POLICY BRIEF

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Understanding the Structural Sources of Chinese International Contractors' Market Power in Africa

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POLICY POINTS

For African countries, it is important to incorporate capacity building and technology transfer requirements as they award contracts to Chinese companies.

Engage directly with contracting firms based on an understanding of their incentive structure within the Chinese political economy. As a starting point, it may be useful to engage the relevant industrial bodies, such as the China International Contractors' Association.

It is important for **China to promulgate relevant legislation** to better regulate these firms' overseas operations, especially with regard to corruption in the deal-making process.

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IN RECENT YEARS, OVER 500 CHINESE CONTRACTING COMPANIES have been active in Africa.[1] As a group, they enjoy a dominant position in the African market. Based on the revenues of the world's 250 largest international contractors, Chinese companies' market share reached 61.9 percent in 2019, up from only a modest 10 percent in 2002.[2] In some countries such as Tanzania, the market share of Chinese companies has recently reached over 80 percent.[3]

China's phenomenal rise in international contracting has been fueled by its state-backed finance. However, data suggests that China's international lending is only a small part of the story. Based on SAIS-CARI's China-Africa loan and contracts datasets, the ratio of infrastructure-related loans to contract turnover was lower than 30 percent in the majority of the years between 2002 and 2018.[4] Country-wise, in none of the countries did the loan-to-contracting turnover ratio surpass 40 percent. This data suggests that Chinese international contractors have independent agency in seeking out their contracts and that their market power is much more than a simple derivative of China's financial power. One of the most important non-Chinese sources of finance for African contracts are multilateral development banks. There, Chinese contractors are again dominant. China was the largest awardee country for the World Bank's major contracts between 2000-2020 except for three years (when it came in as second); for the African Development Bank, Chinese companies received 27.9 percent of the total contract value between 2013 and 2018, four times larger France's contract value – the second largest share. These data points are all the more reason to take Chinese international contractors seriously and understand the source of their market power.

CONTRACTORS AS THE FIRST MOVERS

CONTRARY TO POPULAR OPINION, CHINESE CONTRACTING firms do not enjoy ready support from the state-backed financial institutions. This is not for lack of political will on behalf of the Chinese state, but is instead due to tight regulation on banks out of the state's concern about financial security. Ultimately, this makes China's banks slow to adapt to the needs of their clients. Banks have been locked in a path dependency of export credit-based financing, which requires less sophisticated lending techniques, instead of providing the kind of financial products most suitable for international project contracting. In particular, export buyer's credit has been used to finance some contracts awarded to Chinese companies, and has thus become a major form of China's international lending. It has often been interpreted that awarding contracts to Chinese companies is a "condition" of China's lending, but the actual dynamic may well be that Chinese companies helped secure financing from Chinese banks as part of their bidding, and such financing was only available in the form of buyer's export credit.

Given the limitations of available loan facilities, Chinese international contracting firms have had to find alternative means to support their international market expansion. Some of the largest conglomerates have set up financial companies within their groups or have raised funds directly from the financial market. This is happening at the same time when many companies are transitioning from the role of a pure contractor to a developer as well, meaning they will invest in the projects with their own funds. All this is to say, international bank lending may become less important in China-Africa economic relations going forward.

STRUCTURAL EMBEDDEDNESS

THE CHINESE INTERNATIONAL CONTRACTING firms' market power needs to be understood in relation to their structural position in China's industrial system. The sector is dominated by state-owned enterprises (SOEs). Based on the Chinese Ministry of Commerce's registry, at least 1,105 entities are actively engaging in international project contracting as of February 2021.[5] Among them, only less than one third (320 out of the 1,105) are privately owned. The largest group (527 companies) are subsidiaries of 97 so-called "central SOEs" – large industrial conglomerates administered by China's State-owned Assets Supervision and Administration Commission of the State Council (SASAC)—and their subsidiaries. 241 others belong to provincial or lower-level governments.

