

# Building Soft Power: China's Positive Economic Statecraft in Africa – historical comparisons

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Paper presented at the international conference  
China and Africa Media, Communications and Public Diplomacy

CHINA AND AFRICA  
MEDIA, COMMUNICATIONS  
AND PUBLIC DIPLOMACY



Organised by the Chr. Michelsen Institute (CMI) (Norway) in cooperation with Institute of Journalism and Communication Studies, Chinese Academy of Social Sciences\*

\* Center for Global Media & Communication Studies hosted the conference in association with the Kede College of Capital Normal University

10 - 11 September 2014  
Beijing

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# ***Building Soft Power: China's Positive Economic Statecraft in Africa – historical comparisons***

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**DRAFT – NOT FOR CITATION**

**key-words:** China – Africa – economic statecraft –infrastructure loans - soft power

## **ABSTRACT**

Infrastructure-for-resources loans have rapidly emerged as a key feature in China-Africa relations after the turn of the century. These loans, which have attracted increasing attention from scholars, politicians and media alike, have been used by China over the past decade as a tool to open the gates for Chinese construction and resources companies and also pursue mineral resources security goals in Africa. What is less known though is that infrastructure soft loans have been a recurrent positive economic statecraft instrument used by China in Africa since the 1950s and that the foreign policy goals it pursued have changed dramatically over time.

This paper explores the role of infrastructure loans as a positive economic statecraft tool in Africa over the past six decades, focusing on meaningful changes, how successful it has been in achieving its goals and what it has done for China's soft power on the continent. Although providing a diachronic analysis, the paper will focus on developments over the past decade and how lessons learnt, increased wariness of risks, and rising criticism on the continent has led to

meaningful shifts in the strategies pursued in recent years and the extent to which it has contributed to expand the continent's soft power in the region.

### **ABOUT THE AUTHOR**

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### **ON ECONOMIC STATECRAFT**

The use of instruments by policy makers to pursue a specific goal abroad is commonly referred to as statecraft. While there is no consensual taxonomy of foreign policy instruments, most authors tend to list them in ascending order from soft to hard measures, and ranging from diplomacy to military intervention. A less controversial sorting is Mastanduno's division of statecraft instruments into three major categories: diplomatic, military and economic.<sup>1</sup>

Even though the use of economic instruments can be traced back to ancient Greece, diplomatic and military tools have historically occupied the centre stage in foreign policy making - inspiring

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<sup>1</sup> Michael Mastanduno, "Economic Statecraft," in *Foreign Policy: Theories, Actors, Cases*, eds. S. Smith, A. Hadfield and T. Dunne (Oxford: Oxford University Press, 2008), 172.

most international relations literature from Machiavelli to Clausewitz. In sharp contrast with diplomacy (an attempt to influence through negotiations) and military statecraft (attempt to influence through the use of force), the use of economic statecraft has been underestimated by most analysts, and has therefore received little attention from scholars.<sup>2</sup>

Economic statecraft can be defined as “the use of economic instruments by a government to influence the behavior of another state”, and often involves the use of sanctions or inducements.<sup>3</sup>

Negative economic statecraft entails the use of economic sanctions, coercion or punishment (known as ‘sticks’, ie trade or investment restrictions, financial sanctions, and assets seizure) to interfere with the economy of the target, so as to force a change in its behaviour. Positive economic statecraft, on the other hand, involves the extension of economic incentives or rewards (known as ‘carrots’, ie trade and investment promotion, financial incentives, and technology transfer) in return for compliance with the extender foreign policy goals.

During the Cold War, the use of economic sanctions became a popular foreign policy instrument. This triggered academic interest on negative economic statecraft.<sup>4</sup> Research has focused on two

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<sup>2</sup> D. Baldwin, *Economic Statecraft* (Princeton: Princeton University Press, 1985), 4.

<sup>3</sup> Jean Marie F. Blanchard, E. D. Mansfield & N. M. Ripsman, “The Political Economy of National Security: Economic Statecraft, Interdependence and international Conflict”, in *Power and the Purse: Economic Statecraft, Interdependence and National Security*, eds Blanchard JMF, Mansfield ED & NM Ripsman (London: Frank Cass, 2000), 3.

<sup>4</sup> D. Losman, *International Economic Sanctions: the cases of Cuba, Israel and Rhodesia* (Albuquerque, NM: University of New Mexico Press, 1979); G.C. Hufbauer, J. Schott and K.A. Elliot, *Economic Sanctions Reconsidered: History and Current Policy* (Washington, D.C.: Institute for International Economics, 1990); J. Kishner, *Currency and Coercion: the Political Economy of International Monetary Power* (Princeton: Princeton

major debates: what causes economic sanctions to fail or succeed, and on its usefulness as a foreign policy tool.<sup>5</sup> While some concluded that economic sanctions are not particularly efficient as a foreign policy tool,<sup>6</sup> others consider them useful in signalling intentions or in complementing other forms of statecraft.<sup>7</sup>

Although the use of economic inducements has become more apparent in the context of the fast growing economic interdependence that characterises the post-Cold War World, academic research on positive economic statecraft remains scant. Positive economic statecraft, as defined by Mastanduno, means “the provision or promise of economic benefits to induce changes in the behaviour of a target state.”<sup>8</sup> He distinguishes two types of positive economic statecraft in regard to the ends they intent to pursue: tactical linkage and structural linkage. The first one (also called specific positive linkage) envisages an immediate outcome through the provision of a specific economic inducement. Structural linkage (or general positive linkage), on the other hand, involves a long-term engagement providing a steady stream of economic inducements. These generally favour economic interdependence that gradually transforms domestic interests in the target country, and ultimately leads to a growing influence over the policy options of the weaker

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University Press, 1995); M. Doxey, *International Sanctions in Contemporary Perspective* (London: Macmillan Press, 1996).

