CHINA AND THE TERMS OF TRADE: THE CHALLENGE TO DEVELOPMENT STRATEGY IN SSA

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Paper prepared for Rise of China: Global Opportunities and Challenges Conference, Mount Holyoke, March 2008.

ABSTRACT

China's rapid and relatively recent accession to the global economy has had a number of important impacts for the global economy. Amongst these is the consequence of its rising manufacturing exports and commodity imports for the terms of trade. If this leads to a sustained reversal of the long-term relationship between the prices of manufactures and commodities, it challenges the basic premise of industrialisation which underlies much of development strategy in SSA (and elsewhere). This feeds into, and is in turn fed by, domestic and regional political processes.

1. INTRODUCTION

Beyond the minutiae of everyday, annual and five-year cycles of policy lies the choice of development strategy. This shapes the trajectory of the economy over long periods, affecting not only the rate of economic growth but also its welfare and environmental impacts. It is customary (at least for economists) for this strategic choice to be located as a technical issue. “Which sectors should be privileged?”, “what should be the balance between public and private actors in resource allocation?”, and “what price signals will lead to the optimal outcome” are seen as decisions of economic rationality.

It is widely recognised that the core strategic choice in the development agenda has for some centuries been the commitment to industrialise and to reduce the relative importance of the commodity sectors of the economy. There are both powerful historical and analytical reasons rationalising this strategic choice. But recent developments in the global economy, largely associated with the rise of China and India (the “Asian Drivers”) challenge the logic of the commitment to industrialise at the expense of the commodity sectors. What implications does this hold for development strategies in general, and for the poor economies of sub-Sahara in particular? And, in what political context and with what political configurations will these challenges to core development strategy be associated?

These two questions are addressed in this paper, bearing in mind that the writer’s expertise is predominantly in the realm of economics. In Section 2 we briefly outline the evolution of core development strategy favouring a path of industrialisation. In Section 3, we outline the very recent, rapid and globally integrated growth of China and India. In Section 4 we briefly discuss the mechanisms by which this has an impact on other countries. We follow this in Section 5 by showing the impact which these growth paths have on the terms of trade which underpin the choice of development strategy in favour of industry. In Section 6 we address the challenges this poses to development strategy in SSA, and then in the concluding Section we attempt to place these developments in a context of political economy.

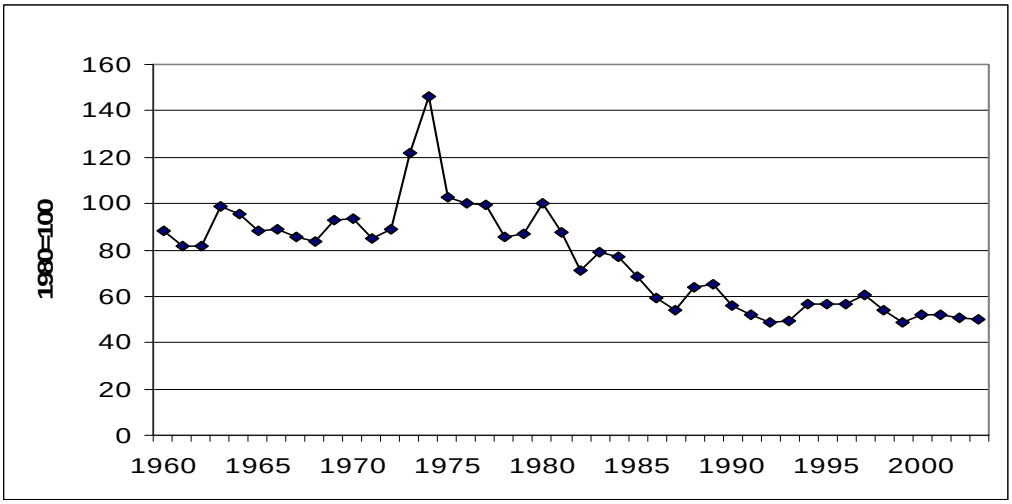
2. INDUSTRIALISATION AS A CORE DEVELOPMENT STRATEGY

After an initial focus on the agricultural sector following Independence in 1947, a severe drought and associated famine during the first half of the 1950s led India to commit its development strategy to a path of industrialisation. In this choice Indian planners were not only influenced by powerful theoretical factors (see below), but also by the demonstration effect of Soviet Russia’s rapid industrialisation as a defence against hostile powers during the 1920s and 1930s. The question of whether to commit this industrialisation path to a heavy- or light-industry focused strategy, echoing a debate in both post-revolutionary Russia and Marxist economics was a subsidiary concern, with India choosing to pursue the development of heavy industry and technology- and capital-intensive capital goods.

Most of the developing world mirrored this strategic commitment to industrial development during the second half of the 20th Century. But it was not just the demonstration effect of India, or soviet development (and indeed, the earlier experience of England, continental Europe and North America) which rationalised this strategic choice. Nor was it the evident association between countries with high levels of per capita income and high shares of industrial development. There were also clear analytical reasons why industry should be favoured at the expense of other sectors. Particularly important here was the trend in relative prices of manufactures and commodities, the terms of trade.

Until the 1950s it was widely believed that the terms of trade would turn against manufactures, and in favour of agricultural products. It was Hans Singer, and then Raul Prebisch, who deflated this belief in the early 1950s (Singer, 1950; Prebisch, 1950). They showed that in actual fact, the terms of trade were turning in favour of manufactures and against commodities (Figure 1 shows the data for the second half of the 20th Century, but in fact the relationship goes back until at least the 1870s). In demolishing this orthodoxy, Singer and Prebisch explained these trends in the terms of trade as resulting from a number of factors – the lower income elasticity of demand and higher price elasticity of demand of commodities;[1] the development of synthetic substitutes for primary products; and the fact that commodities were only one of many inputs into final manufactures meant that a proportionate increase in the price of manufactures would have a lower impact on commodity-producer incomes compared to those arising in the production of commodities.

Figure 1: Manufactures-commodities terms of trade, 1960-2004



Source: Drawn from UNCTAD-database

[1] The income elasticity of demand for manufactures means that as consumer incomes grow, they tend to spend a greater proportion of manufactures than on commodities. The price elasticity of demand for commodities means that for a given increase in prices, demand is likely to fall more than for manufactures.

