COMMONWEALTH
trade hot topics
ISSUE 80

Impact of China and India on SSA Countries: Opportunities, Challenges and Policies

Oliver Morrissey*

Background

Although African countries still account for a small proportion of world trade they have benefited from the growth of large developing countries through increased demand for their exports of primary commodities and associated investment flows. Specifically, China and India have become major trading partners for Sub-Saharan Africa (SSA) countries in the past decade and are becoming important sources of foreign investment (especially China). Trade and investment flows between SSA and these trading partners have increased rapidly since 2001.

As the development of China and India progresses SSA countries are in a prime situation. SSA is a source of mainly cheap minerals and oil needed to meet rapidly growing demand for industrial inputs in China and India. In turn, China and India are low-cost exporters of manufactures with increasing import penetration in SSA. While this will increase the welfare of consumers (through cheaper imports) it may not only undermine competing local labour-intensive industries (such as clothing) in SSA domestic markets, but also in third country export markets. Thus, increased trade with China and India represents opportunities and challenges and the balance of these varies across SSA countries.

An assessment of the opportunities and challenges associated with expanding economic relations with China and India is therefore essential to identify appropriate policy responses for SSA countries. In this regard, this issue of *Commonwealth Trade Hot Topics* reports on a recent study findings prepared for the Commonwealth Secretariat on the economic impact of China and India on SSA, and on the policies and strategies that are required to enhance the ability of SSA countries, individually and regionally, to derive benefits and avail of new opportunities.

SSA's trade relations with China and India

Over the last decade, Sub-Saharan Africa has benefited from the growth of other developing countries, especially China and India particularly in respect of mineral and oil exports. China's appetite for imports has been growing rapidly as it needs raw materials and other inputs (in addition to export markets) to sustain its growth. The strategic importance of Africa, a rich source of raw materials, was recognised by the Forum on China—Africa Cooperation (FOCAC) that first met in Beijing in 2000 and most recently Cairo in 2009. Under FOCAC China grants non-reciprocal duty free access to 190 products imported from 28 of the least developed African countries. Under the India—Africa Forum,

* The author is a Professor of Economics at the University of Nottingham, UK. This Trade Hot Topic is based on a recent Commonwealth Secretariat commissioned study titled, *Impact of China and India on SSA Countries: Opportunities, Challenges and Policies*, which the author prepared jointly with Evious Zgovu. Views expressed here are those of the author and do not necessarily reflect those of the Commonwealth Secretariat.

India has offered tariff-free access for most exports of least developed countries (LDCs), 33 of which are in SSA.

The rapidly growing demand for industrial inputs by China and India has provided major benefits to SSA exporters of oil and mineral resources. Eight resource-rich SSA countries dominate exports to China and India (see Table 1): Angola, Congo (Brazzaville), Equatorial Guinea, Nigeria and Sudan for crude oil; and Democratic Republic of Congo, South Africa and Zambia for metals and ores. Other SSA countries have potential to expand their exports in timber and soft commodities such as cotton and cash crops; fruits, nuts and vegetables; oils and resins; and seafood. From 2000 to 2009, eight exporters accounted for 87 per cent of SSA exports to China in 2000 rising to 92 per cent in 2009; Angola's share varied between 28 per cent and 44 per cent, South Africa between 18 per cent and 33 per cent, with Sudan consistently around 13 per cent (Table 1). In the case of exports to India, Nigeria and South Africa clearly dominate.

China and India are also increasing their import penetration in SSA and, as import shares have increased, they are likely to be displacing imports from the rest of the world. The major products imported from China are: electrical machinery and equipment, mechanical machinery, vehicles, and articles of iron or steel. The major products imported from India are not identical and include: pharmaceutical products, cereals, electrical machinery, and vehicles. To some extent China and India compete against each other in SSA import markets but there are likely to be simple manufactures and consumer goods where China (and India) competes with local or regional producers. Examples of this include furniture (in Burundi, Cape Verde, Namibia and Seychelles), footwear (Malawi, South Africa and Uganda), ceramic products (Cape Verde and Nigeria), and apparel in Sudan and soap in The Gambia. An important observation is that China and India account for significant shares of cotton imports for The Gambia and Mauritius (combined shares are 28 per cent and 17 per cent, respectively). This is an indication of situations where China and India provide textiles (or processed cotton) as an input to garments production in SSA countries, which is often likely to be related to investment by Chinese and Indian firms (perhaps motivated by preferential access to the European Union and US markets).

