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China's preferential trade policy for Africa

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WHILE THOSE aspects of China's foreign policy that concern Africa have received considerable attention, a key dimension — that is, the provisions they make for preferential trade access — has not been the subject of close scrutiny or analysis. Yet this new trade regime is often mentioned alongside Beijing's recent forgiveness of over $1 billion in least developed country (LDC) debt as signifying attempts by China to elevate its international standing,. After all, offering preferential market access to other developing countries is both extremely rare and difficult to criticise. It is a display of magnanimity that China is using to simultaneously reinforce its relations with Africa and to signal its rise to great power status.

The question for Africa remains: is there economic value in this diplomatic offering?

China's massive financial entry into Africa, under the banner of solidarity and political non-interference, is likely to mean that gradually, China's influence on the continent will match that of traditional donors. This will probably occur more rapidly in the many African countries in which governments find the Washington Consensus is unpalatable, liberal forms of governance are a long way off, and providing infrastructure is the development priority of the day. China's newest foreign policy tool, a technique generally associated with industrialised countries only, extends unilateral trade preferences to Africa's LDCs. While it is too early to judge the results of China's package of preferences, we can explore its design and assess the difference it is likely to make to the economies of these countries.

Preferential market access: a novel South–South development?

In the past few years, Chinese officials have announced the elimination of tariffs on 440 products exported by those LDCs in Africa that have entered into formal diplomatic relations with the mainland. The full list of products covered has not been officially published in translation,1 and no-one has yet shown the economic value the new trade terms will have for the African LDCs.

The development economist's argument for trade preferences is that it opens windows of opportunity for the economies of recipient countries. Trade preferences,

if well designed and implemented, provide a price advantage for the developing country's exports. This advantage erodes as multilateral trade liberalisation reduces overall tariff levels, which in turn diminish the margins of preference. The countries that receive preferences are supposed to use the temporary price advantage to expand their existing export industries and perhaps develop new ones, increasing efficiency sufficiently to enable them to compete on less preferential terms in the long run. If all goes well, this will stimulate sustained export-led growth.

Trade preferences for African LDCs have existed in various forms for more than 20 years, but their results have been somewhat disappointing. The two most important preference schemes for African LDCs are the US African Growth and Opportunities Act (AGOA) and the EU Everything but Arms (EBA) Initiative. The US and EU (considering the latter as a single economy) are Africa's two largest export markets, and the preferences they offer African LDCs are broad. AGOA, which applies to 37 African countries, some of them LDCs and some not, provides preferential access to over 6 400 products. EBA preferences apply to LDCs worldwide, and cover 10 200 products. Because of the market size they represent and the breadth of coverage they offer, the US and EU preferences are the standard-bearers for preferential trade terms for LDCs. However, the modest benefits they have earned for the recipient countries suggest that either something is wrong with the design of these preferences, or that the African economies that ought to be profiting from them do not have what is needed to take advantage of transparent price incentives. Both possibilities turn out to be true.

Published empirical findings show that non-tariff barriers, like rules of origin and costs of documentation, can easily undermine what seem to be generous preference schemes for LDCs. Broadman2 also concludes that supply-side constraint, particularly weak or missing infrastructure and an adverse domestic policy environment, are very important in African LDCs. The implication is that blanket duty-free treatment will not necessarily aid development in LDCs. Instead, non-tariff barriers must be minimised and supply-side constraints addressed, either through 'aid for trade' or by targeting industries in African economies that already have existing export capacity. China's new and relatively short list of unilateral preferences does not bear much direct comparison with the expansive US and EU schemes, but the same supply- and demand-side constraints apply.

China's Preferential Trade Access Programme for Africa

In 2005, President Hu Jintao announced that Beijing would offer duty-free treatment to imports from the 39 LDCs around the globe with which it has diplomatic relations. Furthermore, Beijing announced that 190 products from its 39 designated LDCs, most of them in Africa, would benefit from the same terms. At last November's Forum for China Africa Cooperation (FOCAC), China announced that it would more than double the number of items on the duty-free list for 30 African LDCs to 440 items. The date of implementation for these preferences is not known, so our assumption is that the preferences will take effect by the end of 2009.

