

# The People's Republic of China: a Key Partner for the Development of Madagascar (Case of Chinese FDI in Madagascar)

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## Abstract

The study employed the use of quantitative (descriptive analysis such as percentage), qualitative (surveys) and case studies. For instance, surveys carried on the amount of assistance given in terms of scholarships offered by China to Madagascar, building and construction of public goods such as hospitals, provided the necessary information used for analysis of the relationship between the two countries. The use of surveys assisted the study to generate firm level data that allowed the analysis of China and Madagascar investment relations with respect to concerns such as the employment effects as well as the competitive and complementary effects of Chinese firms to local firms. The use of content analysis of relevant documents and reports obtained from various sources was equally involved to corroborate the result obtained from the data. The findings reveal that the major characteristic of Chinese investment in Madagascar is its concentration in a few sectors that are of strategic interest to China, especially in the extractive industries which are carried out largely by state owned enterprises or joint ventures. In addition, the analysis clearly shows that the engagement with China, just like any bilateral relationship, has some advantages and disadvantages and that optimal outcome of the engagement will depend on the policies and institutions that are put in place to maximize the complementary effects and to minimize the competing effects. However, there is need to ensure implementation of laws and regulations in Madagascar and to ensure compliance by the Chinese investors. This study was able to establish the sectors where the incoming FDI from China is directed and the extent at which Chinese FDI is bundled with inflows of aid. The study was also able to show that the incoming Chinese FDI is in resource seeking, and the output targeted at the external market. The study will be of value to academia and to policy makers who are interested in studying the China Africa relationship.

**Keywords:** China, Madagascar, International investment, GDP, FDI

## 1. Introduction

The growing relationship between China and Madagascar is induced by the fact that the two countries have economic complementarities. On one hand, a major development challenge in Madagascar is infrastructure deficiency, with huge investment need. Complementarily, China has developed one of the world's largest and most competitive construction industries with particular expertise in the civil works critical for infrastructure development coupled with its ability to provide the necessary financial assistance to the countries in need including Madagascar. On the other hand, China's industrialization drive and massive inflow of foreign direct investment (FDI) into the country led to fast growing manufacturing economy which requires raw materials such as oil and mineral inputs, hence the need to source them from abroad including Madagascar which is well endowed with these resources.

Positive developments have been recorded in respect of the increasing amounts of imports from China to Madagascar and the investment of Chinese companies, such as in the SOALALA oil company which is the largest company in Madagascar with an investment of USD 2 000 000 000 in oil and steel resources. It further reinforces the prevalence of a link between Chinese FDI and trade in the context of China- Madagascar investment relations. In Madagascar, like in some other African countries, three related factors explain the observed positive developments in Chinese FDI flows. There are in FDI regime, such as tax rate to the investor; privatization program of the government and the aggressive drive of government in attracting FDI into the country. Since FDI constitutes a key channel through which impacts of China's economic growth can be transmitted to the typical African economy, therefore for existing and future FDI inflow from China to be beneficial to Madagascar and China, the following issues in form of questions become pertinent for research.

In what sectors is incoming FDI from China directed? To what extent is Chinese FDI bundled with inflows of aid? Do the funds represent a change in ownership? Are all Chinese investment flows inward to Madagascar? These questions constitute the main research issue of this study.

## 2. Sectors of incoming FDI from China:

First, a flow analysis will provide the investment relationship trend between China and Madagascar in the private

sector. Then, an analysis of stocks by industry activities will provide clarification on the preferred activities by Chinese investors and the Chinese presence in the economy.

Table 1: Chinese FDI flow trend in Madagascar from 2003 to 2008.<sup>1</sup>

Years	2003	2004	2005	2006	2007	2008
Chinese (in millions of USD)	-1,66	16,24	2,59	2,89	2,56	-1,85
China's share (%total FDI)	-1,69	17,11	3,25	0,98	0,33	-0,16

From 2003 to 2008, FDI from China amounted to around USD 20 million (cumulative period) in total. After a record peak in 2004, the average was 1.6 million USD over the last 4 years (2005 to 2008). The year 2008 has even been a disinvestment of - 1.85 million. The situation observed in 2008 can be explained, on one hand, by the repayment of loans made by Chinese companies in Madagascar to their shareholders, and on the other hand by the poor performance in the year 2007<sup>2</sup>.

