China in Africa:
lending, policy space and governance

By Martine Dahle Huse &
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Executive summary

The report findings show that Chinese lending is generally welcome in Africa. The loans that China provides often contribute to financing infrastructure and other projects that African countries need. However, it is of concern that China is lending to countries that already have large debts outstanding. It is not the lending per se that is problematic, since it seems that China's lending occurs in resource rich countries. What makes China a risk to debt sustainability in poor countries is the lack of transparency in loan contraction processes. Loan contracts between China and African countries are not open to public scrutiny. This leaves a lot of power in the hands of a few African leaders. As our case study from Zambia shows, loan contracts are often made at the highest political level, and because of the lack of transparency, the agreements are not available to parliament, civil society or media.

The lack of transparency makes it difficult to assess how much debt is being contracted and on what terms. It also increases the risk that funds will not be used for the intended purposes and might turn out to be cases of illegitimate debt in the future. The report concludes that in order to prevent irresponsible loan contraction, there is a need for responsible lending practices to be put in place.

The report also aims to show that China's presence as a lender in Africa provides an alternative to the traditional donors within the development paradigm. China's non-interference policy implies that China does not have any conditions attached to loans apart from the requirement to support the one-China principle and to reject the legitimacy of Taiwan as a country. Traditional donors on the other hand, have applied conditionality aiming to change African countries' economic policy. Following the recent debt relief initiatives, traditional creditors such as the World Bank and the IMF have less resources to draw on, and their leverage in African countries is diminishing as countries have benefited from debt relief and graduated from debt relief programs monitored by these institutions. The presence of new lenders, including China as an alternative on the creditor arena, is also increasing the leverage that African countries have when dealing with traditional creditors. In many countries policy space has increased as a result of China's presence as an alternative to creditors that apply policy conditionality.

While the non-interference policy might be positively affecting countries because it opens up policy space, it also has negative consequences. China seems to be less concerned with human rights standards and environmental safeguards than other creditors. China's presence in states that oppress the population is also very controversial, and China has been criticised for playing the role of a bystander in contexts where the international community have urged Beijing to use its leverage to influence oppressive regimes to improve their conduct.

Although it is too soon to conclude, so far it would seem that China is likely to have a negative impact on debt sustainability and perhaps contribute to debt crisis in countries where governance is week. Lack of transparency and accountability to the inhabitants does not seem to stand in the way of Chinese lending if a country is able to use natural resources as collateral for loans. The development of responsible financing and framework for implementation of such is therefore paramount to ensure the rights of future generations to freedom from vicious circles of indebtedness.

Recent Chinese lending underlines the urgent need to establish internationally recognised legal standards for responsible lending. The need for transparency, accountability and inclusiveness in loan contraction processes should be recognised by international society. Our case study from Zambia concludes that the Zambian public should have a right to know about and question borrowing, from new and old lenders, before loan agreements are signed. It also recommends that oversight and watchdog institutions such as the parliament, the auditor-general and the attorney general must have clear mandatory authority over the loan contraction process.

Acronyms

ADF	African Development Fund
AfDB	African Development Bank
AFRODAD	African Forum and Network on Debt and Development
AIDS	Acquired Immune Deficiency Syndrome
AU	African Union
BADEA	Arab Bank for Economic Development in Africa
CIDSE	International Cooperation for Development and Solidarity
COMESA	Common Market for Eastern and Southern Africa
CPIA	Country Policy and Institutional Assessment
CSO	Central Statistical Office
CSOs	Civil Society Organisations
CSTNZ	Civil Society Trade Network of Zambia
DRC	Democratic Republic of Congo
DSA	Joint World Bank-IMF Debt Sustainability Analysis
DSF	Joint Debt Sustainability Framework
EIB	European Investment Bank
EPAs	Economic Partnership Agreements
EU	European Union
FDI	Foreign Direct Investment
FNDP	Fifth National Development Plan
FOCAC	Forum for China Africa Cooperation
GDP	Gross Domestic Product
GRZ	Government of the Republic of Zambia
GTZ	Deutsche Gesellschaft fur Technische Zusammenarbeit
HDI	Human Development Index
HIPCs	Heavily Indebted Poor Countries
HIV	Human Immunodeficiency Virus
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFAD	International Fund for Agricultural Development
IFIs	International Finance Institutions
IMF	International Monetary Fund
JCTR	Jesuit Centre for Theological Reflection
LDCs	Least Developed Countries
MCTI	Ministry of Commerce Trade and Industry
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MMD	Movement for Multi-party Democracy
MoFNP	Ministry of Finance and National Planning
NEPAD	New Partnership for Africa's Development
NGO	Non Governmental Organisation
NPV	Net Present Value
ODA	Official Development Assistance
OECD	Organisation of
PRGF	Poverty Reduction Growth Facility
PPP	Purchasing Power Parity
RMB/RMBY	Renminbi
SAP	Structural Adjustment Program
TAZARA	Tanzania-Zambia Railways
UNIP	United National Independence Party
ZESCO	Zambia Electricity Supply Corporation

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I. Introduction

1.1. China – a "new" lender?

The discussion of China as a so-called "new" lender is somewhat misleading considering China's early engagement with Africa. The TAZARA, Tanzania-Zambia railway, is perhaps the most famous example of early Chinese lending so far. Funding was lent to the governments of Tanzania and Zambia to establish a railway as long as 2000 km connecting the copper producing region in northern Zambia with the ports in Dar es Salaam. Much of this debt has been cancelled, yet Zambia's largest debt repayment this year will go to China.

China's excess liquidity is leading China to increase its lending activities in Africa, and in 2006 China pledged to double its aid to Africa during the period of 2006 to 2009. This makes China all the more relevant to African countries and has caused the international society to turn their eyes to China as a "new" lender. In this respect, the rise of China as a "new" lender is not determined by the duration of its presence on the African continent, but by the exploding increase in amounts lent to African countries and by its importance as an lender outside the existing hegemony of development actors and institutions referred to as "traditional" donors or "the West/ Western donors". China exists as an alternative outside most of the development frameworks.

This new rise of an old lender has created both concern and optimism. Traditional donors have cried out in alert predicting increased corruption and non-poverty related spending, whereas many southerners see China as a liberating alternative to the heavily criticised traditional donors. They have been hoping that the promise of this alternative would create greater policy space for developing countries to create their own strategies based on each country's specific needs and concerns. All the same, there is a general new-found consciousness (ranging from sound scepticism to bordering on paranoia) of China; the giant, the dragon, the tiger etc., taking over the world, and particularly Africa, of China being the new potentially imperialist super-power, and of Africa perhaps being re-colonised.

The main scope of this report is to raise awareness on the issue of debt and new lenders in Africa, focusing on China particularly. The report aims to comment on the risk of increasing African countries' external debt, and looks at China's lending to African countries and in particular to Zambia. The influence of Chinese lending on governance in African countries is also discussed.

The main target groups are Norwegian and international civil society as well as others who might be interested in this topic such as students, decision makers and academics.

The report consists of two main parts. The first part presents the general findings. We start by briefly introducing the role of China in Africa, highlighting some of the differences between China and the traditional lenders. We then progress to the issue of debt sustainability in particular, as well as the impact that China has on governance in African countries. The second part of the report presents the case study on Zambia and China. In this part we focus specifically on the background to Zambia's debt situation, Zambia's relations with China and analysing the debt contraction process in Zambia particularly in relation to China.

This report is based on desk study from September 2007 to January 2008 and field work in Zambia October 2007 where interviews with members of Zambian civil society, Zambian government officials and representatives of new and old lenders/donors to Zambia were conducted. Two major constraints of the study are the short time frame during which information was collected, as well as difficulty in accessing detailed information about Chinese loans. The findings of the report are meant to inform and spur debate and do not purport to present an exhaustive study of Chinese lending to Africa.

The report is written by Martine Dahle Huse and Stephen L. Muyakwa on commission by the Norwegian Campaign for Debt Cancellation (SLUG) and The Norwegian Council for Africa (Fellesrådet for Africa). The authors would like to apologise for any mistakes and confirm that the full responsibility for the contents of the report lies with the authors. Comments can be voiced to *martine@slettgjelda.no*.

1.2. The diverse Africa and Zambia as a case

Sub-Saharan Africa does not comprise of a homogenous group of countries. This should also be reflected in the analysis of how the various countries deal with China and how this interaction affects the countries on political, economic and social levels. It is necessary to take note of the diversity of ways in which African countries and China cooperate and it is imperative that the differences between African countries are acknowledged. Ranging from South Africa on the one hand who increased exports to China by 71,3 % during the first eight months of 2007[1], to the many African countries with annual trade deficits to China, to the difficult situation in Darfur[2], to Zimbabwe under boycott by the West, to post-conflict countries like Liberia and the Democratic Republic of Congo (DRC) that have billions of dollars in outstanding debt and are waiting to enter HIPC[3], and last but not least, to the countries that do not support the one-China policy of Peoples Republic of China[4].

The country contexts, in which Chinese engagement with African countries takes place, are complex, and it is impossible to choose one case country that will illustrate all aspects of Chinese lending to Africa and its consequences. Recognising that looking into one country as a case is not enough; we regret not having the opportunity to include other countries in the study. However, the purpose of this report is not to portray an exhaustive picture of the ways African countries deal with China, but to look at some general perspectives from the point of civil society, and to look at one case country in particular, namely Zambia.

These are several reasons why we chose to look at Zambia. One of them is that Zambia is of particular interest to Norwegians since it is one of Norway's five main cooperating partners[5] in Africa and an important recipient of Norwegian development assistance. It was also crucial to choose a country where China's presence as a lender is controversial and debated, among Zambia's relatively strong and vibrant civil society.

So, where does Zambia fit into the long list of African countries? The country is among the Least Developed Countries (LDCs) ranked low on the Human Development Index (HDI) as number 165 of 177 countries. Levels of poverty are high both in rural and urban areas as 75,8 % of the population is living on less than one US$ per day (PPP), and life expectancy at birth is as low as 37,7.[6]

Zambia is a landlocked country with a peaceful past and present, with good relations to neighbouring countries and a stable political environment. The Zambian economy is heavily dependent on commodity exports, mainly of copper and other metals, and the level of diversification is low.[7] Following the oil crisis in 1973, Zambia, like many other African countries, was hit by a decline in commodity prices world wide. Believing that the decline was temporary, the country borrowed money to get through the difficult times. When the rough times turned out to be long lasting, Zambia's debt accumulated and eventually peaked at US$ 7 billion resulting in a debt crisis. Cancellation of more than US$ 6.6 billion[8] as well as a new demand for copper, particularly by the Chinese, has spurred the economy which has been picking up steadily for the last 6 years. Yet, during the last presidential elections, anti-Chinese sentiments surged among Zambians in urban areas and the presence of the Chinese in Zambia is controversial and widely discussed in Zambian media.

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1 Lihua, Yang "Building a balanced and sustainable strategic partnership" in The China Monitor, October 2007 issue. Centre for Chinese Studies, Stellenbosch University, South Africa

2 The Economist, 19 April 2007 "Too few, too late?" *http://www.economist.com/background/displaystory.cfm?story_id=9052142*

3 BBC, 13 November 2007 "IMF ready to cancel Liberia debt" *http://news.bbc.co.uk/2/hi/business/7091917.stm*

4 Taiwan's diplomatic allies in Africa are Swaziland, Gambia, Burkina Faso, and Sao Tome and Principe (BBC "Malawi severs links with Taiwan" http://news.bbc.co.uk/2/hi/asia-pacific/7186918.stm)

5 The other countries are Tanzania, Uganda, Malawi and Mozambique. Other African countries in cooperation with Norway are Angola, Ethiopia, Eritrea, Kenya, Madagascar, Mali, Nigeria, Sudan and South-Africa.

6 UNDP, Human Development Report 2006

7 AfDB/OECD, African Economic Outlook 2007

8 Sitali lauds EU concerns on debt", The Post, Friday October 5, 2007

Part one:

2. China's engagement in Africa

2.1 Key trends in Chinese cooperation with Africa

Chinese aid is mainly invested in infrastructure such as roads, railways, buildings, monuments etc. This is generally very welcomed in African countries where infrastructure is often seriously underdeveloped. Many of the infrastructure projects are implemented to facilitate trade. Although all of the countries in cooperation with China are receiving some sort of aid, the size and form of the aid inflows vary. China does not disclose how much aid and investment is going into different countries, but media announcements in China give the impression that there are clear patterns to where the investment and aid from China is greatest. Countries that supply China with fundamental resources such as oil, metals and woods are strategically important and seem to receive more of both aid and investments than countries that are less resource rich.[9]

Half of global growth in metals demand was accounted for by China in 2004, and one-third of oil demand for the same year.[10] The demand for commodities from China has raised the price levels of many commodities. Apart from Nigeria, Angola, Congo, Gabon, Sudan, Cameroon, the DRC, Côte d'Ivoire and Chad who are net exporters of fuels and lubricants, the remaining African countries are net importers[11]. Record high oil prices make African oil importers suffer as alternative energy sources are rare, expensive and often unexploited.

However, many African countries benefit from higher price levels for other commodities than oil, such as timber, metals and minerals, coffee and tee etc. as commodities make up a large part of their exports. Concerns have been raised that this rise in commodity price levels might slow down efforts to develop products with added value and reinforce African countries' status as commodity exporters, thus further slowing down diversification of the economies.

A great influx of Foreign Direct Investment (FDI) was an important factor that contributed to the growth that China has experienced since the reform and opening up policy was adopted in 1978[12]. Africa is considerably underinvested. The reasons for this are numerous, but mainly connected to the high risks involved and unfavourable investment climates. The Chinese, however, do not seem to share the concerns of other investors, and are willing to invest in African countries. This is probably due to the fact that the Chinese state provides guarantees that cover risks which Chinese companies may encounter. The Chinese state-supported investments are allowing their investments to be realised over a longer timeframe.[13] According to the World Bank, China's FDI to Africa amounted to $US 1.18 billion by mid-2006.[14] Comparatively, Chinese investment in Africa is of smaller scale than on other continents particularly compared to Asia which is a much more important investment destination for China. However, Chinese investment is nevertheless important to African countries.

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[9] The news announcements referred to are collected in the China Monitor of the Centre for Chinese Studies, Stellenbosch University, South Africa *www.ccs.org.za/publications.html*

[10] World Bank China Quick Facts, *http://go.worldbank.org/4Q7SC8DU50*

[11] Goldstein et al., 2006 The Rise of China and India, what's in it for Africa? Development Centre Studies, OECD

[12] NATO "China's development challenge" Committee reports, 2006 Spring session http://www.nato-pa.int/default.asp?SHORTCUT=899

[13] Corkin and AFRODAD, 2008 (forthcoming) "China's contribution to the development of African infrastructure through investment in the extractive industries" AFRODAD

[14] Broadman, 2007. Africa's Silk Road: China and India's new economic frontier The World Bank, *http://go.worldbank.org/G0O2KIPAO0*

2.2 Chinese aid

2.2.1. Frameworks

China does not have a development cooperation agency. According to Davies, the responsibility of development policies and projects is spread out over several political institutions[15]. This might give the impression of a fragmented and unregulated way of providing aid, but the Chinese state is behind most of the assistance provided. The China Exim Bank which handles concessional lending plays a central role, and is reported to be one of the largest financing bodies in the world.[16]

The Forum for China Africa Cooperation (FOCAC) process is perhaps an exception. Created in Beijing in 2000, the FOCAC has become an institutionalised coordination process that covers cooperation between China and African countries. The second ministerial meeting was held in Addis Abeba 2003 and in 2006 there was a high level ministerial meeting in Beijing where 48 African countries were represented and an Action Plan[17] was adopted for the years 2007-2009. The Plan outlines pledges made by China for this period that were announced by Chinese President Hu Jintao during the meeting. 2006 was also the the 50-year anniversary of diplomatic relations between China and Africa, celebrating what started off when China and Egypt established diplomatic relations in 1956.

Pledges for China's aid to African countries in the Beijing Action Plan

During the period 2007-2009 China will:
– double aid from 2006 level within 2009. (It is unclear how much was given in 2006, consequently it is also difficult to estimate how much can be expected in 2009.)
– give preferencial loans amounting to US$ 3 billion of preferencial loans and provide US$ 2 billion of preferential buyer's credits on favorable terms.
– create a China-Africa development fund of US$ 5 billion that can contribute support to Chinese companies investing in Africa.
– construct a conference centre for the African Union.
– cancel zero-interest loans due end 2005 contracted by HIPCs and LDCs in Africa that have diplomatic relations with China.
– increasing the number of zero-tariff products that African countries export to China from 190 to over 400 for LDCs with diplomatic ties with China.
– establish three to five trade and economic cooperation zones in Africa.
– "train 15 000 African professionals; send 100 senior agricultural experts to Africa; set up 10 special agricultural thechnology demonstration centres in Africa; build 30 hospitals in Africa and provide RMB 300 million of grant to provide anti-malaria drugs adn build 30 malaria revention and treatment centres to fight malaria in Africa; dispatch 300 youth volunteers to Africa; build 100 rural schools in Africa; and increase the number of Chinese government scholarships to African students from the current 2000 per year to 4000 per year by 2009."

