Chinese Investment in Africa

Kim-Leigh Tursi

Introduction

Foreign direct investment is often cited in relation to economic development, but the actual mechanisms of this interaction can be quite ambiguous. The first section of this paper addresses this, defining foreign direct investment and differentiating it from other kinds of international capital flows. Here, I describe foreign direct investment's role in development, specifically how it facilitates economic growth by driving technological progress. I also mention determinants that commonly influence a country's attractiveness to foreign direct investment. The second section of this paper highlights the most popular criticisms against Chinese foreign direct investment in Africa. Using these criticisms as a framework, I then assess how China's investment both conforms to and diverges from the general characteristics and effects of foreign direct investment. The third section of this paper briefly speculates on China's underlying motives. By analyzing the nature of Chinese investment in Africa, I put China's investment in the continent in perspective to show that while these activities are not as alarming as recent reports portray them to be, it does demonstrate the importance of and need for foreign direct investment to drive African development.

Foreign Direct Investment (FDI)

Foreign direct investment, hereby referred to as FDI, is a type of international capital flow that describes investments directed toward business interests in another country, usually in the form of establishing operations or acquiring assets (Chen, 2021). These investments can be sponsored by individuals, firms, and foreign states alike. FDI is distinct from other kinds of international capital flows, like portfolio investments, which describe foreign equity purchases, and official development assistance, which describes government aid transfers. Compared to the latter two, the nature of FDI is more involved since the recipients of FDI occupy a more direct role in the economy. For example, a Chinese firm operating in Nigeria is directly integrated into its host's economy. It can modify its operations to respond to external economic stimuli, such as changes in local supply and demand. In comparison, equity holdings would not offer foreign investors the same degree of agency nor would it offer recipient firms the same benefits of foreign capital transfer. Likewise, official development assistance usually involves cash transactions in the form of grants or loans disbursed to recipient governments, which manage these funds. Therefore, a Chinese development grant offered to Nigeria would also lack the responsive agency that comes from being directly integrated into the markets as well as the benefits of foreign capital transfers associated with FDI.

This intensive nature is precisely what distinguishes FDI as an attractive catalyst for development. Though FDI's positive impact on economic development is generally accepted, scholars debate the relative importance of the different effects of FDI and how these actually contribute to economic growth. For example, many agree that FDI contributes to total factor productivity (TFP); however, this metric can be further decomposed into efficiency change and technological change (Suyanto & Salim, 2010). Efficiency change describes the increase in productivity and income that occurs as a country's economy reallocates its labor and other resources into more productive industries (Hu et al., 2021). For example, a country would experience efficiency change if it transitioned from a largely agricultural-based economy into a more manufacturing-based one. On the other hand, technological change refers to the improvements and innovations that result in better physical technology or more efficient production processes. This is an important component in productivity growth, which, according to some studies, contributes more to long-term economic growth than capital accumulation (Hu et al., 2021). Therefore, isolating FDI's effects on technological change—how it facilitates technology transfers, introduces new processes and managerial experiences, and fosters competitive forces that drive technological catch-up among domestic firms—can provide a more intuitive insight into the strength of the linkage between FDI inflows and increased productivity (Hu et al., 2021). Unsurprisingly, the relationship between FDI inflows and technological progress was found to be significant, confirming FDI's ability to influence long-term economic growth.

Having established FDI's identity as an effective driver of sustainable economic growth, understanding the conditions that attract FDI may also reveal more about the nature of FDI and its ability to generate tangible benefits in recipient countries. Ibi Ajayi (2006) identifies four main factors that motivate actors to invest abroad: cheaper resources that may be unavailable domestically, access to new markets in the host country and surrounding region, strategic assets that take advantage of research and development in foreign locations, and efficiency gains from comparative advantages of location, factor endowments, and government incentives abroad. Ibi Ajayi (2006) also identifies some factors that attract flows of FDI, including market size, quality of labor available, good infrastructure, little economic and political uncertainty, open trade policy, a transparent business environment, availability of natural resources, agglomeration economies, and a high return on investments. While some of these conditions, like availability of natural resources and market size, are innate endowments that cannot easily be altered, most can be manipulated by the state, revealing the crucial role that governments play in shaping environments that are attractive to FDI. For example, by prioritizing education initiatives, infrastructure construction, and business incentives, governments can pursue environments that are conducive to business and that are more attractive to FDI.