This disinvestment was recorded mainly in the financial activities sector. Indeed, its FDI stock has experienced a fall of -67% between 2007 and 2008. This is mostly due to poor results in 2007 which led to a decline in corporate capital. The table below shows China's interest in the private sector in Madagascar<sup>3</sup>.

Table 2: Structure of Chinese FDI Stock by sector of activity

	2007		2008	
	Value 10 <sup>3</sup> USD	%	Value 10 <sup>3</sup> USD	%
Agriculture	0,00	0,00	2,66	0,00
Mining	0,00	0,00	8,85	0,01
Manufacturing	27079,84	43,39	27153,54	44,76
Construction public works	20188,78	32,35	18952,36	31,24
Trade	73,22	0,12	345,93	0,57
Transport	7,78	0,01	7,73	0,01
Banking	1702,49	2,73	553,63	0,91
Housing & service provision enterprises	10,57	0,02	276,04	0,46
Telecommunication	13349,18	21,39	13362,71	22,03
Total	62411,85	100,00	60663,46	100,00

Source: INSTAT Madagascar

The table above indicates that the main beneficiaries of FDI from China are in the manufacturing activities, Building Construction and Public Works and Telecommunication.

Compared to the overall FDI stock, the China's weight is 45% in manufacturing sector 14% in construction and Public Works and 13% in telecommunication. Therefore, the contribution of Chinese FDI financing in these industries is not negligible.

Similar to China's policy which is implemented by the central government, these 3 branches represent the priority areas of the China's FDI in Africa. In fact, China's FDI<sup>4</sup> in Africa mainly focuses on manufacturing, mining, construction and service provision sectors. Moreover, China's central government encourages investment of Chinese firms with expertise in industries, agriculture, natural resources and infrastructure.

However, in terms of actual business, the trade industry has the highest number which is 65% of the total. However, FDI stock from China represents only 0.5% of the total. The ownership to a group of companies is very low for Chinese companies operating in this industry.

### 3. FDI and ODA

#### 3.1. Chinese Project, Construction and aid in Madagascar:

Recently, the Prime Minister of Madagascar met shareholders representatives of Guangxin Soalala Mining Project in Madagascar to review the progress of the project as well as advancing the agreement.<sup>5</sup>

This Project is China's largest investment project in Madagascar. The launch of soalala project is to provide a significant raw material site for the industrial development in Madagascar. Hopefully, it will end Madagascar's non-steel history. Soalala project helps in building the local infrastructure including roadway, port, and power

<sup>1</sup> Impact of Investment relations between China and Madagascar/AERC Team/2009

<sup>2</sup> BCM annual report, chambre de commerce de Madagascar 2007

<sup>3</sup> INSTAT, authors analysis

<sup>4</sup> Les échanges entre la Chine et l'Afrique: situation actuelle, perspective et sources pour l'analyse, SATECO N0-100, Paris, France 2006

<sup>5</sup> chinadaily.com.cn/bizchina/2010-05/25/content-9888548.htm; https://ejatlas.org/conflict/wisco-soalala-iron-ore-madagascar

plant construction in northwest Madagascar. The project is not only a vital part of the economic corporation between China-Madagascar, but also a bridge for the social and cultural communication between the people from the two countries. More so, China's one belt one road policy catalyses the pushing forward of the project and emphasizes on Madagascar's social responsibility, respecting the interests of all stakeholders, establishment of local public facilities and services such as education, road construction, medical treatment and public health. All in all, Guangxin's *soalala* spares no effort to improving social condition, relieving poverty, creating jobs, promoting the local development in education and health field.

The *Soalala* project in Madagascar, developed by WISCO, Wuhan Iron and Steel Co, a Chinese Company, commenced in April 1<sup>st</sup>, 2011 with China investing a total of 2 billion US dollars. The project covers an area of 43,000 hectares and the contract is to last 30 years.

Beside, China-Africa cooperation is based on four principles outlined in the 461 Framework for the China-Africa strategic partnership. The four principles are: First, treat each other with full sincerity and as complete equals; second, enhance solidarity and mutual trust; third, jointly pursue inclusive development; fourth, innovate on practical cooperation. This cooperation, which also applies to Madagascar and covers areas<sup>1</sup> such as industrial cooperation projects, financial cooperation projects, poverty reduction projects and ecological and environmental protection projects.

