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From the Desk of...

Dr Martyn Davies
Speaker & Advisor
on Africa and Sino-African Investment

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How Africa can Leverage China. From Asian to African Geese.

Dr Martyn Davies, with his unique understanding of pan-Africa economics and business, provides his insight into the highly significant axis of China-Africa investment.

The recent FOCAC (Forum on China Africa Cooperation) ministerial meeting held last month in Beijing has again upped the ante of China's pervasive engagement of Africa. But despite the Chinese government pledging a further sizeable sum of US$20bn in investment to Africa over the next three years, I believe that China's state-directed capital toward the continent will become less significant to the growing trend of Chinese market-driven outbound investment. This refers in particular to the start of a long term trend of off-shoring of China's low-end labour-intensive manufacturing sector. Whilst China will remain a very competitive manufacturing economy for at least over the medium term, rising production costs will encourage and force Chinese firms to relocate their operations abroad.

At the FOCAC meeting, African policy-makers were intent on winning Chinese "pledges" in the form of foreign investment, concessionary loans, grants and aid – Chinese "state capital" into their economies. This is a wise strategy. A politically-welcoming environment amongst African governments is of paramount importance for Chinese capital. In Europe, the US and recently Australia, there have been government attempts to block Chinese investors from acquiring local assets – in telecoms, in computer hardware and in mining. In Africa, however, there has yet to be a political obstruction to a Chinese investment on the continent.

Despite the slowing down in China's economic growth rate, its outbound investment continues to increase rapidly. In the first half of this year, China's outbound direct investment (ODI) rose 48.2% year-on-year to US$35.42bn. The main thrust of the ODI was from China's state-owned enterprises (SOEs) receiving both encouragement and capital from China's Ministry of Commerce to do so, pursuing "strategic national interest" in international markets, most often commodities focused.

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China's state-capitalist confidence has been fuelled by the US$600bn-odd stimulus package during the western financial crisis, the bulk of which ended up in the coffers of the SOEs. I believe, however, that we have reached the peak of the Chinese state's influence over its own SOEs as well as its ability to direct the commercial interests of these enterprises into the global economy.

I would argue that China’s slowing economy will encourage the process of internationalization of Chinese enterprises, be it either state-owned or private business.

From State Capitalism to the Market

Chasing Beijing-influenced SOE investment into Africa will be Chinese private companies. Traditionally – over the past decade or so – Chinese activity on the continent could be divided into two simple categories, large firm SOE investment and then Chinese micro-enterprises made up of migrants either trading or selling. A new type of Chinese investor will be coming to the continent in the medium term – growing private firms that best represent the real competitiveness emanating from the Chinese economy.

At FOCAC, there was very little focus being placed on the macro forces that are impacting the Chinese domestic Chinese economy and how Africa can strategically benefit from this. Whilst resources have underpinned China’s foray into Africa throughout the first decade of this century, a shift is taking place – no longer planned by the government in Beijing but being shaped by market forces. The potential move of manufacturing out of China to Africa is potentially the next thrust. The dynamic is now changing. Whilst resources have underpinned China’s foray into Africa throughout the first decade of this century, a shift is taking place – no longer planned by the government in Beijing but being shaped by market forces. The potential move of manufacturing out of China to Africa is potentially the next thrust.

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According to Justin Lin, former chief economist of the World Bank and now at Peking University, China is forecast to possibly lose up to 85m labour-intensive manufacturing jobs within the next decade. In the same way that Japan lost 9.7m in the 1960’s and Korea almost 2.5 million in the 1980’s due to rising wages and production costs, the Chinese economy will undergo a similar (but far greater in number) process. Wages for unskilled workers in China are set to increase four-fold in ten years. According to China’s National Statistics Bureau, the average monthly worker’s wage now stands at US$322 with an annual increase last year that topped 20%. Wage inflation and rising production costs are forcing China to become a higher-value and more efficient manufacturer. The days of the derogatory named “Fong-Kong” products are numbered.

The Chinese economy has reached the so-called “Lewis Turning Point” – named after the Nobel Prize-winning economist W. Arthur Lewis. The point refers to the time when manufacturing costs begin to outstrip manufacturing competitiveness. China’s has passed this Lewis Turning Point in the past two years.

