

Impacts and Challenges of a Growing Relationship between China and Sub Saharan Africa

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To be published in V. Padayachee (ed.), “The Political Economy of Africa”, London:
Routledge (2010 forthcoming)

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1. Introduction

The existing literature is clear that China is impacting on Sub Saharan Africa (SSA). What is not clear is the precise nature of that impact. Does it come mainly from trade in cheap manufactured goods? Does it come from China's seemingly insatiable hunger for oil and minerals? What countries benefit and in what sectors? What role do Chinese companies operating in Africa play? How beneficial is Chinese aid and/or international cooperation? Who is losing out, and why?

Most of the literature focuses on trade but other interactions also generate positive or negative impacts. Of the many possibilities, we have identified foreign direct investment, production, and aid as potential channels of impact. In the following pages, we attempt first to take stock of our knowledge. We do by subjecting the most common forms of interaction between China and SSA to a comprehensive and detailed analysis using a systematic framework. We then use this analysis to identify the gaps in our knowledge and suggest ways of bridging them. The paper uses secondary data from a number of sources, including the International Monetary Fund, the World Bank, the US Department of Commerce, as well as published materials and relevant websites.

China's relations with Africa in the modern era have passed through three distinct phases. The first phase followed the Bandung Conference of Non-Aligned Nations in 1955, and resulted in almost four decades of what might be termed "Third World Solidarity". Partly driven by its ideological rivalry with the Soviet Union, China offered decolonising Africa moral and political support, in some cases coupled with limited military support and aid.⁴ The period from the mid-1990s onwards – the subject of the analysis below – represents the second phase of Chinese involvement with SSA. Following a substantial growth in China's trade with Africa, and China's growing need for resources, large and predominantly state-owned enterprises (SOEs) entered SSA as investors and as contractors to Chinese-aid-funded projects in infrastructure and public buildings. The third and emergent phase of Chinese interaction with SSA is one involving small and medium sized, predominantly private-sector, enterprises. These comprise a mixture of firms. Some are incorporated in China and have extended their operations from China to SSA. Others have been started *ab initio* in SSA.

These largely coordinated sallies into SSA have led many observers to characterise China as "having a strategy for Africa", not least in the context of the three-yearly Forum on China Africa Cooperation (FOCAC) conferences. (A mirroring characterisation is that whilst China may have a strategy for Africa, Africa lacks a strategy for China). The fourth and currently emerging phase of Chinese interaction with Africa is one in which small and medium sized enterprises, often started by Chinese who had previously been employed in large scale investments by SOEs, have broken away from the coordinated pack of interventions and act as largely autonomous entrepreneurs (Mohan and Kale, 2007; Gu, 2009)

⁴ The most visible project was the Tanzam railway linking Zambia with Tanzania in an attempt to free Central Africa from dependency on Apartheid South Africa's transport infrastructure.

2. Framework for Analysing Impact

Although there are a number of *channels* through which China's impacts may be transmitted, we focus on three main channels that appear to be particularly pertinent at the present time: 1) trade flows; 2) FDI flows, technology transfer and integration in global value chains; and 3) aid flows. There may also be impacts transmitted through the environment, financial flows, or participation in institutions of regional and global governance (IDS, 2006).

In each channel, China-SSA relations may be either *complementary or competitive* (or indeed both). In trade, for example, China may provide SSA with appropriate capital goods and cheap consumer goods, and SSA may supply China with the commodities it requires to fuel its continued economic expansion. The relationship is complementary because both countries gain from it. However, imports of consumer goods to SSA may displace local producers, leading to sectorally competitive impacts on workers and entrepreneurs.

The distinction between the *direct and indirect* impacts is less obvious, and its significance is less widely recognised. Direct impacts through charting direct trade flows between China and SSA are relatively simple, clear, and easily measured. The indirect impacts occur as a result of China's relations with third countries, working their way indirectly through to SSA. For example, China's demand for commodities may raise their global prices, and even though a country like Ethiopia does not export animal feed to China (a direct relationship), it sells animal feeds into a global market in which prices have been raised by China's growing imports (indirect impact). The indirect impacts of China on SSA are sometimes much more substantial than the direct impacts. However, almost all of the analysis of the impact of China on SSA focuses on direct, bilateral relations, and hence tends to miss these important issues.

Figure 1 integrates these three sets of factors into a synthetic framework to assess the overall impact of China on SSA. As will be shown below, our attempt to complete this synthetic matrix has resulted in several empty cells, and it is unclear to what extent this represents the pattern of China's impact on SSA or the underdeveloped state of our knowledge on these impacts.