This is a beneficial cooperation for Madagascar, especially when we know that China is now up to the forefront of the global economy.

With China's recent economic advancement and taking a leading role in the global economy, Madagascar has also benefitted in terms of development aid given in form of scholarships which translates to higher investment in human resources. China has provided over 350 scholarships to Malagasy over the last 40 years and trained 860 officials, journalists and teachers. In addition, since 1975, China has sent Chinese medical teams to provide medical care to the people of Madagascar.<sup>2</sup>

Cultural cooperation through the Confucius Institute is not left behind. Since 2009, the Confucius Institute opened in the University of Antananarivo and in the other two provinces of the Big Islands of Madagascar, Fianarantsoa and Toamasina. This strategic pillar of Chinese soft power aims to spread Chinese culture around the world and offers an interpreter base from incoming investors wishing to invest in Madagascar.

The opening of direct flights between Antananarivo, capital of Madagascar and Guangzhou are symbols of a diplomatic relationship and close cooperation between the two countries.

More so, China, through the Chinese Society *Societe Sino-malgache des Travaux Publics (SMATP)*<sup>3</sup>, has been involved in rebuilding the national road number 2, linking Antananarivo and Toamasina, the reconstruction of hospitals and the renovation of Mahamasina Stadium and Palace Sports and Culture in the capital of Madagascar.

As recently as August 17, 2015<sup>4</sup>, Mr. President Lu Shan stated that based on the long-term economic cooperation between the two countries, Chinese companies have gained the trust of the government of Madagascar. Thus, China will continue to support the infrastructure construction of Madagascar and intensify their efforts to develop Madagascar.

For the Madagascar Capital Airport Road Project in whose construction CRBC (China Road and Bridge Corporation) participated, because this project was short in construction period and heavy in task, CRBC would organize and mobilize the advantageous resources to complete it efficiently with high quality and ensure the successful holding of the 16th Sommet de la Francophonie (the 16th Summit of Francophone Countries).

Madagascar is very willing to carry out long-term cooperation with the internationally known contractors like CRBC and believed that CRBC has the strength and ability to complete the Airport Road Project. Besides, the President of Madagascar spoke highly of CRBC's contributions to the economic development of Madagascar and hoped that CRBC could participate more in state building and promote the further development of China-Madagascar relations. On the economic and commercial level, China is the fifth largest export partner in Madagascar while it is the first partner of Madagascar import run.

Similarly, China has encouraged a rebalancing of the trade balance with Madagascar in May 2010 giving a 0% tariff treatment for products exported to China.

At times, 95% of products from Madagascar benefit from the exemption from China's tariff treatment.

<sup>1</sup> \*VELONTRASINA PRUDENCE MARIE ZITA, *master s thesis, Relation Commerciale entre la Chine et Madagascar, University of Toamasina, Madagascar, 2010*

<sup>2</sup> \*VELONTRASINA PRUDENCE MARIE ZITA, *Master's thesis, Relation Commerciale entre la Chine et Madagascar P:81, University of Toamasina, Madagascar, 2010*

<sup>3</sup> *Bureau de conseiller economique et commercial de l'Ambassade de Chine a Madagascar/ Avril 2010*

<sup>4</sup> <http://www.crbc.com/site/crbcEN/companyNews/info/2015/2991.html>

### 3.2. Number of Chinese-owned companies in Madagascar<sup>1</sup>:

Sector	Staff	% belonging to a group
Agriculture	1	100,0
Mining	1	100,0
Manufacturing	13	61,5
Construction and public works	4	25,0
Trade	51	9,8
Transport	2	0,0
Banking	1	100,0
Housing and service to enterprises	4	0,0
Telecommunication	1	100,0
Total	78	23,1

After the trade sector, manufacturing activities comes in second position. Majority of them are a subsidiary of foreign companies.

In terms of Chinese investment size, the telecommunication company has an FDI of 14 millions USD. Similarly, there are investments in the construction and public work sectors where a company receives an average of 4 millions USD in FDI stock. An enterprise from the manufacturing sector comes in third position. The position occupied by these first two sectors can be explained particularly by the existence of large sized FDI enterprises. The above table shows the character of these sectors in terms of workforce.

