

THE IMPACT OF CHINA ON SUB SAHARAN AFRICA

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SUMMARY

This paper focuses on the rapidly-growing links between China and SSA. The spotlight is placed on three vectors of interaction – trade, foreign investment and aid. Chinese involvement in Africa is driven predominantly by the quest for material inputs (oil and other primary commodities) required for its infrastructural investments and booming manufacturing sector. At least in the early years of this involvement, there appears to be close coordination between Chinese involvement in these three related vectors.

Chinese involvement in SSA has important policy implications for growth, distribution and policy. Whilst it has provided a spur for some of SSA's key commodity exporting economies, its impact on manufacturing (both that destined for domestic and export markets) has been adverse. Even some of the benefits of the commodity price boom are ambiguous, since these are often associated with rising exchange rates, corruption and violent conflict. Commodity-based production also has adverse distributional impacts when compared to manufacturing.

The rapid growth and significance of enhanced Chinese participation in SSA has important implications for both future research (there are large unknowns and the picture is changing so rapidly) and for a poverty-focused policy agenda.

Biographies

Raphael Kaplinsky was formerly at the Institute of Development Studies, during which time he was responsible for launching the Asian Drivers programme. He is currently Professor of International Development at the Open University where he leads their Asian Drivers programme and also cooperates closely with the African Economic Research Consortium on its Asian Drivers programme. He recently published a book focusing in large part on the impact of China on the global economy - *Globalization, Poverty and Inequality* (Polity Press) – and has researched on global value chains, South Africa, and industrial and technology policy.

Dorothy McCormick is Associate Research Professor and Director of the Institute for Development Studies, University of Nairobi in Nairobi, Kenya, where she has worked since 1988. Her major research and teaching interests are in the area of industrialisation, small enterprise development and entrepreneurship.

Mike Morris holds joint appointments as a Research Professor in the School of Economics, University of Cape Town and the School of Development Studies, University of KwaZulu-Natal. He is also a Director of Benchmarking and Manufacturing Analysts, a consulting company which has been involved in assisting firms in the South African clothing and textile sector and the automotive industry.

EXECUTIVE SUMMARY

The challenge: maximising opportunities and minimising threats

Although SSA's trade with China is relatively small in comparison to its trade with the industrialised countries, it has grown very rapidly, especially since 2001. There is a danger of overestimating the historic and present impact, and underestimating the potential future impact of China on SSA.

1. At a general level, China's impact on SSA:

- involves three primary types of links – trade, production/FDI and aid;
- is in some cases complementary to growth and poverty alleviation, in other cases it is competitive;
- is both direct (in bilateral links between individual countries and China) and indirect (with the impact being felt in third-country markets);
- reflects a mix of strategic, political and economic factors, and involves a range of stakeholders, both within China and in SSA.

Since these varied impacts are unevenly felt within and between countries, it is important to maintain a comprehensive perspective if the opportunities are to be maximised and the threats minimised in such a way as to sustain poverty alleviation and to enhance income distribution.

2. More specifically, with regard to the trade channel:

- China has predominantly imported a limited number of products – mostly oil and hard commodities – from a limited number of SSA economies. In return, it predominantly exports manufactures, mostly final consumption goods.
- Most is known about the direct trade links, in which China now has a growing trade surplus with SSA. These direct trade links combine complementary impacts (notably enhancing consumer welfare through cheap goods), and competitive impacts where there is evidence that domestic manufacturers are in some countries being squeezed by China-sourced imports.
- The indirect trade links, arising through Chinese participation in global markets, are more difficult to assess. In general, it would appear that SSA economies gain from these indirect links, since the price of many of SSA's imports are falling due to growing Chinese competitiveness, and China's imports of commodities are pushing up the prices of SSA exports. However, in some sectors, notably clothing and furniture, there is persuasive evidence that China's growing competitiveness in global markets is having a very harmful impact on poor SSA exporting economies. Lesotho, Swaziland, Madagascar and Kenya have all been badly hit, and there have been particularly damaging impacts on South Africa. Employment loss has been high, with very severe distributional and poverty impacts.

3. With regard to the FDI, production and aid vectors:

- The Chinese presence in SSA appears to be driven primarily by the strategic search for raw materials rather than for final markets or for low-cost production platforms.
- Chinese firms work to longer time horizons than Western and Japanese firms, in part because many are state-owned and do not appear to be subject to the same short-term profit-maximising imperatives, and in part because of their access to low-cost capital.
- There is increasing Chinese participation in the energy and resource sectors, particularly in fragile states such as the Sudan, Angola and the DRC. This is linked to attempts by some fragile states to evade pressures by western donors and NGOs to promote more transparent and better governance.
- Other realms of activity are in infrastructure development (Chinese firms appear to have costs which are one-quarter to one-half less than Western and South African firms); in small enterprises in some countries (for example Sierra Leone); in trading (for example, Namibia); and in farming (for example, as is emerging in Mozambique).
- Chinese aid is growing throughout the region, particularly in recent years, and appears to be carefully targeted to complement its commercial activities, including in fragile states.

What we don't know

Whilst these major policy challenges are clear, important key knowledge gaps exist which need to be filled if policy responses are to be appropriately nuanced for individual country circumstances. The major knowledge gaps are with regard to:

- the need for base-line studies to assess the changing future impact of China on SSA;
- 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);
- 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;
- 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;
- distinguishing generic from sub-regional and country-specific impacts, aiding the classification of different types of SSA economies;

- identifying likely future areas of threat and opportunity;
- determining the drivers of China's strategic engagement with SSA and their impact on transparent and better governance on the continent;

Conclusions

This growing Chinese presence raises six major policy challenges for SSA if the manifold opportunities are to be grasped and the threats minimised:

1. It poses particular threats to the manufacturing sector. Here the outlook is not entirely bleak, but SSA countries need to take explicit steps to counteract the dangers posed to existing and future capabilities in industry.
2. Although the commodity boom favours some SSA economies, it poses very severe problems of economic management. Poorly-handled, a resource-boom can easily become a resource-curse. Much can be learned from the experience of other countries (including in SSA) in handling these resource-booms.
3. Notwithstanding the welfare gains to the poor from lower import prices, the expansion of capital-intensive mineral production and the decline of labour-intensive manufactures pose severe challenges for poverty-alleviation and income distribution. There is, moreover, the additional problem that resource-production is closely associated with violence, corruption and fragile states. Policies to ameliorate these potential adverse poverty-related impacts need to be addressed.
4. Linked to this, China has actively forged closer links with fragile states and this has undermined attempts by the global community to enhance transparency and better governance. There is also emerging evidence that attempts to foster better corporate and environmental governance are also being undermined by China's presence in some SSA countries.
5. African economies are being pulled in different directions with regard to their linkages with other economies. One pressure is to sustain historical links with the EU and North America, cemented by various preferential trading agreements. Another pressure is to strengthen links with other SSA economies, particularly in southern Africa. A third pressure is to enhance links with Asia in general, and China in particular. Scarce administrative and strategic capabilities may require SSA economies to choose how they respond to these various pulls. There are strong arguments for a concerted 'look East' policy.
6. The key capability which SSA economies require is the development of dynamic capabilities to scan changing environments, to develop appropriate strategic responses and to implement these strategies effectively. Unless these capabilities are built – in government, in the corporate and farming sectors, and in civil society – the opportunities offered by Chinese growth may be overwhelmed by the threats which are raised. This applies particularly to emerging sectors of Chinese demand (for example, imports of food products).

All of this poses severe challenges for a variety of stakeholders:

- for governments, firms, farms and civil society within SSA;
- for Chinese stakeholders who may be insufficiently aware of their impact on SSA;
- for DFID and other bi- and multi-lateral agencies who have much to offer in helping to build appropriate (dynamic) capabilities, and to mediate between different governments and stakeholders.

1. INTRODUCTION: CAUTION AND CONTEXT

A policeman encounters a drunkard under a streetlight and asks him what he is doing. "Looking for my house key" is the stuttered and barely audible reply. Ever willing to help, the policeman says – "I'll help you look. Now, where exactly do you think you lost the key?". "Oh, near the pub, a couple of blocks away". "Really", says the policeman, "in that case, why look here?". "Oh, the light is much better here – I'd never find it in the dark near the pub"

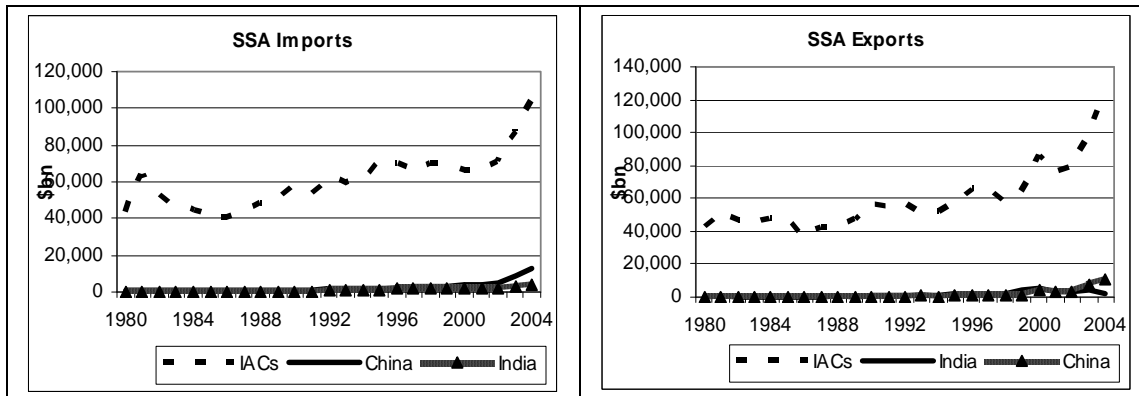
The aphorism of the drunk and the policeman cautions us to be aware of two important pitfalls in assessing the impact of China on SSA (or indeed other regions and countries). First, there is a danger that we focus on those issues where we know something, and ignore those for which we can find no information. This might either be because an issue is real and important, but the information has not been collected, or because the issue is emerging rapidly, and has not yet manifested itself clearly. The second important failing is that there is a tendency to concentrate on measurable phenomena (for example, trade data), and ignore difficult-to-measure issues (for example, the extent to which FDI is motivated by geo-strategic reasons).

It is important to keep a sense of perspective on the existing and potential impacts of China on SSA. Although there has been a recent resurgence of growth in the SSA region, the overall picture on both poverty-reduction and growth remains bleak. There is thus a tendency to continually search for quick-fixes for SSA. As these fail to deliver rapid results, a new straw is clutched. The danger is that China becomes the new "big opportunity" and in so doing, we overestimate both the speed with which these opportunities can be grasped, and the potential negative impact which China's growth poses for SSA.

