

# Policy Brief

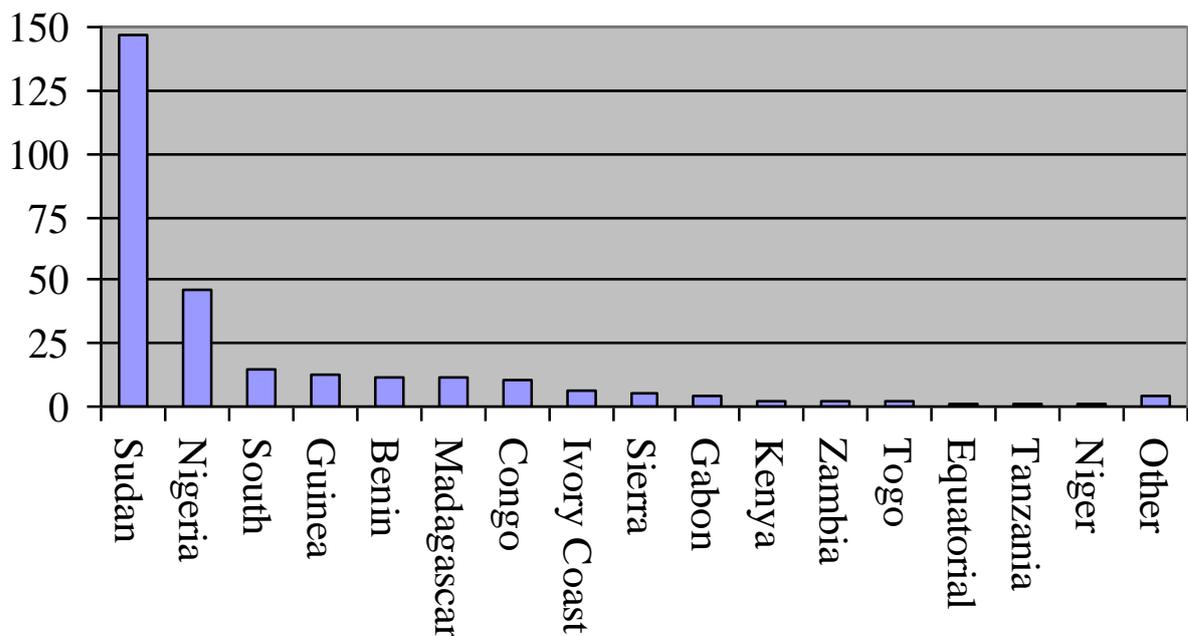
## The Impact of China-Africa Investment Relations: The Case of Zambia

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### Introduction

The rapid growth of Chinese Foreign Direct Investment (FDI) is one of the most significant features of recent developments in the global economy. Starting from zero in the seventies and early eighties, Chinese outward FDI exceeded US\$16 billion in 2006. Much of this outward investment, however, is primarily natural resource seeking. And, given Africa's rich oil and minerals, it is hardly surprising that such investment is increasingly being targeted at Africa's natural resources. Figure 1 displays Chinese FDI flows to Africa in 2004 based on China's official statistics. The pattern gives a clue of China's inclination to invest more in African countries that are rich in oil and mineral resources.

Figure 1: Chinese FDI Flows to Africa, 2004 (Million USD)



Source: Krugelund (2007:9)

Incidentally, the scale and pattern of Chinese FDI in Africa has raised concerns about its possible adverse impacts on African development. For instance, it has been observed that some Chinese enterprises have flouted local import regulations by importing sub-standard products. Similarly, Chinese investors are perceived as being inclined to disregarding labour regulations and as offering poor terms and conditions of work. There has also been apprehension about the loss of tax revenue on account of the tax incentives accorded to Chinese investors, and whose benefits to the host country are seen as doubtful. Besides, some scholars (see for instance, Besada *et al*, 2008) have argued that the recent surge in Chinese FDI in Africa is a response to the Chinese Government's strategic call for a 'go out' policy launched in 2000. Still others have questioned China's practice of bundling aid, trade and investment, arguing that this reduces the real value of an investment project and deny African economies the opportunity to learn and ultimately fully own the project.

