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China's Development Finance to Africa – Risks and Opportunities for DAC Donors

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China has established itself as the most important "new" donor country in Africa: although its concessionary development aid is lower than is often assumed, it has risen sharply over the last decade. If non-concessionary financial flows are included, alongside the USA China is actually already the most potent development financier in Africa. This not only puts "traditional" donors up against nimble and cheap competition, but also creates new challenges in respect of conditionalities, debt thresholds and donor coordination. At the same time, Chinese involvement in Africa also entails opportunities. Traditional donors are forced to provide a better explanation of their approaches and to press ahead with dialogue about ownership and mutual benefit. Furthermore, China's rise in Africa stimulates the debate about the future focus and modalities of development finance.

Development finance is at a turning point. This also applies to Africa: while the "traditional" donors on the OECD Development Assistance Committee (DAC) have dominated to date, they have now been joined by numerous "new" donor countries. One donor in particular – which is not, in fact, a new player on the African continent – attracts by far the most attention: *China*.

China's growing economic significance for Africa is self-evident. In the period from 1998 to 2012, the volume of Chinese-African foreign trade rose from USD 5.5 billion to more than USD 200 billion – in five years' time, China could even become Africa's most important trading partner (Freemantle and Stevens 2012). However, the significance of China's development finance to Africa is unclear, as the country has not published any detailed figures on this issue.

This lack of transparency fosters speculation. At one extreme, Chinese aid to Africa is claimed to outstrip the total volume of official development assistance (ODA) from the DAC donors by a factor of three (Harman 2007). There is also intense speculation surrounding the use of Chinese funds. China, according to popular theory, focuses its aid on commodity-rich countries, supports authoritarian and corrupt rogue regimes, foregoes environmental and social standards and floods its partner countries with its own workers and products. This view also claims that China's rise in Africa is not good news for the DAC donors either, as they are confronted with a nimble and, above all, unscrupulous rival.

But what is the real scale of China's development finance to Africa? And what does this mean for the international development architecture on the African continent? While other studies generally focus on the effects of Chinese aid on African recipient countries (e.g. Asche and Schüller 2008), the present article's main interest is in the implications for traditional donors.

China's development policy in Africa

China's involvement in Africa is not new – indeed, it has operated on the African continent for almost 60 years (Bräutigam 2009). In the mid-1950s, China became the very first developing country to itself provide development aid. The "Five Principles of Peaceful Coexistence" (1954), which, among other topics, emphasised non-interference in internal affairs alongside equality and mutual benefit, provided a framework for this. These principles shape China's foreign policy to this day.

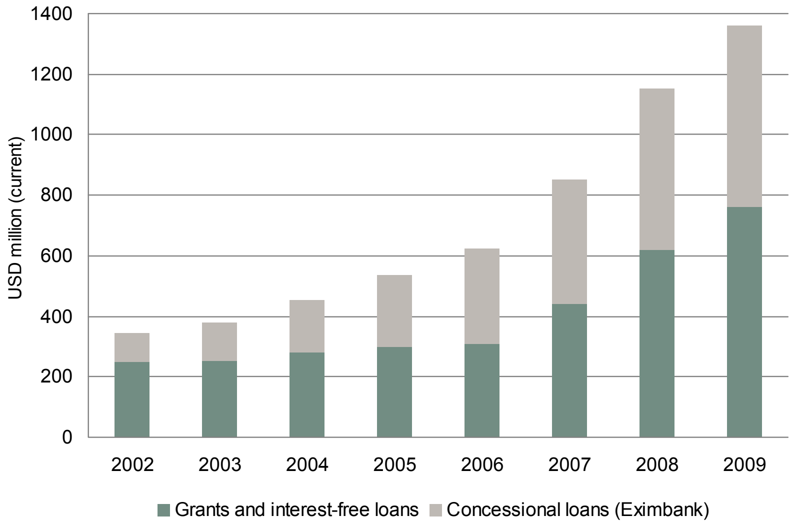
In Africa, China initially concentrated on supporting socialist regimes. In the 1960s and 70s, aid was predominantly deployed to enforce the non-recognition of Taiwan ("One China" Principle) and to limit US and Soviet influence. The geographical scope of these activities was impressive – as far back as 1978, China was supporting over 30 African countries, and therefore more than the USA. Just a short time later, the changes under Deng Xiaoping led to a partial realignment of Chinese development policy, which mainly translated into a stronger focus on mutual benefit. The provision of loans secured against raw materials was symbolic of this change – a model that is still practised today. There was a historical precedent in the Japanese loans to China that were repaid in the form of oil and coal.

