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Impact of the Financial and Economic Crisis on China's Trade, Aid and Capital Inflows to Africa

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Background

Three decades of a high annual economic growth of eight percent has made China the fourth-largest economy in the world. The country commands four percent of global economy, six percent of global trade and 12 percent of global output. The rise of China has led it to forge development and trade relationships with many Africa countries.

Although the global financial and economic crisis poses a threat to the country's economic exploits, its banking institutions are relatively well insulated from the impact of the financial crisis in particular. This sector is highly regulated and dominated by state- owned banks. Chinese assets exposure mainly arises from the potential threat of inflationary policy in the US as the country has nearly USD 2 trillion worth of treasury bills.

The main channels through which the financial crisis will affect China's economy are the drop in the labour intensive manufacturing exports to developed markets (i.e. USA, EU and Japan) and the reduction of FDI inflows. This decline in exports and FDI inflows is expected to cause a drop in economic growth to about 8 percent in 2009, which is a low growth rate by Chinese standards. To ensure that this growth rate is met, which is considered the threshold for sustaining employment and social stability in China, the Government has launched a four trillion yuan stimulus package (i.e. USD 586 billion). This corresponds to about two percent GDP. In addition, the Government has encouraged banks to provide another five trillion yuan (i.e. USD 732 billion) in fresh bank loans, or 2.5 percent of GDP. This stimulus package partially compensates for the drop in Chinese exports and FDI inflows.

The reduction of economic growth in China will also have an impact on China-Africa partnership. China is currently the third biggest trading partner of Africa, with annual trade of USD 106 billion. This marks an increase of 45 percent compared to a year earlier. The trade relationship is, however, unequal. Africa's exports to China are mainly commodity, while imports consist of light manufactured products. In addition, FDI flows from China to Africa are estimated at USD 1.3 billion per year, and are concentrated in resource rich countries in particular. These are Angola, Democratic Republic of Congo, Ethiopia, Nigeria, and Sudan.

Channels of transmission to Africa

The current economic and financial crisis will affect China's trade and capital flows to Africa's resource rich countries in three manners:

1. Limited drop in demand for commodities. China's imports from Africa comprise mainly of commodities for which the demand is relatively inelastic. In combination with a heavy focus of the stimulus package on infrastructure, the decline in commodities exports from Africa to China should be limited. Evidence from Democratic Republic of Congo, Sudan, and Angola indicates that Chinese investments and loans remained steady, although there might be pressure on prices due to falling global demand and terms of trade.

2. Marginal reduction of Chinese FDI inflows, although long-term commitment remains. In terms of FDI, there is little reason to expect significant reduction in China's public and private investments in Africa. As mentioned earlier, the banking sector remains largely unaffected by the financial crisis and the bulk of investments are from Chinese sovereign wealth funds, which are mainly allocated to the infrastructure and commodities sectors in Africa. These are investments with a long-term horizon aimed at alleviating the supply-side constraints to China's growth prospect. Another motivation for China to encourage FDI outflows is that it seeks to diversify its investment from US treasury bonds, which could dilute in value due to the risk of inflation in the US. This policy is in line with the overall "going out" strategy, which seeks to support Chinese companies to become global multinationals. A good example of China's long-term commitment to Africa is the increase of China-Africa Development Fund by an additional USD 2 billion in March 2009, bringing the total to USD 5 billion. These funds will be invested in infrastructure, industrial, and agricultural projects, and are envisaged to be spent in the next two years. However, projects with limited returns, which have subsequently become unprofitable due to drop in global commodities prices, will likely be postponed or cancelled. Such projects have been identified in Guinea-Bissau and Democratic Republic of Congo. In Mauritius, there is some reduction of Chinese investment in the Special Economic Zones (SEZ), although it is not clear whether this is directly linked to the financial crisis.

3. Chinese aid flows to Africa will remain stable. China's annual foreign aid to Africa is estimated to be between USD 1.4 billion and USD 2.7 billion, while loans are about USD 8.5 billion.[1] Therefore, aid to Africa is mainly channelled through finances provided by China's Export-Import Bank. This increases the country's debt burden, which often attracts critics from traditional and multilateral development partners. Within the overall cooperation of the Forum on China-Africa Cooperation (FOCAC), China has also announced additional debt reduction or cancellation as well as multi-annual lines of credit for up to three years. It should be noted that Chinese aid to Africa remains relatively small compared to size of China's GDP.

[1] China's foreign aid is difficult to quantify. The Chinese Government does not release or explain Chinese foreign aid statistics. In addition, foreign aid does not appear to be accounted for in academic literature on the subject.

Policy implications

The policy implications of China's continuous investments in Africa highlight the importance of elaborating a clear China-Africa policy. Each country must design a clear framework for engagement with China. Such engagement must be envisioned so as to contribute to the national development agenda. The focus of China's engagement in Africa on infrastructure development offers important opportunities for synergies between China's investment and AfDB's investment programme. The Bank can plan an important role in helping countries to ensure that China's investment complements those of traditional development partners. Given the widening saving-investments gap faced by most African countries, China's interest in infrastructure investment could be a blessing for the continent. But it is imperative that engagement with China is clearly aligned with national development strategies.

Comments and suggestions can be sent to:

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