<sup>5</sup> J.F. Blanchard et al., “The political economy” 3-5; for a detailed analysis on the validity of positive and negative economic statecraft see Baldwin, *Economic Statecraft*

<sup>6</sup> R. Pape, “Why Economic Sanctions do not work,” *International Security* 22/2 (1997): 90-136.

<sup>7</sup> D. Baldwin, *Economic Statecraft* – especially chapter 8.

<sup>8</sup> Michael Mastanduno, “Economic Statecraft”, (2008) p. 182.

state, ultimately consolidating a coalition with the sanctioning states.<sup>9</sup> This type of economic inducement is in a way linked to the concept of ‘soft power’, developed by Joseph Nye (‘getting others to want the outcomes that you want’).<sup>10</sup>

Based on extensive desk research and cumulative field work from 2006-2013, this paper proposes to examine how China has used infrastructure-for-resources loans as a positive economic statecraft tool in Africa, and how the lessons learnt over the past decade, the increased wariness of risks it faces, and rising criticism on the continent has led to meaningful shifts in recent years. The author also undertakes to analyse the success of this particular instrument in relation to the tactical and structural goals it was designed to pursue.

#### ECONOMIC STATECRAFT IN CHINA'S FOREIGN POLICY

Although China has resorted to military statecraft in the past,<sup>11</sup> Beijing has clearly privileged the use of positive economic statecraft instruments since the onset of the economic reforms introduced by Deng Xiaoping, explained largely by the imperative of creating a friendly international environment favourable to China's economic development. This preference has become evident in both bilateral and multilateral settings. Since its accession to the UN Security Council (UNSC) in 1971, Beijing has typically abstained from voting on economic sanctions resolutions.

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<sup>9</sup> M. Mastanduno, “Economic statecraft, interdependence and national security: agendas for research,” in *Power and the Purse: Economic Statecraft, Interdependence and National Security*, eds. J.F. Blanchard, E.D. Mansfield and N. Ripsman (London: Frank Cass, 2000), 306-309.

<sup>10</sup> J.S. Nye, *Soft Power: the Means to Success in World Politics* (New York: Public Affairs, 2004) p. 5.

<sup>11</sup> Supporting North Korea in the Korean War in the 1950s, the military training of African independence movements in the 1960s, and military intervention in Cambodia in the late 1970s.

A more attentive look at the historical record of China's foreign policy reveals that, in fact, the use of economic inducements to pursue its foreign policy goals has been pervasive since the founding of the PRC.

A significant part of Chinese positive economic statecraft falls under the category that Beijing officially designates as 'foreign aid'<sup>12</sup> which dates back to the early days of the PRC, when Beijing started channelling economic aid and technical assistance to neighbouring communist countries first (Vietnam and North Korea) and then newly independent African countries. From the onset Chinese aid has assumed many different forms, including technical co-operation, human resource development, medical aid, emergency humanitarian aid, overseas volunteer programmes, debt relief and financial aid, all of which serve the ultimate goal of enhancing its image and strengthening its soft power abroad. Whilst the use of all of these instruments has been more or less constant since the founding of the PRC, economic incentives have historically assumed particular importance in that they have been in general more consequential in pursuing Chinese immediate and long term foreign policy goals. The analysis below will show that overtime the extension of soft loans, targeting mainly infrastructure, came to be the most resourceful instrument of Chinese economic statecraft in Africa.

From its inception Chinese economic assistance has shown a very distinctive pragmatic nature, ultimately justified by its developing economy status. Rooted in the core principles of equality, non-conditionality and particularly common development and mutual benefit, Chinese aid was

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<sup>12</sup> Information Office of the State Council of the People's Republic of China, "China's Foreign Aid"(white paper issued in April 2011) accessed May 5, 2011, [http://news.xinhuanet.com/english2010/china/2011-04/21/c\\_13839683\\_20.htm](http://news.xinhuanet.com/english2010/china/2011-04/21/c_13839683_20.htm)

designed to benefit both the extender and the receiver. In this context, while providing assistance, China's foreign aid has also been an instrument to pursue political and economic goals overseas. Resorting to Mastanduno's dichotomy, this study proposes to examine the performance of Chinese economic incentives against two layers of goals underlying its engagement in Africa since the 1950s. The first encompasses a long term political goal, in the spirit of what Mastanduno termed structural linkage. By instigating the gradual emergence of economic interdependence, China hopes to build up its soft power over the continent, so as to enact a coalition that will favour its interests in the long run. The second layer of goals refers to more immediate ends, which can be political or economic in nature.

#### CHINA'S ECONOMIC STATECRAFT IN AFRICA: 1950s-1990s

As mentioned previously, China's use of economic incentives to pursue foreign policy goals date back to the 1950s. In the period under analysis in this section this was explained largely by the growing voting weight of the continent in the UN Assembly as waves of newly independent African countries joined the UN from the 1950s onwards.

In the 1950s China's engagement in Africa was limited to diplomatic contacts mostly in the context of Bandung conference and the non-aligned movement, aimed at gaining diplomatic recognition from newly independent countries. This situation changed dramatically in the following decade as a result of the ideological rift with the Soviet Union.