### 3.3. Inward FDI in Madagascar:

FDI inflows in Madagascar have strongly declined as an effect of the global crisis and especially due to the major political crisis<sup>2</sup> that the country experienced in 2009-2013, which has placed the country into a great diplomatic isolation. Despite the election of the new and current president, the political situation remains uncertain. Madagascar has a tremendous natural potential, but the poor-quality and costly infrastructure (roads, electricity, telecommunications, ports and air freight), its limited access to credit and financial instruments as well as the poor definition of its property titles are all barriers to investment. Political instability has become another major barrier, which has blocked all public investment and provoked the departure of many investors. Nevertheless, the situation seems to show some improvement, which will lead to a gradual return of investments, as evidenced by the resumption of the exploration of Malagasy subsoil and ocean floors, which are rich<sup>3</sup> in oil, gold, chromium and uranium. The Canadian company sherrit has launched an exploitation project for nickel and cobalt, at an estimated cost of more than EUR 4 billion. New oil fields in Tsimororo, have also been opened since 2014. The French company Rhodia is planning to invest in the exploitation of rare soils in the northwest of Madagascar.

### FDI Inward and Stock<sup>4</sup>:

FDI	2012	2013	2014
FDI inward flow (million USD)	812	567	351
FDI stock ( million USD)	5650.1	6377.8	6277.3
Number of Greenfield Investments	8.0	5.0	6.0
FDI inwards (in % of GFCF)	46.6	33.5	21.8
FDI stock ( in % of GDP)	57.0	60.1	59.2

Source: UNCTAD-2014

With regard to the Chinese investment in Madagascar, it is important to point out the various characteristics that can shade light on not only understanding the motivation of Chinese investors but also the potential impacts<sup>5</sup> both negative and positive, of these investments have in the economy. One of the crucial issues is the ownership of these Chinese investment companies by multinational groups. In fact, the penetration of the latter in the economic environment of the country is one of the conditions that foster transfer of technology. In addition, there is the issue of the type of investment chosen by investors.

The distribution of companies by activity sector shows one of the specificities of Chinese investment in

<sup>1</sup> BCM/INSTAT, authors calculations

<sup>2</sup> African Economic outlook 2012/ P:11

<sup>3</sup> Qit Madagascar Minerals, Rio Tinto, Ambatovy and Kraoma SA

<sup>4</sup> UNCTAD-2014

<sup>5</sup> The contribution of Chinese FDI to Africa's growth, July 2013 John Whalley and Aaron Weisbrod

Madagascar. In fact, contrary to the distribution FDI stock, the trade sector represents 65%<sup>1</sup> of Chinese FDI companies. This phenomenon shows the existence of numerous small scale investors in this sector and who subsequently encourage the migration of Chinese into Madagascar and a flooding of Chinese products cheaper than the local product (Maximum de Pareto)<sup>2</sup>. Moreover, Chinese investments in the companies, where there is local involvement, only represent 30% of the Chinese FDI stock. The locals are therefore rarely included in large Chinese investments.

Out of the Chinese FDI in Madagascar, there is some employment creation. For example, permanent employment for more than one year in 2006, Chinese companies have employed 6 041 people. Over 90% of these jobs are from the subsidiary companies.

#### 4. Discussion and analysis

China's activities throughout Africa will continue to expand in tandem with the rise of growing pains. In some ways, Madagascar's experience is similar to that facing many African nations. Given the country's extensive reserves of iron, oil, and hardwoods, and other whole- sale and retail opportunities, the Chinese presence in the nation will probably continue to increase exponentially. Chinese trade opportunities and FDI will help expand Madagascar's economy and some Malagasy "boats" will float with the tide. This appears to be true in dozens of other African nations as well. It is to be expected that frictions will arise. While there are more Chinese, new and old, livings in larger nations such as South Africa or else, few of the countries in Africa have the special relationship that Madagascar has with China, and has had for nearly one and a half centuries. And this is what makes the recent turn of events so unfortunate. Many long- terms ethnic Chinese-Malagasy<sup>3</sup> citizens served their nation well even before independence, and this group is often caught in the "crossfire" as anti-Chinese sentiment boils over into street demonstrations and occasional violence. The Malagasy government should appreciate the complexity of the current situation and work to diffuse anti-Chinese sentiments, rather than rely on anti-foreign sentiment to divert attention from other government failings. China's government also must play important roles in prosecuting illegal activities and ensuring fair and ethical business practices among Chinese-owned businesses, while continuing to promote tolerance and understanding and make inroads in public sentiment by expanding cultural and humanitarian exchanges. As the Malagasy proverb reminds us: "All who live under the sky are woven together like one big mat."

