

# Trilateral Cooperation on Trade and Investment: Implications for African Industrialisation

Africa's trade and investment relations with China and the UK has changed drastically over the last few decades, especially with Chinese economic growth. However, while economic openness, trade and investment appear to have come hand-in-hand with poverty reduction in the rise of the "Asian Tigers" and, recently, in China itself, the links appear, so far, to be less clear in sub-Saharan Africa. Recent research analysing UK and Chinese trade and investment relations and their impacts on poverty reduction with Ethiopia, Kenya, Nigeria and South Africa highlights how both countries can play a complementary role in aid-led investment and meeting local demand.

## China and UK trade with Africa

As China has gained political and economic influence on the global stage, it has expanded its influence and trade in Africa. Between 2004 and 2012, China's share of total merchandise exports and imports by the research's four case study countries increased significantly. Exports to China from Nigeria more than doubled. The increase was threefold, fourfold and even fivefold for Kenya, Ethiopia and South Africa, respectively. During this period, exports to China were the main source of trade growth for these and other sub-Saharan countries.

Not surprisingly, during the same period, even if exports to the UK from Ethiopia and South Africa rose in absolute terms, its share actually fell by more than half. It has, however, remained broadly steady for Kenya and Nigeria. The dynamics of these export ratios is very similar to the general performance of China and the UK in the world market.

The picture for the African countries' imports from the UK and China is similar to that of exports. The UK share has fallen, though not as strongly as the UK share in world imports, while the Chinese share has increased very significantly to the point that for Ethiopia and South Africa, China is their main source of imports.

The composition of Chinese and British imports from Ethiopia, Kenya and South Africa is significantly differentiated. As energy exports weigh heavily in Nigerian trade, British and Chinese imports from this country are largely similar in composition.

The general picture that emerges is that sub-Saharan Africa (SSA)'s trade with China is rapidly growing, is highly concentrated in its exports and highly diversified in its imports. The increased export concentration reflects increased volume demand from China and consequent increases in prices. China is also rapidly increasing its investment presence in SSA, especially among the resource rich countries (see box 1).

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## Trade and investment as means to support poverty reduction

Alongside China's share of both Aid for Trade and total aid increasing in SSA, specifically in Kenya and South Africa, there has also been a move towards a greater policy focus on the role of economic development, economic integration and export-led growth in particular, as a means of accelerating poverty reduction. This may partly be due to the success of using export-led growth to reduce poverty in countries in East and South East Asia as well in China itself. However, this increased emphasis on export-led growth in Africa has not led to similar reductions in poverty (see box 2) perhaps because of the role of resource exports, which are not intensive in unskilled labour and therefore do not create jobs, in the export growth story in Africa.

In fact, the change of the case study countries' trade composition, confirmed by our research, is incentivizing a shift in industrial development towards capital intensive raw materials extraction and away from labour intensive manufactures. This risks the generation of a poverty *inducing* effect. It can, however, be overshot by a China-UK strategy that enables increasing economic integration of African partners and fosters their capacity to act as outsourcers of Chinese production value chains, as wages increase in the rising Asian economy. Informal contacts with Chinese business people in the context of the IDS-CAITEC project raised the question of available skills. This is a well identified problem of coordination. With no available jobs there is no incentive to acquire skills: with no ready supply of skills there is no incentive to invest. The potential, however is present.

## China and UK collaboration on development, trade and aid in Africa

In recent years, China's economic and political influence in low-income countries has increased dramatically, necessitating enhanced dialogue among diverse development partners. Regardless of power structures, all countries should accept the importance of mutual learning and focus on complementarity over competition. There should be more space for pragmatic approaches.

Both China and the UK have increasingly seen advantage in co-operating over development, trade and aid initiatives in Africa. In the wave of economic globalisation, and the growth of their economies, African countries began to participate more in international affairs. The

UK recognised this tendency and as part of its international development policy prioritised the formation of a cooperation alliance with large emerging powers. With its rising importance in African economic and diplomatic relations, China became the UK's preferred cooperation partner in the continent.

