

The commodities scramble for Africa: Is China set to win?

Matthew Hulbert and Chris Melville of Control Risks evaluates China's emergence in Africa and the new challenges this sets for the West and for African development.

Right: Chinese President Hu Jintao (left) and South Africa's President Thabo Mbeki (right) touch a crystal ball to launch the China South Africa economic trade and co-operation website at the Union building in Pretoria, February 2007.

China was Africa's third-largest trading partner in 2005, accounting for US\$39.7bn in trade, a figure that rose to US\$55bn in 2006 and is expected to reach US\$100bn by the end of the decade. President Hu Jintao's tour of African countries in February 2007 further entrenched China's position, but also revealed subtle moves towards greater political responsibility and managing of political risk. Some convergence between Chinese and Western interests could be on the horizon in the longer term, but the business environment could become more challenging for investors in the interim.

Chinese engagement in Africa has strategic implications for other investors, both in terms of future acquisitions and the business environments in which investors operate. Hu's latest visit secured China greater influence in Sudan through US\$70m in loans, equalled in levels of debt cancellation, alongside a grant of US\$40m; US\$60m was given in grants and loans to Cameroon; and a free-trade agreement was struck with Zambia designed to attract US\$800m of Chinese investment in the coming years. China extended soft loans to Liberia and sealed export agreements on energy and minerals with South Africa. Namibia claimed a US\$4.2m grant and US\$5m interest-free loan, while Mozambique and the Seychelles were also on the list of destinations.

In the short-to-medium term, non-Chinese investors will find it difficult to compete with China's strategy of acquiring mineral and oil resources in Africa. Even high-risk environments such as Somalia and Chad are not off limits as China expands its portfolio across the continent. Beijing is increasingly adept at securing resource supplies or effective partnerships with state capital, and using political and economic diplomacy to make quick gains and secure new concessions with inflated signature bonuses from Chinese companies.

Its strategy is based on political non-intervention, married to soft loans, aid packages and infrastructure provision without the strings attached by Western or multilateral organisations. This has led to concern that China's approach will foster weakened governance and higher levels of corruption, undermining future business and operating environments throughout Africa.

The predicament was not lost on leading Western extractives meeting in Davos in January 2007. They increasingly see themselves in direct competition with



state-owned Chinese companies for access to African markets. Western extractives want to see the UN play a greater role in raising standards and are considering greater partnering with the World Bank's International Finance Corporation to offer increased incentives for African leaders. However, both strategies will only have limited traction given that China spent more than US\$10bn on infrastructure projects in Africa in 2006. China will thus continue to gain a stronger stake in upstream assets and downstream activities in Africa through a blend of political and economic incentives.

However, it is important not to overlook the fact that China's engagement in Africa is a long-term strategy, underpinned by a vested interest in political stability throughout the continent by emulating Western 'best practice' in the long run. Such an outlook is starting to permeate many of the Chinese majors, which increasingly adhere to best practice norms and are paying greater attention to political risk, and environmental and social performance.

A sign of evolving policy has been China's tentative moves to put greater pressure on Sudan to allow the UN to play a greater role in Darfur, naming a 'special representative' for the region. The fact that Hu failed to drop in on Harare during his visit was politically (if not operationally) significant.

While this points towards long-term convergence between Chinese and Western interests in Africa, the gap remains distant. Chinese companies will only emulate best practice when this approach is necessary to enter or succeed in advanced markets. They will tend to revert to lower business, environmental and social standards where it is not required. Indeed, contractual negotiations in Sudan and Angola have

a significantly different complexion compared with extensive negotiations in South Africa to conform to international standards and norms; but this remains the exception, not the rule.

Into Africa

The Chinese government is positioning itself as the gatekeeper of African development. It has made a US\$500m donation to the New Partnership for Africa's Development (NEPAD) to ensure that its influence is felt on a multilateral basis. It hosted this year's annual meetings of the African Development Bank (AfDB) in Shanghai as one of 24 non-regional members of the bank, while the third ministerial Forum on China-Africa Co-operation (FOCAC) in November 2006 promised to build a new conference centre for the African Union. Eleven African nations brokered Chinese investment deals at the FOCAC meeting, worth around US\$1.9bn. These developments underline growing Sino-African linkages that have been reinforced by renewed pledges on concessional loans of \$10bn and extensive preferential export buyers' credits amounting to an overall doubling of aid to Africa by 2009.

