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Over the years, China's ambivalent relationship toward Afghanistan has recently begun to change as the prospects of an Afghan stabilized security situation begin to emerge, and the Chinese view is that the momentum is on the side of the Coalition. For an indication of their prognosis of Afghanistan's future, one need only follow where the money is being bet, and the Chinese are betting on success. This growing interest and confidence in our abilities to bring the country under government control, destroy, marginalize or reconcile "spoilers" and bring about structural change in Afghanistan is particularly manifested in China's recent $3.5 billion investment in the Aynak Copper field in Logar province. This is the single largest foreign direct investment in Afghan history and portends to be just the beginning of a systematic and deliberate program to engage the Afghans economically and exploit the vast natural resource wealth of the country. China Metallurgical Group, the company that won the bid is now, for example, also engaged in bidding for the rights to develop iron-ore deposits at Hajigak in the central province of Bamiyan, west of Kabul.

With this deal to extract the enormously rich copper reserves in Aynak, and build the huge infrastructure necessary to do so (apparently even promising to build mosques), Beijing has, in a "single move," strengthened its hold on a vital resource, engineered the single largest investment in Afghan history, promised to create thousands of new Afghan jobs, and established itself as the Afghan government's preeminent business partner and single largest source of tax payments.

And, of course, the commercial and geopolitical benefits of this win-win win-win all accrue to China thanks to the (relative) security offered by the U.S. military. All in all, the project is billed as an example of how China's leaders, flush with money and in control of both the government and major industries, meld strategy, business, and statecraft into a seamless whole.[1]

Critics naturally assert that China is "free-riding" on the extensive stabilization efforts of the United States and the Coalition. While there may be truth in this statement, isn't the establishment of long-term, sustainable economic projects that produce jobs for Afghans, revenues for the central government and enduring municipal infrastructures consistent with our overall goal of Afghan stability?

Background.

China how has now emerged as the second largest exporter to Afghanistan, after Pakistan, with two-way trade totaling in excess of $155MM in 2008. China has taken a renewed interest in both investment as well as development, and Chinese companies are making inroads. The Chinese company ZTE and Huawei partnered with the Afghan Communications Ministry to implement digital telephone switches, providing roughly 200,000 subscriber lines. It has also taken part in the Parwan irrigation project, restoring water supply in Parwan, as well as the reconstruction of the public hospitals in Kabul and Kandahar.[2] The Chinese have also been hired by the European Union (EU) for various construction projects in Afghanistan, including road restoration. President Karzai has been keen to advance ties with China, even stating recently that he would like to have "America's democracy and China's economic success." His government is currently in the process of reviewing current legal statutes as they relate to private industry and more specifically to resource privatization. The development of commercial statutes, the reformation of private property laws, along with the attendant institutions to govern a developing economy all need to become a national priority quickly if the Afghan government wishes to attract a broader group of interested investors.

Aynak Copper Mine Deal.

The most notable project, and first among more that are sure to follow, is the Aynak Copper Mine deal which represents the world's largest untapped copper deposit estimated to be worth up to $88B which is more than double Afghanistan's gross domestic product (GDP). The Chinese consortium Metallurgical Group purchased a 30-year lease for approximately $3.5B, which makes this the largest direct foreign investment in Afghan history. To put this in perspective, this amount is equal to 20 percent of all foreign aid to the country since 2001, and the annual royalties alone from mining operations will represent 45 percent of the Afghan national budget just in this one project. In terms of local development, the Chinese have committed to building a 400 megawatt plant to support the mine, as well as Kabul, and water development and purification, all of which will be available to the local population. The Company, also known as M.C.C., will dig a new coal mine to feed the plant's generators. It will build a smelter to refine copper ore, and a railroad to carry coal to the power plant and copper back to China. If the terms of its contract are to be believed, M.C.C. will also build schools, roads, even mosques for the Afghans. Indeed, the cost of building so many infrastructures in a volatile security environment like Afghanistan is prohibitive for many private firms. But the price tag is tolerable for the Chinese state firm because the project contributes to Beijing's plans for the development of western China and its regional trade links, which is part of a broader strategic outlook.

