The Financial Crisis and China: What are the implications for low income countries?

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1 Introduction

How the financial crisis affects China has implications that extend well beyond its domestic economy. As the world’s third largest economy, albeit with a still low per capita GDP of around $2660, China’s ability to maintain a reasonable level of growth and restructure its domestic economy will be important both for its internal development and stability, and for its contribution to renewed global growth and a rebalancing of the international economic structure. China must be a central player in implementing solutions to the current financial difficulties emanating from western countries, as well as in reshaping global governance institutions and arrangements that will inevitably emerge from this crisis.

What happens in China will thus have far reaching implications, for the west, as well as for many low income economies in Asia, Latin America and Africa, whose recent economic growth has to some degree been stimulated by China’s demand for commodities and intermediate inputs, and its expanding overseas investments.

With the onset of financial crisis in the US, questions were initially raised about the extent to which China was ‘decoupled’ from the global economy, whether it would escape serious impact, and whether in fact China could ‘bail out’ the US and other developed capitalist economies. The speed with which the crisis passed through to the real economy quickly put an end to these speculations, but not to the recognition that China is critical to global recovery - through facilitating credit to badly hit economies, maintaining growth, stimulating demand and contributing to macro-economic re-balancing.

These wider questions about the Chinese economy and the financial crisis are beyond the scope of this paper. However, the initial debates point to the lack of consensus and divergent interpretations of many aspects of China’s economic growth and its international economic integration. Such limited understanding is still more evident with respect to China’s relationships with developing economies, many of which have seen their growth boosted in recent years by Chinese investment, resource demand and development assistance, but on which relatively little systematic empirical analysis exists.

The focus of the current paper is on this particular aspect of China’s global economic influence – its relationships with low income economies, particularly in Africa. We ask how the effects of crisis on China’s real economy, and the responses and measures taken by China to address the current situation, might impact on poor countries, and particularly on growth and poverty in these countries.

Given the speed of the economic downturn in China, following from rapid changes in the early years of the twenty first century, and combined with limited prior research, we can provide only a preliminary analysis of these questions. We start by reviewing the pre-crisis evidence of China’s interactions with a range of emerging and less developed economies, including in Latin America and Asia, but with the major focus on Africa. We then summarise the emerging evidence about the impact of crisis in China, and China’s policy responses. The subsequent section brings these two perspectives together to present a framework for assessing the possible impacts of crisis on low income countries, particularly in Africa, and reviews the limited empirical evidence to date. The final section presents conclusions and a discussion of implications, particularly those of relevance to members of the international development community concerned that efforts to foster sustainable growth, reduce poverty and achieve the Millennium Development Goals will be undermined by the crisis.

2 China’s economic relationships with low income countries

China’s interactions with and impacts on developing countries have increased substantially in recent years, both as an inevitable by-product of China’s growth and economic size, and as a

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1 The remainder of this paper focuses on low income countries where Chinese engagement is significant, including SE Asia and Latin America, but with a principal focus on Africa.
result of deliberate policy initiatives. High levels of sustained growth, its economic size, the resources at its disposal for investment, combined with the strong capacity of the state to direct resources in its longer term strategic interests (particularly concerning its own security in terms of food, energy and other commodities), have led to dramatic increases in both state and private investment in, and trade with, low income countries, to increases in development assistance and cooperation, and to closer political relationships. In 2001, for example, China launched a new ‘Going Out’ (zou chu qu) strategy aimed at strengthening trade relationships and encouraging domestic firms to invest abroad. This has involved picking ‘corporate champions’ to become China’s multinational firms, with policies encouraging their overseas activities. The early years of the twenty first century have seen a steady increase of registered Chinese companies operating overseas, with the numbers of private and unregistered firms likely to be much higher. China’s outbound investment has also risen: from US$2.855 billion in 2003 to US$16.13 billion in 2006. Although China’s FDI remains relatively low (at 1.9% of total state investment in 2006), this was double the 2003 level. Furthermore, at a global level, the early years of the twenty-first century have seen a commensurate rise in China’s role and influence in the institutions of global governance and the production of global public goods - poverty reduction, climate change, trade and security, for example – with implications for many developing countries.

The ways in which China’s growth influences or impacts on low income economies are multiple, vary across different regions and countries, and are as yet relatively poorly researched. Stimulated by concerns over who benefits or loses, and the potential challenge posed by China’s rise to the global economic and political order, an emerging body of literature within international relations, global political economy and economics has started examining these relationships. The impacts on specific countries are determined by both economic and political relationships and operate through direct and indirect channels. The key political conditionality is ending diplomatic recognition of Taiwan. The main direct channels of economic influence are trade, investment and (to a lesser extent but particularly in Africa) aid. Indirectly, China affects world prices of commodities and products, and thus the terms of trade for other low income producers; it potentially effects countries through its currency valuation. Impacts vary by region and among countries within any region, according to type of product, demand from China, and whether production complements or competes in the domestic or third country markets. The significance of these effects also depends on the diversification of the economy in question and the relative strength of a country’s relationships with or dependence on other major economies.

Regional variation

East and south east Asia:

China’s relationships with its more immediate Asian neighbours particularly in east and south east Asia deepened from the 1990s as China came to dominate export processing manufacturing, tying many neighbouring countries into regional production networks and supply chains. China’s influence in the region grew in the context of the Asian Financial

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3 According to official Ministry of Commerce data, the number increased from around 3,400 in 2003 to over 6,000 by 2006.

4 UNCTAD World Investment Report 2007

Crisis of 1997-8 when its ability to maintain its exchange rate and stimulate its domestic economy helped the region recover from crisis.