The Nature of Chinese Investment in Africa

Recently, Chinese investment in Africa has gained much attention from the media, despite representing only 2.0 percent[257] of China's total outbound FDI in 2019 (NBSC, 2020). This concern may stem from the rapid, downright aggressive rate at which Chinese investments have grown. During the last 20 years, China's outbound FDI in Africa has, on average, risen dramatically. In 1996, China's stock of outbound FDI in the continent was a mere $56 million (Shen, 2015). By 2005, this figure grew to $1.5 billion, $20 billion in 2013, and according to the most recent report, currently stands at $44.4 billion (NBSC, 2020). Put in perspective, China now stands as the 5th largest investor in Africa by FDI stock[258], just $2 billion behind the 4th largest investor, the United States, and $3 billion behind the 3rd largest, the United Kingdom (UNCTAD, 2020). Moreover, even as a small percentage of China's total outbound FDI, when the percentage of Chinese outbound FDI stock in Africa is adjusted to exclude tax havens, it ranged between 2.7 to 9.1 times its non-adjusted value from 2009 to 2017 (Hu et al., 2021). Based on FDI's almost universally recognized positive contributions to economic development, China's increased attention toward Africa should represent a welcome influx of capital to a continent that could benefit greatly from it, yet many critics question both the nature and motives of Chinese investment in Africa. To understand why, I first describe these main criticisms that claim that Chinese FDI is predominantly a state endeavor, that Chinese FDI projects do not benefit local economies, and that Chinese FDI is primarily extractive in nature (Shen, 2015). Then, I then assess these criticisms' validity within the context of reality.

One of the biggest concerns about the nature of Chinese investment is that it is predominantly "state investment" made by state-owned enterprises (Shen, 2015). As Yao et al.'s case study on Chinese state-owned enterprise Chinalco, a multinational aluminum company, demonstrates, this may be valid. Following its deteriorating performance after the company's IPO on the Shanghai Stock Exchange in 2007, Chinalco launched an aggressive plan to acquire foreign assets as four of China's largest state-owned banks extended the company $21 billion in low-interest credit with no repayment deadline (Yao et al., 2010). Though this seems quite alarming, Shen's (2015) breakdown of China's 2013 Ministry of Commerce outbound FDI database reveals that cases like Chinalco may not be the norm. Shen classified outbound FDI into government-owned projects, which had over 50 percent majority state ownership, and

[257] In 2018, the portion of China's outbound FDI that went to Africa was 3.8 percent. From 2018 to 2019, China's outbound FDI in Africa decreased from $5.4 billion to $2.7 billion (NBSC, 2020).
[258] $46, $48, and $49 billion for China, the United States, and the United Kingdom, respectively (UNCTAD, 2020).

privately-owned projects, which also included collectively owned enterprises. As it turns out, the number of private outbound FDI projects registered by China's Ministry of Commerce rose from zero in 2000 to 1,217 in 2013, representing a majority of 53 percent of all Chinese investment projects in Africa (Shen, 2015). A McKinsey & Co. (2017) report offers even more generous estimates—that out of the 10,000+ firms operating in Africa, about 90 percent are privately owned. In fact, the role of the private sector may be even understated, as the Ministry of Commerce's $10 million threshold for official outbound FDI certification works to obscure the true volume of FDI attributable to smaller private firms, who can consequently circumvent approvals (Shen, 2015). This information serves as a reminder that although China has the capacity to assert its influence onto foreign business deals in strategic industries and definitely exercises this power on occasion, many private projects and transactions also take place largely removed from the hands of the state. Therefore, Chinese investment cannot and should not be lumped together under a uniform classification of puppet deals with ulterior political motives.

In addition to the concern that the state dominates investing activities in Africa, many are concerned that Chinese investment projects mainly utilize its own workforce from home and thus do little to improve job creation in host economies (Shen, 2015). While it does appear true that Chinese companies initially bring Chinese workers to Africa, this is actually just a feature of the Chinese business model in which Chinese workers establish operations, train local workers on-site, and later give way to the local workforce (Hu et al., 2021). Various studies support this claim—in a survey of 1,000 African companies in 8 countries, 89 percent of employees were African, accounting for almost 300,000 jobs for the small sample alone (McKinsey & Co., 2017). Another study confirms this statistic, estimating that locals compose about 4 out of 5 employees, based on a database of over 400 Chinese firms in more than 40 African countries (Hu et al., 2021). Additionally, in a comparison of Chinese and American firms in Kenya, the results show similar workforce localization rates of 78 and 83 percent, respectively (Rounds & Huang, 2017). These figures indicate that Chinese investment projects do significantly utilize the local workforce and at a level that may be comparable to the United States.

