EUROPEAN
INTERNATIONAL
CONTRACTORS

# THE CASE FOR AN EU-AFRICA PARTNERSHIP FOR SUSTAINABLE INFRASTRUCTURE

## LESSONS LEARNED FROM CHINA‘S INFRASTRUCTURE DELIVERY MODEL IN AFRICA

www.eic-federation.eu

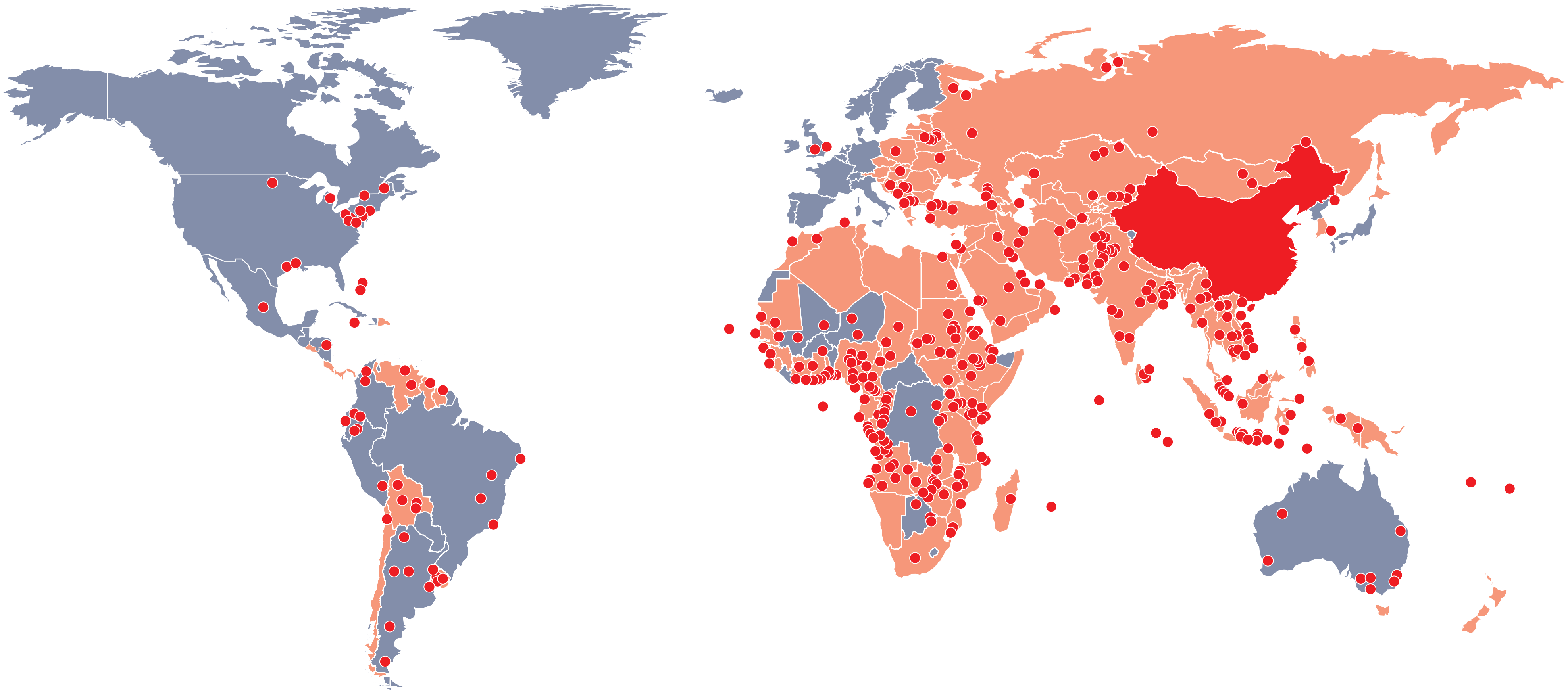


Figure 1
**Projects financed by China's BRI**
(NYT, 2018)

Projects

Belt and Road countries

# Table of Contents



## List of Abbreviations

| | |
|---|---|
| ADB | Asian Development Bank |
| AfDB | African Development Bank |
| AITF | Africa Infrastructure Trust Fund |
| BDB | Bilateral Development Bank |
| CDB | China Development Bank |
| DAC | (OECD) Development Assistance Committee |
| DFI | Development Finance Institution |
| ECA | Export Credit Agency |
| G2G | Government to Government |
| ICA | Infrastructure Consortium for Africa |
| IMF | International Monetary Fund |
| MDB | Multilateral Development Bank |
| ODA | Official Development Assistance |
| SDGs | UN Sustainable Development Goals |
| WB | World Bank |

**Currencies**
(Conversion Rates as of 6th May 2019)

| | |
|---|---|
| EUR | Euro |
| USD | United States Dollar |
| m | million |
| bn | billion |

# Introduction

In consideration of China's growing economic power and political influence, the European Commission and the High Representative for Foreign Affairs and Security Policy published a Joint Communication titled "EU-China – A strategic outlook" on 12 March 2019. The communication aims to start a discussion to refine Europe's approach to be more realistic, assertive and multi-faceted with regard to China. Given that China is a cooperation partner with whom the EU has closely aligned objectives in different policy areas and, simultaneously, a systemic rival promoting alternative models of governance, the European Union needs a flexible and pragmatic whole-of-EU approach enabling a principled promotion of its interests and values.

With regard to China's significant investment in partner countries, the European Commission and the High Representative concluded that China should increase its engagement as an Official Development Assistance donor and a partner in multilateral forums. Further, the European Union should strengthen cooperation with China to meet common responsibilities across all UN pillars, including Development (see proposed Action 1, JOIN 2019 5 Final).

The European Commission and the High Representative observed that Chinese investments have contributed to the growth of many receiving economies including ones in Africa, but these investments also have frequently neglected socio-economic and financial sustainability, resulting potentially in high-level indebtedness and a transfer of control over strategic assets and resources. Against that background, the European Commission and the High Representative have stressed that the European Union must preserve its interest in stability and sustainable economic development and good governance in partner countries and, to this end, must apply more robustly the existing bilateral agreement and financial instruments, and work with China to follow the same principles, e.g. through the implementation of the EU Strategy on Connecting Europe and Asia (see proposed Action 4, JOIN 2019 5 Final).

In its Conclusions from 22 March 2019, the European Council concurred that the EU and its Member States should ensure fair competition within the Single Market and globally, both to protect consumers and to foster economic growth and competitiveness, in line with the long-term strategic interests of the Union. The European Council further reaffirmed its commitment to an open rule-based multilateral trading system with a modernised WTO at its core, and to resisting all forms of protectionism and distortions.

EIC welcomes that the EU Institutions have come to appreciate that the European Union finally needs a coherent approach to address the challenges posed by China. Since its accession to the WTO back in 2001, China has been taking advantage of the existing imbalance in the international trade law more than other trade partners of the EU, which results in a distorted level playing field between internationally active European and other OECD construction companies and their Chinese competitors, most of which are largely state-owned.

The impacts of an unlevel playing field are especially dense in developing and emerging countries where infrastructure development has highest priority. African countries with the lowest access levels to water, electricity and transport connectivity are embracing the promises made by China's Belt and Road Initiative (BRI) to channel more than USD 1 trillion towards infrastructure projects across the globe through state-owned banks and enterprises. While the capital injection is much needed in Africa and elsewhere in order to bridge the current infrastructure funding gap, concerns exist over the economic and strategic impact of China's state-financed infrastructure largesse. At the hands of heavy state-subsidisation, tied contracting and cross-financing of abnormally low bids in international open procurement with profits generated from overpriced Government-to-Government package deals, Chinese state-owned construction firms captured an unnatural share of 62 % in the African infrastructure markets in 2018 – and the same goes for anywhere else in the developing world.

Against this background, Japan, Korea, the U.S. and other OECD countries have started initiatives – working both individually and conjointly – to develop and offer financing alternatives that address these concerns, including Japan's "Expanded Partnership for Quality Infrastructure" or the U.S. "Better Utilisation of Investments Leading to Development" (BUILD) Act. With regard to Africa, leaders and experts from European and African public and private sectors currently discuss in the Africa Transport and Connectivity Task Force, which is part of the new 'Africa-Europe Alliance for Sustainable Investment and Jobs' as announced by President Juncker at his State of the Union Address in 2018, how transport connectivity between Europe and within Africa may be improved.

EIC appreciates that both the EU-China Strategy as well as the Africa-Europe Alliance set out that the key principles of the EU's engagement for connectivity are financial, environmental and social sustainability, transparency, open procurement and a level playing field. Nevertheless, EIC stresses that working together with China and its state-owned contractors under the umbrella of a trilateral cooperation as proposed in the EU-China Strategy would create significant challenges, as this paper shall demonstrate.

To better understand these challenges and the competitive environment for infrastructure financing and delivery in Africa, this paper demonstrates at the hand of China's Africa infrastructure delivery approach what lessons may be drawn for the EU in order to respond to China's dominant position as infrastructure financier on Europe's twin continent.

EIC calls upon the policy-makers in the EU Institutions and in Member States to aim to draw level with the U.S. and Japanese examples and to aspire shifting from being a "Global Payer" to being a "Global Player" in promoting infrastructure connectivity between Europe and Africa. Against this background, EIC is pleased to submit "The Case for an EU-Africa Partnership for Sustainable Infrastructure" for debate.

# Executive Summary and Core Recommendations

The African market bears great potential for the future. However, African countries are faced with the challenges that come with annual demographic and economic growth rates at an average of 2.5%. Only half of Africa's yearly needed infrastructure funds amounting to USD 130 to 170 bn are secured. Transport, waste and water infrastructures – vital components to sustain growth and to reach Sustainable Development goals – remain especially underfunded.

The EU has been focusing on financing "soft" sectors, such as health, education, civil society, etc., instead of public infrastructure. Funding for transport infrastructure has decreased by 20% since 2007; European development assistance is hardly visible. To ensure an adequate infrastructure development in Africa, EIC calls upon the EU Institutions and Member States to:

- Rebalance their sectoral ODA portfolio and put a stronger emphasis on infrastructure, especially in the transport and water sectors (as the main focus currently lies on energy). The OECD Statistics for the year 2018 suggest that these two crucial infrastructure sectors account for only around 10% of European ODA to Africa – comparable figures for Japan and Korea lie at almost 50%. China has committed an average of 50% of its total infrastructure financing in Africa to transport infrastructure over the past six years.

- Pool European development finance and technical expertise for Africa's infrastructure sector in the context of the EU's external action financing instruments. European development ODA is fragmented across many institutions both on EU and Member States' level. This may be an advantage for small-scale projects but it is a hindrance for structuring tailor-made financial offers for large-scale infrastructure projects.

- Increase Europe's competitiveness in financing large-scale infrastructure projects by establishment of an EU financing institution capable of combining European development and export finance, thus matching the performance of Asian and U.S. financing institutions.

- Redesign the EU's current "Blending" concept for infrastructure projects in order to increase visibility and control over project implementation. EIC developed an innovative "Blending 2.0" concept which is designed to catalyse additional commercial finance for public infrastructure projects.

- Introduce a special investment "window" in the EU External Investment Plan dedicated to financially non-viable infrastructure investments in the transport and water sectors, as there are a number of constraining factors for public-private partnerships in Africa's infrastructure sector. An intervention by DFIs and MDBs, for instance in the form of subsidies or guarantees, will be crucial to ensure the financial viability of PPP infrastructure projects in Africa.

Since the early 2000's, China's state-coordinated presence in Africa has increased exponentially. Backed by a state-coordinated subsidisation programme, Chinese contractors have reached a market share of 62% in 2018 (up from 21% in 2005).

At the same time, Chinese-led construction projects in Africa, whether executed under Chinese tied aid schemes or under MDB or BDB international open bidding, have been subject to certain criticism regarding their compliance with the global Sustainable Development Agenda. EIC recommends that European and international DFIs insist on a procurement and delivery process that respects all major aspects of sustainability, including the following elements:

- Sustainable procurement should aim at a selection of the "Most Economically Advantageous Tender" instead of the lowest evaluated offer.
- Environmental, social and health and safety (ESHS) standards should be stipulated in the work requirements stated by the Standard Procurement Documents of European and international DFIs.
- A comprehensive prequalification system should ensure full compliance with the highest international environmental, ethical and social standards and allow for a verification of alleged track records.
- International bidders should put a stronger emphasis on stakeholder communication to achieve value-for-money.

China's reluctance to adhere to the international financial framework such as the OECD rules on export credits distorts fair competition between contractors and development financiers.

As a consequence, Chinese loans offer attractive financial conditions that undercut the offers from European and other OECD Development Financial Institutions (DFIs). To ensure that Africa can sustain its growth, achieve the SDGs, and create a level playing field for market orientated bidding competitors, EIC recommends the following:

- EU institutions and Member States should call upon China to implement and adhere to all decisions, recommendations and guidelines of the OECD Development Assistance Committee.
- EU Institutions and Member States should call upon China to implement and adhere to all obligations determined by the OECD Arrangement on Officially Supported Export Credits.
- As long as China does not follow the same official financing rules and practices as its OECD counterparts, EU institutions and Member States should not allow Chinese companies to participate in infrastructure tenders financed from EU ODA, especially if such companies are state-owned.

