This thesis explores the impact that Chinese aid and investment has on the political economy of resource-rich African countries. In particular, it examines the effects of Chinese resource-for-infrastructure agreements on the political economy of the resource curse. Using Ghana as a case study, this thesis highlights the peculiar obstacles that countries face with regard to managing their resources. In turn, it argues that general prescriptions against the resource curse, such as resource revenue transparency initiatives, like the Extractive Industries Transparency Initiative, are insufficient. As a result, African recipients of Chinese aid require specific institutional arrangements that accurately reflect the specific “rules of the game” that exist under their respective political economies. In the case of Ghana, this thesis argues that vetting Chinese resource-for-infrastructure agreements through the Public Procurement Act serves that need.
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I. Introduction

“Projects of mining, instead of replacing capital employed in them, together with ordinary profits of stock, commonly absorb both capital and stock. They are the projects, therefore, to which of all others a prudent law-giver, who desired to increase the capital of his nation, would least choose to give any extraordinary encouragement”

- Adam Smith, Wealth of Nations (1776)

Many developing countries have yet to adequately leverage their mineral endowments. Data on real per capita gross domestic product (GDP) reveal, for example, that between 1960 and 2000, ninety percent of developing countries that failed to achieve sustained economic growth were heavily dependent on mining, oil and other extractive industries.\(^1\) Worse still, in that group, from a combined total of 3.5 billion citizens in 60 countries, a startling 1.5 billion live on approximately US $2 daily.\(^2\)

Today, a vast majority of political scientists and economists believe that Adam Smith’s cautionary remarks were not directed at mining \textit{per se}, but at the failure of developing countries to implement solid oversight and governance. To that effect, economists, such as Daron Acemoglu and James Robinson, have dedicated their efforts to identifying specific institutional arrangements responsible for creating particular economic outcomes in specific situations.\(^3\) In their estimation, identifying feeble institutions is fundamental to producing positive choices and robust decision-making processes.\(^4\)

In, \textit{Structure and Change in Economic History}, Douglass North defines institutions as “the rules of the game in a society or, more formally,… the humanly devised constraints that

\(^4\) \textit{Ibid.}, at 1.
Acemoglu and Robinson interpret this definition as collective choices that emerge out of specific decision-making processes. In that vein, the political economy of the resource curse – the tendency for resource-rich economies to stagnate in growth and development - is essentially a product of dysfunctional decision-making.

At its core, there is an ostensible conflict of interest between society and the political elite. Deciding how to use and distribute the spoils of natural resources turns on aligning collective interests. Setting “the rules of the game” to force positive results becomes fundamental to guarding resource-rich countries from becoming susceptible to the curse.

Enter China. In 2006, China convened the Forum on China–Africa Cooperation (FOCAC) Summit in Beijing. The conference highlighted the promise of a strategic relationship between the state and the continent. To date, Africa’s trade relationship with China is comparatively small in relation to trade with the West. China is Africa’s third largest export market after the EU and the United States. In 2005, it became the largest individual country exporter for Sub-Saharan Africa with a market share of 7.7 percent, and US$13.4 billion in exports.

Sino-African trade is growing at an impressive rate. The impact in Africa will be significant. There is an imperative need to organize and shape institutions to respond to China’s demands on African natural resources sectors. Chinese demand on resources is spurred by state-driven aid and investment.

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This thesis explores the impact that Chinese aid and investment has on the political economy of resource-rich African countries. In particular, it examines the effects of Chinese resource-for-infrastructure agreements on the political economy of the resource curse. Using Ghana as a case study, this thesis highlights the peculiar obstacles that countries face with regard to managing their resources. In turn, it argues that general prescriptions against the resource curse, such as resource revenue transparency initiatives, like the Extractive Industries Transparency Initiative, are insufficient. As a result, African recipients of Chinese aid require specific institutional arrangements that accurately reflect the specific “rules of the game” that exist under their political economy. In Ghana’s case, I argue that vetting Chinese resource-for-infrastructure agreements through the Public Procurement Act serves that need.

This thesis will proceed as follows. In part I, I discuss issues related to the resource curse. In Chapter 1, I examine and define the basic political economy elements of the resource curse. In addition, I describe the “rentier state” and its application to African mineral economies. In Chapter 2, I review resource revenue transparency. I trace its evolution from an intervening tool in civil conflicts to the Extractive Industries Transparency Initiative. In addition, I discuss why resource revenue transparency initiatives in African mineral economies are insufficient to fully address the resource curse.

In Part II, I examine China’s relationship with Africa. In Chapter 3, I provide a summary of Sino-African relations. I discuss China’s “Go Out” policy and its relationship to Africa. Lastly, in Chapter 4, I analyze the adverse effects that Chinese aid has on Africa. I identify as a fundamental problem the absence of particular institutions to respond appropriately to the impact of Chinese aid and investment. In addition, I subject Ghana to a case study. I examine the
Ghanaian political economy to determine how best to shape its institutions to increase its immunity against the resource curse. Chapter 4 provides concluding remarks.
PART I: RESOURCE CURSE
CHAPTER 1

Chapter 1 examines and defines the basic political economy elements of the resource curse. In addition, it describes the “rentier state” and its application to African mineral economies.

I. What Resource Curse?

By definition, the “resource curse” refers to “the paradox that countries and regions with an abundance of natural resources, … like minerals and fuels, tend to have less economic growth and worse development outcomes than countries with fewer natural resources.”\(^\text{11}\) This is often referred to as the “paradox of plenty”.\(^\text{12}\) There is an ongoing debate about whether the phenomenon in fact exists. Opinions vary. Empirical conclusions seem to differ depending on data, time span and methodology.\(^\text{13}\) For example, by far the most widely cited empirical test to advocate on its behalf is from Sachs and Warner.\(^\text{14}\) Their findings conclude that there is a negative correlation between resource abundance and growth.\(^\text{15}\) In other words, in their estimation, the curse exists.

Others disagree. Recent empirical studies by Nunn and Brunnschweiler reach the opposite conclusion. They each uncover a positive correlation between resource abundance and economic growth. Put bluntly: No curse. Whether there is truth to the myth or whether the curse is merely hyperbolic is beyond the focus of this discussion. Rather, central to this investigation is the need to uncover the extent to which institutions of governance play a role in exacerbating or reducing the adverse effects of a possible curse.

\(^{11}\) http://en.wikipedia.org/wiki/Resource_curse
II. Political Economy and the Resource Curse

In general, there is strong academic leaning towards the idea that, if a curse exists, it is directly attributable to the nexus between institutional arrangements and the exploitation of natural resources. From this perspective, the discussion about institutions and economic growth moves beyond econometric regressions and more towards introducing into the equation key concepts of political economy.

Political economy is defined as “[t]he social science that deals with political science and economics as a unified subject; the study of the interrelationships between political and economic processes.” In the natural resources context, political economy attempts to distill the relationship between political and economic institutions and resource abundance.

The two most basic elements that distinguish the study of natural resources through the political economy lens are rents and institutions (as a formal channel for decision-making). Thus, in political economy models, the resource curse hypothesis is interpreted as a problem of resource rents that promote unproductive and unfavourable decisions.

III. The Basics: Natural Resources

To understand the relationship between rents and institutions in resource-rich countries, it is often useful to begin the analysis by examining natural resources themselves. Understanding what a natural resource is, as well as its relationship to a developing economy, helps to identify

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17 http://www.answers.com/topic/political-economy#ixzz1VsYsv4oXiA
why the overlap creates perverse effects in some developing states and never in others.21

First, point source natural resources - “those [resources] extracted from a narrow geographic or economic base, such as oil, minerals”22 occur naturally. They do not need to be produced.23 There are no economic inputs required to create these assets.

Second, in many developing countries, the occurrence of natural resources typically isolates the industry that engages in extraction from the larger, national economy.24 Defined in technical terms, this isolation is referred to as being “enclaved”. Left on its own, the extraction of natural resources will not widely produce economic benefits for the larger economy.25 For example, oil discovered in Angola may be extracted there but later shipped off to a refinery in Calgary, leaving no economic benefits to Angola’s wider economy.26

Lastly, natural resources are not renewable.27 Once depleted, the income derived from the asset vanishes and cannot be renewed.28

IV. First Element: Rents

Rents are the cornerstone of natural resource ownership. Owners derive scarcity rents from the sale of natural resources.29 Scarcity rents arise from the extraction and sale of a finite resource.30 Resource rents are valued at the difference between the marginal cost of extraction and the world commodity prices at which they can be sold.31

21 Ibid.
22 Lederman & Maloney supra note 14 at 17.
23 Humphreys et al, supra note 20 at 2.
24 Ibid., at 4.
25 Ibid., at 4.
26 Van Mil supra note 13 at 5.
27 Humphreys et al, supra note 20 at 4.
28 Ibid.
30 “Scarcity Rent”, http://www.amosweb.com
31 Ibid.
Further, resource rents are not created equal. In general, rents that require substantial technological inputs before they can be appropriated have a notable, positive effect on economic growth.\textsuperscript{32} On the other hand, rents that require marginal technological inputs are likely to cause more harm than good.\textsuperscript{33} Botswana and Sierra Leone serve as contrasting examples that illustrate the polarizing effects of rents on an economy.

