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Go out and manufacture: Policy support for Chinese FDI in Africa

by
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Energy investments and infrastructure contracts remain prominent in China's Africa engagement. However, investment in manufacturing makes up a significant proportion of Chinese outward foreign direct investment (FDI). Its characteristics – large numbers of smaller transactions by privately owned small and medium-sized firms – make these flows difficult to assess or control. However, China and African governments have an interest in effectively channeling this type of FDI.

Data from investment promotion agencies and Chinese embassies in African countries indicate the growth of Chinese manufacturing.[1] In Nigeria and Ghana, nearly a third of registered Chinese projects are manufacturing ones;[2] in Ethiopia, over 65% of active Chinese firms are manufacturers.[3] This is consistent with surveys in China of internationalizing firms, which point to large numbers of manufacturers going abroad,[4] as well as a trend among private firms towards establishing overseas production sites.[5]

China's government has both domestic and foreign policy reasons for lending official support to this trend. As Beijing faces domestic industrial restructuring and rising wages, the transfer of low-skilled manufacturing capacity abroad incentivizes higher value-added activities at home. It also reduces trade frictions associated with cheap Chinese exports by exchanging a "made in China" stamp for a, e.g., "made in Ethiopia" one. Finally, localizing production for African consumers addresses African concerns with an asymmetrical trade relationship with China – wherein African countries export resources and import manufactures.

There has been increased policy support for manufacturers as they "go out." Official guidance for firms suggests multiple manufacturing sectors for nearly every preferred investment destination. The relaxation of foreign exchange controls, as well as subsidies and credit offered by central and provincial governments, make it easier for smaller firms to internationalize. However, both policy and guidance tend to target state-owned and large private firms. Yet, manufacturers are generally smaller private firms with limited links to the state.

To reduce the risk of international expansion for these types of enterprises, the Chinese government is backing six economic and trade cooperation zones (ETCZs) in Africa. These are modeled on early special economic zones in China, with provisions for manufacturing, housing and retail. They are being developed and financed as FDI projects by large state-owned and private firms – with only limited support from Beijing.

However, most zones have been slow to attract investors. This points to the central challenge of repackaging a successful domestic institution as an OFDI project. Many of the determinants of zone success – policy context, infrastructure delivery, the investment decisions of private firms – lie outside the control of the developers and the Chinese government.

The other side of the China-Africa FDI equation is Africa's capacity to absorb foreign investment. The ways in which manufacturing FDI might contribute to catch-up industrialization is of primary concern for the continent. However, the challenge for many African governments is integrating investment goals with wider industrial planning to enable new FDI flows to contribute to economic transformation.

The best way to do this varies across the 54 African countries with their different market sizes, endowment structures and domestic political demands. However, there are three primary areas for policy intervention. First, large volumes of imports moving through informal networks combined with high production costs for manufacturers restrict sector entry to the largest firms. Better enforcement of trade regulations at ports and borders, and continued infrastructure development will make domestic production more viable.

Second, African policy often targets export sectors, yet Chinese and other foreign manufacturers are mainly seeking local market share. Governments have sensible reasons for emphasizing exports, yet the role of domestic and regional markets in driving growth and structural change in the current African context is often overlooked. Policy recognition of these trends will also allow better integration of manufacturing FDI into the domestic economy – the third and most important area for intervention. Initiatives like domestic supplier programs and training requirements for foreign firms will provide opportunities for local producers and aid in technology transfer.

Localizing production for African consumers – supported by Chinese and other FDI – has potential for many African economies. Ultimately, the best way to attract manufacturing FDI is through investment in the hard and soft infrastructure of the sector as a whole – in power stations and ports as well as education and training.[6] This will benefit all producers, foreign and domestic.

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[1] Xiaofang Shen, "How the private sector is changing Chinese investment in Africa," *Columbia FDI Perspectives*, No. 93, April 15, 2013.

[2] Commercial Counselor's Office of Chinese Embassy in Nigeria; author's analysis of unpublished 2012 Nigerian Investment Promotion Commission figures and unpublished Ghana Investment Promotion Centre figures.

[3] The World Bank, *Chinese FDI in Ethiopia: A World Bank Survey* (Washington DC: The World Bank, November 2012).

[4] Xiaolan Fu, Suyu Liu and Tieli Li, "Determinants and impact of outward direct investment from China: Evidence from a firm-level survey in Guangdong province," University of Oxford Technology & Management for Development Centre Working Paper, TMD-WP-49, available at http://www.tmd-oxford.org/sites/www.tmd-oxford.org/files/publications/SLPTMD-WP-049.pdf.

[5] China International Chamber of Commerce for the Private Sector 2012 survey, unpublished.

[6] *See* Abdoul' Ganiou Mijiyawa, "Myopic reliance on natural resources: How African countries can diversify inward FDI," *Columbia FDI Perspectives,* No. 97, June 17, 2013.

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