As part of this collaborative effort, the UK has developed communication channels with China on its African policies, including on poverty reduction. In February 2009, at the first China-UK Business Summit<sup>1</sup>, former British Prime Minister Gordon Brown and former Chinese Premier Wen Jiabao reached a consensus on China-UK-Africa Agriculture Cooperation. The two countries now hold an annual high-level dialogue through which they exchange views on concrete measures to support African development and possibilities to co-operate more effectively with Africa.

In December 2013, British Prime Minister David Cameron visited China and attended the third China-UK Business Summit, following which China and the UK stepped up efforts to explore cooperation on infrastructure investment and construction in Africa. As a result, the China International Contractors Association (CHINCA) signed a memorandum of understanding with the British Institution of Civil Engineers (ICE).

<sup>1</sup> The China-UK Business Summit is the highest communication and dialogue platform for Chinese and the UK's business circles

## Chinese and UK investment in African case study countries

### China

South Africa and Nigeria are the most important destination of Foreign Direct Investment (FDI) flows and they account for a third of the total Chinese FDI allocated to sub-Saharan Africa (SSA). In fact, almost half of the stock of Chinese investments in SSA are located in South Africa and they represent 1.31% of the total Chinese FDI stocks worldwide. Ethiopia and Kenya received much less Chinese FDI up to 2010 and represent together only 0.2% of the total stock of Chinese FDI in SSA, perhaps reflecting the lack of natural resources in these countries relative to the rest of SSA, although Chinese investment in SSA does not appear to be significantly more skewed towards natural resources than is the case for western investment.

### UK

South Africa, which accounts for almost 1% of the total FDI stocks worldwide, accounts for around 2/3 of the total UK FDI flows to SSA. Nigeria and Kenya represent a much lesser proportion, 6% and 2%, respectively. British FDI to Ethiopia is vanishingly small.

The collaboration was echoed at state department level – for example the UK Department for International Development (DFID) signed a Memorandum of Understanding (MOU) in 2011 with China’s Ministry of Commerce to create a partnership to enhance development cooperation and the achievement of the Millennium Development Goals. It was followed by a further MOU in 2014 with China’s Development Bank for a partnership to promote economic growth and poverty reduction in Africa, and finally another MOU with the Development Research Centre of the State Council in China to establish an International Development Knowledge Centre in 2015.

Increasing wages in China offer the opportunity for low wage jobs to migrate to economies at lower levels of development. China’s intention to move away from export/investment led growth model to a domestic consumption led model clearly offers potential for African economies to increase exports but also move into niches which China based firms are leaving. Competition will be stiff with low-wage South and South East Asian economies ready to move into any gaps. Business environment and effective education and training policies alongside increased investment in hard and soft infrastructure will be key if Africa is to attract investment and know how.

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### **Addressing Africa’s economic development challenges**

As discussed, key economic development challenges across Africa include increasing the diversity of its exports, notably towards manufactures, as well as generating a higher share of processing value added in traditional resource and agricultural and food exports. For this shift to impact on poverty alleviation it needs to generate jobs for low skilled labour as well as opportunities to develop higher skill jobs. That requires inward investment (bringing know how and technology) and market development both in Africa and among developed and emerging markets.

The UK and China are viewed as playing complementary roles in Africa in both trade and investment in the eyes of their own and African governments. The UK brings long experience of aid-led investment across Africa and in the case study countries with a special focus on poverty alleviation. Chinese investment in Africa is increasingly oriented towards meeting domestic demand. There is also growing Chinese investment in infrastructure, transport and energy notably. The UK is also investing in African enterprises and brings expertise in financial services and in aid related investments in hard and soft infrastructure for regional and continental economic integration.

## **Poverty reduction in African countries due to increased trade and investment?**

The linkages between trade and investment, on one hand, and poverty alleviation, on the other, are indirect and often hard to delineate. While economic openness, trade and investment appear to have come hand-in-hand with poverty reduction in the rise of the “Asian Tigers” and, recently, in China itself, the links appear, so far, to be less clear in sub-Saharan Africa (SSA).