While some countries in the region compete with China for markets for low cost manufactured products (e.g. in shoes and textiles), others benefit from China’s market for intermediate production inputs – both in capital goods and in some cases natural resources and commodities. Prior to the current crisis, some of countries in south east as well as south Asia may also have been poised to benefit from China’s rising labour costs and the possible transfer of industries in search of cheaper sources of labour. Other (particularly more developed) Asian economies have a complementary relationship with China as part of regional production networks, and reap benefits from inter-dependence on trade for example in high technology products. The more negative impacts of China’s rise are however also felt among some close neighbours, particularly in relation to environmental issues, water use (in the Mekong Delta) and demand for non-renewable resources such as timber.

**Latin America**

As commodity producers, many countries in Latin America have benefited from improved terms of trade given China’s expanding demand. Overall the implications are varied; according to Guillermo Perry of the World Bank, the rise of China (and India) is not a zero-sum game. China’s economic growth opens a large export market for the LAC region; but others such as Mexico find export growth depressed by competition.6

**Africa:**

As noted above, the main direct channels of economic influence – particularly in Africa – are trade, investment and aid, all of which are closely related. While data remain patchy, the headline trends in the relationships over recent years are clear with significant increases in all three.

**Trade:** According to recent Customs data, in 2008 trade between China and Africa increased by 45% to $107 billion. Exports increased 54% but for the first time Africa has a trade surplus (of over $5 billion). China still lags the US and France as Africa’s third leading trade partner, while regionally African trade with the EU is most significant. In Africa, Angola and South Africa are China’s top two trading partners (see table 1).7 China’s main imports from Africa are oil and gas; Chinese exports to Africa include machinery, vehicles, textiles and manufactured products.

<table>
<thead>
<tr>
<th>Country</th>
<th>Trade with China 2007 (US$bn) [Exports to and imports from China] (% change vs. 2006)</th>
<th>Trade with China 2008 (Jan to Oct) (US$bn)</th>
<th>Trade 2007 (US$bn) (% change vs. 2006)</th>
<th>Trade with China as a % of the total trade, 2007</th>
<th>Major exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td></td>
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<td></td>
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<tr>
<td>Angola</td>
<td></td>
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<tr>
<td>South Africa</td>
<td></td>
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</tr>
<tr>
<td>Sudan</td>
<td></td>
<td></td>
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<td></td>
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</tr>
</tbody>
</table>

Nigeria
Exports: 0.54 (+106.12%) Imports: 3.80 (32.91%)
Exports: 0.48 Imports: 5.60
Exports: 64.05 (+8.35%) Imports: 38.94 (+25.99%)
Exports: 0.84% Imports: 9.76% Fuel, liquefied, natural gas, manufactures

Zambia
Exports: 0.40 (+47.04%) Imports: 0.20 (+91.26%)
Exports: 0.5 Imports: 0.23
Exports: 4.26 (1.50%) Imports: 3.29 (+24.73%)
Exports: 9.39% Imports: 6.08% Copper, Cobalt, Manufactures

Libya
Exports: 1.55 (-8.68%) Imports: 0.86 (+22.02%)
Exports: 2.55 Imports: 1.34
Exports: n.a. Imports: n.a.
Exports: n.a. Imports: n.a.

Congo
Exports: 2.83 (+1.43%) Imports: 0.42 (+73.86%)
Exports: 3.40 Imports: 0.49
Exports: 5.04 (-21.14%) Imports: 1.56 (+2.02%)
Exports: 56.15% Imports: 26.92% Crude oil, oil, wood, manufactures

Algeria
Exports: 1.14 (+692.20%) Imports: 8.69 (+12.66%)
Exports: 0.69 Imports: 3.07
Exports: 60.16 (+0.53%) Imports: 29.63 (+17.04%)
Exports: 1.89% Imports: 9.08% Hydrocarbons, raw materials, semi-manufactures, Food, fuel and energy, capital goods


Investment:
Although still accounting for only about 1% of worldwide FDI flows, China’s FDI outflows overall and to Africa have grown rapidly. The total outflow for 2007 was US$26.51 billion, an increase of 25.3% over 2006 and a massive 828% increase over 2003. China’s FDI outflows to Africa increased almost 5-fold in 2006-7 (from US$520m to US$1574m), compared to a 32.7% increase in 2005-6. They accounted for 5.94% of China’s total outflows in 2007, compared to only 2.62% in 2003. Approximately 3% of China’s FDI stocks are in Africa, compared to over 70% in Asia. For Africa, FDI from China constitutes a still small but rising share, growing from roughly 0.5% of total FDI to Africa in 2003 to 2.97% in 2007.

Table 2 shows FDI for selected African countries with strong economic ties with China. The top recipients in 2007 (with large increases) were South Africa, Nigeria, Algeria and Zambia. Niger (not included) also saw a significant increase to over US$100 million.