# Africa's Need for Infrastructure Investment

**Africa is the fastest growing continent and faces great developmental challenges including migration and poverty.**

The countries of the African continent are undergoing fast and extensive changes. Annual demographic and economic growth rates of 2.5% in average create markets with tremendous potential. Africa is expected to become the most populated and most productive continent by 2040: Within the next 20 years, an additional 1.2 bn people will live in Africa with 12 m young professionals joining the continent's labour force every year. Along with the increase of population comes rapid urban growth. Cities have to deal with 22 m new citizens per year creating new demands for waste, water and transport infrastructure management.[1]

**According to UN SDG 9, infrastructure is key for a well-functioning society.**

High-quality resilient infrastructure is essential for Africa to achieve the SDGs; Goal 9 on Industrial Innovation and Infrastructure states that "to achieve inclusive and sustainable industrialization, competitive economic forces need to be unleashed to generate employment and income, facilitate international trade and enable the efficient use of resources. [. . .] Infrastructure provides the basic physical systems and structures essential to the operation of a society or enterprise."[2] An absence of infrastructure has negative impacts on companies as they face additional costs and challenges to obtain resources and to adapt new technologies. Poor infrastructure absorbs up to 2% of Africa's average per capita growth rates.[3]

**Africa's water, waste and transport infrastructure demand has to be met in order to stimulate economic growth.**

African countries continue to struggle to end poverty and increase employment. Unemployment, especially amongst the young population (60%), is a significant risk factor for political stability causing economic inequality and urban fragility.[4] The way forward is to industrialise, but insufficient stock of productive infrastructure causes the globally lowest access levels to power (47%), water (63%), communication (20%) and transportation services. All these factors slow down the pace of development.[5] Especially transportation remains a problem: Sub-Saharan Africa is mostly landlocked and has a paved road density of 31 km per 100 km$^2$,[6] compared to 134 km per 100 km$^2$ in other low-income countries and 180 km per 100 km$^2$ in Central Europe.[7] The AfDB suggests that the African continent's infrastructure needs amount to USD 130-170 bn annually, with a financing gap of EUR 68-108 bn. As figure 2 demonstrates, the most urgent investment needs are found in the roads sector with USD 800 bn needed by 2040, followed by water and telecommunication sectors.[8]

African markets that rely on trade as generator of growth benefit from better transportation since it increases an effective interconnection of labour, capital and goods. Well-developed transportation systems foster inter-African trade by helping minimising production costs and maximising market coverage.

**Low-quality infrastructure causes demanding living conditions.**

Currently, much of Africa's road network is unpaved, isolating people from basic education, health services, transport corridors, trade hubs and manufacturing sites. Not only are Africa's infrastructure networks deficient regarding coverage (average travel times on key corridors are up to 4 hours longer than in Asia), but the price of the services provided is also exceptionally high compared to global standards. Fares paid in Africa (e.g. for intercontinental calls or kWh) are 3-4 times higher than those paid in other parts of the developing world due to a lack of alternatives, low access and monopolistic provision of basic infrastructure services.

**A substantial infrastructure program for Africa that includes governance and procurement reforms would help receive value for money; sound business and investment environments.**

In general, coverage of communication networks is insufficient, waste management does not function properly and providing access to drinking water remains a challenge due to ground water pollution and drought. 60% of SMEs view low quality of infrastructure as the biggest constraint to their activities in Africa.[9] Roads are in such poor condition that Africa has the highest rate of road traffic fatalities at 26.6 per 100.000 inhabitants.[10] According to the WHO, water scarcity affects 1 in 3 Africans and overall 115 African citizens die due to water pollution every hour, amounting to more than 1 million deaths per year due to a lack of functional sanitation and waste management.[11]

To achieve the SDGs, Africa needs a substantial programme for infrastructure investment and maintenance. This includes a better connection of capitals, power production sites, ports, border crossings and secondary cities with high quality road, water and sanitation networks as well as an all-season road access for Africa's high value agricultural land, and to educational and health facilities.

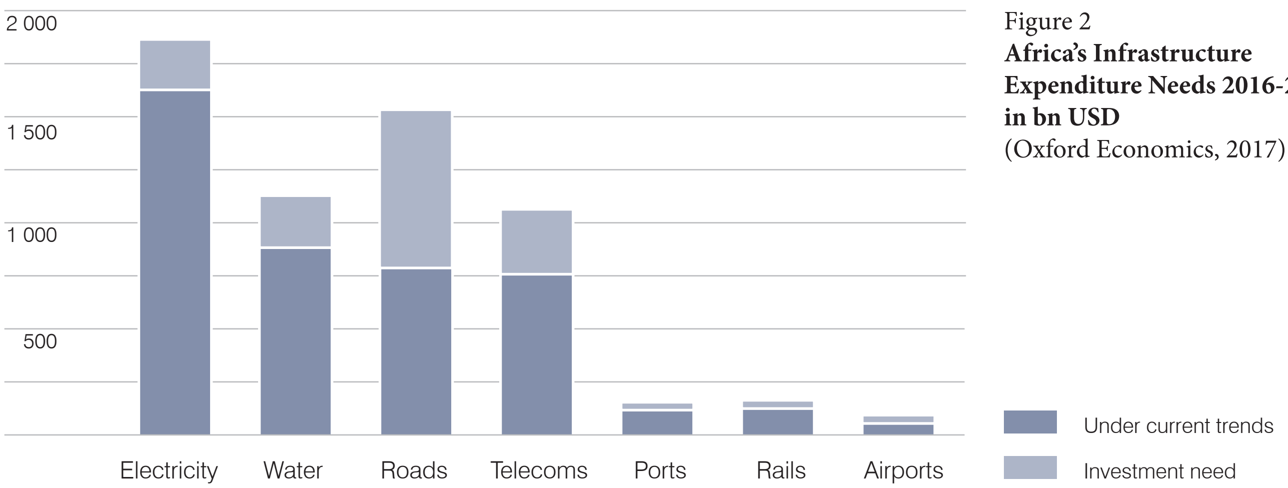



Figure 2
**Africa's Infrastructure Expenditure Needs 2016-2040, in bn USD**
(Oxford Economics, 2017)

**African and European countries should encourage reforms that**

**a. Value maintenance**
**b. Increase private participation**
**c. Promote regional cooperation**
**d. Allocate risks appropriately and plan by bankability**
**e. Identify practical and relevant solutions**
**f. Reduce wasting resources**

## The Road Ahead

With the goal to take adequate measures against climate change, poverty and migration, the African Development Bank[12] recommends that African and European policy makers develop a framework that allows for long-term commitments to infrastructure investment. Projects have to be properly aligned with realistic cost calculation and needs assessments. Investment partnerships between public and private stakeholders have to be encouraged via feasible risk mitigation and regulatory inhibitions should be lifted. Implementing the following reforms would help Africa overcome the challenges ahead:

a) One of the most flagrant errors in infrastructure development is a failure to maintain assets: Infrastructure maintenance needs to be understood as an investment in asset preservation, both by African and European partners.

b) Reform remains essential for tackling operational inefficiencies of utilities, both through private participation and state-owned enterprises.

c) Regional integration significantly reduces infrastructure costs by allowing countries to capture scale economies and to manage regional public goods effectively.

d) Infrastructure policies need to be rethought and more emphasis needs to be put on recovering costs and on recasting subsidies to accelerate access to public infrastructure services.

e) Universal access to these services calls for more attention to remove barriers preventing the uptake of services.

f) Procurement and tax capacities have to be enlarged in order to increase returns and to avoid 'white elephants', corruption, and wasting resources in overpriced projects

# Current Infrastructure Financing for Africa

According to the latest OECD statistics, Official Development Assistance (ODA) net disbursements including concessional and non-concessional loans to Africa have fluctuated over the past years with a recent annual decrease of -1.6%, totalling EUR 50 bn in 2016. ODA net disbursements have been largely provided by the International Financing Institutions including the WB (31%), the EU (30%), the Global Fund (11%) and the African Development Fund (10%); and were predominantly invested in social development (44%), economic infrastructure development (20%) and productive activities (10%).[1]

While the WB has allocated 16.4% of its funds to transport and ICT, 11% to energy and 7.9% to water in 2016, the EU has redirected its focus on social development (30 %), including government and civil society (15.5%). Only 8.7% of net disbursements went to transport and ICT, including technical assistance and rolling stock, whereas energy remains stable at 11%.[2] By creating the Africa Infrastructure Trust Fund (AITF), the EU's regional envelope to Africa has supported 77 transport projects with a volume of EUR 660 m in the period from 2007 until 2015. In 2016, the AITF approved only one grant of EUR 5 m in the roads sector, 8.7% of its annual budget.[3] This represents a decrease of nearly 20% in annual transport investment from the AITF's initial inception in 2007.

**The EU has redirected its development focus from hard to soft targets.**

The combined OECD ODA transport investments of EU institutions and EU Member States amounted to approximately EUR 1 bn in Africa in 2015, compared to EUR 1.6 bn in 2014. With additional funds from the G7, WB and AfDB, the Infrastructure Consortium for Africa (ICA) provided a total of USD 19.7 bn of new loans for Africa's infrastructure projects in 2017.[4] Both numbers show that at the current financing rate, the demand for infrastructure funding will by far not be met until 2040.

**The demand for infrastructure investment will not be met by far until 2040.**

Since the proclamation of the "Year of Africa" in 2006, China has stepped in to meet infrastructure investment needs. As **figure 3** demonstrates, new Chinese sovereign loans to African governments in 2017 amounted to USD 19.4 bn. This marks a steep increase of more than 200% from USD 6.4 bn in 2016. African governments currently owe China a total of USD 100-130 bn, facing an additional USD 60 bn of debt following China's most recent commitment package that was concluded at the FOCAC Meeting in Beijing in December 2018.[5]

**New Chinese infrastructure loans to Africa have increased by more than 200% between 2016 and 2017.**

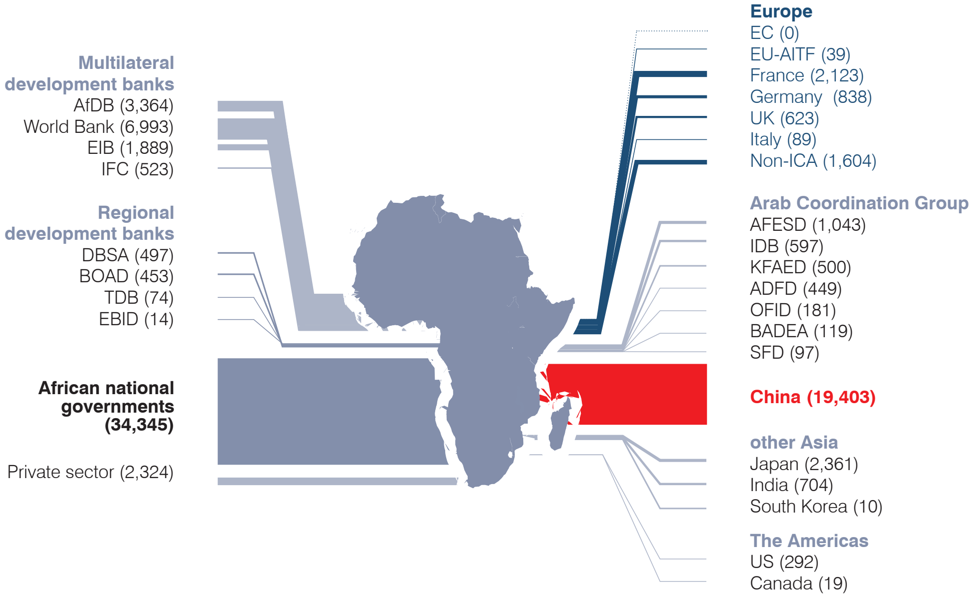



Figure 3
**New Sovereign Loans to Africa, 2017, in m USD**
(ICA, 2018)

While the largest portion of infrastructure investment is still provided by African national governments (USD 34 bn in 2017), China's move to fill the infrastructure funding gap has demonstrated the need for a consolidated focus on infrastructure development, but also given rise to geopolitical concerns among 'traditional' financiers.[6]

**Japan has introduced an infrastructure funding model that is flexible regarding specific lending needs.**

In 2015, Japan set up a financing architecture to level with Chinese infrastructure lending in the Asia-Pacific region. It has been built on three pillars: (1) the expansion of assistance through its ECA NEXI, its Bilateral Development Bank JICA, and its Eximbank JBIC, co-ordinated by the Japanese Ministry of Economic Affairs; (2) an enhanced collaboration with the ADB; and (3) measures to increase funding for high risks projects.[7] Based on these pillars, Japan introduced the USD 200 bn "Partnership for Quality Infrastructure" with a specific Africa Envelope to increase attention to the qualitative dimensions of infrastructure in developing countries. Key aspects include economic efficiency, safety, environmental and social sustainability, local economic and social contribution as well as resilience against natural disasters.[8] Japan's trade insurance now covers all of its investment in Africa, including in the infrastructure sector.[9] Following the Japanese example, the U.S. approved the USD 60 bn BUILD Act to have a greater impact in developing countries, especially on the African continent.[10]

**The EU remains the largest donor to Africa, but its aid is highly fragmented, bureaucratic, hardly visible, and thus unattractive to African governments.**

The EU has shown efforts to draw level with development partners. The External Investment Plan (EIP) seeks to leverage up to EUR 55 bn until 2020 with a guarantee of EUR 4 bn[11] and the new "Africa Europe Alliance for Sustainable Investment and Jobs" foresees an investment goal of EUR 155 bn for Central and South Africa[12]. Their focus lies on boosting trade and employment by facilitating private sector investment rather than on developing the transportation infrastructure which can only be financed by the public sector. Neither the EIP nor the Neighbourhood, Development and International Cooperation Instrument (NDICI) within the Africa Europe Alliance has a dedicated investment plan to support non-viable public infrastructure which needs concessional funding. The European development philosophy of Blending relies on attracting private equity for economically viable project financing. However, in Africa there are only very few such opportunities in the infrastructure sector.