Botswana is a wealthy African country that is rich in diamonds. Sierra Leone is also rich in diamonds. But, by contrast, Sierra Leone is subject to abject poverty, negative growth and civil strife. Regarding rents, economists suggest that one fundamental difference between the two economies is the manner by which their diamonds are extracted. In Botswana, diamonds are located deep underground. They require substantial technological inputs, such as hydraulic shovels, to be extracted. Sierra Leone, on the other hand, has diamonds that exist in shallow surface areas. Diamonds here require very little input and are highly susceptible to looting.\textsuperscript{34} In Botswana, to appropriate rents from diamonds, investment in labour and capital is necessary. The opposite holds true in Sierra Leone. In conclusion, Botswana’s diamond rents generate positive effects in the larger economy and Sierra Leone’s do not.

\textbf{V. Second Element: Institutions}

Definitions of institutions vary.\textsuperscript{35} Here, institutions are described as the rules and restrictions that: 1) limit the ability of individuals to engage in opportunistic behavior; and 2) influence the decisions of individuals within a given society.\textsuperscript{36} These rules and restrictions ultimately combine to create processes for decision-making. For example, economist Daron

\footnotesize
\textsuperscript{33} Ibid.
\textsuperscript{34} Ibid.
\textsuperscript{35} Acemoglu & Robinson, supra note 3, at 6.
Acemoglu suggests that at a political level, “the political institutions of a society [reflect the]
process of collective decision-making and the checks on politicians, and on politically and
economically powerful groups”\(^{37}\). At an economic level, he further asserts that economic
institutions reflect the decision-making process that either discourages or encourages various
actors to engage in specific economic activities.\(^{38}\)

By extension, Acemoglu suggests that “good institutions” function to foster decisions that
enforce property rights for the wider public. The goal is to encourage citizens to partake and
invest in the economic livelihood of a country.\(^{39}\) Likewise, “good institutions” function to
encourage decisions that constrain the actions of elites, powerful actors and politicians from
expropriating national income and wealth.\(^{40}\) Accordingly, in the political economy context of the
resource curse, “good institutions” function to: (1) encourage decisions that constrain powerful,
elite groups from appropriating resource rents; and (2) positively influence the decisions of
individuals not to engage in rent-seeking activities.

Economists, such as Dani Rodrik, for example, do not dispute the tangible benefits of
“good institutions”. Rather, he believes that “[i]t is easier to list the functions that good
institutions perform than it is to describe the shape they should take.”\(^{41}\) In his opinion, defining
the shape of an institution is vital because achieving “the functions that good institutions
perform” can be done in numerous ways.\(^{42}\) Therefore, selecting the best way forward depends

\(^{37}\) Acemoglu \textit{supra} note 18 at 1.
\(^{38}\) \textit{Ibid.}, at 1.
\(^{39}\) Daron Acemoglu, “Root Causes: A Histrocial Approach to Assessing the Role of Institutions in Economic
\(^{40}\) \textit{Ibid.}
\(^{42}\) \textit{Ibid.}
largely on understanding the specific set of existing constraints and challenges that face each country.\textsuperscript{43}

For example, African countries that were once former colonial outposts for resource extraction, like the Democratic Republic of Congo, face a distinct set of challenges for institutional design from Norway as a mature, democratic, oil rich state.

For our purposes, examining both the shape and function of institutions serves dual purposes. First, understanding “shape” provides context for determining how existing rules and restrictions should be formulated when applied to existing political and economic conditions. Second, an institution’s shape is determinative of function. Whether an institution functions to meet its objective depends on its shape.

\textit{i. Institutional Shape}

Modern political economy models of the resource curse divide institutions into centralized and de-centralized models.\textsuperscript{44} In each, the model attempts to predict the response by particular actors when resource rents increase.\textsuperscript{45}

Under a centralized political economy model, the decision-making process over natural resources is confined to political elites.\textsuperscript{46} Political elites are defined as “the power holders of a body politic. The power holders include the leadership and the social formations from which the leaders typically come and to which accountability is maintained”.\textsuperscript{47} Political elites are the direct recipient of resource rents.\textsuperscript{48} In the model, political elites are restricted to making two choices;

\textsuperscript{43} \textit{Ibid.}
\textsuperscript{44} Kolstad and Wiig, supra note 19, at 5320
\textsuperscript{45} \textit{Ibid.}, at 5320.
\textsuperscript{46} \textit{Ibid.}, at 5318.
either pursue activities that maximize the public’s benefit or engage in activities that lead to self-enrichment. Activities that foster self-enrichment are divided equally between increasing the value of holding public office and discouraging outside competition from seeking it.\textsuperscript{49}

The hallmark of the centralized political economy model is spending.\textsuperscript{50} An increase in natural wealth “precipitates investment decisions that neglect ‘due diligence’ procedures, [and promote] excessive spending patterns without thought of the recurrent spending implications.”\textsuperscript{51} For example, in \textit{Paradox of Plenty: Oil Booms and Petro-States}, Terry Lynn Karl describes a phenomenon that occurs in oil-rich countries that she calls “petromania”.\textsuperscript{52} “Petromania” refers to a significant increase in oil rents that leads political actors to spend proceeds haphazardly, mostly on projects that increase their popularity and political performance, or that persuade private actors not to seek public office.\textsuperscript{53}

A decentralized political economy model, on the other hand, highlights the incentives faced by private agents outside of the political elite. In addition, it illustrates the subsequent impact that resources have on their choices.\textsuperscript{54} Decentralized models are also called “rent-seeking” models. Here, “individuals choose between using their effort, time, and talent on rent extracting activities, and using them on productive activities.”\textsuperscript{55}

In general, decentralized models reflect circumstances where resources are abundant but institutions, defined here as rules and restrictions, are weak.\textsuperscript{56} For example, resource-rich countries that experience societal upheavals, political transitions and post-conflict reconstruction

\textsuperscript{49} Kolstad and Wiig, \textit{supra} note 19, at 5318.
\textsuperscript{51} Van Mil \textit{supra} note 13 at 8.
\textsuperscript{52} Terry Lynn Karl, \textit{The Paradox of Plenty: Oil Booms and Petro-States} (University of California Press, 1997)
\textsuperscript{53} \textit{Ibid}.
\textsuperscript{54} Kolstad and Wiig, \textit{supra} note 19, at 5319.
\textsuperscript{55} \textit{Ibid}.
typically face increases in violent, rent-seeking activity, like the criminal predation of natural resources. Following the Cold War, for example, Russia experienced a chronic increase in criminal predation.

\textit{ii. Institutional Function}

In the centralized model, institutions and political structures play central roles.\textsuperscript{58} In an ideal setting, strong institutions that operate within a strong democracy tend to limit opportunities for political elites to misappropriate resource rents.\textsuperscript{59} Thus, when faced with an increase in resource rents, political elites are hard pressed to marshal the increase in rents to their advantage.

In a decentralized model, an increase in rents increases incomes and shifts private actors’ efforts away from productive activities towards rent-seeking.\textsuperscript{60} As a result, the economy experiences little to no growth.\textsuperscript{61} In this setting, an ideal institutional arrangement curbs the profitability of rent-seeking relative to productive activity.\textsuperscript{62}

Between both centralized and decentralized political economy models, two fundamental problems with institutional shape and function emerge. First, where the shape of an institution does not correspond with the outstanding economic and political framework of a country, there will be serious problems with spending and incentives outcomes. Second, if an institution’s shape does not accurately reflect the existing political and economic framework, its function will be severely compromised.

\textsuperscript{58} Kolstad and Wiig, \textit{supra} note 19, at 5319.
\textsuperscript{59} \textit{Ibid}.
\textsuperscript{60} \textit{Ibid}., at 5320.
\textsuperscript{61} \textit{Ibid}.
\textsuperscript{62} \textit{Ibid}.
For example, in Ghana, the Constitution vests substantial authority in the President. In particular, Article 108 of the 1992 Constitution limits Parliament’s ability to change laws governing the collection and spending of public revenue without the President’s consent.63 Parliament’s function, however, is essentially to serve as a constitutional check on the President’s executive authority. As a result, here, the constitution and political framework that represents the shape of Ghana’s political institution, fails to provide Parliament with the necessary tools to limit the President’s exercise of executive authority over spending. In other words, Parliament’s institutional function to curb free exercises of executive authority is seriously limited under the existing rules and regulations that define shape. A more in-depth look at Ghana’s political economy will be taken up in Chapter 4.

Many countries that experience resource curse-like effects exhibit characteristics of both models.64 A clear example of the merger between the centralized and decentralized models, and the problems that arise in both, is reflected in the rentier state.

VI. The Rentier State

The rentier state is a hybrid of centralized and decentralized institutional models. It is a state that occupies a monopoly position on resource rents.65 As the exclusive recipient of rents, the rentier state does not implement economic policies that promote productivity. Likewise, political decisions double as economic initiatives.66

The rentier state seldom taxes.67 It is exclusively a distributive economy. Unlike a productive economy that encourages economic activity and levies taxes to generate income, the

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64 Kolstad and Wiig, supra note 19, at 5320.
66 Ibid., at 309.
67 Ibid., at 308
rentier state relies solely on rents. Rather than encourage economic activity, the state merely acts to collect and distribute rents.

