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The Elusive Quest for Structural Transformation in Africa and its Implications for Job Creation and Poverty Reduction

by

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The Elusive Quest for Structural Transformation & Job Creation in Africa: Will China Make a Difference

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Introduction

- Recent economic development in Africa witnessed an impressive economic growth in the continent, averaging above 5% per annum in the last decade and half
- This growth is primarily propelled by high growth accelerations in natural resources exporters (see Arbache and Page 2008). Sadly, following the slowdown in the world economy since 2013, this growth is sliding back to about 3 in 2013 and then to 1.5% .
- The fact that the demand surge noted above is primarily coming from the emerging South /BRICS/China/India economic relation
- It has also significant implications for structural transformation in Africa which is a major policy objective of almost all African countries today.
- In this presentation I will attempt to summarize the AERC Studies Justin Lin; Brautigam et al , and A. Geda; W.Simbani, L. Senbet

II. The Pattern of Trade & Finance

- International trade, infrastructure, investment (particularly foreign direct investment - FDI), finance, and even services have emerged as channels for African economies to engage with China. In this piece, we focus on the partnership in trade, finance, and FDI
- The level and intensity of the Sino-Africa trade relationship and other activities have increased dramatically since 2000 .
  - By 2016, trade between Africa and China reached over US$200 billion, 66 times higher than the US$ 3 billion level registered in the 1990s.
  - China's rapid economic growth during this period, in part, meant a strong and sustained demand for raw materials, which Africa was ready and able to supply.
- Africa's trade with China is bundled with Chinese finance –
  - the commodity trade is further strengthened through flows of finance from China that includes FDI,and credit financing [But aid is negligible].
  - Handled through the Exim bank of China, which is planning to handle 70-80 % of the USD 100 billion that China is planning to provide to Africa until 2025 (AFP, 2013/with correction).

II. The Pattern of Trade & Finance

- Chinese FDI share (about FDI stock of 17.7 bln 2010) is also rather small being about 3.2% of Africa's US$ 554 bln total FDI i
- FDI flows from China as well as the rest of the BRICX to Africa are characterized by the following major features.
  - First (a) these flows are largely motivated by the desire to secure sources of energy and raw materials as well as to exploit preferential markets in the third market
  - A second (b) features the proliferation of a number of small and medium size firms that usually come with the big Chinese TNCs.
  - Third (c), such FDI do not seem to be deterred by the nature of governance/ fragility of countries.
  - Finally (d), FDI and other forms of investment flows from China are interwoven/bundled with provision of infrastructure, tied concessional development financing and trade, with no political conditionality attached to them.
- To understand Chinese investment engagement, better focus on what I call Chinese Quasi-FDI , not Chinese FDI using the standard" traditional" definition [ie. Its EXIM bank financing]

II. The Pattern of Trade & Finance

- According to Fitch Ratings (2012), a UK-based rating company, it extended about USD 67.2 billion to SSA b/n 2001-2010/Now over 100 (my estimate)
- There are three important features that distinguish these Chinese financing from traditional financing schemes in the continent.
  - First, the majority of these loans were infrastructure related and Chinese firms are often the one that are building it, which invariably are directed at facilitating the export of primary commodity from the continent
  - Second, compared to concessional financing that the majority of countries in the continents used to get from IFIs such as the IDA window of the WB this financing scheme is very expensive.
    - In fact, the terms of CEB engagement in Africa are invariably higher than even the terms employed by Western commercial banks.

II. The Pattern of Trade & Finance

- Third, they are characterized by potential risk that included indebtedness, vulnerability to global economic shocks and political and strategic vulnerability of Africa to China
- Forth, if individual African countries exposure to CBE credit is growing significantly, as has been the case in Ethiopia for instance, it wouldn't be surprising if this Africa's strategic vulnerability position is used by China to advance Chinese and Chinese firms interest
- Finally, the CEB loan is also a vehicle for Chinese Multinationals' global strategy of expansion by helping them to win and involve in various projects in the continent. The sheer magnitude of CEB loans in the continent shows its importance as an instrument of bundling trade, FDI and Chinese government and its TNC's operational interest in Africa (Over 105 billion today in my projection)

III. Challenges and Opportunties

IV. Challenges and Opportunities from AERC Studies

III. Challenges and Opportunities

- The major policy issue for Africa regarding economic engagement with China/BRICS is whether it has brought about, or will bring about, structural transformation of the continent which is key for job-creation.
- Important questions include:
  - what is China's economic impact on Africa?
  - How can the China-Africa economic partnership be leveraged to enhance industrial upgrading and structural transformation in Africa?
  - These are major policy questions with a bearing on development and poverty reduction in the continent
- Indeed, recent poverty and growth studies in the continent point out that structural transformation/job creation is much more important and fundamental for poverty reduction than simple per capita growth observed in the continent (Abebe, 2014; Mckay, 2013).
- This can also be inferred from the comparison of the record of poverty alleviation in East Asia and Africa following a surge in growth and structural transformation versus the growth experience in Africa .
  - In relation to this, McKay (2013) noted that between 1981 and 2008 the East Asian poverty level declined by 63 percentage points (form 77 per cent to 14 per cent), while Africa saw just 4 percentage points reduction both during the comparable period (1981-2008), as well as during the period of its historically excellent growth performance since independence, 2003-2013 (Abebe, 2014; McKay, 2004; 2013).