Table 2: Chinese FDI to select African countries, 2007

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP 2007 (US$Bn) (% change vs. 2006)</th>
<th>Chinese FDI 2007 (US$m) (% change vs. 2006)</th>
<th>Total FDI inflows (US$m) (% change vs. 2006)</th>
<th>Chinese FDI as a % of total inflows</th>
<th>Chinese FDI as a % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>1574.31 (+202.83%)</td>
<td>52982 (+15.80%)</td>
<td>2.97%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Angola</td>
<td>58.5 (+29.42%)</td>
<td>41.19 (+83.97%)</td>
<td>1500 (-45.36%)</td>
<td>7.98%</td>
<td>0.07%</td>
</tr>
<tr>
<td>South Africa</td>
<td>277.6 (+8.9%)</td>
<td>454.41 (+1015.39%)</td>
<td>5692 (+2.33%)</td>
<td>7.98%</td>
<td>0.16%</td>
</tr>
<tr>
<td>Sudan</td>
<td>46.2 (+26.9%)</td>
<td>65.4 (+28.77%)</td>
<td>2436 (-45.36%)</td>
<td>7.98%</td>
<td>0.16%</td>
</tr>
<tr>
<td>Nigeria</td>
<td>165.5 (+12.66%)</td>
<td>390.35 (+475.82%)</td>
<td>1245 (-10.76%)</td>
<td>7.98%</td>
<td>0.16%</td>
</tr>
<tr>
<td>Zambia</td>
<td>11.4 (+48.89%)</td>
<td>119.34 (+36.48%)</td>
<td>984 (+59.74%)</td>
<td>12.13%</td>
<td>1.05%</td>
</tr>
<tr>
<td>Libya</td>
<td>58.3 (+17.3%)</td>
<td>42.26 (-91.12%)</td>
<td>2541 (+26.23%)</td>
<td>1.66%</td>
<td>0.07%</td>
</tr>
<tr>
<td>Congo</td>
<td>7.6 (+13.3%)</td>
<td>2.5 (-81.12%)</td>
<td>352 (2.33%)</td>
<td>0.71%</td>
<td>0.03%</td>
</tr>
<tr>
<td>Algeria</td>
<td>135.3 (+16.14%)</td>
<td>145.92 (+47.50%)</td>
<td>1665 (-7.24%)</td>
<td>8.76%</td>
<td>0.11%</td>
</tr>
</tbody>
</table>

Note: In 2006 Chinese FDI for Libya was a negative figure.
In terms of private investment in Africa, the amount remains small overall but involves a large number of entrepreneurs. One estimate suggests that 88% of investors are responsible for approximately 5% of investment. This is growing rapidly albeit from a low base. However, official statistics on private investors are extremely inaccurate. According to a government report, over 800 Chinese enterprises invest in Africa of which around 100 are state-owned.\(^8\) This certainly underestimates private investors many times. The dominant sectors for FDI to Africa between 1979 and 2000 were manufacturing (textiles) and resource extraction, with telecommunications and construction also growing.\(^9\)

Industry experts expect China’s M&A activities in 2009 to be very active due to abundant liquidity, government support and a strong yuan. Africa and Latin America are likely to be the most-favoured region of China’s M&A. In addition to the policy support envisaged in the stimulus plan, more government efforts have been urged to encourage overseas investment, especially in energy and mining. In the annual session of the CPPCC meeting in March 2009, a delegate submitted a proposal calling for the establishment of an investment fund to support Chinese private enterprises’ overseas investment in energy and mining.\(^10\)

Aid: China’s aid to Africa has increased significantly particularly from the mid-1990s, while remaining a small share of China’s GDP. Chinese aid to Africa dates back to the 1950s, peaking in the 1970s. From the mid-1990s, as China’s growth accelerated and its demand for natural resources increased, aid to Africa again rose sharply. By the late 1990s Africa had become the major recipient of Chinese development assistance, receiving almost half of the total.\(^12\)

China’s international cooperation with Africa continues to expand rapidly. While data is limited, there are various estimations of China’s aid to Africa. According to one Chinese researcher, Chinese external aid and economic support reached US$1.8 million in 2002, and by May 2006, China’s investment in external assistance projects in Africa was valued at US$5.7 billion.\(^13\) In 2007-8, China signed bilateral aid accords with 48 African nations and loan agreements with 22. In spite of this rapid growth, Chinese aid to Africa remains small compared with traditional donors.

China’s aid to Africa takes various approaches; its aid delivery system is complex and lacks a systemic framework in deciding, management and monitoring the aid.\(^14\) One leading scholar, Martyn Davies, notes that, while China’s interpretation of development assistance can be taken to correspond to the DAC definition, China’s foreign aid policy has a wider and more...

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\(^{8}\) http://www.gov.cn/jrzg/2007-05/15/content_615583.htm

\(^{9}\) Biggeri and Sanfilippo, op.cit, 2009


\(^{11}\) CDB to support overseas investment in resources’, Xinhuanet, March 5, 2009, http://news.xinhuanet.com/english/2009-03/05/content_10951438.htm

\(^{12}\) 44% or $1.8 billion according to Brautigam (1998) cited in Alden (2007). See also Li Xiaoyun who provides a figure of 30% of the total over a longer time period. ‘China’s Foreign Aid and Aid to Africa: an overview’, presented in DAC/POVNET Workshop on China’s Experience of Poverty Reduction at Home and in Africa, February 21, 2008, Paris, OECD. Powerpoint presentation available http://www.oecd.org/dataoecd/27/7/40378067.pdf


\(^{14}\) Davies, Martyn ‘China’s Foreign Aid Policy Toward Africa [中國對非洲的援助政策及評價]’, World Economics and Politics [世界經濟與政治], No. 9 (2008), pp.38-44; and Diao Li, and He Fan, ‘Some Reflections on China’s External Development Assistance Strategy [中國的對外發展援助戰略反思]’, Journal of Contemporary Asia-Pacific Studies [當代亞太], NO. 6 (2008), pp. 120-133.
ambiguous scope, making it hard to draw direct comparisons of Chinese and western aid.\textsuperscript{15} China’s influence in the continent has prompted some western countries to find ways respond to this growing presence in Africa. The North South Corridor project, financed by DFID, for example, is a recent initiative reengaging western donors with infrastructure projects in Africa.\textsuperscript{16}

For China, development assistance is valued for associated political relationships and economic opportunities, especially access to resources and markets for manufactured products. There is thus little reason why aid should decrease in the context of the crisis. On the contrary, China is more likely to take such an opportunity to increase its influence in the region and secure its own long term interests. Given high level political commitments to Africa and the forthcoming 2009 China-Africa Summit, China will almost certainly maintain or increase development assistance; as of February 2009, Chinese leaders have reiterated their commitments, announced new projects and assistance, and a reduction or relief of debt.

