Europe China Research and Advice Network (ECRAN)

2010/256-524

Short Term Policy Brief 78

China's Views of Aid and Export Credits

January 2014

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This project is funded by the European Union

This project is implemented by a Consortium led by Steinbeis GmbH & Co. KG für Technologietransfer

Background Briefing: Chinese Views of Aid and Export Credits

Scope of this review

This paper will address the following questions:

- What is distinctive about Chinese views on aid? What is the current Chinese thinking on the post-MDG and post-2015 agenda? How has China's involvement in global forums on development evolved?
- Does China have a unified and coherent approach to aid, and which players and the decisions makers are most closely involved? What is the role of export credits and conditional loans? To what extent do government agencies control and approve state-owned and private companies' ways of doing business in developing countries?
- What scope is there for the European Union and China to work more closely with regard to aid? To what extent would China be open to engage in 'triangular' cooperation in developing countries and under what conditions? What is the likely impact of China's aid programme on European companies operating in developing countries?

Chinese views on aid

Traditional donors who subscribe to the Paris Principles agreed upon by the OECD's Development Assistance Committee (DAC) describe China as an "emerging" donor. While it is also widely used within the burgeoning literature in China on development assistance, the label "emerging" is problematic for several reasons - not least because China has been a development partner of many African countries since the 1950s. Yet the distinction matters, because it informs the way Chinese policy makers and aid practitioners think about how China does development assistance (Zhu 2013). As a developing country, China sees itself as a provider of "South-South Development Cooperation" (SSDC), a concept that has had currency within the United Nations since the launch of the Buenos Aires Plan of Action in 1978.

Providers of SSDC aid like China and traditional DAC donors differ in their interpretation of the Paris Principles. A useful starting point is **Table 1** below, proposed by Park (2011), although many of the distinctions are contentious. For example, bilateral relationships still dominate the aid system overall, even on the part of traditional donors. Similarly, much engagement with multilateral organizations reflects reduced technical capacity and reduced appetite for risk on the part of traditional donors, rather than a strong commitment to multilateralism. Indeed, the recent drop in international aid from DAC donors (by 4% in real terms over 2012) was due to large reductions in multilateral support—bilateral aid actually rose by two percent. Nor is the primacy of mutual benefit limited to emerging donors. Slogans such as "aid for trade" are gaining currency among the aid agencies of many DAC members, and there is a growing trend for aid agencies to be incorporated into foreign ministries, to better serve the national interest.[1]

[1] Recent examples include Canada, Australia and New Zealand.

Table 1 Divergent interpretations of Paris principles

Principles	DAC members	SSDC providers
Ownership	National development strategy (or Poverty Reduction Strategy Papers, PRSPs) outlines priority areas for donors, built up from technical discussion	Ministers/senior officials articulate specific projects for cooperation through high-level political dialogue
Alignment	Use and strengthen recipient institutions and procedures, where feasible. Tying of aid discouraged	Delivery of turnkey projects in short run; capacity building as long term strategy. Tying permissible and widely used
Harmonization	Use common arrangements to minimize burden on recipients. Multilateralism of aid encouraged in all instances	Minimize burden by avoiding cumbersome bureaucratic processes altogether. Occasional use of multilateral system where judged to be in interest
Managing for results	Use recipient-led performance assessment frameworks and support results-based budgeting. Promote international best practice	Focus on delivering aid quickly and at low cost. Use own development experiences and 'how-to' knowledge
Mutual accountability	Make aid transparent and hold accountable to Paris commitments via targets and indicators	Ensure that aid is mutually beneficial. Agree to fully respect each others' sovereignty and eschew policy conditionality

Beyond such inherently problematic distinctions between traditional donors and SSDC providers, some clues as to the post-2015 direction of China's aid program can be gained by reading the work of well-connected economists and policy researchers. China's second **White Paper on Foreign Aid** was due to be released by the State Council in late 2013 (the first was released in 2011), but regardless of the delay, the message from well-connected aid researchers is that China is aiming to make its aid interventions better targeted, better coordinated, and more effective. For example, Zhu Dandan, from Xiamen University's College of Economics, home to China's leading centre for development studies research, recommends the establishment of a separate organization for aid management and coordination, the drawing up of short- to medium-term regional and country plans (a process that will begin in 2014), the establishment of an external committee for the monitoring and evaluation of the aid program (drawn from universities, aid experts, and civil organizations), and a greater role for NGOs. The first of Zhu's recommendations is sure to be adopted and this will mark a significant shift in China's approach to aid. This will be the first time China has employed regional and country plans for its aid program. They are likely to be three- to five-year plans.