The import of this observation on the terms of trade is that long-run income growth would be fostered by moving out of price-sensitive (and, as Singer-Prebisch observed, price-volatile) primary products into income-elastic and price-inelastic manufactures, in other words by making a strategic commitment towards industrial development.

From the late 1970s, a twist was given to this widespread strategic commitment to industrialisation. Based on the extraordinary growth-success of Japan and then the Asian Tigers, the strategic agenda was not just a commitment to industrialisation, but to export-oriented industrialisation. This increasingly became a strategic orthodoxy. For example, the World Bank's influential assessment in 2002 of the link between poverty and deepening globalisation forcefully promoted the case for further globalisation, notably through rapid growth in developing country exports of manufactures. Although the Bank recognised that there was some dispute about the evidence, it pulled few punches - "the doubts that one can retain about each individual study threaten to block our view of the overall forest of evidence. Even though no one study has established that openness to trade [in general, and export oriented industrialisation in particular] has unambiguously helped the representative Third World economy, the preponderance of evidence supports this conclusion" (World Bank, 2002: xi).

Heavily influenced by this multilateral- and bilateral-agency policy agenda, and drawing on the successful growth and manufactured export experience of the first generation of Asian NICs, SSA economies have increasingly oriented their long-term growth objectives to a graduation from the export of primary products to the export of manufactures. The demonstration effect of the astonishing recent emergence of China as a major global exporter of manufactures and its relatively successful performance in meeting the $1/day Millennium Development Goal has provided further impetus to this policy consensus.

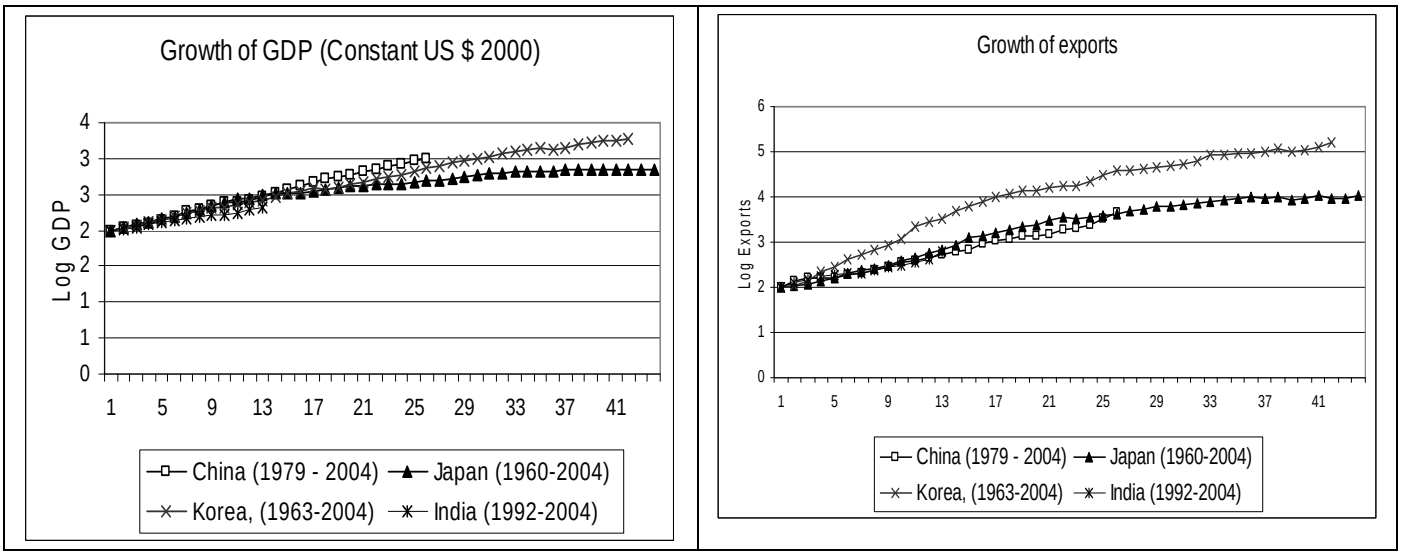
3. ARE THE ASIAN DRIVERS A DISRUPTIVE FORCE IN THE GLOBAL ECONOMY?

On current trends, China will be the second biggest economy in the world by 2016, and India the third largest by 2035. A cluster of other countries in the Asian region, such as Thailand and Vietnam, are also growing rapidly. These newly dynamic Asian economies can collectively be characterised as the "Asian Drivers" of global change (hereafter the ADs). The two key AD economies are China and India. They disrupt the strategic and policy environment, and pose major and distinct challenges for the global and developing economies, for five major reasons.

The first is as a consequence of their size. As Figure 2 shows, from the beginning of their growth spurts (1979 and 1992 respectively), neither GDP or export growth in the two largest AD economies were unique. In recent years other Asian economies (for example Japan and Korea) have experienced similarly rapid growth paths. However, whilst China accounted for 20 per cent

of the world's population and India for 17 per cent in 2002, at no time did the combined population of Japan and Korea exceed four percent of the global total. So, unlike the case of Korea and Japan, who could grow without severe disruption to the global economy, we have to suspend the "small-country assumption" in the case of the ADs. The very high trade intensity of China's growth makes its big-country effect particularly prominent. Between 1985 and 2006, China's exports rose from $50bn to $969 billion, transforming China into the world's third largest trading nation.

Figure 2: Growth of GDP and Exports from onset of rapid growth: China, India, Japan and Korea



Source: Calculated from World Bank, World Development Indicators

Second, the rise of the ADs has been associated with very significant, and growing, imbalances in the global economy. China's current account surplus has grown from a mere £1.6bn (0.3 per cent of GDP) to $239bn (9.1 per cent of GDP). A related imbalance is in financial stocks. By mid-2007 China held foreign exchange reserves in excess of $1.4trillion, with India holding in excess of $200bn. These reserves compare with the total value of FDI stock in the US of $1.7trillion. Depending on how these reserves are utilised (for example, "sovereign wealth funds" – government-owned entities – acquiring assets of large western firms) there is potential for substantial conflict and the possible impositions of controls over foreign ownership in the large previously dominant industrialised economies, undermining the mobility of global financial flows.

