

“Going Global in Groups”: Structural Transformation and China’s Special Economic Zones Overseas

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Summary. — China’s special economic zones helped the country industrialize by attracting foreign investment. In 2006, Beijing initiated an overseas trade and cooperation zone program, assisting Chinese companies to invest abroad while also building China’s soft power through the transfer of a key component of China’s development success. Little is known about the 19 zones approved so far under this program, or the impact they are likely to have on structural transformation and industrial development in their host countries. This paper identifies the 19 zones and their proposed locations, the process of selection, developers, implementation, and the Chinese incentive regime. It then focuses on the African zones. Using a typology of factors that have proven critical for zone development in the past, the paper evaluates the potential of these zones for fostering structural transformation in Africa.

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1. INTRODUCTION

In the space of a decade, China’s economic rise has begun to transform the global economic landscape. China’s emergence as a global economic power is both a threat and an opportunity for structural transformation in Africa. Real and potential economic threats have been telegraphed by media headlines that deplore the impact of Chinese imports on weak industrial sectors, as well as concerns that Chinese investment in natural resources will further “lock” Africa into its traditional role as a raw material exporter (Amsterdam, 2012). At the same time, however, econometric studies suggest a more nuanced picture. Chinese growth may act indirectly as an engine of poverty reduction. Researchers at the OECD found that for every 1% rise in Chinese growth, some 7.7 million people outside China were raised out of poverty (Garroway, Hacibedel, Reisen, & Turkisch, 2012). Weisbrod and Whalley (2011) calculated that Chinese investment, and not simply demand for commodities, had a significant positive impact on growth in sub-Saharan Africa.

Growth is not the same as economic development, however. It may have no relationship to the kinds of activities that will underpin a sustained move up the ladder. For most African countries, structural transformation will likely encompass, at first, a shift of labor and economic activity from low-productivity agriculture to labor-intensive manufacturing. The critical question then becomes: what impact will Chinese engagement have on African manufacturing?

This paper focuses on one aspect of Chinese engagement: overseas special economic zones. While Chinese officials have authorized support for 19 zones worldwide, six of these zones are being built in Africa and most focus primarily on

manufacturing. Given the lack of data on the zones, our methodology is qualitative. We establish a baseline from which their progress can be viewed, over time. To do this, we rely on multiple visits to the zones, their developers, and their African hosts in Egypt, Ethiopia, Mauritius, Nigeria, and Zambia, interviews with the developers in China, and a close review of existing information on the developers’ websites and other primary and secondary sources. In our analysis, we consider the potential of these zones to contribute to Africa’s structural transformation, while cautioning that given their early stage of development, any conclusions must be regarded as preliminary. The next section of the paper places these zones in context by a brief analysis of the various channels through which China’s rise could be affecting African structural transformation. We then turn to a review of the debates over the utility of overseas economic zones as instruments of economic development. An overview and analysis of the zones to date follows, and a final section concludes.

2. CHINA AND AFRICAN MANUFACTURING

China’s rise can affect African manufacturing through a number of competing channels, as several recent studies have demonstrated (Kaplinsky & Morris, 2009; Morris & Einhorn, 2008; Power, 2008; Wood & Mayer, 2011). At one level, Chinese imports provide competition for local firms. As noted below, this competition can be devastating in some countries and

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some sectors, driving local firms out of business. Yet as Schumpeter noted with the phrase “creative destruction,” capitalist competition can also be developmental. Another channel affecting African manufacturing comes through the sale of China’s competitively priced machinery and equipment. Third, trade incentives provided through China’s zero-tariff program could help stimulate manufactured exports, in ways similar to Europe’s “Everything but Arms” (EBA) trade preference program and the United States’ African Growth and Opportunity Act (AGOA). Finally, Chinese firms can invest in joint ventures or solely owned manufacturing firms in Africa. If this were to follow Asian experience, Chinese firms could be catalysts for local firms to move into manufactured exports, although they can also be footloose investors, moving on with only fleeting impact on manufacturing (Bräutigam, 2003; Rotunno, Vézina, & Wang, 2012).

The “competition leading to destruction” channel has received the lion’s share of media attention. In 2009, China exported \$3.1 bn in garments and \$1.42 bn in footwear to Africa, and both categories registered increases: 2.3% and 11.4%, respectively (State Council, 2011). It is easy to find anecdotes about the closure of textile factories in Africa that have succumbed to Chinese competition. Between 2004 and 2008, for example, seventeen Nigerian fabric factories closed, six of which employed more than a thousand workers each (Gabriel & Ahiuma-Young, 2008). Surveys of the Ethiopian shoe industry point to a more nuanced outcome. There, microenterprises in the informal sector suffered most from Chinese import competition, but a significant number of small, medium, and large enterprises fought back by upgrading their capabilities. As a result, some became exporters for the first time (Gebre-Egziabher, 2009; Redi, 2009; Sonobe, Akoten, & Otsuka, 2009).