Challenges and Opportunities… Cont'd

The AERC studies (see special issue of JAE 2018)attempt to shed light on the questions of the economic impact of China on Africa, lessons that African countries can learn from China,

Highlights of the AERC Studies:

- Lin : examines China's economic rise and the opportunities that this brings for manufacturing led structural transformation in Africa.
  - This, however, requires clarity of vision, state capacity and willingness to implement (i.e., a committed, credible, and capable government)
  - China, in contrast, adopted a "pragmatic, gradual, dual-track approach which provided necessary protections to nonviable firms in the priority sectors to avoid their collapse while at the same time simultaneously liberalising the entry of private enterprises, joint ventures, and FDI in labour-intensive sectors, in which it had comparative advantages"
  - African countries should begin by building up the necessary infrastructure and improving the business environment specifically for the sectors where they have comparative advantage (the developmental state approach). Such targeted government interventions will help reduce transactions costs in the comparative advantage sectors

Challenges and Opportunities… Cont'd

Highlights of the AERC Studies: Lin .. Cont'd

- The market on its own will not deliver the needed transformation. Both the state and the market have important roles to play.
- The third key message is that China's rise does present opportunities to Africa. In particular, rising wages in China imply that relocation labour-intensive manufacturing out of China is imminent (a large share of China's 85 million strong manufacturing workforce is in labour-intensive sectors). Africa has low wages and a large enough labour force to absorb the displaced opportunities if China upgrades substantially
- Thus, a strategic and pragmatic approach by African countries should position Africa to take advantage of the imminent relocation of a substantial share of China's 85 million manufacturing jobs

Highlights of the AERC Studies: (2) Brautigam et al

- attempts to characterize Chinese manufacturing investments in Africa (motivated by industrial gradient transfer from China, owing to rising costs of labour in and excess capacity in China

Challenges and Opportunities… Cont'd

- The study focuses on four countries, namely, Ethiopia, Ghana, Nigeria and Tanzania, selected on the basis of having the largest number of Chinese manufacturing investment registrations
- The authors begin by taking stock of the current state of knowledge on Chinese manufacturing investments in Africa, where they show that Chinese manufacturing FDI in Africa stood at $4.6 billion in 2016, making manufacturing the third largest destination of FDI from China.
- In terms of the scope of investment, the authors find that most of the Chinese manufacturing firms were engaged in leather and related products; textiles and wearing apparel; rubber and plastic products; and metal and mineral products
- The interviewed firms mainly engaged in relatively simple, entry-stage manufacturing, in a mix of export-oriented and import-substitution products
- These different types of Chinese manufacturing firms present different opportunities and challenges to Africa, which makes it imperative that policy makers understand the characteristic features of the FDI flowing into their countries.

Challenges and Opportunities… Cont'd

Highlights of the AERC Studies: (3) Geda.

- After a detailed examination of the trade potential between China and Africa, the nature of commodities traded, the evolution of their trade balance as well as the pattern of finance that includes FDI and Chinese EXIM bank credit financing:
  - he argues that the engagement does little to move Africa away from over reliance on primary commodities trade, and thus will likely hinder structural transformation in the continent.
  - In addition, the study argues that the engagement is leading to low quality growth (i.e., growth that is limited to the short term only) and has limited effect on poverty reduction (job creation) and long run growth
- The author notes that the engagement has both challenges and opportunities.The list of challenges identified and discussed in detail include:
  - Locking-in Africa in primary commodity export sector: a sector where the scope for technological development is limited and generally characterized by deteriorating terms of trade and volatility of prices;
  - Poor quality growth: growth limited to a short run only with no (or negative) effect in the long run;

Challenges and Opportunities… Cont'd

Highlights of the AERC Studies: (3) Geda…Cont'd.

- Competitive threat to manufacturing and hence industrialization;
- Vulnerability to macroeconomic ramifications of resource inflows that include "Dutch Disease" and "fiscal response" problems; and
- Its detrimental implications for governance and implications for resource related conflict.

- Finally, the study identifies the following opportunities of the Sino-Africa current economic engagement, which are discussed in detail in the paper:
  - Improvement in terms of trade since 2002 and Africa's position in global politics;
  - Infrastructure construction and financing development in the continent; and,
  - The positive potential implications of the Chinese "rebalancing" policy for manufacturing development in Africa.

Challenges and Opportunities… Cont'd

Highlights of the AERC Studies: (3) Geda…Cont'd.

- However, Geda argues that the persistence of challenges, as opposed to opportunities in the current engagement so far shows the lack of both human and institutional capacity and the resulting lack of informed-policy on the African side to be able to benefit from the China-Africa current economic engagement.
- Without such capacity and informed policy for strategic engagement, Africa may not benefit from its current engagement with China, indeed with any other trade partner, in the long run.
- In this sense, Geda's study is less optimistic than the other two studies by Lin and Brautigam et.al
- These varied perspectives show the importance of further, country specific, studies on the issues raised in these papers.
- It also points to the challenge of coming up with an appropriate policy framework that could be employed across all countries in Africa so as to ensure a positive outcome from the current economic engagement of Africa with China.

The End

THANK YOU