Mao Xiaojing, the deputy director of the Chinese Academy of International Trade and Cooperation (CAITEC, a think tank directly under the Ministry of Commerce, charged with providing research and advice on aid and trade matters) has flagged a few ways in which Chinese aid may shift. While there is little interest in following recent trends in aid provision, such as budget support, Mao suggests there is concern that China's project-based approach (turnkey projects account for 40% of aid) leads to incoherency, and she confirms the Chinese government's intent to provide a higher proportion of grant-based and multilateral development assistance. She also commends sector program assistance as a way for China to "cooperate with specific ministries to provide support, develop plans, and on this basis put forward relevant projects, so that the projects will be complementary, and aid effectiveness will be improved" (Mao 2012, p. 91).

China's Approach to Aid

China's approach to aid is underpinned by both the **Bandung Principles**, announced during the 1955 African-Asian conference in Bandung, and the **Eight Principles of China's Economic Aid and Technical Assistance to Foreign Countries**, outlined by then Premier Zhou Enlai in 1964. These principles, which are still followed to this day, are:

(1) Equality and mutual benefit
(2) No interference in internal affairs, no conditions attached
(3) Interest-free or low interest loans which are readily rescheduled
(4) Self-reliance, not dependency
(5) Low cost, rapid construction with quick results and income generation
(6) Use quality, cost-competitive equipment of Chinese origin
(7) Maximize skill transfer through technical assistance
(8) Chinese experts live at the standard of local experts; no special treatment

In April 2011, the State Council released the first **White Paper on China's Foreign Aid**,[2] which reemphasized the principles of encouraging self-development, imposing no political conditions, adhering to equality, mutual benefit and common development, but also to "keep pace with the times" and look for "reform and innovation." The paper also made available, for the first time, official figures on the cumulative amount of foreign aid provided since the founding of the People's Republic of China. Up until the end of 2009, a total of 256.29 billion RMB (€30.78 billion) in aid, with 106.2 billion RMB (€12.75 billion) in grants, 76.54 billion RMB (€9.19 billion) in interest-free loans and 73.55 billion RMB (€8.83 billion) in concessional loans. As US development expert Deborah Brautigam has noted, matching up China's calculations of foreign aid with the DAC definitions of aid is problematic.[3] For example, in contrast to DAC practice, China includes military aid in its development assistance figures, but does not include scholarships or debt relief. Moreover, it only counts the subsidized portion of its concessional loans as aid, rather than the full face value of the loans. The best estimate of the UNDP is that China provided $4.35 billion in "ODA equivalent/concessional assistance" in 2012 (Tomlinson 2013, p. 23).

As researchers such as Philippa Brant and Lucy Corkin have noted, the apparatus that delivers Chinese development assistance is complex and grounded in domestic priorities, which range from rivalries between ministries or contracting companies, to larger imperatives such as the need to support economic growth and employment. The delivery of China's aid program is the outcome of negotiation – both formal and informal – between

[2] Full text is available at http://news.xinhuanet.com/english2010/china/2011-04/21/c_13839683.htm
[3] See also Brautigam's blog, *China in Africa: the real story*, for insightful posts on the myths about Chinese aid perpetuated by Western and Chinese sources. Available at http://www.chinaafricarealstory.com

central and provincial government agencies, contracting companies, and policy banks. This reflects the situation in many other areas of policy.

Government agencies

The department primarily responsible for delivering Chinese aid is the Ministry of Commerce’s (MOFCOM) *Department of Foreign Aid*. This department, which is responsible for coordinating the aid program, has less than 100 staff, and has no in-country presence. Delivery of the aid program falls to the *economic counselor’s office*, housed either within the embassy or in larger missions in a separate office. The limited resources of this office are not dedicated to development assistance; much of their energy goes towards investment and trade matters. The impact of this structure is to make aid subordinate to economic and diplomatic interests, a substantial difference from the stated (if not always practised) EU approach to development assistance.