With new geological studies revealing other potentially lucrative mineral fields across Afghanistan, the Aynak deal is seen by other would-be foreign investors as a litmus test, giving clues to how Afghanistan deals with international investors, on its level of corruption, and if security can be provided for such high-profile, foreign-funded projects. China is certainly well-positioned to help develop Afghanistan's infrastructure.

Early estimates indicate that 5,000 people will be directly employed in mining and mining support operations, 90 percent of whom will be Afghans. Approximately 15,000-20,000 people will be indirectly employed in run-off industries that indirectly support mining operations such as life support, logistics, and marketing goods to the population. To really put this into further perspective, I think it is interesting to add that based on Afghanistan's patrilineal kinship-based societal structure that the income produced by these jobs can be multiplied by a factor of at least 10, in which 10 nonemployed family members will directly benefit from this economic activity, or in other words, 200,000 Afghans could be positively affected. Once again, this is just one project in one province. However, the critics argue that the Coalition Forces (read U.S.) are providing the enabling environment for Chinese investment activities. In shorthand, the Coalition is spilling blood and treasure, and the Chinese are making the money. It is true that the Afghan National Police (ANP), which does protect the mine, was largely built and trained with American money. The 1,500 guards the police have posted in and around Aynak are special recruits not drawn from the main force. While they are part of the ANP, they are off-tashkeel and paid for directly by the private company. The model of the Afghan Public Protection Force (APPF) protecting both key infrastructure as well as private industry, in lieu of a well regulated, prosperous private security industry, may portend future risks for the government and should be reconsidered and clearly is the subject of another paper.

While the security outcome in Afghanistan is far from assured and the Chinese are admittedly taking sizable risks, the conclusion is inescapable: American troops have helped make Afghanistan safe for Chinese investment, and there is no sense that either government objects to that reality. As diplomats and soldiers alike stress, the war in Afghanistan was never motivated by commercial prospects. Had an American company won Aynak, some Afghans noted, critics inevitably would have accused the United States of waging war to seize the country's mineral wealth. Moreover, if China succeeds in developing Aynak and generating revenue for the Kabul government, that helps achieve an American goal.[3]

In their quest for natural resources, the Chinese have been unusually inventive and indeed bold in undertaking the projects that they have. Increasingly, the world's richest remaining mineral deposits are in hostile territory, malarial jungles, combat zones, and in unstable nations that possess mineral riches, but there is no realistic way to get them to market. With government money and backing behind them, China's state-run giants take risks in places that even the largest private multinationals will not accept, and they can add incentives from railroads to mosques that ordinary mining firms are ill-equipped to provide. "The Chinese have sort of raised the bar. They've taken it beyond the scope of just an extractive operation," a Western official said. "The Chinese are willing to step up and take a long-term strategic approach. If it takes 5 or 10 years, at least they have a beachhead."[4]

Another criticism from Western businesses is that the tender was unfair and marked with fraud and corruption. Foreign experts who closely monitored the bidding process say that the possibility of bribery in Afghanistan, one of the world's most corrupt nations, can hardly be ruled out. But they also say that the Chinese bid was so clearly superior to others that any bribe money may have been incidental to the outcome. Nicklas Norling, an analyst with the Central Asia Caucasus Institute, put it this way: "The Chinese are not doing this illegally. They have a contract with the Afghan government. They benefit, of course, but we do, too. We don't have the skills or the companies or the expertise to develop a project like this."[5]

Chinese Direct Investment Model in Africa.

To possibly forecast the effect that billions of investment dollars can have in societies that are emerging from decades of intrastate conflict and pervasive poverty, a brief examination of the Chinese investment experience in Africa may be instructive. For the past decade, the Chinese economy has been expanding at a nearly double-digit annual growth rate. This rapid expansion requires enormous resources, especially energy. Over the past decade and a half, the Chinese have aggressively pursued opportunities across the African continent, from oil production in Angola and the Sudan, to copper mining in Zambia, forestry in Mozambique, and building roads and railways in the Democratic Republic of Congo (DRC).