Source: Davies, 2007: "China and the end of poverty in Africa – towards mutual benefit?" (p.25)

[15] Davies, 2007 "China and the end of poverty in Africa – towards mutual benefit?" Diakonia
[16] Corkin and AFRODAD, 2008 (forthcoming) "China's contribution to the development of African infrastructure through investment in the extractive industries" AFRODAD
[17] FOCAC Beijing Action Plan, *http://www.chinese-embassy.org.za/eng/zfgx/zfhzlt/t281763.htm*

2.2.2. Form

The Chinese development assistance is provided either as grants, zero-interest loans or concessional loans. China does not provide budget support. All of the Chinese aid is project based. Grants are often given as tied aid, requiring the borrower to purchase Chinese goods or services, and sometimes grants are also provided in kind, meaning that China gives Chinese goods directly. Loans are also often given as tied aid. Loans without interest are often written off in Chinese debt relief operations. The terms and conditions of Chinese concessional loans vary, but these loans have a medium or long-term repayment period and are provided at low interest rates. The grant element included is suggested to be sufficiently high for the loans to be considered as Official Development Assistance (ODA).[18]

2.2.3. Size

Ways of defining and counting aid are not consistent in China, and there is little transparency on how much assistance is actually given to Africa. According to Davies (2007), the reason why China does not publish any details about the amounts of aid given African countries, lies in three simple explanations. Firstly, China is still a developing country itself and therefore the Chinese population might object to China helping Africans instead of the poor people in China. Secondly, China feels that it might be sensitive information for recipient countries and they argue that it is up to African countries to decide if they wish to report on the volume of aid. And thirdly, China does not want African countries, to compare the amounts of aid received among them.[19]

Even though aid figures are not disclosed, the Beijing Action Plan and pledges that China has made on various occasions, indicate that the aid levels are increasing fast and that the amount of loans given is substantial. At the annual meeting of the African Development Bank (AfDB) hosted in Shanghai in 2007, it was announced that China would provide US$ 20 billion in infrastructure and trade financing for Africa over the next three years.[20] Following the same meeting, the US$ 5 billion China-Africa Development Fund was created to provide capital for Chinese enterprises operating in Africa. The fund is also intended to provide support for urban infrastructure, extractive industries, agriculture, manufacturing and energy sectors.[21]

2.3. Main differences between new and old actors

2.3.1. The historical relationship with Africa

The historical relationship with African countries is fundamentally different for traditional and new donors, or Western donors and China. In contrast to Western donors, China never had a presence as a coloniser in Africa. To the contrary, China played the role of a supporter in the struggle for independence of African countries. This is highlighted by a lot of Africans, particularly in response to Western criticism of China. Some Africans feel that the reactions from the West arise because Westerners fear competition from China. Consequently Western objections to China's way of dealing with Africa, is not perceived as a result of concern for African countries, but a protection of Western political and economic interests on the African continent.

The Chinese emphasise that their engagement with Africa is in fact South-South cooperation, and that it should be beneficial to both China and Africa. Rather than emphasising its role as

[18] Davies, 2007 "China and the end of poverty in Africa – towards mutual benefit?" Diakonia (p.53)
[19] Ibid. (p.50)
[20] Ibid. (p.49)
[21] Corkin and AFRODAD, 2008 (forthcoming) "China's contribution to the development of African infrastructure through investment in the extractive industries" AFRODAD

a donor to African countries, China considers its engagement to be a mutual benefit, leading to win-win results.

2.3.2. From develop-ing to develop-ed

China has been Asia's fastest growing economy over the last 20 years and 400 million people have been lifted out of poverty. This is a great achievement that should be recognised as such. However, estimates show that about 18 % of poor people in the world live in China[22]. In actual figures this amounts to 100 million people living on less than $1 a day. Inequality among the Chinese is still great, and wealth distribution has to some extent failed parts of rural China. The record level growth of 9,6% annually during the last decade has not benefited the poorer Chinese regions proportionately. Most of the growth and development has occurred in the coastal regions that have benefited from a great influx of FDI. By contrast, in the western parts of China, many people still live off subsistence incomes.[23]

Today China is in a situation where it is both receiving and giving development aid. In fact, China's World Bank portfolio, including US$ 30 billion in loans and credit, is the largest in the Bank. China graduated from the IDA in 1999, but is still a member of the World Bank which supports a great number of projects in China.[24] It was recently announced that China is to work together with the World Bank in Africa[25].

2.3.3. Inside versus outside of the development paradigm

The lenders and donors within what we could call the development paradigm follow a set of conventional practices. At the centre of this, are the International Finance Institutions (IFIs) and bilateral donors in the Paris Club. Members of the OECD follow the Development Assistance Committee's guidance. China is not a member of the Paris Club, or the OECD, and does not follow OECD standards. And although a member of both the IMF and the World Bank, China has been at the receiving end of the spectrum and has so far not been defining the rules for how 'international donors' should relate to poor countries in the South. This has led many Africans to see China as an alternative outside the hegemonic development regime.

In addition to this, comes the fact that donors within the development paradigm have a mixed record when it comes to the effect of the development assistance provided. Fifty years of traditional aid and lending has not solved Africa's problems, and it is understandable that Africa looks for other alternatives.

The new lenders do not have this track record in Africa. Many of the old projects that China funded during the Cold War are still up and running today. For example, the only pipeline that supplies Zambia with crude oil today was commissioned in 1968[26] and built by the Chinese. So was Indeni Oil refinery (1973), the only refinery in Zambia to date, in Ndola[27].

You are an example of transformation. We in Africa must learn from your success.
President Marc Ravalomanana of Madagascar[28]

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[22] NATO "China's development challenge" Committee reports, 2006 Spring session *http://www.nato-pa.int/default.asp?SHORTCUT=899*
[23] World Bank China Quick Facts, *http://go.worldbank.org/4Q7SC8DU50*
[24] Ibid
[25] Financial Times, 18 December 2007 "World Bank to work with China in Africa" *http://www.ft.com/cms/s/0/e7708f7e-adae-11dc-9386-0000779fd2ac.html*
[26] Tazama pipeline, *http://www.zpa.org.zm/tazama.htm*
[27] Mbendi, Indeni Refining Company, *http://www.mbendi.co.za/rein.htm*
[28] IPS, 17 May 2007 "China: as role model for African development" *http://ipsnews.net/news.asp?idnews=37763* (Ravalomanana addresses the Chinese during the AfDB annual meeting in Beijing 2007 *http://www.madagascar-presidency.gov.mg/index.php/item/661*)

China and the Asian tigers have been mentioned as examples of countries that have chosen paths of development that should be exemplary to African countries. The remarkable results that China have shown since 1978, are highly respected, whereas the West has an unpleasant track record of mixed results.

2.3.4. Quick versus slow

The set of institutionalised rules and procedures that the traditional donors apply in development projects can be a heavy burden on developing countries. The time it takes for a project to advance from an idea to actually being implemented, can take several years and often demands a lot of the developing countries' capacity. Despite measures to cut down on bureaucratic procedures through commitments to the Paris Declaration on Aid Effectiveness[29] (to which China is a signatory), standard procedures can be very time consuming for developing countries. Environmental impact analysis, gender analysis etc. have been created as a result of precaution and lessons from previous failed projects. Some of the procedures that are part of projects funded by traditional donors are there to ensure sustainability and quality of products and services delivered. Nevertheless, some Africans feel that these procedures are slowing down development and have therefore stressed that China in this respect is a preferred partner.

The Chinese do not come with the same set of standards, rules and institutionalised procedures as the traditional donors. This can be seen as resulting in both positive and negative effects. It seems like the general perception is that the Chinese are faster and more efficient than traditional actors although the quality of the assistance delivered is being questioned. There have also been reports that one of the reasons why the Chinese are so fast, is that they often assume total control of every single aspect of a project. They do not always follow international best practices when it comes to for instance tender procedures. It appears that they at times will introduce an idea, fund it and take care of every aspect of the implementation often even including manual work carried out by Chinese workers. But this is not always the case, and the Chinese have expressed that they have intentions to increase the number of joint-ventures with African companies. They also insist that their policy is not to employ Chinese labour if skilled local labour is available for employment.[30]

EIB president critical of Chinese unscrupulous lending

In November 2006, the president of the European Investment Bank (EIB), Philippe Maystadt, was quoted to have said that human rights, labour standards and social- and environmental conditions had made the EIB loose out in Africa and Asia because of competition from Chinese unconditional lending.[31] His conclusion was that traditional donors needed to review their practices and standards which had perhaps become too strict. This was interpreted as a suggestion to lower EIB's environmental and social standards, which according to NGO reports, are far from perfect to begin with.[32] Maystadt's comments were heavily criticised. In February 2007, Maystadt repeated his

[29] The Paris declaration website, *http://www.oecd.org/document/18/0,3343,en_2649_3236398_35401554_1_1_1_1,00.html*
[30] Interview with representatives of the Chinese Embassy in Lusaka
[31] Financial Times, 28 November 2006 "EIB accuses China of unscrupulous loans" *http://us.ft.com/ftgateway/superpage.ft?news_id=fto112820061735286293&page=2*
[32] Bank Information Centre, 7 December 2006 "EIB urges looser environmental and social standards for loans to Africa" *http://www.bicusa.org/en/Article.3037.aspx*
CEE Bankwatch, 7 November 2007 Press release: "NGOs brand EIB the weakest link in EU development aid efforts" *http://bankwatch.org/newsroom/release.shtml?x=2054721*
Simpere, 2007 "Banque européenne d'investissement : six ans de financement du pillage minier en Afrique" *http://www.amisdelaterre.org/Nouveau-rapoprt-des-Amis-de-la.html* Friends of the Earth, France

concerns about Chinese ethical and environmental standards. He was no longer suggesting that the EIB should lower own standards but instead enter into a dialogue

with China on the issue of loan conditions. It is worth mentioning that the explosive growth in China has occurred with tremendous environmental degradation as a side effect, and pollution is now a serious threat to the Chinese population's health.

2.3.5. "Interference" versus non interference

The principle of non interference has been central to Chinese cooperation with African countries. Contrary to traditional lenders, China does not attach any conditionalities to funding. Traditional donors have been much criticised for imposing economic policy conditionality on recipient countries, but have been credited by civil society for responding to pressure from human rights organisations, and putting in place safeguards in countries with weak governance, demanding respect for human rights.

Although China does not attach conditionalities to their loans, this does not mean that borrowing countries are free to spend capital borrowed from China freely according to national priorities. The flexibility of Chinese lending is restricted by the form of Chinese aid as China provides only project based funding and almost exclusively as tied aid or in kind. China does not, for instance, provide budget support targeting health and eduction sectors.

3. Debt crisis, debt sustainability and new loans

Debt Crisis

"There is a tendency to explain the debt crisis on African leaders incompetence. We must of course, take part of the blame, and it is not something I am proud to do. But lets dig deeper into the question. After the first oil crisis in the 1970s, the world market was overflown by "petrodollars". The western banking system was threatened by collaps, resembling the one that hit the system in the 1930s. But the banking system was saved. Not by the International Monetary Fund (IMF), not by the US, but -believe it or not- by the developing countries. Poor countries like my own saved the international financial system by their goodwill to borrow from these oil funds."

Kenneth Kaunda, former president of Zambia, 1996[33]

3.1. Debt build-up

Towards the end of the 20th century, developing countries debt levels culminated and resulted in a debt crisis. The debt had kept on accumulating since the beginning of the 70s when the market was overflowing with so-called "petrodollars" which oil producing countries earned while the oil prices were high as a consequence of the oil crisis. Many of these loans were given to poor countries without due concern as to what the loans went to.

Far too often, funds went directly or indirectly to securing alliances during the cold war. Geopolitical interests were the basis for cooperation between donor countries and receiving countries and donors did not pay sufficient attention as to who benefited from their lending. In many cases creditors willingly looked the other way when corrupt African state leaders diverted funds into own pockets and sometimes even used funds to oppress and terrorise the population in ongoing conflicts.

Remnants of politically motivated lending

During the period of the cold war, criteria for giving out loans were more or less linked to the geopolitical context, and this is to some extent visible in China's recent lending. In the book "The Debt Threat", Noreena Hertz comments on the competition between China and Taiwan for countries' allegiance: "The Chinese and Taiwanese, for example, continue to mirror the bipolar world of the cold war by competing for diplomatic recognition in Africa and the Pacific on the basis of which can give the most aid, with their "clients" playing them off against each other as effectively as ever."[34]

In the 60s and 70s, failed development projects were not uncommon. In many cases, tied aid loans were provided to developing countries motivated partially by a need to rescue failing industries in the North, as was the case in the Norwegian Ship export campaign. In 2006, The Norwegian government made the decision to cancel the accumulated debts owed to Norway by five countries that originated in this project admitting the co-responsibility of Norway as a lender.[35]

[33] Kenneth Kaunda, 5 February 1996, during a speech to the Debt Crisis Network symposium in London
[34] Hertz, 2004. The Debt Threat. Collins, New York (p.35)
[35] Abildsnes, 2007 "Why Norway took creditor responsibility" *http://www.slettgjelda.no/?id=189*

After a period of bad economic governance combined with unrest and autocratic rule, many African countries experienced a second democratic wave. The newly elected governments quickly found themselves in the debt trap. When the time came to pay back the loans, accounts were found empty. There were a lot of cases where donor funding had been spent in unproductive ways, interest rates had skyrocketed and many countries which had contracted large amounts of debt were now in a situation where the only way they could manage to pay back the loans was by contracting new loans. Once inside the debt spiral, many of the poorest countries ended up paying back much more than what they once borrowed and many times what they received in development aid. Efforts to fight poverty were cut short by the debt burden.

3.2. From reckless lending to structural adjustment

Some have speculated that if a country had been able to declare bankruptcy, many countries would have done so to get out of the debt trap. Less than 20 years after independence, countries found that the former colonialists had practically regained control of economic policy in countries that were unable to manage their debt burdens. The indebted countries lost the freedom to govern their countries independently, and were now obliged to comply with conditionality from the International Finance Institutions (IFIs). The structural adjustment programs (SAP) were designed with one aim; to rescue the economy. But to do so, countries had to go through tough and often very unpopular reforms in order to improve macro-economic indicators.

The IFIs have been criticised for prescribing economic policies that follow a "one size fits all" economic model that does not adequately take the various country contexts into account. Because of the debt trap, highly indebted countries went into strict IMF-programs. The policies and conditionality included in these programs include: reducing public budget deficits by limiting spending by the state; extensive privatisation, deregulation and trade liberalisation including export-orientation of the economy and opening up markets.[36] Critics of these conditionalities have called for a more grounded and evidence based approach to development and have protested against conditionality as distorting democratic processes in developing countries.

3.3. Debt cancellation schemes

Around the world, more and more people became aware that debt had become a vicious circle where new loans were contracted in order to pay off interests and loans that had matured. Civil society representatives from both developed and developing countries pushed for debt cancellation on moral grounds arguing that poor people that do not even have access to basic services to cover everyday needs, should not be paying money to the richest countries in the world.

Following these massive protests of the unfair consequences of the debt trap, the Highly Indebted Poor Countries Initiative (HIPC) was established in 1996. Both multilateral and bilateral creditors contribute to the HIPC initiative. In 2005, during the G8 meeting in Gleneagles, the Multilateral Debt Relief Initiative (MDRI) was created. The World Bank, IMF and the African Development Bank (AfDB) committed to provide further debt relief to countries that had graduated from the HIPC process.

Total HIPC and MDRI assistance committed stands at US$ 105,345 billion of which US$ 86,660 billion covers the 25 African countries that have so far reached HIPC completion point or have received interim debt relief by end-July 2007.[37]

The Norwegian Campaign for Debt Cancellation

[36] Van der Hoeven, 2000 "Poverty and Structural Adjustment Some Remarks on Tradeoffs between Equity and Growth" ILO 2000/4 Employment paper, *http://www2.ilo.org/public/english/employment/strat/publ/ep00-4.htm*

[37] IDA & IMF, 2007 "Heavily Indebted Poor Countries Initiative (HIPC) and Multilateral Debt Relief Initiative (MDRI)

3.4. A clean slate – what has debt relief done for poor countries?

The HIPC initiative and the MDRI have wiped out a large proportion of the subsaharan Africa's overall debt. Although there are significant differences between countries, the continent as a whole has seen a great reduction in debt service from 20,8 % of exports of goods and services in 2005 to 7,7 % in 2007.[38]

Albeit the reduction in debt burdens through HIPC, fresh resources that can contribute to poverty reduction, have not increased proportionately. This is partly due to the fact that many highly indebted countries where not paying debt service to bilateral creditors because they were simply unable to pay. Consequently, the size of the budget in for instance Zambia, has not increased as much as one would expect as a result of debt relief. On top of this and in spite of pledges under the Monterrey consensus to increase the amount and improve the quality of development aid, most rich countries have continued to report debt relief as aid, inflating aid figures and thus misrepresenting the amounts of actual aid that can contribute to poverty reduction.

As we have seen, the most important result of the debt cancellation is perhaps not linked to the provision of so-called "fresh" resources, but rather a fresh start with overall improved macro-economic indicators. Debt relief also importantly implies greater freedom because of the increased policy space[39] that countries can potentially utilise to choose from a broader range of economic models: African leaders might dare to think outside the Washington consensus[40] cadres. However, it would be an exaggeration to say that countries that have seen most of their debt cancelled now enjoy complete independence. Western bilateral donors look for the judgement of IMF of a country's economic policy before they engage in cooperation. Many countries are heavily dependent on aid and with few exceptions, this so-called ‹gatekeeper' role of the IMF is still very much in function. This is where new lenders, and in particular China was hoped to have an impact as an alternative that countries could turn to if they did not agree with traditional lenders economic policy conditionality. But has this been the case? We will come back to this.

Although debt relief is, of course, a crucial step in the struggle for poverty reduction, there is still a long way to go in ensuring the social rights of millions of Africans who live below the absolute poverty line of 1 US$ a day. There is a huge financing gap that needs to be filled if Africa is to reach the Millennium Development Goals (MDGs). Debt relief is only part of the solution and fresh resources are needed. Reports show that Western donors are not very good at keeping their promises of delivering aid. Aid levels to Africa have stagnated[41]. The goal of each developed country allocating 0,7 % of GDP in aid, has only been followed up by a handful of countries. Civil Society Organisations (CSOs) have repeatedly published reports evaluating donors to try to encourage the reluctant to catch up with the best performers.[42]

The need for financing is so great that most African countries welcome China's assistance, including loans. This is particularly the case when it comes to large projects. Since the MDGs were set, these have been the focus of traditional lenders assistance. Although the overarching focus on immediate poverty reduction is crucial, other aspects of development have perhaps been neglected. Traditional lenders have been seen to be particularly reluctant to finance large investments in infrastructure and in the energy sector, and this has led Africans to turn to China instead. Some of these projects are considered as prerequisites for growth, and it is expected that loans from China can help remove these bottlenecks for development.

