POLICY BRIEF

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Comparing the Determinants of Western and Chinese Commercial Ties with Africa

David G. Landry

POLICY POINTS

It is important for African countries to foster good governance to increase their attractiveness in the eyes of foreign investors.

Developed countries need to continue to support legislation aimed at preventing business practices among their firms most damaging to good governance worldwide.

The Chinese government needs to make an effort to visibly enforce legislation to combat foreign corrupt activities among Chinese firms.

Western governments, the media, and researchers need to exercise greater caution in how they portray Chinese commercial engagement abroad.

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CHINA'S INCREASING CLOUT IN INTERNATIONAL AFFAIRS came as western actors began to pay increasing attention to the quality of governance in developing countries. Corruption controls, democratic development, and respect for human rights all made it to the forefront of the agenda articulated by the west in the decade following the end of the Cold War, as their foreign policy calculus changed fundamentally. The good governance agenda has also made its way to international business activity, as part of what Buckley et al. call the "institutions-based view of strategy".[1] One of the most consistent findings in that literature is that poor governance quality has a deeply negative impact on international commercial activity. The literature is remarkably consistent on the impacts of the former on the latter. It shows that, all else equal, countries with worse governance outcomes are expected to receive less FDI, invest less, and trade less than their counterparts. Put simply, the causal mechanism raised to explain these findings is that business actors are deterred by poor governance and, as a result, take their business elsewhere.

As the discourse and practices surrounding good governance evolved in the west, a widespread view of Chinese firms' behavior when doing business abroad emerged. According to much of the conventional thinking on the matter, China's engagement abroad, fueled by its thirst for natural resources and in search of markets for cheap Chinese wares, not only disregards governance issues but also undermines the west's efforts to tackle them. The working paper associated with this policy brief is the first to explicitly compare the determinants of the value of Chinese and western commercial engagement. By answering the following questions, it tests the narratives presented in the previous paragraph: (1) Does a relationship exist between African countries' governance outcomes and their commercial ties? (2) Do differences in governance quality impact patterns of FDI and trade in the same way? (3) Does the quality of different governance indicators—corruption controls, political stability, democratic development, and respect for human rights—matter equally for commercial activity? (4) Does the quality of African countries' governance outcomes impact their commercial ties with China and western countries in a systematically different way? (5) Is China's commercial activity in Africa more "resource-seeking" than that of its western counterparts?

Figure 1: Total FDI Flows to Africa, by Country (2003-2012)

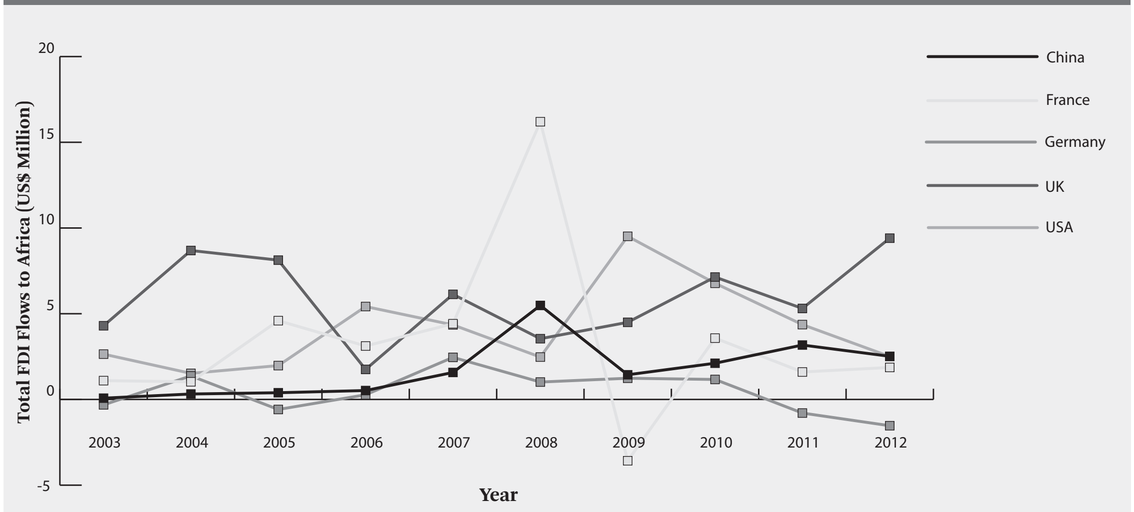
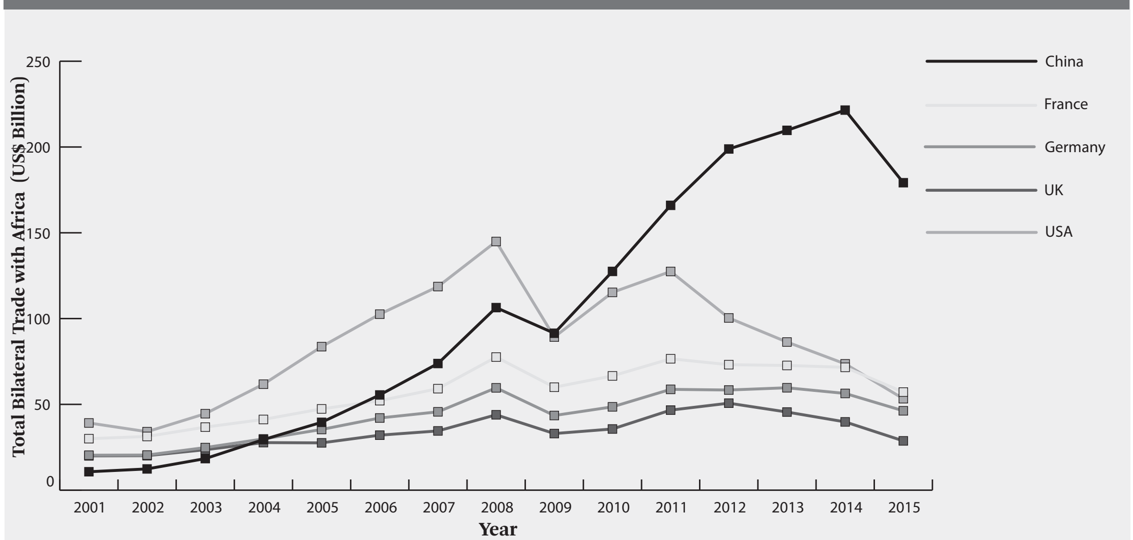