Preliminary analysis of these preferences

Table 1: Most valuable preferences

Product	HS8 Code	Margin of preference (%)	Estimated annual value of preference (US$)	Exporters
Sesame seeds	12074090	10	4,695,623	Djibouti, Eritrea, Ethiopia, Mali, Mozambique, Niger, Senegal, Somalia, Sudan, Tanzania, Togo, Uganda
Copper cathodes	74031100	2	1,334,359	Democratic Republic of Congo, Tanzania, Zambia
Octopus	3075900	17	1,066,201	Guinea, Mauritania, Mozambique, Senegal, Tanzania
Unrefined copper	74020000	2	376,161	Democratic Republic of Congo, Tanzania, Zambia
Goat skin leather	41062100	14	353,211	Eritrea, Ethiopia, Rwanda, Senegal, Somalia, Sudan, Tanzania, Uganda
Cuttle fish & squid	03074900	12	341,595	Angola, Mauritania, Somalia
Unwrought cobalt	81052090	4	231,683	Democratic Republic of Congo, Uganda, Zambia
Vegetable materials for plaiting	14019090	10	158,564	Madagascar, Mauritius
Cocoa beans	18010000	8	151,299	Ethiopia, Guinea, Sierra Leone, Tanzania, Togo, Uganda
Sheep or lamb skin leather	41051010	14	150,262	Ethiopia, Mauritania, Sudan, Tanzania, Uganda

Source: China Customs data, courtesy of Tralac, and own calculations

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suggests that they are well-tailored to the export capacity African LDCs'; 88% of the products on the list have been exports from the African LDCs to China over the last decade. The average margin of preference for these products is 10.4%; that is, China's MFN trade partners will face an average 10.4% tariff on certain items, whereas the African LDCs will not. This is a significant margin of preference, considering that the beneficiary countries were exporting all of these products to China before the special treatment regime was adopted.

Using a simplistic 'implicit transfer' calculation, we estimate that the overall economic value of these preferences is of the order of $10 million per year. The most economically valuable Chinese preferences are either primary products or simply transformed manufactures. These include sesame seeds, cocoa beans, various leathers, and copper and cobalt materials. Twenty-one of the 30 beneficiaries export at least one of the 10 most valuable preference products to China.

Naturally, many products are excluded from the duty-free list. The most important omission is raw cotton, which, although a vital export for many of these LDCs, faces a 40% tariff in China. This charge on cotton costs the 30 LDCs an implicit transfer of $ 68.6 million per year, but it is unrealistic to expect China to reduce the protection it affords its domestic cotton farmers.

There are 49 preference-receiving products that are currently not exported by the African LDCs to China. These could also promise economic benefit if supply constraints are not too great, because the margin of preference is significant at 9.4%,. Most of these products are textiles, yarn and thread. These could offer higher value-added opportunities for African countries if they can transform their silk, cotton, and wool in cost-efficient ways. The average margin of preference for these products offers the African countries a real advantage over China's MFN trade partners, particularly in textiles, as it represents tariff de-escalation for African exporters. China's protection of raw cotton imports in tandem with the duty-free preferential access it provides for cotton products should serve as an incentive to African producers to process raw materials locally before exporting them.

However, African LDCs will be competing with those in Asia that currently export many of these duty-free products to China. Beijing recognises 11 Asian LDCs,[3] and also provides them duty-free access for 190 products, a point that is often forgotten. There is as yet no official indication as to whether the new list of 440 products for Africa will also be made available to Asian economies. If so, it may decrease the competitive advantage of the African LDCs in the Chinese market.

On the other hand, what of China's non-tariff barriers? Its rules of origin are stricter than those in AGOA: at least 40% of value must be added in the exporting country, compared with the 35% regional value-added requirement for AGOA. The EBA requirements are even stricter. However, as already noted, China's preferences mostly cover primary commodities or simple manufactures, which are unlikely to contain substantial imported content. The 40% local value-added requirement will not strip much value from preferences for such products.