Figure 1 alerts us to this danger. It shows that China (and India's) total trade with SSA is a small proportion of SSA's trade with the industrialised countries. On the other hand, as Table 1 shows, the rate of change in these import and export shares has been very rapid, particularly after 2001. In the case of SSA exports, trade with China as a proportion of trade with the industrialised countries rose from 0.4% in 1990 to 2.3% in 1997 and 9% in 2004, and in the case of imports, the rise was even more remarkable, from 1.8% (1990), to 3.8% (1997) and to 12.3% (2004).

To the extent that trade links are an accurate reflection of the wider impact of China on SSA, we draw two conclusions from this trade data. First SSA's current trade links with China are relatively small in relation to its trade with the rest of the world, suggesting a low level of present impact. But, second, China-SSA trade is growing very rapidly. If this growth rate is sustained, the likely future impacts may be very substantial. A similar pattern emerges with regard to flows of FDI and aid into SSA, but these are difficult to quantify.

Figure 1. China-SSA trade as a proportion of SSA trade with industrialised countries



Source: Calculated from IMF DOTS, accessed 2nd February , 2006.

Table 1. Trade with China and India as a proportion of trade with the industrialised countries

	1990	1997	2001	2004
SSA exports to China	0.43%	2.31%	4.10%	8.96%
SSA exports to India	1.37%	3.49%	4.38%	1.58%
China and India	1.81%	5.80%	8.48%	10.54%
SSA imports from China	1.76%	3.84%	6.04%	12.26%
SSA imports from India	0.83%	2.65%	2.76%	4.20%
China and India	2.60%	6.49%	8.80%	16.45%

Source: Calculated from IMF DOTS, accessed 2nd February , 2006.

2. A FRAMEWORK FOR ASSESSING THE IMPACT OF CHINA ON SSA

It is important to be systematic on assessing the impact of China on SSA, particularly in the context of uneven data availability. In providing a framework for a coherent and overall evaluation we can distinguish a number of *vectors* through which these impacts may be transmitted. The three primary vectors in the case of SSA which are covered in this Agenda Report are:

- Trade flows
- FDI flows, technology transfer and integration in global value chains
- Aid flows

These are not the only vectors through which a given country or region may have an impact on another country or region (IDS, 2006). For example, there

may be impacts transmitted through the environment, through financial flows, or through participation in institutions of regional and global governance.

In each of these vectors, it is possible for China-SSA relations to be either *complementary or competitive* (or indeed both). In the case of the trade channel, for example, China may provide SSA with appropriate capital goods and cheap consumer goods, and SSA may provide China with the commodities it requires to fuel its continued economic expansion. Both countries gain from this relationship. On the other hand, China's export of consumer goods to SSA may displace local producers, leading to competitive impacts on workers and entrepreneurs in these sectors.

This distinction between complementarity and competitiveness is easily understood. By contrast the distinction between the *direct and indirect* impacts is less obvious, and its significance is less widely recognised. The direct impacts are relatively simple and clear. In the case of the trade illustrations discussed in the previous paragraph, for example, both complementary and competitive impacts occur as a result of direct bilateral relations between China and SSA. These impacts are often also easily measured, by charting the direct trade flows between China and SSA, breaking this down by sectors and countries, and over time. The indirect impacts are less obvious and occur as a result of China's relations with third-countries, working their way indirectly through to SSA. Staying with the case of trade for example, China's demand for commodities may raise their prices at a global level, and even though a country like Ethiopia does not export animal feed to China (a direct impact), it sells animal feeds into a global market in which prices have been raised by China's growing imports (indirect impact). As we shall see below, and particularly in the case of trade, the indirect impacts of China on SSA may often be much more substantial than the direct impacts. However, almost all of the analysis of the impact of China on SSA (and indeed on other developing countries) focuses on direct, bilateral relations, and hence tend to miss some of the key issues of importance.

Figure 2 integrates these three sets of factors – vectors, complementary-competitive and direct-indirect impacts – into a synthetic framework which can be used to assess the overall impact of China on SSA. As will be shown below, there are a number of empty cells in this synthetic matrix 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. (We return to this issue in the concluding section of this Report).

Figure 2. A synthetic framework for assessing the impact fo China on SSA

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

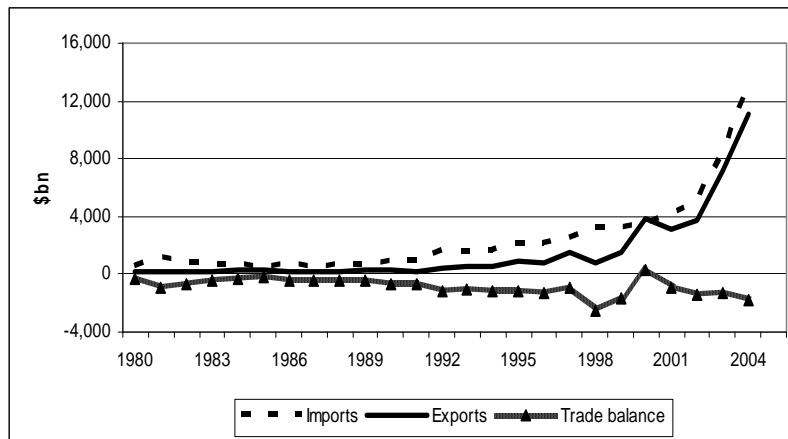
3. VECTORS, COMPLEMENTARY-COMPETITIVE AND DIRECT-INDIRECT IMPACTS

3.1. The Trade Channel

Assessing the impact of indirect trade links

There is a developing understanding of the direct bilateral trade links between SSA and China (notably Jenkins and Edwards, 2005, and Chen. et. al, 2006). In Figure1 and Table 1 above we showed how although China currently represents only a small share of SSA's trade, this is growing very rapidly. Imports from China are expanding more rapidly than exports, so that SSA has a growing trade deficit with China (Figure 2). If oil is excluded, in 2005 SSA's trade balance with China was negative (a deficit of \$7.3bn); if oil is included, it ran a trade surplus of \$5.9bn in the same year

Figure 2. Balance of trade between China and SSA, 1980-2004



Source: Calculated from IMF DOTS, accessed 2nd February , 2006.

The basis for China's rising trade links with SSA has been its extraordinarily rapid growth of more than nine percent p.a. since 1979. One of the main features of this growth has been its deepening trade orientation, with the trade-GDP ratio of 68 percent in 2005, well above the "norm" for large countries. Within this, China has become a major exporter of manufactures

(see below) and a significant importer of commodities.¹ Table 2 shows the growth in trade dependence for a variety of key commodities produced in and exported by various SSA economies. Between 1998 and 2003, China share of increased global demand was 96 percent for steel, 99 percent for nickel, 100 percent for copper and 76 percent for aluminium (Lennon, 2005). This was associated with a depletion of global stocks and an increase in global commodity prices. For example, between 2002 and 2005, average stocks of base metals fell from seven to 3.5 weeks, and LME average prices more than doubled, rising by 160 percent (derived from Lennon and Rowley, 2006).

Low global inventories and high supply inelasticities suggest that global commodity prices will stay firm for some time. But there will inevitably be important changes in the commodity composition of this trade. For example, until mid 2005 China was a large net importer of steel, with a consequent increase in steel, iron ore and steam coal prices. But during 2005 a number of very large new steel plants were commissioned in China, and it has now become a net exporter, with a consequent knock-on effect on lower global steel prices. The price of coal and iron ore (and the shipping required to transport them) remains strong.

Table 2. China's import dependence (%)

	2001	2002	2003	Share of China imports from SSA, 2004
Oil	27.8	30.3	36.0	30.6
Iron ore	29.9	32.5	36.2	4.1
Copper	36.2	43.2	44.0	
Cotton	3.6	4.8	18.4	21.2

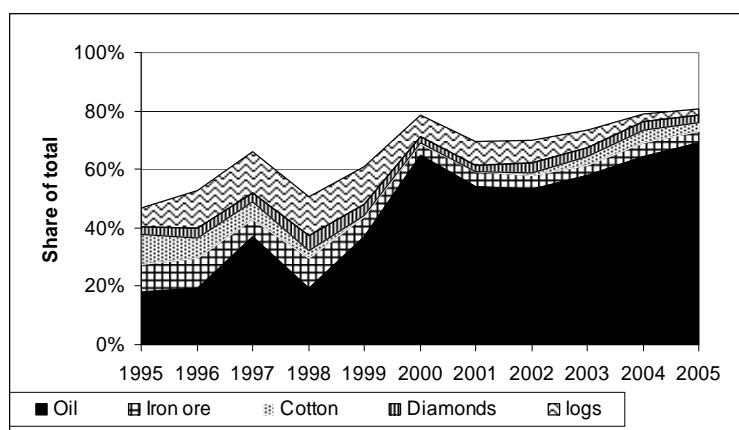
Source: Derived from Chen et. al. (2005) and Sandrey (2006)

China's growing demand for commodity imports has led to an expansion of commodity exports from some SSA economies. As Figure 3 shows, the share in total SSA exports to China of five families of commodities (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 so that whilst the growth of other commodity exports was at a high level, the proportion of the total which they accounted for fell during the decade after 1995. SSA manufactured exports to China were mostly from South Africa. But even in this case, only two products were not derived from basic metals.²

¹ This has major implications for the global manufactures-commodities terms of trade. See Kaplinsky (2005, and 2006)

² These were oil products (less than 1.5 percent of its exports to China) and polymers (less than one percent) (calculated from Sandrey, 2006)

Figure 4: Composition of Chinese Imports from SSA



Source; Derived from Sandrey (2006)

For some SSA economies, the importance of China as a direct destination of exports grew particularly rapidly. In the case of oil, for example, China's share of exports was overwhelming, particularly for fragile states such as Angola, Sudan and the Congo. A similar picture is true for the DRC in the case of basic metal exports (Table3).

Table 3: Share of particular commodities in exports to China

	Crude oil	Metals	Wood	Cotton
Angola	100			
Sudan	98.8			
Nigeria	88.9			
Congo	85.9			
Gabon	54.8		42.3	
DRC		99.6		
Ghana		59.8		
S Africa		45.6		
Cameroon			39.7	
Tanzania			23.4	53.8

Source: Chen et. al. 2005.

On the import side, only seven SSA countries source a significant share of their total imports from China. Sudan, which has growing and policy-related energy links with China (see below) stands out, with 14.2 percent of its imports coming from China, followed by Ghana and Tanzania (9.1 percent), Nigeria (7.1 percent), Ethiopia and Kenya (6.4 percent) and Uganda (5.1 percent) (Jenkins and Edwards, 2005). Almost all of these imports were manufactured products.

