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China's Contribution to the Development of African Infrastructure through Investment in the Extractive Industries

By Lucy Corkin[(1)]

Introduction

China's rising profile in Africa as a development partner has been controversial, not only because of the speed with which China has emerged as a significant donor to Africa, but also because China's aid policies and priorities are not necessarily in line with those of the traditional aid organisations.

There is an emerging structure to China's concessional loan structure to Africa in that development assistance in the form of infrastructure projects is bartered for access to African commodities. This engagement converges with China's strategic interest in the African continent while offering the potential for Africa's poor and vulnerable to gain from improved basic service delivery. There are nevertheless several challenges that need to be acknowledged and overcome in order to ensure that the benefits of China's engagement in Africa are equitably distributed.

China's Growing Role as a Development Partner for Africa

China's development assistance to Africa in the form of infrastructure boasts a long history, dating back to the Tanzara railway, completed and handed over to the Zambian government in 1976. During the Cold War, such projects, under Mao Zedong were distinctly more ideological in purpose[1]. The Tanzara railway for instance was intended to provide a transport corridor to African nations that circumvented the need to enter imperialist Apartheid South Africa. China's current engagement in Africa, while more commercial in nature, has no less of a focus on infrastructure development and rehabilitation.

China's Africa Policy Paper, released in January 2006, emphasised infrastructure as one of ten key sectors for economic collaboration stating:

> *The Chinese Government will step up China-Africa cooperation in transportation, communication, water conservancy, electricity and other infrastructures. It will vigorously encourage Chinese enterprises to participate in the building of infrastructure in African countries, scale up their contracts, and gradually establish multilateral and bilateral mechanisms on contractual projects. Efforts will be made to strengthen technology and management cooperation, focusing on the capacity-building of African nations[2].*

More recently, the Beijing Action Plan[3] (2007- 2009) makes specific reference to co-operation in the construction and infrastructure sectors. Indeed, many Chinese enterprises have recently invested heavily in the continent's road and railway rehabilitation, as well as in several other large infrastructure projects. These projects are usually undertaken by Chinese state-owned enterprises, in line with the "go out" strategy driven by the Chinese government to promote the internationalisation of Chinese companies[4].

This also dovetails with the Chinese government's foreign aid programmes to African countries. Hence, these infrastructure projects are often financed by soft loans from the Chinese government. It is not coincidental that some of the most extensive infrastructure operations planned are in the more resource-endowed African countries, such as Angola, DRC and Gabon. Indeed, critics have commented on China's newfound mercantilist attitude toward Africa, in the global race for energy security and in the procurement of raw materials to fuel China's burgeoning economy[5]. Nevertheless, it is worth noting Africa's eternal irony it is often the most resource-rich states that are in dire need of infrastructure development and support.

Recent events further confirm the growing intended role of China in rebuilding Africa, albeit on its own terms. Significantly, the annual meeting of the African Development Bank was held in May 2007, in Shanghai, only the second such meeting to take place outside of the African continent. Following this meeting, the Chinese State Council approved the creation of US$5 billion China-Africa Development Fund, to be administered by the China Development Bank[6]. The investments of the fund are to be targeted at providing capital for Chinese enterprises engaged in development, investment, economic and trade activities in Africa. The fund is also to provide support for African countries' agricultural, manufacturing and energy sectors, as well as support for urban infrastructure and the extractive industries[7]. The China Development Bank forecasts a 50-year lifespan for the fund, touted as the largest global fund aimed exclusively at African development. This is a note-worthy development in China-Africa relations as it is a further gesture of China's intention to play a major role in Africa's development.

The Nature of China's Infrastructural Development Assistance to Africa

Many are of the opinion that China's recent actions are not different from previous interest by other powers in Africa's mineral wealth and energy resources. Indeed, in individual cases, where infrastructural projects are financed by lines of credit extended to African governments, the only difference on the surface is that China's funds dwarf those of other countries'. This is the case is Angola, where Portugal and Brazil have both extended credit lines in order to acquire market share for their companies. These loans however, only amount to US$300 and US$500 respectively[8].