Another concern that critics have regarding Chinese investment in Africa is that due to its concentration in the oil, gas, and mining industries, it is extractive in nature and mainly serves Chinese resource interests to fuel the expansion of its domestic economy (Shen, 2015). However, these claims too may be unwarranted. For example, Hu et al. (2021) point out that while 30.9 percent of China's total investment stock in Africa in 2011 went to the mining industry, this was actually lower than the global average of 35 percent in Sub-Saharan Africa, according to a 2015 UNCTAD report. Moreover, its share of investments in the mining industry in Africa fell to 22.5 percent in 2017, comparable to that of Europe's (20.3 percent), while construction replaced mining as the highest recipient sector, at 29.8 percent (Hu et al., 2021). Other significant sectors include financial services, manufacturing, and leasing and business services, which ranked third, fourth, and fifth, respectively (Hu et al., 2021). An examination of top Chinese investment recipients[259] based on data from host countries confirms mining and other extractive industries' relative insignificance compared to labor-intensive manufacturing activities and service industries (Shen, 2015). These findings reveal that although China's engagements in the African mining industry are significant, they are not abnormal when compared to Africa's other investors. Furthermore, the concern of Chinese investment primarily being resource-seeking does not reflect the robust diversification of Chinese activities in Africa.

Regardless of whether China's investment in Africa truly does stem from ulterior motives of the state, I argue that its merits should primarily be based on the tangible effects that it produces. In the first section, I established that FDI inflows contribute positively to long-term economic development. The main question now is whether this statement holds true for Chinese investment in Africa, and research indicates that it does. A study conducted over a period from 2003 to 2012 of 36 African countries indicates that Chinese FDI improves income in Africa (Donou-Adonsou & Lim, 2018). When five African governments[260] were surveyed on their perceptions on the economic impact of Chinese investment, all of them reported a positive impact on local job creation, and three of them also reported a positive impact on local industrialization (Shen, 2015). Moreover, econometric modelling by Hu et al. (2021) reveals that Chinese FDI has had a significant and positive impact on Africa's technological progress while non-Chinese FDI has not, possibly due to a stronger technology-enhancing effect between investing and recipient countries when the technology gap between them is smaller. Additionally, Chinese investors appear to be less deterred by poor institutional environments in host countries, giving their investments long-term financial flexibility and risk tolerance that can facilitate more technological spillovers. (Hu et al., 2021). Altogether, these findings support the positive contribution of China's FDI flows to Africa's economic development.

China's Underlying Motives

In the last section, I assessed the nature of Chinese FDI in Africa by investigating common criticisms against it, including that Chinese FDI is predominantly a state endeavor, that Chinese FDI projects do not benefit local economies, and that Chinese FDI is primarily extractive in nature (Shen, 2015). Overall, this assessment reveals that the nature of Chinese FDI in Africa is at least benign, as it functionally does not seem to be universally exploitative. However, this does not automatically testify to the benevolence of China. In order to postulate the motives behind China's increased engagements in Africa, broadening the examination of China's activities beyond FDI may be helpful. This expanded category of activities might also encompass the Chinese state's direct involvement with the continent,

[259] Nigeria, Zambia, Ethiopia, Ghana, Liberia, Rwanda
[260] Liberia Ethiopia, Rwanda, Nigeria, and Zambia

such as the extension of aid and credit toward African governments and policy campaigns related to the continent. For example, this would include China's Belt and Road Initiative, a massive infrastructure development plan to assist developing countries globally.

As China assumes an important role of investor, creditor, and donor for many African states, the most persistent criticism is that China's motives are self-serving and resource-driven (Wu, 2010). However, China's engagements in Africa have only been studied for a little over a decade, so the long-term effects of its presence in the region have yet to be determined (Wu, 2010). Despite this caveat, Xia (2021) provides helpful framework for reflecting on China's motives by grouping China's engagements in Africa into three phases. In the first phase (1950s to late-1970s) China mainly provided ideology-driven development aid to promote anti-colonial and anti-imperial solidarity. In the second phase (1980s to early-2000s), Chinese migrant entrepreneurship became popular. Finally, in phase three (mid-200s to present), the Chinese state began to actively promote China-Africa engagements, bottom-up immigration, and market-driven investments. Although the evolution in China's engagements with Africa may not pinpoint China's exact motives, it does demonstrate China's growing interest in the African continent. Moreover, China's careful approach to working with African states through development assistance and economic diplomacy, as opposed to brute military force, alludes to China's long-term, strategic goals for itself and Africa. These goals may not be apparent yet, but writing off China's primary motive as resource-seeking would likely be a premature oversimplification.

Conclusion

FDI's more involved nature distinguishes it from other kinds of international capital flows. With its ability to drive technological progress through technology transfers and spillovers, FDI is an attractive catalyst for long-term economic development. There are many push and pull factors that influence the flows of FDI. Some of these, including quality of labor, infrastructure, trade policy, and business environment, can be manipulated by the government, emphasizing the critical role that governments play not only in attracting FDI, but also in coaxing economic conditions that are conducive to long-term growth in general.