The third reason why the ADs may disrupt the global economy is that China (especially) and India embody markedly different combinations of state and capitalist development compared with the industrialised world. Chinese enterprises have their roots in state ownership, usually arising from very large and often regionally-based firms (Nolan, 2005; Shenkar, 2005). They reflect a complex and dynamic amalgam of property rights. With access to cheap (and often subsidised) long-term capital, these firms operate with distinctive time-

horizons and are less risk-averse than their western counterparts (Tull, 2006). Associated with these complex forms of ownership and links to regional and central state bodies, Chinese firms often operate abroad as a component of a broader strategic thrust. This is particularly prominent in China's advance in SSA in its search for the energy and commodities required to fuel its industrial advance (Kaplinsky, McCormick and Morris, 2007). What this means is that AD firms tend to invest with much longer time-horizons, are less averse to risk than their western counterparts and are able to call on active state assistance when this is required. Moreover, their base in low income economies means that they are not subject to the same pressures regarding corporate and environmental social responsibility as are the previously dominant western firms.

The fourth reason why the ADs present a new and significant challenge to the global and developing economies is that they combine low incomes and low wages with significant innovative potential. This means that they are able to compete across the range of factor prices. The oft-stated belief (and hope?) that China will run out of unskilled labour is belied by the size of its reserve army of unemployed, estimated at around 100m compared to the 83m people employed in formal sector manufacturing in 2002 (Kaplinsky, 2005). Moreover by 2030, India, also with a large reserve army of underemployed, is likely to have a larger – and younger - population than China. But China and India are not content to operate in this world of cheap labour and mature technologies, and are investing heavily in the building of technological capabilities. China, for example, overtook Japan to become the world's second largest investor in R&D in 2006 (Keeley and Wilsdon, 2007; Leadbeater and Wilson, 2007).

A fifth disruptive consequence of the rise of the ADs is their quest for secure supplies of raw materials. In the 2005-7 period this was an agenda largely played out in SSA, and largely in relation to access to energy. China became an active investor in the Sudan, Angola and Somalia in the search for secure oil supplies, running against established policy agendas of the hitherto dominant western powers, and displacing western energy firms. In Sudan this led to an easing of the pressure over Darfur; in Angola it allowed the government to escape pressure exerted by the Paris Club on transparency in government and in Somalia there is conflict within the state apparatus itself as to the legitimacy of the concession granted to Chinese companies. In Angola, China and India competed directly for access to the fuel deposits, in other cases (as in West Africa) they concentrated on different countries. But it is not just oil that the ADs have targeted in SSA. China has become a heavy investor in the Zambian copper fields, and in various mineral sectors in South and West Africa. Similarly, it is not just in SSA or in oil that their resource hunger is likely to be felt as a disruptive factor. A shortage of softwood in the global building industry in 2007 was a direct consequence of China's demand for timber, and water, too, has begun to loom on the horizon as a potential source of conflict.

As a consequence of these impacts, the ADs are beginning to disrupt the 'political compact' which has underwritten the extension of globalisation in the post WW2 era. China and India are increasingly active in global institutions,

demanding greater say in the regulation and shaping of the global economy. Their own experience belies the efficacy of the Washington Consensus policy agenda, and China and India provide a different policy role-model for many developing economies, with the possible rise of a “Beijing Consensus” to rival the Washington Consensus (Ramo, 2004). These dynamics represent a transition from a quasi-unilateral US-dominated world order to a multipolar power constellation. This is likely to lead to new turbulences and conflicts between the rising and the declining powers within the global governance system (Humphrey and Messner, 2008).

How disruptive are the ADs? Although China’s growth spurt began in the late 1970s and India’s in the early 1990s, their presence in global markets and their global environmental impacts only really began to be felt at the turn of the Millennium. Indeed, India’s impact is much more latent than real at present, although it is likely to become more significant in the future. It is perhaps too soon to conclude that they represent a historically decisive paradigm challenge to policy in SSA. However, as we will show below, their impacts are non-marginal and the pace of change has been, and continues to be extremely rapid. If this is the case, how are these disruptive forces transmitted to other economies, including those in SSA?

India’s presence in Africa is predominantly of historical significance, although it is likely that this will change in the future as it too runs short of raw materials and increases its exports of manufactures. By contrast, China has a large and rapidly growing presence in SSA, and it is this presence which we will consider in the discussion below.

4. HOW ARE THESE DISRUPTIVE FORCES TRANSMITTED TO SSA?

The impact of the ADs on SSA are complex, and arise from a variety of interactions between the ADs and Africa, and the ADs and the global economy. But it is also because China’s presence in Africa is much more coordinated than that of previously dominant northern powers. Thus, whereas western aid tends to be *relatively* distant from its commercial interests, in China’s case there is much less light showing between these two channels of interaction.

An overview of China’s links with SSA distinguishes different channels of impact transmission, the distinction between complementary and competitive impacts, and between direct and indirect impacts.

Channels of interaction

There are a variety of different channels through which individual countries interact with other economies, in their regions and elsewhere. Clearly, these channels are contingent – they change over time, and vary in importance depending on factors such as location, resource endowment, trade links, and geo-strategic significance. Six key channels stand out in importance:

- through trade links

- through investment flows (FDI and portfolio investments)
- through aid
- in institutions of global government
- through flows of people (including migrants)
- through environmental spillovers

Complementary and competitive impacts
In each of these channels of interaction, we can observe a mix of complementary and competitive impacts. For example, with regard to trade, China may both provide cheap inputs and consumer goods to SSA, and be a market for SSA's exports. On the other hand, imports into SSA from China can readily displace local producers. Another example is FDI. China may be a direct source of inward FDI into SSA and perhaps crowd-in FDI into SSA from third countries as parts of extended global value chains. These are complementary impacts. But China may also compete with other economies for global FDI. Similarly, financial flows environmental spillovers and migration may be either complementary or competitive.