Figure 1. A Synthetic Framework for Assessing the Impact of China on SSA

Channel	Impact		
		Direct	Indirect
Trade			
	Complementary		
	Competitive		
Production and FDI		Direct	Indirect
	Complementary		
	Competitive		
Aid		Direct	Indirect
	Complementary		
	Competitive		

3. Channels of Impact

Trade

One of the main features of China's rapid growth has been its deepening trade orientation, with the trade-GDP ratio in excess of 70 percent, well above the "norm" for large countries. Within this, China has become a major exporter of manufactures and a significant importer of commodities. Trade between China and SSA is a small proportion of each region's total trade, but its rapid growth suggests that the trade channel is a significant source of impact. Trade values quintupled from close to \$10 billion in 2002 to more than \$40 billion in 2005, to more than \$50 billion by 2007 and rising by 46% to \$109 billion in 2008.

Table 1. Trade with China as a Proportion of Trade with Industrialised Countries (%)

	1990	1997	2001	2005	2006	2007
SSA Exports to China	0.56	4.08	6.46	15.01	17.82	19.48
SSA Imports From China	2.60	5.50	9.78	17.86	20.29	25.65

Source: Calculated from IMF Dots, Accessed 17th February 2009.

In 1990 SSA's exports to China were less than one per cent of its exports to industrialised countries, but by 2007 this percentage had risen to 19 per cent. Similarly SSA's imports from China, which were 2.6 per cent of its imports from industrialised countries in 1990, had risen to over 25 per cent by 2007. Since 2001, imports from China have been expanding more slowly than exports, allowing SSA's trade balance with China to turn from negative to positive (Kaplinsky and Farooki, 2008).

SSA's exports to China are mainly fuelled by China's growing demand for commodities (Kaplinsky and Farooki, 2008). The share in total SSA commodity exports to China of oil, iron ore, cotton, diamonds and logs grew from less than 50 percent to more than 80 percent between 1995 and 2005. The overwhelming bulk and most rapidly-growing export was oil. SSA manufactured exports to China were mostly from South Africa. But even in this case, nearly all products were derived from basic metals. Whilst Africa is in trade surplus with China in aggregate, its non-oil trade is in sharp deficit.

For some SSA economies, the importance of China as a direct destination of exports grew particularly rapidly. Exports to China account for between 86 and 100 percent of all oil exports for Angola, Sudan, Nigeria, and Congo. A similar picture is true for the DRC, which sends 99.6 percent of its basic metal exports to China. On the import side, only seven SSA countries source a significant share of their total imports from China. In 2007 the most import-dependent SSA economies on China were Angola (33 percent of imports), S Africa (19 percent), Sudan (13 percent) and the DRC (8 percent) (Kaplinsky and Farooki, 2008) Almost all were manufactured products.

What about potential bilateral trade between China and SSA? The evidence on the direct trade links suggests that, on the export side, SSA gains from China's demand for commodities, and on the import side, it gains cheap and appropriate consumer and capital

goods. Outside of textiles, timber and cotton, there appears to be little trade between China and SSA in intermediate goods and little incorporation of China and SSA into coordinated global value chains. Jenkins and Edwards (2006) argue that most of these imports into SSA have substituted for imports from outside of SSA, with the possible exception of Ethiopia and Nigeria, suggesting little displacement of domestic production and few negative impacts on employment and local production. These conclusions suggest a synergistic link between SSA and China, reflecting the optimism prevailing in some circles on the potential opportunities opened for SSA by China's rapid trade expansion (World Bank 2004b).

However, we suggest three major reasons for more cautious conclusions. The analyses of Jenkins and Edwards and the World Bank are conducted on 3-digit SITC trade data. Whilst this shows notable aggregate trends, it hides some important specific impacts which only show up with different, firm-level methodologies. For example, domestically produced clothing and furniture manufactures in both Ghana and South Africa are being displaced by imports from China (Kaplinsky and Morris, 2008). Similar anecdotal evidence can be found with regard to clothing and footwear manufacture in many SSA economies. In Ethiopia, a study of 96 micro, small and medium domestic producers reported that as a consequence of Chinese competition, 28 percent were forced into bankruptcy, and 32 percent downsized activity. The average size of micro enterprises fell from 7 to 4.8 employees, and of SMEs, from 41 to 17 (Tegegne 2007).

Of greater concern are the potential effects on future production. Here, particularly in the case of light consumer goods, there are important and adverse long-term implications for SSA industrialisation (Kaplinsky and Morris 2008). What "spaces" will they be able to move into as their economies grow and they seek to diversify?

However, the most important indicator of caution stems from the *indirect* impact of China's trade with SSA. China's trade footprint is so large that it is in itself altering global prices, and this has significant impacts on SSA. The problem is that these indirect trade impacts are much more difficult to analyse, which is why almost all of the analysis so far has been on the growth and impact of direct trade links.

Most assessment of the impact of indirect trade links have focused on their effects on product prices (Kaplinsky and Santos-Paulino 2006), the similarity (or lack of it) between SSA's and China's exports (Jenkins and Edwards 2006), and the identification of winners and losers from trade with China (Stevens and Kennan (2006). The fact that these have been done at fairly high levels of trade aggregation tends to mask the severity of China's indirect impact on SSA manufactured exports. The actual impacts are better seen by examining particular sectors and products.