**Key channels of influence and impacts – a summary**

Table 3 draws on the existing literature to summarise the key variables influencing China’s relationship with low income economies, and the possible impacts.

[See attached file: Table 3]

**Poverty and distributional impacts of China’s engagement with Africa**

Clearly China’s engagement in Africa has grown significantly following China’s accession to the WTO. GDP growth in many countries has been stimulated by rising commodity prices, largely driven by China’s demand. African economies have become less marginalised from the international economy and trading system, at least in part due to China’s rise. Chinese investments in core infrastructure are also assumed to have direct growth effects, while the increasing number of small private entrepreneurs found across Africa may have a role in stimulating local markets and providing low cost consumer products to the poor.

There is however little systematic evidence on the poverty reducing or distributional impacts of China’s engagement. While there may be many positive effects, there are also issues of concern. Several recurring issues can be noted:

- As seen from table 3, those countries which compete with China for manufactured goods such as textiles face greater competition in both their domestic and external markets, with factory closures and lost jobs.
- China’s labour practices – whether through use of Chinese labour, or the poor conditions offered to local workers – have been a point of contention in many countries.
- While China’s recent development assistance appears to focus more strongly on poverty reduction, social infrastructure and social sectors (particularly health and education), Chinese institutions still have limited capacity to implement and monitor these expenditures and their impacts, to ensure the intended social outcomes.
- In some cases such assistance and infrastructure projects are viewed as not having widespread social benefits (such as building National Stadium) or as primarily benefiting elites.


China’s relationship with regimes considered by the OECD development community to exhibit poor records of governance and human rights raises additional concerns among the wider development community.

Overall it is clear that China’s development assistance is closely tied to state sponsored investment projects, while limited information is available to understand the multiple objectives of such assistance, or to assess its wider impacts, particularly its social and environmental impacts and contribution to poverty reduction.

3 China and the global financial crisis – impacts and responses

It is generally accepted that China’s financial institutions are relatively well-insulated from the direct impacts of crisis, and that the level of exposure to toxic assets is manageable given the degree of state control over financial institutions and the available reserves. The need for economic readjustment of China’s economy had already been recognised, and initial measures were being introduced to address housing and stock market ‘bubbles’, bring down inflation, boost domestic consumption and promote more equitable and sustainable growth.

In the early weeks of the crisis, researchers and policy makers viewed the country as well-situated to weather the crisis, with the major anticipated impact being through consumer confidence translating into reduced consumption.

The speed with which the effects of crisis in the developed capitalist countries passed through to China’s export-dependent economy was unanticipated and dramatic. Since October this has radically altered economic conditions and led to major policy shifts. The situation continues to move fast: as yet there is little evidence that the downturn is bottoming out.

Main impacts and responses

Financial Sector

There are scattered reports of the losses of Chinese financial institutions. In November, Caijing magazine website listed key bank exposures. Since the mid-1990s, bad loans or toxic assets have been placed in Asset Management Companies which has served to decrease high non-performing loan ratios, although the AMCs are themselves at risk of default.

China’s poorly documented informal financial sector, on which many small and medium enterprises depend, may be vulnerable, but little information is available for assessing the significance of any risks.

Fiscal revenues

The Ministry of Finance (MOF) reported a 17.1% decline in China's fiscal revenue in January. This results both from slowing economic growth affecting business profitability, as well as wide-ranging tax cuts introduced to boost the economy. Tax revenue for January 2009 dropped 16.7 percent yoy; duty revenue declined 19.3 percent while takings from stock stamp tax shrank 95.7 percent. MOF’s preliminary statistics reported an overall increase in fiscal revenue to 6.13 trillion yuan for 2008, up 19.5 percent from 2007. In January 2009,
however the Finance Minister hinted at the difficulty of balancing the budget amid the severe economic conditions arising from the financial crisis.\textsuperscript{22}

\textit{Trade:}

China’s heavily export dependent economy has seen a rapid decline of both imports and exports since November, which shows little sign of slowing.

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|c|c|}
\hline
 & Imports & Exports & Imports & Exports \\
\hline
September 2008 & 21.5 & 21.4 & 0.84 & 1.16 \\
October 2008 & 15.4 & 19 & -13.06 & -5.94 \\
November 2008 & -18 & -2.2 & -19.54 & -10.4 \\
December 2008 & -21.3 & -2.8 & -3.63 & -3.33 \\
January 2009 & -43.1 & -17.5 & -28.87 & -18.63 \\
\hline
\end{tabular}
\caption{Imports and Exports September 2008 – January 2009}
\end{table}

Source: China Customs.

Note the January y-o-y figure may be exacerbated by the New Year holiday in January.\textsuperscript{23}

\textit{Enterprise and employment}

The most dramatic real economy effects are on company closures and lost jobs. Widespread company closures and bankruptcy has spread, hitting small and medium enterprises in export production supply chains in southern China particularly hard. In December statements by officials reported that around 670,000 small firms had closed in 2008 with about 6.7 million jobs lost, many in the export hub of Guangdong.\textsuperscript{24} In January, the Ministry of Human Resources and Social Security (MHR) reported a loss of 560,000 urban jobs in the last quarter of 2008 and a rise in the official urban (excluding migrants) unemployment rate to 4.2 per cent (or 8.86 million).\textsuperscript{25}