Until now, SSA countries' imports from China and/or India are highly concentrated with South Africa and Nigeria accounting for more than half of the value SSA imports. Other important SSA countries in terms of import levels are Kenya, Sudan, Madagascar, Ethiopia, Ghana, Uganda and Mauritius. China accounts for over 10 per cent of imports for seven of the SSA countries, and over 20 per cent for Ethiopia and Madagascar. India had a larger import share than China in a number of SSA countries mostly on or close to the Indian Ocean.

There are concerns about the effect of Chinese imports on domestic producers in certain sectors, especially textiles (where India and China export

Table 1: Major SSA exporters to China and India (% exports)

	China			India	
	2000	2005	2009	2000	2008
Angola	34.53	34.25	39.54	0.00	6.17
Congo	6.07	11.85	4.68	0.32	2.39
DR Congo	0.02	0.91	3.06	0.01	0.55
Equatorial Guinea	5.99	7.48	2.84	0.00	0.40
Nigeria	5.75	2.74	2.42	27.61	48.48
South Africa	19.44	17.91	23.42	50.85	26.58
Sudan	13.71	13.60	12.62	0.27	2.61
Zambia	1.30	1.31	3.43	0.49	0.67
Total (top 8)	**86.81**	**90.07**	**92.01**	**79.56**	**87.85**

inputs to the domestic garment sectors) and garments and consumer electrical and electronic goods. Madagascar is an example where China appears to supply the textiles for the growing garment (export) sector. Although lagging behind China, India's import penetration is growing rapidly. India had a larger import share than China in a number of SSA countries such as Mauritius, Kenya, Tanzania, Uganda, Mozambique and Malawi. Most of these have traditionally had a significant expatriate Indian business community so that informal networks are well established.

There is little evidence that China and India can assist the integration of SSA into global value chains although they are often important investors in the garment sector. In some countries China and India have significant shares of textiles imports for the garment sector in which they are likely to have invested to avail of trade preferences to the US or EU markets in particular. This suggests that the SSA countries are positioned in a fragmented production structure rather than supported in developing an independent position in the global supply chain.

Investment from China and India

China's surge of outward foreign direct investment (FDI) is a relatively recent phenomenon, following reforms and deliberate policies under the 'Going Global Strategy' to secure natural resources to fuel rapid growth. The Chinese Government encourages qualified enterprises to go abroad and engage in multinational operations to achieve mutual development. The result of this FDI drive is clearly discernible where Chinese investments abroad doubled each year between 2004 and 2008. Chinese firms have also heavily increased investments in Africa, particularly in the oil sector (in Sudan, Nigeria and Angola), infrastructure construction projects, textiles and clothing (in part to circumvent US and European limits on Chinese textile and clothing exports), and mining. Similar relations are being established with India, which declared commitments on aid, market access and investment at the India—Africa Forum Summit in 2008.

Table 2 illustrates the increasing importance of Chinese FDI in SSA. Eight countries account for about three-quarters of Chinese total inward FDI

Table 2: Chinese FDI stock in selected SSA countries in 2005

	Chinese FDI (US$ million)	Chinese FDI stock in SSA (share of World FDI)
Sudan	351.5	4.6%
Zambia	160.3	3.0%
South Africa	112.3	0.1%
Nigeria	94.1	0.3%
Tanzania	62.0	1.4%
Kenya	58.3	5.2%
Madagascar	49.9	19.9%
Guinea	44.2	7.6%
Zimbabwe	41.6	3.0%
Gabon	35.4	7.2%
Ethiopia	29.8	1.1%
Côte d'Ivoire	29.1	0.7%
Mauritius	26.8	3.3%
DR Congo	25.1	2.8%
Niger	20.4	20.4%
Sierra Leone	18.4	6.1%
Botswana	18.1	2.2%
Rwanda	4.7	6.1%
SSA	1,305.1	0.7%

flows to SSA: Nigeria, Angola, South Africa, Sudan, D R Congo, Equatorial Guinea, Ghana and Zambia. Nigeria, Zambia, South Africa and Sudan were the top four SSA recipients of Chinese FDI in 2005 (in stock terms) while Angola and Equatorial Guinea received large inflows from China more recently. In general, China is investing in same mineral rich SSA countries that attract global FDI. Indian FDI has historically been concentrated in manufacturing, especially garments, and retail and hotel services, especially in Mauritius, but is also diversifying in other countries including into Sudan.