Far-reaching changes in Chinese development policy came about in the mid-1990s, when new sources of finance were introduced alongside the traditional funding instruments of grants and interest-free loans. In this regard, the establishment of the state-owned China Export Import Bank (Eximbank) in 1994 was highly significant. Eximbank's main business consists of awarding commercial export credits to Chinese companies operating abroad. At the same time, however, it has also managed a programme of concessional foreign aid loans since 1995. This further consolidated China's focus on the links between trade and development and on mutual economic benefit.

In 2000, China initiated the *Forum on China-Africa Cooperation* (FOCAC) – a strategic partnership with what now amounts to more than 50 African countries. FOCAC conferences have taken place every three years since then. These meetings have seen steady increases in the financial commitments to Africa and the development of new instruments of cooperation.

Given the aforementioned lack of official fig-

Chart 1: China's ODA-like assistance to Africa, 2002-2009 (estimate)



Data source: Bräutigam (2009)

ures, the precise volume of Chinese aid to Africa can only be estimated.[1] In principle, a distinction needs to be drawn between two types of financial aid. Firstly, China provides funds which equate, or are at least similar, to those of the DAC ODA (official development assistance), as they are motivated by development policy and incorporate a concessionary element. This includes grants and interest-free loans managed by the Chinese Ministry of Commerce and concessional foreign aid loans advanced by Eximbank. Secondly, China also makes funds available which correspond, or are similar, to the "other official flows" (OOF) of the OECD countries, as they are not explicitly linked to development policy goals or do not incorporate a concessionary element. These funds primarily include export credits from Eximbank but also commercial loans provided by China Development Bank (CDB).

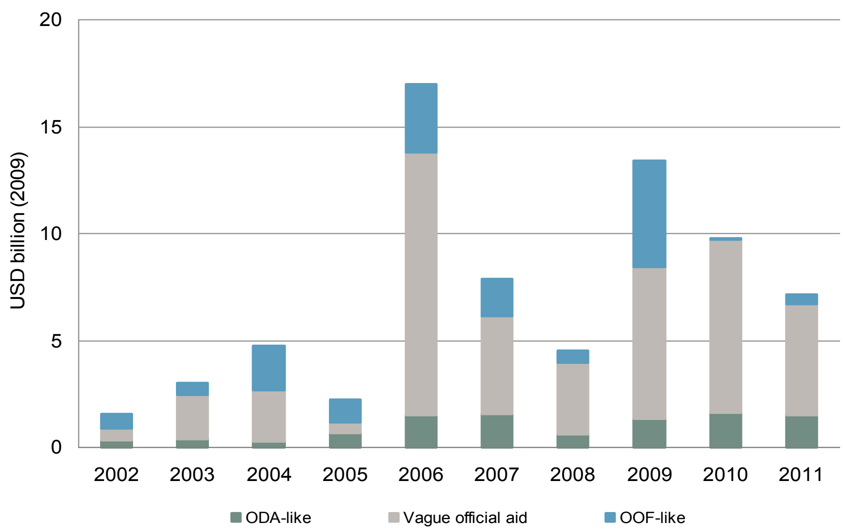
Based on official documents and announcements, expert Deborah Bräutigam (2009, 2011) estimates that China's ODA-like assistance to Africa rose from USD 0.3 billion to USD 1.4 billion over the period from 2002 to 2009 (see chart 1). If this estimate was accurate, China would still be a relatively small donor in comparison with the largest bilateral DAC donors. The US, for example, provided ODA to a value of USD 8.0 billion to Africa in 2009, followed by France (USD 4.9 billion), the UK (USD 3.0 billion), Germany (USD 2.3 billion) and Japan (USD 1.9 billion) (OECD 2013). By contrast, China's OOF-like assistance is estimated to be relatively high (USD 5.1 billion in 2006) – substantially more than that of all the DAC donors together. This would mean that the lion's share of China's development finance to Africa is of a non-concessionary nature.

A more recent study by Strange et al. (2013) based on the evaluation of media reports broadly confirms Bräutigam's findings.[2] In this study as well, a distinction is made between ODA- and OOF-like assistance, supplemented by "vague official finance", which cannot be unequivocally classified but which, according to the authors, is more likely to fall under the OOF category. According to this estimate, China's ODA-like funds climbed from USD 0.3 billion to USD 1.5 billion between 2002 and 2011 (see chart 2). Once again, OOF-like assistance (including "vague official finance") is thought to be considerably higher. Until 2005, this type of official development finance remained at a comparatively low level, but in 2006 it then surged to USD 15.5 billion before stabilising at an average of USD 7.2 billion.[3]

The picture is mixed on the whole. As far as ODA-like funds are concerned, until now China has only been a mid-sized donor to Africa, and its significance should not be overestimated. However, if we turn our attention to OOF-like assistance, China is already the most important provider of finance by some margin. If we take ODA- and OOF-like assistance together, China shares the lead with the USA.