Two-way trade has increased fivefold since 2000, to US\$55bn in 2006. Although this is only 3% of China's total trade, Beijing is close to overtaking France as Africa's second largest commercial partner after the US. By the end of 2006, the Export-Import Bank of China (China Eximbank) was financing more than 200 projects in Africa, mostly on infrastructure. China could thus outstrip total infrastructure lending by the World Bank and the AfDB in the next couple of years.

Yet the main interest from a Chinese perspective is African mineral and oil reserves. China is expected to rely on imports for 45% of its oil by 2010 and could match demand in the US by 2030 for 11Mbd, which marks a radical departure from a situation of near self-sufficiency in the 1980s. As a result, Chinese policy is driven by two strategic aims: securing supplies to feed domestic growth, and positioning China as a global player in international oil.

The strategy is based on acquiring foreign energy resources through long-term contracts and purchasing overseas assets. Some key Chinese investments in the African oil industry in recent years include:

- A US\$350m deal was concluded in 2003 in Algeria.
- In Gabon, a deal was struck with French oil company Total in 2004 to allow for Chinese participation.
- Angola agreed to a US\$2bn loan in 2005 and a further US\$1bn in 2006, with Sinopec holding a 40% stake in oil block 18 after a US\$1.1bn signature bonus for the government in a total investment amounting to more than US\$1.4bn.
- Further deals have been brokered in Nigeria with an US\$800m crude oil sale in June 2006, and additional market access for the China National Offshore Oil Company (CNOOC) and China National Petroleum Corporation (CNPC). Nigeria has recently offered Chinese companies a first right of refusal on four exploration blocs in return for

US\$4bn in infrastructure investment.

- Sinopec holds a 27% stake in an offshore oil field in Côte d'Ivoire.
- Zhejiang Oil Products Company (ZPC), a Sinopec subsidiary, has started extraction in Ethiopia.
- China has a \$4bn stake in Sudan and has started offshore oil exploration and production in Congo and Namibia.
- Chinese interests in Equatorial Guinea rose by 138% from US\$374m in 2003 to US\$889m in 2004 and China offered a substantial loan following the FOCAC meetings.
- CNPC bought the rights to several oil exploration zones in Chad from Canadian companies in 2006.
- CNOOC and its partner, China International Oil and Gas, signed a production-sharing agreement with Somalia's transitional federal government (TFG) in 2006 gaining 49% of profits from any oil they discover. The remaining profit will go to the TFG, which will also receive US\$50m production bonuses for any wells that yield more than 200,000bpd for 75 consecutive days.
- Exploration agreements are in place in Niger, Mali and Mauritania and a production stake in Tunisia.

As the list suggests, China has moved into countries that were previously the preserve of US and European operations, but are also willing to invest in previous 'no-go' zones such as Somalia. China's mineral and metal interests are also growing. It sources platinum from Zimbabwe and South Africa, and manganese, copper, cobalt, bauxite and iron ore from South Africa, Gabon and Zambia. Uranium has been sourced from Namibia, while exploration licences have been agreed in Niger undercutting the French position.

No strings attached?

Most of China's investment in Africa is made through state-owned companies whose individual investments do not have to be profitable if they serve Chinese strategic interests. They are willing to take on greater political risk and accept lower returns because they do not answer to shareholders, but to political leaders who prize control of oil-producing assets. However, commercial interests can still play a role; in 2006, more than half of CNPC's production in Sudan failed to make its way back to China, with Japan thought to be one of the largest recipients. China is thus not averse to making profits.

Within Africa, the Chinese have used a combination of soft loans and aid packages married to private investment ventures and infrastructure development to gain a competitive advantage in the African energy market. While this has provided social gains for Africa by delivering much-needed investment to rebuild crumbling infrastructure and to nudge growth rates towards 6%, it has come at a considerable cost in reducing transparency in revenues, overlooking human rights offences (particularly in relation to Sudan), and reinforcing corruption and bribery. It has also strengthened political ties between Chinese and African

elites based around a doctrine of non-intervention on internal governance arrangements.

It remains uncertain whether such a doctrine would persist should African states not be pliable to Chinese interests – such as by looking to punish a Chinese company for environmental damage or human rights violations, or seeking a major renegotiation of contracts. But so far, African countries are increasingly using the Chinese presence as leverage against Western companies in renegotiations and more forcibly to take robust approaches to institutions such as the IMF to avoid political reforms.