The *Ministry of Foreign Affairs* (MFA) receives requests from host countries, and influences the strategic aspects of aid at a central government level. The ambassador in each country has a small grants program at their disposal, but these grants must also be approved by MOFCOM. In smaller missions, MOFCOM and MFA staff work closely together, while in larger missions they operate relatively independently. Tensions are most acute in medium-scale missions, where lines of decision-making and responsibility are less clear-cut. *Line ministries* associated with social infrastructure and training (such as education, agriculture and health) administer their own programs. The *Ministry of Finance* is responsible for debt relief and multilateral aid. In the past, it provided the interest rate subsidy for China Exim Bank’s concessional loans, but Exim Bank now covers this through its own profits.

Contracting companies

Chinese aid follows a similar decentralized pattern to Japanese aid in the 1970s and 1980s, where companies in the partner nation identify potential projects in collaboration with local partners, and then feed the information back to their headquarters, which will then lobby informally and bid for the projects when they are announced. In smaller nations, a few (or sometimes just one) companies tend to dominate aid delivery. In larger countries, where economies of scale are available, competition between contractors can be fierce. Contractors are not allowed to manage more than three grant aid projects in one country, but there is no upper limit on the number of concessional loan projects they can undertake. Winning the bid for an aid project in a country can often be the first step in a regional expansion plan for these companies. They often go on to bid for projects funded by multilateral institutions such as the World Bank or the African Development Bank, and compete with local and multinational companies in the commercial construction sector.

Policy banks

These institutions are wholly owned by China’s Ministry of Finance. China’s concessional loans are delivered by *China Exim Bank*, but this only makes up a small percentage of its loan portfolio, perhaps around three percent, according to a Standard & Poor’s report from 2006. Export buyers’ credits (for a borrowing country) and export sellers’ credits (short term credits for Chinese companies) are often offered alongside concessional loans for a specific project. It has only three offshore branches, in Paris, St. Petersburg and Johannesburg, limiting its capacity for monitoring and evaluation. It relies heavily on in-country advice from the economic counselor's office and the contracting companies.

Despite its name, *China Development Bank* (CDB) does not engage in concessional lending, but it is even more active than Exim Bank in supporting the entry of Chinese companies into developing countries' markets, offering substantial lines of credit. In terms of total assets, CDB is five times larger than China Exim Bank (Standard & Poor's 2013). A recent study of CDB found that the lines of credit offered by the company to national champions such as Huawei, Sinohydro or the national oil companies are crucial, because they allow them "to get cheaper working capital loans from commercial banks. The United States simply does not have a government owned bank of similar scale or assets" (Sanderson and Forsythe 2013, p. 153).

While under the Paris principles, grants are the preferred mode of aid delivery, it should not be assumed that concessional loans automatically lead to worse development outcomes than grants, particularly for infrastructure projects. Where a project is funded by a concessional loan, the recipient country has greater leverage in the application of building standards, procurement processes, and the use of local labour.

Recent writings by policy researchers suggest the emphasis on using aid as a tool to enable trade and investment is unlikely to change. A recent paper (Huang and Liu 2013, pp. 65-66) in China's most influential development studies journal argued that Chinese aid could:

(1) Directly promote the export of Chinese products;
(2) Promote imports of raw materials from the recipient countries;
(3) Expand overseas markets for Chinese enterprises.

The Chinese central government and many Western journalists often present a common fiction: that the Chinese central government has a high degree of influence over Chinese companies operating overseas. In reality, in-country Chinese companies exercise considerable influence over government policy, whether in the delivery of aid projects, or in the establishment of special economic zones.

Debates around resource security are skillfully utilized by such in-country companies to secure preferential treatment from the Chinese government, whether they are state-owned enterprises in the Papua New Guinea mining industry (Smith 2013), national oil companies in the Kazakh oil sector (McCarthy 2013), or private agribusiness concerns in Myanmar (Kramer and Woods 2012). In the case of small-scale private traders, who dominate the retail and wholesale sectors in many developing nations, the attitude of Chinese central and provincial government agencies responsible for their welfare varies between indifference, exasperation, and contempt.