The rapid pace at which Chinese investment in Africa is growing has brought with it criticisms over its nature and motives. The most popular ones claim that Chinese investment is primarily a function of the state, that Chinese projects mainly employ a workforce brought from home, and that Chinese investment is extractive in nature. However, as it turns out, these claims do not reflect the reality of the situation. Private investment constitutes a significant portion of total Chinese outbound FDI; Chinese projects often utilize the local labor force for a majority of its operations; and China's engagements in the continent are no more extractive than that of other major investors. In fact, Chinese investment may offer even more benefits in terms of technological progress compared to investments made by other, developed countries. Regardless, the measurable benefits yielded by increased Chinese investment in Africa emphasizes the importance of and need for more FDI to continue driving development in the African continent.

Overall, despite talk of China’s growing investment in Africa, the continent remains one of the least invested-in regions in the world, capturing only 2.4 percent of total global FDI flows, second only to Oceania at 0.1 percent (UNCTAD, 2020). Moreover, after already declining by 10 percent in 2019, FDI flows to Africa are expected to fall by another 25 to 40 percent in 2020, exacerbated by low commodity prices (UNCTAD, 2020). However, the implementation of the new African Continental Free Trade Area Agreement may curtail some of these effects, highlighting the importance of regional free trade and capital transfers for Africa’s economic prosperity (UNCTAD, 2020). This and recent investment initiatives from both developed and emerging economies, such as the Prosper Africa Initiative, Choose Africa, and the Forum on China-Africa Cooperation, indicate renewed interest in the continent as an economic opportunity, offering hope for the continent’s future prospects (UNCTAD, 2021). Still, more must be done to increase and diversify investment flows and channel them into structural transformation if Africa is to realize its full potential.

Bibliography

Chen, J. (2021, February 12). Foreign Direct Investment (FDI). *Investopedia*. https://www.investopedia.com/terms/f/fdi.asp

Donou-Adonsou, F., & Lim, S. (2018). On the importance of Chinese investment in Africa. *Review of Development Finance, 8*(1), 63-73. https://doi.org/10.1016/j.rdf.2018.05.003

Hu, D., You, K., & Esiyok, B. (2021). Foreign direct investment among developing markets and its technological impact on host: Evidence from spatial analysis of Chinese investment in Africa.

Ibi Ajayi, S. (2006). Foreign Direct Investment in Sub-Saharan Africa: Origins, Targets, Impact and Potential. African Economic Research Consortium. https://media.africaportal.org/documents/FDI_papers_booklength_volume.pdf

McKinsey & Co. (2017). Dance of the Lions and Dragons - How are Africa and China Engaging, and How will the Partnership Evolve? McKinsey & Company. https://www.mckinsey.com/featured-insights/middle-east-and-africa/the-closest-look-yet-at-chinese-economic-engagement-in-africa

National Bureau of Statistics of China. (2020). *China Statistical Yearbook 2020*. [Data Set]. China Statistics Press. http://www.stats.gov.cn/tjsj/ndsj/2020/indexeh.htm

Rounds, Z., & Huang, H. (2017). We are not so different: A comparative study of employment relations at Chinese and American firms in Kenya. *China Africa Research Initiative*. https://static1.squarespace.com/static/5652847de4b033f56d2bdc29/t/58da9416e4fcb5845eb6da4a/1490719767135/zander+v1.pdf

Shen, X. (2015). Private Chinese Investment in Africa: Myths and Realities. *Development Policy Review*, *33*(1), 83–106. https://doi.org/10.1111/dpr.12093

Suyanto, & Salim, R. A. (2010). Sources of productivity gains from FDI in Indonesia: Is it efficiency improvement or technological progress? *Developing Economies, 48*(4), 450-472. doi:10.1111/j.1746-1049.2010.00115.x

United Nations Conference on Trade and Development. (2020). *World Investment Report 2014*. Geneva: United Nations Conference on Trade and Development. https://unctad.org/system/files/official-document/wir2020_en.pdf

Wu, J. R. (2010). World News: Asia: China rejects criticism of its investments in Africa. *The Wall Street Journal Asia*. http://libproxy.temple.edu/login?url=https://www.proquest.com/newspapers/world-news-asia-china-rejects-criticism/docview/276273426/se-2?accountid=14270

Xia, Ying. (2021). Chinese investment in East Africa: History, status, and impacts. *Journal of Chinese Economic and Business Studies, 19:4, 269-293,* DOI: 10.1080/14765284.2021.1966733

Yao, S., Sutherland, D., & Chen, J. (2010). China's outward FDI and resource-seeking strategy: A case study on Chinalco and Rio Tinto. *Asia-Pacific Journal of Accounting and Economics, 17*(3), 313-325. doi:10.1080/16081625.2010.9720868