Europe remains the largest ODA donor to African countries, but lacks visibility as a donor, primarily because it redirects its investments via multilateral institutions such as the AfDB, which also leads to a loss of control over investment and project implementation.

The 2016 Afrobarometer revealed that China has overtaken Europe's position in positive popular reviews based on investments in infrastructure despite widespread allegations of sub-standard services, underselling of local competitors and heavy investment in resource extraction and exploitation.[13]

## The Road Ahead

After World War II, the "US Marshall Plan" reduced unemployment, improved relations between the U.S. and European countries and ensured long-term economic growth by addressing the reconstruction of infrastructure. Africa needs an investment plan that goes beyond Europe's "Aid for Trade" agenda. This is why Europe should implement a visible EU-Africa Partnership for Sustainable Infrastructure that provides:

a) Concessional loans with attractive interest rates, grace and credit periods for non-financially viable infrastructure projects that do not generate sufficient cash flow to repay loans.

b) A special window in the EU External Investment Plan (EIP) for non-financially viable infrastructure projects in Africa, backed by subsidies and/or guarantees.

c) A single EU Development Finance Institution dedicated to infrastructure that is able to co-ordinate a project pipeline with African partners, as well as to give a higher volume of guarantees, subsidies, and insurances for infrastructure projects in high-risk environments.

d) A harmonised EU platform that gives clear guidance on how to obtain infrastructure funding from the EU.

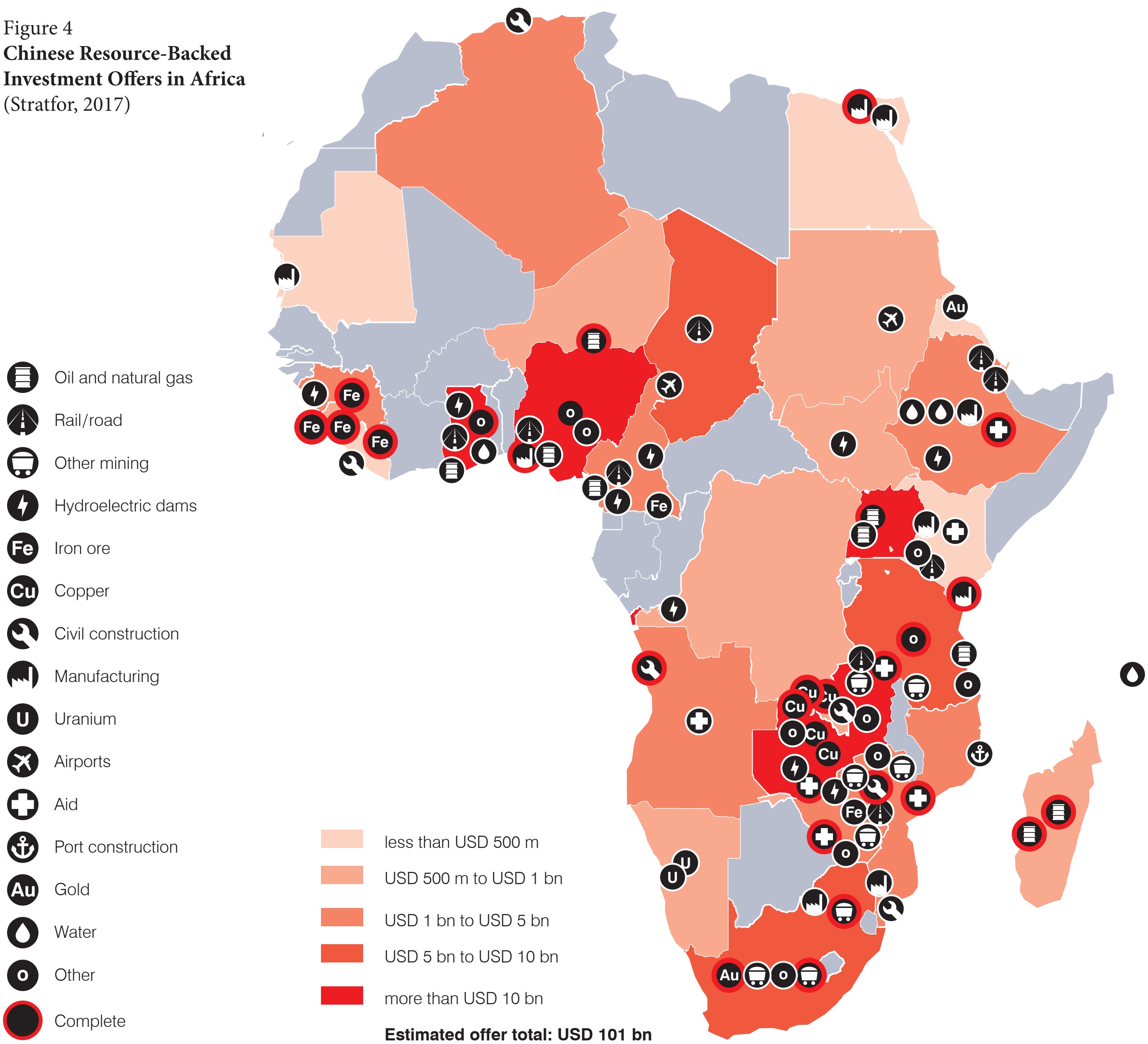
**The EU should establish a mechanism for infrastructure financing in Africa that includes:**

- **Attractive financial packages**
- **A non-financially viable investment window**
- **A single financial institution that administers a project pipeline and provides guarantees and insurances for high-risk projects**
- **A harmonised platform to coordinate projects**

# China's African Business Model

Chinese activities in Africa started in the early 2000s, with China joining the World Trade Organisation (WTO) and proclaiming the Chinese "Year of Africa" in 2006. Since then, its involvement in areas such as agriculture, mining, deforestation and construction has increased exponentially.[1]

Figure 4
**Chinese Resource-Backed Investment Offers in Africa**
(Stratfor, 2017)



**Estimated Chinese infrastructure loans to Africa amount to USD 143 bn in 2017.**

Over a period of 20 years and with an annual Foreign Direct Investment growth rate of 20.5%, China has become the largest bilateral sovereign lender to Africa: In the years 2000-2017, the Chinese government invested USD 143 bn of loans through its policy banks.[2] These funds were not transferred to African governments for International Competitive Tendering but disbursed directly to Chinese state-owned companies active in Africa.

**Chinese lending targets resource-intensive infrastructure and is concluded in individual bilateral Government to Government (G2G) deals.**

China focuses on building investment-heavy extraction and transportation infrastructure (roads, ports and railways) to access resources.[3] Whilst Chinese financial practices are very opaque and hard to scrutinise[4], estimates show that China invested a total of USD 101 bn via government to government (G2G) resource-for-loan deals (barter deals) since 2010. Of these deals, construction and natural resource investment (including transportation) totalled approximately USD 90 bn.[5] Deals made include:

- **Road & Rail, DRC** (USD 9 bn): Credit for Copper & Cobalt
- **Belinga Iron Mine, Gabon** (USD 3 bn): Credit for Iron Ore
- **Souapiti Dam, Guinea** (USD 1 bn): Credit for Bauxite
- **Turbine Power Plant, Nigeria** (USD 1 bn): Credit for Oil
- **Coal/Thermal Power, Zimbabwe** (USD 1 bn): Credit for Chrome

China Eximbank's financing arrangements started with oil-backed deals with Angola in the early 2000s and now include gold mining in Tanzania[6], copper mining in Zambia[7], cobalt mining in Congo[8] and logging in Mozambique.[9] As **figure 4** demonstrates, Chinese Barter Deals since 2010 were mainly made on oil and natural gas extraction (19%), respective underlying infrastructure (18%), and mining activities (23%). Development aid – as defined by the OECD DAC – only accounted for 1.8% and was usually executed as 'pro-bono' construction service (e.g. hospitals) in package deals. Chinese package deals combine so-called "soft" development loans with "hard" export credits, an option that is only allowed within the OECD context if the overall financing terms meet the OECD tied aid criteria. Thus, China takes advantage of staying outside the OECD tied aid regulations and is able to make any package deals that it deems appropriate. This practice has secured Chinese contractors a market share of 62% in 2018.[10]

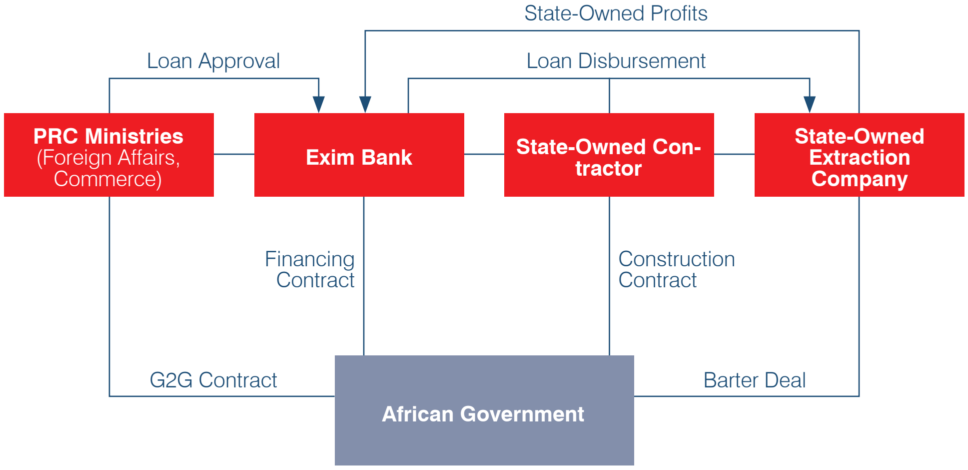
**The engagement of Chinese contractors follows a state-coordinated approach which provides a preferential treatment including exemptions from taxes, tariffs and visa obligations.**

The vast expansion of Chinese state-owned companies in just one decade was facilitated by a sophisticated state-coordinated subsidy program in combination with exclusive targeted political support by the Ministries of Commerce and Foreign Affairs under China's "Going Global" strategy. As **figure 5** reveals, the Chinese government directly or indirectly intervenes in every step of the model: Its Ministries negotiate package deals with African governments and are in charge of approving lending arrangements. African governments conclude the financing contracts of G2G package deals with China Eximbank, while construction and/or extraction contracts and licenses are negotiated with China's state-owned companies under the supervision of the respective Chinese Ministries. After signing, China Eximbank disburses loans directly to the companies, which in turn revert their profits to the bank. Horn et. al (2019) state that such lending practice is not reported by statistical offices of developing countries, creating very opaque international debt statistics.[11]

The model of a **G2G contract** regularly includes tax, tariff and visa exemption, reducing the costs of imported labour, equipment and material. The **financing agreement** sets the rules of procurement to ensure an execution by Chinese companies via direct contracting and enables a fast mobilisation of funding. The **construction contract** allows companies to implement their own standards and rules thus reducing compliance costs, while the **Barter Deal** grants preferential licensing, resource discounts and tax exemptions.

The competitiveness of a construction bid is calculated on two components: the construction costs and the costs of financing. Chinese financial practices allow for more attractive lending conditions that reduce the costs of financing (e.g. interest rates) and tariff exemption enables Chinese companies to import construction material, equipment and labour to much lower prices than local operators can provide. European international contractors have to pay high prices for construction imports while Chinese companies also re-use already imported, 'worn' equipment that is already on site.

Figure 5
**Chinese State-Coordination of Infrastructure Delivery**
(EIC, 2019)



# China's Financial Practices

The economic success of Chinese construction companies abroad mainly originates from massive official financial and political support provided by the Chinese government. It is further facilitated by distortive development and financing practices that are based on China's willingness to deviate from the multilateral official finance system which ought to prevent preferential treatment.