So much for the historic picture. Looking forward, the World Bank study of trade complementarity (World Bank, 2004a and 2004b) attempted to identify areas of potential bilateral trade between China (and India) and SSA. They computed a "Trade Complementarity Index" based on SSA's revealed comparative advantage in exports, and China's revealed comparative advantage in imports, weighted by the importance of these products in the exports and imports of these regions, using a combination of 3- and 4-digit trade data (see Appendix D, World Bank 2004a, Vol. 2). This exercise concluded that on the basis of existing economic specialisation, the potential for future bilateral trade growth with China was not strong, but if China's growing demand for commodities were sustained, this would improve

"Among Asian countries, India (27.8), Korea (11.8), and Japan (6.3) have strong complementarity with African countries on average; these countries are followed by Thailand (3.9), Pakistan (3.3), the Philippines (1.9), and Indonesia (1.6). Other countries such as Singapore (0.6), Hong Kong (0.1), Taiwan (0.0), China (-0.3), and Malaysia (-1.2) do not show high complementarity.... The weak complementarity for some Asian economies such as China and Taiwan seems counterintuitive given the growing volume of African exports to these Asian economies. The reason for China's unexpectedly low score, for example, is because the country has been obtaining raw materials mostly from domestic sources until recently" (World Bank, 2004a, Vol 2: 32).

In summary, looking at this evidence on the direct trade links between China and SSA, 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 clothing and textiles (see below), there appears to be little trade between China and SSA in intermediate goods and little incorporation of China and SSA in coordinated global value chains. Jenkins and Edwards 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 and help to explain the high sense of optimism which prevails in SSA on the potential opportunities opened for SSA by China's rapid trade expansion.

However, this optimistic picture of opportunities opened-up by growing bilateral trade links between SSA and China may reflect a misplaced sense of optimism. There are three major reasons for suggesting a more cautious set of conclusions. First, the analyses of Jenkins and Edwards and the World Bank are conducted on 3-digit SITC trade data. Whilst this shows important aggregate trends, it hides some important specific impacts which only show-up with different, firm-level methodologies. In a study conducted for DFID, Kaplinsky and Morris report that domestically produced clothing and furniture manufactures in both Ghana and South Africa are being displaced by imports from China (Kaplinsky and Morris, 2006a). Similar anecdotal evidence can be found with regard to clothing and footwear manufacture in many SSA economies. For example, in Zambia the trades unions assert that imports of

Chinese clothes have undermined the clothing and electrical sector, and in Nigeria trades unions blame Chinese imports for the loss of 350,000 jobs (<http://www.nzherald.co.nz/>). 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),

However, damaging though these impacts might be, it is not so much the displacement of existing producers which is an outcome of China's growing exports to SSA, but in relation to future production. Here, particularly in the case of light consumer goods – the bulk of Chinese exports to SSA - there are important and adverse long-term implications for SSA industrialisation (Kaplinsky and Morris 2006b). What “spaces” will they be able to move into as their economies grow and they seek to diversify?

However, the third and by far the most important indicator of caution arises in regard to the *indirect* impact of China's trade with SSA. That is, it is not so much in the growth of direct bilateral economic trade links that we must look for impact, but on the indirect links. Both China and SSA trade in global markets. But 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 than the direct impact, which is why almost all of the analysis so far has been on the growth and impact of direct trade links.

Assessing the impact of indirect trade links

A number of attempts have been made to assess the impact of indirect trade links. Using a high level of data disaggregation (HS 8-digit) Kaplinsky and Santos Paulino show that the greater China's participation in trade with the EU, the more likely product prices are to fall, and that this impact is greatest with regard to the products exported into the EU by low-income economies (Kaplinsky and Santos Paulino, 2006). The major product of relevance to SSA was the export of clothing into the EU by Mauritius, Madagascar and South Africa.

Jenkins and Edwards estimate the significance of indirect trade links by computing Export Similarity Indices, utilising 3-digit SITC trade data. They conclude from this that there is little evidence of widespread competition in global markets for manufactured products. However, they caution their results by noting that they are using a high level of data aggregation. For example, by illustration, at 3-digits Botswana and India export the same products – diamonds – and may seem to be in competition with each other. But whilst Botswana exports raw diamonds, India uses these raw diamonds and exports cut-diamonds. In this case, rather than competition between Botswana and India, the relationship is one of complementarity. Thus, at a high 3-digit level

of aggregation the data is unable to distinguish adequately between inter- and intra-industry effects.

Stevens and Kennan (2006) adopt an innovative approach, again utilising trade data, but at a much higher level of disaggregation (6-digit HS classifications). They begin in similar vein to the World Bank's Trade Complementarity Index by identifying products which were significant and rapidly-growing export and import items for China and were in turn relatively intensively traded by developing countries. This yields seven major imports into China (animal feeds, chemicals and five commodities), and eight major Chinese exports (ferrous metals, aluminium and six manufactures). In each case they identify major SSA exporters and importers. They determine beneficiary countries as those which export a product which China imports (a growing market opportunity) or import a product which China exports (falling prices of more appropriate products). The losers are those economies which export products which China exports (export competition and falling prices) or import products which China imports (rising prices).

Using this methodology, it would seem that more SSA economies gain in more sectors than those who lose (Table 4). Most of the gains are experienced by countries which import a product which China exports (Column 2 in Table 4), although some also gain as exporters of products which China imports (Column 1). A few SSA countries lose by competing in global markets where China is an exporter (column 4), and a smaller number of countries who lose by importing products which China imports from the world (Column 5).

Table 4: Trade overlap – number of sectors by country:
(See Table footnote for explanations of column headings)

Country	No. of sectors					
	<i>Trade balance gain</i>			<i>Trade balance loss</i>		
Angola	0	6	6	1	0	1
Benin	0	2	2	0	0	0
Burkina Faso	1	0	1	0	0	0
Cameroon	0	1	1	0	0	0
Chad	0	0	0	0	0	0
Congo Rep.	0	2	2	0	0	0
Congo DR	1	0	1	0	0	0
Ethiopia	1	0	1	0	1	1
Ghana	0	4	4	1	1	2
Guinea	1	1	2	0	0	0
Kenya	0	2	2	1	1	2
Madagascar	0	1	1	0	1	1
Malawi	0	0	0	0	1	1
Mali	0	1	1	0	0	0
Mauritania	1	1	2	0	0	0
Mauritius	0	2	2	0	1	1
Mozambique	0	1	1	0	1	1
Niger	1	1	2	0	0	0

Formatted: Centered

Nigeria	1	6	7	2	1	3
Senegal	0	1	1	0	0	0
South Africa	3	3	6	2	2	4
Sudan	1	4	5	1	0	1
Tanzania	1	2	3	0	0	0
Togo	0	1	1	0	0	0
Uganda	0	1	1	0	0	0
Zambia	1	0	1	0	1	1
Zimbabwe	1	0	1	0	0	0

Potential gain :Column 1 – SSA exports which China imports; Column 2 – SSA imports of China exports; Column 3 – addition of Columns 1 and 2

Potential loss: Column 4 – SSA exports what China exports; Column 5 – SSA imports what China imports; Column 6 – addition of Columns 4 and 5

Source: From Stevens and Kennan (2006)

Assessing the indirect trade links in the clothing and textile sectors

Although insightful, this analysis of indirect trade effects remains at a relatively high level of trade aggregation (6-digits) and masks the severity of China's negative indirect impact of SSA manufacturing exports. This only emerges from more detailed sectoral analyses. By far the most significant manufactured export from SSA in recent years has been in the clothing and textile sector, largely as a result of US AGOA preferences. Table 5 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 5: Growth of SSA clothing and textile exports, 2000-2004

Country	Year	Exports \$ '000	US Share (%)	AGOA as Share of Exports to US (%)
Kenya	2000	78,000	89.6	NA
	2001	87,000	92.7	80
	2002	156,000	95.9	96.6
	2003	234,000	95.8	93.7
	2004	333,000	95.4	97.9
	2005	306,000	95.3	98.5
	YTD 2006			97.5
Lesotho	2000	154,000	94.9	NA
	2001	237,000	94.3	60.1
	2002	350,000	97.9	98.9
	2003	429,000	97.7	94.9
	2004	496,000	97.3	98.2
	2005	406,000	96.5	99.4
	YTD 2006			99.4
Madagascar	2000	633,000	18.9	NA
	2001	709,000	27.4	51.8
	2002	387,000	26.1	84.4
	2003	527,000	41.5	94.8

	2004	784,000	45.5	97.2
	2005	771,000	37.0	98.5
	YTD 2006			96.0
Mauritius	2000	1,652,000	16.3	NA
	2001	1,561,000	16.6	16.3
	2002	1,524,000	18.3	41.8
	2003	1,629,000	17.9	50.2
	2004	1,638,000	15.0	65.2
	2005	1,384,000	12.4	85.8
	YTD 2006			92.1
South Africa	2000	867,000	31.0	NA
	2001	864,000	38.3	17.4
	2002	927,000	39.1	46.9
	2003	1,027,000	41.2	48.7
	2004	756,000	44.1	66.3
	2005	571,000	33.8	64.8
	YTD 2006			53.1
Swaziland	2000	56,000	88.4	NA
	2001	74,000	89.0	17.1
	2002	118,000	92.9	82.7
	2003	174,000	97.7	89.9
	2004	205,000	98.3	98.3
	2005	171,000	99.4	99.0
	YTD 2006			99.5

The primary driver for these growing clothing and textile exports has been trade preferences in general and the US AGOA preference scheme in particular. However, within AGOA, there has been a key derogation on the rules of origin which allows SSA exporters to import inputs from outside of the AGOA region or the US. (Mauritius and South Africa, which do not qualify as least developed countries, do not qualify for this derogation, although Mauritius was provided with a one-year derogation between 2004-2005). This derogation was initially limited to September 2004, then extended to September 2007, and has now been further extended to 2012. The intent of the original rules of origin was to encourage backward integration into the textile sector. However, the consequence of applying the derogation has been that, the only significant case of the development of a textile industry has been the construction of a \$100m denim plant in Lesotho, coming on stream in mid-2004.

In assessing the outcome of the two years of quota removal on these six SSA clothing and textile exporters, we concentrate on the clothing sector since with the exception of South Africa, there are negligible direct exports of textiles to the US. In each case we compare export volumes and market shares for all exports. However, since a key to market developments lies in unit price behaviour, we also analyse unit prices at the highest level of trade disaggregation (10-digit HS product categories).

