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Chinese Debt, Aid and Trade: Opportunity or Threat for Zambia?

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A 'China-Africa Toolkit' has been developed to serve African policymakers as an information database, a source of capacity building and a guide to policy formulation

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ABSTRACT

This paper looks at the threats and opportunities of China's involvement in Africa and Zambia, specifically relating to aid, trade and debt sustainability aspects, and offers policy recommendations that may enable 'China in Africa' to be beneficial for sustainable and pro-poor development in Zambia. China is a rising player on the world stage and is set to shape the 21st century in very significant ways. The ripple effects of China's economic ascendance over the past two decades have reached various aspects of the global economy. It cannot be ignored by countries such as Zambia, where this growing influence is strongly felt in the country's social, economic and political economy.

The three aspects of the China–Zambia relationship discussed are: 1) Zambia's debt, which is crucial because of the country's bad history of indebtedness and difficulty in managing and paying back external debts. 2) China as one of the major sources of financing for Africa, involved in over 35 aid projects in Zambia, including agricultural initiatives and infrastructure developments. 3) Since 2008, the People's Republic of China has increased two-way trade to \$106 billion, making it Africa's second largest trading partner.

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ABBREVIATIONS AND ACRONYMS

AFRODAD	African Forum and Network on Debt and Development
CATIC	China National Aero-Technology Import & Export Corporation
EXIM	Export–Import Bank of China
FDI	foreign direct investment
FOCAC	Forum on China–Africa Cooperation
HIPC	Highly Indebted Poor Countries
JASZ	Joint Assistance Strategy for Zambia
JCTR	Jesuit Centre for Theological Reflection
MDRI	Multilateral Debt Relief Initiative
MOFCOM	Ministry of Commerce, Department of Outward Investment and Economic Cooperation
ODA	official development assistance
PRC	People’s Republic of China
SEZ	Special Economic Zone
TAZARA	Tanzania–Zambia Railway Authority

INTRODUCTION

China is a notable rising player on the world stage and will undeniably shape the 21st century in very significant ways. Its economic growth over the past two decades has generated ripple effects in the global economy that cannot be ignored. This is particularly true for countries such as Zambia where China influences the social, economic and political economy. The debate on China dominated the 2006 general elections in Zambia, and the country has seen numerous sponsored ‘fact finding’ trips and exposure visits by chiefs, government officials, ruling party cadres, and business people to China.

China’s search for natural resources, to satisfy the demands of its increasing industrialisation, has led it to sub-Saharan Africa.¹ This interest has given rise to relationships that, for the Chinese and African heads of state, are mutually beneficial but are viewed with apprehension by most ordinary African folk. These relationships between China and individual African countries take different forms, and include signed agreements, exchange visits, and scholarships. In 2000, the Forum on China–Africa Cooperation (FOCAC) was created, which offers many opportunities and threats for Africa on several fronts.

China’s Policy Paper on Africa (2006), emphasises political equality, mutual trust, economic ‘win-win’ co-operation and cultural exchange. The China–Africa bilateral co-operation policy covers the areas of:

- 1 Political co-operation: high-level visits, exchanges between legislative bodies, political parties, local governments and support in international affairs.
- 2 Economic co-operation: trade, debt reduction and relief, investment, finance, agriculture, infrastructure, natural resources and tourism.
- 3 Human resource development: focus on education, science, culture, health, technology, media, administrative, consular, humanitarian co-operation and people-to-people exchange.
- 4 Peace and security: focus on military, the judiciary and police, conflict settlement and peacekeeping.

This paper looks at the threats and opportunities of China’s engagement in Africa and Zambia, specifically relating to debt sustainability, aid and trade and investment, and offers policy recommendations that may enable ‘China in Africa’ to be beneficial for sustainable and pro-poor development in Zambia.

CHINA AND DEBT SUSTAINABILITY

The question of Zambia’s debt to China is a crucial one for two reasons: Chinese assistance is mainly through loans and (to a lesser extent) grants; and Zambia has a history of difficulty in managing and paying back external debts, largely because of the lack of a legal framework to guide the process.