In the 1960s Beijing started providing technical and financial support to several African independence movements, independent countries governments and even rebel guerillas in exchange for political allegiance to the Chinese communist party in the frame of the Cold War

rivalry with the Soviet Union.<sup>13</sup> Despite many debacles Beijing succeeded in maintaining some degree of influence on the continent and laying strong friendship foundations with a number of African states (i.e. Tanzania, Zambia, Kenya). In the early 1970's the extension of economic incentives and cooperation played an important role in winning African votes which were critical for China to seize the UN Security Council permanent seat from Taiwan. The Tazara railway<sup>14</sup> built in the mid-1970s with a Chinese soft loan stands out to this day as a landmark of China-Africa friendship despite its economic failure, attesting the political success of Beijing's economic statecraft.

China has also consistently deployed economic inducements on the continent to pursue another major political goal - the encirclement of Taiwan, by 'paying off' countries to establish diplomatic ties with Beijing at the expense of Taipei.<sup>15</sup> The success of China's 'dollar diplomacy' grew alongside its swelling financial resources throughout the 1990s and 2000s.<sup>16</sup> Another

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<sup>13</sup> Chris Alden and Ana Alves, "[History and Identity in the Construction of China's Africa Policy](#)", *Review of African Political Economy*, 35/115 (2008): 43-58

<sup>14</sup> The railway was built to link Zambia's rich copper belt to the coastal port of Dar Es Salaam in Tanzania, so as to break the dependency on white-ruled Rhodesia. The decision to construct the railway grew out of a direct request from Zambian president Kenneth Kaunda, and seconded by his Tanzanian counterpart, Julius Nyerere. China assembled a US\$405 million interest free loan for this project, representing at that point the largest single offer of economic assistance granted to an African state by a communist country.

<sup>15</sup> In line with Beijing's 'one China policy' in order to establish diplomatic ties with China any country that recognizes Taiwan must sever ties with Taipei beforehand

<sup>16</sup> At present only four countries in Africa (Sao Tome e Principe, The Gambia, Swaziland and Burkina Faso) have diplomatic ties with Taiwan. The Gambia announced in 2014 that it was to sever ties with Taiwan, and S. Tome e Principe announced that Beijing was setting up a commercial office in its capital.

example of successful deployment of a stream of economic incentives in Africa to pursue foreign political objectives dates from the early 1990s. The swift revival of economic cooperation programmes targeting developing countries in the aftermath of the Tiananmen crisis enabled Beijing to evade the isolation imposed by the West and pre-empted a number of UN resolutions against China on human rights and Taiwan issues throughout the 1990s.

Notwithstanding some economic debacles (projects that failed and loans that were never repaid), China's use of economic incentives in Africa have had in the past a largely positive balance at the tactical level from a political point of view. To a lesser extent, this is also the case at the structural level. The political capital Beijing garnered on the continent throughout the past decades has provided China with exceptional friendship credentials to re-enter the continent in the 21<sup>st</sup> century.

By the end of the 1990s human rights and security issues waned and Beijing's foreign policy rapidly focused on China's WTO accession, the need to access resources overseas to supply its growing domestic demand and the imminent globalisation of its economy. Political issues quickly gave way to economic considerations and China's economic statecraft towards Africa was swiftly recalibrated to create a more conducive environment to facilitate trade, investment and economic cooperation.

In this period Chinese economic incentives in Africa pursued primarily immediate political goals, namely outrun the Soviet Union in the leadership of the international socialist movement; gain international recognition and seize the permanent seat at the UNSC and more recently the diplomatic encirclement of Taiwan. Although Beijing did not succeed in achieving the first goal (mostly owing to the fact that the resources at its disposal were then much smaller than those of the Soviet Union), Chinese economic incentives were undoubtedly instrumental in achieving the

last two objectives, meaning a largely positive balance in regards to its immediate goals. As for the long term goals, whilst its financial support to liberation movements in the 1960s and 1970s may not have turned the balance in its favour in the competition with the SU, it did grant the PRC solid anti-colonialist credentials in the eyes of successive generations of African leaders, still resonating today as a major corner stone in China-Africa solidarity. The same way, despite its economic failure, the Tazara railway remains to this day as an iconic symbol of China's selfless financial assistance to African causes neglected by the west.

#### CHINA'S ECONOMIC STATECRAFT IN AFRICA SINCE 2000

Two decades of economic reforms and phenomenal growth transformed China from a rural economy into the factory of the world. This unprecedented modernisation pace came however at a cost. Whilst it remained among the largest producer of most strategic minerals and fossil fuels, throughout the 1990s domestic consumption gradually outpaced production of most of them making China increasingly reliant on imports to sustain its economic growth. In addition, competition amongst Chinese enterprises in the domestic market became fierce and pressure reached the ceiling as there was little room for them to grow further. By the turn of the century China's priorities had changed dramatically. This shift ultimately led to Beijing's WTO accession and the formal launching of the Go Out policy in 2001. This transformation became particularly apparent in China's foreign policy towards Africa, which agenda swiftly became dominated by economic affairs in sharp contrast with the previous half century. The establishment of the FOCAC in 2000 was a prelude to this new phase in relations, which less than a decade later placed China as Africa's largest trading partner, and major investment and development cooperation partner.

This dramatic remaking of relations was due largely to the swift rewiring of China's economic diplomacy, policies and most importantly positive economic statecraft instruments to pursue its new interests in Africa. The immediate goal was to promote good will and open doors for Chinese companies and exports as well as facilitate access to much needed resources that abound in the continent. Among these instruments are numerous grants in kind (government buildings, stadiums, hospitals and schools built with Chinese materials and by Chinese companies ), debt relief, interest-free loans, and generous low interest credit lines for much needed infrastructure development in Africa. While grants and debt forgiveness served mostly the purpose of improving China's image on the continent and showcase their companies' work in an initial phase, soft loans for infrastructure enabled China to, in addition, open the African markets for its companies and goods as well as pursue resource security goals (long term supply and facilitated access to assets). The growing prominence of these drivers on the Chinese side coupled with the desperate need for infrastructure development on the African side (by early 2000s WB estimated that Africa needed an investment of \$90 bn annually to bridge its infrastructure gap), contributed to the rapid consolidation of soft loans for infrastructure as China's most prominent positive economic statecraft tool deployed on the continent. For this reason the analysis of the present period will focus on this particular instrument.