There are some marked differences in China's approach when compared to that of other such actors.

- The fundamental difference inherent in China's overseas development assistance to Africa, as compared to Western donors, is that Chinese aid comes without political or economic pre-conditions, such as transparency and good governance, as insisted upon by most aid organisations and International Financial Institutions (IFIs). Chinese diplomats repeatedly emphasise that this is in order to uphold the 'non-interference' principle[9], one of the cornerstones of China's foreign policy. Of course, Chinese loans do

Projects Director at Centre for Chinese Studies, Stellenbosch University, South Africa have their own conditions, in that African countries must adhere to the "One China" policy, and revoke diplomatic relations with Taiwan. In addition, concessional loans managed by China Exim Bank often have their own terms of disbursement, as discussed below. Nevertheless, China's advances have been considered preferable by African governments[10].

- Another striking feature about China as a donor to Africa is that the former is also a developing country, suffering many of the socio-economic challenges as the latter. This has arguably informed China's approach to foreign aid in its rhetorical emphasis on a development partnership, as opposed to donor-recipient relationship as well as a consciousness of the sensitivities of sovereignty and self-determination, as reflected in the policy of non-interference.

- Despite the increasing prominence of China's pledges to Africa in terms of debt relief, foreign aid and development assistance, China has no coordinating body for its disbursement[11]. Furthermore, opinion is divided as to what of China's assistance packages to African governments actually constitutes aid. In contrast to Western countries' aid, Chinese aid is used in concert with debt relief, trade agreements, foreign direct investment and other instruments in a package deal specifically designed to further Chinese long-term strategic objectives in each African country engaged[12]. Chinese foreign aid is thus so closely tied to the facilitation of state-directed commercial interests, particularly where Africa's mineral and energy resources are concerned, that it is often difficult to separate aid from investment where China's portfolio in Africa is concerned. Such distinctions remain difficult to establish, particularly as there is a lack of consensus among the Chinese government departments involved. Consequently, exact figures for Chinese aid to Africa remain difficult to establish[13].

For the purposes of this paper, Chinese government concessional loans will be considered development assistance as the low interest rates offered to African countries are subsidized by the Chinese governments. In addition, the concessional loans are awarded according to a developmental mandate[14]. Concessional loans are fast becoming the preferred means of development assistance from China to Africa, as it outweighs the volume of grants[15].

China has several government departments and finance bodies that manage loans. China's principle financing vehicle, China Exim Bank, is currently one of the largest such institutions in the world[16]. According to World Bank estimates, China Exim has disbursed over US$ 12.5 billion for large-scale infrastructural projects in Sub-Saharan African alone although China Exim Bank's official reported figures are much less[17]. More than 80 percent of these were to resource-rich African countries, such as Angola, Nigeria, Zimbabwe and Sudan[18].

A trend is emerging in terms of how China is rolling out concessional loans, of which China Exim bank is the sole lender. Essentially, the debtor country, represented by its Finance Minister will negotiate a loan, which is at least 20 million RMBY (US$2.4 million). The loan interest rate and grace period are separately negotiated, with repayment due bi-annually, following loan negotiation. Loans must be used for infrastructure, social or industrial projects[19].

The loans are a foreign policy tool, particularly in as regards Africa's cash-strapped but resource rich countries, and especially those with major infrastructure needs and who can use their proven resources as collateral. The financing arrangement also addresses China's domestic challenge of structural unemployment. According to the China Exim Bank's concessional loan requirements, Chinese contractors must be awarded the infrastructure contract financed by the loan. Furthermore, in principle no less than 50 percent of the contract's procurement in terms of equipments, materials, technology or services must come from China.

The Barter System

There seems to be an emerging pattern in the way China is disbursing concessional loans to African countries, which is most exemplified in the case of Angola. The so-called "Angola Model", as it is now referred to by Chinese diplomats, whereby low-interest loans are secured with commodities as collateral in a barter arrangement, is readily becoming China's preferred structure of concessional loans to Africa.