China has become a major aid and investment partner for many SSA countries, especially those that are a source of mineral and oil resources. The flow and accumulation of Chinese and Indian investments in SSA has been accompanied by increases in Chinese and Indian migrant workers and traders. Chinese and Indian workers into SSA follow their investment and grant-aided infrastructure and social capital development programmes. Within a short space of time the number of migrant Chinese and Indian workers and traders has increased substantially.

These observations highlight the interlinked nature of Chinese aid and investment; although not well documented, similar issues appear to apply to India. In many cases aid is used in effect to subsidise investments, either directly as part of the investment finance or indirectly by supporting related infrastructure projects. For example, building and rehabilitating roads supports the transport of extracted resources. This is in addition to subsidies that Chinese firms often receive for foreign investment. This need not reduce the benefits to SSA countries, but it does make it difficult, and perhaps irrelevant, to try and distinguish aid and investment.

The more potentially damaging aspect of Chinese projects, whether aid or investment, is their tied nature — Chinese capital goods, inputs and even labour are all used (this may in part explain the large share in machinery imports). Furthermore, once the firms enter with materials and labour for a project they use this to establish themselves in the local economy. At a minimum, this reduces the potential linkages with the local economy as local suppliers are not supported. In some cases it may damage the local economy as local suppliers and labour (given that unskilled labour is abundant in SSA) are displaced. Chinese aid and investment has delivered benefits to SSA countries, but there are reasons to believe that the dynamic benefits are less than they could be. As investment and aid from China and India are linked and often involve firms they offer potential for private sector development.

Aid from China and India

It is difficult to quantify how much aid China and India give to Africa as they do not adopt standard definitions of aid or provide consistent statistics, and concessional flows to Africa are often closely linked to, if not indistinguishable from, trade or investment (such as export credits and lines of credit). China does not provide data on the amount of aid it gives, in total or to individual countries, although it is evident that the amount has grown significantly over the past decade, currently around US$1 billion per annum to SSA. Although most SSA countries receive aid from China, Angola, D R Congo, Nigeria, Sudan and Zambia are the major beneficiaries, highlighting the link to resources (all five of these are among the top exporters to China). India gives much lower amounts of aid but also concentrates its assistance on countries of sources of its exports — Nigeria and Sudan are the major recipients of infrastructure investment, although credits are spread over a number of West African countries. For both China and India the aid is more likely to be in the form of concessional loans rather than grants, concentrated in infrastructure or projects related to trade.

The recent literature identifies three features of the Chinese aid to Africa. First, it is linked to its commercial interest, in particular access to oil, mineral and timber resources. Second, it is typically invested in large infrastructure projects (often transport and related to resource extraction), but includes schools and medical facilities. Third, it is not associated with the types of policy or governance conditions advocated by Western donors. While the unwillingness to engage with policy and governance issues may undermine efforts to ensure that the aid (and associated foreign investment) contributes to development, it should be acknowledged that both China and India espouse principles of partnership and mutual support in their aid.

An additional important feature of Chinese aid is that it is highly tied, not only to Chinese firms for construction and materials but even including Chinese labour. In fact, the Chinese firms that get entry to SSA countries through aid projects tend to remain in the country, setting up a local office and retaining the equipment brought into the country

so that they are locally very competitive. On this basis Chinese aid, as compared to other donors, can be criticised as offering fewer local linkages and hence less benefit to local private sector firms and employment. However, Chinese aid is allocated to building low-cost housing, schools and sports stadia; provision of doctors and humanitarian aid; and scholarships for Africans to study in China.

In the Chinese case, it seems appropriate to consider aid and investment (and perhaps also debt relief) as parts of a strategy for gaining access to a supply of important raw materials. This need not be to the detriment of SSA countries, as long as the resource extraction sector provides revenue to the government (to support development objectives) and provides linkages and employment for the domestic economy. Although current volumes are much lower, India is strengthening its ties with Africa through lines of credit, FDI and technical assistance.

The increased official flows from China have relaxed resource constraints in SSA countries and provided a valuable alternative to traditional (Western) donors targeting important infrastructure projects with lower transaction and trade costs. China is likely to become even more important as a source of aid and investment in the future so the challenge for African countries is how to make the best use of the flexibility provided. India is also likely to become a more important source of aid and investment, given the commitments made at the India—Africa Forum Summit in 2008.

Conclusions and recommendations

Economic relations with China and India have important effects on SSA countries, directly and indirectly and primarily through trade and investment. Although the initial and largest benefits accrue to exporters of fuels, minerals and metals there is promising potential for benefits to timber, cotton and exports of oil seeds, vegetable oils, fish and seafood. As per capita incomes rise in China and India one may anticipate increased demand for fruits and vegetables. Thus, although to date the significant export benefits have been limited to resource exporting countries, there are potential opportunities for other SSA countries, which will be squandered if viable domestic export producers are not supported.