As of 12 December 2006, China was the highest Non-Paris Club creditor to Zambia, whose debt stood at \$217 million.² Zambia’s historical indebtedness to China is concentrated in two areas. Firstly, loans for the construction of the 1 800 kilometre

Tanzania–Zambia Railway Authority (TAZARA) project, which cost over \$450 million and is reported to have been partially cancelled on more than one occasion (the most recent being the cancellation of 50% of the outstanding amount during President Banda's visit to China in March 2010). The second is the loan from China National Aero-Technology Import & Export Corporation (CATIC) for the purchase of earthmoving and other equipment. In order to service the CATIC loan, \$2 million was used from a grant of \$6 million provided by the Chinese government during the visit of the Zambian president (the late Levy Mwanawasa) to China in November 2003.³

Following years of debt crisis, Zambia benefited from debit relief and consequent lower debt stock through the Highly Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiatives (MDRIs). Although the Zambian government has since signaled its commitment to debt sustainability, the rising bilateral debt from countries like China is of concern. New loans from China totaling more than \$500 million in the first half of 2007 will significantly have increased Zambia's external debt figure. In the same year, Zambia's debt installments to China accounted for almost one-third of bilateral debt repayments.⁴ However, there is conflicting information on what these repayments were for.

China is considered to be a preferred lender, as debt cancellation is part of its development assistance package to countries that experience major difficulties in repaying their loans. Unlike traditional lenders, China also allows debt repayments to be rescheduled, and a number of Zambian loans have since been partially or completely cancelled.⁵ However, the cancelled debts appear to be government-to-government loans, not loans involving non-government or even certain government institutions. For instance, \$18 million, of the \$217 million owed by Zambia as of December 2006, was cancelled during Chinese President Hu Jintao's visit to Zambia in February 2007. Yet, the Mulungushi Textiles loan, which dates back to the 1970s, was not included in the cancelled debts.

Debt sustainability is a concern, as in almost all cases where a loan has been cancelled, another one is acquired immediately (or soon after). The situation is made more unsustainable because the cancellation is not comprehensive, like the HIPC and MDRI initiatives, but piecemeal as China is not a member of the Paris Club. To illustrate this, in February 2007, during President Hu's visit, China cancelled a substantial amount of Zambia's debt: a loan maturing on 31 December 2005 for the TAZARA rail line worth \$11 million, and a loan worth \$7 million.⁶ However, between January and March 2007, China announced new loans valued at approximately \$500 million, including \$39 million for electricity upgrade with ZESCO and \$400 million for agricultural equipment, earthmoving equipment and other machinery. An additional loan of \$96 million for stadium construction was announced in 2008.

More recently, after the visit to China by Zambian President Rupiah Banda in March 2010, China granted a \$1 billion concessional loan to the Zambian government, which caused much media frenzy. The loan was for various development projects, including cultural development in the form of a stadium being built in the copper-belt town of Ndola. China provided a further grant of \$10 million to be used to complete the stadium. During the same visit, part of the TAZARA loan was cancelled but was followed by the \$1 billion loan to Zambia. Information concerning the intended use and exact terms and conditions of these loans is at best conflicting. What is worse is that the lion's share of the current information is still based on a combination of aggregate figures and sporadic information from news agencies.⁷

In November 2009, China pledged \$10 billion in low-interest loans over three years, to African countries, putting up a \$1 billion loan facility for small and medium-size firms, and forgiving debt on some interest-free loans. This facility, together with the energy and time invested by Zambian technocrats and politicians on loans from China, raises the fear about whether necessary caution is being taken to avoid plunging the country into another debt crisis. Before loan agreements are signed, the Zambian public should have the right to know about, and question, all borrowing from both new and old lenders. Oversight and watchdog institutions such as parliament, the auditor-general and the attorney-general must have clear mandatory authority over the borrowing process. What is needed is a legal and participatory loan contraction framework, such as that in the Jesuit Centre for Theological Reflection's (JCTR) proposed Debt Management Bill, to be guaranteed by the Zambian constitution.⁸

While China does indeed offer an alternative source of financing, information disclosure is needed in order to clear up suspicions about whether loans from China threaten (or not) debt sustainability in Zambia. It is also important to recognise that Zambia's economic problems are long term and so borrowing for short-term solutions, simply because money is available, is problematic. In the absence of economic reforms, borrowed resources are not adequate to address Zambia's problems and may even worsen the situation.