By far the most significant recent manufactured export from SSA has been clothing and textiles, largely as a result of United States Africa Growth and Opportunity Act (AGOA) preferences. Table 2 shows not just significant export growth, but growing reliance on the US market. For some SSA economies, these rapidly-growing exports have become especially significant. In 2002 clothing and textile exports accounted for 50 percent of

Lesotho's GDP. In Kenya, in 2004 employment in the clothing EPZ enterprises was equivalent to 20 percent of formal sector manufacturing employment.

Table 2: Growth of SSA Clothing and Textile Exports, 2000-2007

		World	US% share
Kenya	2004	326,959	90.5
	2005	301,505	89.9
	2006	311,210	89.9
	2007	289,239	90.5
Lesotho	2004	496,953	97.0
	2005	415,671	94.0
	2006	433,286	94.0
	2007	431,624	93.2
Madagascar	2004	577,637	59.9
	2005	538,212	51.6
	2006	593,652	42.8
	2007	684,103	45.0
Mauritius	2004	1,023,068	23.5
	2005	850,242	19.7
	2006	897,603	14.0
	2007	977,916	12.4
Swaziland	2004	200,031	94.3
	2005	169,814	94.8
	2006	147,638	96.3
	2007	146,912	96.7
South Africa	2004	932,950	20.2
	2005	727,791	14.0
	2006	633,240	14.9
	2007	458,780	13.4

Source: COMTRADE database accessed via World Integrated Trade Solution (WITS) 19th September 2008

The primary driver for these growing clothing and textile exports has been trade preferences in general and the US AGOA preference scheme in particular. AGOA's derogation on the rules of origin allows SSA exporters to import inputs from outside of the AGOA region or the US.⁵ This derogation has been extended on a number of occasions to 2012. The derogation has allowed countries with weak or non-existent textile industries to boost employment and exports through clothing production.

The final integration of the textile sector into WTO rules involved the removal of all quotas, effective 1 January 2005. This opened the US market to imports from China, which had previously been subject to quotas. All of the countries that had been exporting textiles under AGOA experienced a decline in exports following the removal of quotas. Nevertheless, the outcome of quota-removal has not been quite as catastrophic as many

⁵ Only South Africa is excluded from the derogation on the rules of origin.

had anticipated. By value, overall AGOA textile exports fell by 26 percent between 2004 and 2006 (www.agoa.info). Kenya fared best, with its 2006 exports at 95 per cent of their 2004 value. Lesotho, Swaziland, and Madagascar had 2006 exports of 85, 75, and 73 per cent of 2004 values respectively. By contrast, partly as a result of falling unit-prices, China's share in the same product markets increased, suggesting a direct exclusionary impact by China on SSA in third-country markets (Kaplinsky and Morris 2008).

The main reason why SSA's overall export performance was not as bad as expected relates to the degree of effective subsidy offered to AGOA producers in the US. The nominal rates of tariff on the clothing products which AGOA countries export to the US range between 16 and 32 percent. However, in nearly all cases AGOA clothing products can use (duty-free) fabrics and other inputs from outside of SSA in manufacturing their clothing. These imported inputs account for up to 60 percent of costs. Therefore, the implicit "effective rate of subsidy" is substantially higher than the nominal rates of protection would suggest. These effective rates range between 27 and 84 percent for representative exported products (Kaplinsky and Morris, 2008).

This rate of subsidy allows AGOA clothing producers to compete in the US market. This is because scales are low in SSA plants, and many SSA economies suffer from poor bureaucratic and physical infrastructure. But there is also pervasive evidence that many SSA clothing plants have low levels of productivity because of poor organisational procedures, low levels of skill and inadequate management within plants (Manchester Trade Team, 2005; Barnes, Morris and Gastrow, 2006).

The impact of competition from China in third-country markets on poverty and livelihoods is very substantial. Some of this is positive, insofar as reduced prices of clothing imports enhances the consumption power of consumers. But the negative impacts are also very significant. With minimal backward linkages into textiles, the major conduit for income-dispersal in the clothing industry has been through direct employment. The scale of job-losses arising from the end of MFA quotas is alarming (Table 3).⁶ It is not just the degree of job loss, but the nature of the jobs which have gone. Most workers are women, hence severe impacts on families, and in the absence of alternative employment, this decline has major poverty implications. We also know from global experience that rapid economic growth can be a significant factor in reducing poverty levels, and the loss to both GDP and exports arising from a sharp contraction of the clothing sector will have a further negative impact on poverty levels.

