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Asia's Growing Presence in the Global Economy: What's in for Africa?*

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With the emergence of China *and* India in the world economy ever more manifest, Africa's economy and polity will be affected in various, complex ways. The interactions between the Asian giants and Africa are bound to intensify even if the recent period of supercharged growth in the former countries is unlikely to be sustained.

Policy interactions seem relevant in the areas of

- raw material price levels and volatility,
- exchange rate developments and resource allocation (de-industrialisation, vertical integration),
- low-wage competition and income distribution,
- industrialisation strategies, input linkages (in China & India),
- capital-flow effects (such as through FDI, project finance, public-private joint ventures),
- finally the "political economy" (potentially involving corruption, rent-seeking, business environment) of Chinese and Indian FDI and ODA (incidentally pointed out by the last WB global development finance as gaining in magnitude).

The Asian giants are *relevant* for *policy design* by African governments in many ways; we can think of the Asian giants as

- Growth models,
- Key global price setters, including for interest rates,
- Potential markets,
- Competitors,
- Financiers, and
- Polity determinants.

Many African economies are raw material producers (important to Asian import demand). For example, India is by now Cameroon's biggest export destination (cotton) and absorbs Senegal's entire phosphates output. These countries should be therefore subject to heightened donor attention, as they may suffer from Dutch Disease effects in connection with real exchange rate appreciation and high raw material prices, and as they are particularly buffeted should the emergence of China and India temporarily destabilise raw material prices (rather than permanently raise them). Raw material prices are also determined by global output gaps, global interest rates and the US dollar, which in turn are very much governed by Asian growth and by the currency mix into which the Asian economies invest their rising foreign exchange reserves[1].

[1] This holds as long as Asia explicitly or implicitly keeps pegging to the US dollar. For new channels of global macroeconomic interdependence that arise from China's ascendancy, see H. Reisen, M. Grandes and N. Pinaud, *Macroeconomic Policies: New Issues of Interdependence*, OECD Development Centre Technical Paper # 241, Paris 2005.

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In Africa, though, *measurable Dutch Disease effects* may be limited as the continent's export manufacturing sector is very small. To be sure, several countries are also wage-intensive textile and garment producers and hence may be subject to increased textile competition from India and China as the MFA and the respective quotas have been dismantled early 2005. The potentially very rapid rise of Asian producers in the clothing sector affects individual African exporters to the US under the AGOA (Africa Growth and Opportunity Act) and to the EU under the EverythingbutArms (EBA) arrangements - and the structure of the global textiles and apparel sector as a whole. The 2004/05 *African Economic Outlook* last week released by the OECD Development Centre and the African Development Bank points to the Maghreb countries, Mauritius, Madagascar and Lesotho in particular[2]. In any case, where a manufacturing sector exists, productivity levels are way below China's (e.g. in the apparel sector, productivity of labour at the plant level range from 33 to 70 percent); consequently, Africa's competitive base is fragile to Asian competition.

African economies are affected differentially by the competitiveness and growth of Asia. In some cases, there may be complementary effects, as producers benefit from the demand for their outputs from Asia. China and other countries may even want to secure raw materials and improve export infrastructure in selected African countries and offer project finance, FDI and other forms of trade-linked capital flows. At the OECD Development Centre, we aim to address under the FDI dimension three issues:

- Will China and India, and developing Asia more broadly, become an important source of FDI to developing countries?
- What would be the beneficiary sectors – only natural resource intensive sectors?
- Would the poor be able to benefit from these developments, or would they remain outside any benefits, especially if most FDI goes to resource-intensive industries?
- Where will interests be competitive, as Asian economies divert indirectly investment resources away from African economies?

Much of Africa depends and will depend on public ODA rather than private capital flows to finance deficits on the current account. The increasing availability of official development aid (ODA) provided by countries which do not belong to the Paris Club might derail the efforts accomplished in the framework of the HIPC initiative and jeopardize its still flimsy achievements:

. Because the ODA provided by countries like China has less strings attached than that made available by Paris Club countries and multilaterals, it is more attractive for African countries.

. The emergence of non-DAC donors tends make official aid more competitive on the donors side and to weaken the leverage of IFIs on African countries. As a result, it might undermine IFI's ability to impose tight conditionality and high level of concessionality on future debt contracted by African countries. In the event, countries such as China hardly coordinate their official assistance with multilaterals and Paris Club countries.

. While having fewer strings attached, finance provided by countries outside the Paris club is usually far less concessional than the one supplied by bilateral/multilateral donors in the framework of IMF/World Bank programmes. Therefore, this emerging South-South ODA might bring the African debt dynamic (the sustainability of which has already been questioned in the post-HIPC context) back on an upward and unsustainable path.

[2] African textile exports are specifically vulnerable since they are mostly destined for the US and EU markets and mainly concentrated in formerly quota-restrained products. This is an issue also for countries which haven't developed a textile sector yet, but which have plans to move up the value chain by adding value to the raw commodities which they have merely exported so far: example Mali which would like to set up a textile industry based on its cotton output. China's competition may undermine this strategy from its very beginning. In other manufacturing sectors, Chinese competition may jeopardize African (nascent) efforts to diversify away from commodities, too.

Recently, pressure has grown on China to appreciate the Yuan. Did this materialise, other Asian currencies would appreciate, too. How would this change things for Africa? On the trade account, only a limited impact of Yuan appreciation on China's competitiveness should be expected as the import content of Chinese exports is high. Here, the impact would be mostly Keynesian through expected slowdown of US growth, due to higher interest rates as the demand for US treasuries will drop, and lower US demand for Chinese goods due to a negative income effect as US terms of trade worsen.

While on balance the short-term opportunities of Asia's ascendancy and of corresponding South-South trade may outweigh the economic cost for Africa, in particular its raw material and energy exporting economies, there are serious long-term risks. These risks are related to weak governance standards which may lead to misallocation of receipts stemming from higher raw material prices and from disincentives for investment in non-traditional tradable activities, needed for better sharing the benefits of global trade. Competition for Chinese and Indian investments may lead to a race to the bottom, i.e. a weakening of the still low local standards and regulations (environment, labour market, tax, etc.). The OECD Development Centre, jointly with other institutions (BBVA, IDS) has started to investigate the impact of Asia's ascendancy on Africa in its research programme 2005-06.