#### 5. Conclusion:

The largest Chinese project Soalala, helps in building of the local infrastructure including roadway, port, and power plant construction in northwest Madagascar. It is not only a vital part of the economic corporation between China-Madagascar, and also a bridge for the social and cultural communication between the people from the two countries (one belt one road policy). On the economic and commercial level, China is the fifth largest export partner in Madagascar while it is the first partner of Madagascar import run.

Out of the Chinese FDI in Madagascar, there is some employment creation. For example, permanent employment for more than one year in 2006, Chinese companies have employed 6 041 people. Over 90% of these jobs are from the subsidiary companies. In terms of Chinese investment size, the telecommunication company has an FDI of 14 millions USD. Then there is the investment sector of construction and public work where a company receives an average of 4 millions USD in FDI stock.

China is the main partner of Madagascar in relation to trade. The appearance of trade with neighboring countries has much influence on the positive or negative taken by the trade balance of Madagascar regarding the bilateral trade.

Despite the persistence of the balance of trade deficit with china, trade between the two countries has their positive sides to regarding the Malagasy economy. Socio-Economic opportunities arising from this relationship. Moreover, the participation of a country in international trade creates several advantages for it.

The following policy implications lessons for the future China Madagascar economic relations are proposed. Attempts to compromise the benefits of FDI should be persistently resisted by the Madagascar government through active government engagement and negotiation with the Chinese government and economic operators. Good governance and macroeconomic environment in the country should be ensured so as to promote productivity and sustainability of investment. A country desirous of hosting FDI or tourist must well secure the political stability and social environment; and of necessity institute policies aimed at maximizing the direct and indirect benefits as well as in minimizing the possible negative impacts.

<sup>1</sup> BCM/INSTAT, authors analysis

<sup>2</sup> Lexique d Economie, 9<sup>e</sup> edition, P:548, DALLOZ

<sup>3</sup> [https://en.wikipedia.org/wiki/Chinese\\_people\\_in\\_Madagascar](https://en.wikipedia.org/wiki/Chinese_people_in_Madagascar)



For a country to attract efficiency-seeking type of FDI macroeconomic stability must be ensured and distinct, predictable and easy to access policy environment including incentives must be instituted. There is also need to ensure implementation of laws and regulations in Madagascar and to ensure compliance by the Chinese investors. Such laws include labor law, social responsibility law and local content requirement. Madagascar labor congress and its counterpart in the private sector should ensure the observation of Madagascar labor law all firms including the Chinese owned firms. Similarly, the raw material development council should see the compliance of the local content requirement in terms of human and physical materials by all firms especially the foreign ones. The relevant organization such as BIANCO and ministry of labor and so on should ensure compliance with the social responsibility law in Madagascar.

In terms of touristic department, Madagascar needs to encourage, improve and cure its organization related to tourist zone; ensure the social and political environment stability. Also, the local country needs to invest the inflow of resources from the commodity booms in improving investment climate, developing human resource necessary to support investment in new industries and establish development banks necessary to provide financial support to nascent private investors. One of the specific point for China towards Madagascar is few of the countries in Africa have the special relationship that Madagascar has with China, many long- terms ethnic Chinese-Malagasy citizens served their nation well even before independence, and this group is often caught in the “crossfire” as anti-Chinese sentiment boils over into street demonstrations and occasional violence

To this end, there must be good and transparent governance while implementing these initiatives in order to ensure that, the desired outcomes are realized. Successful implementation of these initiatives under good governance will create necessary conditions for Chinese FDI and activities to have significant backward and forward linkages in Madagascar economy for development.

The analysis clearly shows that the engagement with China just like any bilateral relationship has some advantages and disadvantages and that optimal outcome of the engagement will depend on the policies and institutions that are put in place to maximize the competing effects. The study shows that China in virtually everywhere in the local country but information are fragmented about engagement and activities economic. This is manifested the more in government, ministries, agencies and departments. Therefore, we need to establish a coordinating body on China.

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