On the other hand, the Chinese Government, along with hosting African Governments, have defended Chinese investment drive in Africa on grounds that it provides mutual benefits and a new hope for driving the continent's development agenda forward. From this viewpoint, it is argued that Chinese FDI offer the prospect of augmenting domestic resources for development whilst simultaneously improving job opportunities and standards of living for the citizenry. In this regard, Chinese FDI is being credited for various growth-enhancing benefits to the host country – including technology and knowledge transfers, economies of scale and scope, greater efficiency due to competition, creation of backward and forward linkages and access to marketing networks. If this is indeed true, it might be expected that Chinese FDI should have positive effects on national development in host African economies. This study calls focus on Zambia and asks whether indeed Chinese FDI has had positive effects on national development. Accordingly, the research problem is formulated as follows: *examine the economic impact of Chinese FDI in Zambia in order to find out how this has influenced national development, and thus understand what would constitute appropriate strategies and actions to mitigate negative impacts and enhance Zambia's economic development prospects.*

The primary objective of this study was, therefore, to assess the impact of Chinese Investment on the Zambian economy, focusing on the opportunities and the likely challenges associated with it. More specifically, the study aimed to:

- Determine the structure and characteristics of Chinese investments in Zambia
- Assess the FDI and other pertinent regulatory framework in Zambia
- Gauge the gains and losses related to Chinese investments in Zambia
- Assess the relationship between the international financial crisis, aid and Chinese FDI

The focus on Zambia is justified for a number of reasons. Firstly, Zambia's position typifies the rest of Africa. Second, compared to the size of the national economy, Chinese investments in Zambia are of greater interest. According to the Chinese Embassy in Zambia, the stock of Chinese FDI in Zambia reached US \$ 316 million in 2005, and FDI flows reached US\$ 41 million in 2005 (FOCAC 2006). Third, Zambia is one of the three most important destinations of Chinese FDI in Africa. Chinese companies currently invest in most sectors of the Zambian economy. Currently, more than 180 Chinese companies have invested in Zambia and Chinese FDI flows comprised about 12.5 percent of all flows in 2005 and accumulated Chinese FDI now comprise 10.5 percent of the total FDI in Zambia (UNCTAD, 2006; Kragelund, 2007). In fact, these figures are likely to increase significantly in the near future as Hu Jintao, during his most recent visit to Lusaka (February 5<sup>th</sup> 2007), inaugurated the first of three to five African Economic and Trade Cooperation Zones. Consequently, during the next three years, this zone will foster FDI of US\$ 900 million

into Zambia and potentially create over 6,000 new jobs. Zambia, therefore, provides a good case study of the impact of Chinese FDI of a typical African economy.

## Method of Analysis

The study used an inductive method of analysis. Inductive analysis begins with specific observations and builds towards general patterns (Moonilal, 1998:11). The study combined both qualitative and quantitative methods. Three data collection methods were used. First, a review of important documents that shed light on Chinese FDI in Africa. This review was both general and specific to the situation of Zambia. The sources for this data included: related books, articles, journals, pieces of legislation, policy documents, published and unpublished papers and documents from the University of Zambia library and the Internet. This was supplemented by firm level data from the Zambia Development Agency (ZDA) database. Second, structured interviews with managers, trade unionists and selected workers in Chinese companies were conducted. Third, a case study of selected Chinese firms was conducted to gain more specific insights into the nature and functionality of Chinese FDI in Zambia.

The study adopted the analytical framework due to Kaplinsky *et al* (2006). The framework is based on assessing the impact of Chinese FDI along four channels: (i) impact arising from Chinese FDI's presence in the country's natural resource sector, (ii) impact of Chinese FDI's participation in infrastructure project, (iii) impact of Chinese FDI's integration of local production activities in global production networks, and (iv) impact of Chinese small scale entrepreneurial investment on local producers, retailers and consumers.

## Key Findings and Policy Implications

In terms of characteristics of Chinese FDI in Zambia, the study establishes the following:

- The pattern of Chinese FDI involvement in Zambia, exhibits at least three major features: (i) increasing investment in the natural resources sector, mainly mining; (ii) participation in infrastructure projects, and (iii) an influx of small scale Chinese entrepreneurs. Overall, it was found that Chinese investments in Zambia are **primarily resource seeking**, and to a lesser extent market seeking. The major risk from this kind of investment is that it may perpetuate the raw material enclave status of the country. This, therefore, urges for appropriate policy intervention to ensure investment balance and that this tendency does not undermine the local drive for economic diversification.
- Further, in terms of source and nature of Chinese investment capital, it was established that a defining characteristic of Chinese FDI in Zambia is that it mostly comes from firms which are either wholly or partially state-owned and are **driven by broader objectives than merely profit maximization**. Because of this supportive logic, such investments have had access to very low-cost of capital and hence operate with much longer horizons. The Chinese uptake of mines that were closed in the wake of the *World Economic Crisis* is further illustrative of this fact and that Chinese investment motives are shaped by ultra economic considerations. They have been willing to forgo short term high earnings in return for long term benefits. However, the challenge to local industry has been that Chinese firms have tended to win most tenders due to their relatively lower bidding terms which are made possible by their access to relatively low-cost of capital compared to local firms. This urges the need for an appropriate policy for ensuring that local firms are not entirely crowded - out on the basis of high cost of capital existent in the local economy.