China is the biggest player in Angola's post-war reconstruction process. China's Exim Bank extended an oil-backed US$2-billion credit line to the Angolan Government[20]. This loan was later increased by US$1 billion in 2006. In May 2007, an additional US$500 million was negotiated to assist with 'complementary actions'. This, according to a representative of the Angolan Ministry of Finance, encompasses further incidental expenditures that will facilitate the integration of the newly built infrastructural projects into the national economy[21].

The loan is intended to assist Angola in the rebuilding of vital infrastructure and is managed by the Angolan Ministry of Finance. In exchange for the loan, payable at Libor[22] + 1.5 percent over 17 years, including a grace period of 5 years, China has secured 10,000 barrels of oil per day from Angola. The loan, which operates like a current account held in China, under the name of the Angolan Government, is paid directly to the Chinese companies responsible for the construction work. The loan has placed China in a favourable position with the Angolan Government, especially as a much smaller amount of oil must be put up for collateral, as compared to traditional expensive oil-backed loans[23].

This agreement is significant, particularly because Angola had been experiencing difficulties securing capital from the international financial institutions, such as the Paris Club and the International Monetary Fund (IMF). Angola resisted external pressure regarding good governance and transparency, particularly as she felt that these preconditions for financial assistance were unreasonable. External factors have fuelled Angola's resistance; such as the rise in global oil; due in part to China's increasing demand. This has placed Angola's Government in a stronger position vis-à-vis the International Financial Institutions (IFIs), particularly when the prospect of financing from an alternative source emerged.

Tied to the China Exim Bank loan, is the agreement that the public tenders for the construction and civil engineering contracts tabled for Angola's reconstruction will be awarded primarily (70 percent) to Chinese enterprises approved by the Chinese Government. As the loan is not classified as investment, Chinese companies tendering for contracts financed by the China Exim Bank loan do not have to register with the Angolan National Agency for Private Investment (ANIP) according to the Ministry of Finance[24]. Instead, the projects financed by the loan fall under a Program of Public Investments (PIP) in the sectors of public works, health, energy and water, agriculture, telecommunications, the fishing industry and education.

According to the Angolan Ministry of Finance[25], the projects allocated to each sector are managed by their respective ministries while the Ministry of Finance co-ordinates the process of fund allocation. Applications for projects to be financed by the loan are submitted by the various ministries, under the guidance of the Presidency. According to the Chinese Economic Counsellor in Angola[26], the money is managed through a co-operation agreement between the Angolan Ministry of Finance and the Chinese Ministry of Foreign and Commercial Affairs (MOFCOM). Projects are determined by the Angolan Government, who must then present a proposal to the joint-committee of

MOFCOM and the Angolan Ministry of Finance before it can be put out to tender. According to various observers from civil society, however, the Presidency has the overriding say as to where the money is allocated.

China's Exim Bank has increased the amount for the oil-backed loan to Angola several times. , The latest extension occurred in September 2007. An additional US$2 billion loan between the Angolan Government and China Exim Bank was also negotiated[27]. The Angolan Ministry of Finance is currently managing a reported portfolio of over US$ 4.5 billion. Additional loans from China International Fund Ltd, a Hong Kong-based fund management company, have been placed under the auspices of *Gabinete de Reconstrucção Nacional*[28] (GRN), headed by General Helder Vieira Dias "Kopelipa". Kopelipa is also Minister in Chief of the Presidency. The GRN was created specially to manage the Chinese credit line and the large construction projects it was to finance. It is an instrument of the executive, as are the various other *gabinetes* created by the executive. The loans managed by GRN are estimated to be in excess of US$ 9 billion[29]. The result of such a structure is that the money from the PRC loan is centrally controlled by the Angolan Government executive. The NGO Global Witness has raised concerns about the transparency of the procurement process of GRN-managed construction tenders[30].