– Status of Implementation", *http://www.imf.org/external/pp/longres.aspx?id=4208*

38 AfDB/OECD, African Economic Outlook 2007 (table 12)

39 Tan, 2007 "Debt-relief countries can make use of more policy space" Third World Network Briefing paper no. 35

40 Definition 'Washington consensus', *http://en.wikipedia.org/wiki/Washington_Consensus*

41 *Global Monitoring Report 2007*

42 Hayes, 2007 "The reality of aid" Eurodad/Concord

Energy in Zambia

There are massive needs for investments in the Zambian energy sector. Zambia has so far not been able to mobilise enough resources domestically or from traditional donors. If these urgent investments are not made, it is likely that it will choke off growth. Consequently, the mines will not reach their potential and agriculture will suffer as well as households as there will be no increase in electrification. The energy investments that should be made as soon as possible, preferably over the next 5-6 years, would probably demand US$ 1,2 to 1,5 billion. The best solution for Zambia would be to finance this through loans on concessional terms, but there is no such money available. Comparatively, IDA allocations for Zambia are between US$ 50-60 million annually and that includes all of the World Bank's activity in Zambia.[43]

The World Bank and IMF have insisted through conditionality that Zambia privatise the energy supply company, ZESCO, which is today a parastatal. Recently, new lenders have come in. China has signed an agreement with Zambia to develop a 700 MW powerplant, Tata of India has already gone into a joint venture with ZESCO to develop a 120 MW power plant. A Chinese company has been contracted to do the rehabilitation works of Kariba. At Kafue, two out of four companies involved are from Asia, one from China and one from India.[44] *Just by default, Asia, and China, are already coming to the rescue of Zambia on a much more win-win situation than our colleagues in the developed world are operating.*

Chairperson of Private Sector Development Association, Zambia[45]

One of the most important arguments used by opponents of debt cancellation has been that countries that have their debts written off, would no longer be creditworthy and that it would be difficult for these countries to attain loans in the future. However, the contrary seems to be the case, countries that have benefited from debt relief do not have difficulties in getting new loans, and are deemed as having improved credit worthiness. According to an official in the Zambian Ministry of Finance and Planning, the issue of being credit worthy is connected to the very good macro-economic indicators that Zambia has today. "They are queuing up to lend to us", he says, pointing to the fact that improved macro-economic indicators have now made Zambia attractive to lenders and investors. In spite of concerns about another possible debt build up, there are positive sides to this. In Zambia, even local banks are beginning to look for opportunities to lend. This could potentially stimulate local development and employment, especially if local small and medium size enterprises can benefit from easier access to loans.

But are these lenders queuing up aware of the dangers of debt traps? And are they willingly adapting measures to ensure that they are not contributing to another debt build up? Or are they merely concerned with making profit and gaining goodwill in a scramble for resources?

3.5. Debt sustainability

The IMF and the World Bank way of judging whether a country has a sustainable debt burden, is to measure debt to exports, debt to GDP, and debt service to exports. Calculations are done to estimate how much a country can pay back, and how exogenous shocks would affect the scenario. This is intended to show how vulnerable the economy is. The IFIs operate with a traffic light system. If the risk of indebtedness is high, the light is red, if the risk is intermediate, it is yellow and if the risk is low, the light is green. Lenders are encouraged to follow this system to judge whether they should lend to a country or only provide grants.

[43] Interview with IMF Resident Representative in Lusaka
[44] Interview with Chairperson of Private Sector Development Association (PSDA), Zambia
[45] Ibid

The way that the IFIs address the issue of debt sustainability under the joint Debt Sustainability Framework (DSF) has been heavily criticised for failing to take social costs into account. CSOs have called for alternatives, and urged the IFIs to put the MDGs at the centre.[46] As long as poor citizens suffer, all the debt of poor developing countries can be considered non sustainable with regards to the needs and rights of the citizens that suffer from the lack of basic services such as access to education, health services etc. There is a need to talk about debt sustainability, but the danger of ignoring social costs and staring oneself blind at the debt to export, or debt to GDP ratios is looming.

To ensure debt sustainability, CSOs argue that there is a need for universally acceptable standards for responsible lending. It is not sufficient to assess the impact of an eventual loan on fiscal space according to the macro-economic context to assure that the loan can be paid back on time. There is a need to make sure that both creditors and borrowers act responsibly to prevent new cases of irresponsible lending leading to a build-up of illegitimate debts in the future.

Responsible Financing

The existing legislation dealing with debt issues is not sufficient in today's world. Although there are examples of useful debt legislation at national level, this is ignored and nobody is held responsible for cases of irresponsible lending. Learning from the past experience of reckless loan contraction and debt crisis', CSOs have drawn the conclusion that responsible financing practices should be put in place to prevent this from happening again. There is a need to look at financial aspects of lending, but there is also a need to take other issues into account such as governance, human rights and environmental standards. CSOs call for more transparency and inclusiveness in the loan contraction process.

Ongoing discussions in civil society have led to a number of suggestions on how a system for responsible financing should work. The proposal to establish a Fair and Transparent Arbitration Process is supported by many organisations among others the NGO CIDSE:

Such a system, akin to a bankruptcy system at domestic level, could be seen as the first step towards the adoption of an international tribunal on sovereign debt and the elaboration of an international law on debt[47]

NGOs within the debt movement are also discussing a proposal for a Charter on Responsible Financing soon to be published by the European Network on Debt and Development.[48]

3.6. China's impact on debt sustainability in African countries

Parallels can be drawn between the situation in the 70s and now. The position of oil producing countries in the 70s is similar to China's position today. In the 70s, oil earnings needed to be placed and was lent to whoever was interested. There was a need to place the money somewhere fast. Today, it is China who needs to place excess liquidity.

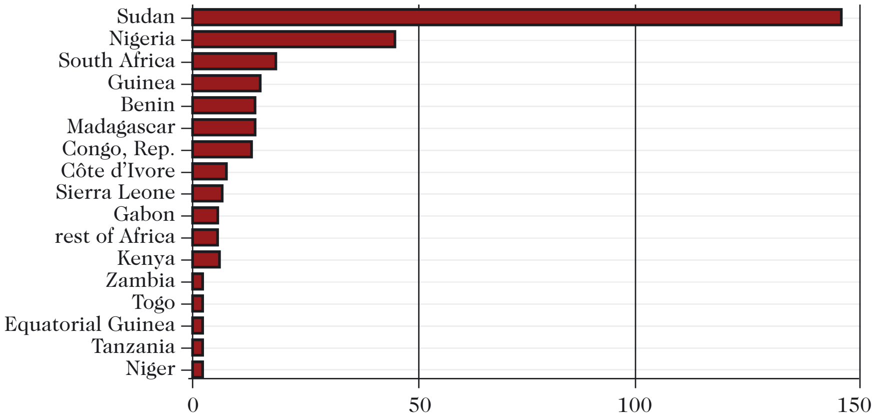
A lot of people have feared that China is investing capital in resource rich countries only to get easy access to resources. They are worried that resource rich countries bargain away resources as collateral. However, there is little evidence to pin this down as a general rule, other than the observation that patterns of Chinese aid delivery follow patterns of trade and investment in resource rich African countries. As some have suggested that FDI flows may be the counterpart of provisions of loans[49], it may be useful to take a look at Chinese flows of FDI to

[46] Oddone, 2005 "Still missing the point: Unpacking the new World Bank/IMF debt sustainability framework", Eurodad
[47] CIDSE, 2007 "A human development approach to preventing new cycles of debt" CIDSE
[48] Hurley, 2008 (forthcoming) "EURODAD Charter on Responsible Financing", Eurodad
[49] Reisen, 2007 "Is China actually helping improve debt sustainability in Africa?" G24 policy brief no. 9, OECD Development Centre

Africa as an indication of where China's lending activities are probably greatest:

Current Chinese FDI Outflows to Africa are Largely, But Not Exclusively, Resource-Oriented

2004 Chinese FDI outflows



Source: Broadman, 2007:100 Africa's Silk Road: China and India's new economic frontier IBRD, World Bank

Chinese loan contracts with African countries are not public. The conditions and terms of loans given by the Chinese are not disclosed either, but bits and pieces of information is released from time to time. For instance, the China Exim Bank responsible for China's concessional loans, has reported that it has approximately US$ 8-9 billion outstanding in African countries[50]. Another example worth mentioning is when in May 2007, during the AfDB's annual meeting hosted by China in Shanghai, it was announced that China would provide about US$ 20 billion in infrastructure and trade financing to Africa over the next three years partly through the form of concessional loans.[51] China has also announced that as part of the pledges made during the FOCAC meeting in Beijing in 2006, interest free loans to African HIPC and Low Income Countries that were due before end 2005 will be cancelled[52].

Because of the lack of transparency and the little knowledge about Chinese loans, it is difficult to say how China is affecting debt sustainability in African countries. But, as mentioned earlier, there are indications that China is lending primarily to resource rich countries that are important trade partners for China. In a recent policy brief published by the OECD Development Centre, the author concludes that the danger of another debt crisis is not overriding because China is lending mainly to resource rich countries, particularly countries endowed with oil or minerals.[53] Most of the resource rich countries that have benefited from debt relief operations are not in immediate danger of falling back into heavy debt.

However, there are several oil producing countries that have not seen a great reduction in debt levels, such as Sudan and Angola. Although debt levels are high, creditors continue to provide non-concessional lending because loans can be collateralised. China is also lending to oppressive states, and has provided Sudan with very large commercial loans for the development of the oil industry while Sudan has billions of dollars outstanding in arrears to traditional creditors.

China's US$ 5 billion loan to DRC

The Chinese loan of US$ 5 billion given to the Democratic Republic of Congo (DRC) in 2007 is highly controversial. The DRC is only halfway through the process of HIPC, and

[50] Davies, 2007 "China and the end of poverty in Africa – towards mutual benefit?" Diakonia (p.54)
[51] Ibid. (p.49)
[52] Ibid. (p.54)
[53] Reisen, 2007 "Is China actually helping improve debt sustainability in Africa?" G24 policy brief no. 9, OECD Development Centre

in December 2006, DRC's external debt level was US$ 11.5 billion according to estimates in the joint World Bank-IMF Debt Sustainability Analysis (DSA). The DSA also estimates that "DRC's debt situation will remain fragile and vulnerable to external shocks even after debt relief."[54] DRC's debt burden was inherited from the rule of the dictator Mobutu Sese Seko, and can be characterised as illegitimate. The DRC has recently contracted large loans from China, are they still supposed to pay back this old and illegitimate debt? Or, will creditor countries that had promised to give debt relief to DRC honour their commitment while watching the country get even more indebted by taking on new loans from China? And if so, how is DRC supposed to pay back the Chinese?

In this case the loan, which will go to development of infrastructure and mining, will be repaid primarily through granting mining concessions to Chinese companies. As part of the loan agreement, $3billion will be allocated to infrastructure projects in the DRC. The infrastructure projects include a 3 400km highway, a 3 200km railway link with Matadi on the Atlantic Ocean, 31 hospitals, 145 health clinics and two universities –investments highly needed in a country racked by 30 years of civil war and which has not benefited from its enormous natural resources. According to a 2005 OECD report, no more than 5 % of the DRC road network is tarred and only 5,7% of the population have access to electricity.[55]

Countries that have very high shares of non-concessional debt in their debt stocks are according to the World Bank, Liberia, Sudan, the DRC, Congo, Côte d'Ivoire and Angola. The five former are considered to be "red light" countries while Angola is considered a "yellow light" country. The latter five accounted for 78 % of the stock of publicly guaranteed for non-concessional external debt among 39 IDA-only countries in 2004. The same year, Angola accounted for 85 % of non-concessional inflows.[56]

The Chinese seem to have a different understanding of indebtedness. Loans are offered to countries that are highly indebted, such as for instance the DRC. During an interview, President of the AfDB, Donald Kaberuka, highlighted what characterises the Chinese way of thinking. He quoted the Chairman of the China Exim bank to have said: "debt sustainability is important but development sustainability is what we are after." He then went on to explain that China focuses on a country's long terms perspectives:

Until recently, the debt sustainability analysis by us and the Bretton Woods organisations was very static. You take the exports and you estimate how much the government can carry on the books with a cut off number of 50%. You know that this has been criticised. It is not forward looking to the potential of the country to repay debt. That is happening now, but what the Chinese are doing is taking an even long-term perspective of the ability to repay debts. Let me give you an example. Take a country with a rich sub-soil that is emerging from war and therefore in terms of its static numbers it doesn't look good. It would be a Highly Indebted Poor Country case or a grant case from the traditional donors. The Chinese are looking at it and saying what is the capacity of this country, which is unexploited? So they exploit that capacity, build infrastructure. Taking a long-term view, the country is able to assess the risk. It is a different analysis.[57]

President of the AfDB, Donald Kaberuka

The Chinese say that if the country is not able to pay, they will not ask for the loan to be repaid. They will discuss the debt and perhaps even cancel it. As with the lending itself, debt

[54] World Bank news release 30 November 2007 "Donors pledge US$4 billion for DR Congo's development" *http://go.worldbank.org/I3SUK62Z90*

[55] Mail&Guardian online, 5 October 2007 "DRC's sun rises in the East" *http://www.mg.co.za/articlePage.aspx?articleid=321170&area=/insight/insight__economy__business*

[56] World Bank, 2006 "IDA countries and non-concessional debt: dealing with the 'Free rider' problem in IDA 14 grant-recipient and post-MDRI countries"

[57] Africa Confidential, January 2007 "Interview with ADB president Donald Kaberuka" *http://www.africa-confidential.com/special-report/id/13/Interview-with-ADB-President-Donald-Kaberuka*

relief seems to be given on a case-by-case basis rather than based on established principles and pre-defined limits of indebtedness.

During interviews conducted in Zambia, CSOs pointed to the lack of transparency and were frustrated that the politicians had negotiated package deals with the Chinese without disclosing the contents of the agreements:

We don't know what is going on until we get to a point where a minister is signing the contract. And I think this has been an issue over a long period of time. We have had our debt cancelled, we had "a clean book", but right now we have no clue exactly how much we have contracted since then. So we may actually get back to the situation that we were in before the debt cancellation. And that is a real concern because we are not told what we are getting into with the Chinese until we see in the press that the minister of foreign affairs or the finance minister is signing a contract.[58]

Programs Officer of Transparency International Zambia

3.7. Free-riders

Creditors that contributed to debt relief under HIPC have expressed concern that the debt cancellations will be followed by another debt build-up if post-MDRI countries resort to non-concessional financing. Donors financing HIPC and MDRI have also shown discontent that donors which did not partake in funding debt cancellations, can now be seen to profit on the fact that others have given debt relief. The term "free-riding" is defined by the World Bank as referring to "situations in which IDA's debt relief or grants could potentially cross-subsidise lenders that offer non-concessional loans to recipient countries."[59]

The World Bank has proposed to combine two strategies in order to prevent free-riding. The first strategy is to enhance creditor coordination around the DSF, the second is to use a disincentive mechanism towards recipient countries to prevent "moral hazard"[60]. If a country chooses to borrow at non-concessional terms, the country will either see the volume of IDA assistance reduced or the terms of assistance hardened.[61]

Civil society has criticised the World Bank's free-rider policy for hitting the borrowing country disproportionately hard since there are no sanctions towards lenders who provide the non-concessional loans. Critics have also pointed out that traditional donors are not following up on aid commitments, thus forcing developing countries to look elsewhere for funding:

Unfortunately, the rich countries do not recognise that impoverished countries' interest in these new, more expensive financial flows is in large part a result of the insufficient amounts of concessional aid that they are providing. Not living up to their own word leaves some developing countries with an open dilemma: to develop risking renewed unsustainability, or to be stuck in underdevelopment because of the chronic shortage of available resources.[62]

It has also been claimed that traditional donors are seeing the so-called new lenders, and China in particular, as a threat to traditional donors' monopolistic status in the development arena because of the availability of large hard currency reserves.[63]

The 2007 HIPC and MDRI implementation document contains a chapter on new lenders and their contribution to debt relief operations. It shows that China has contributed with debt relief outside the HIPC initiative, and has signed protocols or agreements with 17 out of 20

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[58] Interview with representative of Transparency International Zambia

[59] World Bank, 2006 "IDA countries and non-concessional debt: dealing with the 'Free rider' problem in IDA 14 grant-recipient and post-MDRI countries""

[60] The economic term 'moral hazard' can be defined as "the prospect that a party insulated from risk may behave differently from the way they would if they were fully exposed to the risk" *http://en.wikipedia.org/wiki/Moral_hazard*

[61] World Bank, 2006 "IDA countries and non-concessional debt: dealing with the 'Free rider' problem in IDA 14 grant-recipient and post-MDRI countries"

[62] Oddone, 2007 "Debt sustainability or defensive deterrence? The rise of new lenders and the response of the old" Eurodad

[63] Ibid

post-HIPC countries. The World Bank estimates that around 34 % of HIPC debt relief expected from China has been delivered, but it also states that this estimate is based on debtor reporting, which is probably inaccurate and possibly underestimated.[64]

Some have argued that China should simply not be considered a free rider because non-concessional loans mainly go to countries that were not part of HIPC such as Sudan, Angola or Nigeria.[65] It seems that China will lend to countries regardless of whether they have received debt relief, if China considers the country to be an important long-term investment partner. In addition to this fact, China has contributed with debt relief independently and for some countries it has provided debt relief that exceeds what is expected under HIPC. During the FOCAC meeting in 2000, China announced a debt write-off of RMB 10.9 billion that was owed by 31 African HIPC countries and LDCs.[66] In 2005, it was announced that all zero-interest loans to HIPCs that was overdue by end-2004 would be either written off or forgiven. And as we have seen, as a part of the Beijing Action Plan, China has pledged to write off the interest-free loans due end-2005 of all African HIPC countries which have diplomatic relations with China.[67] Consequently, it does not seem entirely fair to call China a free rider. This is particularly true because it seems that in many cases the Chinese do not require repayment of debt if a country is experiencing difficulties[68].

