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Comparing the Determinants of Western and Chinese Development Finance Flows to Africa

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POLICY POINTS

Western countries should consider the extent to which their development finance is disproportionately allocated to former colonies.

Western countries should become more responsive to receiving countries' economic needs in allocating development finance.

China should seek to untie its development finance allocation from its commercial and political strategic interests.

China should attempt to realign some of its development finance loans towards poorer countries.

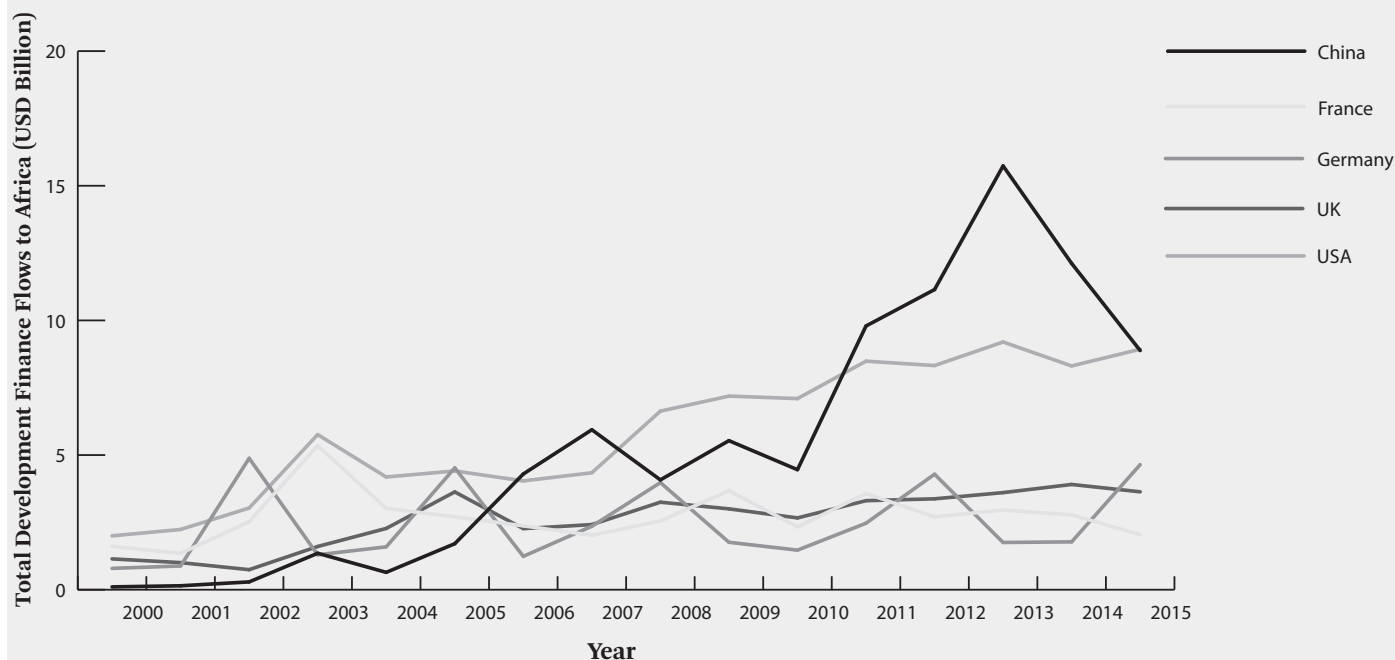
Comparing the Determinants of Western and Chinese Development Finance Flows to Africa

David G. Landry

CHINA ROSE TO PROMINENCE IN THE GLOBAL ECONOMY with breakneck speed in recent decades. Its increasing role in the arenas of international trade and foreign investment has been accompanied by a growing development finance agenda. In 2000, China's annual development finance to Africa totaled US\$121 million and was distributed among a handful of countries. By 2013, it had grown to well over US\$16 billion—a figure comparable to those of the largest western development finance providers (see Figure 1).