As the ChinaAngola financial agreement is in the form of an oil-backed loan, Chinese involvement in the Angolan economy is not considered direct investment in the traditional sense. However, a representative from the Angolan Chamber of Commerce and Industry suggested that the loan still involves capital risk through the potential for loan defaulting, as it is a sizeable sum that is being made available to a developing African country. The Chinese loan provides the means and momentum for Angola to finance the rebuilding of its infrastructure, which can be seen as a long-term investment in terms of business facilitation, especially where improvement in transport networks are concerned.

Another example of the barter system is evident in Gabon. The Gabonese Government officially awarded to the China National Machinery Equipment Import and Export Company (CEMEC) the sole rights to exploit the iron deposits in the Belinga region in September 2006. This project represents a substantial investment, estimated to bring in approximately 30 percent of Gabon's current GDP, at a value of US$ 3, 5 billion. It has an estimated initial capital requirement of US$590 million due to the required infrastructural investment to extract the iron ore. It has been announced that the project will get underway in early 2008 and reach completion in 2011.

In return, CEMEC committed to constructing a special purpose deep-water port at Santa Clara, a railway track running 560 km from Belinga to the coast and a hydro-electric power plant to facilitate the energy required for the operations. It is a long-term project, intended to endure for 15- 20 years, and will involve, not only the extraction of the iron ore, but the development of auxiliary products. This deal thus follows the "Angola Model" closely, as the iron ore reserves will be used as collateral, and Gabon will use it to pay for the substantial infrastructural investment.

The latest development in this emerging pattern is the US$ 5 billion loan China Exim bank announced with the Democratic Republic of Congo (DRC) in September 2007[31]. Informal sources suggest that Chinese investment in the DRC might already be several times higher than this figure[32]. US$ 3 billion of the aid package will be directed towards a 3,200 km railway link between 3,200km between Sakania, in resource-rich Katanga Province, near the Zambian border, to Matadi. Part of the financing will also fund road link of 3,500km linking Kisangani, north-east of Lubumbashi, the capital of Katanga province, Kasumbalesa. The balance of US$ 2 billion will be used to revitalize DRC's mining sector[33]. It was announced that the DRC would repay this loan through tolls to be imposed along the newly constructed roads once they are finished, but also, more importantly, through mining concessions. As the DRC's mineral wealth lies in deposits of cobalt, gold, uranium, diamonds, tantalum, copper and tin, the benefits for China of preferential access to such concessions is apparent[34]. The arrangement thus mirrors closely those negotiated in Angola and Gabon, whereby infrastructure is paid for by the fruits of these countries' extractive industries.

The Proposed 'Win-Win' Situation

Chinese diplomats have been careful to emphasise the mutual benefits of China's engagement with Africa; indeed this is one of the pillars of China's foreign policy approach toward the continent[35].

More Generous Loan Conditions

China's loans to Africa have more favourable terms and give the African governments more ownership over their expenditures. Western aid is more prescriptive and makes the fundamental error of bruising a country's sense of sovereignty. In this way, China has encroached on the IFIs traditional domain of influence and their potential control of domestic policy and affairs of debtor nations. It is the nature of the loan, with its very low interest rate and policy of domestic non-interference that makes the Chinese attractive lenders.

Dedicated infrastructure rehabilitation

The importance of infrastructural development for broader economic and social development is now widely acknowledged. This is evident for example in the establishment of the EU-Africa Partnership on Infrastructure that was launched on 13 July 2006[36]. China has not baulked at the massive investment in infrastructure required to extract Africa's last untouched reserves. The entry of competitive Chinese construction and telecommunications firms offers Africa cheaper access to infrastructure that is essential for economic growth. The products and services that Chinese companies offer, especially in terms of telecommunications and construction, are considerably less expensive than those of European or South African corporates. In the construction industry for instance, Chinese companies have been known to undercut the closest bidder by 25 percent[37]. This, in turn, has the potential to lower the cost of doing business in Africa and thus improve the African business environment.