In fact, poverty reduction in SSA has been limited in the last decade. Looking at the case study countries we see that:

- In the case of Ethiopia, World Development Indicators figures show a small reduction in the share of people living with less than \$1.90/day. The extreme poverty gap has actually slightly increased, from 8.34% in 2004 to 9.04% in 2010.
- Kenya only presents poverty statistics for 2005, both below SSA averages (a 33.6% extreme poverty headcount and an 11.7% extreme poverty gap).
- Nigeria also presents statistics for one year, 2009, but both above SSA average (a 53.46% extreme poverty headcount and a 21.76% poverty gap).
- South Africa shows a significantly better picture, with a reduction of 7% in the extreme poverty headcount and a reduction of 3.3% in the extreme poverty gap between 2005 and 2011.

*Figures provided are the most up-to-date available figures*

## Policy recommendations

### Regional integration via infrastructure investment and trade facilitation

- New national and regional infrastructure projects to further integrate the African regional economy, especially as regional infrastructure projects can be international public goods. Currently, the financial gap is estimated at around US\$ 45-50 billion for African infrastructure, such as the construction of new roads. China and the UK could cooperate on financing infrastructure through project bonds, project equity, joint contracting and co-financing.
- Greater cooperation on trade facilitation, regional trade integration and the building of economic and trade cooperation zones. China and the UK could work together to help African countries improve their customs, tax, inspection and quarantine facilities as well as through efficiency gains and improved trade facilitation through aid for trade.

### Addressing skill shortages and providing technical support

- Investing in jointly funded facilities, where demanded by local governments, to identify local sector-specific skill shortages which are preventing the use of local labour addressing both individual employees and the lack of entrepreneurial skills that stifle the availability of local sub-contractors in support of foreign firms investing. This investment can be supported by the provision of general transferable skills training aimed at the poor for use in light manufacturing.
- Concurrently, African governments and local authorities can be assisted in providing one stop shops to help potential investors understand and operate effectively in the local business environment and local regulatory regimes.

### Development of agriculture and industry

- Technical support for processing of African agricultural products and industrial raw materials, including support for capability in securing the ability to comply with and certify compliance with European Union and Chinese norms and regulations, along the lines of DFID's programmes to support Kenyan farmers. This will strengthen Africa's production of higher value-added goods as well as to provide better market access for African countries' exports.
- Establish a China-UK-Africa policy research system on agriculture and rural development aimed at training skilled agricultural workers, set up specialized regional training centres and conduct food processing and agricultural commerce training. China and the UK could strengthen the popularization of certain agricultural techniques and transfer technology to Africa to help improve the level of agricultural mechanization and agricultural machinery production as well as increase access to agricultural inputs such as fertilizer, pesticides, etc. The existing China-UK Sustainable Agriculture Innovation Network has been extremely active and apparently effective
- Enhance the construction of agricultural infrastructure, improve the trading capacity of agricultural products, cultivate agricultural markets, help speed up production times and reduce costs. Finally, improve regional agricultural markets in Africa by advancing regional and sub-regional integration.

### Investing in cooperation, communication and research mechanisms between China and UK

- Build on existing MOUs by strengthening dialogue and communication and intensify cooperation mechanisms in sustainable development, trade and investment as well as establish regular communication in roundtable meetings between China's MOFCOM and the UK's Departments of Business and of International Development as an important platform for long-term dialogue.
- Further advance China's interaction with Africa's and the UK's relevant government agencies and academia. For example, by extending further cooperation and strengthening understanding of each other's African policies and positions, by holding high-level seminars on China and the UK's African policies, conducting exchanges and joint research on major policy issues such as on growth, competitiveness, innovation, cooperation and African development.

## Further reading

*China-UK Cooperation on African Trade and Investment for Poverty Reduction* (forthcoming), Overview Report, Institute of Development Studies (IDS), Chinese Academy of International Trade and Economic Cooperation (CAITEC), Trade Law Centre (tralac), Consumer Unity and Trust Society (CUTS)

## Credits

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