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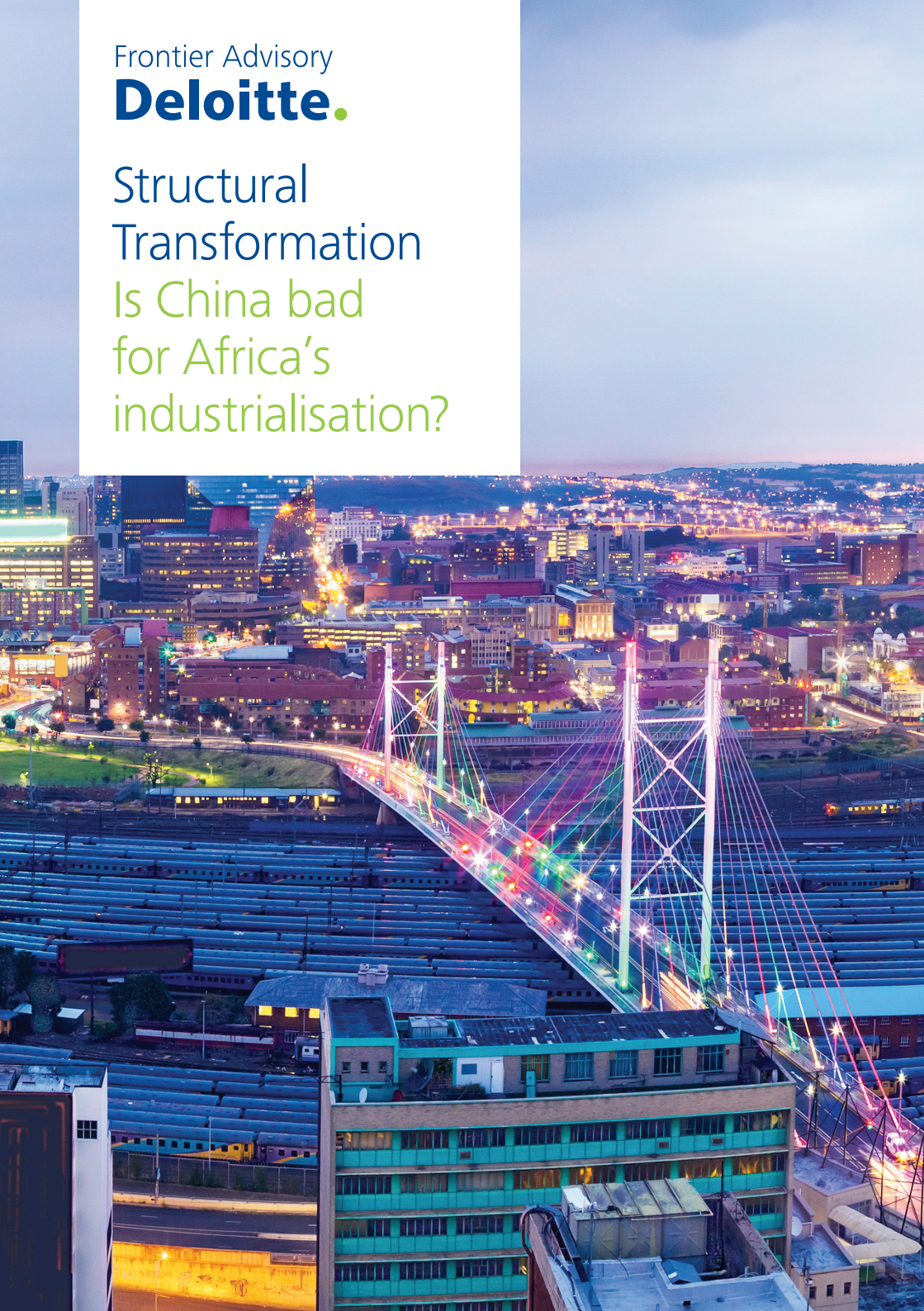
Structural Transformation

Is China bad for Africa's industrialisation?



Is the world's second-largest economy hindering Africa's ability to follow a manufacturing-led growth path in order to industrialise?