Whilst the use of soft loans for infrastructure as a foreign policy instrument in China Africa relations can be traced back to the 1970s and resurfaced again in the late 1990s,<sup>17</sup> its format has changed significantly and its scope has achieved unprecedented reach in the new century. This is

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<sup>17</sup> Peter Hubbard, "Aiding transparency: What we can learn about China's Exim Bank concessional loans", Center for Global development Working Paper 126, September 2007, 4, [http://www.cgdev.org/files/14424\\_file\\_AidingTransparency.pdf](http://www.cgdev.org/files/14424_file_AidingTransparency.pdf).

mostly due to the unmatched financial resources now at its disposal (China possess world's largest foreign exchange reserves - \$165 bn in 2000 to \$4 tn in 2014) and the adjustment of this tool to meet its now primarily economic goals.

In general this type of loan is rooted in two legal instruments: a framework co-operation agreement signed by the two governments stating the general terms (volume, purpose, interest rate and maturity) and a loan agreement signed by the responsible Chinese policy bank and the borrower. Up until the financial crisis in 2008, most soft loans for infrastructure extended to African Countries were concessional loans under China Exim Bank. What makes these loans concessional is that their interest rate (at 1.5% to 3%) is below the benchmark of the People's Bank of China, with the difference being subsidised by the central government. The reimbursement period is relatively long (up to 15–20 years, including a 5–7 years' grace period).<sup>18</sup> Working as an export credit facility, these credit lines come tied to the procurement of services, goods and labour in China (minimum of 50%), leaving in general only a small margin for local content in the host country. The capital never actually leaves China. It is administered on a project basis through the borrower's account with China Exim Bank, and payments are made directly to Chinese contractors after completion of the construction project.

The bulk of these loans have been extended to resource rich countries (i.e. Angola, Nigeria, Sudan, Ghana...). The main reason for this is that China's concessional loans require a sovereign guarantee, which is largely problematic in developing countries owing to their low creditworthiness. In resource-rich countries, China has solved this by locking proceeds from the sale of oil or mining from the borrowing country to secure the loan. In most cases, this locked revenue originates from the sale of the specified commodity to a Chinese SOE. In most cases (i.e.

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<sup>18</sup> PRC, Information Office, "China's Foreign Aid"

Angola), the borrowing country resource parastatal has been placed as the guarantor of the loan. Although most contracts refer to a given volume of oil or mining to service the loan, it is agreed that this figure will in fact fluctuate according to the oscillation of market prices, which may imply adjustments to the term of the loan.<sup>19</sup>

It should be noted that commodity-secured financing in Africa is by no means a Chinese invention. Western private banking institutions have been using this financing vehicle in Africa since the early 1990s to mitigate the risk of lending to resource rich countries.<sup>20</sup> In addition, China has had its own experience as a borrower of these kind of credit facilities in the 1970s when it received a number of oil-backed loans from Japan (China was then an oil exporting country).<sup>21</sup>

The key difference in China's model is that this mechanism is not a mere financing vehicle to support one specific project but an economic statecraft instrument designed and systematically implemented to simultaneously pursue a number of foreign policy goals. Chinese infrastructure loans are entirely a state set-up, knitting together the government in Beijing, its policy banks and resources SOEs. Furthermore, while in normal commodity-backed finance loans are secured against mining or oil exports regardless of the off-taker or final destination, in China's model the off-taker is normally a Chinese state company. Plus collateral supply contracts cover normally a much longer period of time, corresponding to the loan-repayment period. This specific economic

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<sup>19</sup> Personal interview, Angolan oil sector expert, Luanda, Angola, February 1, 2011.

<sup>20</sup> For a detailed study on commodity-backed finance in Africa, see JBIC London Office, "Commodity backed finance in sub-Saharan Africa", Research papers on Africa and Development, October 20, 2006.

<sup>21</sup> Deborah Brautigam, *The Dragon's Gift: The Real Story of China in Africa* (Oxford: Oxford University Press, 2009), 47

statecraft instrument also facilitates the penetration of Chinese construction companies and materials in African markets as the loan contracts normally impose that a high percentage of content, services and often labour for the projects be sourced in China. It also serves as a gate opener for Chinese resource SOEs and in some cases has even facilitated their access to resources equity as illustrated in the section below.

This, however, is by no means a zero-sum game. From an African perspective, this is an equally alluring deal. Chinese soft loans provide a welcome alternative source of credit, with better repayment terms (lower interest + longer reimbursement frame) and easier to access as it comes with no conditions attached in sharp contrast with traditional donors. Also it targets infrastructure projects that have long been neglected by developed countries on the continent. Plus China's delivery is much quicker and cheaper, contributing to lower construction costs in Africa. Last but not least, this alternative source has substantially increased Africa's bargaining power vis-à-vis traditional donors both bilaterally and multilaterally. In this sense infrastructure soft loans also serve a more structural purpose, that of increasing Beijing's political capital on the continent in the long run.

Over the past decade this specific Chinese economic statecraft instrument has become a prominent feature of China-Africa relations, having greatly contributed to change the political, economic and even the physical landscape of the continent. But how has it performed in relation to the immediate and structural goals it is intended to pursue?