AID FROM CHINA: THE 'POT O'GOLD'?

Aid to Africa is part of the agenda of China and other, more developed countries. However, China's approach is unique, as it is not restricted to providing grants. A more appropriate term to describe the Chinese approach is 'development assistance' because it includes aid funds, financing for development (such as concessional loans for trade or infrastructure development) and debt cancellation. Chinese documentation places interventions in Africa under economic co-operation and official development assistance (ODA): 'Co-operation refers to foreign direct investment (FDI) and contracts with Chinese companies, while ODA refers to concessional loans, debt relief and grants'.⁹

China has grown rapidly to become one of the major sources of financing for Africa. According to the Chinese government, China plans to double aid to Africa to \$1 billion per annum. Up until 2006, China had given \$5.74 billion in aid (excluding debt relief), and between 1991 and 2005 sponsored about 900 infrastructure and social development projects. However, the exact amount of development assistance is difficult to establish, as the information is limited and the grants awarded tend to be disbursed in kind through various projects. However, from 1967, when the first aid agreement was established, to 1996, Chinese aid to Zambia is estimated at \$372 million, including traditional grants and zero-interest loans, medical teams and scholarships. China has been involved in over 35 aid projects in Zambia, including agricultural initiatives, infrastructure developmental projects such as roads, the TAZARA project, public buildings like the Government Complex, several water supply developments and the Mulungushi Textiles plant.

The above shows that China is not a new donor to Africa, although, compared to traditional donors, it remains a relatively small donor to Zambia. Its development assistance is in line with the Chinese South-South co-operation thinking and is structured around helping Zambia become self-reliant. Consequently, since 1978, China has supported

education, health, infrastructure and culture in Zambia, sponsoring Zambian students to study in China, sending teachers to work in the University of Zambia and medical teams to Zambia (in 2006, 31 Chinese medical personnel were working in Zambia).¹⁰

The Export–Import (EXIM) Bank of China is now perceived as an important new source of capital, especially for the much-needed infrastructure investment essential for African development. Projects currently receiving financing from China in Zambia range from debt write-offs to the construction of a sports stadium in Ndola, an agricultural demonstration centre, rural schools, a hospital, an anti-malaria centre, as well as 117 Chinese government scholarships between 2007 and 2008.

Essentially, China sees aid as developing greater trade and investment opportunities for the recipient country. However, aid from China is not well understood in Zambia, as information is very scant. What is clear is that China's approach to aid is unconventional and, in many ways, appears to be outside the organised modalities that endeavour to make aid more effective, such as the Paris Declaration or the Accra Agenda for Action. Nevertheless, 'China has signed up to the Paris Declaration and has thereby committed to follow its five main principles ... [But the difficulty is] China probably signed up in its capacity as a recipient rather than as a donor country'.¹¹ Due to this lack of clarity, countries like Zambia face the challenge of how to hold China accountable according to these benchmarks. Furthermore, unlike other donors in Zambia, China has not signed the Joint Assistance Strategy for Zambia (JASZ) – an instrument of harmonisation and division of labour in line with the principles of the Paris Declaration on aid effectiveness – that provides Zambia with some leverage in dealing with traditional Western donors.

More interesting is to look at China's 'no strings attached' policy in relation to African countries, which supposedly translates into a 'no attachment of conditions to aid provided'. One view is that, unlike with Western donors, this policy allows countries greater ownership of the aid resources accessed. However, the opposite view is that it undermines local efforts to increase good governance and international efforts at macroeconomic reform, of which traditional donors to Africa are strong advocates. However, from 2007 onwards, Chinese aid to Zambia has increased significantly and changed markedly in nature. China's aid after 2007 is very different from aid in the 1970s, when the Chinese assisted in the development of the TAZARA railway project without gaining any resources from Zambia. The nature of the aid was considered low quality, as it did not include conditionalities or co-operation with other donors (thus undermining other aid to Zambia). When China began financing the Special Economic Zones (SEZs) in 2006, its economic interests were quite obvious. While this aid brings job creation and increased exports, it does not include proper evaluation systems or humanitarian considerations, which is shown by the lack of transparency, low quality of management, and ill treatment of labour.¹²