The key element of these interactions is the "for whom" component. Countries may be affected differentially – in some economies, for example, imports of fabrics from China may feed productively into a vibrant clothing and textile value chain; in other cases, it may displace a country's exports and production for the domestic market. But these effects are not just felt at the national and economy-wide level. They affect groups within countries differentially. For example, cheap clothing imports from China may displace clothing and textile workers, but cheapen wage goods and hence reduce wage costs for producers in other sectors (which is indeed what has been occurring in many high-income economies during the early years of the 21st Century). These impacts on a complementary-competitive axis may also change over time, and most importantly, they will vary for different classes, regions and groups within economies.

Direct and indirect effects
The complementary-competitive axis of impacts is readily comprehended and widely recognised. Less widely acknowledged is the distinction between direct and indirect impacts. In part this is because the indirect impacts are difficult to measure. However, indirect impacts are often more significant than direct impacts.

Indirect impacts occur in third country markets and institutions. For example, China's trade with the US may open or foreclose the opportunities for SSA economies to export into that market. Similarly, China's high savings rate has had the effect of lowering global interest rates, indirectly facilitating investment in SSA. China's participation in International Financial Institutions may change the conditionality of much of the multilateral aid given to low income economies in general, including those in SSA.

As in the case of the complementary/competitive access, the impact of the direct and indirect impacts can be gauged either at the country level, or at

intra-national levels, for example with regard to different regions, sectors, classes and genders.

Figure 3 summarises this framework for assessing the impact of China on SSA.

Figure 3. A framework for assessing the impact of China on SSA

Channel	Impacts			
	Complementary		Competitive	
	Direct	Indirect	Direct	Indirect
Trade				
Investment				
Aid				
Global governance				
Migrants				
Environment				

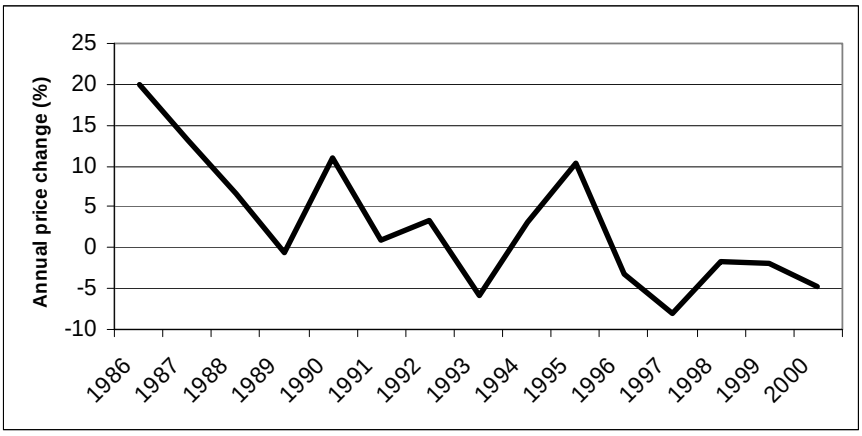
4. THE RISE OF THE CHINA AND THE IMPACT ON THE TERMS OF TRADE

Although Figure 3 charts a number of complex interacting modalities of China's impacts on SSA, in this chapter we will focus on the trade vector and the implications which these development have for SSA development trajectories. In pursuing this discussion we will focus on the impact of China's growing external trade on the terms of trade which, as we saw in Section 2 above has played a formative role in the strategic choice of development strategy on the Africa Continent (and, indeed, elsewhere).

As we enter the 21st century, there is reason to question the conventional wisdom of the terms of trade turning in favour of manufactures and against commodities.. As Asia in general (and China in particular) participates much more actively in global product markets, so historic patterns of relative price movements (as reflected in the terms of trade) have begun to alter.

Much of the second half of the twentieth century was a period of inflation in the global economy. Prices of most commodities rose, although (as we have seen – Figure 1) the price rise was faster for manufactures than for primary products. By the 1990s, most economies had begun to get on top of high rates of inflation and for the OECD economies as a whole the rate of inflation at the turn of the millennium was less than three percent. What followed was a period of price deflation in manufactures, beginning with a slowdown in the rate of inflation in the late 1980s, and then after 1998, in absolute nominal prices (Figure 4).

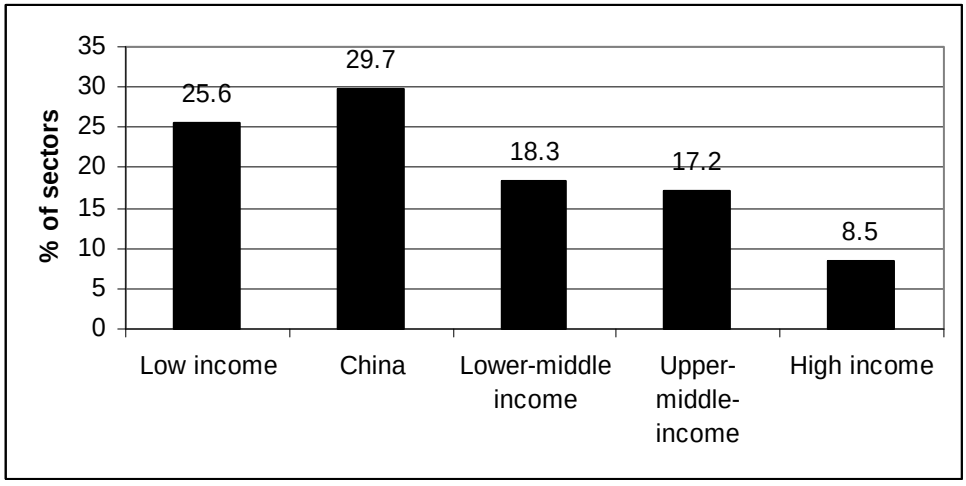
Figure 4: World Manufacturing Export Price, 1986-2000.



Source: Source: IMF, World Economic Outlook Database, September 2003

Figure 5 shows the impact of China's outward oriented industrial growth on this downward trend in the global prices of manufactures. It reports the proportion of the sectors for which the unit-price of imports into the EU from different income-groups (and China) fell between 1988 and 2001. The prices of products exported into the EU by China and low income economies were more likely to decline than the prices of the same products-groupings sourced from other high income economies.