The 7-pillar structure of the rule-based system shown in **figure 6** has been developed over many decades in order to ensure an orderly functioning of officially supported export and development finance. Ideally, it fosters a level playing field to encourage fair competition rather than a choice based on the most favourable, officially supported financial terms and procedures. The global framework includes detailed regulations for development finance, official export credits, financial and technical assistance for countries in debt distress, and debt rescheduling for developing countries to major creditor countries on a multilateral basis rooting in the Paris Club.

In the past decade, China itself has developed from an aid recipient to the largest official financier of projects in developing countries. However, China continues to ignore the multilateral consensus on export and development finance and, unlike OECD countries, does not yet make a clear distinction between ODA and officially supported export credits. China's financial loans are highly intransparent as they do not adhere to OECD DAC and its export credit reporting system.

**China has become the largest infrastructure financier of the world but refuses to play by the rules set under the international financial architecture regarding concessionality, transparency, minimum financing terms and debt rescheduling.**

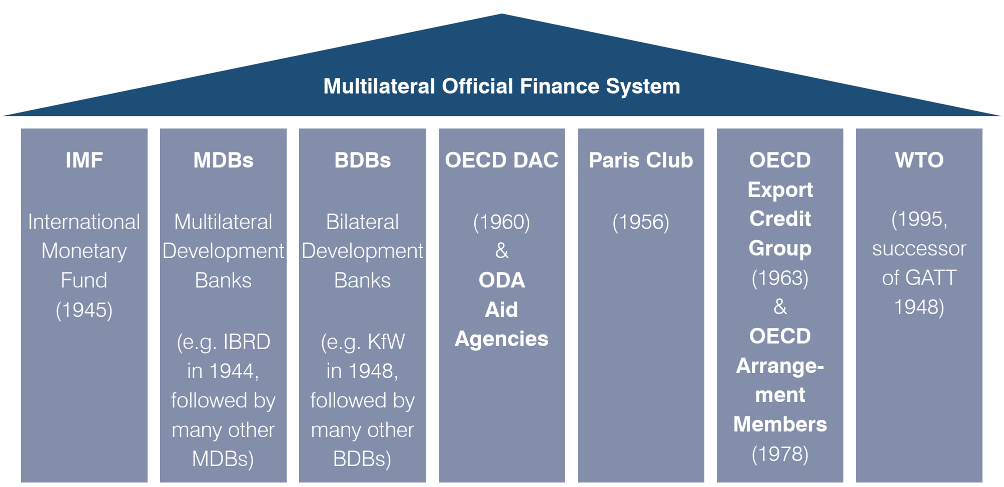



Figure 6
**7 Pillars of the Multilateral Official Finance System**
(Mudde, 2018)

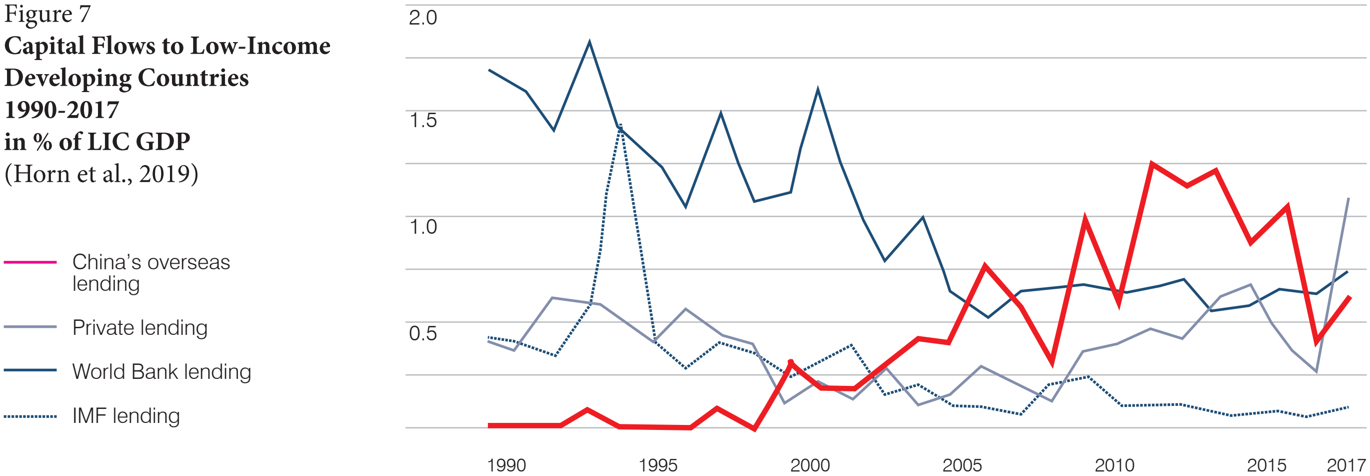
**Not adhering to the financial architecture enables China to implement non-regimented, market-distorting financial practices.**

- **Minimum risk or market-based premiums** for officially supported export credits adopted by the OECD to comply with WTO regulations **do not apply** to China. China can easily undercut pricing from OECD ECAs and create competitive advantages for Chinese construction companies. Sinosure is highly opaque about its pricing.
- **Minimum interest rates** for officially supported export credits do not apply to Chinese official finance. Neither do relevant OECD minimum interest rates to safeguard the WTO obligation – so-called Commercial Interest Reference Rates (CIRRs).
- **Terms and conditions** of export credits regarding the repayment profile, maximum credit periods, maximum grace periods, maximum support for local costs and minimum down payments (15%) do not apply to China.

- China is **not a member of the OECD DAC**. Hence, its 'development loans' lack transparency and are not in line with ODA standards and practices on concessionality. China would have to use substantially higher subsidy funds to meet international aid requirements.[1]

China is not a member of the multilateral official finance system but benefits substantially from a limited participation in four of its pillars: the IMF, MDBs, BDBs and WTO. This limited and selective participation allows China to obtain international public funding – currently, China is the largest borrower from IBRD and ADB with a total outstanding sovereign debt amounting to USD 32.4 bn. By doing so China secures its preferential status as developing country to implement protectionist measures in its domestic market whilst imposing its own lending conditions within the South-South cooperation.

Figure 7
**Capital Flows to Low-Income Developing Countries 1990-2017 in % of LIC GDP**
(Horn et al., 2019)



Official Chinese financing practices cannot be classified as ODA because they are resource-driven. According to the 2018 Aid Transparency Index, China scores lowest of all donors, whilst it is nearly impossible to get data directly from Chinese financial institutions. The core system of Chinese finance includes four types of state-owned actors:[2]

**China's financial system is based on four types of state-owned institutions.**

- **China Eximbank** provides four different financing packages: (1) guarantees for Chinese companies; (2) export seller's credits for financing overseas contracts, exports, and investments of Chinese companies; (3) export buyer's credits for African governments to purchase Chinese goods and services; (4) concessional foreign aid loans.
- **China Development Bank** administers the China Africa Development Fund and China's SME loan program. CDB also supplies commercial loans for investments by Chinese firms and lends to African governments at commercial rates.
- **State-owned Commercial Banks**, including China Construction Bank, Industrial and Commercial Bank of China and Bank of China offer trade finance and guarantees for construction tenders.
- **Sinosure** is a state-owned export credit insurance company and does not itself provide loans but offers insurance on loans and export credits.

**Its practices represent a serious threat to the debt sustainability of developing countries and the stability of the global financial architecture.**

Whilst the G8 members of the Multilateral Official Finance System have agreed to a substantial African debt relief of nearly USD 40 bn in 2005,[3] the United Nations trade body UNCTAD stated that the African external debt stock has rapidly grown to USD 443 bn through bilateral borrowing, syndicated loans and bonds in 2013.[4]
A large part of that external debt (i.e. roughly 50%) is owed to non-Paris club members like China. These lenders are not willing to coordinate their debt portfolio with the rest of the international financial community[5] – this behaviour poses a threat to the global financial architecture since it undermines debt rescheduling policies and sustainable debt criteria, potentially leading to an implosion of international lending institutions. Chinese lending to its top 50 recipients, primarily developing and emerging countries, has mutliplied over the past 10 years and half of these loans are not publicly recorded. Thus the external debt stocks of these recipients have to be adjusted upwards by up to 50% when including China's 'hidden' lending (see **figure 8**).[6]


Figure 8
**Debt to China, Total and „Hidden" Parts**
(Horn et al., 2019)

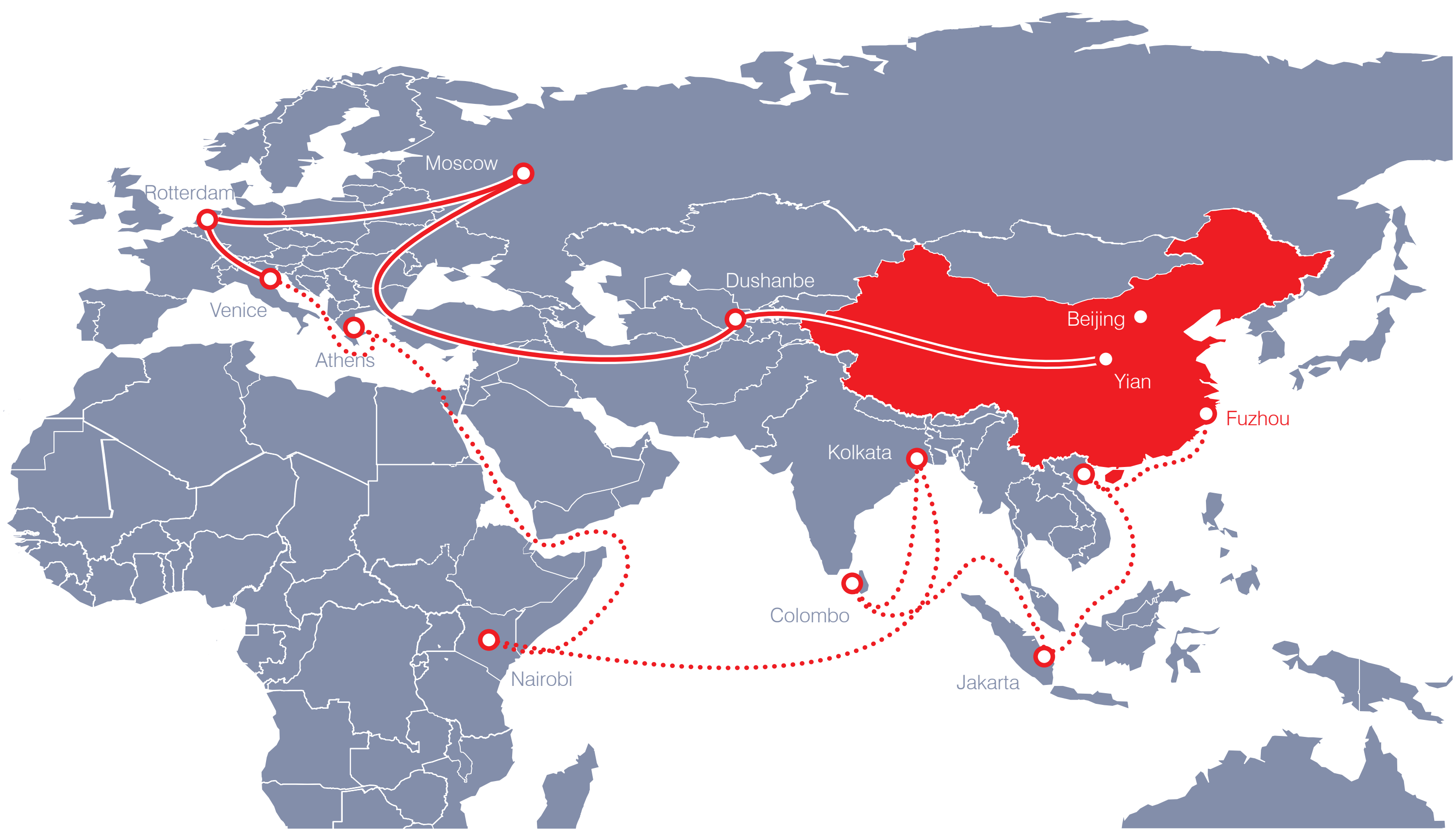
# Global Expansion through Indebtedness

At the Forum of China Africa Cooperation (FOCAC) 2018, China announced its plans to further deepen trade relations with African partners, to strengthen cooperation on security matters and to expand investment plans of the Belt and Road Initiative (BRI) to all of Africa.[1]

**China's investment in developing countries follows a "Going Global" Strategy.**

The BRI or "New Silk Road" was launched in 2013 by Chinese President Xi Jinping, with the ambition to establish a land and maritime transport corridor that improves China's global trade connectivity (**figure 9**). Projects predominantly include infrastructure development (roads, ports, airports, railways and pipelines), power generation (coal and dams) and resource extraction (mines and refineries). Covering two thirds of the world population, 65 countries, a third of the world economy and 75% of all known energy reserves,[2] the USD 6 trillion initiative is expected to advance China's Going Global policy[3] by opening up new markets for goods Made in China by 2025.[4] The project had first been titled "ONE Belt ONE Road", but then had to be reframed since its original name had risen too many geostrategic concerns, preceded by its mission to build new alliances for the annexation of Taiwan to build "One China".[5]