Table 3. Employment Decline in Clothing Sector, 2004-2005

	2004	2005	% decline
Kenya	34,614	31,745	9.3
Lesotho	54,000	40,000	25.9
Swaziland	28,000	16,000	42.9

⁶ South African job losses have been excluded from Table 3 as they are due to a complex web of factors leading to a lack of international competitiveness: exclusion from AGOA derogation, an appreciating exchange rate, high labour costs, inefficient production, surge in Chinese and other imported clothing an fabric.

The employment decline largely omits employment losses in micro and small units for which exact numbers are not readily available. Chinese clothing imports have not only reduced domestic production, but have also displaced imports from neighbouring countries, many of which were previously produced by small-scale tailors, dressmakers, and knitters (for Kenya, see McCormick et al. 2007).

FDI and Production

Chinese investment in Africa has also increased dramatically, driven by both resource and market considerations. Although our data on FDI is more limited than on trade, we piece together a rough picture of Chinese investments in Africa.⁷ There was little Chinese foreign direct investment (FDI) in Africa until around 1990. Then from \$20 million per year in the early 1990s, Chinese FDI in Africa jumped to close to \$100 million in 2000 and reached more than \$1 billion in 2006 (Zafar 2007). This represents a growth rate higher than Chinese FDI to any other part of the world.

Chinese FDI is qualitatively different in kind from European and North American sourced FDI. Historically, Western and Japanese FDI in SSA has come from privately-owned corporations focused on profit maximisation, generally with relatively short time-horizons. By contrast, much of Chinese FDI in SSA comes from wholly or partially state-owned firms with access to very low-cost capital, and operating with much longer time-horizons. Many Chinese investments are linked to achieving strategic objectives, focused on long-term access to raw materials, and closely bundled with aid.

Furthermore, Chinese FDI is at least partly driven by an active government policy (UNCTAD 2007). Currently Chinese companies enjoy four types of incentives: special and general tax incentives, credit and loans, foreign exchange allowances, and a favourable import and export regime. China's FDI to Africa has been further supported by common efforts by the Chinese and African governments, such as high level government and business visits, meetings, summits, joint committees, bilateral agreements, and various investment promotion activities.

Chinese FDI mainly takes the form of equity joint ventures with local entrepreneurs and/or national parastatals (Economist Intelligence Unit 2005; UNCTAD 2007). Some are multi-million-dollar joint ventures with local counterparts - in the energy and resource sectors, in Sudan, Nigeria, Gabon, Angola, Mali, and Zambia, and in manufacturing, including textile factories in Tanzania and Nigeria, and soya and prawn processing in Mozambique (UNCTAD 2007; Bosten 2006). In other cases, the investment and scale of operations are much smaller. In some SSA economies, small-scale entrepreneurial investment is presaged by the construction of specialised shopping malls retailing Chinese goods.

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There are two official sources of data on FDI from China: the Ministry of Commerce (MOFCOM) and the State Administration of Foreign Exchange (SAFE). The most recent detailed analysis of Chinese outward FDI has been provided by UNCTAD (2007) using both of these sources.

The Chinese have become highly visible in infrastructure construction and rehabilitation. Here it is not clear how much Chinese economic activity in SSA comprises FDI, how much is a result of winning commercial tenders, how much is linked to Chinese aid, and how much is part of integrated production networks between Chinese and SSA firms. Participation in infrastructure and construction projects ranges from stadiums in West Africa, to Presidential Palaces (in Kinshasa), dams (a \$650m tender for Nile River Merowe Dam project), pipelines (Sudan), roads, railways and government buildings.

By 2005, the Chinese had invested in 48 African countries (UNCTAD 2007). Table 4 shows the number of projects and investment amounts for the top fourteen recipients. Zambia, South Africa, Mali, and Tanzania top the list, with the remaining countries receiving relatively small amounts.

Table 4. Top 14 SSA Countries Receiving Chinese FDI (1979-2001)

Country	Investments		Investment Amount	
	No.	%	Thousand US\$	%
Zambia	17	3.8	134,126	18.5
South Africa	83	18.5	110,849	15.3
Mali	5	1.1	58,122	8.0
Tanzania	14	3.1	39,483	5.4
Zimbabwe	11	2.5	33,257	4.6
Nigeria	33	7.4	31,144	4.3
D.R. Congo	7	1.6	24,242	3.3
Ghana	17	3.8	19,212	2.6
Kenya	21	4.7	18,475	2.5
Gabon	11	2.5	17,045	2.3
Benin	4	0.9	16,723	2.3
Mauritius	20	4.5	16,657	2.3
Cote d'Ivoire	13	2.9	16,033	2.2
Cameroon	15	3.3	15,851	2.2
Africa total	448		726,532	

Source: World Bank, 2004a

Most SSA investment in China comes from South Africa, with a number of large South African firms having a growing presence. This includes SABMiller (now the world's second largest brewing company), which has invested more than \$400m in China since 1994, and has equity in 30 local breweries (Goldstein, 2004). Other large investors are SASOL, joining local Chinese investors in two very large coal-to-petroleum plants (each at more than \$3bn) in the North West Province of China, Kumba Resources (part of Anglo American) in the production of zinc, SAPPI (also Anglo American, in paper), Polifin in chemicals and ABSA and NEDCOR in the financial sector.

