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China and India Go to Africa

New Deals in the Developing World

Harry G. Broadman

Economic Activity between Africa and Asia is booming like never before. Business between the two continents is not new: India's trade with Africa's eastern and southern regions dates back to at least the days of the Silk Road, and China has been involved on the continent since it started investing there, mostly in infrastructure, during the postcolonial era. But today, partly as a result of accelerating commerce between developing countries throughout the world, the scale and pace of trade and investment flows between Africa and India and China are exceptional. (Throughout, Africa is used as a shorthand for sub-Saharan Africa.) Africa's exports to China increased at an annual rate of 48 percent between 2000 and 2005, two and half times as fast as the rate of the region's exports to the United States and four times as fast as the rate of its exports to the European Union (EU) over the same period.

Much of this activity is concentrated in a handful of African countries and in the extractive industries, such as oil and mining. But increasingly, businesses from China and India are also pursuing strategies in Africa that are about far more than natural resources: in addition to rapidly modernizing industries, both countries have burgeoning middle classes with rising incomes and purchasing power whose members are increasingly buying Africa's light manufactured products, household consumer goods, and processed foods and using its back-office services, tourism facilities, and telecommunications.

Fundamental differences in the resource, labor, and capital endowments of Africa and Asia make them complementary business partners -- meaning that the trend will likely be sustained. This is good news, because the boom is a potentially pivotal opportunity for African countries to move beyond their traditional reliance on single-commodity exports and move up from the bottom of the international production chain, especially if growth-enhancing opportunities for trade and investment with the North continue to be as limited as they have been historically.

Harry G. Broadman, Economic Adviser for the Africa Region at the World Bank, is the author of *Africa's Silk Road: China and India's New Economic Frontier* (World Bank, 2008), from which this essay is drawn. The views expressed here are his own.

To be sure, there are several complications and obstacles. Africa's exports to and investment in Asia remain limited in scale and scope, Chinese and Indian companies in Africa sometimes displace African companies in local markets while creating few jobs there and sometimes even taking some away, and certain of these companies' activities are perceived to complicate already difficult political situations on the ground. What is more, fully realizing the prospects created by Chinese and Indian business is contingent on the implementation of demanding reforms. African governments must adopt policies that enhance African companies' international competitiveness, foster better governance, improve their countries' financial and labor markets, and attract investment in infrastructure. China and India, for their part, must eliminate their protectionist trade policies and allow the import of competitive high-value-added goods and services from Africa.

But if all sides do their share, China's and India's dramatically expanding commercial interest in Africa -- home to 300 million of the world's poorest people and a region that presents the world's most formidable development challenge -- could be an unprecedented opportunity for the region's growth and for its integration into the global economy.

OUT OF AFRICA

Since 1990, both Africa's exports to Asia and its imports from Asia have grown more rapidly than either its exports to or its imports from any other region of the world. Exports grew by 15 percent annually between 1990 and 1995 and by 20 percent between 2000 and 2005; imports grew by 13 percent annually between 1990 and 1995 and by 18 percent between 2000 and 2005. Meanwhile, between 2000 and 2005, the EU's share of exports from Africa dropped by half -- so that Asia now buys about the same size share of Africa's exports as does the United States or the EU, Africa's traditional trading partners.

This recent burst in trade stems from a sharp upturn in the appetite of Asia's emerging economic giants, China and India, for African products -- the result, in turn, of those two countries' booming economies. China and India have eclipsed Japan and South Korea as the most important Asian markets for African goods. Africa's exports to China and India have grown almost twice as fast as the region's total exports. China and India now buy ten percent and three percent, respectively, of all of Africa's exports.

The pattern of China's and India's trade with Africa is concentrated geographically. Eighty-five percent of the continent's exports to China come from five countries, the oil-exporting nations of Angola, Equatorial Guinea, Nigeria, the Republic of Congo, and Sudan. South Africa alone accounts for 68 percent of the region's exports to India, most of which are in minerals, precious stones, metals and alloys, and chemicals. Reflecting the broader profile of Africa's export patterns worldwide, a few unprocessed goods -- namely oil, ore, metals, and raw agricultural commodities -- dominate, accounting for 86 percent of total trade flows to China and India. Value-added manufactured exports make up a small share of Africa's exports -- only eight percent of total exports to China, for example.

