

Chinese investment and small-scale commodity producers in Africa

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Key messages:

Chinese companies adapt their business models according to the context, and share many characteristics with other 'new-entrant' investors.

African producers, governments, and traditional authorities play a key role in facilitating Chinese trade and investments in the rural economy.

In the short term, the impact of Chinese businesses on rural communities is often positive, but longer-term sustainability remains uncertain.

As the challenges posed by the Chinese and other newcomers are different to traditional ones, the policy response should be innovative, with a focus on improving local governance.

This brief summarises and sets in context findings from DFID-ESRC Growth Research Programme project 'Natural resources, rural poverty and China-Africa trade'. The project studied the nature and impacts of Chinese investment and trade in African natural resources, with a focus on the informal natural resource trade in Tanzania, Zambia and Zimbabwe. The research was led by the International Institute for Environment and Development (IIED) in collaboration with the Centre for International Forestry Research (CIFOR), Indaba Agricultural Policy Research Institute (IAPRI) in Zambia, Agricultural Economics, Policy Research and Information Centre (AEPRIC) in Zimbabwe and COWI Tanzania.

Chinese investment and trade in Africa's rural economy

Since 2012, China has become Africa's top trading partner and one of the continent's main investors, prompting ever-increasing attention to China-Africa relations and the implications these might have for Africa's development.

There is already a large body of research on Chinese trade and investment in Africa's land and natural resource sectors. Many studies in the past suggested that Chinese investment in Africa is strongly driven by interest in the continent's abundant raw materials (Sanfilippo, 2010; Biggeri and Sanfilippo, 2009; Schiere, 2010; Kolstad and Wiig, 2011). Yet more recent research suggests that these flows have evolved in response to changing domestic conditions in China, with Chinese companies increasingly shifting their attention towards services and manufacturing (Dollar, 2016).

But while much of the investment landscape has been analysed at the macro level, there is less rigorous empirical and cross-sector research on the socio-economic and environmental impacts on the ground, especially the impact on the rural communities that produce agricultural goods, timber and minerals.

Foreign (Chinese and non-Chinese) interests in Africa's rural economy present both opportunities and challenges. In terms of opportunities, the presence of foreign investors in rural areas, and the fact they are sourcing directly from producers, means that communities can engage

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directly with global value chains, earning cash income and improving their livelihoods. The challenges mainly concern limited social and environmental safeguards, especially because many such activities are conducted in the informal sector, which is subject to less stringent environmental and social safeguards than the formal sector (Weng, 2015).

Box 1: Informality

The informal economy includes all those economic activities outside government regulation and control. These activities are predominant in African economies: it's estimated that in some countries, the informal economy generates 90% of employment opportunities and contributes up to 38% of GDP. In rural areas in particular, the informal sector – which includes much small-scale farming, logging, mining and other economic activities reliant on land and natural resources – is the backbone of the rural economy, with local communities, and especially women and youth, depending on it for their livelihoods (Weng, 2015).

Chinese engagement within Africa's informal rural economy is relatively understudied. Yet, given the size of this sector in African economies, its importance for poverty reduction and environmental conservation, and the growing number of private Chinese investments (especially at small and medium scales), the area requires further investigation.

The DEGRP research

Aims

The research summarised here aimed to provide a more nuanced understanding of how Chinese investment and trade influences the rural economy in Africa and how local stakeholders respond to this, with a specific focus on the informal sector. The project team comprised researchers from the International Institute for

Environment and Development (IIED), the Center for International Forestry (CIFOR), Indaba Agricultural Policy Research Institute (IAPRI) in Zambia, Agricultural Economics, Policy Research and Information Centre (AEPRIC) in Zimbabwe and COWI Tanzania.

The research centered on three key questions:

- **How do Chinese businesses invest in Africa's rural informal economy?** What strategies and business models do Chinese traders and investors use when engaging with African countries, and what, if anything, makes them different from local and foreign actors?
- **How do African actors and governance systems respond to Chinese investments?** To what extent do their responses adapt to, but also shape, the outcome of these investments and related processes?
- **What are the impacts of Chinese investments on the environment and on African small-scale producers in the natural resources sector?** What are the immediate and long-term effects on income of rural communities, social and political issues, and environmental outcomes?

Methods

These questions were explored via in-depth case studies using quantitative and qualitative data. The team looked at Tanzania's mining sector, Zambia's forestry (timber) sector, and the agriculture (cotton) sector in Zambia and Zimbabwe.