Figure 5: Percentage of sectors with negative price trends, 1988/9-2000/2001 by country groupings

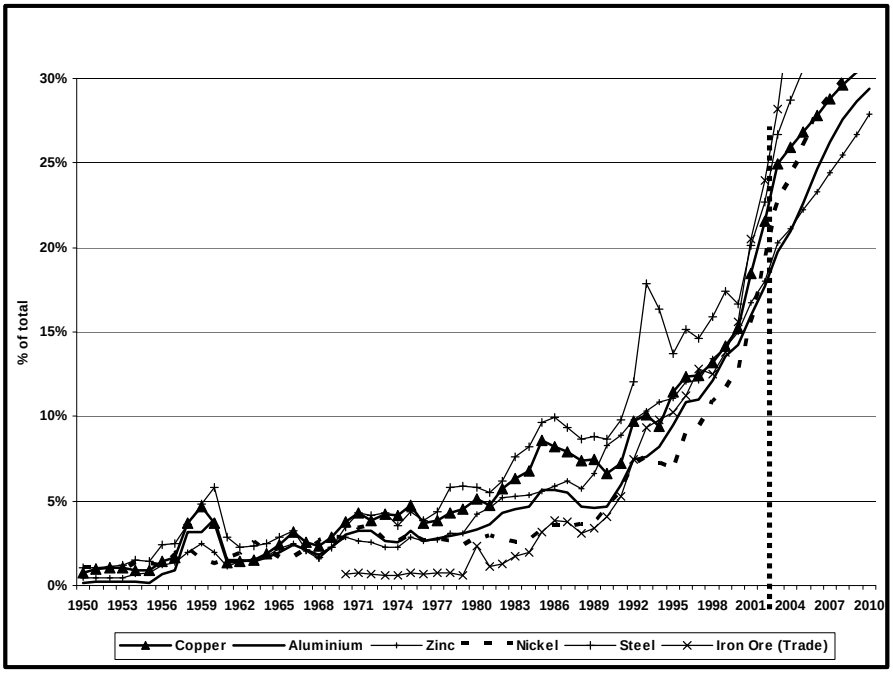


Source: Kaplinsky (2005)

At the same time that manufacturing prices were falling towards the end of the 1990s, commodity prices began to rise. This involves all three of the major components of the commodity sector – the "hard commodities" (minerals, metals and precious stones); fuels (oil, gas and coal); and the "soft commodities", including both food products and primary products feeding into industrial products (for example, cotton, timber and palm oil). A key driver in all of these rising commodity prices was demand from China.

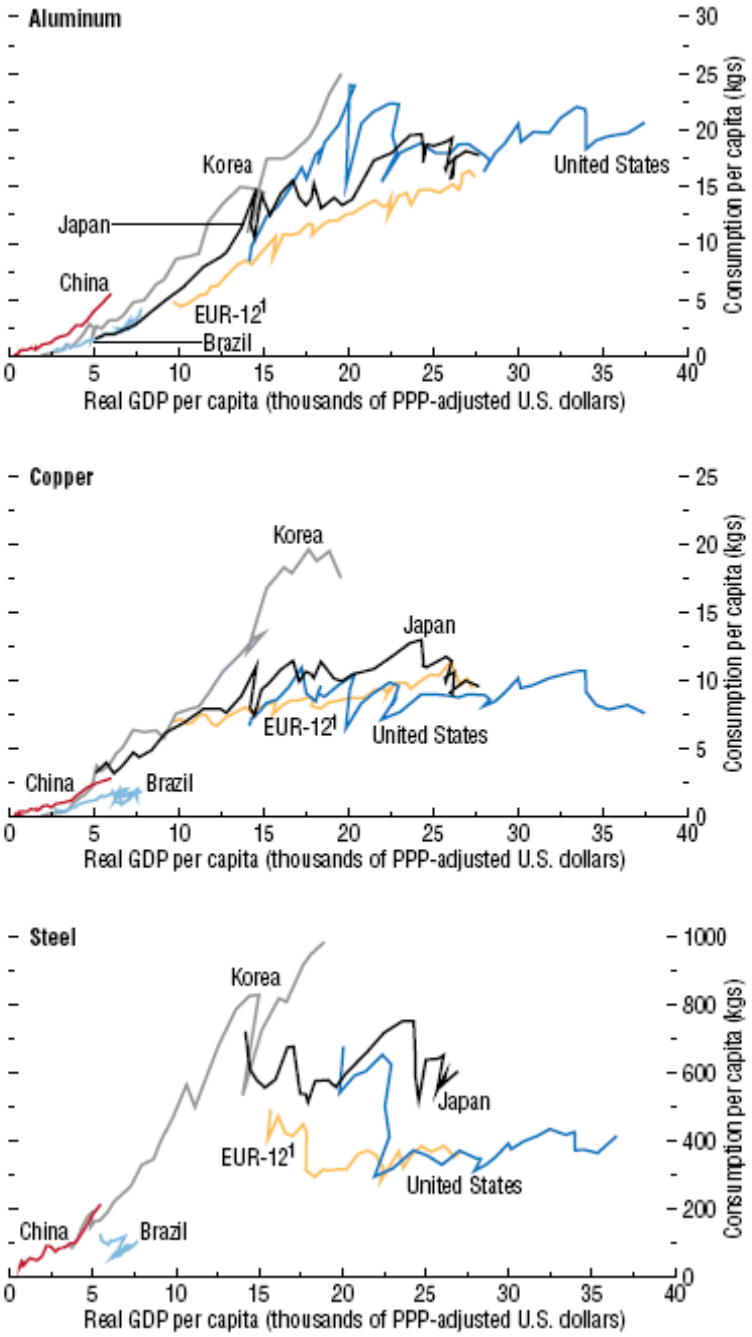
Focusing on basic metals, China's demand for imports has been fuelled by three factors. The first has been the rapid growth of domestic demand for household consumer goods and autos (where production has grown at a dramatic pace). Second, there has been very substantial investment in infrastructure, both in the public and private sector, and this has been particularly basic-metal intensive. And, third, many of China's exports have been of metal-based products. Consequently**,** China's share of global demand for the main base metals (aluminium, copper, iron ore, nickel, steel and zinc) grew from seven-ten percent of global demand in 1993 to 20–25 percent in 2003. In the case of steel, its share has grown from less than 10 percent in 1990 to more than 25 percent in 2003, equivalent to three times that of Japan, and more than either the EU or the US (around 20 percent each). Between 2000 and 2003, China's share of the increase in global demand for aluminium, steel, nickel and copper was 76 percent, 95 percent, 99 percent and 100 percent respectively. As Figure 6 shows, its projected utilisation of these basic metals is likely to grow even further in the future, in part because of its relatively low per-capita consumption of these materials (Figure 7) – bear in mind, China accounts for more than 20 percent of global population, and it is inevitable that as incomes grow and the minerals-intensity of consumption grows as it has in other countries, this will continue to lead to rising demand for imported materials.