#### ASSESSING THE PERFORMANCE OF CHINA'S INFRASTRUCTURE SOFT LOANS IN AFRICA SINCE 2000

The first countries to receive infrastructure-for-resources loans in Africa in the early 2000s were oil-rich countries, namely Angola, Sudan and Nigeria. The blue print of these infrastructure-for-

resources loans was carved out with Angola in early 2004. The deal included a loan of \$2 billion (a second batch of \$2.5 billion was extended in 2007) by China Exim Bank for infrastructure development listed in Luanda's public works budget. According to the guarantee mechanism, this loan is to be repaid with the proceeds of oil sales (equivalent to 10,000 barrels of oil per day) from Sonangol (the Angolan national oil company) to a Chinese company, UNIPEC (China Petroleum & Chemical Corporation – subsidiary of Sinopec, China's second largest national oil company). Soon after Chinese construction companies, materials and labour (up to a negotiated rate of 70% of funded projects) were disembarking in Angola, and construction started almost immediately. Tellingly, Sinopec acquired its first equity stake in the Angolan oil industry around the same time that the loan was inked. The asset in question (50% of Block 18) was being sold by Shell to the Indian ONGC, when Sonangol decided to exercise its right of first refusal and sell it instead to a joint venture (JV), Sonangol–Sinopec International, which it had established in the meanwhile with Sinopec.<sup>22</sup>

Under the leadership of Olusegun Obasanjo (1999–2007), Nigeria also embraced Chinese infrastructure-for-oil deals, reportedly totalling \$12 billion.<sup>23</sup> Chinese NOCs (the CNPC, China National Offshore Oil Corporation or CNOOC, and Sinopec) obtained access to their first stakes in the Nigerian oil industry in exchange for engaging in major infrastructure projects. These included the rehabilitation of Kaduna oil refinery (\$2 billion) by the CNPC, the Lagos–Kano

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<sup>22</sup> Ana C. Alves, *The Oil Factor in Sino-Angolan Relations at the Start of the 21<sup>st</sup> Century*, Occasional Paper 55 (Johannesburg: SAIHA, 2010)

<sup>23</sup> Personal interview, China Exim Bank representative, Beijing, China, August 26, 2009.

1 350 km railway and Mambilla hydroelectric station, with funding from China Exim Bank (\$2.5 billion) backed by Nigerian oil blocks.<sup>24</sup>

Only at a later stage did China begin its outreach to minerals producers based on similar package deals aimed at funding Greenfield mining projects and related infrastructures in exchange for mining concessions and secured by minerals supply. The largest ones were signed with Gabon and the DRC.

In 2006 the Gabonese government granted a Chinese consortium led by a construction company (China National Machinery and Equipment Corporation, CMEC) the right to develop Belinga mine, allegedly containing one of the largest-known untapped deposit of iron ore in the world.<sup>25</sup>

The \$3 billion deal, to be financed by China Exim Bank and to be repaid with revenue from the exploration of Belinga mine, includes the construction of a new 560 km railway line linking Belinga to the Transgabonais, a deepwater mining harbour at Santa Clara, a hydroelectric dam and a steel mill. In exchange the Chinese consortium was granted the exploration rights through the establishment of a JV (Compagnie Minière du Belinga, COMIBEL) in which the Chinese own 75% plus the off-taker rights.

In September 2007 China signed a similar deal with the DRC. The initial \$5 billion loan was increased to \$9 billion in January 2008. Under the agreement, \$6 billion would be allocated in the first phase to the rehabilitation and construction of infrastructure and \$3 billion to mining

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**24** For a detailed study on China's engagement in Nigeria, see G. Mthembu-Salter, *Elephants, Ants and Superpowers: Nigeria's Relations with China*, Occasional Paper 42 (Johannesburg: SAIHA, 2009).

<sup>25</sup> For a detailed study on China's engagement in Gabon, see Romain Dittgen, *To Belinga or Not to Belinga: China's Evolving Engagement in Gabon's Mining Sector*, Occasional Paper 98 (Johannesburg: SAIHA, 2011); Ana C. Alves, *China and Gabon*, China in Africa Project Policy Report 5 (Johannesburg: SAIHA, 2008).

exploration. The projects included a 3 400 km highway, a 3 200 km railway linking Katanga's mining province to Matadi port in the Congo River estuary, 31 hospitals, 145 health centres, two universities and 5 000 housing units.<sup>26</sup> A JV named Sicominex was set up between the Congolese state miner, Gecamines, Sinohydro and the China Railway Engineering Corporation (CREC). The JV, 68% owned by the Chinese part, was to undertake the infrastructure and the development of two mining concessions (copper and cobalt) in Katanga province, with the Chinese retaining the off-taker rights.<sup>27</sup> The loan is to be repaid with revenue obtained from the exploration of these concessions.

It is interesting to note that whereas infrastructure-for-mining deals gave Chinese SOEs direct access to mining assets (i.e. in the DRC and Gabon), in infrastructure-for-oil loans oil equity was not part of the deal but was acquired in parallel (i.e. Angola and Nigeria). This has produced some confusion among analysts. In the first case, the loan is structured around the development of a specific undeveloped mining project that entails the construction of supporting infrastructure. As part of the deal, a designated Chinese SOE assumes a dominant shareholding position, normally in a JV with a parastatal from the borrowing government. In most cases, the Chinese partner also retains the off-taker rights, being that the proceeds from that sale are to be used to service the loan, mitigating by these means the repayment risks.

