, which has a low base of manufacturing jobs, but short-term social benefits may far outweigh medium-term economic ones, so development objectives might not be achieved as dreamt.[8]

From an African perspective, the only rational choice is the ordinary type of SEZ (in fact the one China adopted successfully for itself in the 1980s), in which the host country is the operator, free to select foreign companies, not according to their nationality, but according to their medium- and long-term development goals. Even so, it is worth recalling Samir Amin's warning:

"This strategy has a name – and it is no coincidence – 'redeployment'. Actively supported by the World Bank, it makes the multiplication of new enclaves – the 'free zones' – sound like a 'new order'. Obviously this strategy minimises the role of the local state, consigned to the functions of an administration simply responsible for policing the exploited work force."[9]

African countries can (and should) capitalise on China's experiments, its presence on their continent, and its appetite for raw materials, but they must keep their "eyes open," as former Nigerian finance minister Ngozi Okonjo-Iweala warns.

This article builds upon a shorter blog post published on the China-Africa Research Initiative's blog.

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[1] *OECD Economic Outlook*, no. 1, 2003. Moreover, to be considered as a direct investment, an investment must represent at least 10 percent of the shares; otherwise it is a portfolio investment (therefore most often speculative).
[2] Chinese statisticians use the terms "contracted projects," *chengbao gongcheng*, and "value of turnover fulfilled," *wancheng yingye'e*. "Overseas contracted projects" refer to activities in which overseas construction projects are contracted by Chinese enterprises.
[3] UNCTAD SITC Classes 3 + 27 + 28 + 67.
[4] UNCTAD SITC Classes 6 + 7 + 8 - 667 - 68.
[5] Lamido Sanusi. "Africa Must Get Real about Chinese Ties." *Financial Times*, 11 March 2013.
[6] This is at least what two McKinsey reports published in January and December 2017, entitled, respectively "A Future that Works: Automation, Employment, and Productivity" and "Where Machines Could Replace Humans—and Where They Can't (yet)."
[7] A concession grants an operator a long-term right to use all public service assets allocated to it, including responsibility for the entire operation and investment, but the public authority retains the ownership of assets.
[8] SEZs in Ethiopia are experiencing only moderate success. There is one purely Chinese SEZ (MofCom licensed) and several zones subcontracted to Chinese private operators. See my contribution to the international symposium on emergence organized in Grenoble in May–June 2018: "Rereading Lin Yifu: Africa and the Chinese Emergence Model," https://cecmc.hypotheses.org/40333.
[9] Samir Amin. "Le nouvel ordre économique international, quel avenir?" *Revue Tiers Monde* 21, no. 81 (1980): 43.

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