Aid

Since the 1990s China's aid is increasingly directed towards broad strategic goals of developing links with resource-rich SSA economies (Muekalia 2004; Kaplinsky et al. 2007; Brookes and Shin 2006; Pan 2006; Tull 2006). China's Africa Policy, adopted in 2006, bases China-Africa relations on five principles: Sincerity, equality, mutual benefit, solidarity, and common development. It also reiterates the one-China principle as the

political foundation for the establishment and development of China's relations with African countries and regional organisations (China 2006a; Guoqiang 2007). This was further elaborated in the Beijing Summit (November 2006), which affirmed "a new type of strategic partnership" between China and Africa (King 2006).

Chinese aid to SSA can be grouped into six categories. The first is financial assistance for key investments. As of mid-2005, the Chinese government had provided aid to approximately 800 individual projects. Second, and linked to the first, China cancelled \$1.2 billion in debts owed by 31 African countries in 2004, and has continued to use debt relief as an aid tool. Third China's African Human Resources Development Fund had provided training in China to 9,400 Africans by the end of 2004, and a further 3,800 places were planned for each of 2005 and 2006. 15,600 scholarships were offered to 52 SSA countries in 2005 (China 2006b). Fourth, China has provided technical assistance to SSA – more than 600 teachers and more than 15,000 Chinese doctors have worked in 52 SSA countries, including 1,100 present at the end of 2004. Fifth, China has instituted a programme of tariff exemption for 29 SSA economies, covering 190 products, including food, textiles, minerals and machinery. The policy took effect at the beginning of 2005, and coverage has since been extended to 400 items. Finally, China has in very recent years begun to provide peace-keeping forces to SSA.

Infrastructure aid is useful because of Africa's general need for rehabilitation, expansion, and updating of infrastructure. Debt relief is valuable because resources freed up can be applied to other needs at the discretion of the government. Nevertheless, both have been controversial. Many infrastructure projects have been linked to resource extraction, and subject to criticism on environmental grounds. Some construction projects, like stadiums and government office buildings, have been seen as contributing little to long-term development or poverty reduction, not only because of the nature of the project, but also because they are tied to Chinese inputs and/or do not adhere to good labour practices. Debt relief, like general budget support, is most useful when the country has a clear development agenda into which the freed resources can be channelled. In its absence, debt relief runs the risk of wasting resources or propping up oppressive governments.

More generally Chinese aid has been criticised for failing to pay attention to a range of issues pertaining to good governance, human rights, environmental protection, and social justice (Bosshard 2008; Zafar 2007; Oya 2006; Tull 2006). There is evidence that this is beginning to change. China EXIM Bank, the country's official export credit agency and major lender to Africa, adopted an environmental policy in November 2004 (Bosshard 2008). Although still general, it is clearly a step in the right direction. The Chinese government is also moving cautiously towards greater collaboration with Western donors, especially around issues of environmental sustainability (Lancaster 2007). At the same time, it is clear that China does not want to lose its distinctive character as a donor with a special understanding and sympathy for Africa's development challenges. How this will be worked out, especially in the areas of human rights and social justice, remains to be seen (McCormick 2008).

Channels in Aggregate

These channels are inter-related. China's trade impact (direct and indirect) in clothing and textiles, for example, is closely linked to the integration of SSA and Chinese firms in coordinated global value chains, and China's growing aid programme appears to be closely related to its need for traded commodities.

We also noted a great danger of focusing on the present, the known and the measurable impacts. Moreover, partly because there is a great need to search for a solution to SSA's problems, and partly because the direct bilateral links are easier to see than the indirect, there is a danger of focusing unduly on the positive opportunities and neglecting the potentially negative disruptive impacts of China's growing impact on SSA.

What can be said in aggregate about China's impact on SSA? Figure 2 presents some of the major conclusions emerging from our review of the three key channels:

- We are unable to fill all the “cells” in this framework. For example, it is possible that there will be indirect complementary effects in the FDI/production channel, and it is conceivable that Chinese-coordinated global value chains producing in the Middle East may source inputs from plants located in SSA. Does this inability to fill cells reflect the absence of impacts, unmeasured impacts, or poorly manifested impacts?
- Direct impacts are easily evidenced, both with regard to complementary and competitive effects. By contrast, indirect impacts are more difficult to evidence and much more difficult to measure.
- Data on the trade channel is much better than the production/FDI and aid channels. Is this a function of our lack of knowledge and/or the availability of global trade data, or does the trade impact assert itself first and most significantly?
- With the exception of competitive effects in manufacturing through the trade channel, the balance of existing evidence tends to support the view that the positive impacts (“opportunities”) are probably more important than the negative impacts (“threats”). But it is unclear whether this is a function of the availability of evidence, or the real world.
- It is difficult to generalise across countries and sectors. They might experience the impacts in each of these three channels in very different ways. For example, commodity exporters in SSA may gain from rising commodity prices (complementary indirect effects), whilst SSA commodity importers may suffer from the very same price rise (competitive indirect effects). Five economies account for more than 80 percent of all SSA's oil and gas exports, 12 economies for more than 80 percent of mineral exports, and 22 economies for more than 80 percent of agricultural exports.