Figure 6. Actual and projected global share of China's consumption of base metals, 1950-2010.



Source: Macquarie Research Metals and Mining, personal communication

Figure 7. Per capita consumption of base metals



Source: IMF WEO, Sept 06

This expansion in Chinese commodity imports has been closely reflected in the global prices of many hard commodities. For example between 2002 and 2004, the price of hot-rolled coil steel rose from around $140/tonne to more than $500/tonne, much higher than the previous post-war peak of $400/tonne in 1994. Between 2001 and 2004, copper prices more than doubled from

around 63 cts/lb to $1.40/lb, although in this case they were still lower than the previous post-war peak on $1.55/lb in 1989. [2]

The impact of China on commodity prices also extends to the energy sector. In 2007, China became the largest emitter of greenhouse gases and has a rapidly-growing demand for energy. Each year it *adds* to its capacity a demand which is greater than the total annual electricity generation of South Africa, Africa's largest consumer of electricity and one of the most energy-intensive economies in the world. Much of this demand for energy is met through coal-based generating plants, but some of this energy demand is also reflected in its imports of hydrocarbons, particularly to power its burgeoning stock of autos. Prices of spot steam coal (cif Rotterdam) leapt from $27/tonne to $82/tonne between 2002, and 2004, higher than the previous post-war peak of 1981. Hard-coking coal prices jumped from $50/tonne to more than $100/tonne in the same period, a post-war high. China's thirst for energy was one of the major reasons underlying the rapid rise in global energy prices in 2007, and indeed its demand for hydrocarbons is a major reason underlying China's growing presence in key oil-exporting economies in SSA, notably Angola, Sudan and Nigeria.

The impact of Chinese demand on minerals began to be felt in the late 1990s. However, the impact on agricultural commodities has been more recent, but has been no less significant. Two China-related factors began to drive up the price of soft commodities in the new millennium. The first was the indirect impact of its thirst for energy. This played an important role in spurring the drive towards bio-fuels (both grains and starch-based feedstock for ethanol, and oil-based feedstocks for diesel), placing major demands on a variety of agricultural products such as corn, sugar and palm-oil. Second, rapid income growth in China has led to a changing pattern of food consumption, with growing demand for animal feeds, affecting the price of grains and vegetable oil crops. Prices of many agricultural products consequently jumped. Wheat, soya, palm oil and rubber prices all trebled between 2000 and 2006.

The consequence and significance of these multi-pronged impacts on demand is reflected in a surge in demand for global shipping. As Figure 8 shows, as China's demand for commodity imports grew in the new millennium, and as its exports of manufactures began to surge, the available stock of shipping was increasingly pushed to its limits, and the price of hiring shipping consequently rose by an order of magnitude (that is, by a factor of ten) between the late twentieth century and 2007.

[2] All data in this paragraph from Macquarie Metals and Mining.

Figure 8. Impact of growing Chinese trade on global shipping rates

Although the collective force of these price impacts has been severe, and significantly higher than previous price hikes in the 1920s, 1950s and 1970s, the issue remains whether these changing terms of trade are likely to be sustained. After all, in each of the previous eras of price rises, the relative prices of manufactures and commodities rapidly returned to their long-term trends, generally within a five-to-seven year period. However, this time round, there are reasons to suggest that the change in relative prices will be sustained for a much longer period.

On the manufactures side of the terms of trade equation, although there have been, and will continue to be inflationary pressures in China (as well as an appreciating exchange rate), not only has the impact on the global price of manufactures been muted, but there is significant production capacity in Asia (including in the Chinese interior, as well as in India, Indonesia, Thailand, Vietnam and other low-cost east Asian economies) to suggest that the price of manufactures will continue to be muted for some years to come.

By contrast, on the commodities side, there are a number of factors which suggest that prices will continue to be firm and to rise for some time ahead. First, insofar as minerals and metals are concerned, prices have already shown an upward surge for more than five years and most observers in the metals and mineral sector – including those scarred by the optimism of rising commodity prices in earlier eras – are predicting sustained price pressure until at least 2010. Second, pricing pressures on agricultural commodities are predicted to remain until at least 2016, particularly for grains, starches and vegetable oils (OECD-FAO, @). Third, during previous price-spikes, the source of upward pricing pressure lay in interruptions to supply, such as droughts, frost or wars. However, where price increases arose from augmented demand, they endured for much longer periods (Cashin, Liong and McDermott, 2000). Chinese demand for many commodities is still, as we

have seen, at an early stage of the cycle and is unlikely to peter out soon; Indian demand lies around the corner.

5. THE CHALLENGE TO DEVELOPMENT STRATEGY IN SSA

We can already see the consequences of these changing relative prices on economic performance in SSA. This impact is observable on both the manufactures and commodities side of the terms of trade equation.