- In terms of investment value in absolute and relative terms, the study reveals that the stock of Chinese FDI in Zambia reached US\$316 million in 2005, and FDI flows reached US\$ 41 million in 2005. In relative terms, Chinese FDI flows comprised 12.5 percent of all flows in 2005 and accumulated Chinese FDI comprised 10.5 percent of the total FDI in 2005. The study further establishes that such figures are likely to increase by the end of 2010 because of the **financial commitments made in 2007 to the tune of US\$900 million** for the establishment of Multi-facility economic development zones over this three year period. The policy implication of the multifacility zones are at two-levels: how to ensure that labour standards are decent in these zones and how local firms can equally benefit from the tax incentives associated with firms operating in the zones.
- It was also established that **Chinese investments in Zambia are mostly tied with aid and have limited linkages with local businesses.** The tying of FDI with Aid is in keeping with the Chinese practice of incorporating Aid as a sign of South-to-South cooperation, a practice which predates current Sino-African engagement. In Zambia, the relation between Aid and Investment is aptly demonstrated by projects such as the *National Malaria Centre*, and *Central Statistical Offices*, which were constructed as Aid from China. These infrastructure projects were constructed by state owned Chinese companies. The policy implication for this tendency of bundling aid with investment and lack of local business linkages bears on how to assess the real value of investment and also ensure that such projects can lead to opportunities for local learning and ownership.

In terms of impacts, the study establishes the following:

- To the extent that Chinese Investments have augmented collective resource inflows into the country, this has **improved capacity utilization and generated employment opportunities.** The growth of copper production has been quite impressive.
- It was also observed that the **Chinese trading investors have availed low priced and better quality products.** Where a reasonable proportion of the population is able to access such products, it could be reasonably argued that their welfare would be enhanced.
- On the negative side, **Chinese mining companies are increasingly relying on hiring heavy equipment than procuring new ones.** The problem with this practice is that it will limit the extent of technology transfer in the sense that since the equipment and plant are not assets of the company, the incentive to develop capacity to harness the associated technology will be minimal
- **The increased demand for copper and consequent high prices on the international market poses the risk of reversing the advance towards economic diversification.** The huge investments in the copper industry while generating positive economic impacts, may undo the Government's efforts at diversifying the economy away from mining.
- While the early wave of Chinese firms establishing base in Zambia were investment entities, in the recent past, there has been a new wave of service-related Chinese firms being established. **The service-related firms come in to operate as sources of inputs to Chinese Investors. This has raised concern among stakeholders who fear that local supply companies will lose out to Chinese service firms.**

- **The increased copper production and sales notwithstanding, there has been limited impact on the standards of living for the population.** The reasons accounting for this include: (i) the nature of the development agreements, and (ii) the low tax rates on mining investors. The low tax take from mining investors due to the investment incentives has undermined the positive impact that mining could have on the national economy.
- **The reported use of Chinese labor where locals could be employed, poor working conditions among some Chinese firms has resulted in political agitation.** And to this end, opposition politicians have effectively made Chinese investments an election issue.

## Recommendations

Chinese investments though spread across both extractive and manufacturing sectors are predominantly in mining. The Government should not lose sight of the need to diversify the economy. **Strategies for directing more investment in non-traditional sectors, such as Agriculture and Tourism ought to be stepped up.**

The discontent of workers employed in Chinese firms has had political ramifications, with the major opposition party using this as a campaign tool. **Stepping up the monitoring of work practices in Chinese firms will ameliorate the politicization of Chinese Investments.**

Given the limited employment opportunities obtaining in the country, it is imperative that employment creation strategies are stepped up. **While Chinese firms are contributing toward the creation of jobs, the low level of linkages with local firms is a limiting factor, which should be addressed.**

**The Government should maximize the gains from Chinese Investments by using Chinese international business links to incorporate local firms into the international value chain.** This would enable local firms to earn decent incomes from their activities.

The media has consistently reported over the poor working conditions in Chinese owned firms. **Monitoring of workplace practices is critical, and to this end the capacity of the workplace monitoring arms of Government ought to be raised for them to effectively carry out their mandate.**

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