- We have no available methodology for providing a “net outcome”, even for individual countries and regions. This is partly because some impacts are not measurable, and partly because they involve trade-offs between winners (consumers buying cheap clothing imports) and losers (displaced domestic producers of clothing), often within the same country.

Figure 2: China and SSA: An Elaborated Synthetic View of Three Main Channels, and Complementary-Competitive and Direct-Indirect Impacts

Channel	Impacts		
		Direct	Indirect
Trade	Complementary	<ul style="list-style-type: none"> • Inputs for industries • Cheap consumption goods 	<ul style="list-style-type: none"> • Higher global prices for SSA exports
	Competitive	<ul style="list-style-type: none"> • Displacement of existing and potential local producers by cheap Chinese products 	<ul style="list-style-type: none"> • Competition in external markets – falling prices and falling market shares
Production and FDI		Direct	Indirect
	Complementary	<ul style="list-style-type: none"> • Chinese FDI in SSA, particularly in fragile states • Cheap and appropriate capital goods • Technology transfer • Integration in global value chains, particularly in clothing • Low-cost infrastructure 	
	Competitive	<ul style="list-style-type: none"> • Displacement of existing and potential local producers • Less spin-off to local economy than other foreign contractors • Use of scarce resources 	<ul style="list-style-type: none"> • Competition for global FDI and production platforms • Disinvestment and relocation by other foreign investors (for example, clothing and furniture)
Aid		Direct	Indirect
	Complementary	<ul style="list-style-type: none"> • Grants and concessional finance • Technical assistance • Training • Tariff exemptions • Debt relief 	
	Competitive		Chinese aid to Latin America creates productive capacity which competes with SSA producers and lowers export prices

4. Drawing the issues together

We now address the implications for policy in five key areas. We do not offer detailed prescriptions for change but, instead aim to see these as promoting the basis for discussions with key stakeholders, within SSA and China, and with interested organisations and multi-lateral agencies elsewhere. The key issues are:

1. The challenges posed to industrial policy and sectoral choice
2. Reacting to changing patterns of poverty and income distribution
3. Global and regional links
4. Thinking about the future
5. Filling the knowledge gaps

Challenges posed to industrial policy and sectoral choice

SSA is most clearly challenged by China's impact on its industrial sector. China's impact on SSA industrialisation arises from its growing exports affecting SSA on two related and threatening fronts – competition in internal markets for domestically-oriented manufacturers, and competition in external markets from export-oriented industry.

Most is known about this in the clothing, textiles, furniture and footwear sectors. Chinese imports, are problematic for domestic manufacturers. Ghanaian furniture exporters find it increasingly difficult to compete with Chinese imports, as do South African clothing manufacturers (Kaplinsky and Morris, 2008). A similar pattern can be found in the Ethiopian footwear sector (Tegegne 2007) and the Kenyan clothing sector (Kamau 2007). Although data is scarce, discussions with manufacturers and retailers in a number of SSA economies with domestic manufacturing sectors suggest that import penetration is increasing in all markets, and in most of the traded-goods manufactured sectors.

However, the challenge to SSA industry is much more substantial than these current impacts might suggest. This is because its industry is currently poorly developed, and often largely confined to the food-processing industry (where products degrade over time and have a high transport-to-value ratio), building materials (a high transport-to-value ratio and producing customised products) and the informal manufacturing sector (producing to low levels of quality and largely using waste materials). The real policy challenge is not to existing industry, but to potential industry: what space is there for SSA manufacturing to expand in the future? What implications does this have for the growth of dynamic capabilities, learning externalities and structural transformation?

What can be done? First, there is scope for improving the productivity of existing industries, often by working with value chains rather than individual firms. Detailed firm-level analysis of productivity in the clothing sector in South Africa (Barnes, Morris and Gastrow, 2006) and in COMESA (Manchester Trade Team, 2005) reveal the nature of these productivity gaps. Kaplinsky and Morris (2006) also report evidence of significant productivity improvements following the introduction of training schemes in Lesotho. Competitiveness in all sectors is a moving target, and for various reasons, few SSA industries have hitherto been able to address this challenge of building dynamic capabilities. There is, however, no intrinsic reason why this should be the case, and there is thus considerable scope for effective industrial policies.