On the other hand, the World Bank also considers lenders that provide non-concessional loans to IDA grant-receiving countries as free-riders. So far, there is only one case where the World Bank has made use of the mechanisms targeting free-riding, namely in Angola[69].

In our view, the World Bank's understanding of ‹free-riding' is not ideal. The concept of free-riding would be much more appropriate in contexts where the lack of solidarity between creditors is completely obvious. In that sense, China could be considered to be free-riding through their policy of non-interference. When traditional creditors and borrowing countries are unable to agree on standards of good governance, transparency and accountability, China is able to bypass all of these standards of traditional donors. This has been the case in Angola where government resisted pressure from the IFIs and instead went into loan agreements with China that did not contain any conditionality on good governance and transparency issues.[70] This is a clear example of a case where China can be seen to profit on other lenders. While China chooses not to contribute to accountability in borrowing countries, China also benefits as an investor, from the favourable conditions in countries where traditional donors and recipients have worked together to improve standards of accountability, particularly targeting corruption. In this understanding of the concept, China may be seen as a free-rider.

Another example of clear lack of solidarity is found mainly among commercial creditors. Although it is unusual to use the ‘free-rider’ concept in this way, we find that it is particularly relevant to describe cases where creditors have bought commercial loans at a cheap price and are now going to court to make post-MDRI countries pay back old and mainly commercial debts. These creditors have been named “vulture funds” or “predator funds” for the way they have sought to profit on the situation. They are the real free-riders seeking to profit on other creditors' contribution to debt relief that was meant to free up resources for poverty reduction in the poorest countries of the world. The most known example is perhaps the company Donegal who recently won a law suit against Zambia and was awarded US$ 15,5 million[71].

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64 IDA & IMF, 2007 “Enhanced Heavily Indebted Poor Countries (HIPC) Initiative-Status of Non-Paris Club Official Bilateral Creditor Participation” (p. 5)

65 Reisen, 2007 “Is China actually helping improve debt sustainability in Africa?” G24 policy brief no. 9, OECD Development Centre

66 IDA & IMF, 2007 “Enhanced Heavily Indebted Poor Countries (HIPC) Initiative-Status of Non-Paris Club Official Bilateral Creditor Participation” (p. 7)

67 FOCAC Beijing Action Plan, *http://www.chinese-embassy.org.za/eng/zfgx/zfhzlt/t281763.htm*

68 Interview with Representatives of the Chinese Embassy in Lusaka

69 Interview with World Bank country economist for Zambia and Malawi

70 Corkin and AFRODAD, 2008 (forthcoming) “China's contribution to the development of African infrastructure through investment in the extractive industries” AFRODAD

71 Jubilee Zambia statement “The vulture fund finally bites Zambia and flies away, who next?” April, 2007 *http://www.jctr.org.zm/jubilee/Prvulture09.pdf*

4. China's lending and good governance

4.1. Increased policy space and the China alternative

Debt is a form of slavery!

Kenneth Kaunda, 1996[72]

If debt is slavery, then debt cancellation could perhaps be perceived as a form of liberation. If developing countries' policy space is reduced through conditions set by creditors, then paying back debts and/or receiving debt relief, should in theory result in an increase in policy space for developing countries. The leverage of IFIs has decreased as the landscape of lenders has changed significantly in the last few years. Some lenders, such as the World Bank and the IMF, have seen their reserves shrink following debt relief operations and have been struggling to find ways to replenish the accounts. Although the direct leverage of the IMF has decreased following the debt relief operations, the Funds still has a lot of influence on Southern governments indirectly. Western bilateral donors look for the judgement of IMF of a country's economic policy before they engage in cooperation. This so-called ‹gatekeeper' role of the IMF is the main reason why countries that have theoretically liberated themselves from IMF conditionalities through debt write-offs or by paying back debts, may still choose to engage in a program with the IMF in order to be eligible recipients of Western bilateral aid.

Relationship between IMF and Zambia

There has been a change in the relationship between Zambia and the Fund because Zambia no longer owes the Fund any money (to speak of) as a result of HIPC and MDRI. Previously, the relationship was always characterised by a desperate need to keep lending money to Zambia so it could stay current on its obligations to the Fund. This was a constant sort of rollover operation. There was a necessity to have a strict program continuously. That is no longer the case, their balance of payment position is much stronger. A few years ago they had hardly any reserves, they had virtually been exhausted. Now they have about US$ 1 billion, which is a lot given that they have very limited debt service obligations falling due. The need for balance of payment support is no longer what it used to be. So Zambia has a bit of a choice now, it can choose to have an agreement with the Fund, or it can do without, at least from the perspective of debt service. IMF leverage is no longer direct, but is there indirectly through other donors who demand to see a positive assessment of macro-economic policy performance from the IMF particularly for Budget Support. Our leverage is not as direct as it used to be. It is harder for us to impose very strict conditionality. The perception is that Zambia has matured a bit and should be better at stearing its own course. Nobody wants to go back to the bad days of debt accumulation, inflation and generally living beyond loom. I think it is only right that government take greater ownership of their policies, but they find us useful as scapegoats for things that they find seem unpopular. This is what the Fund has been used for here throughout, and that is why the Fund is so unpopular.[73]

IMF Resident Representative in Zambia

Although development assistance including loans is necessary and crucial to millions of people, a well known side effect is the dependency on donors which may distort democratic processes by creating a situation where leaders of the state show accountability to donors instead of the population. Aid dependent governments have at times gone against the wishes of the citizens in order to please donors because they were left no choice by the structural

[72] Norwegian Council for Africa, 1997 Afrikaårboka (p. 111)
[73] Interview with the IMF Resident Representative in Zambia

adjustment programs and conditionality attached to debt relief initiatives. One example of this was when the IMF programs' public sector expenditure ceilings led to reductions in teachers' salaries.[74] Although this is linked to the policy conditionality that the traditional donors have applied, it does not automatically change by the fact that China is added to the list of donors.

4.2. A challenge for African leaders

China presents an option

I think the challenge for Zambia is that Zambia has to be awake to making the loans and the business agreements we go into with China, making sure that Zambian interests are taken into account. I don't think that this is a new challenge. I think history shows us that the last 50 years of Zambia's existence, we were in some way taken for a ride by all the partners that we talked with whether it was the World Bank, the IMF, the Americans, the British, the Germans, the French, you name them. So the challenge is the same, it's just that maybe now we're a bit more awake, a bit more alive, to the fact that if we don't do it right, we have ourselves to blame. In the past, there was no option, if you didn't deal with the World Bank, nothing happened. Now, we do have an option. (...) Now that the Chinese are there, in my view, it gives us an option to be able to take responsibility for our development, to make the right deals, to look at Zambia's interests in these deals and what is going to benefit this country, and generally to be able to say no, and make a choice between to groups, which is where I think that these are real exiting times because now there are options. That is really the challenge for Zambia. [75]

Chairperson of Private Sector Development Association, Zambia

Debt relief has increased policy space for African countries. In addition, the mere presence of China and other new lenders as a potential alternative to the traditional donors creates an even greater opening for African governments to take charge of their own development. It has also been pointed out that resource rich countries benefiting from the increase in commodity price levels are also gaining leverage as a result of that[76]. These factors put together, it seems that African leaders should be in a better position to negotiate than they used to be. But is this increased leverage reflected in the way African leaders handle the negotiations for agreements with China? As long as agreements between China and African countries are not public, it is difficult to give an answer, and it seems that this question has not been at the forefront of the debate.

An issue that has caused much speculation is the question of Chinese motives for increased engagement with Africa. But, it is important to keep in mind that whether China is spurred by a race for resources, a quest for political support or in access to markets, or even by aspirations to become a world superpower, few of these motives are new to African countries. All partners come with agendas, hidden and overt. In this respect, China is just like any other cooperating partner. And in the end it is up to African governments to negotiate their way to a good deal regardless of whether it is with China or another counterpart.

Of course they (the Chinese, red. ed.) have their mercantile interest. That is normal. You can't blame them. My take on this is that it is Africa and Africans who should try to define and influence the relationship. It is not the Chinese. It is Africans who should define what they want to get from this relationship.

President of the AfDB, Donald Kaberuka[77]

[74] Global Campaign for Education, 2004 "Undervaluing teachers: IMF policies squeeze Zambia's education system" *http://www.oxfam.org/en/files/dc041001_undervaluing_teachers.pdf*

[75] Interview with Chairperson of Private Sector Development Association (PSDA), Zambia

[76] Corkin and AFRODAD, 2008 (forthcoming) "China's contribution to the development of African infrastructure through investment in the extractive industries" AFRODAD

[77] Africa Confidential, January 2007 "Interview with ADB president Donald Kaberuka" *http://www.africa-confidential.com/special-report/id/13/Interview-with-ADB-President-Donald-Kaberuka*

It seems that China behaves differently in different African countries depending on the way these countries meet China. In many countries like for instance Zambia, the Chinese have repeatedly been reported to violate labour rights and to ignore environmental safeguards. In South Africa, where the legislation and the capacity enforce it is better, the Chinese have accepted the Black Economic Empowerment program[78] of the South African government China has even agreed to an agreement that protects South African textile industry. This does not come as a result of goodwill on the part of the Chinese, but as a result of long and hard negotiations where the Chinese responded to pressure from South African leaders who stood strong and protected their interests. If other African countries are able to do the same, the Chinese are likely to respond in a similar way. China needs access to African resources and markets, and it is up to African governments to set as conditions that labour laws are respected and that Chinese companies should create employment opportunities for Africans. It is also up to African leaders to ensure that Human Rights standards are respected and that environmental safety is a priority.

Selling commodities short

For some exporters of non-renewable resources like Zambia, it is of concern that the resources are tapped without the local population earning from it. The privatisation race that has been going on in many countries has left governments in a situation where the control over resources has been sold off to private and often foreign companies. As taxation levels are set far too low, only a small amount of revenue generated actually stays in the country. The example of the copper mines in Zambia is pertinent. Privatisation was rushed into as a result of conditionality and was negotiated at a time when the primary goal was to keep the mines from having to shut down, with the result that only 5-6 % of copper revenues remain in Zambia. Unfortunately, this is the case in many African countries. But compared to the potential earning in mining, this is extremely low. In Botswana the state retains 70 % of diamonds exported and in Norway state revenues from oil production are even higher than that.[79] Nevertheless, it is important to note that China is only benefiting from the same conditions as the other foreign mine owners in Zambia, who are from Canada, Australia, South Africa, United Kingdom and the United States.

4.3. Debt contraction processes – personalisation of politics and zero transparency

The President of China, Hu Jintao, and the Chinese premier, Wen Jiabao, have both been touring African countries several times the last two years. During their visits, they have laid the foundation for cooperation declaring Chinese intentions to cooperate and often made announcements in the media of prestigious projects that would be funded by China. Thereafter, negotiations would start for an agreement that includes elements of trade, investment, debt relief and aid in a package deal.

China does not want to publicise the package deal agreements made with African countries. According to Chinese officials at the Embassy in Lusaka, information is provided on a need to know basis.[80] The key question of why it is so important to the Chinese that the loan arrangements are not public breeds suspicion. The lack of transparency also leaves room for corruption, and it is of concern that there is a danger that the loans contracted in obscurity might turn out as cases of illegitimate debt in the future.

As our case study from Zambia shows, China has in some cases been reported to bypass the proper institutional procedures that are in place and has gone directly to the highest political level to make arrangements with African state leaders. The fact that decisions are made at

[78] Black Economic Empowerment, *http://en.wikipedia.org/wiki/Black_Economic_Empowerment*
[79] Interview with representatives from the Royal Norwegian Embassy to Zambia
[80] Interview with representatives from the Chinese Embassy in Zambia

state house level seemingly without participation from relevant ministries, without discussion in parliament and with no input from civil society, is worrying. There is no insight as to what is being decided until brief media announcements are made. Possibilities for civil society and the media to scrutinise decisions made is severely hampered by this lack of transparency.

If there is one thing that African democracies can do without it is less transparency rendering politics clouded and obscure. Transparency is needed to ensure accountability and good governance. But is China at all concerned with governance and democracy in African countries? It is perhaps tempting to answer that China herself is not a democracy and to let that speaks for it self. If China is less concerned with democratic procedures, and does not advocate for governance in the same way that the Western donors do, this might certainly have a negative impact on nascent and often weak democracies where leaders might feel tempted to place restriction on media and further curtail the opposition.

The lack of transparency may also lead to a personalisation of politics. When ignoring proper institutional processes and making arrangements between presidents only, China may be perceived to be supporting the current regime. This is exemplified in Zambia, where China is thought to support the current President Mwanawasa, whereas opposition candidate Sata at one point during elections threatened that if he was elected, he would kick the Chinese (as well as Indians and Lebanese) out of Zambia. The lack of transparency either provokes protests as in the case with Sata, or it can cripple the opposition and bring public debate to silence.

4.4. China's 'non-interference' in oppressive states

Chinese foreign policy is underpinned by the principle of non-interference mentioned earlier. The policy has been welcomed by many Africans because it implies that the Chinese do not apply conditionality, but it has also been heavily criticised because of the laissez-faire attitude that Beijing seems to be showing in some of the countries that China deals with.

China's non-interference policy means supporting the current regime no matter what, and this is easily interpreted as alignment. The case of Mwanawasa and Sata illustrates how the Chinese cannot keep out of politics, even though they may well, and should, stay out of policy development. Whether they like it or not, by exploiting commercial interest in a given country, their mere presence will inevitably pull China into national politics.

The fact that Beijing is dependent on stability in countries where the Chinese are investing, has at times been pointed to as something positive, and it has been hoped that China will reconsider its principle of non-interference and decide to use their political and economic leverage positively. As the box below shows, China is reluctant to override the principle of non-interference, but is still inclined to do so when it is in their own interest.

There have recently been reports that the Chinese are showing signs that they do care about governance in African countries, exemplified by the decision to take Sudan and Nigeria off the list of countries that Chinese companies are encouraged to invest in.[81] This might be a sign that China has started to see the inconvenience of dealing with states experiencing local conflicts.

China, and others who are investing in oppressive states, will protect their investments to the extent possible. Unfortunately, this might lead to a situation where the oppressive regime is reinforced. Nevertheless, it is a paradox that China is criticised for their presence in, and co-operation with, repressive states while private companies operating in the same environment are not equally scrutinised. The fact that Chinese companies are often parastatals, makes it easy to criticise China while traditional donor countries are not to the same extent held responsible for how private companies based in their countries operate.

[81] Sudan Tribune, 2 March 2007 "Iran, Sudan and Nigeria removed from China incentive list" *http://www.sudantribune.com/spip.php?article20538*

Hollywood express – from Darfur to Beijing and back

Sudan is an example of a country where China's non interference policy has been very controversial. For a long time, China chose not to interfere with Sudanese government's way of handling the crisis in Darfur. International community criticised China for this and wished that China could have played a positive role by engaging. Instead, China chose to protect its interests by remaining neutral in words, while at the same time providing the ruling government with financial support without objecting to oppression of the population in Darfur. This led Hollywood celebrities like Mia Farrow to mobilise threats that there would be a boycott of the Olympic Games in Beijing 2008. China responded to this, and finally used their influence on the Sudanese government to allow a United Nation peacekeeping force to intervene in Darfur providing assistance to the peacekeepers from the African Union already present.[82]

5. Lessons and the way forward

The West calls China a dragon, China calls itself an all-weather friend. Whether one chooses to paint the picture black and white or in shades of grey, the most important question remains, how does one ensure that loans contracted today will not be harmful to the populations of borrowing countries in future?

For civil society, the emergence of new lenders including China, is a factor that highlights the urgent need for responsible financing. Civil society has campaigned for the cancellation of illegitimate debts and stressed the need for commitments to more honourable behaviour in the future both on the part of lenders and borrowers.

China's presence and practice in Africa provokes more questions than answers. Provided that responsible financing mechanisms are put in place, will China's lending fit into those? Is it possible to establish a coherent practice amongst lenders that includes both "traditional" and "new" lenders? The goal would be to create a predictable situation where lenders, including China, would know that loans given under suspiciously untransparent circumstances will not necessarily be repaid. Following responsible lending principles should also be preferable to creditors, as it increases the probability that the loans will be repaid if the principles are followed.

The recent lending from so-called new lenders challenges the development paradigm and consensual thinking of "traditional lenders" following the policy frameworks and prescriptions set by the World Bank and the IMF. By presenting an alternative, the new lenders weaken the leverage of traditional donors and their hegemony is threatened.

It has been suggested that new and traditional donors should not compete but complement each other, and Chinese cooperation with traditional donors seems to be increasing. December 2007, it was announced that China is to work with the World Bank. The cooperation is to take place between China Exim bank, which deals with Chinese concessional loans, and IDA. For the first time in history, China also contributed to funding IDA during the IDA 15 replenishments in 2007[83]. Is this a sign that China is joining the development paradigm as it is today? Or, does it mean that the way the traditional donors see development cooperation is changing? And if so is the case, will it be for the better or for the worse?

The announcement that China is to work together with the World Bank is met with mixed feelings within civil society. Will this make China less of an alternative and reinforce the

[82] New York Times, 12 April 2007 "Darfur collides with Olympics, and China yields" *http://www.nytimes.com/2007/04/13/washington/13diplo.html?_r=1&oref=slogin*

[83] IDA 15 replenishment website, *http://go.worldbank.org/U94WRYNMQ0*

skewed relationship that already exists between traditional donors and recipients of development assistance?