Clarification is still required as to where Chinese official development finance to Africa is deployed and for what purpose. Interestingly, Dreher and Fuchs (2012) find no indications that China concentrates its ODA-like funds on authoritarian, corrupt or commodity-rich countries. Indeed, projects financed by grants or interest-free loans in particular are primarily

Chart 2: China's official development finance to Africa, 2002-2011 (estimate)



Data source: Strange et al. (2013)

[1] The white paper on Chinese development finance (2011) included official figures for the first time, but without breaking these down by years or continents (Bräutigam 2011). According to this information, the total volume of Chinese development aid since the early 1950s is 38.0 billion US dollars.

[2] The reliability of this methodological approach is controversial. See http://www.chinaafricarealstory.com/2013/04/rubbery-numbers-on-chinese-aid.html.

[3] The background to this sharp rise is unclear. Significant new commitments in the context of the 2006 FOCAC Conference are one possible reason.

awarded to forge political alliances, and are therefore distributed fairly evenly across the continent – the only countries not to receive support are those that recognise Taiwan (Bräutigam 2011). The main sectors to receive funding include infrastructure (e.g. government buildings, stadiums, conference centres etc.) on the one hand, and health care and education on the other.

Conversely, OOF-like assistance primarily benefits resource-rich countries. China's economic interests take centre-stage in this area – a state of affairs that is openly communicated. The main sectors to receive funding are infrastructure, transport and energy, with some project financing secured by commodities. One example is the funding for the Bui dam in Ghana, for which the recipient country's cocoa exports serve as a guarantee. As a rule, conditions are not imposed on either ODA- or OOF-like assistance. This is in line with China's principle of non-interference in internal affairs.

What risks does China's involvement in Africa pose to DAC donors?

Even though China's ODA-like funds are likely to be lower than generally assumed, the country has undoubtedly established itself as the most important non-DAC donor in Africa. If the high volume of OOF-like assistance is included, alongside the USA China is actually already the most potent development financier. This is increasingly calling the established development policy framework on the continent into question and entails a series of risks for the DAC donors.

(1) China is a nimble and cheap rival for the DAC donors

In the past, the development finance provided by the DAC donors and China was frequently complementary: while the traditional donors – in the context of the MDGs (Millennium Development Goals) – focused on the social sectors, China primarily operated in the infrastructure area and the productive sector. In future, however, the number of overlaps will increase. Firstly, China's involvement in Africa has not just expanded, it has also diversified – the country is now operating in almost all development policy sectors (Strange et al. 2013). There are, for example, significant touch points in the health care sector (Freeman and Boynton 2011). Secondly, the debate surrounding the post-2015 development agenda suggests that investments in infrastructure and productive sectors will also become increasingly important for the DAC donors.

The rise in overlaps questions the established position of the DAC donors in that China often makes its funds available relatively quickly, and delivers/builds very cheaply. There are multiple reasons for this. Firstly, Chinese companies benefit from subsidised capital costs, giving them competitive advantages in the context of international competitive bidding procedures. Furthermore, China does not feel obliged to observe the DAC principles of "good" development assistance. Accordingly, less importance is ascribed to aspects such as transparency, target group participation (in planning, execution and operations) or environmental and social standards.

In the absence of data, the question as to whether and, above all, to what extent African countries do actually prefer the supposedly faster and cheaper Chinese assistance cannot be answered conclusively. However, anecdotal evidence points to growing competitive pressure. For example, African heads of state have repeatedly made public announcements that their countries prefer China's fast and non-bureaucratic support (e.g. Wade 2008; Kagame 2009). For their part, representatives of Western development organisations complain that China's "unscrupulous" aid – specifically low environmental and social standards – comes at the expense of their own operations (e.g. Beattie and Parker 2006). Furthermore, a ratio for Chinese companies of more than 20% in the last decade in public sector construction orders via the World Bank is at least an indication of their high competitiveness (Reisen 2010).

(2) In future, conditionalities will be harder to enforce

The aim of the DAC donors to tie their aid to certain political and economic conditions and to enforce these terms effectively has always been a difficult undertaking (van de Walle 2001). In future, conditionalities will be even more difficult to enforce in Africa, as China largely provides its assistance without imposing conditions, thus giving the recipient countries greater freedom of choice. As a result, it is now easier to reject development aid that is tied to conditions. Moreover, the economic and financial crises in the north and the alternative development strategies successfully demonstrated by non-DAC donors such as China are further undermining the position of the traditional donors.