Trade is a second area of policy intervention. Here there may be a need for selective protection on the import side. But, as we saw in the earlier discussion of AGOA exports, SSA requires continued preferential treatment against China in external markets. AGOA has been extended to 2012, but this remains a temporary solution. SSA governments would do well to develop active industrial policies that provide incentives to deepening value added in the textiles sector.

A further important lesson is for SSA producers to be less concerned about the sector of production and more focused on identifying niches where they can build barriers to entry to Chinese producers through the development of innovative capabilities. In manufacturing this may be increasingly difficult as Chinese competences grow, whereas in horticulture and services, including knowledge-intensive services, relative capabilities may be high, as in the case of Kenya's horticulture sector, South Africa's medical sector, and East Africa's wildlife tourism sector.

Reacting to changing patterns of poverty and income distribution

Trade-related income poverty and distribution impacts can be significant (McCulloch, Winters and Cirera (2002). Although little is known about the detailed impact on China's trade on SSA patterns of income distribution, there are reasons to believe that it could be substantial.

On the positive side, Chinese manufactured imports benefit consumers, particularly low-income consumers. This is a global phenomenon, since the decline in prices of basic manufactures is a primary factor holding inflation at bay in many OECD economies. Many SSA manufacturers complain that Chinese products are displacing locally-produced commodities. In many countries, the primary displacement effect is on imports of manufactures from other, non-SSA economies, with wholesalers and retailers switching their sourcing to cheap Chinese suppliers often with major positive impacts on consumer welfare. In South Africa, for example, whilst the overall price index increased by 30 percent between 2000 and 2005, that of clothing fell by five percent. Significantly, as in the case of the Ethiopian shoe industry, some of this price decline was due to lower cost imports from China but competition from Chinese manufactures also forced local manufacturers to upgrade their competitiveness (Morris, 2007).

There are also rapidly-emerging negative consequences of Chinese trade on income distribution. On the one hand, employment in many labour-intensive manufacturing sectors is being lost, not only in export-oriented enterprises, but also in micro and small units targeting the local market. On the other hand, the rise in commodity production is associated both with capital-intensive technologies, and because of the large-scale of commodity production, to highly-concentrated forms of ownership. This is not an intrinsic problem of all primary production, since many soft-commodities (tea, coffee, cotton and horticulture) are labour-intensive and locally-owned, But, hitherto, most commodity exports to China have been oil and hard commodities, particularly basic metals.

There is an additional global dimension to these emerging patterns of income distribution, since manufacturing incomes are either largely local within SSA (labour) or flow to firms based in low- and middle-income Asian economies. By contrast, with the exception of South Africa, commodity production almost exclusively occurs through the operations of foreign transnational firms. A mitigating factor with regard to the distributional consequences of commodity production is that it is relatively easy to tax, providing revenues to governments. But the use of these state revenues does not necessarily suggest that their poverty and distributional impacts are positive. Moreover, a legacy of the Washington Consensus Structural Adjustment Programmes has been the transfer of many mines to foreign ownership, often coupled with tax holidays. Consequently, many of the fruits of the recent China-induced commodity-boom were lost to African countries. In Zambia, for example, little of the rise in copper prices accrued to domestic parties, least of all to the state coffers (Weekes, 2008)

Global and regional integration

Historically, most of SSA's trade links have been with the former metropolitan powers, either directly with the UK and France, or more generally with Europe and North America. These links have been strengthened through the development of various forms of preferential trade arrangements (Lome-Cotonou, AGOA, EPAs and FTAs).

Two major developments are disturbing these historical patterns. First, there appears to be a naturally growing regional market in southern Africa, reflecting regional externalities in production (Evans et. al., 2006). But, secondly, the rapid growth in trade between SSA and China suggests a growing "magnetic pull" from the East, posing a major policy challenge to SSA. In the context of stretched policy and administrative systems, and given the growing importance of regional ties in the global economy, who should they link with, and what forms of linkage might this involve? Should they aim to go North, go East or stay local?

Here it is possible to distinguish between what might be termed "passive integration" and "active integration". The former refers to the removal of barriers to trade, as in the case of FTAs and WTO-orchestrated multilateral trade liberalisation. Positive integration involves targeted policies focusing on particular forms of market imperfections (for example, promoting learning about China and its language), strengthening poor infrastructure constraining particular geographical links, and actively seeking to develop various forms of "deep integration" in China-SSA global value chains. It may also involve the development of particular patterns of trade preference, as in the recent Chinese initiative to lower tariffs on imports of manufactures from the least developed SSA economies.

SSA economies need to develop explicit policies in these areas involving a "joined-up" mix of economic and political initiatives. As SSA loosens its links with Europe and North America, it will also be necessary for countries, to determine how much weight they wish to place on intra-continental regional links, and how much on forging new regional links with China and other Asian countries.

