BBVA Research

Emerging Markets

Economic Watch

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Africa forgotten? Certainly not for China!

Economic Analysis

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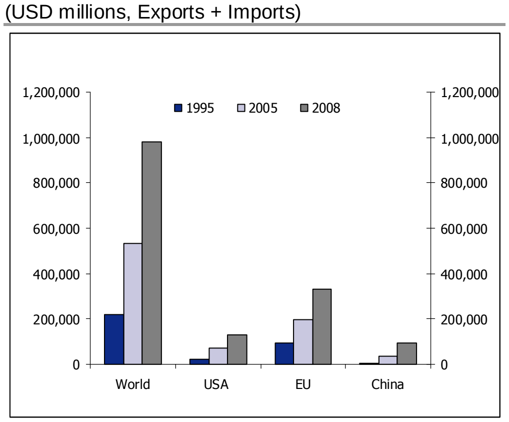
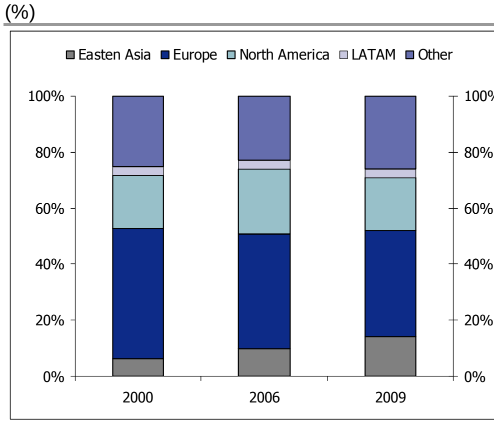
- **From aid to business relations**: Chinese FDI in Africa has multiplied in recent years, and trade flows have boomed. In fact, they are now 30 times larger than in 1995.
- **The importance of natural resources**: African economies are more vulnerable to terms of trade swings because they rely heavily on commodities exports. China becoming a key importer of such commodities, and also a direct investor in such sectors, has also contributing to aggravating Africa's dependency on commodities.
- **The African-Chinese partnership is expected to be long-lasting**: China has a long-term, state-supported objective regarding its outward FDI which allows for the execution of projects with a risk assessment beyond the limits of the short-term market. On the one hand, China should contribute to promoting development in Africa as a way to make its investment sustainable over time. On the other, such support for development does not seem to have gone hand in hand with strengthening African institutions.
- Promoting better institutions in Africa and making Chinese investment in Africa more sustainable over time could be easier to achieve if China teamed up with other investors with deep rooted links with the African region. The **China-Africa Development Fund** is a first step in this direction although still very humble.

Chart 1
Africa: International trade
(USD millions, Exports + Imports)



Source: UNCTAD

Chart 2
Africa: Total exports destination
(%)



Source: UNCTAD

From aid to business relations

Even though China's interest in Africa has recently become a hot topic, relations among the two economies date back to the 1950s. Initially, Chinese aid programs constitute the bulk of their economic relations. By the 1980s China was the 8^{th} largest bilateral donor in Africa and barter trade was frequently used as raw materials were used to pay for Chinese exports. Between 1995 and 2008, trade flows boomed and China became the third largest trading partner for Africa, after the European Union and the United States.

China's experience in aid programs became the springboard for its FDI into Africa once it became legal in the 1990s. Since 2007, FDI flows have been increasing and now surpass the FDI flows into Latin America. In 2008, they accounted for nearly 10% of total outward FDI investment from China. In relative terms, these flows are quite important for African economies, since they represent almost 6% of their GDP, almost 60% higher when compared with Latin American countries. In spite of these recent dynamics, China's major stake for outward direct investment is within Asia, with more than 70% of the total for 2008, followed by Latin America, with 18%.

The importance of natural resources

Although some authors argue that China's interest is not so focused on oil or even natural resources in general (Brautigam 2009), Chinese outward FDI investment is clearly biased towards this sector. Two main points support this observation: (i) the African exports structure, where the oil share of total exports is almost 60%, 2.4 times higher than in Latin America and (ii) African fuel exports towards Asia are 3.2 times greater than those from Latin America. Such heightened dependence on commodity exports increases Africa's vulnerability to swings in commodity prices.

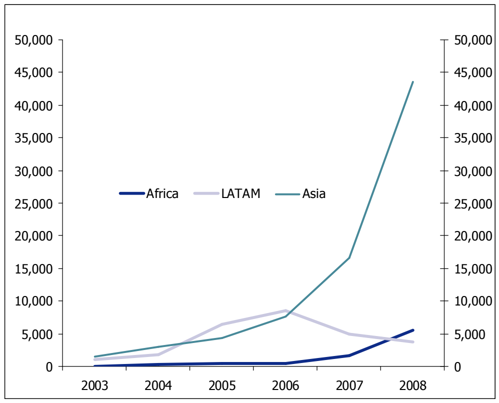
On the other hand, investment in other sectors like manufacturing and infrastructure has gained importance in recent years (Gu 2009). Some firms invest as a way of gaining direct access to the African market and increasing their penetration using technology already developed in China. In some particular cases, for example, the apparel industry, African preferential trade agreements with the USA and the EU help Chinese enterprises to circumvent import quotas on their products. Finally, many cooperation agreements are focused on improving infrastructure (roads, railroads, airports, hospitals, etc) with soft loans granted by Chinese major banks under the condition that they use Chinese suppliers and construction companies.