Figure 9
**The Belt and Road Initiative**
(World Bank, 2017)



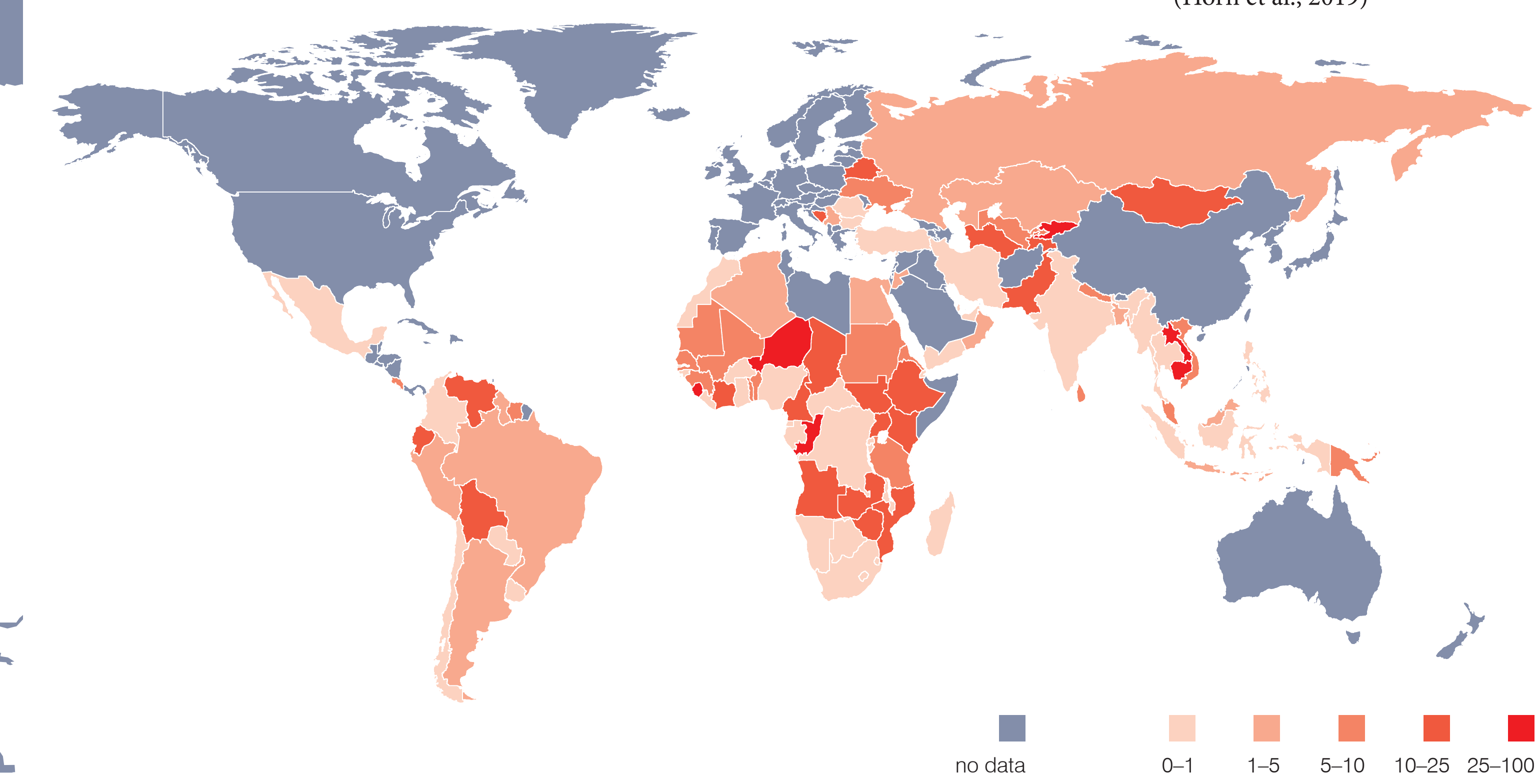
**China's drive for expansion comes at a high cost but is still highly regarded in Africa.**

While multiple studies reported a positive impact of the Chinese engagement in Africa,[6] (an aspect that President Xi Jinping referred to as a Win-Win approach[7]), various NGOs, independent research tanks and African politicians voiced criticism on the impact of Chinese projects on African societies, economies, environment and governance. China is confronted with allegations of favouring cooperation with autocratic regimes, of being strictly resource-driven and of exploiting the underdevelopment of African economies by setting up Chinese monopolies. Notwithstanding, China's own remarkable development still serves as a role model for many African countries. Chinese financial packages are widely endorsed, and despite allegations of discrimination, China is still seen as a hand that keeps on giving.[8]

**Anecdotal evidence highlights China's state-driven expansion policy not only in Africa but also in Europe.**

However, at a closer look there is anecdotal evidence of a state-coordinated expansion policy driven by national interests. This policy operates on the issue of indebtedness: Due to high debt (also called "debt traps" [9]) Chinese debtors find themselves pressured to sell vital parts of their infrastructure in order to settle debts. China's debt diplomacy has forced Sri Lanka to hand over its Colombo port[10] in 2018, and the same procedure is currently being debated for Kenya's Mombasa port[11]. These ports are vital economic hubs for China's BRI maritime network[12] (see **figure 9**). There are currently only few examples that demonstrate the risks of unsustainable debt. Nevertheless, **figure 10** shows that many countries and especially ones on the African continent, commit themselves to financial dependency.

Figure 10
**World Map of External Debt to China in % of debtor GDP (as of 2017, direct loans only)**
(Horn et al., 2019)



Paying attention to such allegations shows that it is worthwhile to elaborate China's impact on fair competition, sustainability, ethics and debt sustainability in African countries. Members of the OECD DAC (ratified in 2001 and revised in 2014) agreed to untie their ODA as it had been observed that tied aid can increase the costs of projects. Untying aid to Least Developed Countries (LDCs) was meant to foster cooperation and effective partnerships, to strengthen ownership, to demonstrate responsiveness to partner countries' needs and to help them grow into the global economy.[13]

**As China is not part of the OECD DAC Untied Aid Agreement, its projects are not subject to International Competitive Bidding.**

China is not a member of the OECD DAC and therefore does not have to adhere to the recommendation of the OECD to untie aid. Its funds are fully tied to state-owned contractors. Due to an absence of International Competitive Bidding, negotiated G2G contracts tend to be heavily overpriced compared to market prices. Furthermore, African countries gain little returns on Chinese projects due to tax and tariff exemptions. The selling of resources below market price further reduces returns. As a consequence, Chinese official finance practices are a serious threat to debt sustainability in developing countries. As **figure 11** demonstrates, their debt has risen substantially over the past years, with Non-Paris Club debt owed mostly to China now accounting for more than 50% of outstanding liabilities In Africa.[14]

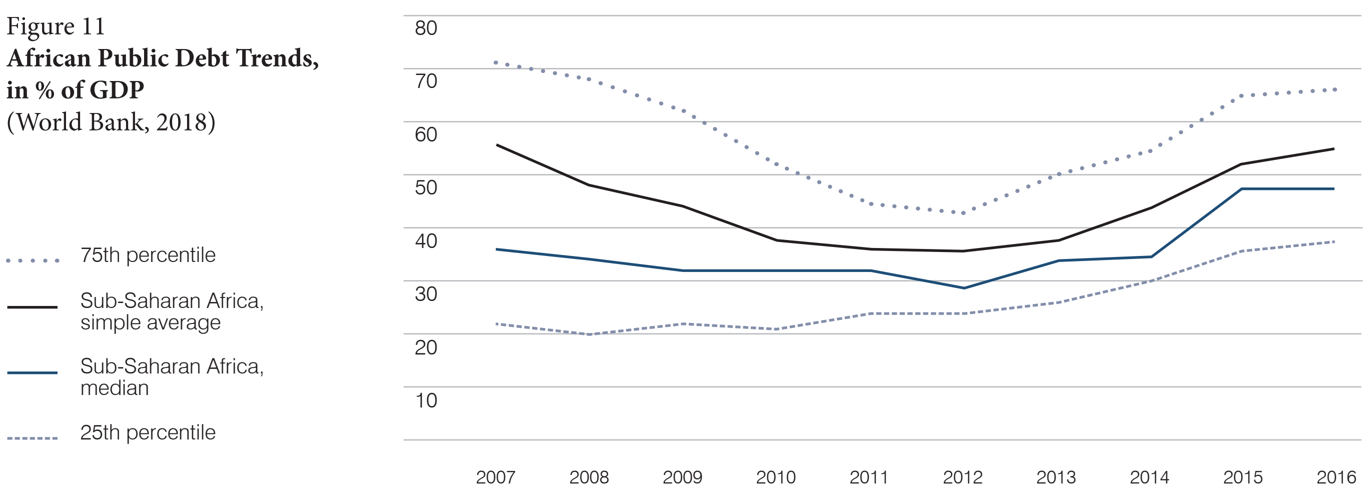
**China's lending practices are inconsistent with the OECD's and UNCTAD's ambitions to stop the fast deterioration of debt sustainability.**

OECD and UNCTAD have urged donor countries to implement measures to reverse the fast deterioration of debt sustainability in developing countries. This represents a major obstacle for UN SDGs and for the endeavor to close the present infrastructure funding gap. As Chapter 1 of this paper outlines, measures include the removal of barriers to investment, strengthening of local trade and private sector development, building tax revenue capacities and helping developing countries to prevent tax avoidance and evasion. Current Chinese financial practices counteract these endeavors.[15]

**Its bilateral debt workouts increase the risk of debt traps.**

With its debt diplomacy, China attempts to gain and secure access to natural resources, to obtain strategically vital infrastructure, and to potentially set up overseas military bases, as the example of Djibouti has shown.[16] Since China is not a member of the Paris Club, its bilateral debt workouts open up the possibility to acquire economically vital infrastructure in cases where debtors are unable to offset FDI and sovereign loans.[17] China remains secretive about its lending practices[18] but the consequences of its financial practices have demonstrated that its "Win-Win" narrative is in fact a serious threat for the sovereignty of developing countries and the Global Financial Framework as a whole.

Figure 11
**African Public Debt Trends, in % of GDP**
(World Bank, 2018)



# Impacts on Fair Competition

There are several drivers that have facilitated essential competitive advantages for Chinese companies apart from export subsidies outside the international lending framework. As a result, these companies may offer services at dumping prices (or at so-called "China price"). Factors in favour of this practice are: Low wages, lax regulations and preferential treatment.[1]

The Chinese price for export services is linked to protectionist measures for the domestic Chinese market (Chinese exporting companies are often excluded from VAT). This has helped Chinese companies to create monopolies in foreign markets. Over the past ten years, Chinese contractors have doubled their market share across Africa from 28% to 56% at the expense of their European competitors, many of whom have left the market altogether (**figure 12**). China's global market share has tripled from 7% to 21%.[2]

**The success of Chinese companies is based on:**

- **Abnormally low bids, low wages, lax regulations and preferential treatment**
- **Coordinated collusion in tendering**
- **Monopolistic market expansion and service provision**

European international contractors are not the only companies that struggle with the state-led Chinese market expansion in Africa. According to a study conducted by the University of Stellenbosch, local contractors and companies within the subordinated construction value chain have stated that they do not see any chance in competing with Chinese companies in tenders that are procured via competitive bidding. Multiple respondents have voiced concerns over collusion in bids and undue influence in procurement decision-making and related administrative procedures.[3]

In 2018, McKinsey stated in a report[4] that Chinese companies expand their activities outside their value chains once they have established market presence. This means that construction companies become active in ICT, manufacturing companies participate in the farming industry and mining companies are advancing in the energy sector. Parts of Africa's infrastructure are currently built, owned and operated by Chinese state-owned companies. These companies serve as market entry facilitator and diplomatic leverage to promote the "One China policy", and as resource supplier for domestic production.

According to McKinsey, Chinese companies generate a profit margin of more than 20%. Profit margins of this size are highly unusual in both international and national construction markets. It is likely that they relate to projects that are financed by the Chinese government and are thus exempt from International Competitive Tendering.