According to a CASS survey conducted in late 2008, including migrants would but the unemployment rate over 9.4 per cent.\textsuperscript{26} A Ministry of Human Resources survey in late December 2008 found 4.85 million jobless migrant workers had returned to their hometowns by the end of November, with over 10 million migrants out of work nationwide. By January the accepted figure had risen to 20 million with 6-7 million new workers expected to enter the migrant labour force during the year.\textsuperscript{27} Unemployment among new graduates is also a major concern, with an estimated 12 percent (1.5 million) jobless at the end of 2008, and 6.1 million expected to enter the job market in 2009.\textsuperscript{28} Many more workers in the ‘informal economy’, without contracts or social protection, and excluded from official statistics, are also threatened by loss of livelihoods.\textsuperscript{29}

\begin{itemize}
\item \textsuperscript{22} “China sees growing difficulty balancing budget amid "severe" conditions”, Xinhuanet, 26 January 2009, \url{http://news.xinhuanet.com/english/2009-01/26/content_10721713.htm}
\item \textsuperscript{23} January y-o-y decline of 32.6%, in part explained by early Chinese New Year holiday. China Daily Eclips 17/2/2009
\item \textsuperscript{24} Tan Yingzi, ‘Jobseekers frustrated as employment worsens’, \textit{China Daily}, Dec 20, 2008, \url{http://www.chinadaily.com.cn/china/2008-12/20/content_7325070.htm}
\item \textsuperscript{25} ‘560,000 mainland jobs axed in 3 months’, \textit{SCMP}, January 20, 2009, \url{http://www.scmp.com/portal/site/SCMP/menuitem.2af62ecb329d3d7733492d9253a0a0a0/?vgnextoid=efd6e070a13fe110YgnVCM100000360a0a0aRCRD&ss=China&ss=News}
\item \textsuperscript{26} Jane Cai, ‘Urban jobless rate may touch 30-year high’, \textit{SCMP}, January 21, 2009, \url{http://www.scmp.com/portal/site/SCMP/menuitem.2af62ecb329d3d7733492d9253a0a0a0/?vgnextoid=b3975168c34fe110YgnVCM100000360a0a0aRCRD&ss=China&ss=News}
\item \textsuperscript{27} Central Work Leading Group Feb 3 \url{http://www.financialpost.com/story.html?id=1244709}
\item \textsuperscript{28} Tan Yingzi, ‘Jobseekers frustrated as employment worsens’, \textit{China Daily}, Dec 20, 2008, \url{http://www.chinadaily.com.cn/china/2008-12/20/content_7325070.htm}
\item \textsuperscript{29} ‘全國上半年近7萬企業倒閉 考驗政府就業政策’, Sina News, Nov 2, 2008, \url{http://chinanews.sina.com/news/2008/1102/06413034795.html}
\end{itemize}
What does this mean for growth?

Growth forecasts have been revised downwards possibly to as low as 6% for the coming year, down from 11.7% in 2007, and around 10% for 2008. There is however little agreement among economists on the depth of the downturn. In December, expectations of around 8% were still common, with the World Bank predicting 7.5% and the IMF around 6.5%. Sobering figures in January have led to downward revisions. Estimates by economists across 14 financial institutions range between 5% and 8%, while the lowest estimate for Q1 is only 3%.  

In a report by a government think-tank, the Chinese Academy of Sciences (CAS) published in January, the authors predict slower growth in the first half but picking up with the stimulus package to an annual rate of 8.3%. The report also estimates that the primary, secondary and tertiary industries will expand at 5 percent, 9.8 percent and 9.5 percent, respectively. The growth rate of exports and imports is expected to drop to 6.5 percent and 4.6 percent respectively. The authors expect that the stimulus package will help China to an early recovery in the third quarter.

The government’s stated aim – reiterated by the Premier Wen Jiabao at the recent National People’s Congress opening – remains to ‘guarantee 8%’ growth in 2009. This is the minimum level of growth widely believed necessary to secure an acceptable level of employment and avoid social disruption. Under current circumstances, the prospects of this at least in the first two quarters, and probably beyond, seem slim.

Government response to crisis

China has responded to the slowing down of its economy and the impacts of the crisis with more expansionary macro-economic policies and a massive fiscal stimulus package. Among the policies rapidly introduced to limit the depth and cushion the impacts of economic slowdown, interest rates were successively cut (five times in four months from mid-September, by 2.16%); credit controls relaxed and reserve ratios reduced; taxes cut; rebates provided to exporters; funds set up to pay wages owed to laid-off workers in bankrupt enterprises and a number of initiatives introduced to assist laid-off migrant workers and unemployed college leavers.

Given the negative impacts on China’s export trade, the government raised tax rebates for certain exports to help producers cope with smaller profit margins as a result of slacking market demand, the yuan’s appreciation and rising production costs. The adjustment involves 3,486 items from labour-intensive industries such as textile, garment, toy, hi-tech and high added value sectors like anti-AIDS drugs and tempered glass. These items account for 25.8 percent of those covered by the country’s Customs Tariffs.

In an effort to achieve the 8% ‘minimum’ growth that the Central Government considers necessary to maintain employment and social stability, as well as to stimulate domestic demand, the central government has introduced a $586 (£380) billion fiscal stimulus package over 2 years, to be supplemented by increased local government funding and with the

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(ibid)


These policy initiatives have been reported in the press. See also Xue Lan ‘Voices from the South’.

http://www.chinadaily.com.cn/china/2008-10/21/content_7126456.htm
likelihood of further initiatives to come.\textsuperscript{37} The government estimates that the package will drive economic growth up by one percent each year.\textsuperscript{38} According to World Bank estimates, over half the projected 2009 growth of 7.5\% will come from government influenced spending.\textsuperscript{39}

The main content of the government’s plan to stimulate growth and domestic demand includes spending on infrastructure, particularly in areas that affect people’s livelihoods (housing, rural infrastructure and social sectors), and industry-specific support for industrial growth and upgrading. The package focuses on ten areas, including low-income housing, rural infrastructure, transportation, health and education, environment, industry, disaster rebuilding, taxes and finance. The first tranche of 100 billion yuan was allocated in 4\textsuperscript{th} quarter 2008, with the second 130 billion planned for February 2009; the remainder will be disbursed over two years to 2010. In addition, a comprehensive reform of value-added taxes would cut industry costs by 120 billion yuan. Commercial banks’ credit ceilings will also be abolished to channel more lending to priority projects, rural areas, smaller enterprises, technical innovation and industrial rationalization through mergers and acquisitions.