Nevertheless, there is no clear evidence – at least to date – to support the assumption that China's growing involvement in Africa is weakening the instrument of conditionality. Strange et al. (2013) cite a range of case studies that appear to support this assumption. For example, Angola apparently rejected IMF aid tied to the transparent use of oil receipts, as there was an alternative available in the form of an interest-free loan from China's Eximbank. However, Hackenesch (2011) finds no evidence to suggest that Chinese development funding in Angola and Ethiopia is undermining the good governance conditions that are attached to the European Commission's aid programmes.

(3) Chinese loans potentially jeopardise Western debt reduction initiatives

The more China, as one of the world's largest net creditors, increases its lending to African nations, the greater are the concerns that it could destroy the successes achieved in combating debt. Although China too has repeatedly waived debt claims on African partners on its own initiative, the volume of Chinese lending to Africa has risen hugely since the mid-2000s. As a result, there is a risk that this will run counter to Western moves to forgive debt.

The risk of a new debt spiral should not be exaggerated as China has focused its lending to date on relatively solvent, commodity-rich nations such as Angola or Sudan. This is based on an approach which measures a country's ability to repay not on the current macroeconomic indicators used by the IMF and the World Bank, but instead on forecast revenues from commodity exports (Bräutigam 2009). The fact that Chinese infrastructure loans promote growth and can therefore have the indirect effect of easing debt is also worthy of consideration (Reisen and Paulo 2009). Nonetheless, unrestricted growth in Chinese lending does harbour risks. For example, the repayment of the loans secured by raw materials depends on the recipient countries being in a position to continue generating these commodity proceeds. However, this in turn depends on factors that cannot be completely controlled, such as price fluctuations, failed harvests and extreme weather events.

(4) Effective donor coordination is made even more difficult

To date, progress has been slow in advancing the aim of the DAC donors to better coordinate their own activities as part of the Paris process for more effective development aid (OECD 2011). China's growing strength in global development financing is likely to make the task of effective donor coordination even more difficult.

Until now, the DAC donor countries have done their best to integrate the new donors into their established system of principles and rules of conduct. There has been a corresponding rise in the membership of new donors in OECD working groups. China is also involved as part of the China-DAC Study Group, which is dedicated to dialogue between China and the DAC donors and, in particular, deals with China's development cooperation in Africa.[4] Nonetheless, the country has done relatively little to integrate with the international donor community. Although it did sign the Paris Declaration, China's participation in the OECD Creditor Reporting System (CRS) and the International Aid Transparency Initiative (IATI) remains a distant prospect. Also, China does not participate in local donor coordination mechanisms in Africa either (Shinn 2011). One reason for the country's reluctance to cooperate may be that China has not traditionally regarded itself as a donor, but instead declares its activities as South-South cooperation. However, the fact that China does not wish to be robbed of its comparative cost advantages in competition with the DAC donors is probably of greater significance in this regard.

As there is little chance of involving China in existing coordination mechanisms, there is a need for new forms of cooperation. Trilateral cooperations are one widely discussed option, albeit one in which China showed little interest for a long time (Grimm 2011; Patey and Large 2012). Yet this does appear to be slowly changing. In the white paper on development finance referred to above, trilateral cooperations are, for the first time, mentioned as a possible instrument of Chinese development policy – a commitment that is currently being implemented with the UK's Department for International Development (DFID) in particular. Trilateral cooperations will be particularly successful if they feature noticeable benefits not just for China and the respective DAC donors, but also for the recipient country. African recipient nations in particular have treated this instrument with scepticism in the past, as they regard it as the precursor to a new "donor cartel".

What opportunities does China's involvement in Africa offer to DAC donors?

In the established donor countries, China's growing presence in Africa is predominantly perceived as a danger to their own work. This attitude overlooks the fact that China's involvement in Africa also entails opportunities for the DAC donors.

(1) The traditional donors are compelled to provide a better explanation of their approaches

In the context of intensified competitive pressure, a positive incentive is emerging for the DAC donors to critically review their own procedures and to examine options to accelerate project planning and implementation. However, it is obvious that this must not lead to a race to the bottom in development policy. Instead, the key issue is to provide a better explanation of the added value generated by the DAC donors' own development strategies and approaches and, at the same time, to subject the specific forms they take to a cost/benefit analysis in dialogue with the relevant partner country.