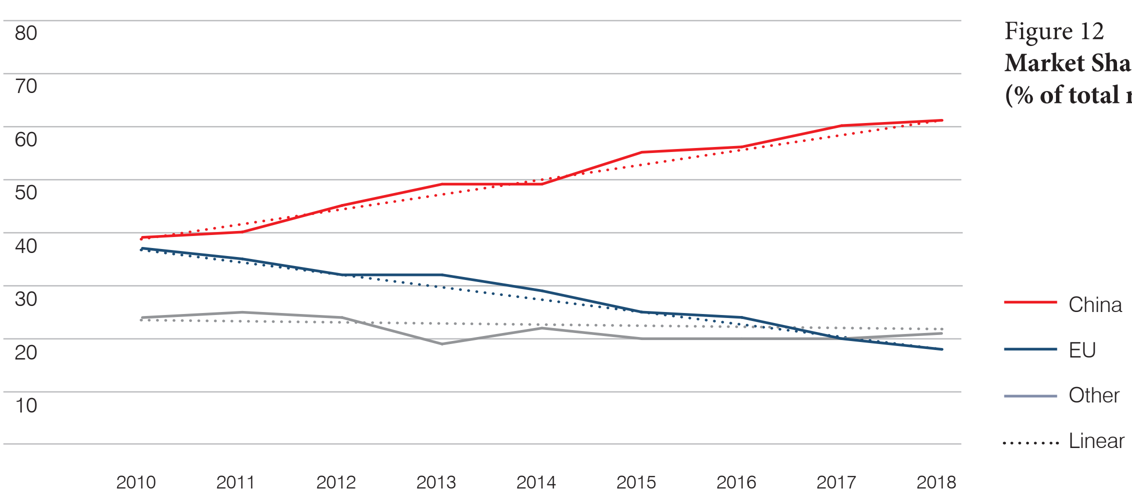



Figure 12
**Market Shares in Africa (% of total revenue)**

For international contractors the abovementioned alleged profit margins represent a serious obstacle in the realisation of infrastructure projects financed by Multilateral or Bilateral Development Banks where Chinese bidders often undercut their international rivals by 20% or more. The fact that bid prices offered by Chinese contractors usually lie below the direct costs indicates that high profits generated via projects under tied Chinese financing agreements are "re-invested" to distort competition in international open tenders.

**Basing their decision on the lowest price, African borrowers of Multilateral and bilateral Development Banks often select Chinese state-owned contractors in international competitive bidding.**

In the context of International Competitive Bidding, Chinese bids are consistently found to be abnormally low. Furthermore, there have been reports of bidding practices that undermine conventional bidding standards: Several Chinese companies participate in the bidding procedure with differently priced bids. After the closest bid has won, the winning company contracts its Chinese competitors for the execution of project works. This type of behavior leads to a heavy distortion of competition and to project cost explosion via price undercutting.

African borrowers of European DFIs, MDBs and BDBs often choose Chinese contractors based on the lowest price. As a consequence, Chinese contractors gained ground in international open competitive tenders while being cross-financed through subsidies, supported by high returns on G2G contracts and exempted from taxes and tariffs.

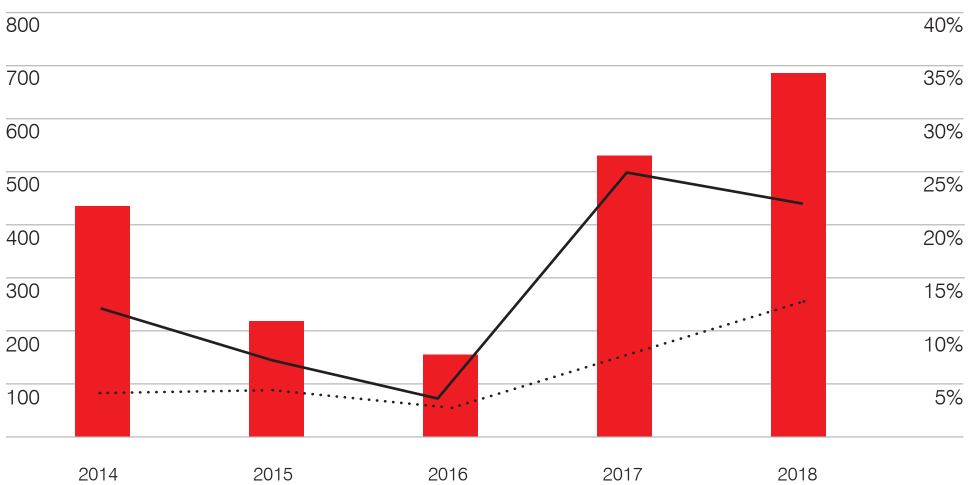
This trend is illustrated by **figure 13** which shows a sharp increase of World Bank-financed transport infrastructure projects awarded to Chinese contractors. Respective research from Rhodium Group suggests that Chinese firms captured as much as 21% of all World Bank-financed transportation infrastructure project value in 2018, up from 12% in 2014.[5]

Figure 13
**World Bank Transportation Infrastructure Projects Won by Chinese Firms, 2014-2018**
(Kratz, et al., 2019)

Overseas contracts won, percent (RHS)

Overseas contract value won, percent (RHS)

Contract Value (USD millions)



**Examples of European DFI Tender Awards to Chinese contractors**
(EIC, research 2019)

The following list shows examples of tenders by European Financial Development Institutions that have been awarded to Chinese contractors due to abnormally low bids. The examples provided account for a total of roughly USD 255 m (conversion rates as of 06 May 2019) over the past 3 years, and have been financed by the EIB, EU and AFD.

**Zambia: Two substations and associated switching stations in 2 lots:**
- Lot 1: Chilanga 132/33/11 kV procured to SEPCO electric Power Construction Corporation in April 2018 for USD 11,701,984.00 (USD 11.7 m)
- Lot 2: Chawama 132/11 KV procured to Sieyuan Electric Co. Ltd. in Joint Venture with Techno Electric Engineering Co. in September 2018 for USD 10,768,794.05 (USD 10.8 m)

**Tanzania: Project "Rehabilitation and Upgrading of Regional Airports"**
- Shinyanga Airport, procured to China Henan International Cooperation Group Co. Ltd. (CHICA) in June 2017 for USD 21,379,040.11 (USD 21.4 m)
- Sumbawanga Airport, procured to Sino-Shine Overseas Construction & Investment East Africa Ltd. in May 2017 for USD 24,304,083.62 (USD 24.3 m)
- Tabora Airport, procured to Beijing Construction Engineering Group in May 2017 for USD 11,751,291.07 (USD 11.7 m)

**Kenya: Isebania-Kisii-Ahero Road Rehabilitation,
supported by the EU, both in 2017**
- Lot 1: Rehabilitation and upgrading of Isebania-Kisii road (86 km), procured to China Henan International Corporation Group for USD 83,794,100.00 (USD  3.8 m)
- Lot 2: Rehabilitation and upgrading of Kisii-Ahero road (84 km), procured to Third Engineering Bureau of China Construction Company for USD 91,588,900.00 (USD 91.6 m)

# Impacts on Sustainability and Ethics

The success of the Chinese G2G contracting model largely relies on short delivery periods between conception and execution of projects. Especially with regard to the representative function of large infrastructure projects, African policy makers embrace bids that foresee project delivery within one legislative period. The fast delivery, however, is not warranted by shorter construction periods but by shorter project planning phases.

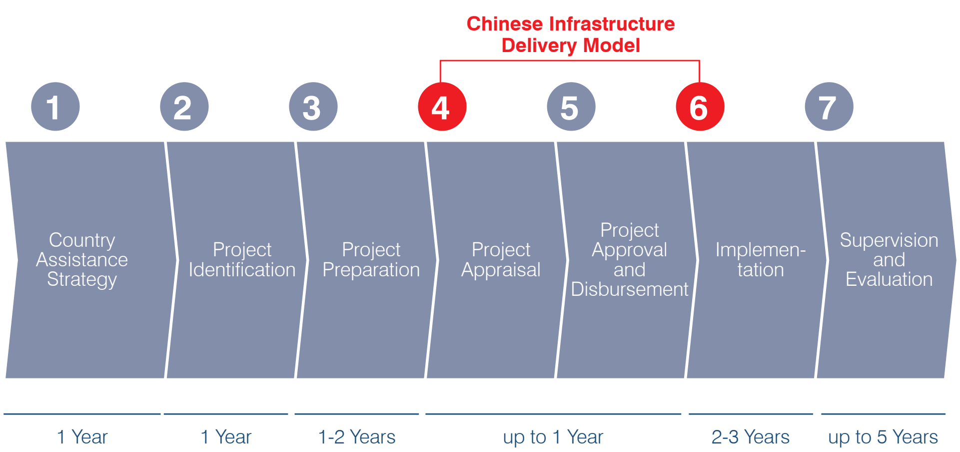
**China's fast completion of construction works comes at the expense of thorough feasibility studies and proper engineering designs.**

**Figure 14** displays a typical project cycle applied by most MDBs, EDFIs and BDBs.[1] Projects that are relevant to a country's long-term development are identified on the basis of a comprehensive Country Assessment Strategy. Due to lengthy feasibility and bankability studies, a project's approval and the disbursement of funds can take several years. The Chinese model, however, does not require thorough project planning and design. Upon initiation by an African government and/or a Chinese state-owned enterprise, G2G contracts get signed within a few months or even weeks, effectuating the disbursement of funds by one of the Chinese policy banks. The contractor to execute the project is quickly established via internal competition for which only Chinese bidders are eligible; construction works can therefore be completed without bureaucratic supervision or compliance issues.

**Chinese companies disregard occupational health and safety standards thus risking fatal accidents and pollution.**

Chinese contractors are not obliged to apply international best practices on managing environmental, social, health & safety and governance risks for projects in Africa; thus, they are more likely to take shortcuts in project engineering. When dealing with difficulties such as unqualified local staff, Chinese contractors may import workers to Africa while profiting from low wages and visa liberalisation. (E.g.: For the construction of the Tazara railway line between Zambia and Tanzania, the contractor imported 56,000 engineers and workers.[2]) The annual total number of Chinese workers in Africa lies around 250,000.[3] This raises concerns about a negative impact on local employment. Equipment and blueprints that are only provided in Mandarin frequently render an employment of local workers impossible in the first place.[4]

Figure 14
**Chinese Infrastructure Delivery Model compared to the MDB project Life Cycle**
(EIC, 2019)



There are reports of degrading working conditions – discrimination, violent treatment and even sexual assault – on working sites across the African continent.[5] It is also criticised that long-time equipment on the ground remains unchecked and workers' damaged protective equipment is not being replaced (see Kenya case study on page 31). Due to fatalities through landslides, falling boulders or asphyxiation, Chinese contractors already started building their own cemeteries for workers and engineers who died on duty.[6] In 2017, Amnesty International published a report on Congo strongly condemning the employment of children in the Chinese mining industry.[7]

**An incomplete sustainability assessment results in disastrous impacts on society and the environment.**

The Chinese infrastructure delivery model is not only criticised for deficient labour standards. The Belt and Road Initiative is generally considered to be the environmentally riskiest project in history.[8] Concerns arise from previous experiences with illegal mining and logging activities in Uganda and Mozambique that brought on severe consequences for the environment such as water and air pollution and erosion and destruction of vegetation and natural habitats.[9] In the case of the Lamu Port Project and the standard-gauge railway through Kenya's Nairobi National Park, construction works have severely damaged UNESCO World Heritage sites.[10] Even though China is increasingly investing in green energy at home, it strongly favours fossil fuelled energy production abroad.[11] While this type of energy is cheaper in the short run, it has potentially disastrous impacts on the environment, as China's pollution at home has demonstrated.

Beyond consequences for workers and citizens, a lack of project implementation standards often leads to lower quality, shorter life span and higher maintenance needs of works. The pictures below demonstrate how poor planning and execution leads to significantly higher costs, non-performance of work, inefficient spending and "white elephants" – projects that end up being of no use or value. Examples are: A ghost town in Luanda, a collapsed bridge in Budalangi, a road 'washed away' in Lusaka.

**Corrupt practices have proven negative spill over effects on local societies.**

The evidence highlights the main issue with poor project design, abnormally low bids and lack of compliance: Corruption and undue business conduct are endemic problems in Africa and they jeopardise a level playing field. Since China has not ratified OECD conventions it is not accountable for bribery of foreign officials and export credits. Hence, officials of state-owned companies usually do not have to face punishment for paying facilitation bribes, counterfeiting certificates and track records, colluding on bids and for undue influence.[12] The result of such practices is irresponsible corporate behaviour such as changes in design or personnel without permission. Other unethical behaviour includes deviation from bidder instructions and local laws by exclusion of clauses on conflict of interests and contractor liability (see Zambia case study on page 31).[13] While the WB had cross-debarred the respective contractors, they were still selected for the procurement of other projects.[14] Also, studies have proven a negative spill-over effect on the ethical behaviour of the local society.[15]

Overall, the Chinese infrastructure delivery model in Africa does not align with international standards and norms. Some of these standards are ignored due to the fact that China did not ratify the respective conventions (such as OECD DAC, OECD BEPS and OECD Anti-Bribery agreement); violations of other agreements (such as the G20 agreements, UNCAC, UN Global Compact or ILO Conventions) are simply not being prosecuted.