Improved the Business Environment in Africa

Chinese firms are essentially beginning to redefine Africa's risk profile. Investment in Africa is traditionally seen as a commercially risky venture, given the often inhospitable business environment and political instability. Chinese companies are entering into African economies through the contracts made available to them through concessional loans. They are appearing to adapt to the African environment more readily than traditional market-players and are quickly stimulating renewed interest in African markets.

The Chinese Government has adopted a long-term view of its business forays in Africa. This longer term vision of commercial engagement also quantifies risk in a different manner to traditional investors. Chinese companies are often perceived to be less cognizant of risk when investing in Africa; however, this is not necessarily true. Chinese state-supported investors and state-owned companies are simply afforded a longer time-period in order to allow their investment to be realised. China's "state capital" approach to engagement, through the likes of China Exim Bank, is answerable to political stakeholders, not private or institutional shareholders.

Energy Security

While certainly not the only reason[38], one of the most important motives for Chinese commercial forays into Africa is the growing need for raw materials and oil to feed China's burgeoning economy. China became a net oil importer in 1993, and it was ranked as the second largest oil importer after the US in 2004[39]. China currently imports 28 percent of its oil from Africa, primarily from Sudan, Congo, Angola and Nigeria[40]. Particularly due to its strategic importance for economic growth, the procurement of secure oil supplies are a principal national interest and form a fundamental part of China's foreign policy. All China's oil companies are state-owned, and have worked in close concert with China's Exim Bank in several key African oil acquisitions, in countries such as Nigeria, Angola and Sudan.

The state-directed nature of Chinese engagement in Africa results in "coalition investment"[41] across various sectors. This is evident in several African countries where Chinese companies work on projects spanning construction and extractive industries, such as in Angola, Gabon and Zambia, which endows Chinese companies with a competitive advantage that its traditional competitors do not enjoy, particularly if they are backed by Chinese government concessional loans.

The Need for New Markets

Decades of an industrially-led command economy have resulted in gross oversupply in many sectors in China's domestic market, driving down prices. In addition, regional competition between companies is consequently so fierce that products sold but not made in any given province are heavily taxed. Expansion into international markets provides more scope for a product to attain greater market distribution and added value, with fewer tax obligations[42]. It also stimulates foreign demand for products substantially cheaper than the global average. The need to find new markets for products has become a matter of survival for many Chinese companies.

Resource-rich African countries, for their part, have been experiencing the highest rates of economic growth in several decades, fuelled in no small part by China's appetite for African oil and raw materials[43]. Consequently, African consumer markets appear promising, and it is ensured that a fair portion of the loan money returns to China's domestic economy, while alleviating pressure on a surplus capacity domestic economy. The use of aid facilitates access into Africa's markets for Chinese companies and products[44].

In addition, the development of transport infrastructure will also assist with a wider market distribution of Chinese imported goods. Heavy investment by Chinese companies in the telecommunications infrastructure in countries as Angola and Uganda, oil pipe lines from southern Sudan to Port Sudan on the Red Sea coast, electric power lines, massive irrigation and hydroelectric power systems, along with procurement, supply and distribution networks across the continent can be expected to have a significant impact in reducing the cost of producing and transporting products. Thus, Chinese investment in road and railway systems such as the Benguela, Tanzara and Belinga railways is of strategic importance in providing Chinese products market access.

The Effects on the International Donor Community

China's increasing role as a donor and financier for Africa has implications for the donor community and the diminishing leverage they have on enforcing policies of governmental transparency. The emergence of China as an alternative source of funding has been particularly welcome, considering the paucity of options available to the African governments and the urgency with which such funds are required.

Despite collaborating with the World Bank on several other smaller projects, China prefers to go it alone on the big loans, which are normally linked to securing natural resources. The World Bank offered assistance for the Belinga project to the Gabonese government in the forms of a cross-sectoral package of expertise, but was turned down. World Bank also offered to be a middle-man and possibly even as a co-funder for CEMEC and was also turned down, despite the expertise that World Bank might be able to offer[45].