The Tanzania study looked at artisanal and small-scale mining in Tanzania, particularly of gold and copper ores, to understand the implications of foreign investment (both Chinese and non-Chinese) for the sector's governance. The Zambian forestry study examined the mukula (rosewood) trade in Zambia to understand how Chinese trade and investments affect rural livelihoods, the environment and natural resource governance. The third study compared the cotton sectors of Zambia and Zimbabwe, examining how the market has been

shaped by the arrival of Chinese and other emerging economy investors.

The team used a variety of methodologies to unpack the political and economic relationships between Chinese and African stakeholders. Household surveys were conducted with over 700 households; over 130 individuals were interviewed; and around 100 focus group discussions were conducted in the three countries selected. The team then used value chain analysis and impact and political economy analysis frameworks to analyse the quantitative and qualitative data.

Findings & analysis

How Chinese businesses invest in Africa's rural economy

Business strategies

The early literature on Chinese investment in the African rural economy focused on investment in natural resources led by large State-Owned Enterprises (Schiere, 2010; Kaplinsky and Morris, 2009). More recent research, however, has highlighted that Chinese investment in Africa encompasses many diverse companies, with different interests and objectives (Gu, 2009; Shen, 2015). The context and the specific business these private and public companies are in may also affect their approach or specific business strategies.

The case studies analysed in this research provide support to this view, showing that Chinese companies adapt their business models according to the context. The case studies also demonstrate that, contrary to popular perceptions of Chinese dominance over Africa's natural resources sector, Chinese companies' market positions in relation to other foreign investors varies greatly depending on the country and the commodity.

The study of the mukula industry in Zambia, for example, shows that Chinese companies have modified their strategies in response to a changing context, expanding or contracting the range of their operations according to the current

needs and to what makes business sense.

Chinese nationals initially managed almost all the links of the value chain, sourcing the timber in Zambia and selling it in China. However with time, Zambian nationals have taken control of the activities located in Zambia. Zambian rural populations are now felling the trees, and Zambian traders and intermediaries are in charge of navigating the Zambian bureaucracy, for example by obtaining permits for the export of mukula. However, Chinese businesses have remained in charge of bringing the timber to China and distributing it in the Chinese market.

In contrast, the studies of the mining sector in Tanzania and the cotton sector in Zambia and Zimbabwe show how Chinese businesses have managed to insert themselves into mature markets dominated by investors from the West and other emerging economies. Chinese investors are new entrants in those sectors, compared to more established players from South Africa and India. As such, they have not been able to penetrate more mature parts of the market, where established companies had already taken up the more lucrative business opportunities, and there was limited space for new entrants to gain profits using existing business models.

However, in the case of mining, Chinese and other new foreign investors did manage to penetrate less mature parts of the value chain, such as the tailings market, a market undervalued prior to their arrival. Similarly in cotton, the Chinese and other new entrant investors also devised new business models to work with producers. As new entrants, the Chinese companies had to test the market upon their arrival, and revise their business strategies when their initial choices were not successful.

Differences between Chinese and other actors

Are Chinese companies and investors behaving differently from others? The case studies reveal that the presence of Chinese traders and investors can create significant disruptions to existing business arrangements with producers

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and government. However, is the disruptor role unique to Chinese actors, or do other investors also share similar characteristics? The short answer is 'no': Chinese companies seem to share many characteristics with other new entrant investors.

In Zambia and Zimbabwe's cotton sectors, the sale of cotton by producers and the purchase of cotton by cotton companies is generally regulated through contractual arrangements. However, cotton companies often need more cotton than the contracted farmers can supply to keep processing plants or 'ginneries' at full capacity. As a result, some companies are willing to purchase cotton outside of formal contracts in a practice called 'side-buying'. Meanwhile, cash-strapped farmers are often also willing to side-sell the cotton if the companies pay cash.

This disruptive practice is very widespread, particularly among new entrants in the sector. Research indicates that most companies in the sector, both Chinese and non-Chinese, engage in the practice.

In the mining sector in Tanzania, Chinese investors engage with artisanal, small-scale mines. Their involvement with the smaller mines, again, is not unique to Chinese businesses, but is shared with other emerging market investors. These case studies suggest that a company's nationality is a less useful predictor of business behaviours than whether they are new entrants or established players.

