On The Legal Issues of the Chinese Enterprises' Investment in Africa

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[Abstract] In recent years, Chinese enterprises' investment in Africa accelerates, and becomes the leading role in overseas investment of Chinese enterprises. This paper examines the status quo, the challenges and the opportunities of Chinese enterprises' investment in Africa, as well as the legal regime that regulates such investment.

Key words: investment in Africa; legal regime; foreign exchange; insurance; political risk

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I. The status quo and evaluation of the Chinese enterprises' investment in Africa

In recent years, foreign investment, including it in the third world countries like African area, is the trend of Chinese investment. FDI (Foreign direct investment) of the Chinese enterprises is accelerating… From 2002 to 2006, the average annual growth rate of China's foreign direct investment is 70.25%; during the same period, the global average growth rate is 22.45%. At the end of 2007, the amount of China's foreign direct investment is over 109.35 billion U.S. dollars.

With the improvement of African investment environment, China's investment in Africa grows steadily. From 2001 to 2006, the Chinese government's investment on infrastructure in sub-Saharan Africa soars from less than one billion U.S. dollars per year to 70 billion U.S. dollars per year. According to the statistics collected by Chinese Ministry of Commerce, the total amount of investment in 49 countries and regions in Africa accumulated to 26 billion U.S. dollars at the end of 2008, 7.8 billion U.S dollars of which come from direct investment. From January to June 2009, in the context of rapid decline of global foreign direct investment, Chinese enterprises achieved a total amount of 552 million U.S. dollars (non -financial), increased by 81 % over last year (1). In the same time period, China's enterprises signed contracting labor contracts in Africa with the target of 22.45 billion U.S. dollars, and completed the turnover of 11.53

(1) http://news.163.com/09/l104/16/5N9Q16D9000120GU.html

billion U.S. dollars, with the year -on -year increase of 25% and 61.1% respectively(2).

Chinese enterprises have set up and commenced the construction of Zambia -Sino trade and economic cooperation zone, Mauritius -Tianli Economic and Trade Cooperation Zone, Nigeria -Guangdong economic and trade cooperation zone, the Egyptian Suez economic and trade cooperation zone, the Nigerian Lekki Free Trade Zone, Ethiopian Eastern Industrial Park. Some of the cooperation zones have already been provided with a certain scale and began to make considerable profit. Take the Zambian economic and trade cooperation zone for example, after nearly five years' construction, this zone have been invested by 107.08 million U.S. dollars on infrastructure, including water, electricity, gas, roads, communications, sewage system, etc; leveled land 1.8775 million square meters and the constructed public facilities 44100 square meters. The zone has successfully introduced 13 companies including the color Africa Mining Co., Ltd., Chambishi hydrometallurgy Co., Ltd., Chambishi sulfuric acid Co., Ltd., Chambishi copper smelting Co., Ltd., including mining industry, exploration industry, non-ferrous metal processing industry, chemical manufacturing, metal processing industry, construction and other industries, attracting investment of about 820 million U.S. dollars; the amount of completion of the investment has exceeded 500 million U.S. dollars. By the end of August 2009, enterprises in the zone have achieved sales revenue of 340 million U.S. dollars, and paid the tax of 47.4753 million U.S. dollars to the Zambian government at all levels. They have produced 315,000 tons of copper concentrate, with the copper volume

(2) http://www.cs.com.cn/xwzx/03/200908/t20090818_2185241.htm

of 141.8 thousand tons; cathode copper 16814 tons and provided the almost 4,000 jobs to Zambia. The zone still has 23 investment projects under negotiation at present, of which 12 companies have signed the investment intent, and another 13 enterprises have the intention to invest; the proposed investment amounting to 60 million U.S. dollars (3) .

(3) http://www.gov.cn/gzdt/2009-10/27/content_1449970.htm

The Chinese enterprises' investment in Africa shows the following characteristics:

1. The major target countries of Chinese enterprises' investment are Zambia, South Africa, Mali, Egypt, Nigeria, Tanzania, Zimbabwe, Congo (DRC), Kenya, Mauritius and Angola, etc. Over 70% of the investment goes to Nigeria, Angola, Sudan and Ethiopia. The investment fields include trade, telecommunications, manufacturing, resource exploration, transportation, agriculture and so on. The infrastructure is the main focus: by the end of 2007, China has provided financing for the completion of ten hydropower projects in sub-Saharan Africa areas. These projects are expected to enhance 30% of the African generating capacity. In the sector of transportation, China invested 4 billion U.S. dollars in Africa to maintain the 1,350-kilometer-railway and build 1,600 kilometer new railway.