The strong state representation in the industry has been the result of China's unique history. The very first few companies to engage in international contracting were created by the Chinese state at the end of the 1970s when the country was initiating the economic transition. The idea was that such an industry could be used to earn the much-needed foreign exchange, learn from international experience, and promote the export of Chinese equipment and materials.[6] The companies were created by converting some of the government functions under the line ministries and the provincial governments, many of them formerly foreign aid offices handling China's turnkey aid projects. Many of the newly created international contracting firms continued to engage in the implementation of Chinese aid projects, which effectively became a market-entry strategy for them into many developing countries.[7]

This first generation of contracting firms tended to be simple, broker-like firms whose role was to facilitate the participation in international contracting of the specific sectors and regions they represented. Realizing that their lack of in-house construction or engineering capacity was a limitation, the Chinese government started to push for "industrialization, conglomeration, and internationalization" in the contracting industry in the early 1990s.[8] Purposeful policies were put in place to encourage China's established construction and engineering firms to enter international contracting. Smaller firms administered by lower-level governments were kept out of this business while selected large firms were given priority access to major state-invested projects in China in order to build up their expertise for international contracting.[9] In short, the state created a protected environment for the elite companies to practice their skills and catch up with the international standard.

Meanwhile, many of the international contracting firms created earlier by the state were integrated into gigantic industrial groups. For example, in 1982 the China State Construction and Engineering Corporation (CSCEC), the very first firm created in 1979 to participate in international contracting, was integrated into a larger group sharing the same name, which effectively took over the construction capacity of the entire nation formerly administered under the State Construction Commission. Similarly, in other sectors such as road and harbor construction, railway construction, and hydropower engineering, formerly small-scale international contracting firms were integrated into nation-wide industrial conglomerates. Encouraged by the state's internationalization policy, these conglomerates sorted their existing capacity and devoted resources to the international contracting arms, instantly boosting their technical capacity. Some of them quickly rose to high rankings in the Engineering News Record's (ENR) top 250 international contractors. These were the "national champions" created by the state under the very special circumstances of China's transition from command to market economy; fostering them to become competitive players in the international market has been one of the state's strategic goals, and consecutive policies have been put in place to support them.[10]

INTERNATIONAL CONTRACTING FIRMS AS EXPLORERS

CHINESE INTERNATIONAL CONTRACTING FIRMS are not passive receivers of the state's favorable treatment. They exert agency in their exploration of international markets and demonstrate higher risk-taking tendencies than average SOEs, partly due to the looser regulation on Chinese companies' overseas operations.

It will be crucial to follow the activities of the international contracting firms, which have been on the frontline of China's economic globalization. In Africa, many Chinese contracting firms have been linking their contracting activities with resource exploration. In recent years, many have become active in the development of industrial zones. While these ventures have been the result of the companies' agency in seeking profitable opportunities, they are also responding to the structural needs of the Chinese economy at different times-- securing resource supplies since the 2000s and transferring excess production capacity abroad since the 2010s. The transition to the role of developer also reflects the state's urge for them to upgrade services and move up the value chain. As developers of large-scale infrastructure or industrial projects, the companies will need to become more deeply involved in local political and economic affairs, which can have profound implications for future China-Africa relations.

POLICY RECOMMENDATIONS

MY STUDY CALLS FOR GREATER SCHOLARLY and policy attention on the Chinese international contracting firms as a distinct group of actors in China-Africa economic relations. This industry has been cultivated by the state to help China attain a more favorable position in the international economy. These firms are competitive in the African market not simply because of China's financial support; rather, they are backed by China's national industrial system. **For African countries, it is important to incorporate capacity building and technology transfer requirements as they award contracts to Chinese companies, or their domination in the market may suppress development of local capacity.**

Many international civil society organizations have focused on influencing Chinese banks' lending policies to regulate the impact of Chinese-financed projects. While important, it may not be the most effective approach, given the likely diminishing role of bank lending in Chinese international contracting firms' future activities. **It is important to engage directly with the contracting firms based on an understanding of their incentive structure within the Chinese political economy. As a starting point, it may be useful to engage the relevant industrial bodies, such as the China International Contractors' Association.**

Chinese international contracting firms as a group have shown a higher appetite for risk, partly due to the fierce competition among them. Excessive risk-taking can result in financial and reputational damage for China. **It is important for China to promulgate relevant legislation to better regulate these firms' overseas operations, especially with regard to corruption in the deal-making process.** ★

ENDNOTES

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