Other non-tariff barriers may pose a greater problem. According to China's 2006 WTO Trade Policy Review, 6.5% of tariff lines were subject to discretionary import prohibitions on grounds of health, environmental safety and national security concerns. The partial list of these restrictions available through the WTO shows they applied to at least two of the 440 preferred lines, but it is unclear whether they were enforced against any African LDCs. There is a real risk that in the future China will impose import prohibitions against African LDCs on the basis of health and environmental concerns, given both that many of the duty-free products are of animal origin, and that capacity for quality control in LDCs is generally weak.

In sum, the Chinese authorities have designed a preference scheme well-suited to the export capacity of the African economies it intends to help, yet it will probably have only a small economic impact. With an implicit transfer of about $10 million per year spread across 30 countries, the estimated economic value (excluding oil) represents only about 1.2% of exports from these countries' to China. As Table 2 shows, about half of the beneficiaries may see an implicit transfer of less than $100,000 per year. Barring an unexpectedly strong supply response in Africa, the preferences will not alter trade flows to China much, and certainly will not reduce the bilateral trade deficits run by those of Africa's economies that do not export oil.

However (and this was the case before the preferential regime was introduced), over 90% of LDC exports enter China duty-free. This makes it difficult for Beijing to craft a Chinese preference programme that is capable of making a dramatic impact on these economies (barring a preference for import-sensitive raw cotton). This means that any feasible Chinese trade preferences for the LDCs will be of greater symbolic than economic value. However, this essentially diplomatic offering by Beijing has provided some genuine commercial benefits.

Conclusion

China's foreign policy toolkit has indeed become more sophisticated, and the trade preferences it now offers to Africa have at least a dual use. One is the ostensible purpose of the preferences: to allow Africa's poorest economies to increase the volume and perhaps diversify the nature of their exports, through advantageous market access. While the benefits are likely to be modest for most of the 30 countries concerned, the preferences have been thoughtfully tailored to their export capacities. The other rationale remains diplomatic. Beijing aims to reinforce its ties with Africa, and simultaneously to signal the importance of China, both as a trading partner and as a credible alternative to Western donors.

Recommendations

Policy-makers in the 30 African countries that will benefit from the new policy should not overestimate the gains they will make from

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Chinese trade preferences. Nevertheless, they can devise policies that will improve their chances of earning the full value of, or even multiplying, the benefits accruing to local producers. The following recommendations outline ways in which African trade policies can be geared to take full advantage of China's new trade terms.

- Work with the local Chinese embassy to publish and explain the list of 440 products and the applicable rules of origin to domestic producers and exporters.
- Open discussions with the Chinese Ministry of Commerce on similar preferential treatment for all exports that now face a Chinese MFN tariff of 20% or less. Presumably, these imports are not highly sensitive for China, and tariff removal would result in an annual transfer of an additional $5.1 million for African producers.
- Ensure that Chinese project and development finance targets those industries and activities that are eligible for preferential treatment in China.
- Seek Chinese investment in the domestic processing of raw African cotton and equivalent materials, to promote vertical integration in African economies. This is best pursued starting at the ministerial level, as private investors have shown little independent interest in African processing, and will probably become involved only if government incentives are offered. Beijing is clearly disposed to make investments or offer investment incentives where they will strengthen relations with African governments. ■

Endnotes

1 No English-language list of the 440 products has been published with FOCAC materials, or anywhere else on the worldwide web. We are grateful to the Chinese diplomatic staff who provided the list of products and the applicable rules of origin. It is unclear whether this information is embargoed, so we do not reproduce it here, but it has been used as the basis for our analysis. We believe that African exporters might take greater advantage of these preferences if the Chinese Ministry of Commerce (MOFCOM) published this information on the MOFCOM and FOCAC websites in English, French and Portuguese.

2 Broadman H, Africa's Silk Road: China and India's New Economic Frontier. Washington: the World Bank, 2006. pp. 108–113.

3 These are Afghanistan, Bangladesh, Bhutan, Cambodia, Laos, the Maldives, Myanmar, Nepal, Timor Leste, Vanuatu and Samoa.

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