In late November, the government extended a subsidy program for rural households to purchase household appliances following the success of a pilot in October. The program contributed to a 30\% year-on-year increase in sales of household appliances. The government has also introduced sector-specific stimulus packages to boost industrial growth and domestic consumption, for example:

- for the auto industry: a reduction in purchase taxes and subsidies to farmers to replace outdated vehicles;\textsuperscript{40} 10 billion yuan to upgrading automakers’ technology and developing alternative energy vehicles.\textsuperscript{41}

- for textiles: increasing the tax rebate for textile and garment exports by 1\% to 15\% from February 1, 2009; allocation of funding to companies to upgrade technology and develop domestic brands.

Further sector-specific plans are likely to be introduced, including for the property sector and a 500 billion yuan package for the petrochemical industry.\textsuperscript{42}

Local governments have also introduced measures to spur growth and employment locally. In Zhejiang, the government has slashed 152 items of administrative fees and issued policy stimulus packages for the manufacturing and export sectors.\textsuperscript{43} Several local governments issued coupons to low-income families during the Spring Festival holiday: for example Hangzhou and Chengdu issued coupons valued at 1000 million yuan (US$146.3 million) and 37.91 million yuan respectively for locally registered low-income families before the Chinese New Year.

\textsuperscript{39} World Bank Quarterly Update December 2008
\textsuperscript{40} ‘Analysts: China may have surpassed U.S. in Jan. auto sales’, Xinhusnet, 6 February 2009, http://news.xinhuanet.com/english/2009-02/06/content_10771783.htm
New Year holiday as a way to boost local consumption. A number of initiatives to promote employment creation and entrepreneurship, including establishing rural retail chains, incentives for self-employment and training for migrant workers, are also in place or under discussion.

As of early March, it is clear that the downturn is showing little sign of bottoming out. Although some signs of optimism are being noted, and the leadership has reiterated its 8% growth target for 2009, the challenges are enormous. In particular, China has to balance the immediate objective of growth and employment, in order to avoid serious social disruption at home, with the fundamental need to reorient its economy by reducing its export dependence and promoting domestic demand. The latter is critical not only for China but for global recovery and macro-economic adjustment, but in the short term will result in significant policy trade-offs that the government will have to manage.

4 China’s crisis: implications for low income countries

How will the impact of the economic downturn, together with the policy responses taken by China, feed through into its interactions with low income economies, particularly in Africa?

It is important first to note that China is only one, and still a relatively small albeit growing, influence on Africa’s economic growth and development. Much of the impact on Africa of China’s rise has been indirect – through changing commodity prices and improving terms of trade. Similarly, most of the impact of the downturn will be through these economic effects.

More directly, China’s downturn could directly impact those economies where poverty is high, but where Chinese investment, resource demand and development assistance have significantly boosted growth in recent years. At the same time, China’s policy measures, particularly the infrastructure oriented stimulus package, combined with China’s long terms interests to secure energy and food resources, and its financial capacity to pursue these objectives, suggest that China can play an important role in cushioning the impact of global recession for some low income economies.

Based on the key variables and channels of influence discussed in section 2, we present hypotheses about the possible impacts of China’s crisis for developing economies.

Hypotheses

Trade

- China’s domestic stimulus package with its focus on infrastructure should stimulate demand for commodities from countries in Africa and Latin America at a time of otherwise falling global demand and deteriorating terms of trade.
- However, given falling prices and weak demand elsewhere, these countries will be in a weaker bargaining position in negotiating deals
- Those countries providing intermediate products for China’s export manufacturing will see a decline in demand
- Those countries competing for third country markets will also see a fall in market demand

State investment

- China will exercise caution in investments in the financial sector where it is unable to assess complex risks
- China will seek opportunities created by the crisis to increase mergers and acquisitions especially in the energy sector or areas of importance for China’s long term food and energy security and growth.
- China may seek to renegotiate existing deals in the light of falling commodity prices
Private investment

- Small entrepreneurs with accumulated savings may seek new opportunities in less exploited African markets. This in part depends on whether opportunities in an already competitive Chinese market are further restricted, as well as the extent to which the downturn limits growth and investment opportunities in countries in Africa.

Aid

- China will maintain and possibly increase its development assistance to Africa

Other potential factors

- China will resist rising protectionist policies in the west; any increase in protectionism will however affect low income economies hard.
- China’s currency is likely to continue a gradual appreciation. How countries are affected will depend on their relationship with China: goods imported from China will become more expensive.

Which countries are at risk?

A number of frameworks have been assembled for identifying ‘at risk’ countries. In general, although largely shielded from the financial crisis, low-income African economies are at risk from the economic downturn associated with crisis. The IMF for example has estimated that a decline in world growth of one percentage point would lead to a 0.5 percentage point drop in Africa’s GDP. Many of Africa’s economies are vulnerable because:

- their main economic partners are the US and EU whose economies are directly affected by crisis
- some are heavily dependent on income from remittances and tourism which will be affected by the downturn
- a heavy dependence on resource exports means that they are hit hard by the decline in global trade
- commodity producers face declining terms of trade
- some have high current account or budget deficits
- some have a high dependence on western aid which may also be threatened.