But this is changing, because the boom, driven until now by the growing demand for supplies for China's and India's expanding industries, is increasingly propelled by the incipient consumption of those countries' middle classes. China and India are beginning to import from Africa far more than fuels and minerals and metal products; their imports now include commodities (such as cotton or food products) that have undergone some labor-intensive processing in Africa and will be further processed in Asia in preparation for industrial or consumer use. To be sure, China and India export far more manufactured goods, machinery, electronics, and medical supplies to Africa than Africa does to China and India, and the imbalance exposes Africa to some risks: a sizable number of consumer goods from China and India directly compete against Africa's domestic products. But imports from China and India increasingly include capital goods, and those are helping to bolster the competitiveness of Africa's manufacturing sector by providing intermediate inputs for products that are assembled or processed in Africa and then shipped to the EU, the United States, and other markets.

The rapid increase in foreign direct investment (FDI) flows between Asia and Africa, even though much more modest than the increase in trade, is also noteworthy. India's cumulative FDI in Africa was $1.8 billion as of the end of 2004; China's was $1.3 billion as of the end of 2005. Over the past decade, much of this investment, too, has been concentrated in a few countries and in the extractive industries: for example, 50 percent of the FDI from China went to the oil- or mineral-rich countries of Nigeria, Sudan, and Zambia. But in the last few years, China's and India's FDI flows to Africa have begun to reach many other sectors (including apparel, agroprocessing, power generation, road construction, tourism, and telecommunications) and many more countries (including Botswana, Ethiopia, Kenya, Madagascar, Mauritius, Mozambique, Senegal, South Africa, and Uganda).

SOUTH BY SOUTHEAST

Owing to differences in China's and India's cultures, political systems, and economic policies, there are significant variations between the operations of Chinese and Indian firms in Africa. Whereas most Chinese businesses on the continent are medium-sized or large state-owned or state-controlled enterprises, Indian companies vary more in size and are typically either privately owned or under mixed private-public ownership. As a result, the two sets of firms perceive commercial risks differently, which colors their business strategies in a variety of ways. Chinese firms tend to enter new markets in Africa by building new facilities, creating business entities that are vertically integrated, buying supplies from China rather than local markets, and selling in Africa mostly to government entities. They rarely facilitate the integration of their workers into the African socioeconomic fabric. Knowing that they can rely on Beijing's deep pockets, they are often able to outbid competitors for procurement contracts from local governments. On the other hand, most Indian firms in Africa acquire established businesses, are less vertically integrated, prefer to procure supplies locally or from international markets (rather than from Indian suppliers), engage in far more sales to private African entities, and encourage the local integration of their workers. In a 2006 survey of 450 business owners in Africa, almost half of the respondents who were ethnically Indian had taken on African nationalities (with most of the other half retaining their Indian nationality), compared with only four percent of firm owners who were ethnically Chinese (the other 96 percent had retained their Chinese nationality). This finding suggests that Indian immigrants are substantially more integrated into the African business community than are Chinese immigrants, who are relative newcomers.

The commercial activity of Chinese and Indian companies in Africa has been significantly aided by Beijing's and New Delhi's public programs for trade and investment finance. The Chinese government, largely through the Export-Import Bank of China and more recently through the China Development Bank, provides export credits, loans, and investment guarantees to Chinese investors. At the end of 2005, its concessional loans to all of Africa reached $800 million and covered 55 projects in 22 countries. In 2006, Beijing issued "China's African Policy," which set out core principles to guide future cooperation with the continent, and hosted a widely heralded summit with 48 African leaders, at which President Hu Jintao announced that China would double its assistance to African countries by 2009, provide them with $5 billion in concessional loans and credits, establish a $5 billion fund to encourage Chinese investment in Africa, and cancel the interest-free debt it was owed by 33 African states. Likewise, the Export-Import Bank of India facilitates trade and investment between India and African countries. Its activities have historically been concentrated in eastern and southern Africa, where, thanks to a long tradition of commerce and immigration, an Indian diaspora is already well established. But the bank recently launched the Focus Africa Program to identify new priority areas for bilateral trade and investment. In 2006, it extended to African countries a line of credit totaling $558 million, about half of which went to the Bank for Investment and Development of the Economic Community of West African States.