STRUCTURAL TRANSFORMATION

Is China bad for Africa's industrialisation?

China has quickly become Africa's single largest trading partner. In just over a decade, merchandise trade increased almost 20-fold, from about US$ 10.5 billion in 2000 to more than US$ 220 billion in 2014, increasing by 25-30 percent annually. China is also among the leading emerging market investors in Africa.

While Sino-African relations are often touted as "win-win" by Chinese and African leaders, commercial relations, particularly trade relations, between China and the continent have received criticism for being biased toward Africa's natural resource exports in return for Chinese manufactured consumer goods. What is argued to be a relatively unequal trade structure between the Asian manufacturing powerhouse and the African continent has led many to suggest that China's manufactured exports are crowding out opportunities for Africa's industrialisation.

Africa's trade mirrors its state of industrialisation

Critics of Africa's trade structure with China should note that Sino-Africa merchandise trade mirrors Africa's total trade with the rest of the world. Natural resources underpin the continent's exports to China. Indeed, African nations have been linked to China's fast-paced economic growth through the provision of raw materials. This is true not only for exports, but also through prices and investments. In 2012, 93.5 percent of China's imports from Africa consisted of primary commodities, such as oil and minerals, precious stones and non-monetary gold. This represents an increase of more than 7 percentage points from 2002, when primary commodities constituted 86 percent of imports. When evaluating Africa's export profile in relation to, for example, the United States (US) a similar trend emerges. In 2012, 87.5 percent of US imports from Africa were primary commodities, down from a high of 92.8 percent in 2007.

On the import side, Africa imports low technology, labour-intensive manufactured goods from the world. This is despite the existence of a large semi-skilled or unskilled labour pool in many African countries that could produce such goods.

For example, more than 70 percent of Africa's imports of manufactures in 2012 consisted of labour-intensive and resource-based manufactures and low to medium-skill and technology manufactured goods. This is not in line with economic trade theory, which suggests that, given its abundant labour resources, African economies should by now have developed a robust manufacturing base and diversified away from a reliance on natural resources toward light manufacturing activity.

But, this has not been the case. Over the past three decades, Africa's manufacturing value added has declined, and economic diversification has been limited. Africa's share in global manufacturing value added dropped from 1.2 percent in 2000 to 1.1 percent in 2008. Manufactured exports contributed only 1.3 percent to global manufacturing exports in 2008, up slightly from 1 percent in 2000. The region to date remains marginalised in global value chains.

The Asian export-led growth miracle

Looking East, developing Asia's share in global manufacturing value added displayed a different trend, rising from 13 percent to 24 percent from 2000 to 2008. China has been at the forefront of this development. Thus, it is important to understand what has driven the region's success and what has contributed to Africa's relative failure.

In China, in particular, a constructive policy package that opened markets and implemented favourable trade and exchange rate policies, together with a sound and stable government that provided an enabling environment to attract investment and secure property rights, were crucial building blocks that contributed to an export-driven strategy mainly targeted toward the US.

Africa has failed to emulate this success largely because it has lacked an enabling policy environment. Despite significant tariff preferences into markets, such as the US under the African Growth and Opportunity Act (AGOA), Africa's manufactures are not competitive. Deficient infrastructure has led to higher production and transaction costs. Poor leadership, governance, weak institutions and rent-seeking activities have also detracted from diversification opportunities into value-added sectors.

Chinese competition in Africa and other markets

In contrast, China has quickly become the price setter for manufactured goods globally. This has affected African manufactures' market shares in both domestic and export markets. Notably, competitive pressures have been most visible in the clothing and textiles sector, as this is the one sector where substantial manufactured export capacity exists in Africa (relative to other manufacturing subsectors).