Beginning with manufactures, the impact has been felt in production for the domestic market. Take two basic industries, footwear and clothing as an example. In Ethiopia, although competition from Chinese shoe imports has led to an upgrading of processes and design by many domestic firms, it has simultaneously had a negative impact on employment and domestic output. 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 microenterprises fell from 7 to 4.8 employees, and of SMEs, from 41 to 17 (Egziabher, 2006),

In South Africa, imports from China grew from 16.5 percent of total apparel imports in 1995 to 74.2 percent in 2005 (all data in this and the following paragraph from Morris, 2007). Including imports from Hong Kong, China-sourced apparel was 78.8 percent of total apparel imports in 2005. The expansion of apparel imports was associated with a period of rapid decline in formal sector manufacturing in both clothing and textiles. In apparel, employment fell from 97,958 in 2004 to 78,694 in 2006, and in textiles from 21,380 in 2003 to 16,800 in 2005. Morris cautions that this over-estimates the extent of employment loss, since at the same time there is evidence that the informal apparel sector grew rapidly. However, wages and job security in the informal sector are much inferior to the formal sector, suggesting a period of wage compression during this period of import expansion from China. In Zambia, an embarrassing incident during President Hu Jintao's visit to Zambia as part of his tour around SSA in early 2007 was the closure of the Mulungushi textile factory and the loss of more than 1,000 jobs. This was a direct result of competitive imports from China, and, ironically, led to the closure of a textiles factory which the Chinese had built and supported with great fanfare in the 1970s.

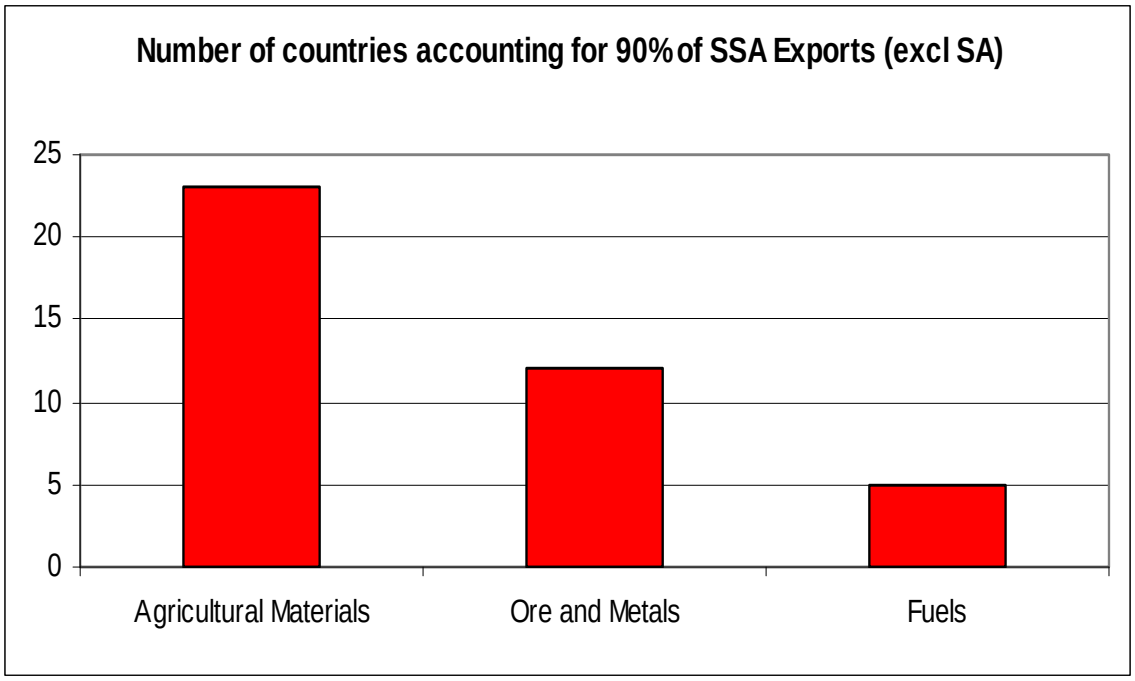
But the negative impact of Chinese competition can also be observed on the export front, this time the effect being indirect in nature. Between 2000 and 2006, six SSA economies (Kenya, Lesotho, Madagascar, Mauritius, South Africa and Swaziland) expanded their apparel exports to the US to significant volumes, taking advantage of the African Growth and Opportunity Act (AGOA) preferences. In 2005, Kenya's clothing exports to the US were in excess of $300m; for Lesotho, the figure was just over $400m. Here, SSA economies were favoured not just by quantitative quotas on Chinese exports to the US, but also by tariff preferences. With the ending of the Multifibers Agreement at the end of 2004, SSA apparel exporters were subject to intensified competition from China and other Asian economies in that the quota controls

were removed. And despite the fact that they continued to benefit from tariff preferences, their exports were severely hit. In the first two years, total SSA clothing exports to the US fell by 26 percent; during the same period, Chinese clothing exports of the same product groups rose by 71 percent. In Lesotho, this led to the loss of 29 percent of apparel jobs – bear in mind that apparel exports *were* manufactured exports (Lesotho having no other manufactures to sell abroad) and that Lesotho is one of the poorest countries in the world with few other employment opportunities available. In neighbouring Swaziland, almost as dependent on apparel exports as Lesotho, employment fell by 56 percent. The wider significance of these developments should not be overlooked, since excluding South Africa, apparel accounted for more than half of all SSA manufactured exports in 2006.

Of course, the impact of Chinese exports of manufactures to SSA was not all negative. The apparel exports of Kenya, Lesotho and Swaziland – all least developed countries – were dependent on the incorporation of Chinese fabrics (an option not open to the higher income South African, Mauritian and Malagasy economies).[3] An increasing share of SSA's machinery and equipment is also being sourced from China, often at a much lower price, and being more appropriate in nature to competitive products previously sourced from high income economies. But it is the consumer who has been most favoured by Chinese manufactured exports to SSA. 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).

On the commodities side, rising prices have had a positive impact, but on a smaller group of countries. High energy prices have meant that five economies have gained significantly – Angola, Nigeria, Equatorial Guinea, The Congo and Sudan. On the other hand, oil-importing countries – the majority of SSA economies - have been hard hit, and so severe has this been that the rise in oil prices exceeded the total inflow of aid and debt forgiveness in 2007. On the minerals and metals side, the country distribution of gains has been somewhat more widespread, but even then only 12 countries accounted for more than 90 percent of all SSA's metals and minerals exports. Agricultural commodities show the greatest potential for beneficial spread effects from rising primary product prices, with 23 (out of 51) SSA economies accounting for more than 90 percent of total exports (Figure 9).