Such government backing has sometimes led to the perception that the overseas activities of Chinese and Indian companies are an extension of the two countries' foreign policies (much as support from the U.S. government and the EU for similar programs has caused similar perceptions). That can be a public-relations headache for Beijing and New Delhi given some of the downsides of these activities for Africans. Indeed, there are significant problems and imbalances. Whereas Asia buys almost one-quarter of Africa's total exports, Africa's exports to Asia represent little more than one percent of the world's exports to Asia. African FDI in Asia is extremely small, in both absolute and relative terms. Typical Chinese and Indian investments in Africa, such as large-scale oil or mineral exploration projects, are capital intensive and so create few new jobs. Furthermore, as Chinese and Indian entrepreneurs bring consumer goods from home into Africa, they sometimes displace African producers in domestic sales and exports, for example, in the textile and apparel sectors. Competition can spur African firms to become more efficient, but it can also create unemployment and inflict other social costs. Where African workers have been displaced, such as in Zambia, there have been sharp reactions and public demonstrations. Worse, some governments, nongovernmental organizations, and media outlets have recently criticized Chinese firms for the political implications of their activities -- for example, for the conflict in Darfur. Beijing is increasingly aware that the overseas activities of Chinese companies can be a liability and that it needs to mitigate the costs to its reputation. It has begun to take steps to do so by, for example, recently issuing "good corporate citizen" guidelines to govern the operations of Chinese multinationals in Africa.

Nevertheless, on balance, China's and India's rapidly growing commerce with Africa presents a major development opportunity for the continent. In recent years, the international marketplace has witnessed a big change: production chains have been divided into discrete functions, each of which can be performed by a separate entity, such as a foreign subsidiary or supplier. This development has boosted trade in intermediate goods and components and enabled corporations worldwide to become more footloose. The advent of data systems that provide real-time information on the international movement of goods up and down the production chain has allowed for the more efficient and ever cheaper shipping over long distances not only of assembled durable goods but also of components for just-in-time manufacturing products and -- an important point for the fertile countries of Africa -- of perishable goods. The result has been the rapid growth of trade within related industries, also known as network trade, in which, for example, a country imports cotton in order to produce garments and then exports those garments to third countries. This is true especially relative to the more traditional trade of final goods from different industries, such as the export of bananas or the import of machinery.

Such global value chains offer African countries a chance to increase the volume, diversity, and worth of their exports. African companies in several industries -- for instance, the automobile industry (in South Africa), the fresh-cut-flower industry (in Uganda), and apparel manufacturing (in Kenya) -- either have already engaged in or have strong prospects for engaging in network trade. And because many of the Chinese and Indian firms active in Africa are part of multinational corporations integrated into global value chains, doing business with them can help African companies expand their own engagement in network trade. This expansion is already evident in the areas of food processing (in Tanzania), textiles (in Ghana), fishing (in Senegal), and back-office services (in Tanzania).

As a result of their integrated corporate structures, moreover, Chinese and Indian multinationals engaged in Africa have played a significant role in facilitating links between trade and FDI. This is important because in some sectors, such as the extractive industries, the flow of investment from these firms to Africa increases the volume of African exports by offering markets not only to those firms' home countries but also to countries outside of Asia. These links between trade and FDI offer important opportunities to African firms, and in order to exploit them, more and more of these companies are entering into joint ventures with Chinese and Indian investors. By virtue of their integration in global corporate structures, Chinese and Indian businesses in Africa are also able to run larger operations and thus achieve greater economies of scale than their African counterparts. Thus, they can export a wider array of higher-value goods than can African firms in the same sectors. They also are more extensively integrated into both Africa's own regional trade networks and a geographically wider set of markets outside of Africa. In other words, Chinese and Indian firms in Africa are at the vanguard of the integration of African economies across the continent and into the global marketplace.