2. A large part of Chinese investment of infrastructure in Africa are based on the framework of Chinese government and African countries' bilateral agreements and conducted in the form of preferential loan offered by the Export -Import Bank of China. Nearly two-thirds of the investments focus on hydroelectric power generation and railway projects. As pointed out in the reports of World Bank, the natural resources that China imported from sub-Saharan Africa reached 220 billion U.S. dollars in 2006, of which 80% is the crude oil. Currently 30% of Chinese crude oil imports, 80% of the cobalt imports and 40% of the manganese imports depend are from Africa. Moreover, China's infrastructure investment uses the so-called "Angolan Model" more frequently. That is to say, Chinese Export -Import Bank accepts those countries repaying

the loans by natural resources. According to the statistics provided by World Bank, eight infrastructure projects of Chinese investment in Africa apply this model [4].

3. The government plays a leading role in Chinese enterprises' investment in Africa. In order to stipulate and promote the investment, China has already signed the investment protection agreements with 28 African countries, double taxation avoidance agreements with eight African countries, and is still working on signing agreements with other key countries. The Sino -African Cooperation Forum is playing the role as an intermediary and a bridge. Since 2006 Sino -African Cooperation Forum Beijing Summit, China has taken the measure like establishing Sino -African development fund and building the foreign trade and economic zone to support and encourage the Chinese enterprise invest in Africa. The investment has achieved leaps and bounds. The zones that Chinese enterprises set up in Africa like Zambia and China trade and economic cooperation zone, Mauritius Tian -li Economic and Trade Cooperation Zone, Nigeria -Guangdong economic and trade cooperation zone, the Egyptian Suez economic and trade cooperation zone, the Nigerian Lekki Free Trade Zone, Ethiopia Eastern Industrial Park have started the construction; some of them have began to make profits.

(4) http://4128631 .blog.hexun.com/21224042_d.html

II. The difficulties and risks Facing Chinese enterprises' investment in Africa

The continuing increase of Chinese investment in Africa receives welcome from the targeted countries because it promotes the local economic development, provides job opportunities, and boosts the government revenue; however, the investment also meets a lot of difficulties and risks.

1. Unstable political situation and unsecure environment Due to historical and practical reasons, the political development in Africa is unbalanced. Some countries have racial, religion, territorial conflicts and anti-government armed forces, high crime rate and deteriorating public security. In some other countries like Algeria the terrorist activities still exist. Although the local government adopted strict measurement to defend terrorist activities, the employees of the Chinese enterprises still face the threats in Algeria. In Nigeria, phenomena like the local domestic armed conflicts, terrorism, separatism, religious conflicts, armed robbery, and extortion, etc. always occur. In the early 2007, there were two cases of kidnapping of Chinese employees happened in Nigeria.

In addition, a number of the unemployed attribute high unemployment rate in some African countries to the foreign investors taking away their livelihood. They are extremely discontent with the foreign investors and even robbed them. The Chinese people are used to be called "the most secure people abroad"; however, the contemporary situation is very unsatisfying since the cases that Chinese workers in Africa being attacked and kidnapped occurred once and again in recent years. We must realize the fact that the overseas Chinese workers are facing more and more threats. The following chart shows the major political hijacks:

Time	Event	Result
24th, Apr., 2007	A project team of a Chinese petroleum company based in Southeastern Ethiopia were attacked by terrorists	Nine killed and seven kidnapped
25th, Jan., 2007	Five Chinese workers were robbed in the south river Emonet region of Nigeria	Through negotiation of Chinese and Nigerian government, the hostage were released after 13 days in custody
26th, Mar., 2004	Workers of the Liaohe Oil field road- building company	Two people died
	which belongs to the National Petroleum Group died when constructing in Sudan	

2. The business environment is expecting to be improved

According to a British news report, there are 35 countries that are not suitable to do business in, of which 27 countries are in Africa. It takes 155 days to register a company in Congo and the registration fee equals quintuple of local citizens' income. In Sierra Leone, the tax burden so high as equal to thrice of the company profits. In Angola, it takes 47 procedures and 1000 days to perform a contract.