In the second case, following commodity-secured financing market practices, Chinese loans have targeted primarily oil-rich countries with an established producing capacity. Often these loans

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<sup>26</sup> J. Bavier, "China to lend DRC \$5bn in latest Africa foray", *Mail & Guardian*, September 18, 2007,

<http://mg.co.za/article/2007-09-18-china-to-lend-drc-5bn-in-latest-africa-foray> .

<sup>27</sup> J. Bavier, "China's DRC Investment \$9 billion – 3\$ billion for mining", *Reuters-Kinshasa*, February 16, 2008

<http://www.mineweb.com/mineweb/view/mineweb/en/page67?oid=47452&sn=Detail>.

are secured against oil exports to China from blocks that are already on-stream. Although no access to oil equity was included in the loan contracts, in most cases Chinese NOCs acquired assets in parallel to these deals, often benefiting from the receiving government's favour, sparing them from having to compete directly with the more experienced and much better equipped (in terms of technology and expertise) international resource companies.

However, although China's eagerness to provide cheaper and unconditional loans and willingness to embrace large infrastructure projects neglected by Western donors has represented a valuable competitive advantage for Chinese companies in Africa (helping to offset their latecomer status on the continent), it has not always produced the desired outcome.

This is the case with the DRC, where project development has been delayed by traditional donors' pressure over Kinshasa to renegotiate the contract, having the loan been revised and downsized to \$6 billion in 2009. Other issues include the suspected embezzlement by Gecamines officials of the signature bonuses paid by the Chinese consortium. The contract signed in 2009 is only partially under implementation, as the bulk of the loan is yet to be released, pending approval by the relevant authorities on both sides.<sup>28</sup> In Gabon, the Belinga project has been postponed repeatedly due to persistent disagreements (regarding labour and environmental issues) and calls for renegotiation of the contract, perceived by civil society as too favourable to China. The global commodity price volatility, civil society dissent and the changing domestic political landscape (following Omar Bongo's death) have also added new risks and costs for the Chinese.<sup>29</sup> The contract has been revised twice (2009 and 2012) and rumours have been

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<sup>28</sup> For more detail, see Johanna Jansson "The Sicomines agreement revisited: prudent Chinese banks and risk-taking Chinese companies", *Review of African Political Economy*, 40/135 (2013) 152-162

<sup>29</sup> See Romain Dittgen, *To Belinga*

circulating in the media that Gabon has been courting BHP Billiton and Vale to take over the project.<sup>30</sup> Lastly, in Nigeria, most Chinese oil exploration contracts awarded by Obasanjo and loans signed under his rule were frozen by his successor, Umaru Musa Yar'Adua, immediately after the elections in 2007, followed by a review of the Nigerian oil industry regulatory framework under President Goodluck Jonathan. Even in countries where the same regime remains in power, like in Angola and Sudan, China's oil interests have been affected by other setbacks, including a souring of relations with Sonangol in Angola due to a disagreement over a refinery project and the secession of South Sudan (where most oil deposits are located) from Sudan.

Although those experiences have clearly exposed the vulnerabilities of this economic statecraft instrument in the African context, this tool has performed relatively well in oil producing countries in regards to its immediate goals, in that it has produced long term supply contracts and important oil equity (i.e. Angola and Sudan) as well as opened the gates for Chinese construction and oil companies to penetrate these markets. On the other hand, the the loans structured around Greenfield mining projects (i.e. DRC and Gabon) seem to have become particularly problematic in that production (and hence long term supply and repayment) turned out very unpredictable in this context. From a more structural point of view, China's initial political capital gains were to some extent eroded by a number of setbacks, namely, pressure from traditional donors, regime change and waning of political support/contract-revision and civil society criticism.

The difficulties discussed and the volatility in commodities markets deriving from the onset of the global economic crisis at the end of 2008 led to a temporary halt in large-scale infrastructure

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<sup>30</sup> Agence France Press, "Gabon renegotiating China mining deal", *News 24*, June 12, 2012,

<http://www.news24.com/Africa/News/Gabon-renegotiating-China-mining-deal-20120607> .

lending. That no large credit lines were extended by China to African countries in 2009 and 2010 (contrasting with the massive loans that China extended to national oil companies in Brazil, Russia and Kazakhstan during this same period) suggests that Beijing took a step back to assess the situation on the continent. However, mounting financing difficulties of some resource-rich African countries in the context of the global economic crisis compelled its leaders to knock at China's door for funding, meaning that this kind of economic incentives remained a major source of China's political capital on the continent. And it was in this context that a new batch of infrastructure loans was announced in 2011 and 2012.

In 2009 Ghana approached China Development Bank (CDB) to request a loan to fund infrastructure necessary to develop its newly found hydrocarbons deposits. The \$3 billion loan<sup>31</sup> secured by crude sales (13,000 barrels per day – with UNIPEC as the off-taker) took two years to negotiate, and was signed in December 2011. After a lively domestic discussion, the infrastructure-for-oil agreement was finally approved in parliament in 2012. The initial batch (\$1.5 billion) was earmarked to fund the gas infrastructure linked to exploration of the Jubilee field (the onshore–offshore pipeline and the gas processing plant) and the ICT infrastructure for its surveillance.<sup>32</sup> Its disbursement however has been slow, hindered mostly by risk considerations on the Chinese side. As of early 2014 only \$600 million had been disbursed, in two tranches, with a third one expected later in the year. Other infrastructure to be contemplated by the second batch

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<sup>31</sup> Ministry of Finance, Republic of Ghana, “US\$ Billion Term Loan facility Agreement Between China Development Bank and Government of Ghana – Summary”, accessed May 20, 2014, <http://www.mofep.gov.gh/?q=reports/cdb-loan-summary-050112> ()

<sup>32</sup> S. Verma, “Sino–African ties: The Ghana case study”, *FT Tilt*, August 29, 2011, <http://tilt.ft.com/#!/posts/2011-08/28946/ghana-china>.