As China's development finance portfolio grew, the west paid increasing attention to the quality of governance in the developing world and how they relate to economic development. More specifically, issues like corruption controls, democratic development, and respect for human rights all became a more integral part of western countries' foreign policy agendas. This increasing focus on governance development has also been featured prominently in western countries' development programming. For example, the USAID website states: "we are integrating democracy programming throughout our core development work, focusing on strengthening and promoting human rights, accountable and transparent governance, and an independent and politically active civil society across all our work."¹

Many have hypothesized that China's growing economic and political footprint is undermining the west's drive to promote good governance in developing countries—and in Africa in particular—by predominantly engaging with countries ruled through corruption, autocracy, and despotism. According to much of the conventional thinking on the matter, China's engagement abroad not only disregards governance issues, but undermines the west's efforts to tackle them. A slew of reporting documents how Chinese commercial actors and Chinese policy banks—the two often being conflated—operate. Headlines like "China in Africa: Investment or Exploitation" reported by al Jazeera and "China in Africa: The New Imperialists?" in *The New Yorker* are commonplace.² In a hugely influential piece, Moises Naím refers to Chinese aid as "rogue aid."³ He states: "It is development assistance that is nondemocratic in origin and nontransparent in practice; its effect is typically to stifle real progress while hurting average citizens." Furthermore, China has been accused of distributing development finance to further its own strategic and economic interests, rather than to benefit the recipients of its money.

Figure 1: Total Development Finance Flows to Africa, by country (2000-2015)

French states: “Contracts are greased with monetary bribes and other enticements like expense-paid shopping trips to China and scholarships there for elite children. Adding to the opacity, China typically favors its state-owned companies for African projects and bypasses open, competitive bidding procedures.”⁴

The working paper associated with this policy brief tests these narratives by asking the following questions: (1) What impacts do African countries’ governance levels, resource endowment, and economic development, as well as their trade ties and political alignment with sending countries, have on the development finance they receive? (2) Do these factors impact China and western countries’ development finance differently? (3) Are some governance indicators more important than others in predicting China and the west’s development finance? To answer these questions, it explores whether various governance indicators among African countries impact the development finance they can secure from China and western countries differently. It is the first work to explicitly compare the determinants of the value of Chinese and western development finance. It employs panel country-level development finance flows data for 2000 to 2015 as an outcome variable.⁵ The impact of governance, natural resources, receiving countries’ needs, bilateral trade ties, and political alignment on development finance is tested through gravity models. The models control for various economic, political, and geographic factors, and for whether the sending

country is China. All the models are estimated using fixed effects reflecting the sending country, the receiving country, and the year captured by the data.

The working paper finds that the overall governance quality of African countries plays a positive role in predicting the development finance they receive from the west. That said, in terms of the impacts of specific governance indicators, only political stability has a statistically significant effect on western development finance. Surprisingly, neither political alignment nor bilateral trade play a statistically significant role in predicting western development finance. This finding contradicts many earlier works on this topic.⁵ This might be due to the fact that the data used in this paper is relatively recent—it only dates back to 2000—which would suggest that the importance of the strategic and commercial considerations identified by previous works as key determinants of western development finance flows has diminished. That said, a more likely scenario is that political alignment and bilateral trade’s lack of statistical significance in predicting western development finance is due to inclusion of colonial and language dummy variables in the models.

The working paper also finds that governance quality plays a much stronger role in predicting western development finance than that of China. More specifically, western countries send more development finance than China to African countries with lower corruption levels and a better human rights track record.

That said, it also finds that, in absolute terms, China does not send more development finance to African countries with worse governance outcomes. In other words, China simply appears to disregard governance quality in its allocation of development finance. Additionally, bilateral trade relations and UN voting alignment have a stronger impact on China's development finance than that of western countries, and China allocates more development finance than the west to richer African countries. In other words, China favors its economic and political partners more than the west in allocating development finance and does not take receiving countries' level of needs into account as much as they do. The latter is likely due to loan repayment considerations, as China's policy banks expect to have their loans reimbursed. Finally, colonial ties—which only apply to the western countries sample—play a very large role in predicting development finance flows to Africa.

Brautigam presents a useful taxonomy of factors that shape China's foreign aid. First, the policy principle of non-interference, crafted in the 1950s, still plays an important role in shaping China's foreign aid.⁶ Second, China's very notion of development—which is informed by its decades-long experience as a revolutionary communist country—differs fundamentally from that of western countries, with important implications for its aid. Third, the fact that China has long been—and still is—an aid recipient shapes its own foreign aid agenda. As a sending country, it mimics many of the deals it received when it was on the other side of the aid relationship. Finally, over time, China's aid has become an economic instrument its leaders can employ to support its own firms' exports and, in turn, its domestic development.

The first and fourth factors listed by Brautigam are particularly helpful when contextualizing the findings of this paper. As the principle of non-interference would suggest, receiving countries' aggregate levels of governance development have virtually no impact on China's development finance. This is consistent with existing literature on the determinants of China's development finance, which also find that governance do not seem to impact China's development finance flows.⁷ This paper also supports Brautigam's assertion that China's aid has become an economic instrument to support Chinese firms' exports. It finds that bilateral trade plays a positive, statistically significant, role in predicting China's development finance to African countries, as does political alignment. This suggests that Chinese loans are not only a tool of commercial promotion, but also a means to support Chinese foreign policy.

