No strings

Why developing countries like doing business with China

CONGO'S experience of China is fairly typical of most resource-rich but otherwise poor countries. For both Africa and Latin America, China is still only the third-biggest trading partner, after the United States and the European Union-although its trade with both continents is growing very fast. In terms of investment, China ranks even lower.

The only countries where China has become the pre-eminent ally and commercial partner are those that have been ostracised by the West, such as Myanmar and Sudan. In both places China's diplomatic support and investment has made it easier for nasty regimes to defy international pressure. And in both places China's payoff comes in the form of natural resources.

Chinese firms have invested $15 billion in Sudan since 1996, largely in the oil industry. That has allowed the country to raise its production from almost nothing to over 500,000 b/d, hugely boosting government revenue. The arrangement has been particularly beneficial for Sudan because American sanctions in place since 1997 have kept some of the biggest international oil companies out of the country. But it has also been a boon for China because Sudan is one of the few foreign countries where China National Petroleum Corporation (CNPC) has been able to buy a big stake in some prolific oilfields and been allowed to manage them directly (see box, next page). Some 10% of China's oil imports now come from Sudan.

That has given China an incentive to reject sanctions on Sudan whenever they have been proposed in the UN Security Council. The oil revenue, meanwhile, has provided the Sudanese government with the cash to wage war. In fact, Chinese firms have gone further and built arms factories in Sudan, which have proved particularly handy since the UN imposed an arms embargo in 2004.

Myanmar is a source of timber, gems and food for China. If all goes according to plan, it will soon serve as a transit route for oil from the Indian Ocean to southern China, providing an alternative to the crowded Singapore Strait. Myanmar is also said to play host to a Chinese military surveillance station which provides critical intelligence on India. Myanmar's military junta, in return, can count on China to defend it against other countries. Last year, when it began shooting at protesters, China vetoed the sanctions that America proposed in the Security Council.

But the West was at loggerheads with Sudan and Myanmar long before China developed its appetite for natural resources. Chinese diplomats say they did not cause the abuses that Westerners are complaining about, so should not be held responsible for dealing with them. China has not been the only country to break ranks: Malaysia's and India's state-owned oil companies also have investments in Myanmar and Sudan. Russia, for its part, vetoed America's bid to impose sanctions on Myanmar last year, and Thailand buys Myanmar's natural gas.

China is not just cultivating these countries so that it can lay its hands on their natural resources. He Wenping, of the Chinese Academy of Social Sciences, says it also wants to counter Taiwan's efforts to win diplomatic recognition and to garner support in bodies such as the World Trade Organisation and the United Nations. Encouragingly, that seems to suggest that China is trying to bolster its position within existing international institutions, rather than to create rival networks of disaffected pariah states.

As a repressive regime itself, the Chinese government clearly has an interest in advancing the principle that outsiders should not interfere in the affairs of other countries, however repressive their regimes. But as China's international ties become more complicated, argues Chris Alden of the London School of Economics, Chinese diplomats are beginning to moderate their reflexive stand against interference. Wen Jiabao, China's prime minister, has called for democracy in Myanmar. China has also changed its stance on Sudan as international outrage about events in Darfur has grown and activists have branded the Beijing games as "the genocide Olympics". Last year China helped to persuade Sudan to admit UN peacekeepers-a move it had long resisted, with China's blessing. China has even sent troops of its own to join the UN force.

Play by the rules

At the same time resource-rich countries are becoming more demanding. In 2006 the government of Gabon, having discovered that Sinopec, another Chinese state-owned oil firm, did not have the required environmental permits, ordered it to halt a big drilling project in a national park. Peru has fined Shougang Group several times for abuses of labour law and breaches of its initial investment contract. The government of the Philippines has suspended a Chinese firm's $3.8 billion scheme to grow grain for export after a series of Chinese in- »

Intrepid explorers

China's mining and oil firms pop up everywhere

DO CHINA'S state-owned mining and oil firms have an unfair advantage over their Western rivals? They certainly have deep pockets: in 2006, for example, Sinopec, one of China's three big state-owned oil firms, raised eyebrows when it offered a record price—over $2 billion—for the right to explore for oil in three parcels of Angola's territorial waters. In 2005 one of the others, CNOOC, lined up billions of dollars in cheap loans from state-owned banks to fund its ill-fated takeover bid for Unocal, an American oil firm.