How do African actors respond to Chinese engagement?

The early narrative around the China-Africa relationship focuses on China as an active player moving into Africa, with African countries often presented as the background for China's actions. But more recent studies have focused on how African stakeholders react to the Chinese actors, putting African agency under the spotlight (Mohan and Lampert, 2013).

The three case studies analysed for this research present clear evidence that the African counterparts reacted and contributed

significantly to shaping the Chinese presence in their own countries. While the active roles played by local producers and business partners may not be surprising, the three case studies also highlight the role of the local government and traditional authorities.

In Zambia's timber sector, small-scale timber producers were already operating mostly in the informal sector. This situation was exacerbated by the arrival of Chinese investors and the sudden surge in demand for mukula in rural areas. How did the Zambian government react? Zambian authorities have shown a varied response, banning and then allowing the harvesting of mukula at different points in time.

In addition, national and local levels of government, as well as traditional authorities, have all tried to assert their control over this resource, which suddenly became valuable around 2012, due to increased demand from the Chinese. Traditional authorities in particular have exercised their power widely to regulate mukula-based harvesting and trading relationships, at times for personal benefits. Zambian political actors have all been actively involved in claiming a share of this newly emerging business activity, clearly displaying the extent of their agency.

In the case of Tanzania, government officials played a critical role in enabling the partnership between Chinese and other foreign investors and small-scale mines. Although small-scale mining licenses were, until 2017, strictly reserved for Tanzanian citizens, the research presented here shows that local government officials often prioritised sector development over potential social and economic impacts of this development, condoning or even at times facilitating partnerships despite licensing rules. This was likely made easier by ambiguities around environmental and social safeguards for foreigner-linked mines operating with small-scale licenses, despite the fact that such mines pose a higher risk to the environment and communities than traditional small-scale mines.

How have producers' livelihoods and the environment been affected?

Impacts on producer livelihoods

Most literature regarding China's role in Africa's natural resources sector and rural development has fallen short of providing rigorous empirical data on the social and environmental impacts. The research addressed here helps fill this gap.

The case studies show, for example, that in the short term, the impact of Chinese businesses on rural communities has been positive. In the Zambian timber sector, loggers have received financial benefits, and the presence of Chinese traders has allowed rural Zambian loggers, traders and brokers to access the global market directly in a sector traditionally controlled by formal companies. As of 2012, mukula logging has become the most important source of income among the farmers surveyed in the study.

In Tanzania's mining sector, both Chinese- and foreign-owned mines provide employment to the local population. In the Chinese mines examined, 70-80% of the staff are local, and the wages offered are higher than the minimum wage in Tanzania, as per sector regulations. The companies also offer additional benefits such as transport and medicines, which is similar to other foreign non-Chinese mines.

In the Zambian and Zimbabwean cotton sectors, the research revealed that the practice of paying producers in cash and up front – an arrangement initially only offered by Chinese companies but later replicated by others – was highly popular among farmers, who often suffer from cash shortages, especially during seasons when payments for school fees and other basic necessities are due.

In the longer-term, however, the positive effects are less clear. The extensive exploitation of these natural resources for their short-term benefits might endanger their ability to provide in the longer term.

For instance, the research showed that the profitability of the Zambian timber sector has decreased, with the average profit per tree

shrinking each year. This has been due to the dwindling resource base, and increasing costs of harvesting partially caused by an unclear policy framework.

In the agriculture sector in Zambia and Zimbabwe, meanwhile, the prevalence of side-selling disincentivises companies from providing inputs and services to the farmers. Companies are understandably reluctant to invest when many farmers break the terms of their contract, however ultimately this contributes to slowed productivity growth. The buyers offering cash (but no extension services) can outcompete those who offer extension services, and this has negative impacts on long-term productivity.

In addition, as the cash payment is provided at the point of exchange, and the transaction is quick, there is limited time for buyers to check the quality of cotton. This discourages the production of high quality cotton, which in the longer-term may bring down the price of cotton.

Environmental impacts

These trade and investment dynamics also pose significant risks for the environment, contributing to biodiversity losses, soil depletion and pollution. This is especially true in the informal economy, where environmental safeguards may not be present, or may not be strictly implemented.