(\$1.5 billion) includes the development of harbour facilities, railway lines and agriculture projects. The contract stipulates that 60% of the funded projects have to be contracted to Chinese companies. In line with this, Sinopec is the contractor for the gas pipelines. Although Chinese oil companies did not obtain any assets upstream parallel to the loan, it did enable Sinopec to enter the sector downstream with a high profile project. Accra has been allegedly negotiating with China Exim Bank another \$10.4 billion credit facility since 2010 for social infrastructure (including roads, railroads, education, electricity and water supply), which is also to be secured by oil revenue.<sup>33</sup>

In 2011 China Exim Bank signed with Angola another \$3 billion infrastructure credit facility backed by oil. Negotiations took two years, in sharp contrast with the few months that preceded the signing of the first loan in 2004. That same year Angola concluded another two infrastructure loan agreements with China, one with ICBC (\$2.5 billion) and the other with CDB (\$1.5 billion), the latter allegedly not secured by oil sales but by a sovereign warranty.<sup>34</sup> Most of the projects are still to be developed by Chinese construction companies with materials and labour sourced in China. However, unlike in 2004, none of these loans produced any collateral hard assets for Sinopec or even downstream contracts suggesting that Sinopec is still paying the price for ditching the joint refinery project in 2006.

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<sup>33</sup> Billie A. McTernan and Marshall Van Valen, “Ghana’s funding gaps, ‘go-slows’ and Chinese hopes”, The Africa Report, January 20, 2014, accessed May 20, 2014 <http://www.theafricareport.com/West-Africa/ghanas-funding-gaps-go-slows-and-chinese-hopes.html>

<sup>34</sup> Ana C. Alves, “Taming the dragon: Sinopec’s interests in Angola”, *China and Angola: A Marriage of Convenience*, eds Ana C. Alves and Marcus Power (Cape Town: Fahamu, 2012)

Nigeria, is also part of this list. In February 2012 it was announced that Lagos was negotiating a \$3 billion loan with China Exim Bank and the CDB for the completion of various infrastructure projects in the fields of oil and gas, energy, transportation, aviation, education and agriculture.<sup>35</sup> As of May 2014, only \$1.1 billion had been agreed upon but yet to be disbursed. In 2011, the Nigeria National Petroleum Company reportedly signed a memorandum of understanding (MoU) with China State Construction Engineering Corporation (CSCEC) for the construction of three greenfield refineries and a petroleum complex. The project investment reportedly amounts to \$28.5 billion and is to be financed by a consortium of Chinese banks. The CSCEC-led consortium is to retain an 80% controlling stake in the projects until costs are recovered.<sup>36</sup> These loans come in at a time when China is expected to increase its oil imports on the back of falling US intake, currently the largest importer of Nigerian oil.

A number of other loans are reportedly in the pipeline. In late April 2012, during President Salva Kiir's visit to Beijing, South Sudan announced it was negotiating an \$8 billion loan with China for infrastructure, including road construction, agriculture, hydroelectric plants and telecommunications.<sup>37</sup> Despite the reluctance of the Chinese authorities to publicly confirm these negotiations, the fact that the bulk of the reserves of the former Sudan are now under the control of Juba suggests that Beijing may have an interest in pursuing this, though restrained by the

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**35** Nse Anthony-Uko, "Nigeria: President Jonathan Finalises U.S.\$1.1 Billion Loan Deal With China", *Allafrica*, July 21, 2013, accessed May 20, 2014, <http://allafrica.com/stories/201307110351.html>

<sup>36</sup> K. Sharife, "China and Nigeria oil", *Pambazuka News*, January 26, 2011, <http://www.pambazuka.org/en/category/features/70400>.

<sup>37</sup> *Sudan Tribune*, "South Sudan's announcement of \$8bn loan from China draws scepticism", May 15, 2012, <http://www.sudantribune.com/South-Sudan-s-announcement-of-8,42605>.

current civil war context. In September 2013, the media have circulated again news of a \$ 1-2 billion loan under negotiation. Among the countries that have been courting Beijing for infrastructure loans is South Africa, not an oil producer but a mining powerhouse. South Africa's Industrial Development Corporation, a state investment agency, is said to be in talks with China for a loan to fund part of its \$12.75 billion infrastructure programme covering the next five years.<sup>38</sup> South African oil company, Petro South Africa, is also said to be in talks with Sinopec for the construction of a world-class \$10 billion crude-oil refinery in Port Elizabeth.<sup>39</sup> This suggests that the loan model already applied in South America and Central Asia – direct loans to national oil companies- might be soon a reality in Africa.<sup>40</sup> Another country in this prospecting list is Kenya. In August 2013, during President U. Kenyatta visit to Beijing, Kenya signed an MoU with China for a loan of \$ 5 billion, allegedly for power projects and a railroad linking the port of Mombasa to Uganda. This facility should be understood in a context in which Kenya is expected to become East Africa's largest oil exporter by 2016.

However, this renewed African appetite for Chinese cheap infrastructure loans may land Beijing in very tricky situations. Chinese loans allegedly under negotiation with East African countries such as Ethiopia, that are earmarked for contentious dams and irrigation projects in highly

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<sup>38</sup> Reuters, "South Africa's IDC says in loan talks with China", *Reuters*, April 20, 2012,

<http://www.reuters.com/article/2012/04/20/safrica-idAFL6E8FK5O420120420>.