In addition to the economic and financial comparative advantages that the Chinese enjoy over Western competitors, the Chinese engage a social and political narrative that resonates on the continent. To begin with, the Chinese government presents itself as a noncolonial power, which has itself been the victim of colonialism at the end of the 19th and the beginning of the 20th centuries. The following two key elements frame their investment strategy:

1. China tries to gain political influence, playing the card of being itself a successful developing country.
2. China can provide an alternative development model, which puts stability as more important than democracy; in fact, they adhere to the official policy of noninterference in internal matters.

The first element is certainly true on its face, and the second element, while appealing to African government, is a source of criticism by the West. China, for example, is blamed for turning a blind eye regarding the humanitarian crisis in Darfur, while it executes oil deals with the Sudanese who now supply nearly 7 percent of Chinese oil imports.

Chinese Deputy Foreign Minister Zhou Wenzhong's comments in a recent interview demonstrate China's utter lack of concern for political volatility in Africa: "Business is business. We try to separate politics from business. Secondly, I think the internal situation in the Sudan is an internal affair, and we are not in a position to impose upon them."[6]

This ″hands off″ attitude is particularly attractive to developing nations that grow weary of what they perceive to be finger wagging, sermonizing Western nations that hold developmental aid hostage to political and social reform efforts. Moreover, the Chinese government has actively advocated a Chinese-style economic development model to African countries based on a restricted market system constrained by the over-arching priority of maintaining a single-party, totalitarian government. Many authoritarian African regimes, desperate to invigorate their fraying economies while maintaining a strong grip on political power, seem to find the Chinese economic development and reform model preferable to the free-market and representative-government policies promoted by the United States and the EU.

Last November, in the Egyptian resort town of Sharm el Sheikh, Chinese Premier Wen Jiaboa announced a series of new pledges for Chinese assistance to African countries and in the process made many observers in the West very uneasy. Westerners think they know what Africa needs to do in order to develop: liberalize markets, get pricing right, and promote democracy. And they think they know what China is doing there: offering huge no-strings-attached aid packages to resource-rich countries that prop up pariah regimes.[7]

However, to be fair to the Chinese, their investments can be considered in a different context. They themselves have managed to move hundreds of millions of their own people out of poverty over the last 30 years by a hybrid form of capitalism based on state intervention and incentives that attract private capital. In Africa, they have mixed a "hard-nosed but clear-eyed self-interest with the lessons of its own successful development."[8] This is in stark contrast to decades of failed aid projects undertaken by the West.

China's first level of engagement is to offer governments resource-backed development loans. This is inspired by its experience at home. In the late 1970s, the Chinese understood that it required modern technology and infrastructure but had no foreign currency reserves by which to obtain them. China leveraged its ample natural resources of oil, coal, and other minerals to obtain resource-backed loans from the Japanese. In other words, China repaid its loans from Japan with shipments of oil and coal. In 1980, Japan financed six major railway, port, and hydroelectric projects which helped to build China's transportation corridors and power grids. China has applied this model forward and concluded deals in at least seven resource-rich countries in Africa for a total of nearly $14 Billion. Reconstruction in post-war Angola, for example, has been helped by three oil-backed loans from Beijing under which Chinese companies have built road, railways, hospitals, schools, and water systems. Similarly, Nigeria took two loans to finance projects to generate electricity. The Chinese are also building a hydropower plant in the DRC to be repaid in oil, and another in Ghana which will be repaid in cocoa beans.[9]

These resource backed infrastructure loans actually have the positive result of acting as an ″agency of restraint″ by ensuring that some of the country's natural resource wealth will be spent on development projects and the delivery of government services rather than ending up in the Swiss and Dubai bank accounts of its leaders. One point of significant comparative advantage that Chinese firms can leverage is the power of the China Export-Import Bank. They can offer loans often at market or even below market rates, which do not qualify as aid as such but can help development.