As can be seen from Table 6 and Figure 3, the major trends were that:

- The value of SSA clothing exports to the US dropped by 25 per cent between 2004 and 2006. (January-November for both years) This masked differential country performance. Lesotho experienced a fall in export value of 15 per cent, most of which occurred in 2005; its exports stabilised in 2006. Madagascar, fared worse (a decline of 24 per cent), as did Swaziland (22 per cent). Kenya saw largely unchanged exports (a fall of only three per cent). The biggest casualties were South Africa (a decline of 54 per cent) and Mauritius (a decline of 62 per cent). Significantly neither of these latter two economies were able to utilise the 3rd country fabric derogation.
- By contrast, in the same period, the value of China's clothing and textile exports to the US increased by 82 per cent. In the major products exported to the US by AGOA, the value of Chinese exports rose by 161 per cent. (the aggregate export values are for 2004-2006; the changes in unit values are for 2004-2005).³
- Unit prices on average remained reasonably stable in key product groupings for individual SSA countries, with Madagascar experiencing the sharpest decline (10 per cent). In contrast, in the same product groupings, the unit value of Chinese exports almost halved. (However, it is not clear to what extent this was due to a reduction in the unit prices of individual products, or China's entry into producing lower-end products within each of these 10-digit product classifications) Need data or reference to Kaplinsky and Morris. Cant just say this.
- In general AGOA economies performed less badly in their major exported items than they did in aggregate, suggesting a process of specialisation. However, alarmingly, in general China's export growth and the rate of price decline in these AGOA-populated sectors were greater than for its overall textile and clothing exports, suggesting potentially heightened competition for SSA products in the future.
- There has been significant churn as exporting firms in SSA have struggled with competition. For example, seven of the 10 largest product items (10-digit classification) exported from AGOA between January-November 2006 were not exported to the US in the same period in 2005, and only six of the 10 major exported items in 2005 were exported in 2006.
- The share of SSA exporters in the US clothing and textiles imports grew between 2001 and 2004, reflecting the combination of quota-access and preferential AGOA trading arrangements. However, the removal of MFA quotas set back this advance, and African exporters experienced a significant fall in their share of the US market after quota removal (Figure 3). By contrast, the share of China in each of these major product markets grew significantly.

³ Because of the degree in churn in exported products (see accompanying text below) it was not feasible to compare unit price performance over the 2006-2004 period.

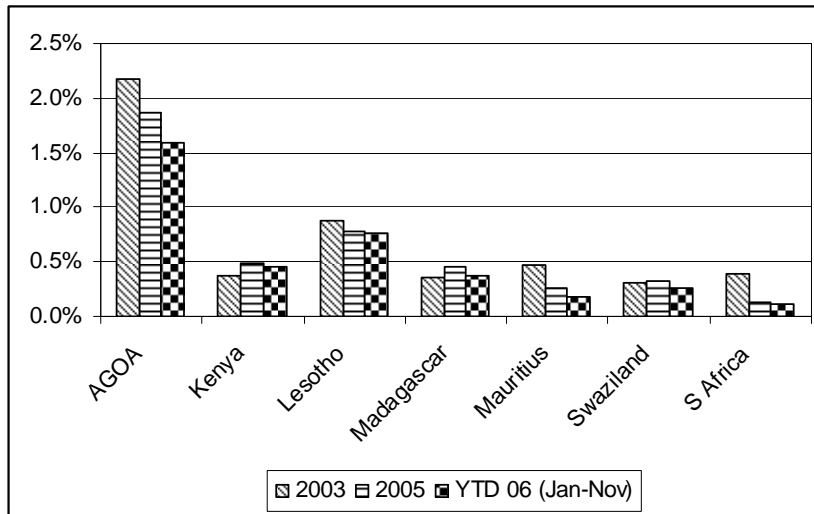
Table 6: Change in value of clothing exports to the US, 2004, 2005 and 2006 (January-November data in all years) (%)

	2005/2004		2006/2005		2006/04		Change in Unit Price of top 10 products 2005/04	
	SSA	China	SSA	China	SSA	China	SSA	China
AGOA	-16.5	56.9	-11.4	14.1	-25.2	82.0	-0.9%	-46%
Kenya	-2.5	77.8	-2.5	13.7	-3.3	106.3	-1.9%	-45%
Lesotho	-14.3	110.8	0.3	20.8	-14.6	160.4	-3.2%	-46%
Madagascar	-14.4	72.0	-14.9	16.3	-24.2	104.1	-9.5%	-44%
Mauritius	-26.4	73.2	-30.6	13.5	-61.6	100.0	-4.6%	-45%
Swaziland	-9.9	93.0	-16.2	15.3	-22.4	128.1	-2.7%	-52%
S Africa	-43.7	63.7	-18.7	11.5	-54.0	85.8	3.0%	-33%

Source: Calculated from <http://dataweb.usitc.gov> data, accessed on 10th January 2006

^a Unit prices calculated for top 10 products in 2004 for each AGOA country's exports

Figure 3: AGOA country share of US market in All product categories in which country exports were concentrated in 2003-YTD2006



Source: Calculated from <http://dataweb.usitc.gov> data, accessed on 10th January 2006

^a Unit prices calculated for top 10 products in 2004 for each AGOA country's exports

A major consequence of this decline in exports from the AGOA region was the impact on employment and overall economic activity. At its peak, in 2002, Lesotho's clothing exports to the US accounted for virtually all manufactured exports, and were equivalent to 50 percent of GDP. In Kenya in 2003, clothing enterprises accounted for the equivalent of nearly 20 percent of all formal sector manufacturing employment. Table 7 shows the impact of quota removal on employment in 2005. In Swaziland, most severely affected, overall employment almost halved. In Lesotho, in the first half of 2005, eight of the 47 garment exporting factories closed and employment fell by 26 per cent. Even in Kenya (where clothing exports had only fallen by 2.5 percent in 2005), employment declined by nearly ten percent. The impact on South African is

more severe than appears from Table 7, since there had been employment loss in the industry in the years preceding quota removal, although the exact figures are difficult to determine (Edwards and Morris 2006). This was a result of competition in third country markets (South Africa had never been able to benefit from the 3rd country fabric provision), an appreciation of the Rand, and the direct impact of Chinese competition in the domestic market.

Table 7: Employment decline in the clothing sector, 2004-2005.

	2004	2005	% decline
Kenya	34,614	31,745	9.3
Lesotho	54,000	40,000	25.9
S Africa	98,000	83,000	15.3
Swaziland	28,000	16,000	42.9

Source: Kenya and Swaziland - Industry and Government interviews; Lesotho- Morris and Sedowski 2006b; South Africa – Edwards and Morris 2006

However, after this initial decline following the removal of MFA quotas in 2005, the position in Lesotho and Kenya stabilised in 2006. In Lesotho's case, employment rose from the trough of 40,000 in mid-2005 to 45,000 in late 2006, still below the 2004 peak of 54,000 in 2004, and the decline in export value was halted. In Kenya, the fall in export values remained low. Interviews with manufactures and buyers in both countries and the US suggest three factors which explain this performance. First, in the case of Lesotho, its DCCS scheme⁴ provided subsidies to local producers. Second, the US buyers sourcing from Lesotho were mindful of the possibility of China Safeguards being sustained.⁵ Third, in both countries buyers and producers had the expectation that the 3rd country sourcing provision (which had been due to expire in September 2005), would be maintained (as we shall see below, this was broadly correct). And, finally, in the case of Kenya, its currency did not appreciate relative to the US\$. (We will return to the significance of these findings in Section 4 below).

Why did the other AGOA exporters not experience a similar stabilisation in 2006? Neither South Africa or Mauritius were able to benefit from the 3rd country fabric provision. Moreover, South African producers experienced a

⁴ The Duty Credit Certificate Scheme subsidises clothing exporters from South African Customs Union member states but is regarded as being WTO non-compliant and was ended in 2005. However, under pressure from industry and governments of Lesotho, Swaziland, Botswana and Namibia, the South African government belatedly, and late, agreed to an interim extension until March 2007 with a proviso that industry come up with a new WTO compliant scheme.

⁵ The Chinese accession agreement to the WTO, allows for safeguard tariffs and quotas to be applied solely against Chinese textiles and clothing, even when imports exert only a slight adverse impact on the domestic industry. In June 2005, the EU and China reached an agreement that limited 10 categories of Chinese textiles exports to the EU to between 8 and 12.5 percent growth above a specified base period for the next three years. In December 2005, the US and Chinese trade representatives agreed to a three-year agreement reducing US imports of Chinese textile and apparel products in all or parts of 34 sensitive categories.

rising exchange rate and suffered more than most from a breakdown in extending the DCCS. In the case of Swaziland, notwithstanding a decline in products destined for the US market, 2006 showed a stabilisation of exports as a number of South African firms relocated and 'exported' into the South African domestic market. The stabilization of exports in 2006 is not reflected in the data because it is intra SACU trade and appears as an increase in clothes for the domestic market. Moreover, Swaziland did not benefit from an efficient policy infrastructure which has distinguished Lesotho's response to the crisis. Finally, in the case of Madagascar, two factors led to a diversion of exports away from the USA and into other markets. Firstly many of the principals in the clothing sector were of Mauritian or European origin, and they had made the strategic decision to focus on the EU market (witness the relatively low share of the US in Madagascar's exports in Table 5 above).⁶ Secondly, in 2005 the Madagascan producers began to supply the rapidly expanding South African market

A similar story can be told for the resource-intensive and labour-intensive furniture sector (Kaplinsky and Morris, 2006a). SSA's share of global furniture trade has fallen since the mid-1990s from more than one percent to less than one percent, and now largely comprises of exports from SSA. But South African furniture exports are falling rapidly, and firm-level research shows direct competitive impacts from Chinese (and Vietnamese and Indonesian) producers in global markets (Table 8).

Table 8: Comparative costs of same item of garden furniture from SSA and Asia

	Average price	Price index
Ghana	£50	100%
South Africa	£60	120%
China	£30	60%

Source: Kaplinsky and Morris, 2006a

3.2. FDI and the production channel

"Most European companies abandoned Sierra Leone long ago, but where Africa's traditional business partners see only difficulty, the Chinese see opportunity. They are the new pioneers in Africa, and - seemingly unnoticed by aid planners and foreign ministries in Europe - they are changing the face of the continent."
Hilsum (2006)

Chinese FDI, and indeed as we shall see, Chinese aid 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.