China: Increasing or reducing risk?

Economic effects: The economic effects of China’s downturn will be felt by countries depending on their own economic structure. These include in particular:

- falling commodity prices and weakening terms of trade for commodity producers (Africa, Latin America);
- a reversal of the recent rise in China’s labour costs (Asia)
- weaker demand from China for manufactured inputs (Asia)

China’s emergence as a major trading partner of Africa will contribute to the economic downturn affecting certain economies, but is generally less important than their trade with other regions, while China has negligible impacts in terms of remittances and tourism.

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44 See for example DFID’s vulnerability analysis and Dirk Willem te Velde, ‘The Global Financial Crisis and Developing Countries’, Background Note, October 2008, London: ODI.
45 IMF World Economic Outlook, April 2008
Policy effects:

- China’s infrastructure investments as part of its fiscal stimulus package will help to maintain demand for raw materials and energy
- China is taking advantage of economic downturn to seek investment opportunities overseas that help to secure its long term strategic energy, mineral and food security
- China has reiterated its commitment to maintain aid to Africa

Evidence

The evidence of impacts to date is inevitably largely anecdotal. Huge uncertainty remains about the likely depth of the downturn, and the impact of China’s stimulus package.

- global trade has fallen overall
- demand for some inputs from China (e.g cobalt) has collapsed, leading to halting of production and loss of jobs e.g. in DRC
- Chinese state companies are pushing ahead with strategic energy sector investments and infrastructure projects, for example, stakes in Rio Tinto and OZ Minerals Ltd.\(^{48}\)
- Private companies such as the Shenzhen based company Huawei Technology are continuing to expand in technology areas in Africa.\(^{49}\)
- During early 2009 visits of government leaders to Africa, China has committed to further aid and development cooperation

The following box summarises some recent deals between China and African countries.

<table>
<thead>
<tr>
<th>Congo</th>
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<tr>
<td>A marketing director at a private firm in Zhejiang, which supplies cobalt and nickel compounds for use in mobile phone batteries, was quoted as saying that most Chinese-invested firms had shut down their operations in Congo. They were not expected to resume production soon because of worsening economic conditions and falling prices. Congo's franc fell and foreign reserves dropped to a 5-year low. A widely reported $9 billion package of Chinese loans, investment and infrastructure projects in return for Congolese minerals contracts may be cut back to $6 billion, partly to appease the IMF which has expressed voiced concern at Congo taking on such huge debts.</td>
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<th>Angola</th>
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<tr>
<td>Trade with Angola, China's biggest source of African crude oil, reached $25.3 billion in 2007 and Beijing has offered Luanda $5 billion in oil-backed loans.</td>
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<tr>
<th>Zambia</th>
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<tr>
<td>The second copper smelter was reported to be opened in January 2009 as part of the controversial Chambishi development. A second economic zone was also launched where Chinese firms will assemble electrical goods such as TVs and cellphones for export.</td>
</tr>
</tbody>
</table>


\(^{49}\) ‘China marches on in Africa despite downturn’, Reuters, January 28, 2009, [http://www.reuters.com/article/companyNewsAndPR/idUSLM43673820090128?pageNumber=3&verticalBrandChannel=0](http://www.reuters.com/article/companyNewsAndPR/idUSLM43673820090128?pageNumber=3&verticalBrandChannel=0)
According to one Chinese researcher, China is unlikely to reduce its investment in the mining sector in Zambia, despite the crisis and economic downturn. Zambian state media reported that Chinese and Indian firms have expressed interest in taking over Zambia’s top cobalt producer Luanshya Copper Mines since it halted operations in December.

**Senegal**

In February, China signed a loan and aid deal with Senegal worth $90 million US, involving a purchase by China of 10,000 tonnes of Senegalese groundnut oil.\(^5\)

**Guinea**

Talks between the world’s top exporter of bauxite aluminium ore over a multi-billion-dollar deal with China to build hydropower dams, roads and bridges in return for mines have slowed as the economic climate has worsened, but also hampered by Guinea’s political instability.

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**The implications**

The evidence suggests that China, as anticipated, continues to seek economic opportunities in its own long term interests, and presents these as a win-win situation for Africa in the current economic climate. Both China and Africa are likely to seek to fill any vacuum arising from a decline in trade, investment and aid from western economies. China in particular will view this as a strategic opportunity to expand its presence, and reduce the costs of its engagement in Africa and its access to raw materials.

For Africa, while providing short term advantage, the wider environment may also reduce their negotiating power with China. Depending on the terms and conditions of specific deals, and the prices of commodities, the outcomes may be more or less advantageous to these countries, and may have different implications for their own development strategies in the longer term.

There are risks associated with China’s investments across the continent: as noted in section 2, they have provoked criticism and in some cases protest over labour standards and conditions, and unfair competition. Aid is tied closely to major investment projects; there is little systematic monitoring of the social and environmental impacts; and issues related to human rights and governance are ignored on the principle of non-interference. These conditions mean that the poverty reducing impacts are hard to ascertain, and are likely not to be as significant as they otherwise might be.

The major challenge will be to ensure that African countries benefit from this relationship despite a weak bargaining position at a time of deteriorating terms of trade; and that the opportunity for China to ‘buy cheap’ is not at the longer term expense of Africa’s sustainable development and poverty reduction.

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5 Conclusions

Overall, the financial crisis is likely to increase the relative importance of China’s economic relationships in Africa both in the short and longer term. This significance of this change will depend not only on changes in China’s policies, investment, trade or demand with respect to low income countries but also on the changes between these countries and their other key development and trade partners. How African countries fare in the short run will depend at least as much on what happens in the US and Europe.