From an import perspective, the issue is whether competition from cheap imports is preventing the growth of domestic producers. Although the major products imported from China and India are machinery and equipment, vehicles and pharmaceutical products that do not compete with local industries (except perhaps in South Africa), Chinese consumer goods (electronics, clothing, shoes) have captured an increasing import share in SSA (and India may follow). SSA countries may have to increase their efforts to support domestic production and employment, but this should be by focusing on sectors that use available resources. Value added processing offers the most viable manufacturing opportunities, especially in agri-business.

Chinese FDI in SSA is quite concentrated: Nigeria, South Africa, Sudan and Zambia have the largest stock; Angola and Equatorial Guinea are more recent hosts. In general, China is investing in the same mineral rich SSA countries that attract global FDI. Indian FDI is at much lower levels and concentrated, traditionally in Mauritius and more recently in countries such as Côte d'Ivoire, Senegal and Sudan. Chinese aid and investment has delivered benefits to SSA countries, but there are many reasons to believe that the dynamic benefits are less than they could be. Specifically, Chinese aid (and investment) appears to have few linkages with the local economy. In terms of investment, SSA governments should remain aware that FDI can be transient in nature. It is often possible to predict that this is likely if the investment is motivated by accessing trade preferences that may themselves be temporary. Investment motivated by securing access to resources is more long-term, but SSA must ensure it receives the right price.

A number of policy recommendations follow from the discussion. As the details are country specific, they are summarised in general terms:

SSA countries should increase their share of export revenues. Mineral exporters should ensure that they receive a competitive market price or share of the resource rent so that appropriate revenue is generated for the country. The revenue from exports should be invested in promoting development; this may be achieved most effectively through a designated, transparent fund.

SSA countries should target new markets. Producers of non-mineral (soft) commodities should be supported in identifying opportunities to export to China and India, by providing market information and access to networks. This is especially relevant for LDCs that are granted preferential access to China and India for most commodities, and has

potential in a wide variety of agricultural commodities.

Effective export diversification should be based on identifying value-added activities to process available resources. Individual countries should identify the resources they possess and where there are feasible opportunities (for example, adequate supply to reach an efficient scale of production, and access to inputs such as energy) to establish processing industries.

Develop a co-ordinated investment strategy. SSA governments should ensure that aid and investment projects by China and India do contribute to the local economy and development. This requires that projects link to sectors the government wants to develop or provide national and regional infrastructure to increase productive efficiency and reduce trade costs. Investment by China and India is motivated by their own commercial interests and cannot be assumed to assist the integration of SSA producers into global value chains. The experience with garments industry cautions that such investment can be transitory.

SSA countries should co-operate. More effective engagement with China and India is possible if SSA countries co-operate. A co-ordinated or at least consistent approach to terms of access to mineral resources would increase the bargaining power of SSA countries and allow a greater share of the revenue to remain in the source economy. Co-operation has strengthened Africa's position in trade negotiations, such as in the World Trade Organization (WTO), and would also encourage regional investment projects.

Policy must recognise the broader trade environment. Relations with China and India will be affected by trade agreements with other parties, notably the EU but also future developments in the WTO. To the extent that trade agreements enhance preferential access of SSA exporters to world markets they will also make SSA more attractive for investment.

These policy recommendations are not inherently specific to relations with China and India. African countries should strive to avoid the 'resource curse' by negotiating access to resources more transparently with all countries or multinationals, and should strive to use aid and investment from all sources more effectively. New economic partners provide new opportunities but the underlying issues are unchanged and SSA should avoid the errors of the past. SSA countries should not look to China and India to provide support for the development of domestic production, although they should not neglect opportunities that arise. Foreign investment delivers the greatest benefits when it provides linkages to the local economy, such as through employment or demand for local supplies. Chinese investment has not evidently delivered these benefits, and this is an issue that governments should monitor.

Ultimately, African development is its own responsibility. This means that SSA governments should ensure that they receive and use revenue from export earnings as such revenue is the major benefit of trade with all partners, and should strive to realise all opportunities to diversify production and exports.

International Trade & Regional Co-operation Section at the Commonwealth Secretariat

This Trade Hot Topic is brought out by the International Trade and Regional Co-operation (ITRC) Section of the Economic Affairs Division (EAD) of the Commonwealth Secretariat, which is the main intergovernmental agency of the Commonwealth — an association of 54 independent states, comprising large and small, developed and developing, landlocked and island economies — facilitating consultation and co-operation among member governments and countries in the common interest of their peoples and in the promotion of international consensus-building.