Most rentier states are distinguished by their dependence on exports and an excessive reliance on resource rents. Lastly, without taxation, citizens living in rentier states have very limited say over government. Government activity is therefore often cloaked in darkness and the government seldom responds to society’s demands.

Several negative outcomes emerge from the rentier-state model. First, the higher the level of rents, the more that rent-seeking occurs. Second, as a distributive economy, the rentier state misses key opportunities to invest in long-term projects for growth and development. Third, arbitrary government practices arise when resource rents are high. Lastly, private interest groups influence spending by either being invited to be a part of the rentier state, through political patronage for instance, or, otherwise, by benefitting from government spending that pacifies dissent.

VII. Africa, Mineral economies and their Institutions

“Economies shape institutions and, in turn, are shaped by them.” In mineral economies, a relatively high dependence on exports shapes institutions. Other additional factors also play a key role in setting an institution’s shape.

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68 Yates, supra note 50 at 15.
69 Ibid.
70 Shambayati, supra note 65 at 309.
71 Van Mil supra note 13 at 9.
73 Ibid.
74 Ibid.
75 Van Mil supra note 13 at 9.
76 Karl, supra note 52, at 6.
77 Ibid., at 13.
78 Michael Shafer, Winners and Losers: How Sectors Shape the Developmental Prospects of States (1994)
A prevailing hypothesis suggests that, aside from exports, the revenues generated from the state’s leading economic sector strongly influence shape. The “sectoral hypothesis”, put forward by writers, like Michael Shafer and Terry Lynn Karl, reflects Dani Rodrik’s earlier suggestion that understanding the specific set of existing constraints and challenges that face each country is crucial to forming strong institutions.

Studies indicate that states that derive high rents from natural resources tend to nurture “non-developmental” economies. In cases where resource rents represent between 15 and 50 percent of GDP, political and economic agents compete for rents. In the 1990s, for example, countries that had a measurable dependence on resource rents equal to 13-21 percent of GDP frequently engaged in rent-seeking. These countries also promoted policies that marginalized wealth creation in the economy.

At least one quarter of all African countries is mineral rich. A mineral rich economy typically generates at least 8 percent of GDP and 40 percent of its export earnings from its mineral sector. Many African mineral economies are underdeveloped. To grasp the full extent of their underdevelopment, it is useful to trace their institutional development back to their social and political origins.

Mineral rich countries in Africa were almost all at one point extractive colonial outposts. For most, existing institutions are, as some describe, mere vestiges of a historically

79 Karl, supra note 52, at 13.
80 Rodrik, supra note 41, at 100–104
83 Ibid., at 11-12.
84 Ibid., at 3
85 Ibid.
86 Ibid.
87 Karl, supra note 52 at 6.
imbedded system that was “geared toward the subjugation and control of a domestic population by an expatriate minority.” Early governance structures were forged into very concentrated, highly authoritarian political structures with economic ties and interests vested in the colonizing mainland.

Today, the large majority of mineral-rich, sub-Saharan African countries exhibit rentier-state characteristics. In Africa, the rentier state emerged following a spate of nationalization programs in the 1970’s.

Nationalization programs were widely thought to be appropriate for reducing the gaps that exacerbated negative growth in domestic economies. Instead, the entire opposite occurred.

Before nationalization, foreign multinationals shielded host states from export instability. Their size, experience and expertise in handling exploration, extraction and exportation activities offered host states security against volatile markets. After nationalization, state budgets were ill-equipped to replace the fiscal and technical capacity that the multinationals formerly possessed.

Today, negative growth in African mineral economies extensively exists. Studies show that in a vast number of countries, overall growth in commodity export activity has not been distributed equally throughout the economy. Weak or “bad institutions” have, of course, been frequently identified as both the root cause and the focal point for inoculating mineral economies from the palpable effects of an ostensible “resource curse”.

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90 Ibid.
92 Ibid, at 320.
93 Ibid.
94 Ibid.
95 Ibid.
96 Ibid.
Chapter 2

Chapter 2 reviews resource revenue transparency. It traces its evolution from an intervening tool in civil conflicts to the Extractive Industries Transparency Initiative. In addition, it discusses why resource revenue transparency initiatives in African mineral economies are insufficient to fully address the resource curse.

I. Resource Revenue Transparency

Inimical public spending decisions and incentives for private individuals to engage in rent-seeking are two basic elements that define the political economy of the resource curse.\(^97\) Spending and rent-seeking are driven by the collection and distribution of resource rents.\(^98\) More particularly, through legal and financial instruments, such as concession agreements and mining royalties,\(^99\) resource rents generate revenue. Ultimately, revenue is collected and distributed in the economy.

“Opacity is the glue holding together the patterns of revenue extraction and distribution that characterize [rentier states].”\(^100\) In Angola, for instance, one in every four dollars earned from oil revenues vanishes without a trace.\(^101\) To date, Angola has failed to account for nearly $US4bil in oil receipts.\(^102\)

To defend against the resource curse, governments and NGOs advocate resource revenue transparency in extractive industries. Transparency can be defined as “timely and reliable economic, social and political information . . . accessible to all relevant stakeholders”.\(^103\)

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\(^97\) See Kolstad and Wiig, supra note 19.
\(^100\) Karl, supra note 16, at 265.
\(^101\) Global Witness, supra note 99, at 3.
\(^102\) http://en.wikipedia.org/wiki/Outline_of_Angola
Transparent oversight over revenues imposes a system of accountability that constrains spending and curbs rent-seeking.\textsuperscript{104}

\textbf{II. How Does Transparency Work?}

The common experience in many of Africa’s resource-rich countries is that there are too few domestic stakeholders with access to information. Without information, demands on government seldom occur. The paucity of information flowing to domestic stakeholders is directly related to the exclusivity between extraction companies and host states.\textsuperscript{105}

“Companies do not publish what they pay to states, and states do not disclose what they earn and spend.”\textsuperscript{106} It is an industry standard for concessionary contracts between host and foreign multinationals to contain confidentiality clauses that bar key financial terms from being published. Also, as a matter of general practice, most governments do not disclose even the most basic information concerning use and sale of natural resources.\textsuperscript{107}

The opacity that shrouds these relationships produces short-lived “win-win” scenarios. For extraction companies, contract confidentiality is advantageous because it permits companies to pursue “off-the-books” transactions to boost profits.\textsuperscript{108} For governments, large amounts of revenue can be collected and distributed without public scrutiny. In the long run, these illicit transactions ultimately:

“raise the transaction[…] costs of doing business…, negatively influence[…] the amount of foreign direct investment, lower[…] the productivity of infrastructure expenditures, affect[…] decisions about which projects to undertake, and [are] negatively correlated with foreign currency ratings, thereby damaging future performance.”\textsuperscript{109}

\begin{footnotesize}
\begin{enumerate}
\item Marie Müller, “Revenue Transparency to Mitigate the Resource Curse in the Niger Delta? Potential and reality of NEITI” (2010) Bonn International Centre for Conversion, Occasional Paper V at 16.\textsuperscript{104}
\item Karl supra note 16 at 265.\textsuperscript{105}
\item Ibid.\textsuperscript{106}
\item Ibid., at 266.\textsuperscript{107}
\item Ibid.\textsuperscript{108}
\item Karl, supra note 16, at 268.\textsuperscript{109}
\end{enumerate}
\end{footnotesize}
Revenue transparency initiatives in political settings tend to move “off-the-books” transactions back into the government budget. There, revenues and expenses are published. A government budget is a legal document that is tabled by the executive, and then later approved by the legislature.\(^{110}\) The budget is arguably the most important economic policy instrument for government because it reflects social and economic priorities that translate into decisions about spending and collection.\(^{111}\) The design of the budgeting process and political institutional arrangements are intertwined.\(^{112}\) Sound institutions arguably lead to solid budgeting processes.\(^{113}\) Solid budgeting processes bolster government accountability, limit misappropriation and support efficient use of public resources.\(^{114}\)

In, *Do More Transparent Governments Govern Better*, Roumeen Islam offers specific insight into the relationship between transparency and institutional quality.\(^{115}\) She suggests that “[i]n countries where different constituents are able to gauge economic performance, and where citizens are well[-]informed, people are more likely to demand governments that govern better and governments have more of an incentive to do well.”\(^{116}\) By extension, she discovers that there is evidence of a close relationship between increased flows of information and positive economic growth.\(^{117}\)

Lastly, she finds that “[m]ore transparent governments govern better for a wide number of governance indicators such as government effectiveness, regulatory burden, corruption, voice


\(^{113}\) *Ibid.*, at 3.

\(^{114}\) *Ibid.*


\(^{117}\) *Ibid.*, at 36.
and accountability, the rule of law, bureaucratic efficiency, contract repudiation [and] expropriation risk.”  

The same even applies in autocratic environments, but to a lesser degree. 

III. Why Transparency?

The origin of revenue transparency in extractive industries began with the relationship between natural resources and violence. In the years leading up to the 1990s, NGOs discovered that feuding parties in the Balkans and many African countries were exploiting and selling natural resources to purchase arms and to fund mercenary armies.