HOLDING BACK

Unfortunately, various constraints are preventing such benefits from spreading across more economic sectors and to more countries in Africa. For one thing, tariffs in many African states, as well as in China and India, still limit trade, even though as members of the World Trade Organization (WTO), these countries have relatively liberalized trade policy regimes and have set tariffs on a nondiscriminatory basis, at "most favored nation" levels. The average tariff rates that most of Africa's leading exports face in Asia, including in China and India, are higher than those they face in the United States and the EU. This is particularly the case with agricultural commodities, and especially in India. Matters are better and improving in China: as part of its 2006 economic-assistance package, Beijing unilaterally eliminated tariffs on 190 commodities from Africa's 25 least-developed countries, and in 2007 it began to increase the number of exempted commodities to 440. But in China and India, African products continue to face the far more serious problem of escalating tariff-rate structures, under which more processed imports are subject to higher tariffs. This rule has discouraged the import of high-value-added processed products from Africa, such as ground coffee, cocoa powder, and roasted cashews. African states, for their part, have lowered many of their import tariff rates significantly in recent times, and major imports from China and India, including electronics, machinery, and transportation equipment, generally face relatively modest tariffs. But African states maintain many high tariffs against the Asian goods they import the most, such as textiles, yarn, apparel, footwear, and light manufactured goods. This has a pernicious effect: high import tariffs on textiles and yarn, for instance, raise production costs for African apparel manufacturers and thus limit the competitiveness of their products.

Another set of problems arises from the current network of trade agreements that African countries have been fashioning to foster regional integration, a critical goal on a continent with so many small and landlocked countries. Africa has not been immune to the worldwide proliferation of regional free-trade agreements that has occurred, along with multilateral trade liberalization, over the past 30 years. Every African country is now a member of at least four different agreements, and there are eight formal "regional economic communities" (or customs unions) and eight other types of regional integration entities or initiatives on the continent. The resulting "spaghetti bowl" of overlapping agreements has complicated customs administration and processing, driving up the cost of trade and deterring investment. The 2006 survey of 450 business owners operating in Africa suggested that most of them -- be they Chinese, Indian, or African -- find these arrangements ineffective at best and at worst an impediment to trade within Africa.

To be sure, these traditional trade-policy-related factors are critical constraints on the ability of African businesses (and governments) to make the most of the activities of Chinese and Indian companies. But perhaps more important are the constraints resulting from domestic economic factors not usually thought of as connected to international commerce. Most African nations, like other developing countries, have a thin base of internationally competitive domestic enterprises, nascent market institutions, and underdeveloped national infrastructure -- all of which prevent local businesses from engaging significantly in sustainable and profitable international transactions. There has been increasing diversity in the performance of African governments trying to deal with these problems in recent years, with several countries making significant improvements, such as Burkina Faso, Ghana, Madagascar, Mauritius, and Mozambique. But in many states, poor governance and regulatory burdens remain serious limitations to trade and investment. These countries have seriously deficient judicial systems due to inadequate resources and human capital, weak institutions, and a lack of transparency. Business disputes tend to be costly, in terms of both time and fees. And inefficiency is sometimes compounded by corruption, with insidious effects: smaller African companies carry a disproportionately large burden when it comes to making unofficial payments, and exporters and large firms tend to be inspected more often, which seriously constrains their ability to conduct business.

All of this is unfortunate because vigorous competition in African markets could help increase the local benefits of trade with and investment from China and India. African countries with more intense competition among domestic firms (such as Mauritius and South Africa) make better exporters. Likewise, the African sectors that face more internal competition not only attract more FDI from China and India but also eventually become more effective at penetrating Asian and other markets. There is also a positive consequence for African companies in Africa: in African markets that face tougher competition because of imports from Asia, the barriers for African start-ups to enter the market generally drop. In other words, domestic competition and international integration reinforce each other over time; success at home breeds success abroad, and vice versa.

But such benefits are often impeded by prosaic problems such as poorly functioning capital markets, limited skilled labor, and lack of infrastructure. Restricted access to finance is one of the most significant constraints on business development and expansion in Africa. Acute shortages of skilled labor, coupled with restrictive domestic labor regulations that limit the mobility and flexibility of workers, increase the costs of running a business. Business costs in Africa are also high because the quality of the power supply is poor, telephone service is erratic, and Internet access is limited. In Senegal and Tanzania, for example, there are interruptions in electric power during 20-25 percent of production time. Telecommunications networks, especially those geared toward business services, are still woefully underdeveloped in Africa, even though a surge of private providers of mobile telephony is helping greatly by providing higher-quality service at lower cost. Inefficient transport systems and ports and problems with other basic logistics create serious bottlenecks that slow the movement of goods within Africa and to outside markets: it can be as expensive to transport products from Angola to South Africa as it is to ship them from Angola to China.