When China and the World Bank have decided to work together, this should not increase World Bank leverage and the negative impacts of donor presence on democratic processes by reinforcing the conditionality of donors dictating which development path a country should follow. The underlying goal of all assistance to developing countries must be to make it redundant, and not to reinforce the ties of dependency undermining the role of the state in African countries. For development in Africa to be successful and beneficial to Africans, Africans must be in the drivers' seat.

For traditional donors, it is a question of making the development assistance more attractive to African countries without lowering standards. In order to develop, countries may want to take on loans and should have the right to do so when they see it as useful. To be attractive (and fair) to developing countries, economic policy conditionality, meaning conditionality intended to change a country's economic policy, must be completely abandoned to achieve a true partnership between donor and recipient. China has also demonstrated that it is possible to give preferential loans with very low interest and a repayment period that is reported to exceed most of what one has seen from Western donors.

On the other hand, China urgently needs to take the issue of transparency seriously and review the significance and implementation of the policy of non interference. By financing the regimes, regardless of how the rest of the population is treated, China is perceived to be interferring as a supporter of the people currently in power.

When China is exposed to pressure, China may react positively to that, but if nobody protests, then nothing happens and it is business as usual. Civil society must put pressure on China and engage in dialogue with China and other donors. It is also crucial that civil society work to influence the way that African countries handle China. African leaders should hold China accountable and must not let China take advantage of weaknesses in African countries' legislation. Internationally recognised legal standards for responsible lending would serve as a tool for African leaders to hold China and other creditors responsible.

Although the Chinese companies have been seen to violate labour laws and to ignore environmental safeguards, they are not the only ones who have trouble living up to best practices, and this is yet another reason why universal law needs to be established. Some people feel it is an ironic display of double-standards when traditional donors on the one hand criticise China while on the other hand object to establishing universal regulation that would require commitment to responsible financing.

African leaders should know, by painful experience, that by signing a loan agreement you are also signing away part of your freedom, on the other hand, a loan coupled with good ideas can also enhance your freedom. It's a double-edged sword. Consequently, the appeal to African leaders must be to think twice about contracting cheap loans from China. By allowing public scrutiny in the loan contraction process, the legitimacy of loans contracted will increase and hopefully debt levels in Africa will stabilise at a level that Africans view as sustainable.

Part two:

6. Chinese lending to Zambia

This case study examines and outlines China's engagement in Zambia in particular on issues like aid, lending, trade and business relations. It investigates such questions as what are the key trends? What are the main differences between the new and old actors in how they do business? What has been the response of the old lenders?

The study presents available information and data on China's role in Zambia. This information should be looked at in light of the debate on responsible lending, illegitimate debt and the possibility that new lenders are free-riding on the highly indebted poor countries (HIPC) debt cancellation initiative. This requires a close look at Chinese business deals and aid/loans and export-credit packages. In this context the following questions are important. How are Chinese loans given, what criteria are used, and for what purpose? What are the conditions? Is the new lending responsible? Will the countries be able to repay the loans or do they risk defaulting? What happens to countries that default? What are the differences between the new lenders and the old – the Washington Consensus vs. the Beijing Consensus?

The Zambian case study seeks to provide information on Zambia's borrowing from China as well as Zambian perspectives on China's role in the country, including civil society attitudes and strategies.

7. Background to Zambia's Debt Situation

Zambia gained independence from Britain in 1964. At that time, Zambia was one of the most prosperous and promising nations in Africa. The country's rich endowment with arable land, water and mineral resources held great promise and potential for sustainable economic development. The new Zambian political elite inherited very poor and inadequate infrastructure, and human capital from the colonial regime. The new government of the United National Independence Party (UNIP) set about building schools, a university, roads and hospitals. The inherited copper sales revenue was utilised for this purpose.

In the first ten years after independence, the nation experienced growth averaging 2.4 percent a year, significantly lower than population growth, thereby leading to declining per capita incomes.

Starting in 1975, Zambia faced falling copper prices and higher oil prices. Government and multilateral donor agencies initially thought this development was a temporary phenomenon. Still anticipating a rise in copper prices, the government resorted to heavy borrowing to sustain the economy. By the early 1980s, however, it was becoming clear that the socialist economic reforms were not bearing fruit. In the period between 1983 and 1985 the government attempted an IMF/World Bank Structural Adjustment Programme (SAP) that had stringent conditions attached to it. The SAP was abandoned in May 1987, after massive food riots on the Copperbelt province. The SAP was replaced by another, local programme that re-imposed the government controls of the 1970s. The economy, however, continued to decline; poverty levels rose and debt had swelled to US$ 7.1 billion by 1991. Clearly, Zambia's debt crisis was not confined to domestic issues of policy failure and lack of good governance. It also originated from significant external shocks that were poorly addressed by domestic political elites and the international financial institutions (IFIs).

In October 1991 the people of Zambia, discontented with the performance of the reforms thus far, elected the Movement for Multi-party Democracy (MMD) government. The new government introduced and pushed neo-liberal economic reform policies that were supported by the IMF, World Bank and other donor agencies. At the heart of the reforms was the dismantling of the state owned enterprises, and the anticipation that the private sector would be a more efficient engine for economic growth. Additional reform objectives were to downsize the civil service, liberalise trade, exchange and interest rates. The state's role was reduced to that of the creation of an enabling environment for private sector growth[84].

7.1. Heavily Indebted Poor Countries (HIPC) Initiative

In December 2000, Zambia qualified for the Heavily Indebted Poor Countries (HIPC) Initiative. In December 2003, Zambia was supposed to reach the HIPC completion point but, for various reasons failed to reach the completion point until 2005.

In the interim period between the decision and completion points, the IMF provided debt relief of US$452 million in net present value (NPV) terms, while the International Development Association (IDA) provided relief of US$98 million. Zambia has also benefited from interim assistance granted by the African Development Bank (AfDB), the OPEC Fund for International Development, the European Union (EU), and the Paris Club creditors. Total HIPC Initiative assistance to Zambia was in excess of US$380 million in NPV terms during the interim period, and Paris Club creditors have provided interim relief beyond HIPC Initiative assistance[85].

7.2. Multilateral Debt Relief Initiative (MDRI)

Under the G8 Gleneagles proposal of 2005 also known as Multilateral Debt Relief Initiative (MDRI), the IMF approved significant debt relief for Zambia in December 2005. As part of the Initiative, the IMF agreed to provide 100 percent debt relief for Zambia on all debt incurred by Zambia to the IMF before January 1, 2005 that had remained outstanding. IMF debt relief amounts to approximately US$ 577 million, or US$ 572 million excluding remaining assistance under the Heavily Indebted Poor Countries Initiative. This debt relief became available in early January 2006 as soon as the remaining consents of the contributors to the PRGF Trust Subsidy Account had been received. The international community had made these additional resources available to help Zambia make progress toward poverty reduction[86].

With attainment of the completion point under the HIPC and even before MDRI debt relief, Zambia's external debt and debt service indicators would remain quite low over the long term compared with the various threshold indicators of potential debt distress. There is now the recently introduced IMF-World Bank Debt Sustainability Assessment (DSA) framework. That framework, discussed in more detail further below, sets indicative, country-specific debt burden thresholds that depend on the quality of a country's policies and institutions. As measured by the World Bank's Country Policy and Institutional Assessment (CPIA), Zambia ranks as a "medium performer" in terms of policies and institutions. The indicative thresholds of potential debt distress for countries in this category are a net present value (NPV) of debt-to-exports ratio of 150 percent, an NPV of debt-to reserve ratio of 250 percent, an NPV of debt-to-GDP ratio of 40 percent, and debt service-to-exports and revenue ratios of 20 and 30 percent, respectively. Zambia's debt indicators remained well below these threshold levels both under the baseline scenario and under most stress tests, except for a scenario involving a sharp fall in copper prices. After MDRI debt relief, debt and debt service burden indicators never came close to their respective thresholds even in such an adverse scenario. This essentially means that with MDRI Zambia's likelihood of encountering debt distresses in the future is very low according to the parametres the IFIs use to assess debt sustainability.

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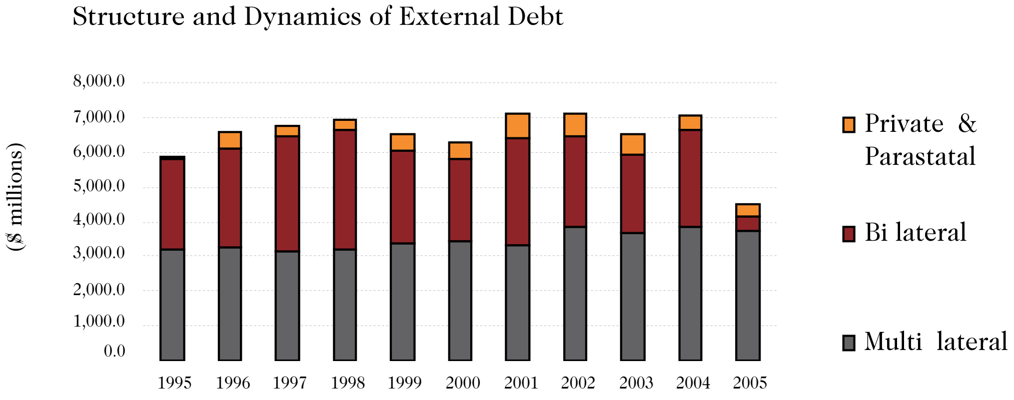
[84] Muyakwa S. L. and CSTNZ, 2007 "The Impact of Chinese Economic Activities in Zambia, Malawi and Mozambique" Lusaka, Zambia.
[85] Cheelo C. et al., 2007 "Zambia: Debt Strategies to Meet the Millennium Development Goals" Lusaka, Zambia.
[86] Ibid

Largely due to the debt relief from the HIPC initiative, at the close of 2005, Zambia's overall external debt stock reduced by 36.1 percent to US$ 4.5 billion from US$ 7.1 billion at end-2004. According to the Ministry of Finance (MOFNP, 2006), the dramatic overall reduction in the country's debt stock emanated from the cancellation of debt by members of the Paris Club following Zambia's ascension to the HIPC Completion Point, which was not coupled with significant further borrowing from the Club. The stock of Paris Club debt in 2005 declined by 95.3 percent to US$117.5 million (from US$2,483 million in 2004), implying a debt write off of US$2,365.5 million by the Club (see, Figure 1).

Figure I: Structure and Dynamics of Zambia's External Debt

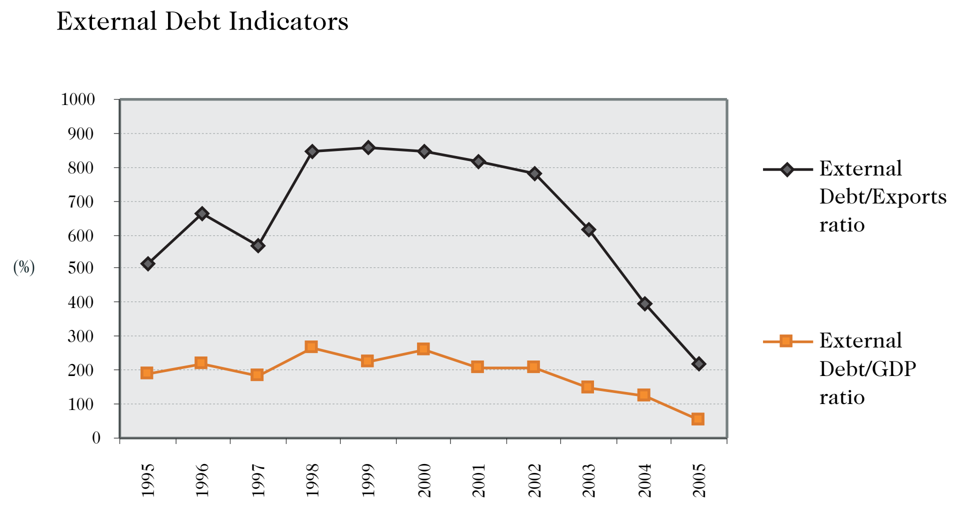


Source: Cheelo C. et al (2007)

On the other hand, despite the impressive debt relief figures on multilateral debt highlighted above (presumably achieved through HIPC), official Ministry of Finance data show that there was only a marginal change in the stock of multilateral debt from 2004 to 2005. The multilateral debt component declined by only 4.0 percent from US$3.9 billion in 2004 to US$3.7 billion in 2005. Without giving any specific details on the types, sizes and purposes new loans the Ministry of Finance (MOFNP, 2006) reports that this was mainly because of the contraction of new multilateral loans that negated the debt relief gains made on the multilateral component. Hence, overall, although Figure 1 shows a general decline in the debt levels, there was an increase in debt owed to the World Bank, African Development Bank and Non-Paris Club members due to contraction of new debt.

As would be expected given the foregoing, relative to both exports and GDP, total external debt has been reduced considerably, declining steadily from 1999 to 2002 and then quite dramatically from 2002 to 2005 (see Figure 2). This simply provides further evidence of the contribution of HIPC debt relief to debt reduction outturns.

Figure 2: Zambia's External Debt Indicators

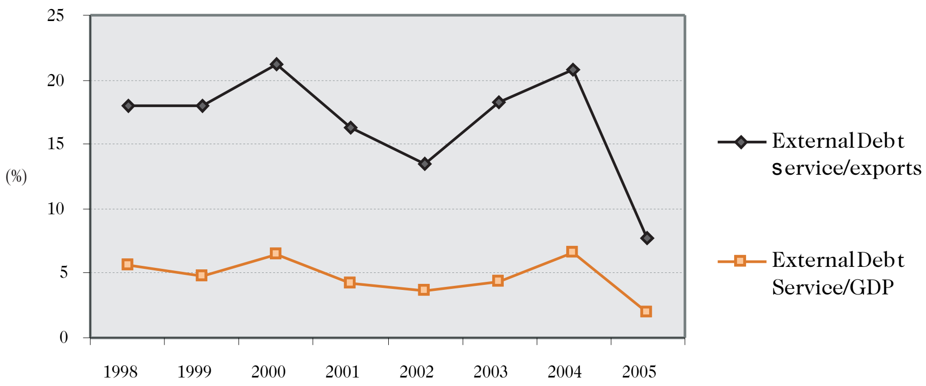


Source: Cheelo C. et al (2007)

Generally, a key concern regarding external debt management is usually the cost of the debt to export earnings in terms of debt service payments, but judging from the country's recent debt service record, this does not seem to be a significant concern in Zambia. As a proportion of exports, external debt servicing in 2005 was 7.7 percent, down from 20.9 percent the previous year. Figure 3 below illustrates the external debt service-to-export and external debt service-to-GDP dynamics during 1998 to 2005. Clearly, the debt relief efforts realized in 2005 reduced the country's debt service costs and burden.

Figure 3: Zambia's External Debt Service Ratios.

External Debt Service ratios: 1998-2005



Source: Cheelo C. et al. 2007 «Zambia: Debt Strategies to Meet the Millennium Development Goals»

In absolute terms, external sector's service payments, excluding amortisation, amounted to US$33.5 million in 2005, a reduction of 2.5 percent from US$34.3 million in 2004.The bulk of the payments – amounting to US$23.8 million or 71 percent of total payments – were to multilateral institutions. Payments to Paris Club and Non-Paris club creditors for 27.9 percent and 0.1 percent of the total, respectively.

The latest debt position is shown in table 1 below. Between 2005 and 2006, total government debt reduced by 83.1 % from US$ 4,123.8 to 6, 96.7 million. Multilateral debt stands at US$ 390.4 million while bilateral debt is at US$ 147.0 million in 2006.

Table 1: Latest External Debt Stock 2004 to 2006 (US$ Million)

Debt Source	*2004*	*2005*	*2006*	*% change 2005/2006*
Multilateral	3,872.0	3,715.7	390.4	(89.5)
ADF	311.0	377.5	88.1	(76.7)
World Bank	2,359.0	2,436.4	253.9	(89.6)
IMF	890.0	591.1	32.5	(94.5)
Others	312.0	310.7	205.8	(33.8)
Bilateral	2,748.0	408.1	147.0	(64.0)
Paris Club	2,483.0	117.5	6.7	(94.3)
Non Paris Club	265.0	290.6	140.3	(51.7)
Total GRZ Debt	6,620.0	4,123.8	6,96.7	(83.1)
Private and Parastatal Debt	460.0	404.2	840.3	107.9
Total External Debt	7,080.0	4,528.0	1,569.5	(65.3)

Source: MoFNP (2007): Economic Report page 41.

In terms of new loans, the government contracted a total of US$ 79,684,088 in 2006. The bulk of the new debt is from the World Bank International Development Association (IDA) and International Fund for Agricultural Development (IFAD), BADEA, China and then OPEC Fund, (See table 2 below for details).

Table 2: Loan Contraction in 2006

Creditor	*Purpose*	*Date Signed*	*Amount*	*USD Equivalent*
IDA	Public Service Management Support Water Sector Performance	10/02/2006	SDR 20,700,000	29,754,760
IDA	Improvement of public service management	22/12/2006	SDR 15,700,000	22,567,620
IFAD	Smallholder Livestock Investment	20/06/2006	SDR 7,000,000	10,310,934
P.R. China	TAZARA Protocol	22/06/2006	RMB 50,000,000	6,250,774
BADEA	Water Supply to Six Towns	14/09/2006	USD 6,800,000	6,800,000
OPEC FUND	Water Supply to Six Towns	13/12/2006	USD 4,000,000	USD 4,000,000
			Total	79,684,088

Source: MoFNP (2007): Economic Report page 41.

7.3. Economic Development Implications of External Debt Relief

In view of the benefits from the HIPC initiative and currently also benefiting from the MDRI, Zambia has already had a significant proportion of its external debt obligations written off. This hopefully will allow the country to channel some of the debt resources to poverty reduction programme spending.