The ways in which Chinese and western actors engage with other countries, and particularly in Africa, are widely perceived to be at odds. This leads to reporting in the media, non-governmental organizations, and government agencies that lacks empirical grounding and often propagates exaggerations. For these reasons, systematically and accurately investigating how the respective approaches of China and the west with regards to development finance differ represents an important line of scholarship. While the working paper finds that governance quality plays a greater role in predicting western countries' allocation of development finance than that of China, it does not find evidence to support the common assertion that China is directly undermining countries' governance development through its development finance. Rather, China simply appears to allocate development finance without taking the governance environment of receiving countries into account. The working paper also finds that bilateral commercial and political ties have a significantly greater impact on China's development finance than on that of western countries, and that China allocates more development finance to richer African countries than the west. Interestingly, the determinants of China's development finance patterns today have important parallels to those of western countries not so long ago, as indicated by the literature review section of the working paper. Therefore, it is entirely possible that the determinants of China's development finance could change going forward, just like those of western countries' have.

Comparing this working paper's findings to those of earlier pieces of literature reveals clear signs of progress in terms of how western countries allocate development finance. That said, further progress is needed—specifically in terms of how development finance responds to receiving countries' levels of need. This research also points to links between the types of governance African countries aim to foster and the development finance they are able to secure as a result. It suggests that sustaining better governance structures—and corruption controls and political stability in particular—will lead to greater development finance inflows from western countries. Finally, this paper suggests that, if China wants to be viewed as a responsible provider of development finance—and if it wishes to maximize the impact of its development finance in Africa—it should seek to untie its development finance allocation from its commercial and political strategic interests and to better target receiving countries on the basis of need.

POLICY RECOMMENDATIONS

THIS RESEARCH HAS IMPORTANT POLICY IMPLICATIONS:

1. Western countries should consider the extent to which their development finance is disproportionately allocated to former colonies and, more broadly, countries with which they share a common language.
2. Western countries should become more responsive to receiving countries' economic needs in allocating development finance—in other words, they should seek to do a better job of targeting poorer countries.
3. To be perceived as a more responsible donor, China should seek to untie its development finance allocation from its commercial and political strategic interests.
4. China should attempt to realign some of its development finance loans towards poorer countries—as richer African countries currently receive a disproportionate share of its development finance. ★

3. Moises Naím, “Rogue Aid,” *Foreign Policy* 159, (2007): 95-96.
4. Howard W. French, “Into Africa: China's Wild Rush,” *New York Times*, May 16, 2014, http://www.nytimes.com/2014/05/17/opinion/into-africa-chinas-wild-rush.html?_r=0.
5. Alberto Alesina and David Dollar, “Who Gives Foreign Aid to Whom and Why?” *Journal of Economic Growth* 5, no. 1 (2000): 33-63; Jean-Claude Berthélemy, “Bilateral Donors' Interest vs. Recipients' Development Motives in Aid Allocation: Do all Donors Behave the Same?” *Review of Development Economics* 10, no. 2 (2006): 192; Craig Burnside and David Dollar, “Aid, Policies, and Growth: Revisiting the Evidence,” World Bank, Working Paper No. 2834, 2004; see working paper for full list .
6. Deborah Brautigam, *The Dragon's Gift: The Real Story of China in Africa* (Oxford, UK: Oxford University Press, 2009).
7. Axel Dreher and Andreas Fuchs, “Rogue Aid? An Empirical Analysis of China's Aid Allocation,” *Canadian Journal of Economics* 48, no. 3 (2015): 988-1023; Axel Dreher, Andreas Fuchs, Brad Parks, Austin M. Strange, and Michael J Tierney, “Apples and Dragon Fruits: The Determinants of Aid and Other Forms of State Financing from China to Africa,” *International Studies Quarterly* 62, no. 1 (March 2018): 182-194.

ENDNOTES

1. “Democracy, Human Rights, and Governance,” USAID, 2016, <https://www.usaid.gov/what-we-do/democracy-human-rights-and-governance>.
2. “China in Africa: investment or exploitation?” *Al Jazeera*, May 4, 2014, <https://www.aljazeera.com/programmes/insidestory/2014/05/china-africa-investment-exploitation-201454154158396626.html>; Alexis Okeowo, “China in Africa: the New Imperialists?” *The New Yorker*, Jun. 12, 2013, <https://www.newyorker.com/news/news-desk/china-in-africa-the-new-imperialists>.

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