Chinese competition is also likely to have affected African exports in third markets: the United States and Europe. For several decades, the Multi-fiber Arrangement (MFA) imposed a quota system on textile exports from countries like China, allowing space for domestic textile production and imports from other textile exporting countries. After the MFA ended on January 1, 2005, exports of clothing from Mauritius, Madagascar, Lesotho, and Kenya—four of sub-Saharan Africa’s major exporting countries to the United States and Europe—stagnated or fell (US Department of Commerce, 2011; WISER, 2011). However, in at least one of these countries, Madagascar, other factors compounded the problem. A December 2009 coup, and related sanctions imposed by the United States, caused a collapse in garment exports (Easterly & Freschi, 2010). Others have argued that the decline in exports from some southern African countries can be traced in part to an exit by Chinese manufacturers who had invested locally, but could no longer compete with their compatriots located in Asia (Rotunno *et al.*, 2012).

More generally, however, data from across Africa point to a highly uneven pattern of manufacturing growth. In the aggregate, sub-Saharan African countries have experienced a long term relative decline in the percentage of their GDP coming from manufacturing, from 17.5% in 1965 to less than 15% in 2005 (Lin, 2011). Yet this masks important temporal and spatial variation. For example, between 2005 and 2008, despite facing a common challenge of imports from China, manufacturing in sub-Saharan Africa grew by an average of 5% annually, until the impact of the global financial crisis in 2009. Moreover, value added, adjusted for inflation, grew every year between 2005 and 2011, with the sole exception of 2009.¹ On the other hand, manufacturing activity varies, with some

countries experiencing rapid growth (often from a low base) while others have stagnated or declined.

Some of the manufacturing growth may be due to an increase in Chinese manufacturing investment in Africa. The proportion of Chinese outward bound foreign direct investment in the manufacturing sector has increased sharply in recent years. In 2010, Chinese outward FDI in manufacturing came to \$4.7 bn, compared with mining at \$5.7 bn (Statistical Bulletin, 2010). Sectoral investment flows are not generally disaggregated on a regional basis, but the Chinese announced that Chinese investment in African manufacturing from 2009 to 2012 made up \$1.33 billion, and accounted for 15.3% of investment stocks by the end of 2011 (State Council, 2013). These figures help explain why the export of equipment and machinery is one of the fastest growing sectors in Chinese exports to Africa.

In addition, the Chinese government offers indirect incentives for Chinese manufactures to shift their production to Africa through the program granting tariff-free entry to more than 400 products from Africa’s low income countries, including a wide variety of manufactured goods such as motor vehicle spare parts, diesel generators, gardening tools, knit clothing, and leather wallets (Freemantle & Stevens, 2010). As a Chinese ambassador pointed out: “This policy does not only encourage Chinese enterprises to invest in Africa . . . people all over the world who invest in Africa can enjoy this treatment” (Lin, 2010).

Finally, the Chinese government is backing the construction of six overseas special economic zones in Africa, part of a global program that has seen 19 zones selected for support. These special economic zones, called “trade and economic cooperation zones” in official announcements, were apparently positioned to serve several strategic objectives for China. First, they could help increase demand for Chinese-made machinery and equipment, while making it easier to provide product support. Second, by producing overseas and exporting to Europe or North America, Chinese companies would be able to avoid trade frictions and barriers imposed on exports from China (Xinhua, 2006). Third, they could assist China’s efforts to boost its own domestic restructuring and move up the value chain at home (Xu, Li, & Wang, 2006). Fourth, they were intended to create economies of scale for overseas investment, and in particular, to assist less experienced small and medium-sized enterprises to venture overseas “in groups” (Bo, 2007; Fu, 2007). Finally, fifth, they were viewed as a way to transfer one element of China’s own success to other developing countries. This aspect of Chinese engagement would in theory be helpful for recipient countries, while also benefiting China (Bräutigam and Tang, 2011a, 2011b, 2012).²

The idea of setting up special economic zones and industrial clusters overseas to serve as magnets for manufacturing firms to venture outward is not original to China. Developing countries in Asia, including China, host perhaps dozens of industrial zones under various regulatory and incentive regimes, some built by Japanese trading companies like Sumitomo. Trading companies have worked in partnership with sending country governments to encourage regional production chains (Hatch, 2010).

The idea that industrial clusters can promote structural transformation has a long history. Porter (1990) popularized the idea in *The Competitive Advantage of Nations*. Economists have emphasized that clusters take advantage of agglomeration economies, economies of scale, reduce transactions, and search costs (Greenwald & Stiglitz, 1986; Krugman, 1991; Lin & Monga, 2011)

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