The resources needed to achieve the goals of the Fifth National Development Plan (FNDP) and the Milennium Development Goals (MDGs) are likely to exceed those freed up under the debt relief initiatives. While it would be expected that in response, the government will continue to make efforts to increase its domestic resource mobilization, there will be clear limits to the size of domestic resources that can be generated. This is mainly due to a) the high unemployment and poverty levels thus limiting personal income tax levels; b) the generous tax concessions given to foreign direct investment (FDI) operators, especially the “Development Agreements” signed with the new mine owners and c) weak tax collection systems. The scope may exist for reallocating expenditures within the national budget. On this score, civil society organizations (CSOs) fear that the will to make hard reallocation choices to priority areas will most likely be found wanting.

In the medium term Zambia will need to significantly supplement the rather limited domestic resources with those provided by donors. A key issue is therefore about the terms on which Zambia will receive these external resources – whether as grants or as loans. The FNDP intention is clear: government intends to make every effort to mobilize additional resource to achieve the goals of the Plan. Basically, it is clear to see that an increasing preference for grant (ODA) financing to invest in the FNDP and MDGs will be inevitable. Naturally, the issue is then one of trying to forecast the size and predictability of future aid inflows.

Of course, considering that Zambia has been given a new lease of ‘life after debt’, new loans will increasingly become an option for development financing.

On the other hand, there is the possibility that some amount of non-concessional (i.e. on market terms) borrowing will be undertaken. Then the concern will be that the debt may again build up to be an unsustainable future liability. It therefore becomes important to try to understand what should constitute a ‘sustainable’ level of debt in respect of the human development imperative of poverty reduction if additional loans will be entered into. The role of China is critical in this respect, and we turn to that issue in the next section of this paper.

8. Zambia China Relations

Many observers talk about China as a new actor on the African and Zambian scene. This view is quite misleading. The historical ties between China and Zambia date back to the pre-independence period when the present-day Zambia was then a colony of Great Britain. At that time the relationship was in the form of Chinese assistance to the black Zambian opposition parties fighting for independence. This assistance comprised of financial and material donations. From the literature (review), it may be observed that the historical engagement between China and Africa is rooted in a shared experience and struggle for national liberation and independence. The Zambia-China relationship can be divided into three distinctive periods[87].

The first period is from 1949 to 1979. During this phase of the relationship, the focus was on support to liberation or independence struggle and the establishment of diplomatic missions, economic reconstruction and consolidation of national independence. China provided assistance to the liberation or independence struggle and aid towards economic reconstruction and consolidation of national independence. In return, Zambia and many other African countries provided support to China in the international arena and allowed China to establish diplomatic missions. Clearly, the political factor and ideology were the dominant factors explaining relations between Zambia and China and Africa and China in this period.[88]

The second period is from 1979 to 1999. This is the period of profound changes in both Zambia/ Africa and China. In Zambia and Africa, this was the period of International Monetary Fund and World Bank sponsored structural adjustment programs (SAPs) and liberalisation as well as adoption of multi party democratic systems of government. China meanwhile was emerging from social chaos and economic crisis arising from the great Cultural Revolution. China adopted an Open Door Policy, economic reforms which put economic development at the centre of national development strategy. Ideology was put on the sideline. In 1991, a "Going Out" policy was initiated which put Africa as a major policy target area. The Zambia/Africa-China relationship continued on the traditional basis of friendship with a particular focus on economic and political cooperation.

The economic cooperation became more diversified from the provision of traditional aid to preferential loans, contract bidding for construction and direct investment in Africa. Africa became more supportive of the One China Policy and supported China's diplomatic engagement at the multilateral level such as the United Nations, the World Trade Organisation and other fora.

The third episode runs from 1999 to date. The main pre-occupation of African countries at the turn of the new millennium became wealth creation or poverty reduction, peace and stability, promotion of economic development and achievement of the Millennium Development Goals. African countries worked together for a common purpose which saw the creation of a new development paradigm such as the New Partnership for African Development (NEPAD) and the African Union (AU) in 2002, as a way of solidifying its strategy for common economic development effort.

8.1. Zambia's Debt with China

In the course of that long Zambia China relationship, China was able to provide Zambia with loans. The table in annex 1 shows the loan description, outstanding arrears and total debt stock. Zambia's debt to China stood at US$217 million as of December 12, 2006, making China the highest Non-Paris Club creditor to the Country. Most of this debt was, however, written off when the Chinese President visited Zambia in early 2007. (See section 9.4 for more details.)

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[87] Mwanawina I. and AFRODAD, 2008 (forthcoming) "An Assessment of Chinese Development Assistance in Africa" AFRODAD

[88] The Soviet factor, the Great Cultural Revolution in China and emergence of communist beliefs in some African leaders could be cited with respect to ideology.

8.2. Chinese Projects (1967-2006)

Successive Zambian governments have labeled China as an all weather friend. This is partly because China has been extending assistance to Zambia prior to and after the attainment of independence in 1996[89]. The assistance has been in the form of loans and to a lesser extent, grants. Prior to Zambia's liberalisation and privatisation drive of 1991, China had implemented several public projects. The main star projects being the Tanzania-Zambia Railways (TAZARA), construction of roads, New Government Complex, Mulungushi Textile Mill, and construction of houses in Ndola ,provision of short-wave transmitters, scholarships and Medical doctors. After privatisation, China opened a branch of the Bank of China and a Trade and Commercial Centre in Lusaka. It also acquired the Chambishi Copper Mine. China has thus transforming its status from a copper buyer to a producer. China has further opened a cotton ginnery in Eastern Province of Zambia as a response to Zambia Government's encouragement of rural development. Table three below highlights Zambia's economic engagement with China over the years.

Table 3. Chinese Engagement in Zambia

Year	*Type*	*Amount (in million RMBY or US$)*	
1967	Economic and technical cooperation	RMBY	41.36
	Loan, construction of TAZARA	RMBY	484
1974	Economic and technical cooperation	RMBY	100
1979	Loan, 12 locomotives	RMBY	5.58
1986	Loan, TAZARA spare parts	RMBY	5
1987	Loan, assorted spares and road rehabilitation	RMBY	50
1988	Economic and technical cooperation	RMBY	50
1990	Economic and technical cooperation	RMBY	30
1992	Loan	RMBY	30
1993	Economic and technical cooperation	RMBY	50
1995	Grant, Cash, relief food & general goods	US$	1.2
1996	Grant, implements & sports goods	RMBY	3
	Loan, New Government Complex	US$	8
1997	Economic and technical cooperation	RMBY	30
	Loans	RMBY	50.6
1998	Grant, relief food	US$	0.2
	Grant, Medicine	RMBY	0.2
	Five water pumps	RMBY	2
	Economic and technical cooperation	RMBY	20
1999	Grant, relief food	US$	0.2
	Grant, office equipment	RMBY	4
	Loan, FM transmitters in seven provinces, TAZARA locomotives overhaul. training personnel	RMBY	52
	Economic and technical cooperation	RMBY	30
2000	Grant, equipment for National Assembly	RMBY	1
	Economic and technical cooperation	RMBY	30
2001	Grant, cash for OAU	US$	0.5
	Loan	RMBY	100
	Grant, good to OAU and web printing press	RMBY	6.9
	Economic and technical cooperation	RMBY	20
2002	Loan, FM transmitters for seven provinces, new government complex & special loan	RMBY	120.9
	Grant, maize (4,500 tons)		
	Economic and technical cooperation	RMBY	30

[89] Mwanawina I. and AFRODAD, 2008 (forthcoming) "An Assessment of Chinese Development Assistance in Africa" AFRODAD

2003	Grant, web printing press	RMBY	0.55
	Economic and technical cooperation	US$	6
2004	Economic and technical cooperation	US$	7.1
	Loan, TAZARA	US$	11
2006	Loan TAZARA	US$	10
	Grant, relief food	US$	1
	Economic and technical cooperation, extension of radio transmitters	RMBY	3.8
	Economic and technical cooperation, anti malaria medicines	US$	0.2

Over the period from 1967 to 2006, the loans have amounted to RMBY 1,413.79 million plus US$ 42.1 million while grants accounted for RMBY 17.1 million plus US$ 3.3 million in addition to 4,500 tons of maize in kind. The magnitude of Economic and Technical Assistance has been high, explaining the major component of the country's indebtedness. The loans are themselves soft loans.
The Chinese engagement in the main covers the following sectors:

- Agriculture;
- Mining;
- Manufacturing;
- Construction;
- Communication and Transport; and
- Health;

The Chinese Government is keen to state that most this engagement is without conditionalities. The assistance is dictated largely by the Zambia Government initiative and Chinese expression of solidarity but also commercial interests. A classic example being TAZARA which Western Countries considered not to be viable. China has supported over 35 projects in Zambia. Key engagements include but not limited to:

Agriculture Sector

In 2003, the Chinese government provided training to Zambian nationals in the fields of rice production, agricultural machinery, acupuncture, small hydropower, food and agro processing, and tropical disease control.

Mining Sector

The Zambia Investment Centre Statistics show significant investment from China. From 1993 to 2006, Chinese investment pledges amounted to US$378 million across all sectors with manufacturing accounting for 60%. As a consequence of the privatisation exercise, China Non-Ferrosus Metal Mining Group Corporation Limited (NFCA) acquired the Chambeshi mine. The mine is located on a 41 km² piece of land which has since the visit of the Chinese President, Mr. Hu Jintao in December 2005 been established as the Chambeshi Special Economic Zone expected to provide Chinese and other enterprises with favourable investment incentives.

Manufacturing Sector

The Zambia – China Mulungushi Textiles (ZCMT) produces Cotton fabrics. The company started its operations in Zambia on 22nd January, 1997. The Ownership and organizational structure is 66% and 34% by the Chinese and Zambian governments respectively. The company was offered tax exemption for 3 years (1997-2000). The company is currently non operational due to financial problems arising from stiff competition from imported textiles not least from China.

Construction Sector

The thrust of Chinese engagement in Zambia is in the construction, communications, transport and building sectors. The main highlight is the Government Complex, which started in 1985 as a party head-quarters building for the then ruling party, the United National Independence Party (UNIP). The complex comprises of six buildings. The construction was funded from the Zambia government coffers, which has taken over the complex, and presently houses several government ministries.

Communications and Transport Sector

TAZARA was constructed under a bilateral agreement between China and Zambia signed in 1965. Project planning and design commenced in 1968. Project implementation started in 1970 and was completed in 1976. TAZARA links Kapiri Mposhi in Zambia to the Tanzanian port of Dar-es-Salaam. Financing for the project was provided by Chinese government loan dated 18th April 1968 in the amount of US$ 91 million to the governments of Zambia and Tanzania. China has since continued to provide loan finance to the project. In December 1992, an interest-free loan amounting to US$ 10.8 million was provided to enable TAZARA procure passenger coaches and spare parts under Economic and Technical Cooperation. A technical assistance loan was given on August 11, 1995 for engineers and technicians in the amount of US$ 26.7 million. Further Economic and Technical Assistance was signed on July 16, 2001 and December 31, 2004 which provided for, among others direct cash assistance in the amount of US$ 6 million for purchase of fuel and spare parts from third parties. An interest free loan in the amount of RMB 90 million (US$ 11 million) was provided on November 5, 2004 while another in the amount of RMB 100 million was given in July 2006. Thus, China provided soft loans of over US$ 157.7 million to the TAZARA project over the period from 1965 to 2006 to be shared equally between the governments of Tanzania and Zambia.

The Lusaka - Kaoma Road was financed by an interest-free loan of £7 million (US$ 12 million) from China in 1967. The construction of the road commenced in 1969 and was completed in 1975.

The Serenje-Samfya-Mansa was financed by a loan from China in the total of amount was RMBY 75 million (US$ 14 million) under the Economic and Technical Cooperation Agreement originally signed in February 1974 and extended in May 1987. In June 2006, China expressed interest to assist Zambia in constructing Chembe Bridge across the Luapula River in Luapula Province.

The government of Zambia entered into a agreement provided by China for the Construction of the Diplomatic Radio Station on May 29, 1972 but implemented through the 1967 loan of £7 million and completed in 1973 at an actual cost of £118,975.

At a commercial level, the Zambia TeleCommunications Company Limited (ZAMTEL) entered into a soft loan agreement financed by Export and Import (EXIM) Bank of China under the government of Zambia guarantee in the amount of US$ 13,200,128. The scope of the project involves supply, installation and commissioning of 14 digital telephone exchanges and 50 hops of transmission equipment. ZAMTEL also entered into another commercial contract with ZTE Corporation of China on March 22, 2002 in the amount of US$ 21,570,244 for the supply, delivery and installation and commissioning of the GSM cellular telephone system in Zambia.

Health Sector

China has traditionally assisted Zambia in this sector through the provision of doctors and medicine. The cooperation dates back to 1977. Since then the 11 Chinese teams have operated in Zambia with a total of 263 Chinese doctors. The 12th medical team of 28 doctors came to Zambia in January 2003. China also provides medical equipment to Zambia. Cooperation on anti malaria medicines was signed during the FOCAC Beijing Summit in November 2006. China also provides scholarships to Zambians and in turn is supposed to provide some scholarships to the Chinese.

The more complete list of projects is attached to this report as annex 2.

9. The Loan Contraction Process and Transparency

9.1. Loans and Guarantees (Authorisation) Act

There are a number of laws that work together to authorise and regulate public external borrowing. The Legal framework changed substantially in 1969 from what it was at Independence. It is very significant that the current law was enacted at around the time when a referendum was held to usher in the One-Party State. The political domination of the then ruling party, United National Independence Party (UNIP) and its government was clearly intended to extend to public borrowing. Law reforms had the effect of ousting parliamentary control over the borrowing process and legalising undemocratic contraction and management of loans.[90]

Under the current legal framework, the most important piece of legislation is the "Loans and Guarantees (Authorisation) Act, Cap 366" of the Laws of Zambia. This Act is primarily intended to give blanket authority to the Government to borrow. Once this authority is given, the loan contraction process tends to follow international principles and rules.

There are a number of acts that authorise the application of international law and multilateral financial institutions in Zambia. These are the International Development Association. Cap. 361; Bretton Woods Agreements Act, Cap. 367; International Finance Corporation, Cap. 368. These acts enable Zambia to be a member of and therefore eligible to borrow from these institutions.

The key provisions of the Loans and Guarantees (Authorisation) Act are as follows:

- Loans may be raised through the issue of bonds and stock, issue of treasury bills and by agreement in writing. The Minister of Finance determines the terms and conditions applicable. It is important to note that this expectation is unrealistic in view of the fact that the Minister is expected to negotiate terms that are favourable to Zambia in circumstances where the lenders clearly have the upper hand.

- Section 3 of the Act gives the Minister of Finance a general power to borrow both within and outside Zambia, as he may deem desirable. This gives the Minister too much discretion to commit the country to debt. The ceiling on borrowing is contained in a statutory instrument authorised by resolution of the National Assembly. (Under Article 80 of the Constitution, a statutory instrument is to be published in the Gazette within 28 days after it is approved by Parliament). When the National Assembly is not sitting, the Minister is authorised in the public interest and with the approval of the President, under section 26, to vary the ceiling on borrowing to the extent necessary to raise an urgent loan or guarantee. This creates a loophole. Under the current law, external loans are not subjected to the scrutiny of Parliament before they are obtained, nor is the Auditor-General supplied with all loan documentation. The present borrowing ceiling was set under Cap 366, by statutory Instrument No. 53 of 1998, at a maximum of K20 trillion. This is the maximum allowed to be outstanding at any one time on loans raised from outside the Republic. In addition, the Government can guarantee up to 200 billion Kwacha. It is not clear whether these figures were determined on the basis of the country's ability to absorb and service such debt or simply to accommodate the existing debt obligations and their multiplication due to a failure to pay back or service them adequately. There is some concern that if twenty trillion Kwacha amounted to $ 4 billion at the 1998 exchange rate, and the actual outstanding debt at the time was $ 7 billion, then the ceiling is not properly defined and realistic.

- Loans for a period of not more than one year are payable into a special depository account but those for more than a year are payable into the general revenues of the Republic. These loans are then difficult to monitor. It is desirable that loans raised for a specific purpose must be applied only to that purpose.

[90] Most of the information in this section draws on Muyakwa S. L. and AFRODAD, 2004 "Making Loans Work For The Poor In Zambia" AFRODAD

- All debt charges are paid out of the general revenues of the Republic and details included in the financial report to Parliament. We need to take note that this report thus comes after the fact and serves little useful purpose.

- Although a sinking fund may be established in the public interest where a loan is obtained through the issue of bonds or stock, it is mandatory to establish a sinking fund for the redemption of not less than 75% of the loan only where bonds and stock issued in respect thereof exceed 10 years. Currently, sinking funds are not used in practice[91].

- Under the Loans (Stock, Bonds and Treasury Bills) Regulations appended to the Act, in the case of any loan raised by the issue of stock and bonds the Bank of Zambia shall keep a register of each issue of stock and bonds. The holders of the stock and bonds are also registered. Questions arise as to whether this has been done consistently.

- Under Parts V and VI of the Act, the minister can guarantee or grant loans to persons and on such conditions as stated under the same provisions of the Act. For instance, upon the issue of a warrant by the President, the Minister can on written agreement and whatever conditions he deems fit, grant loans out of the general revenues of the Republic to any person or body specified in the warrant. The Minister thus has wide and dangerous discretionary powers to lend out public resources.

- Although loans contracted under prior Acts remain valid, all new loans must be raised under the Loans and Guarantees (Authorisation) Act or other written law enacted in future. This section rules out the use of a previous Act, which placed more stringent measures on Government including the passing of an Act of Parliament to authorise a public loan. (Namely, the General Loan and Stock Act of 1931).

Clearly, the Loans and Guarantees (Authorisation) Act does not provide adequate guidance with regard to the procedure to be followed by the Ministry of Finance in negotiating and monitoring loans. It should offer better protection from the risks of borrowing internationally.