In Zambia, the Ministry of Finance and National Planning normally co-ordinates development assistance, but other government ministries have negotiated directly with the People's Republic of China (PRC) for development assistance and involved the Ministry of Finance only when payments are required. This is due, in large, part to the fact that, compared to other donors, aid from China has lower transaction costs, less complicated procedures, no expensive studies or analysis, and a reasonably short transfer time. What remains to be answered is whether this is good for accountability, co-ordination and essentially aid effectiveness.

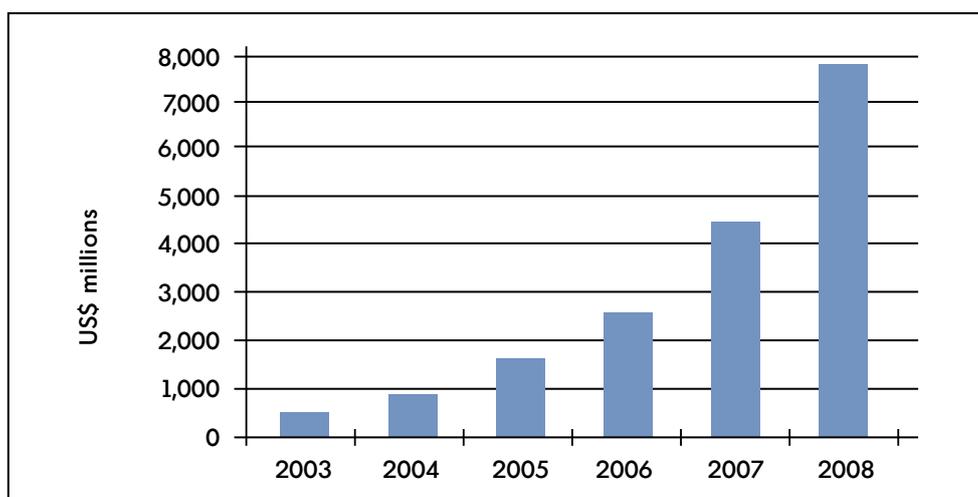
CHINA'S TRADE AND INVESTMENT: ECONOMIC SAVIOUR?

China's trade and investment in Africa has skyrocketed in recent years: overall trade with Africa rose from \$10.6 billion in 2000 to \$75.5 billion in 2008, helping to propel Africa's growth rate to 5.8% in 2008, its best performance since 1974. Trade between Zambia and China, specifically, exceeded \$1.2 billion. In 2009, China promised at FOCAC to increase Africa's two-way trade to \$100 billion by 2010, to become Africa's single largest trading partner.

Such impressive trade statistics should be to Africa's advantage. Unfortunately, like other developed countries, China is very much in the business of extraction, which leads to trade in mostly raw commodities from Africa to China and finished goods from China to Africa and is not unlike past experiences with the West. While 'China's rising demand for Africa's natural resources has helped to re-establish Africa as a source of valuable commodities for the global market',¹³ commodity booms can pose a challenge to macroeconomic management in Africa, perhaps leading to 'Dutch disease' and other challenges.¹⁴

On the other hand, trade with China need not be a one-way export of commodities. The country is a huge, rapidly growing, export market for finished products, which Zambia only has to take full advantage of. Since 2005, China has applied zero-tariff treatment for trade with African countries, and, as at the end of June 2009, about \$890 million African products enjoyed preferential treatment. A key platform of the FOCAC IV ministerial meeting in 2009 was to encourage imports of finished African goods into the Chinese market. The total annual growth of Sino-Africa trade has averaged more than 40%, and stood at \$106.8 billion in 2008 versus \$30 billion just four years earlier in 2004. By 2006, the number of zero-tariff Zambian exports into China had grown, from 192 in 2005, to over 452. This is occurring in the context of a decline in demand for Africa's basic exports to the West. For instance, Africa's share in the EU foreign trade has fallen 3.2% to about 1.3% between 1989 and 2009.