The Zambian timber sector case study highlighted several issues relating to environmental impact. The household survey conducted found that the producers harvested trees that were smaller than the minimum size deemed acceptable by law. In general, respondents reported little awareness of environmental regulations, and that safeguarding the environment was not their primary concern. In addition, there seemed to be very little evidence to suggest that harvesting activities are monitored to assess their impact – most government controls tend to concern revenue issues rather than environmental criteria.

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In the Tanzanian mining sector, environmental challenges are linked to the processing of minerals. Water contamination is common, and so are the clearance of vegetation and extensive use of timber, the use of mercury in processing processes, noise pollution and loss of cattle due to fatalities in the proximity of the mines. The analysis of environmental compliance between Chinese and non-Chinese mines conducted under this research seems to suggest that the Chinese players, on average, lag behind other foreign investors, although they are slightly better than Tanzanian-owned mines, and significant differences were observed even among the four Chinese investors. More systematic research is needed to explore this further.

In the Zambian and Zimbabwean cotton sectors, negative environmental effects include the use of pesticides and associated pesticide resistance, as well as decline in soil health. Extension training is one of the main ways to reduce the misuse of pesticides, and to decrease the associated risks, but ginneries and companies purchasing cotton – especially new entrants from China and other emerging economies – are increasingly less involved in providing such extension services.

These case studies highlight several areas of concern around the environmental and social impacts of investment in natural resources. However, none of these concerns are uniquely related to Chinese businesses. The case of mukula is peculiar because the expansion of the market is due to Chinese demand, but the challenges of regulatory enforcement are shared by other formal companies and are not directly linked to Chinese companies. In the mining and agriculture sector case studies, the challenges seemed to pertain to Chinese and foreign non-Chinese investors alike.

What does this teach us?

The three cases studies analysed look at Chinese investment in Africa's rural economy, and provide an overview of the behaviours that shape these investments, and of the responses to and impacts of these investments. Five key

insights emerge from these explorations into the short- and long-term impacts on rural communities and on the environment.

First, Chinese businesses disrupted the existing market arrangements when they entered, be it through demanding a particular commodity or investing in its exploitation. However, the business practices employed and the effects these generate are not necessarily uniquely linked to Chinese investors, but rather to new entrants in a specific sector or market, especially if these are from emerging markets.

Second, the research shows that African stakeholders played a key role in facilitating Chinese-linked trade and investments in the rural economy. Not only were local producers and brokers instrumental in the value chains; government and traditional authorities also shaped and benefited from these activities in various ways.

Third, the impacts of Chinese engagement on rural communities are varied and complicated. The immediate short-term effects are often positive, providing economic benefits to local communities, but in the longer-term environmental issues may affect the stock of certain resources, ultimately compromising long-term benefits. However, again, the research does not show that such impacts are unique to Chinese businesses, but are similar across the spectrum of foreign investors. This suggests that the existing governance systems are often not adequately equipped to respond to challenges posed by new investors in small-scale resource and land-based economic activities, be they Chinese or from elsewhere.

Fourth, this research tells a cautionary tale about development research or interventions focused solely on Chinese actors. The heterogeneous nature of China-Africa commercial relationships highlights the need to engage with a range of stakeholders to influence change. In the case of timber, for example, the behaviours of Chinese traders and investors are a key determinant of the process, and therefore

advocacy directed at the Chinese side might be more effective. By contrast, in the case of cotton and artisanal small-scale mining, influencing local policy decisions might be more effective.

Finally, the research highlights that regulatory responses by national governments – mostly designed around the logic of ‘classic’ business strategies used by established players in the formal economy – have proved inadequate. In the face of disruptive business strategies employed by the Chinese and other newcomers, governance systems have proved too slow in design and implementation and over-reliant on industry self-governance. Overall, the government’s responses have achieved limited success in all cases, at times not only doing little to allay environmental concerns but also harming the interests of small-scale producers. Therefore improving local governance – through increased capacity, aligned incentive structures and better horizontal and vertical coordination across government agencies – should be the top priority for development policy-making regardless of the sector and actor focus.

Final research reports

- [Chinese investments and Africa’s small-scale producers: disruptions and opportunities](#)
- [Contract farming and informality: drivers and governance responses in Zambia and Zimbabwe](#)
- [Informality, global capital, rural development and the environment: Mukula \(rosewood\) trade between China and Zambia](#)
- [The new face of informality in the Tanzanian mineral economy: Transforming artisanal mining through foreign investment](#)

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