The significance of China’s impact on specific countries will vary by the size and nature of its economic relationship with China, and the net effect of changing price and demand for their commodities. While African economies are vulnerable, in many cases the impacts of crisis may be buffered to some extent by China’s immediate demands for resources and its long term interests. This may help slow down the decline in growth rates, but it is harder to make any meaningful predictions about the likely poverty impacts.

The potential shift in relative importance of China relative to other regions may have important implications for reshaping economic cooperation and development assistance for the longer term, and for the relative role of China and the west in low income countries, particularly in Africa. If China can steer its own economy through crisis, it may become a development partner of choice with increasing ‘Soft Power’ influence in the developing world. It may appear as a steadying factor in trade and investment compared to the west.

What does this mean for Africa and the international development community?

- African countries need to recognise that they are dealing with both Chinese state and private sectors. Private entrepreneurs are transferring part of their value chain to Africa, providing Africa with an opportunity to push up the value chain. These developments require, a multifaceted African response involving government, the private sector, unions and NGOs.

- The commitment of western countries to continued trade, investment and development assistance to Africa may play a role in strengthening the bargaining power of these countries, enabling them to ensure better deals for Africa and to monitor the impacts of Chinese investment and assistance, and in particular the poverty reduction and distributional impacts.

- The development community should take this opportunity to understand China’s strategic interests and motivations in order to enhance collaboration in the goals of renewed but sustainable growth, poverty reduction and achievement of the MDGs.

- The trans-national dimension of the financial crisis requires a multilateral response. The development community should develop a common framework for a “global development partnership” creating a network for bilateral/trilateral/multilateral dialogue and cooperation at various levels.

The crisis provides an opportunity for China, alongside other emerging economies, to play a greater role in reshaping international governance institutions. The reconstituting of the international governance architecture which will inevitably emerge from the current crisis will consolidate China’s role and influence, while also bringing with it further responsibilities within the international community.
<table>
<thead>
<tr>
<th>Key variables/ factors of influence</th>
<th>Impact</th>
<th>Countries affected (egs)</th>
<th>Sources / empirical analysis</th>
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<tbody>
<tr>
<td>Growth in DC exports to China</td>
<td>Complementary</td>
<td>Mexico, Honduras; Bangladesh, Pakistan; Cambodia, Indonesia, Vietnam; Ethiopia</td>
<td>Rhys and Edwards (2004)</td>
</tr>
<tr>
<td>DC exports to 3rd markets</td>
<td>Competitive (esp. labour intensive products)</td>
<td>Bangladesh, Cambodia, Bolivia Brazil, Honduras, Mexico, Cameroon, Ethiopia, Mozambique, Nigeria, Uganda, South Africa</td>
<td>Asian Drivers – IDS Bulletin, WD etc</td>
</tr>
<tr>
<td>China exports to DCs</td>
<td>Competitive – displacement Poor may benefit</td>
<td>Increased Chinese FDI to Africa</td>
<td>Stallings (2007)</td>
</tr>
<tr>
<td>FDI</td>
<td>Competitive /complementary</td>
<td>SSA / LA</td>
<td>Overall benefits of economic integration in region and development of production networks, larger internal markets, economies of scale.</td>
</tr>
<tr>
<td>Indirect: Price effects / TOT</td>
<td>Positive for commodity producers</td>
<td>East Asia – Taiwan, S. Korea, Japan</td>
<td>Eichengreen and Tong (2006)</td>
</tr>
<tr>
<td>China’s move up product cycle</td>
<td>Competitive</td>
<td>South east Asia</td>
<td>Stallings (2007)</td>
</tr>
<tr>
<td>Demand for capital / intermediate inputs</td>
<td>Complementary</td>
<td>South east Asia</td>
<td>Stallings (2007)</td>
</tr>
<tr>
<td>Growth in export production</td>
<td>Competitive</td>
<td>South east Asia</td>
<td>Stallings (2007)</td>
</tr>
<tr>
<td>Nature of products:</td>
<td>Positive but concerns over low quality labour conditions for resource extraction</td>
<td>Australia, Brazil Peru Chile Angola, Congo</td>
<td>Stallings (2007)</td>
</tr>
<tr>
<td>Manufactured goods – components into production</td>
<td>Positive</td>
<td>Bangladesh, Pakistan, Vietnam</td>
<td>Stallings (2007)</td>
</tr>
<tr>
<td>Manufactured goods – consumer (eg shoes, textiles)</td>
<td>Negative / crowding out But benefit from rising value of RMB and increase Chinese labour costs</td>
<td>LA / Mexico</td>
<td>Stallings (2007)</td>
</tr>
<tr>
<td>FDI – Indirect ’China effect’</td>
<td>No FDI diversion from LA except Mexico Complementary effects of flows for regional production networks</td>
<td>South east / East Asia</td>
<td>Stallings (2007)</td>
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<tr>
<td>Indirect - price effects: Commodity prices Terms of Trade – impact of China as function of 5 key variables (Zafar):</td>
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<td>---------------------------------------------------------------</td>
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<tr>
<td>- % of oil/metal in exports</td>
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<td>- % textiles in trade</td>
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<tr>
<td>- relationship between world S/D for commodity</td>
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<tr>
<td>- dependence on imported oil</td>
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<td>- % increase in world demand for commodity accounted for by China</td>
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<tr>
<th>Positive but concerns of ‘Dutch Disease’ Widening differentials between oil rich/poor countries</th>
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<tr>
<th>Africa (oil / mineral producers) Benefit: Angola (mineral + oil exporter) Ambiguous: Botswana, CAR (mineral rich/oil importer)</th>
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<tr>
<th>Zafar (2007) (also OECD – Goldstein et al. (2006))</th>
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