In addition to the Loans and Guarantees (Authorisation) Act, the Republic of Zambia can also obtain funds from foreign sources through several means. The Government may issue treasury bills through the "Treasury Bills Act, Cap. 348". It can also issue stock and bonds or execute loan agreements under a number of Acts both current and moribund. The General Loans (Guarantee) Act is a general guarantee by the Government.

Under the General Loan and Stock Act, 1931, Cap. 350, money may be obtained through the issue of debentures. This Act is no longer used but it offers much better protection to the Republic than Cap 366. Of special note are the following:

a) That an Act of Parliament is required to authorise borrowing;
b) That there are ceilings on the life of a loan; and
c) That a trustee administered sinking fund must be established.
d) The date for redemption of stock should not exceed 60 years from the date of issue.
e) If the sinking fund is insufficient to cover the principal money borrowed then and only then are they chargeable to the general revenues of the Republic.

9.2. Constitutional and Statutory Controls on Borrowing

The authority to borrow is controlled and limited through a number of laws including the Constitution. Thus certain Acts provide mechanisms to monitor and control the power to borrow. However, such laws are either inadequate or ignored by the Minister of Finance because the regulatory mechanisms they create are weak and ineffectual. Below, we outline the key controlling mechanisms.

[91] Officers queried at the Ministry of Finance by Jubilee Zambia were unaware of the provision or what it entails.

9.2.1. The Attorney General

The specific functions of the Attorney general are to cause the drafting of and sign all Government bills to be presented to Parliament. To draw and peruse agreements, contracts, treaties, conventions and any other documents to which the Government is a party or has an interest. An agreement, contract, treaty, convention or other document in which the Government has an interest should not be concluded without the legal advice of the Attorney General unless the law provides otherwise. It must be noted that the Attorney General is an integral part of Government and therefore not well placed to give independent advice.

9.2.2. The Auditor-General

The Auditor-General is the watchdog of the nation's finances and his or her office is set up in such a way as to ensure his or her independence in the performance of these functions. This officer's appointment is ratified by Parliament, the salary is a direct debit on the general revenues and the officer cannot be removed from office without complying with lengthy constitutional requirements. However it must be noted that the office itself is inadequately funded and dependent upon the Ministry of Finance for regular grants. All staff other than the Auditor-General are seconded by the Ministry of Finance[92]. The functions of the Auditor-General are set out in an Act of Parliament - the Public Audit Act, Cap. 378 of the Laws of Zambia.

The Auditor-General's function is to audit the accounts relating to the general revenues of the Republic. This includes auditing any expenditure charged by the Constitution or any other law on the general revenues and making a report thereon to the President within twelve months after each financial year. In practice this Report is usually late, sometimes by as much as two or three years.

9.2.3. Parliament and Budgetary Controls

Parliament does not have direct control over the extent to which the nation can be exposed to external debt since such power is the prerogative of the Minister of Finance. Parliament's powers are exercised through more general budgetary controls. Parliament's committee of Ways and Means, which also doubles as the Committee of Supply and Demand examines the Government budget under various heads of expenditure and approves certain amounts to be spent under each head.

Such general controls in expenditure may help to limit Government expenditure of external loan funds and begin with the President's good sense in authorising expenditure.

9.2.4. Public Reporting and the Public Accounts Committee of Parliament

The Public Accounts Committee is the Parliamentary institution mandated to scrutinise Government expenditure by verifying and commenting on the Auditor-General's report. The Committee's findings and recommendations for disciplinary action in the event of mismanagement of public resources are presented to Parliament as a whole and published. The Committee can request for any information other than ministerial files and minutes. It can also summon any controlling officers including the Minister of Finance to appear before it. However its recommendations come after the fact and are generally ignored. The Government's 'action taken' reports invariably say nothing more than 'noted'.

[92] Jubilee Zambia reports that this office suffers from lack of cooperation with the Ministry of Finance.

9.2.5. Ministry of Finance Internal Controls

The Finance (Control and Management) Act, Cap.347 of the Laws of Zambia regulates the way in which public revenues are expended as well as the management of public finances. Public moneys are defined under the Act to a) include all revenues and all moneys raised or received for purposes of or benefit of the Republic and b) to include all stamps, bonds, debentures and other securities raised or received by or on behalf of or for the benefit of the Republic. Clearly the Act covers loans. The Finance Control and Management Act regulates public funds only from the expenditure point of view and is not very helpful when it comes to the loan contraction process. It is also not strong enough to handle financial abuse in a country in which corruption and abuse of office are rampant. Year after year the Auditor-General's reports contain cases of financial abuse and yet little or no action is taken against perpetrators. The Ministry of Finance and National Planning is in the process of developing a debt management strategy. This strategy has not been subjected to public discussion. IMF officials have deemed the document inadequate.

9.2.6. Bank of Zambia Controls

The role of the Bank of Zambia in external debt management is not very clear, with the exception of balance of payments support provided by creditors. In general, the Bank is to receive and disburse Government money and keep account thereof under the Bank of Zambia Act, Cap. 360 of the Laws of Zambia.

9.3. Loan Contraction Process in Zambia in practice

The External Resource Mobilisation (ERM) department of the Ministry of Finance is responsible for borrowing from external sources. It has three sections. The Bilateral and Multilateral Units are responsible for non-debt creating transactions. Borrowing is confined to a Debt Unit. The Unit is responsible for contracting and managing external loans. The process of contracting loans is not written down hence there is no standard procedure to guide loan negotiators. Clearly, this violates the UNITAR model mentioned earlier.

Once the department of investments and debt management receives a request for funding from a line ministry, it approaches creditors likely to favour that particular type of project. If the creditors are agreeable to the project, they send a 'standard' draft loan agreement for review by the Ministry of Finance. It is very important at this time to assess the financial implications of the various clauses and conditions in the agreements in order to avoid committing the country to impossible demands. In practice not enough attention is given to the study of the draft loan agreement because of the assumption that it is not negotiable. It may not even be submitted to the Treasury Consul or the Attorney- General for their comments. And yet as a contractual agreement every part of the document ought to be negotiable to ensure true agreement and justify enforcement of obligations created.

Although loan agreements may vary, they normally include the following:

A preamble that includes definitions, the names of the parties and the purpose of the loan. Borrowers need to analyse the definitions of the key concepts carefully and appreciate their implications before agreeing to sign.

1. A section on terms and conditions in the loan agreement spells out the borrower's financial obligations including the interest rate, commitment fees, legal and out of pocket expenses, penalties and amortisation. The interest rate is very hard to renegotiate once it is established and the penalties for late payment may be onerous. Creditors usually push for what they claim are standard terms in loan agreements. But it is very important to ensure that the country can comply with the terms and conditions in the agreement. The loan agreement must be seen as a contract and therefore subject to the rules of contract.

2. The borrower must make certain representations of fact relating to the financial and legal status of the borrower. For instance that the legal requirements under the national law have been complied with. It must also equate the ranking of new debt to any other existing unsecured indebtedness.

A section under covenants and undertakings deals with promises by the borrower to perform or refrain from doing anything (such as changing domestic law) that would affect its financial condition and integrity. Covenants generally project into the future so the borrower must be careful not to unduly restrict its financial and operational activities[93].

A section on pre-conditions to disbursement sets forth a number of conditions which the borrower must meet before the loan is disbursed. These conditions may be excessive and irrelevant unduly delaying draw down on money that is already incurring commitment fees. They should be negotiated to a minimum.

A section on default generally identifies events that give the lender the right to accelerate the maturity of the debt and terminate its commitment. These events must be few and clear – not subject to arbitrary determination by the creditor. For instance they should not include factors beyond the control of the borrower. In the case of technical default (violation of covenants) as opposed to blatant default (non-payment), the borrower should ensure a reasonable grace period in which to effect compliance before penalties become applicable. Borrowers should also avoid cross-default clauses under which default on one loan triggers default on other loans.

In case of disagreement or default, the loan agreement also contains the law that will determine any dispute. Currently the creditor determines the law that is applicable. (This position is due to a reversal of the traditional position under which, the law of the Borrower State, was applicable in cases where the lender was not a nation state.) The applicable law and dispute resolution institution - whether international or in a creditor state - is heavily dominated by jurists from the North. For instance loan agreements generally include a waiver of sovereign immunity placing the borrower at the same level, as the creditor be it a bank or multilateral financing institution.

Zambia has generally performed very badly with regard to loan negotiation. The initiation, negotiation and conclusion of loan agreements has tended to been as if the lender is doing the country a favour and should not be asked too many questions lest the loan is withdrawn. The fact of the matter, however, is that the lender is often just as keen to lend as the borrower is to borrow. If they do not lend they will run out of business. It is thus incumbent upon the Zambian Government to negotiate for favourable loan conditions and preferably opt for grants especially on social sectors such as health and education.

As it is now in Zambia, once the draft loan agreement is approved, having undergone minimal negotiation or examination of the contractual obligations, a signing ceremony will take place either locally or abroad. At this point access to the proceeds of the loan will be dependent on the fulfilment of certain pre-conditions such as setting up a project unit to implement the project, open bank accounts etc.

The project accountant draws on the funds using a withdrawal application form. Un-disbursed funds remain in the custody of the creditor but are committed to the project. It may take years to fully disburse a loan. Not all monies may be disbursed due to failure to comply with conditionalities along the way. Yet commitment fees are due and payable throughout. Sometimes creditors cancel loans because disbursement has gone beyond the contracted period. All these obstacles carry financial costs in addition to fees and charges such as interest on disbursed funds.

The same problems also arise with regard to balance of payments support. Where the Government fails to comply with conditionalities such as privatisation then promised support may be withheld, throwing the budget into disarray. In 2003, the IMF with held US $ 1 million budgetary support to the Zambian Government because the government over spent its budget by US$ 125 million. The Government was also dragging its feet over the privatisation of the

[93] Jubilee Zambia notes that a country should not sign away its right to defence in case of default as has been known to happen in the case of Zambia.

Zambia National Commercial Bank. Over the period the EU withheld aid to Zambia because of the projected budget overrun. The United States government deferred their promise to cancel US$600 million in bilateral debts because Zambia failed to reach the HIPC completion point.

The process of monitoring loans begins once the loan agreement has been signed. One copy of the agreement is kept by the Director of Investments and Loans. Copies are also sent to the Ministry of Legal affairs and Treasury Consul. The officers in the Debt Unit open a folder on the loan. The folder contains the creditor reference number, the date when the loan was signed, the date it takes effect, the period during which draw down should take place, amount and currency of loan, economic sector, repayment dates, interest and rate, penalties and applicability. All this information goes into a database used to manage debt. Once the loan becomes effective and disbursement begins, disbursement records are also maintained. The database is used to project debt service due for purposes of budgeting. Each year the budget indicates in Kwacha terms what amounts to the equivalent in dollars of debt service on a month by month, basis. This figure is agreed with the IMF.

9.4. Loan Contraction Process with the Chinese

As stated earlier, China has given the Zambian Government loans and grants over a long period of time. In general terms, the loan contraction process can be said to follow the above stated procedures. This is because the loans from China, like the other loans, are contracted mainly through the Ministry of Finance and National Planning. There are, however, instances where the political leaders initiate and agree on a project and then hand over to the technocrats to conclude the process later. This means that the Chinese loans are sanctioned at very high political levels in both China and Zambia and, in many cases, sanctioned by the two countries' Presidents.

Sources at the Jesuit Centre for Theological Reflection (JCTR) who have been closely following Chinese economic relations with Zambia outline the following developments during the Chinese President Hu Jintao's visit to Zambia in February 2007:

a) A loan maturing on 31st December 2005 for the TAZARA Rail line worth eleven (11) million US$ was cancelled.
b) A loan worth seven (7) million US$ was also cancelled at the same time.
c) A new loan of thirty nine (39) million US$ was contracted for the supply of agricultural inputs, earth moving equipment and other machinery from China. The exact conditions attached to this loan are not very clear.
d) During this same period, a loan of four hundred (400) million US$ from China was announced. Since this loan was first announced, there has been a marked silence over it.
e) A loan worth ninety six (96) million US$ from China was also announced. Up to now, it is not clear what this loan is for and what conditions are attached to it.
f) During the same visit, China offered to construct a football stadium in Zambia. This is as a grant from China to Zambia.

Discussions with sources at the Chinese Embassy in Zambia revealed the following:

a) China is going to put up a hospital in the North Western Province of Zambia, a school project, and anti malaria centre and supply anti malaria drugs, an agricultural demonstration centre and supply agricultural experts and volunteers from China and
b) China will construct and operate an export processing zone at Chambeshi on the Copperbelt that will create employment for sixty thousand (60,000) people;

9.5. How do Zambians feel about the Chinese presence in Zambia?

During a workshop organized by the Friedrich Ebert Stiftung of Germany in Zambia in October 2007[94], several stakeholders, especially trade union representatives, strongly complained

[94] This was during the presentation of the following study: Friedrich Ebert Stiftung (2007) "The Social and Economic

about the working conditions in Chinese operated companies.

We have problems working with the Chinese. They pay very low wages; they discourage trade union activities and say that our (workers) demands go beyond what has been agreed upon between the two Presidents of China and Zambia. When we complain, we are told "go and ask your President what we agreed!" How can we deal with this situation? We do not know what was agreed between our President and the Chinese President. We need help on this!

Representative of a Trade Union in Zambia

The Friedrich Ebert Study cited above came to the following conclusion about Asian (read Chinese) economic activities in Zambia:

The results obtained in this study suggest that the social economic impact of Asian FDI in Zambia is mixed. On one hand, Asian FDI has had positive effects on national development, for instance, in terms of increased production, increased levels of employment, transfer of capital and technology, infrastructure development, cheap and affordable goods. On the other hand, the labour market has had to endure, on balance, more negative effects, for instance, in terms low wages and poor terms and conditions of employment; industrial accident and hazardous work environments and casualization. Besides, the impact on the standard of living of the citizenry has, hitherto, been limited. The concentration of Asian FDI in extractive activities means that the poor have largely not benefited directly from these investments. Against this background, the conclusion the study reached is that Asian FDI in Zambia is neither good nor bad. Rather, while it has augmented domestic resources for development, it has not provided a basis for a win-win situation. Ibid. page 39.

The discussions among Zambians about Chinese economic activities in Zambia can roughly be divided into three parts. Firstly, parts of the Zambian bureaucracy and the politicians currently in power, who see China as "the great savior" without whom Zambia would languish in poverty forever. Any questions about China directed to this category of people is met with a defensive response such as "don't you know that the Chinese built the TAZARA rail line?" This category of Zambians sees nothing wrong with Chinese economic activities in Zambia. This group is lead by current republican President Dr. Levy P. Mwanawasa SC.

China is the only hope that Zambia has – Levy Mwanawasa

During a visit to the Clinton Global Initiative in September, President Mwanawasa "urged countries in the Western world to redeem themselves before criticising China for giving more aid to Africa." According to reports in Zambian newspapers, he said that Western countries were often reluctant to finance development projects in Africa, and noted that China had come out very clearly as a more dependable partner. The construction of the TAZARA railway line was mentioned as an example of Chinese assistance. He also mentioned the US$ 900 million economic zone that the Chinese will construct on the Copperbelt, where an estimated 60 000 people would be employed.[95]

Not all Zambians were pleased with the statement that Mwanawasa made:

I hear the president made a statement when he was in New York that the only thing that will save Zambia is China. That's very unfortunate. He should have said that the only people that can help us grow the economy are the Zambians. It would have made more sense.

Representative of Transparency International Zambia

The second category is composed of people who acknowledge the need for investment in Zambia- from China and other sources. This category of Zambians, among whom many are aca-

Impact of Asian FDI in Zambia: A Case of Chinese and Indian Investments in Zambia" Lusaka, Zambia

95 – The Times of Zambia, 29 September 2007 "Levy extols China – as Zambia's only hope for development"
– Daily Mail, 29 September 2007 "China central to Zambia's growth agenda"

demics, see the problems with the Chinese investors as a symptom of the weaknesses of an ill conceived and poorly administered investment regime in Zambia. They say that the Chinese are taking advantage (maybe more than other investors) of the weak labour, environment and immigration laws and the low implementation capacity of the organs tasked with the responsibility of enforcing the laws. They see that there is something wrong with Chinese and to a lesser extent with all investors citing the case of the "Development Agreements" the government signed with mining investors exempting them from paying tax, the full cost of electricity and water and yet these same entities are posting huge profits (thanks to high commodity prices) and remitting huge dividends and allowances to their home countries. They see the solution in improving the legal framework for investors and building the capacity of the law enforcement agencies. These Zambians, as earlier stated, welcome foreign investment as long as this can translate into tangible benefits for the population. The export processing zone, football stadium and others are welcome as long as there is quality employment creation, forward and backward linkages. This category of Zambians' views are published in literature such as the "For Whom the Wind Falls: Winners and Losers in the privatization of Zambia's copper mines" and the studies by Friedrich Ebert Stiftung and Civil Society Trade Network of Zambia.

The third and most critical category is that of the many ordinary Zambians on the street. The majority of Zambians are often poor, uneducated, unemployed or underemployed. Among this category of Zambians you will find many who see the Chinese as the source of their depravation. They feel the Government in power is not taking care of them well, because a) they are too busy protecting the Chinese and b) the Chinese are supporting the Government in suppressing them. This category of Zambians see the export processing zone concept and the football stadium as further evidence of the Government's desire to provide opportunities for employment to the Chinese at the expense of the Zambians. These Zambians see the solution in getting rid of the current government and, more importantly, getting rid of the Chinese. Such action will see their situation improve as jobs left by departing Chinese will become available to them and new (preferably Taiwanese) investors will come in with a serious sense of commitment to the development of Zambia. This category of Zambians is championed by opposition politician Michael Sata of the Patriotic Front Party.