At the same time, due to the historical reasons, the infrastructure of many African countries is underdeveloped and unable to meet the demand of regular development of enterprises. For example, the incontinent transportation blocks the transportation of raw materials and products for companies; the lack of electric power affects the normal performance of companies, etc.

3. The scattered operation and unfamiliarity of local laws or habits of Chinese enterprises

Currently a considerable amount of Chinese enterprises operate in a decentralized and repeated pattern. They only pursue short-term benefit and increase the market share merely by lowering the prices. The phenomena, to a certain extent, affect the reputation of Chinese products and enterprises. Meanwhile, a small part of Chinese enterprises are not familiar with and therefore not acting in accordance with local laws or regulations when hiring Employees.

4. The fierce competition of African market

Along with the economic revitalization and globalization, Africa, as a continent rich of recourses and huge market potential, attracts the attention of the world. Its market competition becomes increasingly fierce.

5. The complexity of African conditions

There are dozens of countries in Africa and each has different situations, market opportunities and developments. The Chinese enterprises lack a thorough and systematic understanding of each country's politics, economics, society, law and cultural environment. This is a crucial problem that Chinese enterprises face when investing and marketing in Africa.

III. Opportunities of Chinese enterprises investing in Africa

1. From the perspective of global economic development

Since the global economic situation turns better, governments increase their aids to Africa. Meanwhile, the further reduction of African countries' external debt burden accelerates the economic development of Africa and creates good chances for investors.

2. From the perspective of African economic development

International Monetary Fund has recently released a report "World Economic Outlook" and pointed out that during the last 20 years of 20th Century, Africa only attracts billions of U.S. dollars from the whole FDI; however in 2005 the figures goes up to 30 billion U.S. dollars. From the proportion of FDI/GDP, Africa is now the hottest destination of investment. Three aspects show that African macroeconomic policy and business environment have been largely improved:

A. The economy is in the stage of steady growth. In the recent three years, the growth rate remained at around 5%.
B. African countries are jointed and self-reliant. They have high motivation of seeking development. African countries The African countries have formed "Africa Development New Partnership Plan". They adhere to the independent develop, attach importance to the harmonious international community relationship and put it into

practice. They have created beneficial environment for the economic revival of African countries.

C. The level of government management has improved. Most African countries continue to carry on the economic reform, enhance the economic fundamental construction and improve the government management. From the aspect of drawing foreign investment, they have implemented the "one-stop" service and simplify the approval procedures. At the same time, preferential policies which encourage investment are being continually adopted.

3. The positive attitude of Chinese government

There is long-established friendship and cooperation of China and African countries. Since the reforming and opening up, the economic cooperation between China and Africa has been promoted, which can be shown in two aspects:

A. High importance attached to Sino-African relationship.

In 2006 the Chinese government issued "Chinese Policy on Africa Paper" which is the first document thoroughly explaining the policies on Africa since 1949 when PRC was founded. This fully demonstrates that Chinese government cherishes the friendship and hopes to achieve the steady and healthy development of Sino -African economic and trade cooperation through the method of increasing the aid, investing and trading.

B. More supports are given to the enterprises investing in Africa. During the Beijing Summit of Sino -African Cooperation Forum in November 2006, Premier Wen Jiabao announced eight measurement and five suggestions to enhance the cooperation with Africa. Besides the measurements mentioned in the "Chinese Policy on Africa Paper", he also proposed to set up Sino -African development fund with five billion U.S. dollars and provide special fund to set up economic and trade zone. Implanting our countries' experience of establishing development zone to Africa can on one hand accelerate African countries' economic development, on the other hand solve the problem of lacking experience in developing African market.

In order to encourage companies to invest in Africa, Chinese government has launched a series of policies and measurements, e.g., "Regulations on matters of foreign investment approval", "measures on foreign economic and technical cooperation funds management", "Directory of industries in foreign investment", establishing "information platform for overseas investment intentions", "foreign investment projects Information Platform" and "overseas investment intermediary service information platform", and "Obstacle Report Rules on the Investment to Different Countries" and so on. Chinese government has released the control on foreign investment, simplified the procedure, established information platform, promoted the convenience of investment and provided the negotiation system for obstacles and problems aroused from foreign investment. They use the bilateral system to better protect the rights in international market [(5)] .