Such obstacles, in turn, increase the costs to businesses -- even those of African origin -- of conducting cross-border transactions with the continent. Foreign companies hunting for deals in Africa are often constrained by inadequate information about how to spot new market opportunities, search for new trading or investment partners, establish marketing channels, transfer personnel and technology, or determine how best to utilize logistical, transport, and communications systems. For example, African firms rarely adhere to internationally recognized technical standards and accreditation schemes, such as those governed by the International Organization for Standardization. That limits the ability of potential importers in China and India to compare the quality of African products with that of similar goods produced elsewhere.

A LEVER FOR GROWTH

Market opportunities for trade with and investment from international actors will no doubt continue to grow for Africa. But as the world economy globalizes further, competition from other regions in the South will become stronger. Thus, African policymakers must make better use of Asia's current involvement as a lever for growth. China's and India's rapidly growing activities in Africa are a major opportunity for the continent's economies to move away from an excessive reliance on a few raw commodities and toward greater production of labor-intensive light manufactured goods and services. This engagement could also help African companies become more efficient by exposing them to more competition, advances in technology, and modern labor skills. And it could lead to greater integration of African countries not only with other regions of the world but, perhaps most important, on the continent itself, where most domestic markets are too small and too shallow to sustain the large-scale production of internationally competitive exports.

Devising and implementing an agenda for reform is thus critical. Experiences elsewhere -- the East Asian economic miracle, the recent accession of several central and eastern European countries to the EU -- have shown that reform tends to be most successful when it involves a combination of actions. Three lessons stand out in particular for African governments and their prospective partners and investors from China and India. First, it is important to implement sound policies regarding tariffs and trade agreements and, even more so -- especially in African states -- to reform fundamental features of domestic economies. Second, policies should facilitate linkages between investment and trade flows in order to create opportunities for African firms to engage in modern network trade. Third, there should be a clear division of labor among the various stakeholders -- Africans, Chinese, Indians, and the international community, including multilateral and bilateral development agencies.

Both African and Asian countries must lower their overall tariffs, including those set at most-favored-nation levels, ideally within the context of the Doha Round of WTO negotiations but unilaterally if necessary. Beijing's recent decision to lift all import tariffs on hundreds of commodities from some of Africa's least-developed countries is a good start. But China and India should also eliminate their escalating tariff structures, which prevent Africa's leading high-valued-added processed goods from entering their markets at competitive prices. Africa, for its part, must rationalize and harmonize its confusing and inefficient network of overlapping regional trade agreements. This is a tall order since the regional entities overseeing the agreements have strong vested interests in maintaining them. Yet it is absolutely essential for Africa's development to accelerate regional integration -- which is the underlying objective of these agreements anyway. Other regions of the world, such as southeastern Europe, have begun to simplify their trade agreements, sometimes with the help of expertise from the WTO, the World Bank, and other international organizations.

Once the flow of commerce between Africa and Asia is encouraged, it must be translated into greater growth in Africa. Such growth will come only when Africa's domestic markets are more fully reformed so as to increase competition, ensure sound governance, develop infrastructure, and generally foster a hospitable investment climate. To this end, African governments should further eliminate administrative and policy barriers that prevent new businesses from entering the market and commercially nonviable firms from exiting it. The competition policies of most African countries are still underdeveloped; they must be institutionalized in order to build and maintain vigorously competitive industries and guard against restrictive business practices. This will require not only enacting competition laws based on global best practices and establishing enforcement agencies with regulatory authority, well-trained staffs, and political clout but also educating the public to understand that market competition plays a pivotal role in economic development by driving the costs of products and services down and improving choice, quality, and innovation.

Such reforms should be implemented in tandem with two closely related sets of policies. First, it is important to facilitate the growth of private African businesses through reforms that reduce rigidities in the continent's labor markets (by lowering the costs of hiring and firing personnel), further develop its financial markets (by increasing the availability of credit and lowering its cost to productive enterprises), and strengthen workers' skills (by offering them training and secondary and postsecondary education). Second, it is essential to increase the institutional capacity of African states to develop and enforce social, environmental, and product-safety standards that conform to international norms and apply to all investors, domestic or foreign.