<sup>39</sup> W. Roelf, "South Africa turns to China for refinery project", *Business Day*, May 12, 2012,

<http://www.businessday.co.za/articles/Content.aspx?id=172236>.

<sup>40</sup> In mid-2013 unconfirmed news circulated in Lusophone media that China Exim Bank was negotiating a \$1 billion loan with Sonangol.

volatile border regions (ie Lake Turkana) threaten to drag China into African regional conflicts, which could seriously harm its interests and political capital in Africa.<sup>41</sup>

Over the years China has become more attuned to the risks and as a result changed a few features and became more cautious when extending this kind of soft loans. Other Chinese banks have joined China Exim Bank in financing infrastructure in Africa in this second phase, namely CDB (until recently most active in South America and Central Asia). As a result, concessional loans (a privilege of Exim Bank) are giving way to credit lines in more commercial terms, though still at lower rates than financial markets. The new loans are now targeting other sectors as well, namely manufactures and agriculture, signalling a trend towards diversification.

Infrastructure loans seem also to have dropped the goal of facilitating Chinese SOEs access of to equity assets as its companies became increasingly confident in venturing out on their own on the continent. Through mergers and acquisitions they have gathered a significant portfolio in Africa in recent years, benefitting from the financial contraction and ensuing divesting strategies of western resource companies.<sup>42</sup> The new loans seem to focus instead in securing mid and downstream contracts (i.e. Ghana & Nigeria) for its oil companies, in addition to long term supply contracts and opening doors for Chinese companies and goods in an expanding portfolio of sectors. Despite notable changes, which attest to the resilience of this instrument, this type of loans remain thus China's most prominent economic statecraft tool in the continent, and the most

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<sup>41</sup> Peter Bossard, "Chinese loans could fuel regional conflict in East Africa," China Dialogue, January 14, 2013, <http://www.chinadialogue.net/article/show/single/en/5601-Chinese-loans-could-fuel-regional-conflict-in-East-Africa>.

<sup>42</sup> Ana C. Alves, *China's economic statecraft and African mineral resources: Changing Modes of Engagement*, SAIIA Occasional Paper (Johannesburg: SAIIA, January 2013)

promising in pursuing its immediate goals and in building up Beijing's credentials as a reliable partner in Africa.

## **CONCLUSION**

In the past, economic incentives, in particular soft loans extended to African countries in the 1960s, 1970s and 1990s, have proven very useful in pursuing China's most critical foreign policy goals in that period, namely gaining international recognition and UN membership, circumventing western criticism in multilateral fora and the encirclement of Taiwan. Its performance was also positive in regards to goals of a more structural nature. Despite the meagre financial resources at its disposal at the time and even the sometimes controversial support to liberation movements and rebel guerrillas in the early 1960s, Chinese economic statecraft deployed during this period produced in the long run strong credentials as an all-weather friend in the eyes of Africans. This positive image, largely explains the warm welcome when China re-entered the continent at the turn of the century.

This time around though, Beijing's immediate goals were mostly economic in nature, namely, open markets for its companies and products, secure long term resources supply contracts, and acquired resources assets overseas. As a latecomer and inexperienced economic player and still lagging behind in terms of technology and expertise of its Western competitors, Chinese penetration in Africa has relied heavily on Beijing's positive economic statecraft, particularly soft loans for infrastructure.

So far this tool has been relatively successful at the tactical linkage level, particularly as a gate opener for Chinese companies, technology and goods, especially in the construction sector and

increasingly in the oil industry downstream. However, in regards to resource security goals, the success is questionable. Access to hard assets through this instrument has been far less consequential than expected, with most of the assets acquired yet to begin producing, gone or about to be lost.<sup>43</sup> Securing long term supply of strategic minerals also revealed problematic. These loans have failed so far to produce long term supply of minerals (i.e. Gabon and DRC deals). In regards to oil, although long term supply contracts were secured, the reality is that a significant part of the crude that underwrites the loans is actually sold on the spot market by the incumbent Chinese oil company, and therefore not shipped back to China.

Although China's intensifying economic exchanges with the continent account to a great extent for the continent's clear geo-economic shift towards the East since the early 2000s, it is still far too early to assess what this means in terms of China's soft power on the continent in the long term. Whilst economic incentives have been critical in building China's political capital amongst African elites, it has been far less consequential in gaining the minds and hearts of Africans. And while this was not important in the previous period, it has become a critical factor in the information age. For this reason, from a structural point of view, the success of this economic statecraft instrument at this particular point in time looks uncertain. In contrast with the enthusiasm that characterised the early stages of deployment of this tool, China has faced in recent years an unprecedented wave of criticism from civil society and increasingly from African leaders. These loans, although timely and cheap, are not creating much needed jobs for the locals, or fuelling local business class or industries since the bulk of the projects content is sourced in

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<sup>43</sup> Namely oil blocks in Nigeria, the Belinga iron ore project in Gabon, and the cobalt mines in Katanga, the DRC.

The only exception is an oil stake (50% of Oil Block 18) in Angola acquired by Sinopec as collateral to the 2004 China Exim Bank loan, which is actually among the largest-producing blocks in the country.

China. Also, the low quality of the infrastructure provided has raised fears among Africans that they are exchanging their finite resources for infrastructure that will not last a generation. Even though China's image has benefitted in the short run by providing Africans with a cheaper and frills-free funding alternative, being catalogued as just another neo-colonial power will undoubtedly harm China's political capital and soft power on the continent in the long run.

Chinese soft loans in Africa have undoubtedly reached a major tipping point at both tactical and structural levels. The challenge for Beijing at present is how to solve all the issues above in a way that does not harm its interests, and at the same time do it quick enough to offset the intensifying criticism.