In March 2009, the Ministry of Commerce issued "Measures for Overseas Investment Management" which systematically make it clear that the government department should have provided a full rage of government service.

(5) Sep. 22th, 2007, “International Commercial Papers” http://www.haet.gov.cn/news/houtal. asp?id=6748

IV. Legal regime of Chinese enterprises' investment in Africa

1. The legal system of foreign exchange

Since the African countries are just beginning to develop economics and the financial systems need to be improved, China launched series of regulation concerning foreign exchange. Chinese enterprises need to pay attention to the following issues when investing in Africa:

(1) Eligible subject.

There are no specific restrictions on the eligible subject. "Overseas investment foreign exchange management measure" defines overseas investment foreign exchange as the companies, enterprises and other institutions (exclude foreign companies, overseas enterprises or with stocks owned by them) conduct manufacture and management (6). "On matters of foreign investment approval requirements to start a business" Article II noted that China support and encourage the advantageous enterprises with all forms invest and set up companies abroad (7). This article should be considered the qualification of subjects. "Interim Management Measures of approving overseas investment projects "states that investment projects must be approved first. Any legal entity (investment subject) in China, and through the controlled companies or organizations, need to be approved when invest in foreign countries (include newly construct, merger and acquisition, hold stocks, increase capital, re-invest). That is to say that the

(6) Art. 2 of "Overseas investment foreign exchange management measure"

(7) "On matters of foreign investment approval requirements to start a business" Article II

qualified subject is legal entity, not including person and households. Therefore, without restrictions do not mean the invested projects are with no restrains. It is the prerequisite to pay attention to investment direction.

(2) Censorship of the source of foreign exchange.

Companies, enterprises or organizations planning to invest in Africa should provide the foreign exchange management department with materials of foreign exchange management situation in targeted countries and certification of income before waiting for the approval. State Foreign Exchange Management Bureau enacted "Notice on simplification of overseas investment exchange funding sources" on Mar. 19 th 2003. The procedure is simplified. First, review is not required with the investment made in kind, aid projects and strategic investment projects approved by the State Council. Second, the original "measure" regulates 30 days to finish the review, but in practice it only takes 20 days. Last, the legitimate examination mainly focused on the form. The examination of overseas investment foreign exchange develops in the direction of convenience [(8)].

(3) Registration of foreign investment.

a. Domestic individual resident invest in Africa.

In situation that individual residence put domestic assets, equity to overseas enterprises and directly or indirectly owns the shares or stocks of overseas enterprises, if the domestic enterprises that were merged (or set up for the purpose of merger) did not register in Foreign Exchange bureau

(8) "on the simplification of foreign investment sources of foreign exchange funds to review issues related to notice"

after Jan 24th 2005, the individuals cannot take other foreign exchange services.

b. Domestic enterprises invest in Africa.

"Notice on Some adjustment of overseas investment on the foreign exchange management policy" enacted by Foreign Exchange Bureau on June 6th 2006 adopts the ranking system. The current law regulates that investors can use owned foreign exchange, RMB, debt. Since July 1 st 2006, the bureau no longer restricts each branches of the bureau the approved overseas investment quota to purchase foreign exchange. After examination, investors submit to the relevant authorities for approval of overseas investment pursuant to certain provisions. Before the formal approval, they can use owned exchange, RMB, or debt as early cost with the authorization of the foreign exchange bureau.

(4) Transferring foreign exchange abroad. This is a key issue on the foreign exchange of overseas investment. It is a must to follow the above first and second procedures. There are three other issues, the first is the margin. According to the current law, when registering the foreign investment, it should deposit 5% as margin. The margin should be put in the special bank account designated by foreign exchange administration department. When the rebate profits accumulate to the transferred foreign exchange, the margin can be returned. The interest of margin follows the national standard. If investors do have practical difficulties, they can hand in a promise in written form to administration department. The margin account ensures the return of foreign exchange and guarantees the security of national foreign exchange. However it adds burdens to the companies, the 5% margin

could have been used as new investment, but it is now deposited in the bank account. The author thinks that this method should be adjusted in order to better use the money. The second issue is the early costs (including performance bonds) because there is very strict restraint of usage. The third issue is the formalities of transferring foreign exchange (9).