[3] Ironically this means that headline export figures from these economies significantly overstate the extent of domestic value added.



6. POLITICS AND ECONOMICS INTERACT

So far we have addressed the impact of China on the global terms of trade as an issue affecting the choice of an optimum strategy of economic development. We have argued that these China-induced changes in relative prices undermine the feasibility of industrial development in an open economy. Without protection and other state measures designed to foster the industrial sector, SSA will be driven even further backwards into a commodity specialisation. Within this, whilst the continent does have valuable resources in fuels and minerals and metals, its geology and climate are not particularly favourable for agriculture (Bloom and Sachs, 1998). Moreover, only five countries account for 90 percent of all fuel exports, and 12 countries for 90 percent of all metals and minerals exports. Thus, the country-distribution of the benefits from the commodity boom is likely to be limited in nature, unless there are significant intra-regional spillovers from commodity-exporting economies (about which we currently know very little).

However, as we observed in the opening remarks to this paper, there is a danger of reducing this analysis to the realm of rational economic choice. In fact, there are a series of very important social, political and environmental characteristics of mineral-producing economies which feed into wider political processes. Here we can identify two groups of such impacts – those affecting what are called “point commodities”, that is commodities such as fuels, metals and minerals which are located under the ground and are immovable in nature, and “diffuse commodities” such as coffee and cocoa which can be produced in a wide range of places (Auty, 2004).

Before considering each of these commodity groups, it is helpful to begin with a brief characterisation of the manufacturing sector. In the early stages of the

development strategy debate in the 1950s, 1960s and 1970s, it was common to characterise manufacturing as being capital- and skill-intensive, with few spread effects and therefore being undesirable in comparison to the agricultural sector. However, the global fragmentation of value chains during the 1980s and 1990s led to the outsourcing of the labour-intensive and unskilled stages of production to the developing world, so that manufacturing – particularly export-oriented manufacturing – has increasingly been seen as being developmentally beneficial in nature.

Instead, it is the point-commodities sector which displays many of the negative social and economic characteristics previously attributed to the manufacturing sector. Mines and oil-fields are highly capital- and skill-intensive in nature. They employ few people, many of whom are expatriates. They involve very large agglomerations of financial capital, thus almost always either involving foreign ownership or domestic ownership by wealthy individuals and corporations. They are thus supportive – indeed generative – of very high levels of inequality. Moreover, because the revenue generated by most point commodities is highly concentrated (that is, limited payments of large sums of capital), they are ideally suited to appropriation by individuals. or small groups of people. In the case of precious stones and metals, the output is also easy to conceal. The capital-intensive nature of their production systems involves large contracts which are favourable to corrupt sourcing decisions. It is therefore not surprising that in most of SSA (and indeed in many other economies), point-commodities are closely associated with corruption and violent conflict. It doesn't take too long to scan SSA economies and see how tight this association has been. Add to this negative environmental spillovers, and there are further reasons to be concerned about the developmental impact (as opposed to the economic impact) of a deepening of point-commodity specialisation in SSA.

Point commodities therefore are associated with particular forms of political coalitions. This may involve relatively stable democratic structures with deeply-imbedded inequality (South Africa, with a wide portfolio of point-commodities, is probably the best example), systems which are relatively stable but which are deeply undemocratic, unequal and corrupt (Equatorial Guinea and oil) or those which are highly unstable, unequal and corrupt and which associated with frequent military coups (Nigeria) and wars (Sierra Leone, DRC).

By contrast, the diffuse commodities are often associated with much less developmentally malign patterns of political coalitions. They may often incorporate small and medium scale producers, both in crop production and crop processing. They also involve more elaborate value chains, either because of the spoilage of untreated crops such as sugar, or because of weight- or volume-loss in processing (timber). But whilst a specialisation in these diffuse agricultural commodities may have better spread effects, here too SSA producers face challenges. First, as noted earlier, the geology and climate in SSA is not generally conducive to their production, and many SSA countries may become net importers rather than net exporters of foodstuffs, thus suffering additionally from changing terms of trade. Urban consumers will

be particularly badly hit. Second, insofar as these agricultural commodities are being exported to markets in high-income countries, they are increasingly subject to standards (such as environmental and labour standards) and, by their nature, these standards are often exclusive of small-scale producers (Kaplinsky and Morris, 2001). And, third, the prices of diffused commodities are often highly volatile in nature, since they are subject to changing climatic conditions. In an era of rapid climate change and climate variability, thee adverse factors may be deleterious to welfare.

One final factor takes us squarely into the political domain. The point commodities – the primary beneficiaries so far of the changing terms of trade - are highly capital intensive and an economic specialisation in these sectors is likely to be associated with high levels of unemployment. In the early years of the 21st century, for the first time more than half of the world's population lived in cities (UN-Habitat, 2003), and urban poverty has been growing much more rapidly than rural poverty (Chen and Ravallion, 2007). Whereas the cities of earlier centuries has been places of industry, modern cities have become dumping grounds for the dispossessed and marginalised. As a consequence, urban politics have moved from class-based allegiances to pre-modernist, millenarian and faith-based affiliations – the religious right of the north, fundamentalist Islam and Judaism in the middle east and Asia, and Pentecostal churches in Latin America and Africa (Davis, 2004). In many respects they represent the politics of the dispossessed, excluded from the fruits of the commodity boom.

One final point. In moving beyond an exclusive focus on the economic impact of the commodity boom, we do not only face the danger of defining a narrow and technicist agenda, making policy recommendations in an apolitical vacuum, and therefore frequently being surprised when they are not implemented. We also face the additional danger of reading-off political events from economic and technological determinants, a direction of analytical causality which privileges the technical over the social and political. Politics in SSA are not just a consequence of external factors (including prices); it has its own dynamics so that commodity specialisations are often a reflection both of external determinants and internal political processes. Which commodities are exploited, in which regions and with which ownership structures reflects domestic politics and has a dynamic of its own, notwithstanding the impact of external factors.

But, whatever this direction of causality may be, there can be little doubt that SSA political economies may be in for a rocky ride. Many opportunities are opened by the rise of the Asian Drivers in general, and China in particular. But the challenges are manifest, complex and significant.

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