Anti-Chinese sentiments

At the moment of the 2006 presidential elections in Zambia, groups of frustrated Zambians took to the streets protesting against the Chinese presence in Zambia. Michael Sata, one of the candidates running for presidency, drew on these anti-Chinese sentiments. Sata heavily criticised the Chinese and claimed that it would be better for Zambia to support Taiwan. He also suggested that Chinese, Indian and Lebanese should be deported because of mistreating Zambian workers. This lead the Chinese to state that they might leave Zambia in case Sata was elected.[96] Interestingly, Sata won the election in the two constituencies where the Chinese presence is the most prominent, namely the Copperbelt and the capital Lusaka. It is noteworthy that during the elections, China was pulled into national politics whether they wanted to or not. The principle of non-interference was threatened and perhaps violated.

In terms of the loan contraction process, the Chinese Government is, not bound by the rules that the World Bank and other creditors follow in providing loans. They follow their own unique process that is more "politically" than "technically" correct. Decisions on Chinese loans are often first entered into after the traditional creditors have refused to fund the project. The classic examples are the TAZARA Rail line and the football stadium on the Copperbelt. In both cases, the Zambian Government says that they first tried to get help from the traditional western creditors and failed and "as a last resort" turned to the Chinese.
A further important point to note is that the Chinese loans though classified as concessional loans are in fact grants because there is no repayment enforcement mechanism in place. Both

[96] BBC, 29 September 2006 "Profile: Zambia's 'King Cobra'", *http://news.bbc.co.uk/2/hi/africa/5378726.stm*

the Chinese officials and the Zambian Government officials state that there is no pressure put on Zambia to repay the loan. Should Zambia fail to pay at the stipulated time, some postponement negotiations are initiated. Should the repayment continue to be a problem, the loan can be written off. This has happened on earlier occasions. However, it is interesting to note that the way of determining whether or not a country, in this case Zambia, is able to keep servicing debt, seems to be decided by criteria that are unknown and perhaps decided on an ad hoc basis. In view of the fact that the Chinese have stated their commitment to reaching the Millennium Development Goals, and taking into account that Zambia is facing a serious financing gap that will need to be filled in order for the country to reach the MDGs, it would be interesting to know what criteria are used to decide that Zambia is able to repay the loans to China. In fact, although China has granted debt relief to Zambia, Zambia's largest debt repayment in 2007 will go to China.

9.6. Reactions from Traditional Lenders

A heated issue...

"EU Cautions Zambian Govt ... it'll be a scandal to get back into debt" reads the front page headlines of the Zambian newspaper The Post October 3, 2007. The statement by Dr. Fee, head of the European Unions delegation in Zambia, followed the previous days' announcement that China would provide a loan of 39 US$ to Zambia. According to The Post, Dr Fee said "African countries were "mortgaging" themselves by getting loans from China". He pointed to the fact that the EU provides grants in stead of loans.

Two days later, another front page headline read "Zambia free to choose partners". The Zambian minister of finance and planning, Magande, had reacted to the EU delegations warnings, stating that the EU should not decide for Zambia which partners to associate with. "Whilst we appreciate the help we receive from the EU, they should not decide for us which country should give us help. It is very clear in international relations that it is not proper to interfere in our relationships with other cooperating partners", Magande said.[97]

In an article published the same day, Jubilee Zambia then responded stating that: "It is good that institutions representing creditor governments are also keen to see prudent management of the fiscal space provided by debt cancellation initiatives." Muyatwa Sitali, on behalf of Jubilee Zambia, requested that the Zambian government provide information on Zambia's external debt portfolio stating that Jubilee Zambia is shocked at the rate at which the Zambian government has been contracting loans recently. Sitali noted that Zambia had already negotiated over US$ 100 million in 2007 from creditors such as the World Bank, IMF, AfDB and non Paris Club members including China. Jubilee Zambia is worried that benefits from a US$ 6.6 billion debt relief provided under the HIPC and MDR initiatives, will be undermined by the new loans contracted. [98]

The Western countries have expressed anxiety at the way the Chinese give loans to countries in Africa generally and Zambia in particular. The main fears are that:

a) The traditional lenders have just written off Zambia's debt and thus the country, at least on paper, appears creditworthy. The Chinese, by giving new loans, are free- riding and hoping to harvest/ reap where they did not plant the seeds.
b) The Chinese do not ask questions of good governance and rule of law prior to giving loans. This undermines the long initiated democratization process that is beginning to bear fruit in Africa generally and Zambia in particular.

[97] Zambia Daily Mail, 5 October 2007 "Zambia free to choose partners"
[98] The Post, 5 October 2007 "Sitali lauds EU concerns on debt"

c) The Chinese are giving loans for projects that do not “add value” to the development process of the country, such as football stadiums and state palaces.
d) The Chinese loans appear cheap in terms of low interest rates but there appears to be a “hidden” cost in terms of either poor quality goods or workmanship in the execution of the project or the loan repayment is structured in such a way that the interest is “inbuilt” in the principal amount.

In spite of these concerns generally raised during interviews with representatives of traditional donors present in Zambia[99], it was also highlighted that the Chinese investments could potentially be very positive to Zambia. Donors expressed hope that China would join the Budget Support Donor Group and participate in the Joint Assistance Strategy. Some also suggested that the traditional donors today have a limited resource base, and are struggling to replenishment the funds. European bilateral donors have started to provide budget support in form of grants and have seized to give out loans. Grants, of course, exhaust the sources of funding while loan repayments with interest ensure that the funds are regularly replaced. When debt relief or cancellation is provided, this also means tapping into resources. Both the IMF and the World Bank have experienced a decrease in available funds after HIPC and MDRI. This affects their capacity to provide developing countries with funding, and because of that, some of the representatives of traditional donors to Zambia, felt that non traditional donors should come in because they have resources that the traditional donors do not have. What Zambia gets annually from traditional donors is nothing compared to what China can come in with. Because of this, some donors felt that China and the traditional donors might potentially complement each other.

It was also mentioned that some of the investments made by the Chinese are targeting so-called “bottlenecks” blocking development. Although the situation is not black and white, roughly, one could say that while traditional donors focus directly on health and education through granting budget support, the Chinese concentrate on constructing roads and improving energy supply for industrial development and trade. All of this is urgently needed, and generally traditional donors are aware of the potentially positive role that China can play in Zambia. However, concerns were raised of the way that China acts, and as to how Chinese actors operate in Zambia.

Like the Zambian civil society, the traditional donors would like to see more openness and transparency from China. Zambia, being a member of the IMF, is duty bound to provide information to the organisation as and when requested to do so. As of today, the country does not have an agreement with the IMF since the latest PRGF expired. However, Zambia has expressed interest to come to a new standby facility with the IMF as a way of enhancing her creditworthiness with other potential donors and creditors. This will increase the power that the IMF has to monitor the cooperation between the Government and the Chinese and will increase the IMFs influence on Zambia’s financial management. As of today, the loans contracted by Zambia which are publicly guaranteed for, are open to scrutiny by the World Bank. This does not concern parastatals or non guaranteed credits, and consequently the conditions attached to project agreements falling into these categories are not up for criticism.

9.7. Reactions from China

The Chinese authorities have expressed exasperation at the criticisms generally leveled at them by the west. Their standard responses are as follows:
a) The west has had social and economic ties with Africa stretching for over four hundred-years. In that time, there is no tangible evidence to show what development they have delivered to Africa. To the contrary, the West has prospered at the expense of Africa during that time. The case of Zambian copper mining is cited where for over a hundred years,
b) Zambian copper has been mined but Zambia to day is one of the poorest countries in the World.
c) The west is the main trading partner of China in terms of turnover. It is, therefore, surpris-

[99] Interviews were conducted with representatives of the Royal Norwegian Embassy, the Delegation of the European Commission to Zambia, the IMF and the World Bank.

ing that the west is advising Africa to be weary of China when they themselves are making brisk business with China.

d) China, like Africa, is a developing society. China may stand to understand and appreciate the problems of Africa more than the west. China is walking away from poverty and would want to share this experience with Africa.

e) The Chinese officials believe that the West fears the instability often reported about the African continent and is therefore more interested in giving grants to Africa generally, and Zambia in particular, instead of foreign direct investment. The Chinese believe that grants can not resolve the many developmental challenges the continent finds itself in. The

f) Chinese do not fear risks in Africa and thus are investing heavily to what seems to be the disillusionment of the west.

The Chinese Embassy officials interviewed stated that China wants to assist Zambia develop the same way that China is developing. They stated that the west does not want to invest in Africa generally and Zambia in particular because they feel the investment climate is not right and there are too many risks.

"It is therefore strange that the West does not want China to invest in Africa and Zambia! How will development take place without investment? Grants are not adequate to grow an economy."

Councellor of Commercial and Economic Affairs, Chinese Embassy, Lusaka

Responding to allegations that the Chinese investment does not create jobs for Zambians, the Chinese Embassy stated that this is incorrect:

"The fear that China is employing Chinese workers in Zambia is unfounded. It is Chinese policy to employ Zambian workers whenever these are available with the right qualifications. Only when these are not available do we bring in Chinese experts. In fact, it is very expensive in terms of transport, allowances and housing to bring in Chinese experts. Work permits are also a problem to obtain in Zambia"

Councellor of Commercial and Economic Affairs, Chinese Embassy, Lusaka

10. Conclusions and Recommendations

10.1. Conclusions

Zambia has had a difficult time contracting, managing and paying back external debt. The reasons are many and varied. The main reasons are failure to recognise that Zambia's economic problems were not of a short term but long term nature. The borrowed resources, in the absence of economic reforms were not adequate to address the problem and in fact only made matters worse. This was a failure by both Zambia and the creditors.

Now that most of Zambia's external debt has been written off, there is urgent need to develop a coherent and participative debt management strategy and stay along that strategy. The Chinese loans, though welcome, may jeopardize Zambia's chances of keeping by the agreed debt management strategy because of the political overtones involved. The tendency by China to give loans without exhausting the procedures of the loan contraction process, inadequate as they may be, may make Zambia accrue loans that may not be priority in the poverty reduction drive that the country is persuing.

Zambian NGOs, donors and well wishers need to keep a close eye on Chinese loans and raise the alarm when need be. To the extent that the Chinese loans do not have very strict loan repayment conditions, these fears are somewhat reduced.

10.2. Recommendations

- Oversight and watchdog institutions such as Parliament, the Auditor-General and the Attorney General must have clear mandatory authority over the borrowing process.

- The Zambian public should have a right to know about and question all borrowing, from both new and old lenders, before loan agreements are signed. This right should be incorporated in the Bill of Rights.

- There should be a law relating to borrowing detailed in one Act of Parliament and authorised by the Zambian Constitution.

- Norwegian NGOs should strengthen and work closely with African and Zambian NGOs to monitor the effects of loans on the development process and democracy in Africa generally and Zambia in particular.

Annex I:

Description and value of Chinese Debt to Zambia

United States Dollars

Description	*Debt Disbursed & Outstanding*	*Arrears (Principal & Interest)*	*Total Debt (Including Areas)*
Radio and TV Broadcasting	0.00	225,468.09	225,468.09
Bridging Finance for Project	635,402.33	5,718,620.97	6,354,023.30
Chingola Maize Mill	611,146.40	916,719.60	1,527,866.00
Highway Transport Infrastructure	0.00	14,491,737.42	14,491,737.42
Mansa-Samfya-Serenje Road 1987	0.00	6,354,023.30	6,354,023.30
Multiple Sector Loan I	1,906,206.99	4,447,816.31	6,354,023.30
Multiple Sector II	0.00	709,109.00	709,109.00
Multiple Sector Loan III	1,143,724.20	2,668,689.79	3,812,413.98
Multiple Sector IV	935,103.50	2,223,908.16	3,177,011.65
Multiple V	0.00	18,950,879.32	18,950,879.32
Multiple Projects China	0.00	10,612,492.42	10,612,492.42
Special Equipment 325	0.00	5,812,413.98	3,812,413.98
Tazara Coaches and Spare Parts	10,166,437.29	2,541,609.32	12,708,046.61
Tazara Spare Parts and Technical Personnel	1,143,724.20	762,482.80	1,906,206.99
Tazara Spare Parts 93 2022	0.00	635,402.33	635,402.33
Tazara Spares Parts 1986	0.00	62,777,750.24	62,777,750.24
Zambia Tanzania Railways		0.00	
Sub Total	17,512,848.39	140,073,031.21	157,585,879.60
Supplier credit (commercial)			
CACTIC-consolidated 2005	59,626,306.35	0.00	59.626,306.35
Sub Total	59,626,306.35	0.00	59.626,306.35
GRAND TOTAL	77,139,154.74	140,073,031.21	217,212,185.95

Source: Afrodad Study on China Zambia Economic Relations (forthcoming)

Annex 2:

List of Cooperation Projects between Zambia and China

1. Economic and Technical Cooperation (RMBY 41.36 million, 23/06/67)
   (i) Lusaka – Kaoma Road
   (ii) Diplomatic Radio Station
   (iii) Training for Diplomatic Radio Station
   (iv) Makeni Government Factory
   (v) Ten Agricultural Tractors
   (vi) Bore-hole Drilling and Water Supply
   (vii) Ministry of Defence
   (viii) Personnel Training for TAZARA

2. Construction of TAZARA (RMBY 494 million, 05/09/67)
3. Economic and Technical Cooperation (RMBY 100 million, 24/02/74)
   (i) Ministry of Defence
   (ii) Mulungushi Textiles
   (iii) Chingola Maize Mills
   (iv) Mununga Quarry
   (v) Kafue Agriculture Technical Cooperation
   (vi) Kafushi Agriculture Technical Cooperation
   (vii) Repair Project for Chambeshi River Railway Bridge
   (viii) Mungule Quarry Products
   (ix) Spare Parts for TAZARA
   (x) Medical Equipment and Medicines
   (xi) Serenje-Mansa Road
   (xii) 225 – 227 Road

4. Loan for 12 Locomotives (RMBY 5.58 million, 31/08/79)
5. Loan for spare parts for TAZARA (RMBY 5 million, 14/08/86)
6. Loan RMBY 50 million 24/05/87
   (i) Spare Parts for TAZARA
   (ii) Repairs for Diplomatic Radio Stations
   (iii) Repairs for Chingola Maize Mills
   (iv) Rehabilitation of Lusaka-Kaoma Road
   (v) Second Phase of Serenje-Mansa Road

7. Economic and Technical Cooperation (RMBY 50 million, 02/03/88)
   (i) Serenje - Mansa Road
   (ii) Machinery and Equipment for Lusaka-Kaoma Road

8. Economic and Technical Cooperation (RMBY 30 million, 28/09/90)
9. Special Train Loan (RMBY 30 million, 09/12/92)
10. Economic and Technical Cooperation (RMBY 50 million, 09/10/93)
11. Cash (US$ 1 million, 09/08/95)
12. Donation of Relief Food (US$ 0.2 million, 05/10/95)
13. Donation of Implements & Sports Goods (RMBY 1 million,17/01/96)
14. New Government Complex (US$ 8 million, 21/06/96)
15. Donation of General Goods (RMBY 3 million, 11/09/96)
16. Economic and Technical Cooperation (RMBY 30 million, 05/05/97)
17. Special Train loan (RMBY 50 million, 05/05/97)
18. Construction of Bailey Bridge (RMBY 0.6 million, 24/11/97)
19. Donation of Relief food (US$ 0.2 million, 02/02/98)
20. Five Water Pumps to Kabwe (RMBY 2 million, 23/04/98)
21. Donation of Medicine (RMBY 0.2 million, 04/98)

22. Economic and Technical Cooperation (RMBY 20 million, 27/07/98)
 (i) Completion of the refurbishment of the new Government Complex

23. Donation of Relief food (US$ 0.2 million, 22/02/99)
24. F. M. Transmitters for Seven Provinces (RMBY 2 million, 09/07/99)
25. Donation of Office Equipment (RMBY 2 million, 29/09/99)
26. Donation of Office Equipment (RMBY 2 million, 26/10/99)
27. Special Train Loan (RMBY 50 million, 10/12/99)
 (i) Overhauling 2 CKD Locomotives for TAZARA.
 (ii) Technical construction and personnel training for railway sleeper plant for TAZARA.

28. Economic and Technical Cooperation (RMBY 30 million, 29/12/99)
29. Donation of Equipment to National Assembly (RMBY 1 million, 21/02/00)
30. Economic and Technical Cooperation (RMBY 30 million, 1/10/00)
31. Donation of cash to OAU (US$ 0.5 million, 07/03/01)
32. Donation of goods to OAU (RMBY 5 million, 07/03/01)
33. Concessional Loan (RMBY 100 million, 25/06/01)
34. No information
35. Special Train Loan (RMBY 50 million, 19/07/01)
36. Economic and Technical Cooperation (RMBY 20 million, 24/07/01)
37. Donation of Web Printing Press (RMBY 1.9 million, 31/12/01)
38. FM Transmitters for Seven Provinces (RMBY 1.7 million, 18/03/02)
39. Donation of maize (4,500 tonnes, 06/08/02)
40. New Government Complex (RMBY 69.2 million, 16/09/02)
41. Economic and Technical Cooperation (RMBY 30 million, 26/12/02)
42. Special Train Loan (RMBY 50 million, 31/12/02)
43. Web Printing Press (RMBY 0.55 million, 19/07/03)
44. Economic and Technical Cooperation (US$ 6 million, 07/11/03)
45. Economic and Technical Cooperation (US$ 1.1 million, 17/02/04)
46. Economic and Technical Cooperation (US$ 2.5 million, 6/11/04)
47. Special Loan to TAZARA (US$ 11 million, 6/11/04)
48. Cash for Purchase of Relief Food (US$ 1 million, 9/02/06)
49. Special Loan for TAZARA (US$ 10 million, 22/06/06)
50. Economic and Technical Cooperation: Extension of Cooperation for the FM Radio Transmitters (RMBY 3,820,000.00, 11/2006)
51. Economic and Technical Cooperation: Anti-malaria Medicines (RMBY 1.5 million (US$ 200,000), 11/ 2006)

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