Thanks to its trillions in foreign exchange reserves, China can offer loans at highly competitive interest rates. For instance, EximBank gave the Angolan government three loans at rates from LIBOR (the London Interbank Offered Rate, the rate banks charge each other on loans), plus 1.25 percent to LIBOR, plus 1.75, as well as generous grace periods and long repayment terms. Commercial lenders, such as Standard Chartered Bank have charged Angola LIBOR, plus 2.5, and more without grace periods and faster repayment terms.[10]

The Chinese loan terms are often better than deals from the West. As President Joseph Kabila has pointed out, a $3 billion joint mining venture in the DRC gives his government a 32 percent share compared to the 7-25 percent typical of Western mining deals. Former Angolan Finance Minster Jose Pedro de Morais has said that by setting "a new benchmark," a $2 billion loan from China EximBank in 2004 helped Angola negotiate terms for other commercial loans. It is clear that even the mere presence of Chinese commercial interests have a tendency to reduce the "risk premiums" on loan facilities ordinarily exacted by Western financial institutions.

Far from the characterization of African countries being exploited for their natural resources and as being essentially powerless in these transactions, African states have aggressively negotiated to protect their interests ensuring maximum benefit to their populations. African states have been driving harder and better informed bargains. For example, Angola requires Chinese companies to subcontract 30 percent of the work to local firms and has insisted that they solicit at least three bids for every project they plan to undertake. The DRC will receive a $3 billion copper-backed loan from Beijing which will help finance railways, road, hospitals, and universities. The Congolese government has also stipulated that no more than 20 percent of the construction workers involved can be Chinese, and that at least one-half of 1 percent of the costs of each project must be spent on worker training.

The undertaking in the construction of African infrastructure is enormous, and large-size self-financing projects seem to be the answer. The Chinese are taking a macro-level investment and development approach on a scale that is needed in countries that lack modern infrastructure. While we use the misnomer of "reconstruction," which implies that something functional may have existed, the Chinese rightly take the view of "construction" which is to create infrastructure, systems, and processes within states where heretofore none have existed. This developmental model is surely applicable to Afghanistan where modern infrastructure has never really existed.

While the West supports microfinance schemes for the poor in Africa, China has set up a $5 billion equity fund to foster investment there. The West advocates trade liberalization to open African Markets; China constructs special economic zones again on a macro scale to encourage investment. Westerners support government and democracy; the Chinese build roads and dams. "By doing this, China may in fact be supporting dictatorial or corrupt regimes, and this is an inconvenient truth, the West also supports such regimes when it advances its interests."[11] Given the limits of the West's success in promoting development in Africa so far, perhaps Westerners should be less judgmental and more open-minded in considering the application of the Chinese model both in Africa but more directly here in Afghanistan.

Lessons for Afghanistan.

How much of the $3.5 billion of the Aynak deal will go into paying and training Afghan workers and buying goods from Afghan subcontractors, and thereby help to stimulate the Afghan economy directly, is anyone's guess. This is the fundamental question that I hope both the Chinese and the Afghan government get right. I don't think the United States should be overly concerned about Beijing's efforts to form positive political and economic relationships with Afghanistan. We would do well to remember that Chinese are also affected by Afghan instability particularly as it manifests in the illegal drug trade which makes its way into their more affluent provinces, as well as Islamic extremism which has also has begun to infect their minority Muslim populations in Xinjiang. Perhaps at this point, there may well be a confluence of positive intentions among the Afghans, the Coalition Forces, the Peoples Republic and regional neighbors. All would essentially benefit from a stable Afghanistan in the long run. The improvement of the security situation in Afghanistan must be matched with parallel and concurrent efforts to develop a long-term sustainable economy capable of lifting the economic condition of the ordinary citizen, fostering normalized trade relations with its neighbors while providing the needed income streams for the central government. It is only in these large-scale development undertakings that the concomitant economic spin-offs can bring about these outcomes. Nongovernmental organization projects, provisional reconstruction team activities, and donor funded and assisted projects while nominally helpful merely help around the edges of the long-term existential problem of developing Afghanistan.

It makes sense to let the Chinese take risks and do "the heavy lifting" with regard to initiating these projects, but the United States should have a part to play by providing geological and mining experts to the Afghan government to help them knowledgeably and skillfully negotiate these deals. Chinese investment can provide the large-scale long-term piece and stability to add to the shorter and intermediate stabilization efforts that the coalition now provides, which in time will end.

It was best summed up by one Western government official in reference to the Aynak project when he said "To the extent that the Chinese bring Afghanistan up to speed and start paying a billion dollars a year in royalties that would mean that Afghanistan is on a firmer ground to start paying for its own security."

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