In the mid-1990’s, organizations such as Global Witness and Partnership Africa Canada began to investigate the effect natural resources had on violent civil conflict. Larger organizations like Amnesty International began to conduct similar research. The academic community, led by economists, such as Paul Collier, followed closely behind. The accumulation of research produced reached generally the same conclusion: The effective management of natural resources was vital to stemming outbursts of violent conflict.

Today, the deficit of information on resource revenues is recognized as a major source of corruption, underdevelopment, and a key variable in a formula for violent civil conflict. The United Nations’ Global Compact presses for revenue transparency. In its Extractive Industries Review, the World Bank also recommends that revenue transparency initiatives, like the

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118 Ibid., at 23.  
119 Ibid., at 29.  
121 Ibid., at 60.  
122 Ibid.  
124 Haufler, supra note 120 at 60.  
125 Ibid.  
126 Ibid., at 61.
Extractive Industries Transparency Initiative, be applied in future extractive industry investments.  

IV. Extractive Industries Transparency Initiative (EITI)

At its core, the EITI is a voluntary tool that requires countries that agree to its terms to publish all revenues related to the sale of natural resources. In its earliest stages, the EITI was a foreign policy initiative promoted first by Prime Minister Tony Blair and the UK government. In 2006, the initiative evolved into an autonomous, international organization.

Under the EITI, participating companies undertaking extraction projects are committed to reporting all the taxes and payments they make to local governments. Participating governments are likewise required to publish the revenues they receive from extraction companies. All reports are to be audited by an independent third party. Revenue reporting is conducted with the intention to generate public discussion about the oversight of natural resource revenues.

Under the initiative, there are candidate countries and compliant countries. Candidate countries have met all the necessary requirements at the ‘sign up’ stage. They have: (1) made a public commitment to implement EITI; (2) made a commitment to work with both civil society and the private sector; (3) officially appointed an individual to lead the EITI.

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130 Haufler, supra note 120, at 54.
131 Ibid.
132 Ibid.
133 Ibid.
135 Ibid. at 16.
136 Ibid.
(4) produced a mutually agreeable Work Plan between stakeholders;\textsuperscript{138} and (5) published the work plan to implement EITI.\textsuperscript{139}

After the ‘sign up’ stage, implementation occurs. Implementation includes: (1) setting up a multi-stakeholder committee that oversees reporting procedures; (2) setting up a formal disclosure mechanism that verifies both private enterprise and government disclosures; and (3) agreeing on the manner that information will be disseminated.\textsuperscript{140}

Lastly, there is an independent validation process that assesses a country’s implementation process.\textsuperscript{141} Successfully completing the implementation process leads to becoming EITI Compliant.\textsuperscript{142} Compliant countries are required to meet and maintain EITI standards to remain Compliant. If a Compliant country falls below standard, the Board reserves the right to recommend a second validation or revoke Compliant status.\textsuperscript{143}

V. Transparency and its Shortcomings

Transparency initiatives are sometimes successful. In Uganda, for example, the government sponsored a newspaper campaign to inform stakeholders about where and to whom large school-grants were being sent. The program was initiated in response to allegations that grants were being siphoned off. The newspaper campaign was a success. Grant theft was reduced from 80 per cent in 1995 to less than 20 per cent in 2001 because public information was used to limit theft by public officials.\textsuperscript{144}

\textsuperscript{137} Ibid.
\textsuperscript{138} Ibid. at 17.
\textsuperscript{139} Bartlett, supra note 134, at 18, 20.
\textsuperscript{140} Ibid.
\textsuperscript{142} Bartlett, supra note 134 at 13.
\textsuperscript{143} Ibid.
Regarding transparency over the collection and distribution of resource revenues, victories like that in Uganda are not easily replicated. “[T]ransparency may well be a necessary condition for better management of [natural resource] wealth, but it is unlikely to be a sufficient condition.” Transparency, at a rudimentary level, is about altering the myopic incentives that face decision-makers. When resource rents in African mineral economies increase, because of an increase in price for instance, transparency initiatives, such as the EITI, attempt to make it difficult for political elites to distort information regarding revenue. It fails however to address the need for transparency in other related areas, such as procurement or the distribution of resource revenues. Issues with transparency at the procurement stage will be taken up in Chapter 4.

Transparency initiatives have several shortcomings. For example, excessive spending defines the political economy of the resource curse. Yet, the EITI focuses solely on revenue collection. That said, some studies suggest that “the EITI initiative…gives priority to the wrong set of issues in resource rich countries.” The World Bank is currently promoting a version of EITI to monitor revenue use.

Regarding institutional shape and function, transparency initiatives target an institution’s function, to ensure appropriate collection of natural resource revenue. Transparency initiatives, however, do not affect an institution’s shape. Here lies the problem with relying on transparency initiatives as the sole prescription against the resource curse.

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146 West African Resource Watch, supra note 111.
148 Ibid.
149 Ibid.
150 Ibid., at 8.
An institution’s shape and function is integral to the resource curse hypothesis. Institutional shape provides the political and economic context for determining how rules and restrictions should be applied under certain conditions. Institutional function is a response to shape. Ultimately, an institution functions to meet a particular objective.

For instance, in the Ugandan example, to help administer the effective distribution of school grants, the government initiated the newspaper campaign. The newspaper campaign was formed against Uganda’s political and economic framework. The campaign was designed to bridge the information gap between the grant-making government and recipient schools. Its function was of course to reduce grant theft by public officials. Therefore, to fully address the resource curse, transparency initiatives must address weaknesses in both institutional shape and institutional function.

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151 See Chapter 1
152 See Chapter 1
PART II: CHINA
CHAPTER 3

Chapter 3 is a summary of Sino-African relations. It discusses China’s “Go Out” policy and its relationship to Africa.

I. General Facts

On a global level, China holds several distinctions. First, at 1.3 billion people, it is the world’s most populated country. Next, with a GDP of US$10.03 trillion, it is the second largest economy in the world after the USA. Third, at 10.3 percent, China is among the fastest growing economies in the world today.

There is a serious downside to China’s growth and size. Tied to its exponential growth and size is its stark inability to supply the natural resources required to fuel its growth and to satisfy national demand. Simply put, China lacks natural resource security. Formerly East Asia’s largest oil exporter, China has been a net importer of oil since 1993. In 2005, China became the second largest oil importer in the world with a total demand of 6.5 million barrels per day. Between 2000 and 2005, Chinese demand for oil accounted for forty percent of total world demand. Likewise, China is the world’s largest importer of several minerals. In 2005, Chinese

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153 http://www.google.ca/publicdata/explore?ds=d5bncpppjof8f9_&met_y=sp_pop_totl&idim=country:CHN&dl=en&hl=en&q=chinese+population#ctype=l&strail=false&nselm=h&met_y=sp_pop_totl&scale_y=lin&ind_y=false&rdim=country&qidim=country:CHN&ifdim=country&hl=en&dl=en
155 Ibid.
161 Holsag et al, supra note 158, at 7.
imports of iron ore, copper, cobalt and aluminum reflected increases in demand of 570 percent, 738 percent, 4,145 percent, and 2,247 percent respectively.\(^{162}\) Between 2000 and 2003, Chinese demand for minerals accounted for at least three-quarters of the increase in world demand.\(^{163}\)

II. “Go Out”: Foreign Relations Meet Commercial Interests

China has been actively promoting its “Go Out” strategy to Chinese entrepreneurs and managers of State-Owned Enterprises (SOEs).\(^{164}\) “Go Out” is a hybrid of soft-gloved international diplomacy and aggressive economic activities. The combination seeks to satisfy China’s political interests abroad and its private, commercial interests in select countries.\(^{165}\) In, *The Dragon’s Gift: The Real Story of China in Africa*, Deborah Brautigam cynically describes the enterprise as “Checkbook Diplomacy”. She describes a process where the Chinese reinforce long-term political relations by selectively distributing aid and loans, to secure market access for finished goods and resources to satisfy domestic demand.\(^{166}\)

“Go Out” is partly motivated by the country’s unequivocal need for natural resources.\(^{167}\) The other part is to locate potentially large consumer markets to which to sell its manufactured goods. The latter component lies beyond the focus of this paper. “Go Out” reflects, in part, China’s difficulty with securing foreign natural resources.\(^{168}\) Natural resources are of strategic importance to the energy, industrial and security policies of several countries. As a result, it is relatively difficult for foreign actors, like China, to gain reasonable access. Countries outside of

\(^{162}\) *Ibid.*


\(^{166}\) Brautigam, supra note 165 at 67.

\(^{167}\) Holsag et al, supra note 158, at 7.

Africa that are well endowed with national resources, such as Brazil and Canada, typically guard those resources closely. In Canada, for example, a law was passed that bars China’s Minmetals from acquiring a majority share in Noranda, a large Canadian mining corporation.\(^{169}\) By comparison, sub-Saharan Africa’s protection over natural resources is lax. As a result, Africa is a large beneficiary of China’s “Go Out” policy.