Figure 1: Chinese foreign direct investment in Africa, 2003–2008



Source: Chinese Statistical Bulletin of FDI, 2008

The PRC shows great interest in trade and investment on the continent, ‘the share of Africa in total Chinese outward FDI has been marginal up until now, but is increasing rapidly. In May 2007, China announced that it will provide about US\$20 billion in infrastructure and trade financing to Africa over the next three years.’¹⁵ About 1 000 Chinese enterprises were approved or registered to do business in Africa in 2009,¹⁶ and Zambia has seen an increase in the number of Chinese business people and technical experts. While the government describes this influx as a demonstration of the favourable business and investment climate in the country, many Zambians view it with suspicion. Some Chinese compete with Zambians for low-level jobs and with small-scale traders (e.g. making desks for the local schools), while many Chinese traders have taken up shops in the extensive market of Kamwala, the city’s oldest trading place, which raises questions around whether investors should be involved at such low levels of commerce.

Large-scale Chinese investment in Zambia has indeed occurred. In 1997, the Bank of China opened a branch in Zambia, the first in the sub-Saharan region, while in June 2001, the China Investment and Trade Developing Centre opened for business. The ultimate, so far, has been the development of an economic and trade zone co-operation agreement, which is expected to establish a SEZ in the Chambeshi mines, the first of five such facilities planned for Africa. This will bring a total investment of over \$800 million and create 6 000 jobs, and has great potential because SEZs not only provide jobs but also benefit from substantial infrastructure investment and development assistance.

In 2009, Chinese investment in Zambia stood at about \$1 billion, making it by far the biggest investor in the country. In addition, as the Zambian minister of finance said, ‘Chinese investment has helped to attract other investors into the country’.¹⁷ However, this is only worthwhile if Zambia is able to obtain appropriate rents from the Chinese and other investors’ exploitation of the country’s natural resources. And, more importantly, if the country is able to ensure that such revenue is invested in long-term industrial development projects.

Table 1: Chinese investment in Zambia as a share of total investment (\$ million)

	2004	2005	2006	2007
Chinese investment	14.0	40.8	209.0	284.1
Total investment flow	239.0	2570	695.0	1,500.0

Source: Compiled from Zambia Development Agency data

China is clearly the investor of choice for Zambian bureaucrats. Following the Zambian president’s visit to China in March 2010, the minister of commerce, trade and industry proclaimed the visit a success: ‘President Banda had secured investments to support projects to develop two mini-hydro power stations, roads, housing, education sector programmes and the construction of a stadium through the agreements. The agreements will result in the creation of 4 000 jobs in the Lusaka sub-zone alone, and other jobs from the construction of a stadium in Lusaka and the other projects.’¹⁸ He also disclosed that the China–Africa Development Fund would be housing its regional office for

Central Africa in Zambia, demonstrating the Chinese perception of Zambia as a priority investment destination.

Unfortunately, the trade and investment ‘deals’ between China and most African governments are opaque and on barter terms largely dictated by China. What is alarming is that the Transparency International’s Bribe Payers Index¹⁹ rates Chinese businesses as some of the most willing to give bribes, which further raises questions about the genuineness of the contracts and tenders awarded to Chinese firms that now have the lion’s share of all construction projects in Zambia. While evidence is hard to find, it is clear that the Chinese government’s position as a prominent investor and donor has helped both large state-owned and smaller private enterprises to expand their market access opportunities.²⁰ China is, however, beginning to be more open to co-operation that may allow for more scrutiny of their activities. For instance, the World Bank’s private sector arm, the International Finance Corporation has signed its first deal to finance Chinese investment in Africa, a move the World Bank hopes will help to discourage violations of human rights and poor environmental standards that China is famous for. In the same vein, some bilateral donors in Zambia intend partnering with the Chinese-financed hospital project in Lusaka. The practice of openness necessary to facilitate checks and balances is unfortunately not one that Chinese investors currently subscribe to.