The strategic value of Chinese loans for African leaders is that they come free of governance conditions (other than facilitating closer Sino-African ties), while delivering economic change. When the IMF was negotiating a loan for Angola that included provisions on stemming corruption and improving economic management, the government ended negotiations in favour of a US\$2bn loan from China Eximbank. The deal offered an interest rate of 1.5% repayment over 17 years, with 10,000bpd of crude oil to be supplied in the first instance, rising to 40,000bpd. China also agreed to rebuild the Benguela railway, and provide a new airport in the capital Luanda and a new refinery in Lobito. These promises helped China undercut a bid from ONGC of India. IMF demands on corruption did not form part of the agreement.

In April 2006, the Dutch government decided to suspend \$150m in aid to Kenya because of longstanding corruption concerns. On the same day, China was working on securing an oil exploitation agreement with the Kenyan government. In Sudan, China is the biggest investor, with total stakes of US\$4bn through a combination of arms shipments and oil supplies; CNPC owns a 40% share in the Greater Nile Petroleum Operating Company, with an equity flow of around 150,000bpd. Governance concerns have not been high on the Chinese agenda. Concessions in Nigeria have also been linked to arms sales for use in the Niger delta.

Failure to diversify

The added long-term danger for Africa is that the widespread investment in oil will lead to a failure in economic diversification and will fuel currency overvaluations, undermining export-orientated manufacturing. Although by no means a new issue, or indeed the preserve of Chinese influence, the misuse of resource revenue could lead to a struggle for access to wealth, dramatically increasing political instability and allowing for proliferation of 'resource enclaves' held by a small number of elites. Indeed, the World Bank


notes that the possibility of conflict in resource-rich areas is around 8% higher than in those devoid of such commodities.

Within loan agreements, infrastructure provision often excludes non-Chinese suppliers, undermining wider economic growth, and this is accompanied by a lack of fiscal transparency and accountability. This highlights a greater concern that Chinese engagement in Africa emphasises reliance on oil, leading to typical 'resource curse' problems with an overdependence on a limited number of commodities. This threat makes African states increasingly vulnerable to price shocks. Once oil receipts roll in from China, the temptation for local elites to not diversify their economies is exacerbated, as is the possibility of increased corruption.

The global picture

Despite these grave concerns around governance, China is rapidly integrating its huge labour forces into the world economy, helping to hold world growth above 4%. This has been a crucial factor in improving the terms of trade for primary commodity producers. From a financial perspective, demand from Asian investors has contributed to the low level of US interest rates through the recycling of foreign exchange reserves into US securities. This has further stimulated raw material prices, impacting on raw exports from Africa.

In more highly regulated environments such as South Africa, Chinese engagement has followed a different course. Standards for joint ventures are significantly higher. Thus, bargaining positions and regulatory requirements should not be seen as static in Sino-African relations. As Chinese firms become increasingly 'marketised' through public listings, greater accountability to shareholders, adherence to governance principles and more social awareness, their business practices will evolve to encompass heightened levels of reputational and political risk awareness with greater attention to social and environmental impacts.

But until effective revenue transparency is put in place alongside economic diversification, both Africa and all investors (whether Chinese or otherwise) remain likely to lose out, with corruption and political instability likely to rise. The greater fear is that Western companies will find it more profitable to backslide on standards, rather than try to bring China into line with emerging best practice. Abandoning such principles in the short term would almost certainly bring longer-term political, economic and reputational damage. 'Winning' and 'losing' Africa could prove to be the wrong way of looking at the situation, political stability is ultimately not a zero sum game. 

1. All three Chinese state-controlled oil groups, China National Petroleum Corporation, China National Offshore Oil Corporation and Sinopec have extensive interests. China gets about 24% of its oil imports from Africa and is the continent's second-largest oil customer after the US (based on 2005 figures).
2. China's increased exposure following fatal attacks by Ogaden separatists on an oil-exploration unit in eastern Ethiopia and continuing abductions in southern Nigeria has also brought home the importance of physical security in high-risk areas.
3. However, considerable caution is needed here; on a cumulative basis, the largest investors in Africa remain the UK, US, Germany and France, with the whole of Asia only accounting for 10% of direct investment in 2005. China falls behind India and Malaysia on this basis, and its supposed dominance over the continent based more on conjecture than operational reality. China also continues to rely on world markets for its oil with its national oil companies' total equity of oil production overseas accounting for a mere 15% of Chinese impacts.
4. On the Nile fields in the north, CNPC is operating with Petronas, ONGC and Sudapet. A similar number of partners can be seen in the Dar Field, with a 5% stake held by the UAE.
5. China is already well aware of reputational issues. When PetroChina went public, CNPC's assets in Sudan were some of those withheld from the offering