For example, US imports of apparel and clothing amounted to US$ 7 billion in 2008. Given improvements in its global competitiveness, China was able to expand its share of exports in this sector from 11.4 percent in 1990 to 14.6 percent in 2000 and to 34.5 percent in 2008. Relatively speaking, the African share of apparel and clothing to the US declined from 11.9 percent in 1990 to 6.6 percent in 2000 and to only 2.5 percent in 2008. Although African economies were growing rapidly — Sub-Saharan Africa recorded an average GDP growth rate of 5.9 percent according to the International Monetary Fund (IMF)—and they had a tariff preference during

this period, they were not able to expand or even hold constant their market share in the US, largely because of mounting Chinese competition in that market.

Import competition has also been a cause for concern. A case in point is South Africa, where clothing and textiles make up an important share of total manufactured exports. Protective measures had to be taken in the economy to assist this ailing sector in 2007. It was claimed that the sector was stifled by vibrant Chinese competition, despite the imposition of high tariff barriers of more than 40 percent.

Undoubtedly, China is a notable competitor for Africa's clothing and textiles sector — a key employment-creating sector and an accepted springboard for diversification. Such competition, coupled with greater Chinese resource demand, has arguably steered some African economies toward greater specialisation in natural resource production. Yet, it is Beijing that has expressed goodwill and shown action to address these imbalances in some African countries' trade and productive engagements with China.

Opportunities for Africa in light of China's structural changes

China's shifting production structure and move up the technology value chain, coupled with Beijing's pursuit of a more sustainable growth path, is resulting in reforms of its industrial capacity, and ultimately a shift from "Made in China" to "Created in China." The World Bank estimates that more than 80 million Chinese lower-end manufacturing job opportunities will move offshore over the medium term, owing to rising labour and input costs. As mature, labour-intensive industries look to move abroad to relatively lower-cost regions, opportunities in these industries should be captured by competitive and forward- looking African economies that are positioning themselves to attract such investment.

Chinese companies are increasingly seeking to expand their investments beyond resources in Africa. This includes sectors, such as automobile assembly, electronic products, cement, steel, garments and shoe-making. Already, private-sector companies are involved in local processing projects, such as leather, financed by players, such as the China-Africa Development Fund (CADFund).

Another development supporting this is the Chinese-funded and constructed special economic zones (SEZs) in markets, such as Ethiopia, Mauritius, Nigeria and Zambia. These zones could be key contributors to unlock Africa's diversification potential and movement into value-added based industries and exports. The dedicated geographic areas are positioning to attract productive sector industry investments. Supported by transport, power and other business infrastructure rollouts as well as preferential tariff structures for exports into China as well as traditional export markets (like the US and Europe), these zones, if managed effectively, could be game changers for Africa's diversification saga. The SEZs look to attract foreign direct investment (FDI) based on various fiscal and other incentives and to generate foreign reserves from value-added exports. Ultimately, though, they are aimed at creating opportunities for local employment, skills and technology transfers, as well as the potential for backward linkages in host countries to pursue greater diversification of exports and domestic economic activities.

Looking ahead

With China already a major contributor to Africa's infrastructure stock and a key financier of the continent's development, African policymakers should be actively seeking to attract Chinese factors of production in sectors, such as industry, assembly and agro-processing by drawing Chinese capital, skills and technology, either through joint ventures or partnerships. Chinese partners have already financially supported such ventures. Also, as domestic structural changes in China accelerate—with the country moving away from being a leading exporter to becoming a key consumer and an important source of investment—this could bolster the industrialisation prospects of African countries that recognise this opportunity and position themselves accordingly.

However, a net positive impact from China's activities in Africa will be directly dependent on a number of factors and developments on the African side. These include improvements in governance and a generally greater concern for the development of economies and increased overall living standards, rather than the enrichment of a few individuals, in order to limit the existing diffused and short-term rent-seeking behaviour of African leaders and stakeholders. It also requires crafting and implementing relevant policies, together with building credible institutions that actively support economic diversification, backward and forward linkages between sectors and global value chains. Finally, in order to attract investment into manufacturing activities in SEZs, which should be seen as tools for broader economic diversification and industrialisation, greater expansion of the skills base will be required along with continued investments in economically enabling infrastructure. Weakenesses in either of these areas could be key deterrents for investment and could prevent African economies from reaping associated positive spillovers from China's activity in Africa.

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