⁶ Unlike China which faces duties in exporting clothing into the EU (generally in excess of 12 per cent, but varying with the product), SSA exporters into the EU benefit from zero-tariff entry

By contrast, much of Chinese FDI in SSA comes from firms which are either wholly- or partially state-owned. They have access to very low-cost capital, and hence operate with much longer time-horizons. Moreover, many of these investments are either explicitly or implicitly linked to achieving strategic objectives, often those which are focused on long-term access to raw materials, and are closely bundled with Chinese aid (Broadman, 2007).

Unlike the trade channel where there is extensive data (particularly in relation to aggregate flows, and flows over time), data on FDI flows is limited. In part this is because FDI is inherently difficult to measure. It is also not clear how much of 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. The anecdotal evidence emerging from SSA is that in many countries, there is a rapidly growth evidence of Chinese entrepreneurship, sometimes through large firms (such as in infrastructure projects), and in other cases through smaller scale initiatives (such as in Sierra Leone and Namibia).

China has become a major participant in the global flow of FDI. But its role has primarily been as an importer of FDI. Together with Hong Kong, its share of global FDI directed at developing countries grew from an average of 34 percent in 1991-6 to 41.7 percent in 2000.⁷ By contrast, SSA's share in the same period fell from 5 to 3.5 percent. China has been much less significant as a source of FDI. Its share of outward FDI between 2000 and 2003 was less than 0.5 percent of global total flows (UNCTAD data, cited in Jenkins and Edwards, 2005: 32).

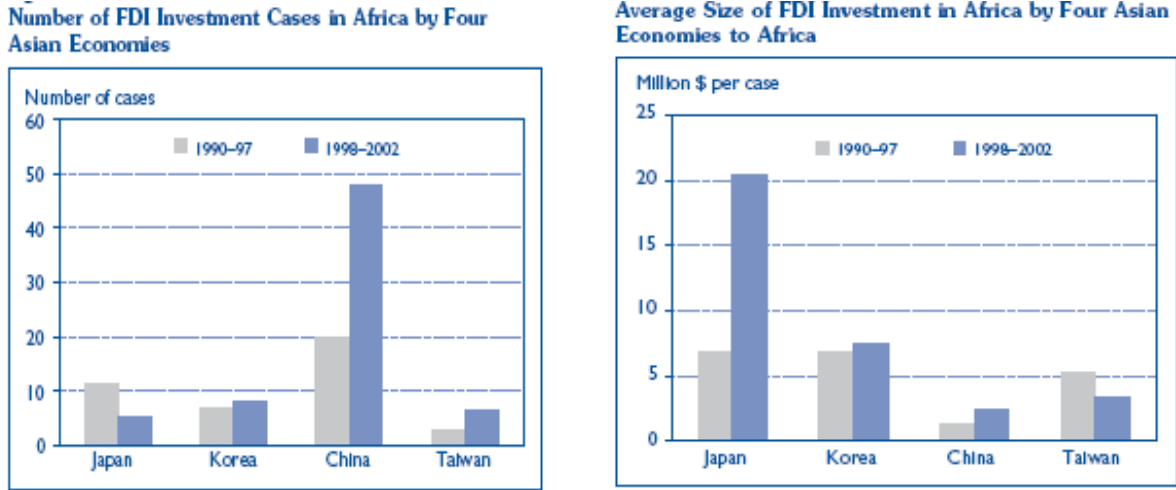
Figure 5 provides data on the extent of known Chinese FDI flows to SSA, and compares these to flows from other Asian economies.⁸ It does not reflect recent, post 2002 investments in the oil sector in Sudan, Angola and Nigeria. This data shows a rapid growth in the flow of Chinese FDI, following the government's "go global" strategy initiated in 2001 and directed at the corporate sector. FDI in SSA reached a total of \$1bn by mid-2005, up by \$125m in the first six months of 2005 alone. For many firms, SSA is an important proving ground. As a Chinese hotel manager in Sierra Leone observed, "Africa is a good environment for Chinese investment, because it's not too competitive," (Hilsum 2005). However, notwithstanding this drive to outward FDI, the official number of investments recorded by the Chinese Ministry of Commerce remain small – less than 50 investments p.a. between 1998 and 2002. By comparison with that from other Asian economies, Chinese FDI also tends to be relatively small-scale, with an average size of less than \$3m between 1998 and 2002. However, after 1998 the flow of Chinese FDI increased dramatically, exceeding the value of flows from Japan

⁷ Some of this was "round-tripping" FDI – Chinese firms exporting capital to Hong Kong and then taking advantage of government incentives for inward FDI.

⁸ The data in Figures 5 and 6 and Table 9 are drawn from the Ministry of Finance of Japan, the Export-Import Bank of Korea, The Ministry of Commerce of People's Republic of China, and the Ministry of Economic Affairs of Taiwan.

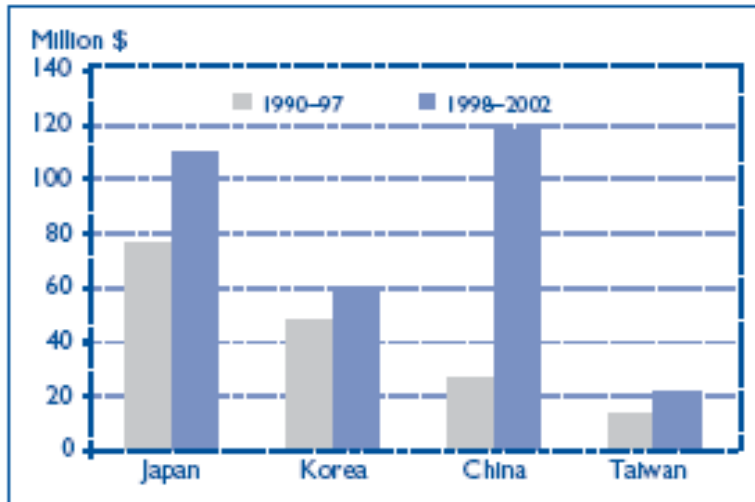
(Figure 6). As Table 9 shows, prior to the large Chinese investments in the energy sector in SSA in recent years, most of this FDI was directed to South Africa (manufacturing) and Zambia (copper).

Figure 5: Annual FDI flows from China, Japan, Korea and Taiwan, annual number and average size.



Source: World Bank, (2004a), Patterns of Africa-Asia Trade and Investment, Potential for Ownership and Partnership, Africa Region Private Sector Group, Washington: World Bank. Vol. 2.

Figure 6: Annual FDI flows from China, Japan, Korea and Taiwan, aggregate annual value



Source: World Bank, (2004a), Patterns of Africa-Asia Trade and Investment, Potential for Ownership and Partnership, Africa Region Private Sector Group, Washington: World Bank. Vol. 2.

Table 9. Top 20 SSA countries receiving Chinese FDI (1979-2001) and sectoral concentration

Country	No. of Investments	Investment amount (thousand \$)
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%)
Egypt	17 (3.8%)	30,635 (4.2%)
D. R. of 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%)
Niger	3 (0.7%)	14,964 (2.1%)
Mozambique	6 (1.3%)	14,638 (2.0%)
Guinea	5 (1.1%)	11,827 (1.6%)
Sudan	9 (2.0%)	11,675 (1.6%)
Eq. Guinea	4 (0.9%)	11,315 (1.6%)
Africa total	448	726,532

Industry	No. of projects	Amount invested (\$ million)
Service	200 (40.1%)	124.50 (18.3%)
Manufacturing	230 (46.1%)	315.27 (46.3%)
Machinery	20 (4.0%)	16.06 (2.4%)
Electric appliances	36 (7.2%)	25.40 (3.7%)
Light Industries	82 (16.4%)	86.54 (12.7%)
Spinning and weaving	58 (11.6%)	101.60 (14.9%)
Others	34 (6.8%)	85.67 (12.6%)
Agriculture	22 (4.4%)	48.13 (7.1%)
Resource development	44 (8.8%)	187.60 (27.5%)
Other	3 (0.6%)	5.85 (0.9%)
Total	499	681.35

Source: World Bank, (2004a), *Patterns of Africa-Asia Trade and Investment. Potential for Ownership and Partnership*, Africa Region Private Sector Group, Washington: World Bank. Vol. 2.

The pattern of recent Chinese involvement in production in SSA, including through FDI, can be characterised by four major trends:

- Increasing investments in the energy and resource sectors
- Participation in infrastructural projects
- Participation in global production networks
- Small scale entrepreneurial investments

Investments in the energy and resource sectors

In recent years, Chinese energy companies have become increasingly prominent as investors in Africa. The Chinese National Petroleum Corporation (CNPC) is heavily involved in Sudan where it is engaged in a joint venture with the Sudan Government, Petronas (Malaysia) and the Talisman Energy (Canada). It has a 40 percent share in the \$1.7bn Greater Nile Petroleum Operating Company, an equivalent share in a new project in Dafur and in the Melut Basin. It is a big investor in Nigeria where it received access to exploration sites as part of a package which included the construction of a

1,000 megawatt hydroelectric plant in Mambila. It also has a controlling share of a refinery in Kaduna. A second Chinese energy company, Sinopec, is an investor in the Sudan, Gabon and Angola.

Chinese investments in the mining sector, primarily in copper in Zambia, have exceeded \$160m and Chinese firms are beginning to invest also in cobalt and copper mines in the DRC.

Investment in infrastructural projects

Chinese firms have become an increasingly important participant in the construction sector (Centre for Chinese Studies, 2006). Many of these firms are state-owned, as in the case of the China Road and Bridge Corporation which was involved in 500 construction projects by 2004. Participation in infrastructure and construction projects range from stadiums in West Africa, to Presidential Palaces (in Kinshasa), dams (a \$650m tender for Nile River Merowe Dam project), roads, railways and government buildings.

Chinese involvement in Mozambique is indicative both of the growing scale of these activities, and the competitiveness of Chinese firms. (This discussion on Mozambique is drawn from Bosten, 2006). Remarkably, it also occurs in an economy where currently China appears to see no specific strategic interest in resources to feed the growing appetite of its manufacturing sector. It has singularly failed to invest in any of the recent investments in the Mozal Aluminium Smelter, Sasol Natural Gas, Kenmare Mineral Sands, Moatize Coal Mines and the Corridor Sands Titanium Project. Chinese firms have also not tendered for some large infrastructure projects such as the Maputo Port Development Project, the Limpopo railway line, the Zambezi Bridge construction (2006-2009), and the rehabilitation of the Sena railway line.