In particular, it is important to make clear that the Chinese assistance that is not provided in accordance with the DAC principles may entail higher follow-on costs for the relevant partners, at least in the medium to long term. Among other elements, this includes corruption due to inadequate transparency, social conflicts due to the inadequate participation of citizens and low environmental and social standards, high maintenance expenses due to low-quality construction and the non-participation of the local economy due to tied aid. Interestingly, more and more people in Africa too are speaking out about the downsides to Chinese involvement on the continent (e.g. Hunt 2013). If DAC donors can succeed in putting forward a compelling case for the mid- to long-term benefits of their own approaches, they will emerge from the new competitive situation in better shape.

(2) Boost to dialogue on ownership and mutual benefit

As mentioned above, China does not perceive itself as a donor country, but understands its development funding as South-South cooperation between equal partners. In view of China's ascent to a world power, this statement should be treated with caution. Nonetheless, in Africa China is indeed viewed more as a partner of equal standing when compared with the DAC donors: according to a widely-held view, China operates more modestly and respectfully, takes far more time and pays more attention to its partners' priorities. "I find that the Chinese treat us as equals, while the West treats us as former subjects," commented the former president of Botswana, Festus Mogae, articulating the feelings of many African heads of state and government (quoted in Reisen and Paulo 2009).

Under the Paris Agenda, the DAC donors are also endeavouring to achieve greater ownership and alignment. However, progress on this has only been slow to date (OECD 2011). In this context, the new competitive situation with China creates an additional incentive for the DAC donors to pay even more attention in future to ensuring that the projects supported take account not only of their own development policy ideas, but also of the priorities for the partner governments ("client orientation"). This fosters ownership and dialogue on an equal footing.

Dialogue between equal partners also involves speaking more openly about projects in areas of mutual interest – an approach which China in particular has practised for some time and which is widely welcomed by recipients. This focus on mutual benefit can relate to shared economic interests or the protection of global public goods.

(3) Infrastructure and the productive sector are back on the development agenda

On account of their focus on the MDGs, the DAC donors have long neglected investments in economic infrastructure and the productive sector (agriculture, manufacturing industry etc.). In the infrastructure area in Africa alone, this has created a funding gap of USD 93 billion (Foster and Briceño-Garmendia 2010). The new donors, above all China, have filled this gap, attracting a great deal of approval in many African countries.

The DAC donors have also (re)discovered the importance of investments in infrastructure and the productive sector of late. This is reflected in the recent discussion surrounding the post-2015 development agenda (HLP 2013), for example. On the one hand, the resulting overlaps with the Chinese activities may lead to more direct competition, but on the other they also create more scope for cooperation of mutual interest.

[4] For further information on the China-DAC Study Group, see http://www.oecd.org/development/povertyreduction/thechina-dacstudygroup.htm..

(4) Stimulus for the debate surrounding the future of development finance

The bulk of official Chinese assistance to Africa is OOF-like and therefore, at least under DAC criteria, does not count as development cooperation. Nonetheless, China's OOF-like investments undoubtedly support development. The best example is the China-Africa Development Fund (CADF), which was established in 2006 and which promotes joint ventures between Chinese and African companies. Non-concessionary infrastructure loans secured against raw materials or the establishment of overseas economic zones for Chinese companies are also relevant from a development policy point of view.

China's broad-based financial involvement in Africa has far-reaching implications for the debate surrounding the future of development finance on this continent and beyond. Firstly, China shows that, alongside conventional concessionary aid, non-concessionary funding also plays a key role in development finance and must therefore be acknowledged accordingly. This also applies to “blended” financing, a form which China is increasingly using (e.g. in the case of the Bui dam in Ghana). Secondly, China's involvement demonstrates that there is great potential for private sector investment on the African continent. This business-focused development strategy was long "frowned upon" in most DAC donor countries, but greater involvement of the private sector is increasingly meeting with approval.

Conclusion: competition or convergence?

Will there be a rapprochement between China and the DAC donors or will it retain its own way of working? Are the traditional donors prepared to learn from China, or will they insist on their established standards?

At present, there is much to suggest that the positions will converge. Against a backdrop of growing criticism of its approach, China will at least move closer to many of the DAC donors' standards. Internal discussions regarding greater conditionality already appear to be taking place. It is likely that the largest differences will remain in the area of human rights. The DAC donors will also subject their methods to a more robust cost/benefit analysis in the context of more intense competition, but without jettisoning their central principles. Above all, the recipient countries – which are now exhibiting greater confidence – will demand more development policy quality from China and quicker aid as well as greater client orientation from the traditional donors. Ultimately, this could benefit all those involved.■

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