**III. “When Africa met China”**

Africa is well endowed with natural resources. China has enormous resource demands. China’s entry into sub-Saharan Africa is driven not only by demand but also by strategy.\(^{170}\) For example, unlike countries that invest in natural resource industries, like Canada and Brazil, most resource-rich African countries are less likely and often unable to productively exploit their own resources.\(^{171}\) Chinese investors have progressively filled that gap and become increasingly active on the continent.\(^{172}\) In Zambia, for example, Chinese extraction companies have doubled copper production in less than one decade.\(^{173}\) Overall, bilateral trade with Africa has grown from US$10.6 billion in 2000 to US$73 billion in 2007.\(^{174}\) To date, bilateral trade exceeds US$114 billion.\(^{175}\)

Few African countries impose protectionist policies that bar substantial foreign ownership of domestic natural resources.\(^{176}\) Chinese bilateral investment treaties (BITS) with

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\(^{169}\) *Ibid.*

\(^{170}\) Brautigam, *supra* note 165, at 311.


\(^{173}\) Haglun, Dan “In It for the Long Term? Governance and Learning among Chinese Investors in Zambia’s Copper Sector” (2009) 199 The China Quarterly at 635.

\(^{174}\) Tycholiz, *supra* note 156, at 615.

\(^{175}\) CNN, China and India’s Trade with Africa (2011), http://edition.cnn.com

African countries have grown in part for that reason.\textsuperscript{177} China is signatory to twenty-eight BITS with Africa.\textsuperscript{178}

Taken together, Africa’s endowment of natural resources, opportunities for investment and relatively open access to natural resources distinguishes it as a valuable trading partner and investment prospect. It also creates a targeted opportunity for China to support its natural resource requirements.

China and Africa share a storied history. Modern China’s political engagement with Africa began in the 1950s against the backdrop of the Cold War.\textsuperscript{179} In 1989, the emphasis on the relationship shifted. Following the Chinese government’s widely condemned attacks on protestors in Tiananmen Square, diplomatic relations between the two evolved.\textsuperscript{180}

Several years following the incident in Tiananmen Square, China looked to African states to support its contentious return to the UN Security Council and international politics more generally. By renewing its interest in fostering Third World relationships, China successfully realized its goal of legitimate reinstatement into international affairs.\textsuperscript{181} In addition, in the face of growing Western recognition of Taiwan as a legitimate candidate for independence, China needed and largely received African support in bolstering its “One China” principle. “One China” essentially rejects any recognition of independence in Taiwan. China now looks to expand its economic ties with Africa.


\textsuperscript{178} Ibid.


\textsuperscript{180} Ibid.

IV. Investment and Aid

Africa continues to be in dire need of foreign investment and aid. It is estimated that the entire continent faces an annual US$64 billion shortfall in its investment needs.\textsuperscript{182} In light of its longstanding relationship with Africa and its intensive demand for resources, China seeks to fulfill Africa’s requirements for investment and aid.\textsuperscript{183}

Chinese lending to Africa is an indistinguishable mix of aid and foreign direct investment.\textsuperscript{184} Chinese aid to Africa is carefully packaged so that it does not resemble aid in the conventional sense.\textsuperscript{185}

First, unlike in the West, Chinese aid encourages recipients to use the funds efficiently and subject to ‘market–oriented’ principles.\textsuperscript{186} By contrast, Western aid programs dedicate substantial resources to poverty alleviation and economic development without committing to investments in infrastructure and industry.\textsuperscript{187}

Second, Sino-Africa relations are undergirded by five foundational principles: “[s]incerity, equality and mutual benefit, solidarity and common development”. In 2006, China released its first \textit{White Paper on China’s Africa Policy}. Regarding Chinese exploitation of Africa’s natural resources, the white paper states:

“\text{The Chinese Government facilitates information sharing and cooperation with Africa in resources areas. It encourages and supports competent Chinese enterprises to cooperate with African nations in various ways on the basis of the principle of mutual benefit and common development, to develop and exploit rationally their resources, with a view to helping African countries to translate}

\textsuperscript{182} Elizabeth Asiedu, “Foreign Direct Investment in Africa: The Role of Natural Resources, Market Size, Government Policy, Institutions and Political Instability” (2006) 29 The World Economy 1 at 64.

\textsuperscript{183} Jakobson, \textit{supra} note 179, at 407.


\textsuperscript{185} Jakobson, \textit{supra} note 179, at 410.

\textsuperscript{186} Brautigam, \textit{supra} note 165, at 79.

\textsuperscript{187} \textit{Ibid.}, at 81.
their advantages in resources to competitive strength and realize sustainable
development in their own countries and the continent as a whole.”

Lastly, China is a developmental state. It relies on executive policies to achieve
development goals. Core to the state’s management of economic affairs is its ability to
influence SOEs and some large, private enterprises. Chinese influence over the vast majority
of domestic enterprises is, however, low.

“Public opinion, still sees China as a centrally controlled, monolithic, unitary actor.”
In all reality, the government does not exert hands-on control and discipline over all private and
state-owned business doing business abroad. It has even been suggested that the state does not
have a full accounting of all Chinese firms operating in Africa.

The Chinese government does not have a monopoly over Africa. Following a gradual
liberalization of its economy, China slowly reduced state oversight over private business. To
date, China, as a sovereign state, readily competes with independent Chinese firms abroad.
Therefore, aside from “Go Out”, Chinese businesses in Africa are a diverse group of state-owned
and independent firms that compete in similar markets and have no distinct ties to one another.
In 2009, there were approximately 1600 Chinese companies – private and state-owned – doing
business in Africa.

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188 White Paper on China’s Africa Policy.
189 Brautigam, supra note 165, at 79.
190 Ibid., at 80.
191 Ibid.
192 Taylor & Yuhua, supra note 181, at 717.
193 Ibid.
194 Ibid.
195 Ibid., at 716.
196 Ibid., at 721.
197 Ibid., at 717.
V. Traditional Lending and Development in Africa

Financing development in underdeveloped countries has historically been the exclusive domain of international finance institutions (IFIs) and select bilateral donors. In general, these lenders and donors have subscribed to OECD Development Assistance Committee guidelines. Lending to Africa has traditionally been defined by these rules. Featured most prominently among these informal rules is the Debt Sustainability Framework (DSF). Debt sustainability – a critical measure for dispersing and receiving loans – is a fundamental concern to IFIs and bilateral donors.

The DSF assists low-income debtor countries assess their borrowing needs and ability to repay debt. It offers lenders an opportunity to ensure that borrowed funds meet debtor countries’ development goals and reasonable debt sustainability plans. Lastly, the DSF serves as an ad hoc alert system to the World Bank and the IMF. It warns them of potential crises with sovereign debtor debt.

Under the DSF, debt sustainability analyses are routinely administered as defenses against risk. In general, DSF analyses include an analysis of a debtor’s debt burden over a twenty year period, the debtor’s vulnerability to exogenous shocks, and a measurement of the risk of debt against the quality of a debtor’s policies and institutions.

The DSF is a result of earlier failed private / public lending initiatives. In the 1970s, at the height of the oil boom, oil rich countries were depositing hefty sums in commercial banks. At that time, industrialized countries were not looking for loans. Banks responded by structuring

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200 Ibid.
202 Ibid.
203 Ibid.
lending arrangements with developing countries.\textsuperscript{204} These agreements seldom reflected issues with debt sustainability.

In the beginning, commercial banks earned huge profits on developing country loans. By 1982, commercial banks had collectively lent nearly 287.7 percent of their bank capital to the developing world.\textsuperscript{205} Moreover, bankers operated under the false impression that “[c]ountries don’t go out of business....The infrastructure doesn’t go away, the productivity of the people doesn’t go away, the natural resources don’t go away. And so their assets always exceed their liabilities, which is the technical reason for bankruptcy. And that’s very different from a company.”\textsuperscript{206} By 1983, the entire enterprise collapsed under the weight of a global recession. IFIs have since resumed control of the international lending process and more particularly Africa’s financing agenda.\textsuperscript{207}

Lending under the DSF has been criticized for its rigidity. Critics argue that the framework overlooks vital social concerns that cannot be measured using the existing system.\textsuperscript{208}

In 2007, AfDB President Kaberuku stated:

\begin{quote}
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[er]-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, 
\end{quote}

\textsuperscript{206} \textit{Ibid.}
\textsuperscript{207} 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.” Huse & Muyakwa, supra note 199, at 17.
\textsuperscript{208} \textit{Ibid.}, at 20.
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.\textsuperscript{209}

VI. Chinese Loans to Africa

Under direction from the Ministry of Commerce, the Chinese Export-Import (Exim) Bank administers concessional aid loans.\textsuperscript{210} China’s massive three trillion dollar foreign exchange reserve finances the loans.\textsuperscript{211} Aid to Africa is a combination of trade and mutual cooperation.\textsuperscript{212} In 2009, total Chinese aid to Africa was estimated at US$2.1 billion.\textsuperscript{213}

The Chinese frequently lend funds to highly indebted nations with substantial natural resources with which to repay the loan.\textsuperscript{214} The conventional mechanics that govern lending to sovereign debtors does not apply because Chinese loans are administered by policy makers and not bankers \textit{per se}.\textsuperscript{215}

In general, Chinese loans to African debtors must be spent, in part, on Chinese firms that are guaranteed contracts to build infrastructure projects.\textsuperscript{216} The unique lending arrangement is commonly referred to as the “Angolan Model”. Under the model, a loan is tied together with an agreement from the recipient to use some of the proceeds towards employing a Chinese firm.\textsuperscript{217}

Under the original “Angolan Model” deal, China lent Angola a total of US$4.5 billion. In March 2004, the first US$2 billion financing package focused on financing the construction of Angolan infrastructure and public works projects. Three years later, an additional US$500 million was added to the original amount. In September 2007 an additional oil-backed loan of

\textsuperscript{209}Huse & Muyakwa, \textit{supra} note 199, at 22.  
\textsuperscript{210}Brautigam, \textit{supra} note 165, at 80.  
\textsuperscript{211}The China Daily, “China’s forex reserves hit $3t in june”, http://www.chinadaily.com.cn  
\textsuperscript{212}Brautigam, \textit{supra} note 165, at 80.  
\textsuperscript{213}Benedicte Christensen, \textit{supra} note 198, at 8.  
\textsuperscript{214}Huse & Muyakwa, \textit{supra} note 199, at 22.  
\textsuperscript{216}The Economist, ”The Chinese in Africa: Trying to pull together” April 20, 2011.  
\textsuperscript{217}Davies, \textit{supra} note 215, at 14.
US$2 billion was negotiated. To date, at least 100 additional projects have been earmarked to receive funding under the Angola model.