Instead, Chinese firms began by engaging in prominent Chinese aid-related projects such as the Mozambique Parliament buildings (1999), the building for the Ministry of Foreign Affairs (2004), the Chissano Conference Centre (2003) and the new military quarter. Each of these projects either involves gift-aid or loans on concessional terms, ranging from £5m for the Conference Centre to \$12m for the Ministry of Foreign Affairs building. In Namibia, Chinese firms have built aid-related showpieces such as the Supreme Court and the Police and Prison Training College in Windhoek, a luxury hotel in Walvis bay and a housing estate in Katimo Mulilo (Dobler, 2006).

Very recently, Chinese firms have begun to branch out into a soya processing plant (\$10m), the production of prawns (\$12m), a large shopping centre and industrial warehousing in Maputo. Perhaps more significantly, Chinese firms have begun to compete effectively in the rehabilitation of infrastructure, particularly roads, where Chinese firms are involved in the repair of more than 600 kms of Mozambique's roads (two-thirds of the total being rehabilitated), and the rehabilitation of a large bridge between Mozambique and Tanzania. Chinese firms have also recently won tenders to repair water systems in Maputo (\$30m) and Beira and Quelimane (\$15m).

This growing participation in construction and infrastructure reflects the competitiveness of Chinese firms, which are reported to provide good quality projects at a price discount of 25 to 50 percent compared to other foreign investors. It is not clear how this cost-advantage is derived, but preliminary enquiry suggests it arises from a combination of factors which include:

- Lower margins
- Chinese firms have access to much cheaper capital than local investors⁹
- The almost exclusive employment of low-paid Chinese staff, often apparently living at even lower standards than the Mozambique population, and living in seclude barracks
- The use of Chinese materials, with very little local sourcing
- The use of standard designs
- Less attention to environmental impacts
- Access to a hard currency premium paid by the Chinese government
- The Chinese Government provides subsidies to Chinese companies when they establish themselves overseas

A study of Chinese Construction firms in four SSA economies (Angola, Sierra Leone, Tanzania and Zambia) provides some data on the source of the competitiveness of Chinese construction firms (Centre for Chinese Studies, 2006). This arises in part from the intensive use of Chinese labour. For example, in Angola, Chinese construction firms pay Chinese workers around \$1 per day, compared to non-Chinese companies who pay their Angolan workers \$3-4 per day. But it also arises from the use of cheap inputs sourced largely from China rather than from the local economy. Again, in Angola, cement imported from China costs \$4/50kg, compared to \$10/kg for Angolan-made cement. Chinese firms also benefited heavily from low-cost and sometimes subsidised capital, although this was more difficult to evidence.

Incorporation in global production systems

Chinese manufactured exports are more effectively described as “East Asian products”, incorporating inputs from surrounding countries (Humphrey and Schmitz, 2006). In fact China is in trade-deficit in its region. This reflects a process of the growing interconnection of production in regional, coordinated value chains, and trade in increasingly finely-differentiated intermediate products.¹⁰

With one exception, there is little evidence that Chinese and SSA firms are interconnected in these global value chains. The exception is the case of textiles and garments. As saw in Section 3.1 above, exports of clothing to the US have become very significant for six SSA economies, including for four

⁹ In the case of the clothing and textiles sectors, the cost of capital for Chinese investors (less than three percent) is much lower than for COMESA investors (in the region of 15 percent) (Manchester Trade Team, 2005)

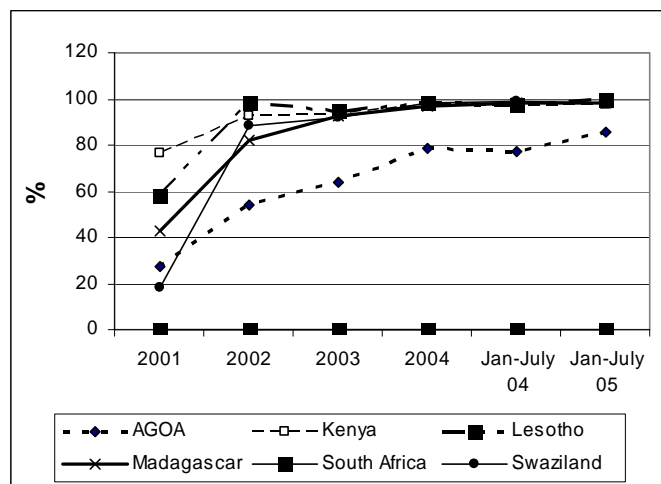
¹⁰ This is one reason why the use of aggregate trade data provides little insight into the drivers of trade since it fails to distinguish between largely “arms-length” inter-industry trade in complementary products and intra-industry trade in intermediates in coordinated global and regional value chains

least developed economies – Lesotho, Madagascar, Kenya and Swaziland. The basis for their export success under the AGOA programme is the specific derogation which gives them the opportunity to incorporate fabric and other inputs sourced from outside the AGOA region or the USA. This is a temporary derogation which has been extended once (from September 2005 to 2007), and which is currently the subject of intense lobbying.

As Figure 6 shows, the result has been a very rapid rise in the proportion of non-AGOA and non-US sourced cloth incorporated in SSA AGOA exports to the USA. Only South Africa (and Mauritius – not included in this figure) are excluded from this derogation, with the consequence (as we saw above in Table 5) of a sharp fall in its AGOA exports following quota removal in 2005. Most of these AGOA clothing producers source their textiles from China. This is even the case for the Taiwanese clothing exporters, many of whom came to SSA in the late 1980s precisely because the governments of the recipient countries had refused to recognise mainland China.

What this phenomenon displays is the very industry-specific integration of production in global value chains. But it is fragile, and most foreign investors (almost exclusively Asian-owned), as well as domestically-owned firms, clothing firms report that if the derogation is not renewed after September 2007, they will close their SSA plants (Kaplinsky and Morris, 2006a).

Figure 6: Share of non-AGOA and non-US cloth in AGOA exports to US, 2004-2005.



Source: Calculated from US Department of Commerce, Office of Textiles and Apparel (OTEXA).

Small scale entrepreneurial investments

In some SSA economies, there appears to be the growth of small-scale entrepreneurial investment from China, often presaged by the construction of specialised shopping malls retailing Chinese goods. One country for which there is fragmentary evidence is Sierra Leone. Here, Chinese FDI has

become very prominent, particularly in a context where more traditional European and US investors have been wary of political risks and are subject to pressures to support good governance. Chinese investors appear to be less concerned with these risks and very flexible and rapid in their responses. The Sierra Leone ambassador to Beijing observed that

'The Chinese are doing more than the G8 to make poverty history...If a G8 country had wanted to rebuild the stadium, we'd still be holding meetings! The Chinese just come and do it. They don't hold meetings about environmental impact assessment, human rights, bad governance and good governance. I'm not saying it's right, just that Chinese investment is succeeding because they don't set high benchmarks.' (Hilsum, 2005).

Investments in Sierra Leone include a joint venture with the government in an industrial estate making mattresses, tiles, hair lotions and other light industrial products. Unlike other Chinese FDI in SSA's resource and energy sectors, most of these investments in Sierra Leone are undertaken by small-scale private investors, in this case mostly from Hunan Province (Financial Times, 16th March 2005).

An important, and almost certainly significant (albeit poorly evidenced) channel of Chinese presence in SSA is the growing number of Chinese traders to be found in many SSA economies. A good example of this is the expanding community of wholesalers in Oshikango, Namibia, a small trading town on the broader with Southern Angola (Dobler, 2006). By 2005 there were between 70 and 120 Chinese working in 22 shops in this trading complex. They originate from all over China, and have little in common, even speaking different Chinese dialects. The pioneer in this region came to Namibia in 1993, and moved to Oshikango in 1999. Perhaps because of his relative longevity, he is the only trader who has diversified into other regions in Namibia, Oshikango's Chinese traders mostly import and then re-export basic consumer goods such as clothing, textiles, footwear, simple electronic consumer goods and mattresses. These are sold at a very cheap price – a carton of 300 shoes, for example, for \$100.¹¹ This phenomenon of small-scale trading is not limited to Namibia, and similar rapidly-growing trade-linked communities are found all over SSA. The number of Chinese living in Lusaka is estimated to have increased from 3,000 to 30,000 over the past decade., with an estimated 160,000 Chinese living in South Africa, many of whom are clustered in a suburb of Johannesburg.

SSA FDI in China.

The flow of FDI between SSA and China is not one-way, although most of SSA investment in China comes from South Africa. Here a number of large South African firms have 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,

¹¹ The invoiced import price for these same products is an astonishingly-low \$5, suggesting the possibility of under-invoicing from China, perhaps to fund round-tripping FDI back into China.

2004). Other large investors are SASOL, which is about to join 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 owned by Anglo American, in paper), Polifin in chemicals and ABSA and NEDCOR in the financial sector.

Aside from these South African investments, there are a few isolated cases of firms whose origins lay in SSA investing in China. Chandaria Holdings, with its roots in Tanzania and subsequently in Kenya, has for example a number of manufacturing plants in China which it sees as the focal point for its new investments in developing countries (Interview with Dr Manu Chandaria, June 2004).

3.3. The Aid Channel

As in the linked case of FDI, Chinese aid to SSA, of which little is known, appears to be very closely linked to strategic and political objectives, perhaps even more so than the aid offered by some European countries and the US. The formal links between China and SSA go back to the Bandung Conference in 1955. Until the mid-1990s, much of this aid was directed to Liberation Movements and to further the desire to politically isolate Taiwan. But since the mid 1990s, aid appears to be increasingly directed towards broader strategic objectives, and in particular to the development of links with resource-rich SSA economies. In general, Chinese aid is closely bundled with infrastructural projects, often linked to the extraction and export of minerals and oil to China.

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, including flagship projects such as the 1,860 km TAZARA railway linking Zambia and Tanzania in the early 1970s (Box 1.). Linked to this, in recent years, has been a programme of limited debt-relief, totalling RMB10.5bn owed by 31 SSA countries. The third form of aid provided has been a growing training programme (<http://english.sina.com/china/1/2006/0107/60908.html>, accessed 3rd March 2006). 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. 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 at the end of 2004).

Fifth, in an initiative announced at the second ministerial meeting of the Sino-African Co-operation Forum held at the end of 2003 China has instituted a programme of tariff exemption for 25 SSA economies, covering 190 products, including food, textiles, minerals and machinery. The policy took effect at the beginning of 2005 (People's Daily, 20/10/05, www.chinadaily.com.cn/ accessed 3rd March 2006). These trade references are called for since, as can be seen from Table 10, Chinese tariffs on imports from SSA, although

generally lower than Indian tariffs, were significantly higher than those in other Asian economies. We do not have data on the differential tariffs levied by China on imports from SSA compared to tariffs levied by individual SSA countries on imports from China. Finally, China has in very recent years begun to provide peace-keeping forces to SSA, with 1,500 troops being deployed by mid-2006.