The African-Chinese partnership is expected to endure in the long-term

For African economies, this "new model" is another opportunity for transitioning towards development. Nevertheless, special care must be taken to ensure that, this time, it be reflected in a tangible benefits instead of repeating the story of excessive concentration on commodity exports and even losing the ownership of raw materials. Furthermore, such economic development should come hand in hand with improving institutions since it has long been identified as a key deterrent for growth and better income distribution in Africa.

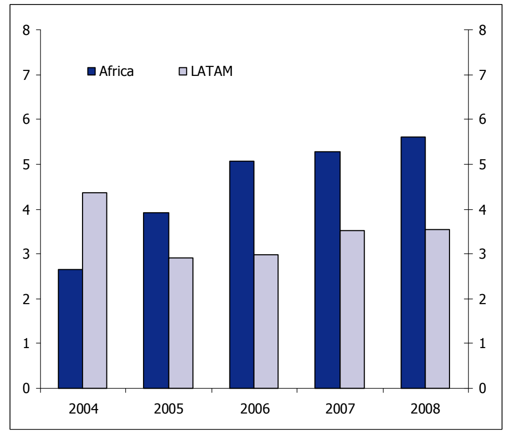
China has a long-term, state-supported objective regarding its outward FDI which allows for the execution of projects with a risk assessment beyond the limits of the short-term market. Nevertheless, China should contribute to promoting development in Africa as a way to make their current investments sustainable over time. To that end, collaboration with other countries/regions, which have been long term partners with Africa is warranted. The most obvious one is Europe. Some steps in this direction have already been taken. For instance the China-Africa Development Fund (CADF) was created in 2007 with USD 5 billion in resources to invest in infrastructure in a joint venture with European countries with solid know-how and ex-colonial ties. By late 2008, almost 20 projects were approved for almost USD 2 billion but there has been little evidence of foreign participation. However, CADF has been opened to African projects without Chinese involvement. There are also many cases where bilateral cooperation agreements include the building of social infrastructure such as hospitals, schools and roads. Nevertheless, China should also promote and support other projects aimed at strengthening institutions on the African continent in order to foster democracy and fight corruption; otherwise, the weak institutional framework will continue to restrain African growth and development in the long run. China's increasing role in international institutions should help improve the monitoring of institutional development in African countries.

Chart 3
China outward direct investment
(flow, USD million)



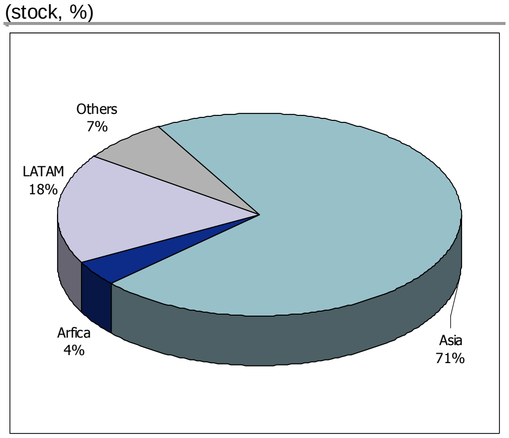
Source: UNCTAD

Chart 4
FDI inward flows
(as percentage of GDP, %)



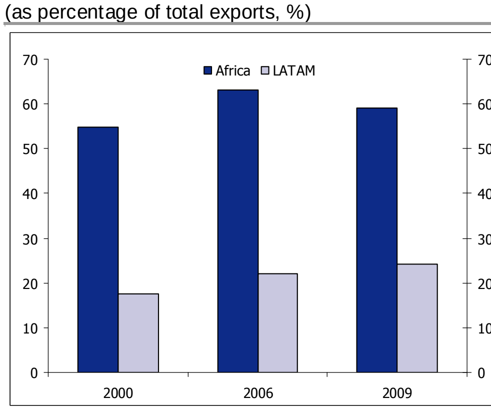
Source: UNCTAD

Chart 5
China: Outward Direct Investment Position in 2008
(stock, %)



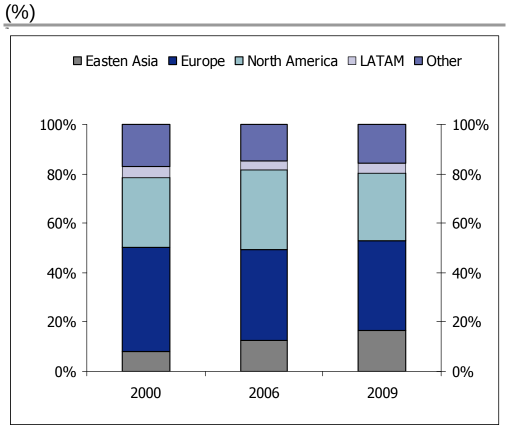
Source: UNCTAD

Chart 6
Fuel exports share
(as percentage of total exports, %)



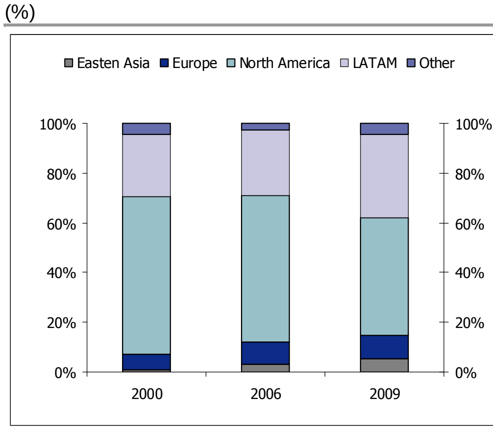
Source: UNCTAD

Chart 7
Africa: Fuel exports destination
(%)



Source: UNCTAD

Chart 8
LATAM: Fuel exports destination
(%)



Source: UNCTAD

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