2. The legal regime of insurance

Currently there is no specific foreign investment insurance law. The major national laws concerning this field are administrative rules enacted by ministries of the State Council. The international laws are mainly the bilateral agreements and conventions that China signed.

In 2003 and 2004, the State Reform and Development Commission and China Ex-Import Bank issued the credit supporting policy on foreign investment (10) . It is ruled that these two institutions establish the system of foreign investment credit support. In 2005, the State Reform and Development Commission and China Export Credit Insurance Company jointly published "Key projects on the establishment of overseas investment risk protection mechanism for notification of relevant issues" (Foreign Development and Reform Commission [2008] No. 113) to support policy support. In 2006, the State Development Bank and China Export Credit

(9) http://www.661aw.cn/channel/lawarticle/2007-10-07/2650.aspx

(10)"encouraged by the state on key projects for overseas investment credit support to issues related to notice" (Development and Reform Foreign [2003] No. 226), "National Development and Reform Commission of China Import and Export Bank on the state encourages The overseas investment credit support to key projects to give notice of policy" (Development and Reform of foreign capital [2004] No. 2345)

Insurance Company launched "On Further strengthen key projects of foreign financial and insurance support for issues related to notice" (Development Bank [2006] No. 11). However, on one hand, China Export Credit Insurance Company is still in the searching and learning stage; on the other hand, foreign investment protection system is a combination of national laws and international law. It needs legislation backup and an institutional standard system.

In 1998, commissioned by the State Council, export credit department of China People's Insurance Company Property & Casualty Insurance Co., Ltd. opened the foreign investment insurance (political insurance). Any companies set at abroad, with the ex-import management rights and good management situation can apply for this insurance. China set up the first specialized official export credit insurance organization, China Export Credit Insurance Company in December 2001. This company has started the "overseas investment service" one year after. This company which started to operate on Dec. 18 th 2001 is the only insurance organization. It is approved by the State Council with 40 billion Yuan registration capital. The capital source is the risk fund of export credit which is budgeted in the finance of the State Council.

3. The legal system of the Chinese enterprises' stock equity structure

It is a natural trend for Chinese enterprises to invest in Africa. There are opportunities as well as challenges for these companies. Some projects succeed, others failed. In order to avoid risk and increate the benefits, different methods can be chosen:

(1) "Share output" structure.

Chinese side provides the initial credit capital or engineering techniques and management assistance and benefits in the form of yearly output volume or output share promised beforehand. This enables both sides supervise the performance of contract to see whether there is any breach. The Chinese side does not need to think too much about the governance because it does not own any share or hold any stock.

(2) Fixed interest rate credit. This is similar to corporate bond, loans and the above mentioned "share resource". The difference is that the Chinese side receives fixed cash repay.

(3) Corporation Convertible bond. The Chinese side gets either fixed output "share", or fixed cash interest, but it must convert its credits to stock rights after certain years. This structure can ensure each side's supervision to see whether the return has been realized or not.

(4) "Joint-capital without holding stocks". The Chinese enterprises, as minority shareholders and foreign investors would certainly bring the governance problems when holding stocks. The good side is that it is safer to own the property rights than hold the stocks because it would not be taken as attacking target of local government or nationalism, and it can also raise the managers' initiative of governing the company.

(5) "Whole capital checks or holding the whole stocks". The equity is 100% controlled by the Chinese side or the Chinese side is the majority shareholders.

No matter what method the company chooses, it needs to consider the specific situation and promote two parties' common acceptance and mutual benefits.

4. The legal regime of taxes

China has early noted the international usage and avoided double taxation.

In order to promote Chinese enterprises invest in Africa, China has already signed the investment protection agreements with 28 African countries, double taxation avoidance agreements with eight African countries, and is still working on signing agreements with other key countries. Therefore, Chinese enterprises generally can avoid double taxation.

The author suggests the Chinese enterprises consider the following legal issues concerning taxation,

(1) Choose the territories with low taxation burden.

First, they should use the different tax system in different countries and territories to choose the area with light taxation burden. Second, they should take different countries' withholding tax rate in account. Third, they must notice whether the target country has singed any agreement concerning tax with China.

(2) Choose reasonable organizational structure model.