In circumstances where money is not likely available to repay the loan, natural resources are committed as a means of payment. Under the original Angolan lending arrangement, for example, China agreed to a joint venture with Angola’s Sonangol that secured it a minimum daily supply of oil for its national oil corporation, Sinopec. 218

Chinese lending has been a boon to African mining and mining exploration. In light of the global financial crisis, Chinese loans have filled a void left empty by the flight of Western capital. In 2009, one report indicated:

“the scarcity of capital is … impacting negatively on the development of African infrastructure. According to the Development Bank of Southern Africa (DBSA), prior to the crisis Africa had committed to 2361 such projects. Currently, 1114 projects are going ahead – a massive reduction of 52.8 per cent. This is due largely to the fact that the crisis has made ‘financing (both debt and equity) more onerous and difficult to secure.’” 219

Despite western investors’ immediate retreat, Chinese investment in African extractive industries has flourished. Chinese investment in African natural resources has also positively expanded China’s loan portfolio in mineral rich countries. 220

VII. “Go Out” and Mine

“Go-Out” is insistent on creating internationally competitive mining operations. 221 In 2002, China consolidated its mining industry by absorbing several thousands of small and medium size mining companies into a few large national firms. 222 For example, the state brought together several mining firms to create China Nonferrous Metals Mining (CNMIM) and the

218 Davies, supra note 215, at 14.
219 Ibid., at 15.
220 Ibid., at 9.
221 Holsag et al, supra note 158, at 12.
222 Ibid.
Chinese Aluminum Group (CAG). The private companies that have emerged as leaders under the larger umbrella groups have received significant financial and management support from the state.

To bolster the “Go Out” initiative in the mining sector, the Ministry of Finance offers domestic mining companies preferential tax and capital benefits when engaged in mining operations abroad. The tax and capital credits operate as an incentive to domestic mining companies to venture abroad to discover mining opportunities overseas. Further, to increase exploration and extraction endeavors in Africa, China has established the China-Africa Development Fund. The fund is earmarked specifically for investment projects in Africa.

China exerts influence over independent mining companies who operate overseas. Designated as a ‘strategic investment sector’, the policy over mining operations is outlined by the State Development and Planning Commission (SDPC) who assess and plan for the country’s natural resource requirements. The plan is then passed down to the National State Council (NSC) who administers the plan and issues instructions to respective ministries and specialized agencies. Those particular ministries and agencies, in turn, are responsible for green-lighting the applications of business that apply for state support to operate abroad.

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223 Ibid.
224 Ibid.
225 Ibid.
227 Holsag et al, supra note 158, at 11.
228 Ibid., at 10.
229 Ibid.
230 Taylor & Yuhua, supra note 181, at 715.
Chapter 4

Chapter 4 analyzes the adverse effects that Chinese aid has on Africa. It identifies as a fundamental problem the absence of specific institutions to respond appropriately to the impact of Chinese aid and investment. In addition, it subjects Ghana to a case study. It examines the Ghanaian political economy to determine how best to shape its institutions to increase its immunity against the resource curse. Chapter 4 provides concluding remarks.

I. An Incompatible Friendship

Each African state has its peculiar shortcomings that contribute to its inability to harness resource wealth. Only general conclusions may be drawn here about how to address fundamental weaknesses in each country’s institutional shape and function. As such, only certain elements common to the African rentier model, like the sectoral hypothesis, may explain, in part, why spending and incentives distort a state’s ability to use resource revenues judiciously.

The rentier model cannot be wholly relied upon to reflect the idiosyncratic features that distinguish each country. For example, in Nigeria, pre-colonial arrangements that originally offered three dominant ethnic groups living in three different parts of the country relative political autonomy has evolved into an ineffective federal system that unevenly distributes oil revenues along ethnic lines.\textsuperscript{231} Nigeria’s unique arrangement is not reflected in the rentier model.

Merely introducing broad-based solutions that address institutional dysfunctions common to the rentier model, such as resource revenue transparency, may fail to fully inoculate African governments against the adverse effects of a resource curse. By extension, China’s engagement with African mineral economies may further complicate matters.

General consensus is that “[t]he country contexts, in which Chinese engagement with African countries takes place, are complex, and it is impossible to choose one case country that

\textsuperscript{231} Marie Müller, \textit{supra} note 104, at 15.
will illustrate all aspects of Chinese lending to Africa and its consequences." In *The Rise of China and the Natural Resource Curse in Africa*, Meyersson, Padró i Miquel and Quian find that, in the short term, African natural resource exports to China raise economic growth. The downside is that, in the long run, the growth increase is paralleled by a decrease in democratic accountability. In conclusion, short term benefits from Africa’s natural resource export trade with China may have negative long term effects.

II. What is the Problem?

The Chinese behave differently in different African countries depending on the manner in which host countries regulate institutions and enforce domestic laws. For example,

“[In] 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 [to] enforce it [are] better, the Chinese have accepted the Black Economic Empowerment program of the South African government. China has even agreed to an agreement that protects [the] South African textile industry.”

Public and private Chinese firms’ divergent behavior in Africa creates several problems that epitomize latent weaknesses in the institutions that shape African rentier states. Recall that institutional shape gives context for determining how existing rules and restrictions should be applied against an existing political and economic framework. In particular, these weaknesses exist in the centralized political economy of the resource curse.

To briefly recap, the centralized political economy model centres on government spending, emphasizes the concentration of decision making power in political elites over resources rents, and distinguishes between the choice to pursue self maximizing activities and

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232 Huse & Muyakwa, supra note 199, at 9.
234 Ibid.
235 Huse & Muyakwa, supra note 199, at 27.
236 Ibid.
237 See Chapter 1
publicly beneficial ones. Under the model, a government may either respond to special interests or act altruistically. 238

China’s relationship with African mineral economies is grounded in executive-level bilateral agreements. Bilateral agreements are common in centralized political economy models. Political elites in African mineral economies typically maintain executive discretion to conclude bilateral agreements. Jenson and Wantchekon find that “executive discretion over the distribution of resource rents [in countries with poor institutions] has a significant impact on political regimes.” 239 They conclude that executive discretion over resources tends to encourage higher levels of government spending and mostly represents negative outcomes in African countries. 240 Jenson and Wantchekon’s predictions fit with the centralized model of the resource curse.

The concentration of power in a small pool of political elites to conclude bilateral agreements creates problems that reinforce the resource curse hypothesis in at least three different ways. First, between 2001 and 2007, ninety-two percent of Chinese loans to Africa were distributed as concessional loans through China’s Exim Bank. 241 Concessional loan agreements require sovereign guarantees and are therefore executed at a high ministerial or executive level. 242

To secure loans, many African countries rich in natural resources often commit to repayment with natural resources, as Angola does with oil. These resource-for-infrastructure agreements are not captured in the budget because they do not directly contribute to public

238 Kolstad & Wiig, supra note 147, at 3.
240 Ibid., at 4.
242 Ibid., at v.
revenue.\textsuperscript{243} Rather, natural resources are paid for through infrastructure projects.\textsuperscript{244} Despite the absence of a direct source of revenue, resource-for-infrastructure deals between Africa and China have the propensity to encourage bribery and corruption.\textsuperscript{245}

Chinese managers are reportedly notorious for paying bribes to secure foreign contracts.\textsuperscript{246} In 2006, Transparency International ranked Chinese companies second worst in the world for their propensity to offer bribes overseas.\textsuperscript{247} In 2009, on account of their reputation for offering bribes, the World Bank barred several large Chinese companies from tendering bids on certain African projects.\textsuperscript{248}

Bribes, or kickbacks, are becoming an ever-present feature of African resources-for-infrastructure deals.\textsuperscript{249} The Namibian government, for instance, has publicly charged a state-owned Chinese company for facilitating a deal with millions of dollars in illegal kickbacks.\textsuperscript{250} Continent-wide, there have been allegations that “China is using [resource-for-infrastructure loans] to buy the loyalty of the political elite.”\textsuperscript{251}

China has no specific laws against bribing foreign officials.\textsuperscript{252} The Chinese government has not yet made it a priority to seek out and punish bribery abroad.\textsuperscript{253} It has been alleged by a few that it even has “an added incentive to look the other way [regarding foreign bribery] because of the state’s ties to many foreign aid contractors — connections that sometimes extend

\textsuperscript{243} Paul Collier, The Plundered Planet: How to Reconcile Prosperity with Nature (Allen Lane, 2010) at 123.
\textsuperscript{244} Ibid.
\textsuperscript{245} Brautigam, supra note 165, at 295.
\textsuperscript{246} Ibid.
\textsuperscript{247} Ibid.
\textsuperscript{248} Ibid.
\textsuperscript{250} Ibid.
\textsuperscript{251} Ibid.
\textsuperscript{252} Ibid.
\textsuperscript{253} Ibid.
to families of the Communist Party elite.”

