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On the importance of Chinese investment in Africa

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Abstract

With the growing presence of China in Africa over the last two decades, this paper investigates the impact of Chinese foreign direct investment (FDI) on economic performance in Africa, which we compare to that of the traditional economic partners of African countries, including the U.S., France, and Germany. Also, we explore whether China's new relationship with Africa has somehow altered the preexisting relationship between Africa and its traditional partners. Our results, using the fixed-effects and instrumental variable approaches to 36 countries over the period 2003–2012, indicate that Chinese FDI improves income in Africa. We also find that the impact is more pronounced for U.S. and German investment. Moreover, there is evidence that Chinese investment crowds out U.S. investment in Africa, whereas France seems to be competing with China. These results imply that as the Chinese economy grows, the demand for resources has increased its intensive competition with the U.S. rather than with France.

JEL classification: F21; O11; O55

Keywords: Foreign direct investment; Standard of living; Africa

1. Introduction

China's engagement in Africa has been growing in many aspects such as trade, investment, and aid. Over the last decade, although the traditional partners of the African countries, namely the European Union and the United States, continue to dominate foreign direct investment (FDI) in Africa, the rise of China is highly noticeable. For instance, from 2003 to 2011, the flow of Chinese investment to Africa grew by more than 30 times, while that of the United States grew only by about one third (UNCTAD Bilateral FDI Statistics, 2014).

The growth rate of the stock of Chinese outward investment around the world was positive during the period 2004–2011 with an average of 37.93%. As shown in Table 1, total investment increased until 2007. The subsequent years show a decrease in the growth rate probably because of the global financial crisis of 2008. Investment in Africa shows a similar pattern. However, unlike the world investment, investment in Africa has been at higher rates around mid-2000. Although this investment has gone a bit down compared to others from 2009, the average growth rate of Chinese investment in Africa is the second highest (57%) apart from that of Europe (65%). In terms of flows, Africa ranks third with an average of 107% after Oceania (128%) and North America (113%).[1] Some of the top destinations of Chinese investments in Africa include South Africa, Nigeria, Zambia, Algeria, Sudan, and Angola. The stock of foreign direct investment in these countries represents more than 50% of the total investment in Africa in 2012 (Leung and Zhou, 2014), and most of the investment is concentrated in mining, finance, and construction industries.

This explosion of Chinese FDI in Africa is preceded by different presidents' visits to Africa. For example, following President Jiang Zemin's tour in Africa in 1996, a new relationship was established between China and Africa (Alden, 2005). This relationship is driven by the increased demand for resources to support China's fast-growing economy and it has given considerable weight to economic cooperation and development at the expense of political and ideological considerations. This new

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[1] These figures are not, however, reported in the table to conserve space.

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Table 1
Growth rate (%) of Chinese outward direct investment (stock) around the world.

Year	Asia	Africa	Europe	Latin America	North America	Oceania	World
2004	25.85	83.12	38.81	79.00	65.76	15.18	34.78
2005	22.33	77.34	88.12	38.72	38.94	19.55	27.76
2006	17.15	60.28	78.31	71.71	25.63	44.47	31.15
2007	65.11	74.51	96.43	25.42	104.21	94.83	57.16
2008	65.77	74.90	15.15	30.52	12.93	108.48	56.03
2009	41.30	19.59	69.01	−5.10	41.67	68.21	33.58
2010	22.96	39.75	81.06	43.41	51.01	34.09	29.08
2011	33.00	24.55	55.63	25.75	72.08	39.50	33.91
Average	36.68	56.75	65.32	38.68	51.53	53.04	37.93

Source: authors' calculations using the 2011 Statistical Bulletin of Chinese Outward Foreign Direct Investment.

relationship, which some people termed "win–win", is destined to help not only China, but also African countries in terms of growth and development. President Hu Jintao, during his visit to Gabon in 2004, has emphasized the free of political conditionality of the relationship and particularly the mutual benefits that underlie it (Alden, 2005). However, if there are many papers that have discussed the investment of China in Africa, not many things have been said among scholars about these mutual benefits or win-win deals.

This paper investigates the impact of Chinese FDI on economic performance in Africa. Specifically, we first examine whether Chinese investment is conducive for development in Africa. Our main hypothesis is that if China gets returns on its investments in Africa, the win-win deal will require an improvement in the standard of living of Africans. Secondly, we compare Chinese FDI to that of Africa's traditional partners – the U.S., France, and Germany – in enhancing African growth. Lastly, we explore whether China's new relationship with Africa has somehow altered the preexisting relationship between Africa and any of those traditional economic partners.

Our paper contributes to the existing literature in a couple of ways. First, it fills the gap by providing econometric analyses on the relationship between Chinese FDI and income of African countries. To the best of our knowledge, Asiedu (2006) and Cheung et al. (2012) are the only ones who provide a formal econometric analysis of Chinese outward direct investment in Africa. However, their studies focus on the determinants of Chinese outward direct investment. Secondly, previous studies on the relationship between FDI and growth mostly use aggregate FDI of the host country, that is, total foreign investment in the host country. Our study uses specific FDIs, such as China's FDI, the United States' FDI, or Germany's FDI. Lastly, we provide evidence whether the presence of China has distorted existing economic relationships on the continent. The results of this study should help government authorities in Africa to better select or diversify their economic partners.

Our results using the fixed-effects and the instrumental variable approaches to 36 countries over the period 2003–2012 indicate that Chinese FDI has a positive effect on the standard of living in Africa. We also find evidence that U.S. and German investment, unlike French investment, raise income per capita more than that of China. Moreover, there is evidence that Chinese investment crowds out U.S. investment in Africa, thereby undermining the preexisting relationship between Africa and the U.S., whereas France seems to be competing with China.

The rest of the paper is structured as follows: in Section 2, we review the literature. In Section 3, we present the methodology and the data. Section 4 presents results for the United Sates. Section 5 presents results for the European Union. Section 6 concludes.

2. Literature review

It is important to start with a brief overview of the motivation or the determinants of FDI. Gelb (2005) has reported that market-seeking and resource-seeking determine South-South investments. In an empirical analysis, Cheung et al. (2012) investigate the determinants of Chinese outward direct investment in Africa and find that market-seeking, risk factor, and resource-seeking motivate their investment in Africa. Trade intensity and China's contracted projects are also found to be significant determinants. Likewise, Asiedu (2006) has also investigated the determinants of Chinese FDI in Africa. She uses a panel that comprises 22 countries in Sub-Saharan Africa and finds that countries that are endowed with natural resources or have large markets have attracted more FDI. Moreover, her results indicate that good infrastructure, an educated labor force, macroeconomic stability, openness to FDI, an efficient legal system, less corruption, and political stability also promote FDI. A key takeaway from this discussion is that FDI is motivated by self-interest. That is, foreign investors invest in a recipient country and expect to reap profits from their investment. Theoretically, that is the motivation behind investment. It is then fair to say that China gets returns on its investment. The next question is whether African countries also benefit from this investment.

Many studies have investigated Chinese FDI in Africa, but most of them are limited to analytical frameworks. Put differently, very few studies have used sound theories and econometric methods in their investigation. For example, Klaver and Trebilcock (2011) analyze the Chinese investment in Africa, and more importantly, they ask the question of whether Chinese investment in Africa is good or bad for Africa. They point out seven ways Chinese investment contribute to African growth: commodity prices (China's demand for resources raised commodity prices), capacity to extract (many African countries lack the capacity to extract their own resources), infrastructure