Photos
**Examples of Chinese Projects without "added value"**

15
Ghost Town
(Luanda)

16
Road washed away
(Lusaka)

There are a great number of international safeguards in place to ensure sustainable and responsible business and governmental conduct in connection with multilaterally financed infrastructure projects:

- Aarhus Convention on Civil Participation and Transparency
- Agenda 2030 (Sustainable Development Goals)
- Basel Conventions on Hazardous Waste Disposal and Solvency requirements
- ESPO Convention on Cross-border Environmental Impact Assessments
- G20 Agreement on Operational Guidelines for Sustainable Financing
- G20 Agreements on the International Financial Architecture (Cannes, 2011), Development Policy, Energy and Climate (Antalya, 2015), Corruption (Seoul, 2010), Trade (Pittsburgh, 2009)
- IFC Performance Standards on Environmental and Social Sustainability
- ILO Conventions on International Labour Standards (for multinational enterprises)
- ISO 45001 on occupational health and safety
- OECD Guidlines for Multinational Enterprises, with independent compliance procedures through national contact points
- OECD Recommendation of the Council on Common Approaches for Officially Supported Export Credits and Environmental and Social Due Diligence
- OHCHR (International Covenant on Civil and Political Rights)
- Open Contracting Partnership on Disclosing Procurement Data
- UNECE Convention on Long-range Transboundary Air Pollution
- UN Convention on Anti-Corruption

# Exemplary Cases

## Overpricing of Direct Contracting in the DRC

In 2014, the human rights watchdog ASADHO released a report on the partnership implementation between the Democratic Republic of Congo and Chinese state-owned companies. The audits covered package deals on various transport and mining projects totalling USD 6 bn. The report found that the projects concluded via direct contracting were unjustifiably priced up to 5 times higher compared with international costs. The audit also revealed that the pavement of the roads broke shortly after construction, that no feasibility studies were concluded, no information and compensation schemes applied, works were partly not finished or completed with great delay and that financial flows were highly intransparent.[1]

## Unsustainable and Resource Backed Lending in Angola

The lack of sustainability has already proven disastrous for many other African countries, first and foremost Angola. Between 2003 and 2006, China invested nearly USD 3 bn in Angola, of which 76% was targeted towards infrastructure concluded within various package deals. Following the oil crisis and Angola's inability to cover for the loans, many contractors withdrew, leaving behind unfinished projects. Investigations into the work done so far revealed a striking low infrastructure quality, including potholes, cracks in a newly built hospital as well as heavy environmental pollution. Even more problematic was that uncoordinated Chinese investment focused on the extraction of raw minerals and oil had led to asymmetric growth, leading the country into a heavy recession that relied on stable prices to serve its barter deals. Leaving traditional manufacturing behind, resource-backed investment created high unemployment and poverty rates as well as a lack in medical infrastructure, environmental pollution and an increased perceived corruption rate.[2]

## Unethical Business Conduct in Zambia

After a series of allegations of low-quality construction, the Zambian Auditor-General investigated construction permits for Zambia's Road Development Programme that was financed by the EU, EIB and KfW. The report concluded that contracts were awarded to Chinese contractors even though they had been non-responsive, had changed designs and personnel without permission and had failed to comply with bidding instructions and local laws. The exclusion of clauses on conflicts of interest, maximum price variation and contractor's liability, lead to unfinished works and an overall low quality of infrastructure. According to Zambian academics, the influx of Chinese contractors and the investigated allegations had been facilitated by a systematic web of corruption – a problem many African countries are struggling with.[3]

## Inhumane Working Conditions in Kenya

The World Bank cut funding to a Chinese executed project in Uganda based on claims of sexual harassment by Chinese workers on the construction site. As a consequence, more attention was paid to labour conditions also in Kenya. In 2018, the Central Organisation of Trade Unions Kenya (COTU-K) issued a press release to advocate measures against dehumanising working conditions on Chinese construction sites, such as sexual assault, discrimination, violent treatment and improper working contracts. The release also criticised that long-time employed equipment on the ground remains unchecked and damaged protective equipment is not being replaced.[4]

# Conclusion and EIC Recommendations

This paper has demonstrated that China has gained immense popularity with African governments and has established itself as the largest financier for major infrastructure projects on the continent within less than two decades. Chinese overseas infrastructure finance projects typically comprise a lump-sum approach on the basis of a government-to-government agreement. Such deals are often combined with natural resource development and the promise of a preferential policy bank loan on terms that are irreconcilable with the multilateral rules on both development finance (incl. ODA and other forms of development finance) and officially supported export credits. Chinese financing is usually tied to a delivery by Chinese state-owned construction companies for at least the lion's share of the contract value.

Given Africa's huge infrastructure deficit and urgent need to close the respective financing gap, the abovementioned lump-sum approach has been tolerated for the past decade by policy-makers and financiers in the OECD countries as well as by Multilateral and Bilateral Development Banks (MDB/BDB) with the consequence that the multilateral official finance system is presently eroding. Japan and Korea reacted to Chinese official finance practices with a substantial increase of untied investment loans – which are outside of the scope of the relevant OECD rules.

In the context of an initiative titled "Expanded Partnership for Quality Infrastructure", Japan committed to provide financing of approximately USD 200 bn from 2017 to 2021, which shall be allocated to infrastructure projects across the world. In autumn 2018, the U.S. decided to consolidate the Development Credit Authority of the U.S. Agency for International Development (USAID) with the Overseas Private Investment Corporation (OPIC). The goal is to provide USD 60 bn in loans, loan guarantees, and insurance to U.S. companies that invest or operate in developing nations with a focus on the infrastructure sector.

It is high time that the European Union live up to its self-proclaimed status as the world's leading donor of development assistance in order to face the challenges posed by the Chinese infrastructure delivery model in Africa.

With the new "Africa-Europe Alliance for Sustainable Investment and Jobs", announced by President Jean-Claude Juncker in September 2018, Europe is stepping up the partnership with its "twin continent" with the ultimate goal to deepen trade and investment relationships and to give new perspectives to young generations.

European international contractors have a long track-record of delivering quality infrastructure in Africa that started in the early decades of the past century. There are good examples where the presence of European construction companies in Africa has lifted the local industry to a higher performance level, with one of the benefits of such collaboration being that European companies do not export a large amount of their workforce, but rely on local personnel to manage the project as far as possible. In their daily activities in Africa, European companies employ and train the local workforce in accordance with internationally recognised labour standards and they transfer technical know-how to their local partners.

Against this background, EIC proposes to establish a new "EU-Africa Partnership for Sustainable Infrastructure" under the umbrella of the Africa-Europe Alliance for Sustainable Investment and Jobs. The goal shall be to increase the EU's visibility in infrastructure development in Africa, to ensure a level-playing field for European infrastructure providers in Africa and to reach the Sustainable Development Goals. However, in order to make this vision a reality, the European Union needs to reassess its infrastructure development policy and to ensure:

1. **Enhanced EU Infrastructure Financing**
2. **Reciprocity in EU External Aid**
3. **Sustainable Procurement of Infrastructure Projects**

## 1. Enhanced EU Infrastructure Financing

In order to increase the visibility of Europe's Official Development Assistance (ODA) in Africa and to promote the achievements of the Sustainable Development Goals, EIC calls upon policy-makers of the EU and its Member States to aim to act as a "Global Player" rather than a "Global Payer" and to reassess the current modalities of European development and export financing in the infrastructure sector.

**EIC calls upon the EU to:**

**EIC acknowledges that the EU and its Member States remain the largest global development donor, but its development assistance is too fragmented to present Europe as an attractive and competitive partner and financier of large-scale infrastructure projects in Africa.**

**Extend its sectoral ODA portfolio to the water and transport infrastructure sector**

- **EIC calls upon the EU and its Member States to rebalance the sectoral ODA portfolio and to put a stronger emphasis on the infrastructure sector, and especially on transport and water.** The OECD Statistics for the year 2018 suggest that these two crucial infrastructure sectors account for only around 10% of the European ODA to Africa; comparable figures for Japan and Korea lie at almost 50%. China has also committed an average of 50% of its total infrastructure financing in Africa to transport infrastructure over the past six years.

**Pool European development and export finance and streamline project implementation cycles**

- **EIC observes an urgent need for the European Union to draw level with Asian and U. S. Development Finance Institutions, Exim Banks and policy banks, aid agencies, etc. in terms of both volume and management capacity for infrastructure finance in third markets, and specifically in Africa.** For the EU to improve its respective competitiveness it will be necessary in the context of the EU's external action financing instruments to (1) pool European development finance and technical expertise for Africa's infrastructure sector; (2) to establish a complementary EU financing institution with a broad mandate to provide competitive finance, including all forms of Official Finance such as development and export finance linked to the "European interest"; and (3) to streamline the project implementation cycle for EU-financed infrastructure. Presently, European finance is fragmented across many institutions both on EU and Member States' level operating under various mandates. This may be an advantage for small-scale investments in the social sectors, but it is a hindrance for structuring tailor-made EU financial offers for large-scale infrastructure projects globally. A more streamlined and versatile financing institution on EU level, capable of combining European development and export finance and thus of matching the performance of Asian and U. S. institutions, could work alongside European DFIs and ECAs and aggregate existing financial capacity and technical expertise.

- **EIC recalls its innovative concept of "Blending 2.0" as a financial tool to catalyse commercial finance for public infrastructure projects in Africa** that do not generate sufficient direct project income while being critical for social and economic development of the country. This may affect transport, roads, bridges, railways, drinking water & sanitation, ports, airports, health and education. EIC's "Blending 2.0" concept is composed of EU grant funding subsidising interest rates for concessional development loans arranged by European Development Finance Institutions. The latter (EDFI) may partially syndicate loan tranches to commercial banks to the extent that commercial bank finance can be guaranteed via comprehensive insurance cover from participating Export Credit Insurance Agencies.

**Upgrade financial tools to „Blending 2.0" in order to catalyse commercial finance for public infrastructure projects**

- **EIC questions the EU's practice to provide the bulk of its infrastructure ODA to Africa via "Blending" with non-European actors. Through transferring EU ODA to the World Bank or the African Development Bank under the Blending modality, the EU inevitably loses visibility and control of project implementation.** This practice also conflicts with the European Court of Auditors' recommendation to the European Commission to use the Blending mechanism only when there is a clear added value. The Court's audit in 2014 showed that this had previously not always been the case.

**Redesign the current „Blending" concept in order to be more visible and in control of project implementation**

- **EIC calls for the introduction of a special "window" in the EU External Investment Plan (EIP) dedicated to non-viable transport infrastructure investments** because there are a number of constraining factors for public-private partnerships in Africa's infrastructure sector – e.g. inadequate legal and regulatory frameworks, a lack of technical skills to manage PPP programmes, small market size and limited financial markets. This is why an intervention by DFIs and MDBs, for instance in the form of subsidies or guarantees, will be crucial to ensure the financial viability of PPP infrastructure projects in Africa.

**Introduce an investment window for financially non-viable transport infrastructure in the EIP**

## 2. Reciprocity in EU External Aid

Chinese Official Lending Practices distort fair international competition because they are incompatible with the tried and tested multilateral rules on export and development finance. In order to create a level playing field, Europe needs a strong and harmonised response to China's current overseas lending policies and practices. Together with other OECD governments, the EU and its Members States should point out problems brought on from the currently unlevel playing field for official finance. A potential collapse of the unique multilateral official finance system should be a priority issue on the agenda of the G-7, the G-20 and of MDBs.

**EIC calls upon the EU to:**

**As long as there is no adequate global framework on official finance, the EU's Institutions and Member States should consider the implementation of interim measures.**

**Ensure reciprocity with regard to the obligations of the OECD Arrangement on Official Supported Export Credits**

- **EIC calls upon the EU Institutions and Member States to create a level playing field vis-à-vis China with regard to all obligations determined by the OECD Arrangement on Officially Supported Export Credits.** The Arrangement, which was initially created in the 1970s, remains the only detailed international rulebook on officially supported export credits and encourages competition among exporters based on the quality and price of goods and services rather than on the most favourable officially supported financial terms and conditions. Hence, China should be convinced to at least apply the minimum terms and conditions of the so-called "OECD Consensus" for its overseas financing activities. Further, China should become a member of the "Paris Club" and cease to negotiate debt re-scheduling agreements on a bilateral basis as well as commit to the OECD's environmental, ethical and social due diligence rules in connection with export finance and export credits.

**Ensure reciprocity with regard to the guidelines of the OECD Development Assistance Committee**

- **EIC calls upon the EU Institutions and Member States to create a level playing field vis-à-vis China with regard to all decisions, recommendations and guidelines of the OECD Development Assistance Committee.** At present, Chinese development loans do not meet the minimum concessionality levels that the OECD-DAC applies to tied aid – 50% for Least Developed Countries and 35% for other countries –, meaning that China would have to use substantially higher subsidy amounts to meet international aid requirements. Chinese development loans are a serious threat for debt sustainability in developing countries. To top things off, China asks countries that wish to qualify for a concessional loan to grant some kind of preferential treatment to the project such as: tax-free repatriation of the payments on the loan; relief on import tariffs for inputs; lower income tax.