In conclusion, kickbacks result in the patent abuse of public office that leads to corruption: a widely recognized symptom of the resource curse.

Second, under the terms of Chinese concessional loans, lending agreements guarantee private and state-owned Chinese contractors infrastructure contracts in the host state. Contractors are selected from a closed list of Chinese firms. A substantial portion of infrastructure contracts are tied to projects that facilitate resource extraction and export.

The connection between resource extraction and infrastructure development in Africa is well known: The lack of infrastructure in Africa impedes resource-rich countries from maximizing their ability to profitably develop and export natural resources. As a result, to remove bottlenecks, Chinese loans in African natural resource sectors are often packaged together with infrastructure deals. In the end, the greatest value of these agreements is often concentrated in and around extractive industries: another symptom of the resource curse.

For example, in Sudan, China is constructing a pipeline that will connect a major oilfield to a port near the Red Sea. In Angola, construction is centred on building railroads between oil and mineral deposit sites and ports. In Botswana, Chinese firms are constructing the Trans-Kgalagadi railway to connect Botswana with Namibia in order to transport coal to China from landlocked Botswana via Namibian ports. In Guinea, Chinese firms built the Souapiti Dam to generate the power needed to process bauxite associated with its mining interests.

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254 Ibid.
255 Davies, supra note 215, at 13.
257 Foster et al, supra note 241, at 37.
258 Ibid.
259 Brautigam, supra note 165, at 277.
260 See Zafar, supra note 159.
262 Foster et al, supra note 241, at 38.
263 Ibid.
projects are a small sample of the infrastructure projects being completed in Africa through resource-for-infrastructure deals.

Lastly, the terms under China’s bilateral agreements with African countries are rarely made public. In Zambia, a programs officer with Transparency International reported:

“We don’t know what is going on until we get to a point where a minister is signing the contract….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.”

Taken together, bribery, enclaved benefits and opaque deal-making are each reoccurring themes of a resource curse. It appears that the root problem with Sino-African resource-for-infrastructure agreements is that political elites have the ability to create self-enriching outcomes through the conclusion of high-level bilateral agreements.

An often overlooked consequence of Chinese resources-for-infrastructure agreements is that they either bypass or expose weaknesses in national procurement policies. Public procurement should be a transparent, competitive contracting system used to purchase goods and services on behalf of a government. Studies show that “[p]ublic procurement has a large potential to boost economic development in general, and private sector development in particular.”

For the most part, Chinese bilateral agreements with African nations are rarely, if ever, vetted through a national procurement process. Likewise, they do not require competitive

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265 Huse & Muyakwa, supra note 199, at 13.
266 http://en.wikipedia.org/wiki/Government_procurement
268 LaFraniere and Grobler, supra note 249.
For example, in Zimbabwe, the Chinese government once fulfilled an order for fighter jets that was not approved by parliament or its government procurement board.\footnote{269} “Multilateral agencies, such as the African Development Bank and the World Bank, [on the other hand] require unrestricted International Competitive Bidding to take place on all significant contracts that they finance. The procurement data from these agencies is publicly available.”\footnote{271} The problem with weak or absent procurement laws in Sino-African bilateral arrangements is manifest in several countries. In Uganda, the government has recently blocked a Chinese loan over serious procurement concerns with Chinese bilateral agreements.\footnote{272} Charges of procurement abuse and overpricing have forced the Ugandan government to halt a US$74 million loan from China.\footnote{273}

In conclusion, the problem with resource-for-infrastructure agreements may be reduced to a fundamental issue with institutional shape. Each of the above outcomes suggests that there may be missing or weak sets of rules and regulations that should be used to limit public benefits from flowing exclusively between the Chinese and the local political elite.

**III. Ghana: Case Study**

Ghana hints at a way forward. In 2011, in response to a roundtable meeting on contract transparency in the country’s natural resource sector, the Attorney General advocated that all mineral and oil deals become subject to the Public Procurement Act.\footnote{274} Recognizing that mineral and oil deals in Ghana are not subject to the Public Procurement Act, the Attorney General stated

\footnote{269} Ibid.\footnote{270} Brautigam, supra note 165, at 290.\footnote{271} Foster et al, supra note 241, at 25.\footnote{272} Michael Malakata, Uganda Blocks Chinese Loan over Procurement Concerns, IDG News Service, August 4, 2011, online: http://news.idg.no\footnote{273} Ibid.\footnote{274} Ghana Oil Watch, “Oil and Mining Deals Not Subject to Procurement Law – Ghana” (April 20, 2011), online: http://www.ghanaoilwatch.org.
that the oversight “is a serious gap in the law which exposes the multi-million dollar contracting of investments in mining and petroleum activities to rent-seeking and other corrupt practices.”

In light of this very recent move by Ghana’s Attorney General to press for an amendment to its national procurement laws, Ghana serves as a genuine example of an African country, rich in minerals (and now oil), that is taking progressive measures to change the shape of the existing institutions that perpetuate the centralized political economy model of the resource curse.

Ghana has recently discovered oil. In addition, Ghana supports a relatively large mining industry. In July 2011, the World Bank issued a report on Ghana’s mining sector. Titled *The Political Economy of the Mining Sector in Ghana*, the review was conducted partly in response to a prime opportunity to critically review the country’s management of its mining sector before bringing its oil reserves online.

Like many of its resource-rich neighbours, Ghana’s mineral wealth has had only a modest impact on development. Despite its mediocre record for development, the country has been described as “an interesting case in natural resource management because of the international community’s recognition that it has functioning democratic institutions with a relatively successful democratic tradition.”

The World Bank has identified Ghana’s institutions and political structure as central to understanding and addressing the impact of mining on the Ghanaian economy. In its report, the World Bank highlights, in part, “incentive problems in institutions, directly or peripherally involved in mining governance, an excessively centralized policy-making process, a powerful

\[\text{\textsuperscript{275}}\text{Ibid.}\]


\[\text{\textsuperscript{277}}\text{Ibid., at 6.}\]

\[\text{\textsuperscript{278}}\text{Ibid.}\]

\[\text{\textsuperscript{279}}\text{Ibid.}\]
executive president, [and] a lack of transparency” as fundamental issues that need to be addressed before problems in its mining sector can be reversed.\textsuperscript{280} These factors are all common to the resource curse hypothesis.\textsuperscript{281}

\textit{i. China in Ghana}

Since discovering oil, China’s interest in Ghana’s natural resources has heightened considerably. In 2006, China concluded a bilateral loan agreement with Ghana valued at US$15bn.\textsuperscript{282} The loan includes: a $US10.4bn concessionary-loan agreement from the Exim Bank for various infrastructure projects; a separate loan of US$3.4bn from the China Development Bank; and a US$1.2bn agreement with Chinese company Bosai Minerals Group to build a bauxite and aluminum refinery.\textsuperscript{283} Ghana’s deputy Minister of Finance and Economic Planning, Mr. Seth Tekpeh, has confirmed that “[t]he repayment for these loans would not come from the budget but through exports.”\textsuperscript{284}

Ghana’s relationship with China precedes the US$15billion loan. Ghana and China have shared diplomatic ties since 1960.\textsuperscript{285} In 1962, Ghana supported China in its war with India.\textsuperscript{286} In 1964, Ghana received its first concessional loan from China.\textsuperscript{287} In the 1970s, Ghana was a fervent supporter of China’s return to the UN. In 1989, following the shooting in Tiananmen Square, Ghana was first to send a senior diplomat to Beijing.\textsuperscript{288} In 1990, China repaid Ghana for

\textsuperscript{280} \textit{Ibid.}
\textsuperscript{281} \textit{Ibid.}
\textsuperscript{282} Ghana Web, “China to pump $16bn into Ghana” (2010), http://www.ghanaweb.com
\textsuperscript{283} \textit{Ibid.}
\textsuperscript{284} \textit{Ibid.}
\textsuperscript{286} \textit{Ibid.}
\textsuperscript{288} Idun-Arkhurst, \textit{supra} note 285, at 6.
its loyalties by building the National Theatre. Lastly, between 2003 and 2004, bilateral trade increased by 70 percent.