Figure 2: Total Bilateral Trade Flows with Africa, by Country (2001-2015)



The impact of African countries' governance outcomes on Chinese and western commercial activity is tested through gravity models. The working paper finds that governance plays a statistically significant positive role in predicting African countries' commercial activities. It finds that a standard deviation increase in governance quality in an African country (roughly the difference between Sierra Leone and Senegal in 2015) is associated with an increase of almost 150 percent in the FDI inflows it receives from China, France, Germany, the UK, and the US, an increase in exports to these countries of 21 percent, and an increase in imports from these countries of 12 percent. Comparing the strength of the relationship between governance on the one hand and FDI inflows, exports, and imports on the other strongly suggests that governance plays a more important role in predicting FDI than trade. This lends some support to Habib and Zurawicki's hypothesis that investment is more sensitive to governance quality than trade, because it generally entails a longer time horizon and often comprises larger upfront costs.[2] As mentioned above, these results reflect the whole sample comprising both China and western countries.

The working paper also finds that the role of governance quality in predicting the commercial activities of Chinese and western firms does not differ significantly. A standard deviation increase in governance quality is associated with a 144 percent increase in western FDI, a 30 percent increase in exports to the west, and a nine percent rise in imports from the west. Meanwhile, a standard deviation increase in governance quality is associated with a 122 percent increase in Chinese FDI, a two percent decrease in exports to China, and a 17 percent rise in imports from China. Importantly, none of the China-specific coefficients presented below are different from their western counterparts to a statistically significant degree. These coefficients show that western firms engage more than their Chinese counterparts with African countries that have better governance outcomes. That said, they also demonstrate that, in absolute terms, governance quality has a positive relationship with Chinese investments in, and exports to, African countries.

With regards to the relationship between specific governance indicators and commercial activity, and consistently with Chen, Dollar, and Tang's findings, the working paper finds that political stability plays a positive role in predicting Chinese investment in Africa—as is the case for the western sample.[3] A standard deviation increase in political stability is associated with a 93 percent increase in western FDI and a 72 percent increase in Chinese FDI (with a coefficient that does not differ significantly from that of the west). The working paper also finds that democratic development and respect for human rights do not play a consistent role in predicting commercial activity. While western firms invest less in and export less to, but import more from, African countries with higher levels of democratic development the exact opposite is true with regards to Chinese firms. Similarly, both western and Chinese firms invest more in African countries with greater respect for human rights, but the impact of human rights on their imports and exports is minimal in economic terms.

Finally, the working paper finds that countries with low corruption levels consistently attract significantly more western commercial activity and that Chinese firms engage more than their western counterparts with countries that suffer from higher corruption levels. More specifically, a standard deviation increase in the quality of corruption controls among African countries is associated with a 112 percent increase in western investment and a 55 percent increase in Chinese FDI. Furthermore, a standard deviation increase in corruption controls is associated with a 46 percent increase in African countries' exports to western countries and a 40 percent decrease in their exports to China. Finally, a standard deviation increase in corruption controls is associated with a 36 percent increase in African imports from the west and an 8 percent increase in their imports from China. In all three models, the difference between the west's and China's respective coefficients is statistically significant at the one percent level. This suggests that laws like the FCPA, which the western countries sampled in this paper implement and enforce, are working. This finding is also likely driven by the fact that corruption controls, unlike democratic development and respect for human rights, have a direct impact on firms' bottom line. Simply put, bribes are expensive, and it makes sense for firms to try to avoid them. Compared to their western counterparts, Chinese firms consistently engage more commercially with more corrupt African countries, though imports are the only Chinese commercial activity which are negatively associated with corruption controls in absolute terms. This is likely linked to the fact that African countries' resources wealth plays an important role in predicting their exports to China—the paradox of plenty tells us that natural resource rents often go hand in hand with high corruption levels.