Strengthening governance by improving the quality of basic market institutions, establishing more effective systems of checks and balances, and reducing incentives for corruption is also critical to the international economic integration of Africa. As it is in other developing regions of the world, achieving progress in governance in Africa will be a formidable task. But in recent years, a growing number of Africa's leaders have established or started participating in major regional initiatives to deal with the continent's governance problems, such as the African Peer Review Mechanism of the New Partnership for Africa's Development and the Extractive Industries Transparency Initiative. However, more extensive measures at the national level are still needed to increase transparency and accountability in the conduct of public officials: the implementation of effective systems to manage public finances, the establishment of ombudsmen and competitive public-procurement practices, and the reform of public administration to align pay with performance would be good first steps. Improving governance will also require strengthening the enforcement of commercial contracts. The settlement of international business disputes in Africa is generally impaired by lengthy procedures, the lack of qualified and independent judges, and weak enforcement mechanisms. Policies that simplify (and so reduce the costs of) formal legal procedures would fortify the sanctity of contract and property rights, thus improving businesses' confidence in Africa's investment climate. In recent years, several countries, such as Ghana, Mauritius, Mozambique, Namibia, Rwanda, South Africa, and Tanzania, have already made promising advances in implementing such reforms.

Finally, it is essential to develop and improve the infrastructure in most African countries, especially those that have small markets or are landlocked. A clear priority should be to improve and modernize these countries' road and rail transport systems, ports, and telecommunications and information technology capacities. Meeting this challenge will require continued privatization or private-public partnerships to entice new investments. Customs procedures must be simplified. The focus should be on improving coordination among border-related agencies; making customs codes and associated regulations rule-based, transparent, and commercially oriented; and introducing customs authorities to information technology. The development experiences of other regions with contiguous landlocked countries, such as the Balkans or Central Asia, can provide practical lessons for African reformers.

Against this backdrop, African governments should also implement measures specifically intended to encourage Chinese and Indian businesses operating in Africa to forge linkages between their investments on the continent and trade flows out of it. African countries that bring their FDI policy regimes in line with international best practices in order to attract world-class investors -- including sophisticated Chinese and Indian multinationals -- will increase their national firms' chances to participate in the international marketplace. Indeed, the formation of such linkages is critical to enabling African actors to take advantage of the continent's vast natural-resource wealth, extract more value from the processing of these resources, and increase the participation of African firms in modern network trade. Creating world-class FDI policy regimes means, among other things, treating foreign investors like national investors, ensuring that all trade-related investment measures are consistent with WTO rules, providing for binding international arbitration for disputes between states and private investors, and abiding by international legal standards for expropriation and compensation.

This reform agenda will, of course, take years -- if not decades -- to implement: hence the importance of explicitly acknowledging who needs to do what. Inevitably, the lion's share of the effort will fall to the parties with the most to gain from reform -- in this case, primarily African states and to a lesser extent China and India. African states, which must implement wide systemic reforms, have the most daunting tasks. One especially difficult job facing China and India is eliminating their escalating tariff rates. The international development agencies will have to share some of the burden, not only through traditional budgetary support but also by supporting institutional capacity building in African countries (especially in competition policy and governance), the development of infrastructure and the financial sector, the harmonization of trade agreements and technical standards, and the improvement of customs regimes and secondary education. They can also play a key role in encouraging international companies to respect fiduciary, social, and environmental safeguards in overseas investments in Africa.

As the global marketplace becomes increasingly integrated, much is at stake for the economic welfare of Africa. After years of stop-and-go economic growth, many African countries now appear to be advancing at a sustainable pace. Over the past decade, Africa grew at an average rate of 5.4 percent, on par with the rest of the world. The dramatic increase in commerce recently between Africa and Asia's emerging giants -- China and India -- is a major contributor to this growth. Africans cannot afford to be left behind in the newest phase of globalization -- the maturation of South-South commerce, which China and India are leading. African leaders must be proactive and take advantage of the opportunities created by China's and India's commercial interest in Africa by pursuing bold reforms that serve Africa's self-interest. And the rest of the world must work to ensure that Africans can benefit from these new patterns of international commerce.