The first is the subsidiary company with independent legal entity. The second is the branch company set up by overseas investment company.

These two models have different taxations. Reasonable choice can bring companies benefit.

(3) Choose preferential capital structure.

Companies' management capital is usually constituted by owned capital and loan capital. The general tax laws in Africa regulate that stock dividend cannot be listed in the expenditure; it can only be assigned in the profits after tax. However the interest payment can be listed in the expenditure and be deduced from the income tax payable. Therefore, the enterprises have to consider the appropriate proportion of owned capital and loan capital to produce more benefit. What's more, the enterprises can choose financing leasing as an importance financing method. This can not only get the capital in need, but also save enterprises' borrowing power. The rent interest can be deduced before income tax, which further decreases the cardinal number of income tax.

5. The legal regime of avoidance of political risks

In order to prepare for the political and legal risks, enterprises need to pay attention to the following points:

A. Select the target market cautiously.

Enterprise should systematically study and evaluate the host country's political, legal and social environment. It is normally contacted through government overseas agencies, embassies, consulates, overseas branches, especially the Chinese enterprises that are already set up in the investment project. Enterprises use all the resources to better understand the situations in host countries and assess the risk index of the country or territory, like the stability of political situation, ethnic conflicts, religious conflict, emotion and power of xenophobia, relation with neighbor countries, diplomacy and folk contact with China, the investment and management activities of Chinese enterprises, etc.

B. Sign the cooperation contract.

Before entering the countries or territories with risks, enterprises should include the security insurance in the contract as a clause of the contract or formal written document.

C. Tender the offer.

Enterprises should fully consider the negative effect and economic losses brought by the security issues and include the security cost when offering.

D. Foreign investment insurance.

The international usage accepts only four basic types of overseas investment insurance: prohibiting foreign exchange insurance, nationalization or requisition insurance, war insurance, interruption of business insurance. The insurance amount is within 90% of the investment amount. Chinese enterprises would gradually insure through international insurance organizations, like the U.S. Overseas Private Investment Corporation, North American Insurance Company, British Exports Credits Guarantee Department, etc. At the same time, they will issue the personal accidental insurance for each worker. Once accidents occur, they have enough capital guarantees. This can reduce the company's burden by immediately solving the medication aiding fee (11).

E. Enhancing the bonding with host countries.

From the form of FDI, China gradually adopt more joint ventures or cooperative management. This will help the host country and China tightly bond together and shoulder the benefits and risks together. Chinese enterprises would gradually raise the stock share of local employees in the company. This can help the local employees find the sense the belonging to the company, attract the host countries' attention and appropriately rely on host country's finance organizations. This will reduce the financing cost, enhance the efficiency and convenience, and constituted alliance with local financial field. What's more, they put the local companies in the priority list when purchasing raw materials and component parts. Although it will raise the cost, it is actually promoting the development of certain industries of the host country and satisfying local government. These measures can bind the local industry with Chinese enterprise to improve the risk resistant ability. Moreover, it can make contributions to local economic development, like undertaking projects which stipulate the economic development but the local country has no ability to finish. This can create more job opportunities for the host country and provide talents training,

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(11) Hexian XU, Some proposal on improving the security conditions of Chinese employees working at oversea construction projects sites, International Economic Cooperation, 2004 (10)

technical supports [12] . Last, it can harmonize with all circles of the society. The Chinese enterprises would attach high importance to blend in local society through public activities and create harmonious, common promoting and developing condition between enterprises and the public [13].

f. Chinese enterprises would know more about the local laws and usages therefore can better deal with relevant matters according to the law.

(12) Xiaohui Yan, Minghua Nie, Analysis on the political risks faced by Chinese enterprises in the overseas markets and selected countermeasures, International Economic Cooperation, 2007(٧)

(13) Hong Chu, Prevention of risks of Chinese Enterprises foreign investment, JOURNAL OF SHENYANG AGRICULTURAL UNIVERSITY (SOCIAL SCIENCES EDITION) ,2006 8(٢)

Epilogue

Chinese enterprises' investment in Africa will be improving based on principle of mutual benefit, win -win policy, lawful operation and joint development. It will expand in the approach of overcoming difficulties, resolving risks and seeking for opportunities. The law will be an important tool of preventing and resolving risks and conflicts, as well as a safeguard maintaining the common interests of both sides.