It has been a very disruptive period over the last ten years for foreign manufacturers that have battled to compete with the Chinese manufacturing machine. South Africa’s own textile and garments industry along with other sectors have undoubtedly felt the pain. China’s labour-intensive manufacturing competitiveness is, however, now on the wane.

The inevitable result will be the relocation of Chinese low-end manufacturing to lesser-cost developing economy destinations. This will create enormous opportunities for low income economies with nascent manufacturing sectors. Lin supports this argument by citing the figure of China’s apparel exports amounting to US$107bn in 2009, compared to sub-Saharan Africa's total apparel exports of just US$2bn. The opportunity for Africa to capture a share of this revenue from relocated Chinese factories is indeed enormous.

From Asian to African Geese?

East Asia's growth model has been characterised by US academic Daniel Okimoto as a V-shaped flying geese pattern with Japan as the leading regional economy. By the 1970's, Japan was followed by the Tiger Economies of Hong Kong, Singapore, South Korea and Taiwan. The third tier of Asian geese includes Malaysia, Thailand and now recently Vietnam. But the lead goose is undoubtedly China. Its economy is not so much a flying goose in formation as it is a Boeing 747 roaring past such has been its disruptive impact.

The emerging competitors to African countries' manufacturing aspirations are all Asian – Indonesia, Philippines and Vietnam. Their labour costs are becoming relatively cheaper as China's rise.

If we apply this model to Africa, can we begin to identify the leading geese? Whilst South Africa is undoubtedly the lead goose on the continent, as rising production and wage costs in our economy have increased, we have not seen South African manufacturing shift to lesser cost African economies except perhaps textile and garment production moving to Lesotho. It is unfortunate that regional economies in SADC have not done enough to make themselves attractive to South African manufacturing in the way that Asian economies did to attract Japanese manufacturing that divested from its own economy in the 1970's.

As there are few states in sub-Saharan Africa that are sufficiently differentiating themselves from their neighbours – Ethiopia, Ghana and Rwanda stand out as exceptions – perhaps the "African geese" can fall into formation with the Asian model. Which African states will proactively build the required institutions and enabling environments to attract manufacturing into their economies and step up on the bottom rung of the industrial value chain?

But where will Chinese industry which now accounts for over 20% of global manufacturing begin to move to? The emerging competitors to African countries' manufacturing aspirations are all Asian – Indonesia, Philippines and Vietnam. Their labour costs are becoming relatively cheaper as China's rise. According to Bank of America quoted in Bloomberg Businessweek, their economies are "poised to accelerate, propelling the area's currencies and fueling consumer and property booms." Supported by young populations – the so-called demographic dividend – and high literacy that is above 92% in all three Southeast Asian states (Bloomberg Businessweek), Asian states are well-positioned to benefit from the relocation of China's low-end manufacturing.

Africa did not lay the foundations for industrialization that our Asian counterparts/competitors did in the 1970's and 1980's. The "latecomer challenge" now lies in building the necessary infrastructure, institutions and skills base to attract the investment. African states did not foresee the China-driven "commodity super cycle" of the last decade and thus did not fully leverage the opportunity it presented for its resource sectors. It is imperative that we now recognize the upcoming shift driven by market forces in China's manufacturing sector in order to give impetus to African industrialization and beneficiation ambitions. Africa's relationship with China is no longer just about attracting state capital but also now private investment.

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About Dr Martyn Davies and The Insight Bureau

Martyn Davies is South Africa's premier economist and business analyst and a commentator on Africa and its relationship with the world's emerging markets. He is the CEO of Frontier Advisory, a Young Global Leader of the World Economic Forum and is a member of the Forum's Global Agenda Council on China. Martyn is the Director of the China Africa Network at the Gordon Institute of Business Science (GIBS), University of Pretoria, South Africa and is a faculty member of the school. Martyn is also a faculty member at the University of Pretoria, South Africa. He has also lectured by invitation at Harvard University, MIT, London School of Economics, IE Business School, the Chinese Academy of Social Sciences, the African Development Bank, the OECD, the European Commission, the British Parliament and the World Bank. He is widely published in academia and has written for the *Financial Times* and the *Washington Post* and is a regular media commentator for the BBC, CNBC, CCTV, Al Jazeera, Reuters and AFP. www.insightbureau.com/MartynDavies.html

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www.insightbureau.com Tel: +65-6300-2495 engage_us@insightbureau.com