The working paper paints a mixed pictured as to whether China's commercial activity is more resource-seeking than that of the west. The impact of resource wealth on western FDI is not statistically significant and China's coefficient does not differ from the west's to a statistically significant degree. That said, a one percent increase in resource wealth as a share of GDP is associated with a two percent increase in exports to the west and a four percent increase in exports to China (which is different from the west's coefficient at the one percent level, suggesting that Chinese firms import more than their western counterparts from resource-rich African countries). Finally, the working paper finds that a one percent increase in resource wealth is associated with a one percent increase in both western imports and Chinese imports.

The working paper's findings provide clear answers to the paper's questions and substantiates some of its key hypotheses—though they fail to support others. First, African countries' governance outcomes play a positive and statistically significant role in predicting commercial activity. This is hardly surprising and is consistent with the rich literature on the subject. Second, governance quality's economic impact on FDI is stronger than that on trade. In other words, commercial actors appear more willing to import from, and export to, African countries that have poor governance outcomes than to invest in them. Third, corruption controls represent by far the strongest determinant of western countries' commercial activity in Africa. Fourth, the relationships between aggregate governance quality and western and Chinese firms' respective levels of commercial engagement in Africa do not differ significantly. This is quite surprising and contradicts much of the existing literature. This may also be due to the fact that this paper employs data spanning a much longer time period than most of the existing literature, which would suggest that Chinese firms are becoming more averse to countries with poor governance outcomes over time. This would not be surprising—Chinese firms have historically had much less exposure to foreign jurisdictions than their western counterparts and may have taken time to develop a similar aversion to governance risks as they have. Finally, the role of natural resource wealth in predicting commercial activity does not differ significantly between western firms and their Chinese counterparts—with the exception of Chinese imports, which are significantly more resource-driven than those of the west.

According to much of the conventional thinking on the matter, China's commercial engagement abroad not only disregards governance issues, but also undermines the west's efforts to tackle them, by disproportionately targeting countries with higher corruption levels and worse human rights track records. Another frequent claim regarding China is that its economic engagement in Africa is only forthcoming when the continent's abundant natural resources are at play. The findings summarized here reveal the need for actors in academia, the media, the private sector, and government, to re-evaluate their notions regarding the forces that drive commercial engagement in Africa—and that of China in particular.

POLICY RECOMMENDATIONS

1.) It is critically important for African countries—and countries from the broader developing world—to foster good governance in order to increase their attractiveness in the eyes of foreign investors, the competitiveness of their exports in world markets, and the ability of domestic consumers to consume goods imported from other countries.

2.) It is important for developed countries, from which most of the world's capital flows, to continue to support legislation like the FCPA and its counterparts in other OECD countries, aimed at preventing business practices among their firms that are most damaging to good governance worldwide.

3.) With its growing economic footprint, and given the fact that its firms have acquired a reputation for disproportionately engaging in corrupt behavior abroad, the Chinese government should make a concerted effort to visibly enforce the legislation it has in place to combat foreign corrupt activities among Chinese firms and to bring that legislation in line with that of OECD countries.

4.) Given the findings presented here and in the working paper, it is important for western governments, media organizations, and researchers to exercise greater caution in how they portray Chinese commercial engagement abroad. ★

ENDNOTES

1. Peter J. Buckley, L. Jeremey Clegg, Adam R. Cross, Hinrich Voss, and Ping Zheng, "The determinants of Chinese outward Foreign Direct Investment," *Journal of International Business Studies* 38, (2007): 499-518.
2. Mohsin Habib and Leon Zurawicki, "Corruption and Its Effect on Trade and FDI," Transparency International *Global Corruption Report* 2005 (2005): 305-307.
3. Wenjie Chen, David Dollar, and Heiwai Tang, "Why is China investing in Africa? Evidence from the Firm Level," Brookings Institution Working Paper (2015).

AUTHOR

DAVID G. LANDRY is a researcher and consultant working on issues of economic development and good governance. He received his PhD in international development from the Johns Hopkins School of Advanced International Studies. He also holds an MSc in global governance and diplomacy from the University of Oxford and a BA in international development from McGill University.

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SAIS China-Africa Research Initiative
1717 Massachusetts Ave NW, Suite 733
Washington, DC 20036
www.sais-cari.org
Email: sais-cari@jhu.edu

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