Potential for collaboration between EU and China

It should not be assumed that all actors in the recipient country believe that closer cooperation, or even coordination, between China and EU countries is a positive development. Nor should it be assumed that such demand exists on the part of the host government. However, many writers have noted that traditional and emerging donors can be complementary—traditional donors have moved away from physical infrastructure and production towards institution building and social infrastructure, such as education and health. Emerging donors, especially China, are able to fill the gap in meeting infrastructure and productive needs in a less bureaucratic manner.

Aside from complementarities, the arrival of emerging donors has given many partner countries a greater degree of leverage over traditional donors and genuine ownership of their domestic development agenda. The views of Kenya's ambassador to China, Julius Ole Sunkuli, on the proposed dialogue on US-China development cooperation are instructive. A leaked US embassy cable describes his views as follows (Wikileaks 2010):

> "Sunkuli claimed that Africa was better off thanks to China's practical, bilateral approach to development assistance and was concerned that this would be changed by Western interference. He said he saw no concrete benefit for Africa in even minimal cooperation. Sunkuli said Africans were frustrated by Western insistence on capacity building, which translated, in his eyes, into conferences and seminars. They instead preferred China's focus on infrastructure and tangible projects. He also worried that Africa would lose the benefit of having some leverage to negotiate with their donors if their development partners joined forces".

As a minister in a Pacific country put it recently, when I raised the prospect of Australia and China cooperating closely on aid projects, "I'm thankful that you've come to me at this stage, not earlier, otherwise they wouldn't have done what they have done. We wouldn't have gotten our hospital."

It is likely that trilateral cooperation between China and the EU will be more welcomed by some sections of the host country governments than others. Ministries responsible for aid coordination (such as Finance or Treasury), that gain leverage by EU donors linking aid funding to areas such as public financial management reform, can be expected to welcome greater cooperation and coordination. This may not be the case for senior officials or ministries that are strengthened by China's direct, government-to-government approach (such as Foreign Affairs or Commerce), or line ministers responsible for the areas where China's aid spending is targeted, such as infrastructure, education, and health.

Many researchers have questioned the value and prospects of triangular cooperation, noting that even 'traditional' donors with similar views on how to approach development assistance have struggled to cooperate, or even coordinate their activities (Chandy and Kharas 2011). As a starting point, Chinese and EU actors could look to:

- Low-cost avenues for furthering aid coordination between EU and Chinese donors in country;
- Enhancing the sharing of information on aid activities with partner countries;
- Possibilities to support technical exchange, particularly in agriculture, science and technology, and health between China, EU and the recipient countries;
- Potential infrastructure projects for triangular cooperation.

In the context of EU donors seeking greater 'value for money' from development assistance after the global financial crisis, there is scope for EU actors to share their experiences with China through multilateral organizations such as the UNDP. This engagement can occur either in the recipient country, in regional centers, or in Beijing. It might involve providing advice on how China could shift their aid towards program sector assistance rather than one-off projects, thus achieving more coherence and effectiveness in their aid program. China also faces new domestic pressures to achieve outcomes with the Chinese public starting to question the value of the central state supporting overseas aid and investment, particularly in countries with a higher GDP per capita than China.

From the perspective of EU companies operating in developing countries, the impact of China's aid program will depend on which sector they are active in. Impacts are likely to be greatest on those operating in economic infrastructure and construction. At present, the targeting of concessional loans in a given country is difficult to predict, as China is highly responsive to requests from host governments, whose needs shift over time, and may also be influenced by the electoral cycle.

Chinese companies do pose a challenge to EU companies in the infrastructure sector. They enjoy an edge in the cost of labour and construction materials and have a reputation for finishing projects ahead of schedule. It should not, however, be assumed that *all* Chinese companies will be averse to working with EU companies on construction projects. As a recent Transparency International survey of 100 emerging market companies indicated, there is immense variation among Chinese companies in terms of organizational transparency and anti-corruption activities. Many Chinese companies lack international experience, requiring new management and technical skills to move up the value chain. Partnering with a European company with a long history in the host country offers advantages. Trilateral projects provide a framework for such cooperation to occur and may lead to opportunities in other developing nations or reduce barriers to entry in the Chinese domestic construction sector.

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