Box 1. China's rehabilitation of railway infrastructure in oil-supplying SSA economies

In 2006 China provided soft-loans to finance the reconstruction of creaking transport infrastructure in a number of SSA oil-supplying economies. These loans included:

- \$1bn to Nigeria to repair old lines and supply new rolling stock and equipment
- rebuild almost half of Angola's 754 road highways
- \$500m to overhaul Angola's rail network
- offer of a further \$1.5bn to upgrade other parts of Angola's transport network

Source: Guardian, 23rd May 2006.

Table 10: Average Applied Tariff Rates of Asian Countries on Imports from Africa, by SITC Product Group, %, 2001

SITC group	China	India	Indonesia	Japan	Korea	Malaysia	Singapore	Asia average
0	31.77	36.58	5.14	5.69	7.02	1.15	0.00	11.65
1	34.06	36.87	5.08	1.27	16.53		0.00	18.59
2	2.24	9.31	0.26	0.08	4.20	0.10	0.00	2.32
3	7.09	28.60	0.00	0.17	4.78	0.38	0.00	5.04
4	56.77	44.67	5.00	1.04	8.00	3.21	0.00	24.97
5	10.24	33.34	3.73	0.05	6.87	1.23	0.00	22.22
6	6.12	28.48	2.27	0.63	3.74	1.47	0.00	3.60
7	14.09	29.35	0.40	0.00	2.84	6.30	0.00	5.59
8	27.69	32.37	10.64	5.33	8.24	2.59	0.00	8.47
9	6.25	35.00	5.78	0.00	3.00	0.06	0.00	34.14

Notes: Average applied MFN rates are weighted by imports from the 53 African countries to individual Asian countries. All tariff rates used are for 2001, except for Korea, for which 1999 rates are used. The Asia average is the average rates for the 12 Asian countries covered by this study.

Source: WITS analysis of UNCTAD TRAINS and UN Comtrade.

Source: World Bank, (2004a), Patterns of Africa-Asia Trade and Investment, Potential for Ownership and Partnership, Africa Region Private Sector Group, Washington: World Bank. Vol. 2.

3.4 The vectors in aggregate

In assessing the overall impact of these links between China and SSA, we return to the architectural classifications laid out in Section 2. We began by observing that China's impact on SSA can be gauged in relation to three primary vectors – trade, production and FDI, and aid. Each of these vectors, as we have seen in Section 3, is 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 saw in Section 2 that these links may be both complementary and competitive, and direct and indirect.

We also noted at the outset of this Agenda-Paper in Section 1 that there is 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 direct (and perhaps more negative indirect impacts), 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.

With these caveats in mind, what can be said in aggregate about China's impact on SSA? Figure 7 is an elaboration of the synthetic framework which we set out in Figure 2 above. It presents some of the major conclusions which emerged from our review of what is known about the three key vectors (and discussed in Sections 3.1-3.3). A number of tentative conclusions can be drawn, although the major point of Figure 8 is not so much to provide a comprehensive overview (since so little is known about the detail of these impacts, and so many are only of emerging importance), but rather a framework for thinking through the issues and the range and extent of potential impacts.

The conclusions which we draw are as follows:

- We are not able 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. But we can find no evidence for this type of linkage. 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 impacts. By contrast, indirect inputs are more difficult to evidence and much more difficult to measure.

- Data on the trade channel (Section 3.1 above) is much better than that on the production/FDI and aid vectors. Is this a function of our lack of knowledge on production and aid and/or the availability of global trade data, or does the trade impact assert itself first and most significantly?
- With the exception of indirect competitive effects in manufacturing through the trade channel, in general the balance of existing evidence would tend 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 evidence which is available, or the reality of the real world.
- It is difficult to generalise across countries and sectors. They might experience the impacts in each of these three vectors 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).
- 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).
- Figure 8 provides a largely static picture. For example, it suggests that the trade impacts have been most important so far. How will this change over time?

Figure 8: China and SSA: The three primary vectors, and complementary-competitive and direct-indirect 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 	
Competitive		Chinese aid to Latin America creates productive capacity which competes with SSA producers and lowers export prices	

4. KEY ISSUES

What follows from this analysis of the impact of China on SSA, and how does this inform major policy choices?

In the discussion which follows in this section, we address the implications for policy in six key areas. We do not offer detailed prescriptions for change but, instead, as in the case of the synthetic framework used to assess the impact of China on SSA, to see these as promoting the basis for discussions with key stakeholders, within SSA and China, in DFID and with and in other bi- and multi-lateral agencies. The key issues are:

1. The challenges posed to industrial policy and sectoral choice
2. The problems posed for commodity producers
3. Reacting to changing patterns of poverty and income distribution
4. The implications for the promotion of good governance, particularly in regard to fragile states
5. Global and regional links
6. Thinking about the future
7. Filling the knowledge gaps

4.1 The challenges posed to industrial policy and sectoral choice

It is in the industrial sector that SSA is most clearly challenged by the growth of the Chinese economy. In the absence of Chinese demand for SSA manufactured exports (with the marginal exception of South Africa) China's impact on SSA industrialisation arises from its growing exports. This affects SSA on two related and threatening fronts – competition in internal markets for domestically-oriented manufacturers, and competition in external markets from export-oriented industry.

It is in the clothing, textiles, furniture and footwear sectors that most is known about these issues. With regard to domestic markets, imports from Asia

generally, and China in particular, are making life very hard for domestic manufacturers. Ghanaian furniture and clothing exporters find it increasingly difficult to compete with Chinese imports, as do South African manufacturers (Kaplinsky and Morris, 2006b). A similar pattern can be found in the Ethiopian footwear sector (Egziabher, 2006). 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 for much of SSA, industry is currently poorly developed, and is 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. That is, what space is there for SSA manufacturing to expand in the future? And, what implications does this have for the growth of dynamic capabilities, learning externalities and structural transformation?

What can be done about this bleak picture? First, there is scope for improving the productivity of existing industries, often by working with value chains (for example, forestry, timber and furniture) rather than individual firms or subsectors. 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) detail the nature of these productivity gaps. Kaplinsky and Morris (2006a) 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.

A second area of policy intervention arises with respect to trade policy. 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 (and other Asian economies) in external markets. With regard to the US, the derogation on rules of entry in the clothing sector must be sustained beyond September 2007, even if it provides incentives which act contrary to deepening value added in the textiles sector. To avoid this stifling innovation, there is therefore the need to link AGOA rules of origin derogation to active industrial policies to promote the textiles sector in the SSA region. EU rules of origin are so tightly specified and restrictive that they provide little scope for least developed country exports of manufactures from SSA, particularly in the clothing and textiles sector.

A further important lesson which emerges from China's growing trade presence is for SSA producers to be less concerned about the sector of

production (for example, manufacturing versus services versus agriculture) 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 tourist sector.

4.2. The problems posed for commodity producers

Probably the most significant opportunity opened-up to SSA by China's rapid growth is the enhanced incentives which rising demand and prices provide to commodity producing countries. Many SSA economies have rich primary product resources, including some of the poorest economies such as Nigeria, the DRC and Angola, many of whom are characterised by fragile states. Rapid growth in South Africa (and in other middle-income commodity exporters in Latin America) is an indication of the benefits which this might provide.

Yet, one of the sharpest lessons we can draw from comparative international experience is that there is no clear correlation between development and commodity resources. Some commodity producers have fared well – Australia and Canada are cases in point. By contrast other commodity producers have fared badly, reflecting what some have termed the “resource curse”. In yet other cases such as Korea and Japan, rapid economic growth has occurred without significant resources – indeed, it is often argued that they grew *because* of the absence of resources.

Nevertheless, China's growing demand for resources does offer significant opportunities to many SSA economies. But the lesson which can be drawn from international experience is that the benefits of this resource boom will not follow automatically – they need effective management. In addition to the link between patterns of governance and resource-exploitation (which we will consider below in Section 4.4), this poses four major challenges to economic and social policy.

First and foremost, those economies with suitable natural resources, need to develop the supply elasticities required to take advantage of raised global demand and prices. This may require a combination of inputs, including enhanced infrastructure, targeted wooing of selected global resource-producing firms and the development of training and research and technology organisations (RTOs) in the respective National Systems of Innovation.

Second, resources are often finite (at least in high-grade deposits) and prices are often cyclical. There is thus a clear need to husband resource to ensure that the fruits can be drawn down over time, rather than at a single point in time. This poses important challenges for the economic management of resource rents (as Gottschalk and Prates, 2005 stress in their analysis of China's growing trade with Latin America). Clearly SSA policy-makers can

gain from comparative experience in this regard. Third, and related, one of the major problems posed by a growth in commodity prices is the impact on exchange rates – the “Dutch Disease”. Higher exports and raised prices often lead to currency appreciation. This creates problems for other exporting sectors, and promotes forms of structural change which lead to a reallocation of resources from the traded- to the non-traded goods sectors. Many non-commodity exporters in SSA are beginning to suffer from these Dutch Disease effects, particularly those linked to the appreciating Rand. Here there are perverse and adverse impacts on Lesotho and Swaziland – they face the downside of a currency appreciating due to commodity exports, without benefiting on the upside from raised commodity revenues. Again, SSA governments can learn from international experience in this regard, including from relatively successful SSA economies such as Botswana.

A fourth policy challenge arises in regard to the management of the environmental consequences of resource exploitation. This is most topical in relation to the depletion of forests (www.globaltimber.org.uk), which affects not only large global issues such as climate change, but also the location-specific degradation of specific environments (such as the recent mudslide in the Philippines which destroyed a whole town and arose as a consequence of illegal timber logging). These environmental spillovers are often substantial, and are not confined to the logging sector. The negative externalities may also be widespread, arising in part also as a consequence of transporting commodities to the coast.

4.3. Reacting to changing patterns of poverty and income distribution

Trade-related income poverty and distribution impacts can be very substantial (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 will be very substantial.

On the positive side, one of the major implications of growing imports of manufactures from China are the benefits which this provides to consumers, particularly to low-income consumers. This is not just a phenomenon affecting SSA, since the decline in prices of basic manufactures is a primary factor holding inflation at bay in many OECD economies (including the UK). As we have seen, many SSA manufacturers complain that Chinese products are displacing locally-produced commodities, but as Jenkins and Edwards point out, the primary displacement effect is on imports of manufactures from other, non-SSA economies.¹² Wholesalers and retailers are switching their sourcing to cheap Chinese suppliers, and this almost certainly has major positive

¹² Jenkins and Edwards conclude, “In the absence of data on the expenditure patterns of poor households and the extent to which they consume imported goods it is only possible to make a crude estimate of the likely impact of imports.” (Jenkins and Edwards, 2005: 29). “Only in Uganda of the eight countries, do basic consumer goods account for more than 20 per cent of total imports from China, although both Ghana and Tanzania are slightly below this level.” (ibid: 29).

impacts on consumer welfare. It is however an unmeasured impact, and we have little idea of its overall significance in consumer welfare, nor in which sectors the primary benefits are being felt. This is because most household consumption studies do not collect data at a sufficiently disaggregated basis, failing even to distinguish between food- and non-food purchases, let alone different types or sources of manufactures.