Many donor institutions are voicing concerns that any leverage they possess vis-à-vis African governments is being rapidly eroded by the arrival of substantial concessional loans from China, with few conditions. China regularly reaffirms its commitment to the delivery of bilateral assistance compatible with the means at its disposal. Focused on 'mutual prosperity'[46], China proclaims to have no interest in the domestic affairs of African states and this can be very attractive.

Increased Leverage of Africa

The shifting global dynamics and the rise in commodities prices offers African countries greater leverage vis-à-vis global commodity markets and traditional development partners. The increased competition for Africa's resources could strengthen the bidding between prospective investors. This would allow African governments be more assertive, and discerning, in securing more favourable concession agreements for their countries' development. Several African governments, such as that of Angola, are already using China's interest in their oil reserves to diversify investment in the national economy.

Where to from here?

Alongside the opportunities, however, are several challenges. The success of the Chinese firms, which have entered Africa through concessional loan agreements, while instrumental in the rapid development of Africa's essential infrastructure, is also at the expense of local fledgling industries which cannot compete.

The key lies in the hands of African policy-makers to take advantage of this opportunity to boost economic growth. Generally speaking Africa lacks institutional regulatory frameworks and government capacity to monitor and encourage direct investment in terms of local skills development and technology transfer. The conditions under which foreign companies enter African markets should be re-examined in order to cultivate and harness the development of local companies and/or small and medium enterprises (SMEs), while they can still play the natural resources card.

An additional challenge is the question of whether the African Governments have ownership of the infrastructure development process. This is in view of the fact that at least 50 percent of the contracts funded by the loan money goes to Chinese companies, in addition to the original loan, which will also be paid back to China Exim Bank. Furthermore, once these large-scale projects have been completed, the question of their maintenance arises. Either the Chinese companies must be kept on at additional expense or the project is handed over to the local authorities with the risk of it falling into disuse over time through a lack of funds and/or skills and technological know-how.

Conclusion

The Chinese Government's long-term strategic outlook on engagement with Africa has the potential to benefit both African countries and Chinese commercial interests.

Through the structure of China Exim Bank's concessional loans, substantial funding has been allocated to refurbishing and constructing infrastructure networks in many African countries. It is evident that that much of such financing directed at infrastructure is located strategically in resource-rich countries. This will better facilitate the extraction of African minerals China requires to fuel its domestic growth. The international donor community has raised concerns as to the process of such arrangements, particularly in terms of prospects for transparency in the extractive industries.

Nevertheless, China's rising profile as a donor in Africa has placed infrastructure firmly on the developmental agenda. This is particularly in war-ravaged countries such as Angola and DRC, which, while resource rich, are very under-developed and need such infrastructure to revitalise their national economies.

China is a state actor driven by national interest, and it is important for African states to harness growing commercial and political ties with China is order to leverage them for sustainable domestic growth. Forgoing the temptation of rapidly delivered Chinese turn-key projects, African governments need to lay claim to ownership of their development process. This can be done by using the leverage afforded by rising commodity prices to negotiate more participation by the African private sector in these construction deals. The formulation of legislation and regulatory frameworks enforcing joint-ventures and the employment of local labour will help technology transferral and facilitate economic knock-on effects in related industries.

African governments need to channel the windfall revenues from export commodities into developing local capacity to ensure that the opportunity for infrastructural and economic rejuvenation is seized. Policy frameworks to facilitate the emergence of a private sector that can stimulate economic diversification are required, rather than maintaining a state-led economy reliant on a single export commodity. China's long-term approach to commercial engagement in Africa must therefore be matched by African governments in order for developmental challenges to be tackled and sustainably addressed.

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African Forum and Network on Debit and Evelopment
31 Atkinson Drive, Hillside
PO Box Cy1517, Causeway, Harare, Zimbabwe
Tel: +263 4 778531/6, Fax: +263 4 747878
Email: afrodad@afrodad.co.zw
Website: www.afrodad.org