ITRC is entrusted with the responsibilities of undertaking policy-oriented research and analysis on trade and development issues and providing informed inputs into the related discourses involving Commonwealth members. The ITRC approach is to scan the trade and development landscape for areas where orthodox approaches are ineffective or where there are public policy failures or gaps, and to seek heterodox approaches to address those. Its work plan is flexible to enable quick response to emerging issues in the international trading environment that impact particularly on two highly vulnerable Commonwealth constituencies — least developed countries (LDCs) and small states.

Scope of ITRC Work

ITRC undertakes activities principally in three broad areas:

- It supports Commonwealth developing members in their negotiation of multilateral and regional trade agreements that promote developmentfriendly outcomes, notably their economic growth through expanded trade.
- It conducts policy research and consultations increase understanding of the changing of the international trading environment and of policy options for successful adaptation.
- It contributes to the processes involving the multilateral and bilateral trade regimes that advance the more beneficial participation of Commonwealth developing country members, particularly small states and LDCs.

ITRC Recent Activities

ITRC's most recent activities focus on assisting member states in the WTO Doha Round and the Economic Partnership Agreement (EPA) negotiations involving the African, Caribbean and Pacific countries (ACP) the European Union (EU), undertaking analytical research on a range of trade policy and development issues, and supporting workshops/dialogues for facilitating consensus-building on issues of Commonwealth members' interest, exchange of ideas, and disseminating results from informed analysis.

Selected Recent Meetings/Workshops supported by ITRC

16 September 2010: Session by the Commonwealth Secretariat at the WTO Public Forum 2010, on 'Africa in international trade: impediments and opportunities', WTO Headquarters, Geneva, Switzerland.

28 June 2010: Consultation Meeting on WTO Accession, held in Brussels, Belgium

26 June 2010: Workshop on Policy Barriers in Intra-regional Trade in South Asia, held in Dhaka, Bangladesh

14-15 June 2010: High Level Workshop on Aid for Trade in East African Community countries, held in Dar-es-Salaam, Tanzania

3-4 June 2010: Trade policy Workshop with the Members of Parliaments in the Pacific, held in Samoa

27-28 May 2010: Trade policy Workshop with East African Members of Parliaments, held in Arusha, Tanzania

4 May 2010: Workshop on Potential Supply Chains in South Asian Textiles and Clothing, held in Colombo, Sri Lanka

3-4 May 2010: Commonwealth Investment Experts Group Meeting for the Pacific, held in Port Vila, Vanuatu

3 April 2010: Workshop on Developing Supply Chains in the Textile and Clothing Industries in South Asia, held in Dhaka, Bangladesh

15-16 March 2010: Commonwealth Roundtable - Regional Trading & Integration Arrangements, held in Hampshire, UK

2 November 2009: High-Level Meeting for WTO Representative of ACP Missions, held in Geneva, Switzerland

26 October 2009: Discussion meeting with the WTO's Geneva Week Participants, held in Geneva, Switzerland

Subjects of the Previous Ten Issues of the Commonwealth Trade Hot Topics Series

Issue 79: Competitiveness Impacts of Climate Change on LDC's export trade

Issue 78: Opportunities and Challenges for Intra-ACP Trade in Fish and Fishery Products

Issue 77: The Lisbon Treaty and Commonwealth Developing Countries: Implications for ACP-EU trade and trade negotiations

Issue 76: Changing EU Policies and ACP Exports

Issue 75: Aid for Trade: Policy Issues for ACP States

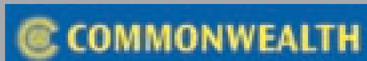
Issue 74: Fairtrade, the Windward Islands and The Changing EU Banana Regime

Issue 73: Political Economy Factors Affecting Efficient Functioning of Markets

Issue 72: A Commonwealth Guide on International Investment Agreement Provisions Promoting Sustainable Development

Issue 71: Doha Decision-Making: Implications of the Consensus and Single-Undertaking Principles for Developing Countries

Issue 70: Inclusiveness of Trade Policy-Making - Challenges and Possible Responses for Better Stakeholder Participation



trade
hot topics

ISSN: 2071-8527 (print) **ISSN: 2071-9914** (online)

Series editor: Dr Mohammad A Razzaque

Produced by the Economic Affairs Division of the Commonwealth Secretariat

For further information or to contribute to the Series, please email m.razzaque@commonwealth.int