**Declare companies from OECD non-compliant jurisdictions ineligible for infrastructure tenders**

- As long as China does not follow the same official financing rules and practices as its OECD counterparts, **EIC calls upon the EU Institutions and Member States to declare Chinese companies ineligible for participation in infrastructure tenders directly and indirectly financed from EU ODA, especially if such companies are state-owned.** The EU Institutions and Member States should only untie European ODA to other OECD and non-OECD countries on a reciprocal basis. Reciprocity should be fully transparent and verifiable, and it must be ascertained that untied aid is not de facto tied.

## 3. Sustainable Procurement of Infrastructure Projects

The UN 2030 Agenda for Sustainable Development lists 17 Goals for all stakeholders to promote prosperity while protecting the planet. Ending poverty must go hand in hand with strategies that spur economic growth, address social needs including education, health, social protection, and job opportunities and that tackle the issues of climate change and environmental protection. The international export and development finance community, i.e. International Financing Institutions, Multilateral Development Banks, Bilateral Development Agencies, Export Credit Agencies, etc. should all work together to ensure that their financial support exclusively goes to sustainable and resilient infrastructure projects.

**Institutions and agencies should insist on a procurement and delivery process that respects all major aspects of sustainability: e.g. protection of the environment and of Human Rights; inclusion of local value chains, labour and business ethics.**

**EIC calls upon the EU to:**

- **EIC calls for an implementation of mandatory sustainable procurement procedures in all tenders from European Development Financial Institutions and Multilateral Development Banks.** To this end, sustainable procurement should be inscribed into the Articles of Agreement and into the policy rules and regulations of all development financiers. Sustainable procurement should aim at a selection of the "Most Economically Advantageous Tender" in order to safeguard compliance with all Environmental, Social, Health and Safety (ESHS) requirements. Since the lowest price tender will not provide the optimal technical solution while leaving financial means to produce the desired environmental and social outcomes, a selection method should be implemented which is economic in nature and also integrates life-cycle, environmental and social criteria, without replacing the primary objectives of procurement.

  **Make Sustainable Procurement Procedures mandatory**

- **EIC recommends to include environmental and social and health and safety (ESHS) standards in the work requirements stated in the Standard Procurement Documents of all MDBs and BDBs.** Such sustainability requirements should cover all aspects regarding (1) health and safety, (2) local labour and relations with local communities, (3) protection of the environment and the people. These requirements need to also be incorporated in a project's life-cycle assessment alongside design, build, operation/maintenance and disposal.

  **Introduce strict sustainable tender criteria as work requirements**

- **EIC advocates a prequalification system that ensures full compliance with the highest international environmental, ethical and social standards and allows for a verification of alleged track records.** For instance, the classical prequalification criteria relating to Financial Capacity and Technical Experience should be complemented with criteria on sustainability that include mandatory certification of Quality (ISO 9001), Environmental (ISO 14001) and Health and Safety Management (ISO 45001) as well as full regard of the ILO Core Labour Standards and Ethical Business Principles (OECD Anti-Bribery rules, ISO 37001, etc.).

  **Establish transparent and comprehensive prequalification systems to ensure full compliance**

- **EIC anticipates a stronger emphasis on stakeholder communication to achieve value-for-money.** Bidders should have to demonstrate an inclusive stakeholder management plan that vouches for the relevance of a project and takes into account project specific social, safety and environmental needs. Respecting local content requirements and fully complying with local and international law and guidelines should be self-evident.

  **Improve stakeholder engagement**

**Tables and Graphs**

1 Kan, K. et al. (2018). China Rules – How China became a superpower. New York Times.
2 Gulland, A. (2018). African countries must spend their way out of poverty by investing trillions in roads, water and power. The Telegraph.
3 Salawou, M. et al. (2017). Infrastructure Financing Trends in Africa – 2017. African Development Bank.
4 Badkar, M. (2012). The Big Chinese Investments in Africa since 2010. Business Insider.
5 European International Contractors (2019).
6 Mudde, P. (2018). Official Finance Practices of the PR China. European International Contractors.
7, 8 Horn, S. et al. (2019). China's Overseas Lending. Harvard Kennedy School.
9 World Bank (2018). The Belt and Road Initiative. The World Bank Group.
10 Horn et al. (2019). World Map of External Debt to China (as of 2017, direct loans only)
11 World Bank (2019). International Debt Statistics. The World Bank Group.
12 European International Contractors (2019).
13 Kratz, A. et al. (2019). Leveraging the Chinese State Against Foreign Firms: Rail and Beyond.
14 European International Contractors (2019).
15 Badkar, M. (2012). Chinese-Built Ghost Town in the Middle of Angola. Business Insider.
16 N. N. (2009) Motorists start using the Lusaka-Chirundu road again. Lusaka Times.

**Chapter 1**

1, 3, 5, 12 AfDB (2018). African Economic Outlook. African Development Bank.
2 UN (2018). Sustainable Development Goal 9. United Nations.
4 Commins, S. (2018). From Urban Fragility to Urban Stability. Africa Center for Strategic Studies.
6, 9 Foster, V. et al. (2010). Africa's Infrastructure – A Time for Transformation. The World Bank Group.
7 Knoema (2019). World Data Atlas on Road Density. Knoema Corporation.
8 Gulland, A. (2018). African countries must spend their way out of poverty by investing trillions in roads, water and power. The Telegraph.
10 AFP (2018). Road accident deaths swell to 1.35 million each year: WHO. Media Kenya.
11 WHO (2019). Water – Regional Office for Africa. World Health Organization.

**Chapter 2**

1, 2 OECD (2019). Aid at a glance chart. Organisation for Economic Co-Operation and Development.
3 AITF. (2019). The EU-Africa Infrastructure Trust Fund.
4 Salawou, M. et al. (2017). Infrastructure Financing Trends in Africa – 2017. African Development Bank.
5 Gov CN (2018). Headlines of the FOCAC Summit 2018.
6 Anton, M. (2012). The U.S. economic, political and geostrategic response to China's presence in Africa.
7 G7 (2018). Principles for Promoting Quality Infrastructure Investment. GOV Japan.
8 IBRD (2018). Quality Infrastructure Investment (QII) Partnership. The World Bank Group.
9 Tsuji, T (2019). Japan's trade insurance to cover full African investment. Nikkei Asian Review.
10 OPIC (2018). THE BUILD ACT. GOV USA.
11 EU (2018). EU External Investment Plan.
12 EU (2019). Africa-Europe Alliance.
13 AD112 (2019). China's growing presence in Africa wins largely positive popular reviews. Afrobarometer.

**Chapter 3**

1 CCS (2006). China's Interest and Activity in Africa's Construction and Infrastructure Sectors. Centre for Chinese Studies.
2 CARI (2019). DATA: Chinese Investment in Africa. Johns Hopkins University.
3, 5 Badkar, M. (2012). The Big Chinese Investments in Africa since 2010. Business Insider.
4 Massa, I. (2011). Export Finance Activities by the Chinese Government. European Parliament.
6 Mordant, N. (2018). Exclusive: Acacia. China miners in talks over Tanzania gold deal. Thomson Reuters.
7 Mfula, C. (2018). Chinese firm launches $ 832 million Zambia copper mine. Thomson Reuters.
8 Farchy, J. (2018). China has a secret weapon in the race to dominate electric cars. Bloomberg.
9 Farge, E. (2018). Mozambique reforms timber sector to counter illegal logging. Thomson Reuters.
10 ENR (2019). Top 250 International Contractors.

**Chapter 4**

1, 5 Mudde, P. (2018). Official Finance Practices of the PR China. European International Contractors.
2 Brautigam, D. (2016). Eastern Promises: New Data on Chinese Loans in Africa, 2000 to 2014. China Africa Research Initiative.
3 Africa Renewal (2005). Industrial countries write Africa's debt. United Nations.
4 UNCTAD (2016). Africa should find new ways to finance development. United Nations.
6 Horn, S. et al. (2019). China's Overseas Lending. Harvard Kennedy School.

**Chapter 5**

1 Gov CN (2018). Africa: China Pitches Peace and Security Cooperation Framework to Africa. FOCAC 2018.
2 World Bank (2018). The Belt and Road Initiative. The World Bank Group.
3 China Policy (2017). China Going Global – between ambition and capacity. Policy CN.
4 Cyrill, M. (2018). What is Made in China 2025 and Why Has it Made the World So Nervous? China Briefing.
5 BBC (2017). What is the 'One china' policy? BBC News.
6 Gov CN (2018). China-Africa is a win-win: official. FOCAC 2018.
7 Adisu, K. et al. (2010). The Impact of Chinese Investment in Africa. Research Gate.
8 AD112 (2019). China's growing presence in Africa wins largely positive popular reviews. Afrobarometer.
9 Holslag, J. (2019). The Silk Road Trap. Polity Press.
10 Abi-Habib, M. (2018). How China Got Sri Lanka to Cough Up a Port. The New York Times.
11 Niba, W. (2019). Will Kenya's Mombasa port be taken over by the Chinese? RFI.
12 OECD (2019). Untied Aid. Organisation for Economic Co-Operation and Development.
13, 17 Mudde, P. (2018). Official Finance Practices of the PR China. European International Contractors.
14, 18 Washington Post (2018). US, World Bank, IMF balk over billions in secret China loans to poor nations. The Straits Times.
15 UNCTAD (2016). Financing for development: Debt and debt sustainability and interrelated systemic issues. United Nations.
16 Zhou, L. (2017). How a Chinese investment boom is changing the face of Djibouti. South China Morning Post.

**Chapter 6**

1 Navarro, P. (2006). The Economics of the «China Price». China Perspectives.
2 Reina, T. (2018). ENR's 2018 Top 250 International Contractors: Markets Begin to Turn Around. Engineering News-Record.
3 CCS (2006). China's Interest and Activity in Africa's Construction and Infrastructure Sectors. Centre for Chinese Studies.
4 Sun, I. (2017). Dance of the lions and dragons – How are Africa and China engaging, and how will the partnership evolve? McKinsey & Company.
5 Kratz, A. et al. (2019). Leveraging the Chinese State Against Foreign Firms: Rail and Beyond.

**Chapter 7**

1 World Bank (1993). The World Bank project cycle (English). World Bank information Brief. Washington, D.C.: World Bank Group.
2, 6 Thou, L. (2018). China touts 'martyrs' killed working on Zambia infrastructure projects as symbol of friendship. South China Morning Post.
3 CARI (2019). DATA: Chinese Workers in Africa. Johns Hopkins University.
4 CCS (2006). China's Interest and Activity in Africa's Construction and Infrastructure Sectors. Centre for Chinese Studies.
5 Kakai, K. (2018). Press Statement on Dehumanizing Working Conditions at the SGR. Cotu-K.
7 Joshi, S. (2017). Industry giants fail to tackle child labour allegations in cobalt battery supply chains. Amnesty International.
8 Zak, S. (2018). China's Belt and Road Initiative 'riskiest environmental project in history'. Futures Centre.
9 Farge, E. (2018). Mozambique reforms timber sector to counter illegal logging. Thomson Reuters.
10 Ombour, R. (2018). Environmentalists in Kenya Protest China-Backed Railway Construction. VOA News.
11 Walker, B. (2016). China cuts pollution at home, grows coal abroad. Climate Home News.
12 Meservey, J. (2018). Chinese Corruption in Africa Undermines Beijing's Rhetoric About Friendship with the Continent. The Heritage Foundation.
13 GOV Zambia (2017). Report of the Auditor General on the Road Projects under The Road Development Agency (RDA). GOV Zambia.
14 Placido, D. (2018). Palace seeks second change for blacklisted Chinese firms tapped for Marawi rehab. ABS-news.
15 Isaksson, A.-S. (2018). Chinese aid and local corruption. Journal of Public Economics.

**Chapter 8**

1 Leshnev, S. (2016). A Criminal State. Enough Project.
2 CCS (2006). China's Interest and Activity in Africa's Construction and Infrastructure Sectors. Centre for Chinese Studies.
3 GOV Zambia (2017). Report of the Auditor General on the Road Projects under The Road Development Agency (RDA). GOV Zambia.
4 Kakai, K. (2018). Press Statement on Dehumanizing Working Conditions at the SGR. Cotu-K.

## About EIC

European International Contractors (EIC) has as its members construction industry trade associations from fifteen European countries. In 2017, the international turnover of companies associated with EIC's Member Federations amounted to more than EUR 175 bn, of which around EUR 16 bn were generated in Africa. Its contractors can look back on a long tradition of dedicated engagement in the developing world, and in particular in Africa. There are many good examples where the presence of the European construction industry has lifted local industries to a higher level. This is also because European companies do not export a large part of their workforce, equipment and material to distant sites, but they rely on a small number of key business personnel to manage projects in collaboration with local partners.

**Imprint**

**European International Contractors e.V.**
Kurfuerstenstrasse 129
D-10785 Berlin
Phone: +49 30 21286-244
Fax: +49 30 21286-285
E-Mail: info@eic-federation.eu

Director and responsible under § 10 MDStV:
RA Frank Kehlenbach

Vereinsregisternummer:
VR 18 482 B
(Amtsgericht Berlin-Charlottenburg, 14057 Berlin)



**www.eic-federation.eu**