Within a weak regulatory setting, Chinese investment poses significant challenges. The Chinese take full advantage of the weaknesses, such as poor quality control, labour protection or land allocation, in countries like Zambia, and export their bad practices alongside their investments. The exporting of bad practices is one of the major causes of the controversial debate about China dumping cheap, low-quality products in Africa; in Zambia there is much uneasiness about these imports that have choked many Zambian small traders. Ironically, as a direct result of competitive imports, the Mulungushi Textiles factory closed in early 2007, at almost the same time as President Hu Jintao’s visit to Zambia. Financed by China in the 1970s as a sign of Sino–Zambian solidarity, the factory was once the biggest textile factory in the country, but ceased production after suffering repeated losses. More than 1 000 jobs were lost and the infrastructure left to waste.

As is clear from this study, the impact of China on the Zambian economy has varied across time and within different sectors. While the new investment and trade opportunities presented by Beijing are certainly welcome, the problems associated with certain Chinese investors and experienced by the textile sector are reminders of unanticipated consequences. The following recommendations will help ensure that the development implications of these opportunities are fully realised.

RECOMMENDATIONS

- 1 The high turnout of African heads of state at the FOCAC meeting showed the importance of the Sino–Africa relations. Hence, the African Union, and individual African states such as Zambia, must develop policy papers to guide the relations and correspond to China’s own policy on Africa. The policy papers must set clear guidelines, limits and expectations.
- 2 China has come in to fill the financing gap in Africa and in Zambia, but needs to adhere to some minimum standards of governance. Hence, the Zambian government

must ensure that legal provisions to guide debt management are in place, authorised by the Zambian Constitution, giving oversight and watchdog institutions such as parliament, the auditor-general and the attorney-general clear mandatory authority over the borrowing process. This could entail the speedy consideration of the JCTR proposed Debt Management Bill.

- 3 As state–firm dynamics are by no means exclusive to Chinese investment, Zambian regulations and their enforcement need to be looked at. Labour standards, quality control by the Zambia Bureau of Standards, environmental impact analysis and checks, tendering and land tenure processes must be strengthened to prevent Chinese and other investors taking undue advantage of Zambian resources and people.
- 4 Zambia should re-formulate bilateral co-operation in the context of joint and sub-contracting arrangements, as an effective method of enhancing skills transfer and capacity building in local industry.
- 5 The Freedom of Information Act must be put in place so that the Zambian public has the right to question and access information about all borrowing, trade and investment agreements, as well as aid flow from both new and old partners, before and after the agreements are signed.
- 6 Zambian private sector must endeavour to take full advantage of the zero-tariff export window provided by China and begin to add value to products for export.
- 7 Zambia needs to put in place measures that will ensure decent job creation, appropriate rent from the exploitation of the country’s natural resources, and investment of such revenue in long-term industrial development projects.
- 8 The fact that China’s \$1.3 trillion of foreign exchange reserves may now be used for overseas investment projects opens up the potential for infrastructural transformation in Africa.²¹ Zambia must take full advantage of this and ensure that, in particular, rural infrastructure development is prioritised.
- 9 Zambian civil society must intensify its engagement with the government of Zambia, the PRC, and civil society in China, and continue to lobby for the above recommendations.

CONCLUSION

China presents both an opportunity for Africa – to reduce its marginalisation from the global economy – and a challenge – to harness the influx of resources for pro-poor growth and effective poverty-reducing economic development. China’s phenomenal economic growth can serve as a source of inspiration and opportunity for much of Africa, and the PRC has the ability to be an important role model for Africa. This developing relationship gives the continent’s countries renewed hope that they too can start to rise out of poverty and become important players on the global scene. However, China poses a challenge to good governance in Africa because of its continued financing of troubled and illegitimate governments. Furthermore, a weak regulatory setting and fundamental flaws in the Zambian economy makes economic co-operation with China an unintended threat. Zambia needs to significantly change how it engages with China. China has a policy on Africa and the question remains: Does Zambia have a policy on China? What are the

strategic intentions of being part of FOCAC? The starting point for Zambia could very well be to develop a policy on China.

ENDNOTES

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