That hints at the official backing China's big resources firms seem to enjoy. Since 2002 the government has exhorted them to seek their fortunes overseas. The National Development and Reform Commission, a planning ministry of sorts, keeps a list of countries where it encourages Chinese investment with special incentives. Chinese aid to Africa seems to be concentrated in countries where Chinese resources firms are also investing heavily, such as Sudan and Angola.

All this has stirred fears that Chinese firms, in cahoots with their shareholders in government, are squeezing out Western competition and locking up supplies of natural resources for the future. But, points out Erica Downs of the Brookings Institution, a think-tank, Chinese oil firms usually invest overseas in partnership with Western firms or other national oil companies (NOCs). Moreover, they tend to be passive shareholders, not operators that exercise day-to-day control over the investment. And they mostly sell their share of the oil produced on the open market, rather than spirit it back to China.

Wood Mackenzie, a consultancy, has examined the prices paid by Chinese oil firms for acquisitions and exploration rights and calculated that most of them are likely to earn a very respectable rate of return of 15-20%. "The contention that 'win at all costs' tactics are being pursued by the Asian NOCs in asset acquisitions is simply not substantiated," Wood Mackenzie concluded.

Chinese firms do have access to countries that many Western ones do not, such as Sudan and Iran—but if they are exploiting oil that would otherwise go undeveloped, they are increasing the global supply and so reducing the price. They also seem to have access to cheaper capital, and are not being required to pay onerous dividends to the state. But again, that means Chinese banks and taxpayers are subsidising oil production, reducing the price the rest of the world has to pay.

Besides, Chinese firms are not as invincible as they are made out to be. After all, Chevron, an American oil firm, managed to snatch UNOCAL from CNOOC's jaws. And Chinalco is struggling to prevent BHP Billiton's proposed takeover of Rio Tinto.

vestments became the subject of a bribery scandal. Chinese mines in Zambia have suffered from labour unrest. The naive notion that stronger commercial ties offer lots of painless "win-win" opportunities to both China and the resource-rich countries of Africa and Latin America is coming under greater scrutiny on both sides.

Developing countries are understandably keen to ensure that they get the maximum economic benefit from their extractive industries. Russia, for example, is gradually ratcheting up its export tax on raw timber so that the Chinese firms now simply harvesting wood in the forests of Siberia will have to set up sawmills there as well. That will spell the end of the dozens of wood-processing firms that have sprung up across the border in the Chinese town of Manzhouli.

The governments of both Brazil and Argentina have said they want to export more than just minerals and food to China, and have begun to stem the flood of cheap Chinese imports they are receiving in return. As Thabo Mbeki, South Africa's president, has put it, "China cannot just come here and dig for raw materials and then go away and sell us manufactured goods."

The benefits of China's growing appetite for natural resources to the producer countries are clear. Increased Chinese demand and the higher prices that go with it have boosted both the volume and the value of their exports. For countries that also sell manufactured goods the calculation is less clear-cut but probably still positive. Chinese competition may have driven up the cost of inputs of raw materials, kept wages low and reduced the selling price of manufactures, yet in most cases this is more than outweighed both by growing Chinese demand for imports and by the global boost to purchasing power from cheap Chinese manufactures.

Rolling out the welcome mat

A recent World Bank study simulated the effects of China's and India's growth on the rest of the world, starting from various assumptions. In every case it came up with positive results for all but a handful of European and Asian countries.

Similarly, a series of reports from the World Bank, the Inter-American Development Bank and the Organisation for Economic Co-operation and Development concluded that China's emergence is beneficial to Latin America. The most recent one, from the World Bank, found strong evidence that Chinese demand was boosting Latin American exports and little indication that Chinese exports were crowding Latin American ones out of other markets. It seems that for resource-rich countries the main risk of China's hunger for commodities is that it might wane. •

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