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, most visibly in export-oriented clothing enterprises (see Table 7 above). On the other hand, the rise in commodity production is associated both with capital-intensive technologies (biasing returns to holders of capital, rather than to labour), 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 (such as 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 (including in India and Sri Lanka). 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 as we shall see in Section 4.4 below, the use of these state revenues does not necessarily suggest that their poverty and distributional impacts are positive.

4.4. The implications for the promotion of good governance, particularly in regard to fragile states

Recent years have seen concerted and multifaceted attempts by Western aid donors, consumers and NGOs to promote various initiatives aimed at promoting good governance in SSA. Some of these address the issue of transparency, some are targeted at preventing abuses of human rights and some are aimed at the corporate sector with respect to labour rights and environmental impacts.

Much of Chinese FDI and investment in SSA has run against attempts by the global aid-community to promote better governance in SSA. For example, in the Sudan, the major Canadian investor withdrew because of concerns about Darfur and Sudan's poor record on human rights. Its 40 percent shareholding was replaced by CNPC, a China-state-owned oil company. This has led to Sudan's emergence as a net oil-exporter. It has also led to China becoming a major exporter of manufactures to Sudan. China supplies weaponry to Sudan and has helped construct plants in Sudan to manufacture small arms and ammunition. More visibly, China has vetoed attempts in the Security Council to actively censure Sudan for the civil war in Darfur.

In Angola, after Western donors postponed a donors-conference meeting due to concerns with non-transparency in mid-2005, China offered Angola a soft-loan of \$2bn. This soft loan, for 17 years at 1.5 percent p.a with a five year grace period (but tied to China-sourced inputs) also enabled Chinese firms to win-out over Indian competitors in accessing Angolan oil reserves. In Zimbabwe, although offering much less involvement and aid than Mugabe requested, Chinese firms have invested in the minerals and farming sectors, and have helped rehabilitate roads. In June 2006, China agreed to build three power stations and provide other infrastructural assistance worth in excess of \$1bn in exchange for commodities such as chrome. Whilst Western countries have embargoed arms-sales to Zimbabwe, China has continued supplying military equipment, including K8 fighter planes.

In the private sector, whilst Western firms have demanded fair labour practices in production in products sourced directly from SSA countries, some of the production routed through Chinese firms has not complied with labour standards in the same way (Kaplinsky and Morris, 2006a). There are also accusations that Chinese firms have imported illegally-logged timber from SSA (www.globaltimber.org.uk), and as we saw earlier, the Sierra Leone ambassador to Beijing remarked that the Chinese “don't hold meetings about environmental impact assessment, human rights, bad governance and good governance. I'm not saying it's right, just that Chinese investment is succeeding because they don't set high benchmarks” (Hilsum, 2005),

The ability of Chinese firms to invest in fragile states – such as Angola, the DRC, Sudan and Sierra Leone – is almost certainly linked to the political economy of the Chinese corporate sector. Many Chinese firms investing on SSA are partly or wholly state-owned, and reflect the desire of the Chinese government to build a long-term presence in a resource-rich continent. But, perhaps even more so than in the case of other forms of Chinese participation in SSA, this is an area of great sensitivity which is characterised by assertion and rumour as much as by detailed evidence.

There is a further indirect impact of China's demand for commodities on the nature of governance in SSA. In the 1960s in particular, the very large surpluses that some African economies could earn from exporting agricultural commodities stimulated kleptocratic governance and undermined the legitimacy of newly-independent regimes. Since the 1970s, world market prices for most agricultural exports have declined substantially, and this form of kleptocracy has declined considerably. However, recent research shows that rents derived from the extraction of 'point resources' (oil, gas, diamonds and minerals) have, since the 1970s, clearly encouraged authoritarian rule, high military expenditure, corruption and violence (Rosser, 2006). There are wide variations within Africa. Whilst Botswana is often cited as the exception to the general pattern, in other African countries, the discovery of large mineral resources has led to the deterioration in the standard of living of most people. This is the recent experience of the African country where Chinese companies are most deeply involved in resource extraction - the Sudan. Thus, to the extent that there is a generic trend towards commodity production

and mineral rents as a consequence of China's growing need for material inputs, it is likely that this will exacerbate some forms of poor governance in SSA.

4.5. Global and regional integration

Historically, most of SSA's trade links have been with the former metropolitan powers, either directly with the UK (in the case of Anglophone countries) and France (for Francophone countries), 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). It is not surprising therefore, as we saw in Figure 1 above, that currently most of SSA's trade is with the historically industrialised countries.

Two major developments are disturbing these historical patterns. First, and this conclusion emerges from the data on trade patterns, there appears to be a naturally growing regional market in southern Africa, as is occurring in the case of Mercosur in Latin America, reflecting regional externalities in production (Evans, Kaplinsky and Robinson, 2006a). But, secondly, the rapid growth in trade between SSA and China (and to some extent India) evidenced in Table 1 suggests a growing "magnetic pull" from the East. This poses a major policy challenge to individual and groups of SSA economies, particularly relevant in the context of stretched policy and administrative systems – 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 "Negative Integration" and "Positive Integration" (Evans, et. al., 2006b). The former refers to the removal of barriers to trade, as in the case of FTAs and WTO-orchestrated multilateral trade liberalisation. In contrast, 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 25 least developed SSA economies.

Increasingly, SSA economies are going to need to develop explicit policies in these areas. It will necessarily involved 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, particularly those in southern Africa, 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 Driver economies.

4.6. Thinking about the future – the development of "dynamic capabilities"

As we have seen, economic and political links between China and SSA are changing very rapidly. From the perspective of SSA economies, therefore, it is the capacity to change, to grasp opportunities and to minimise threats that is key. In the business literature, this is referred to as the development of “dynamic capabilities”. This involves a combination of search-capabilities, strategic-formulation-capabilities and implementation-capabilities, as well as the capacity to continually change these as new threats and opportunities arise.

Many of the dynamic capabilities which are required to meet these challenges are prefigured in the policy-related issues discussed in Sections 4.1-4.6 above. There is however at least one additional capability which is required, and that 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. China has recently “certified” seven SSA countries as tourist destinations, with more than 70,000 tourists visiting Africa in the twenty months to end-2005. With the growth in Chinese per capita incomes, there is likely to be a considerable growth in tourism in the future.

Another possibility is in regard 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 (FAO 2002). So far, China has sourced very little food from SSA (or, indeed, from elsewhere), 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). Although this has had knock-on effects of Ethiopia’s exports of sesame (a substitute in some markets for soya), 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 they do, will these imports come directly from eastern and southern African economies which have a demonstrated comparative advantage in some of these sectors, or will SSA gain indirectly from China’s growing imports from a supply-constrained global economy? As we saw above, Chinese investors are beginning to pioneer soya production in Mozambique and this may be a sign of future prospects.

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 is the possibility that energy prices will rise significantly as a consequence of constrained global supplies and rapidly growing demand from China and India. So, too, might the price for other SSA imports, including food. What pressures will a

rapidly diversifying Chinese economy place on economies such as South Africa who have become successful exporters of automobiles and auto components?

4.7. Filling the knowledge gaps

It is abundantly clear from the discussion above that we know more about the questions which have to be addressed on China's impact on SA than on the nature of these impacts. 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 vectors of transmission are indeed trade, FDI/production and aid, and that we know more about the direct impacts than the indirect impacts. We can also conclude that 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 widen and deepen the policy perspectives listed in Section 4.6 above, key knowledge gaps need to be addressed, amongst which the following are most important:

- The need for base-line studies to assess the changing future impact of China on SSA
- 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 foodcrops)
- 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.
- 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.
- Distinguishing generic from sub-regional and country-specific impacts, aiding the classification of different types of SSA economies
- Identifying likely future areas of threat and opportunity

- Determining the drivers of China's strategic engagement with SSA and their impact on transparent and better governance on the continent
- Diffusing lessons from the successful experience in coping with the challenges posed by China, drawn both from within SSA and from other regions

AN AGENDA FOR WHOM?

Meeting this policy agenda and knowledge-gaps is a multifaceted task. It clearly is a challenge which confronts all the major stakeholders *in SSA*. Governments are clearly key stakeholders. But so are many SSA producers – firms and farms – who are affected, directly and/or indirectly by existing and potential Chinese expansion. How aware are they of these opportunities and threats, and what capabilities do they require to develop these strategic capabilities and to respond appropriately? Similar questions can of course be asked with respect to a range of civil society actors such as trades unions and NGOs.

The Chinese government and key stakeholders *in China* face analogous challenges. Are they adequately aware not just of the opportunities which are being opened-up in SSA, but also of the threats which they pose to different stakeholders in SSA? An example is the case of SSA's AGOA clothing exports which experienced an almost 20 percent fall in the first year after quota removal with devastating impacts on employment in Lesotho and Swaziland. Are Chinese stakeholders aware of the problems which previous generations of resource-hungry foreign investors confronted in SSA, including growing resentment from the local population due to limited spillovers into the local economy? May they begin to suffer the same disruption in their resource activities as are currently being experienced by Shell in Nigeria, or in previous decades when African countries nationalised resource-firms in part because of their low linkages with the local economy? Does China need to think about engaging with western aid donors in the promotion of good governance in SSA, not just as issues in human rights, but in order to maintain the rule of law which Chinese investors require if they wish to obtain long-term and profitable access to SSA resources and markets? What responsibilities, if any, does the Chinese government have to uphold the interests of SSA in institutions of global governance?

What implications are there for *DFID and other bi- and multi-lateral agencies*? What roles might they play in building appropriate dynamic capabilities in SSA, in making the Chinese more aware not just of their positive impact, but also the negative direct and indirect impacts of their growth on SSA? How might China be persuaded to participate more actively in the promotion of more transparent and better governance in SSA, particularly in countries with fragile states? What role might they play in intermediating discussions Chinese and SSA stakeholders?

This Agenda-setting paper makes no pretence to answer these, and other important questions. Instead it has attempted to provide a framework for assessing the state of our knowledge, and for structuring a systematic response on behalf of key stakeholders in SSA and China.

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