**ii. Mining and Institutions**

Ghana has a long history of mineral endowment which led in colonial times to the country being known as the Gold Coast. Today, its mining sector contributes approximately 41 percent of total exports earnings, 14 percent of total tax revenues, and 5.5 percent of Ghana’s gross domestic product. The institutional arrangements surrounding mining are layered. The highest order of decision-making rests in the President, then the Parliament, and lastly, in the ministries and public agencies.

The Ministry of Lands, Forestry and Mines generally oversees management of all natural resources. The Mineral Commission regulates and manages mineral resource development and sets policy. The Inspectorate Division of Minerals Commission and the Precious Minerals Marketing Co. Ltd. enforce regulations and promote the development of precious minerals, respectively.

Despite the hierarchical regulatory framework, the president maintains wide-ranging authority over mining sector governance. Under Article 257 (6) of the 1992 Constitution, the President holds in trust for the people and the Republic “[e]very mineral in its natural state in, under or upon land in Ghana.” Likewise, the Constitution states: “[w]here land is required to

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289 Ibid.
290 Tsikata et al, supra note 287, at 3.
291 Ayee et al, supra note 276, at 6.
292 Ibid, at 8.
293 Ibid., at 12
295 Ibid.
296 Ibid.
secure the development or utilization of a mineral resource, the President may acquire the land or authorize its occupation and use under an applicable enactment for the time being in force."  

Under the 2006 Minerals and Mining Act, Parliament is responsible for ratifying all mining leases and contracts. Prospective mining leases and contracts are brought forward by the Mineral Commission and then introduced to Parliament through a Select Committee. Before issuing a license or approving a contract, “[t]he Select Committee is responsible for conducting due diligence and examining the capacity, reputation, and finances of the company under review.”

Ghana’s democratic regime concentrates substantial decision-making power in the President. By design, the Constitution allows the President to override many of Parliament’s decisions. That authority includes overriding final decisions to issue mining licenses and to approve mining agreements. Executive authority to override Parliament’s decisions over mining agreements has allegedly reduced overall trust in the process.

Regarding mining licenses, Ghana does not use open tendering or bidding processes. Rather, the process for awarding licenses is conducted through a confidential, administrative process. On recommendation from the Mineral Commission, applicants submit a request for a mining lease to the Minister of Mines for approval.

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297 Ayee et al, supra note 276, 16.
298 Ibid.
299 Ibid.
300 Ibid.
301 Ibid., at 15
302 Ibid., at 19
303 Ibid., at 21
304 Ibid.
305 Ibid., at 23
iii. Public Procurement Act, 2003

Public procurement in Ghana represents approximately seventeen percent of GDP and eighty percent of tax revenue. The Public Procurement Act (Act) was enacted “to provide for public procurement; establish the Public Procurement Board; make administrative and institutional arrangements for procurement; stipulate tendering procedures and provide for purposes connected with these.” Towards that end, the Act establishes a Public Procurement Board (Board) “to harmoni[z]e the processes of public procurement in the public service to secure a judicious, economic and efficient use of state resources in public procurement and ensure that public procurement is carried out in a fair, transparent and non-discriminatory manner.” To achieve such ends, section 59(4)(c) requires that a procurement contract be evaluated on:

“... the effect [it] will have on (i) the balance of payments position and foreign exchange reserves of the country; (ii) the countertrade arrangements offered by suppliers or contractors; (iii) the extent of local content, including manufacturer, labour and materials, in goods, works or services being offered by suppliers or contractors; (iv) the economic-development potential offered by tenders, including domestic investment or other business activity; (v) the encouragement of employment, the reservation of certain production for domestic suppliers; (vi) the transfer of technology; (vii) the development of managerial, scientific and operational skills; and (d) national security considerations.”

Section 69(2)(c) also provides that contracts should be evaluated on:

“(i) the effect that the acceptance of a proposal will have on the balance of payments position and foreign exchange reserves of the country; (ii) the extent of participation by nationals; (iii) the economic development potential offered by the proposal, including domestic investment or other business activity; (iv) the encouragement of employment; (v) the transfer of technology; (vi) the development of managerial, scientific and operational skills; (vii) the countertrade arrangements offered by consultants; and (d) national security

308 Ibid.
309 Ibid.
Likewise, in terms of a sole-source or no-bid contract:

“single-source procurement [may proceed] with the approval of the Board after public notice and time for comment where procurement from a particular supplier or contractor is necessary in order to promote a policy specified in section 59(4)(c), (d) or 69(2)(c)(i), and procurement from another supplier or contractor cannot promote that policy.”

Lastly, customers who are unsatisfied with either contract performance or delivery of goods may bring forward a complaint to the Appeals and Complaint Panel.

Prior to Act, tied aid from foreign donors often bypassed national procurement mechanisms. Today, following enactment, mineral-based bilateral agreements with China, like all mineral-based agreements, are not subject to the Act. In a recent report, Mr. Sallas Mensah, CEO of the Board, confirmed that petroleum and mining contracts are not subject to national procurement laws. Ghana’s participation in transparency initiatives, like the EITI, is also perceived by many to be insufficient in addressing corruption and rent-seeking. Its critics believe that the “interest of the people will not be wholly cured by the mere publication of … contracts.”

Proponents of amending the Procurement Act to include mineral and oil deals argue that the change “is of primary importance in ensuring that the state doesn’t get shortchanged in the contracting process[.]”

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Ibid.
Ibid.
EURODAD, supra note 267, at 10.
Ibid. at 11.
Idun-Arkhurst, supra note 285, at 19.
Ghana Oil Watch, supra note 274.
corruption happens, and this happens even before contracts are negotiated". In addition, proponents submit that “mining concessions … are essentially procurement activities that involve the state acting for and on behalf of the people and so must follow the law as provided for in the [Public] Procurement Act.”

IV. Recommendations

The Public Procurement Act presents Ghana with a prime opportunity to change the shape of the institutions that govern the collection and distribution of resource rents. Articles 9 and 14 of the UN Convention Against Corruption stress the need for transparent and accountable public mechanisms, like national procurement processes.

Subjecting Ghanaian mineral and oil agreements to a formal procurement process achieves several very important ends. First, it significantly reduces the executive authority vested in the President by the Constitution. The “unbalanced concentration of power in the hands of the executive” is perhaps the greatest obstacle to concluding transparent mining and oil agreements in Ghana. In 2008, for example, the President approved 21 mining leases without Parliament’s consent and approval.

The balance of power that falls squarely in the hands of the executive is representative of the centralized political economy model of the resource curse. In the model, a small handful of political elites maintain authority over spending. In Ghana, the same situation applies. The absence of effective institutional and constitutional checks against biased, executive decision-

317 Ibid.
318 Mensah, supra note 315.
320 Ayee et al, supra note 276, at 14.
321 Ibid., at 24.
making strongly suggests that political incentive problems undergird Ghana’s relatively low success rate for effectively managing mining.\textsuperscript{322}

Second, in regard to Chinese resource-for-infrastructure agreements, sections 59(4)(c) and 69(2)(c) may likely address potential concerns with the bilateral arrangements in order to prevent outcomes like that in Uganda. Both macroeconomic and firm level effects of resource-for–infrastructure deals may be scrutinized under the terms stipulated under the Act. In addition, agreements that list one company to perform contractual duties may be subject to section 40(2). Overall, under the Act, the entire deal-making process may be subject to openness, transparency and public debate.

Third, the procurement process, in general, reduces the likelihood of bribery. The problems with bribery and kickbacks that are becoming commonplace with resource-for-infrastructure agreements can be minimized before they become a persistent problem.

V. Conclusion

In his book, \textit{The Plundered Planet: How to Reconcile Prosperity with Nature}, Paul Collier recommends lifting the veil of secrecy over China’s resource-for-infrastructure deals.\textsuperscript{323} His response to Chinese aid is to subject the agreements to a competitive bidding process.\textsuperscript{324} Collier’s suggestion corresponds with the Paris Declaration on Aid Effectiveness and its commitment to strengthening national procurement systems.\textsuperscript{325}

The Declaration, reads in part, “aid effectiveness must increase significantly…to support partner country efforts to strengthen governance and improve development performance. This will be all the more important if existing and new bilateral and multilateral initiatives lead to

\textsuperscript{322} \textit{Ibid.}, at 21.
\textsuperscript{323} Collier, \textit{supra} note 243, at 124.
\textsuperscript{324} \textit{Ibid.}
significant further increases in aid.\textsuperscript{326} That said, the speed and size of Chinese aid and investment in Africa has the serious potential of either lifting millions out from poverty or exacerbating the resource curse.\textsuperscript{327} It is therefore vital to Africa’s development that the opportunity to lift citizens of the \textit{Bottom Billion} out from poverty by triggering economic growth and development is not overlooked.\textsuperscript{328}

To the extent that China’s resource requirements are intensive, the potential for encouraging heightened rent capture by political elites in mineral rich African countries is a stark reality.\textsuperscript{329} Therefore, the analysis and recommendations set forth for maximizing the economic benefits of Ghana’s relationship with China should be referred to as a working example of how institutions in other countries can be shaped against an existing economic and political framework to meet specific objectives.

\textsuperscript{327} Kaplinsky et al, supra note 9, at 1.
\textsuperscript{328} Collier, supra note 243, at 230.
\textsuperscript{329} Kaplinsky et al, supra note 9, at 31.


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