Thinking about the future – developing “dynamic capabilities”

For SSA economies the capacity to change, to grasp opportunities and to minimise threats is critical - referred to as the development of “dynamic capabilities”. It involves a combination of search capabilities, strategic-formulation capabilities and implementation capabilities, as well as the capacity to change continually as new threats and opportunities arise.

Many of the dynamic capabilities required to meet these challenges are prefigured in the policy-related issues discussed above. An additional capability is the ability of SSA producers to anticipate future opportunities and threats opened up by sustained Chinese expansion. For example, one emerging opportunity is the promotion of Chinese tourism. By 2006 China had granted tourist destination status to 26 African countries (People’s Daily Online, 6 November 2006). The number of Chinese tourists to Africa reached 110,000 in 2005, doubling the 2004 figure. With the growth in Chinese per capita incomes, tourism will accelerate. This has clear links to the manufacturing sector in the form of opportunities for producers of many items needed to establish and operate a tourist destination - furniture, textiles, uniforms, processed food and beverages, soaps and cleaning supplies.

Another possibility refers to China’s food needs. At 3,040, China’s per capita calorie consumption is on average 90 percent of that in the high income economies (Chen et al., 2006), so future import needs are likely to reflect a change in the composition of food consumption rather than a significant increase in its volume. So far, China has sourced very little food from SSA, partly because it has imported intermediates such as animal feed to support its own meat-producing sector. Most of the feed imported so far has been soya, and the primary origin of these imports has been from Latin America (Jenkins, Dussel Peters and Moreira, 2006), and SSA has gained little from this trade in animal-feeds.

This raises a series of strategic issues for SSA food producers, which require careful consideration, informed by data rather than wild speculation. Will China continue to produce its own meat? Will its growing per capita income lead it to import horticultural products, fish and chicken? If so, will these imports come directly from eastern and southern African economies which have a demonstrated comparative advantage, or will SSA gain indirectly from China’s growing imports from a supply-constrained global economy?

These examples of tourism and soya are just that – examples. They represent future possibilities. At the same time, it is also necessary to anticipate future threats. A major potential problem for many SSA economies lies in the escalation of energy prices. Constrained global supplies and rapidly growing demand from China and India pushed prices far above previous estimates. So, too, the prices of other SSA imports, including food, might climb to new highs.

Filling the knowledge gaps

We know more about the questions to be addressed than on the nature of China's impact. There are significant knowledge gaps, and unless these are filled, policy and capability development will be undermined and may be misdirected.

We can conclude with some confidence that the three primary channels of transmission are indeed trade, FDI/production and aid, and that we know more about the direct impacts than the indirect impacts. In order to understand China's growing involvement in SSA, it is as important to focus on the geostrategic and political imperatives, as on the narrow pursuit of financial gain. But, other than this, we cannot at present draw any conclusions with confidence. We cannot assess whether on balance China's impact is likely to be positive or negative, and for which countries and regions, and for which particular stakeholders in particular countries and regions.

In order to establish a good foundation for policy development, key knowledge gaps suggest at least seven different types of research:

1. Base-line studies to assess the changing future impact of China on SSA
2. Analyses of the determinants of SSA competitiveness and the steps required to enhance productivity (for example, in clothing, textiles, footwear and furniture, as well as in export-oriented food crops).
3. A more thorough assessment of indirect impacts of China's trade on SSA, facilitating the development of appropriate policies for providing special and differential treatment to low income SSA economies in global markets.
4. Studies aimed at determining the impact of China on consumer welfare, income distribution and absolute poverty levels in SSA, through an analysis of the consumer benefits derived from cheaper imports, and the distributional implications of a switch in specialisation away from labour-intensive manufactures to capital intensive commodities.
5. Studies that distinguish generic from sub-regional and country-specific impacts, aiding the classification of different types of SSA economies
6. An analysis of the extent of Chinese migrants in SSA, their origins, their sectors of activity and their synergistic role with the entry of Chinese state-owned enterprises in Africa's resource and infrastructure sectors.
7. Research into likely future areas of threat and opportunity

Conclusions

There is a growing realisation that China's present and potential impact on SSA is both far-reaching and complex. Our synthetic framework, whilst disentangling the impact of three major channels and their various effects, has produced only a partial picture of China's impact on SSA. This is at least partly because of gaps in our knowledge. Some of these gaps result from lack of data, but others arise because the organisation of Chinese society means that the channels are intertwined in ways not immediately obvious to outsiders. This appears to be especially true of the production and aid channels, but may also apply to trade. The result is that some potentially important areas of impact may be misunderstood or missed altogether.

China's public pronouncements convey a desire for a relationship of South-South cooperation, of one developing country helping another (King 2006). Such a two-way relationship can only be fruitful if both parties respect one another and are ready to listen and learn from each other's experience. The relationship also needs to be underpinned by an understanding of how the actions of one are likely to affect the life of the other. Only then will genuine partnerships be possible.

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