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China–UK–Africa Trilateral Cooperation on Trade and Investment: Prospects and Challenges for Partnership for Africa's Development

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Contents

Abbreviations	2
Acknowledgements	3
Abstract	4
1 Introduction	5
1.1 From bilateral to trilateral cooperation in Africa	5
1.2 China–Africa cooperation	6
1.3 UK–Africa cooperation	8
1.4 China–UK–Africa cooperation	9
2 A framework for China–UK–Africa trilateral cooperation	11
2.1 Trilateral cooperation: advantages and challenges	11
2.2 Priority areas for poverty reduction cooperation in Africa	11
2.3 Platforms and mechanisms	13
3 The cases: Kenya and South Africa	14
3.1 Economic performance and poverty reduction	14
3.2 Chinese and UK trade	16
3.2.1 South Africa	17
3.2.2 Kenya	18
3.3 Chinese and UK investment	19
3.4 Chinese and UK development assistance	20
4 Opportunities, challenges and recommendations	23
4.1 Linking South Africa into global value chains	23
4.2 Expanding investment in Kenya	24
4.3 Boosting trade and lowering barriers	24
4.4 Sharing information and enhancing transparency	25
References	26
Boxes	
Box 1.1 Trilateral cooperation in African agriculture	10
Tables	
Table 3.1 Key economic indicators, 2014	15
Table 3.2 Key poverty reduction indicators	16
Table 3.3 Chinese and UK Merchandise Trade with Kenya and South Africa	17
Table 3.4 Comparing Chinese and UK FDI in Kenya and South Africa	20
Table 3.5 Comparing UK and global gross ODA and AfT disbursements, 2014	22

Abbreviations

AfDB	African Development Bank
AfT	Aid for Trade
AICD	Africa Infrastructure Country Diagnostics
CAITEC	Chinese Academy of International Trade and Economic Cooperation
CHINCA	China International Contractors Association
COMESA	Common Market for Eastern and Southern Africa
CUTS	Consumer Unity and Trust Society
DFID	Department for International Development (UK)
EAC	East African Community
EU	European Union
FCO	Foreign & Commonwealth Office (UK)
FDI	foreign direct investment
GDP	gross domestic product
GSP	Generalised System of Preferences
ICE	Institution of Civil Engineers (UK)
IMF	International Monetary Fund
MFN	most favoured nation
MoU	Memorandum of Understanding
NEPAD	New Partnership for Africa's Development
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PMO	Prime Minister's Office
PPP	Purchasing Power Parity
SADC	Southern Africa Development Community
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
WTO	World Trade Organization

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Abstract

This study was conducted in the context of the China–UK Cooperation on African Trade and Investment for Poverty Reduction. It focuses on the evolution of bilateral relations between China and the UK towards trilateral relations with Africa and on building a framework for future cooperation. Special attention is given to infrastructure, agriculture and trade facilitation. It analyses the current engagement of Kenya and South Africa with the UK and China. Main findings and recommendations are that South Africa and Kenya should be linked more to global value chains and to raise the awareness of it as a possible outsourcing destination. Reducing non-tariff barriers between the countries could generate positive impact for local livelihoods and welfare-enhancing effects. Sharing more information and enhancing transparency is recommended for further success in the trilateral cooperation.

1 Introduction

The last decade has been characterised by an increased dynamism in the trade of developing countries. A key driver of developing country exports, China saw its share of world trade more than quadruple from 3 per cent to more than 12 per cent between 2000 and 2015. Developed countries, meanwhile, have seen their share shrink considerably. For the same period, the UK's share of global trade halved – even though the country's exports continued to grow in nominal terms (UNCTAD n.d.). Taken together, these trends point to a new global trade geography and in particular to the rise of the South.

Outside Asia, developing countries have achieved more modest gains. Between 2000 and 2014, Africa's share of world trade only increased from 2.3 to 2.9 per cent (UNCTAD n.d.). While South–South trade can offer new opportunities for growth and poverty reduction, it is clear that many African countries still face serious constraints in accessing regional and global markets. China and the UK each have sought to enhance Africa's trade position through developmental and commercial channels. More recently, however, there have been signs of a stronger China–UK bilateral relationship: the UK joined the new China-led Asian Infrastructure Investment Bank, and during his October 2015 state visit to the UK, Chinese President Xi Jinping signed £30bn in business deals (HM Treasury 2015; PMO 2015).

Against this background of strengthened China–UK ties, the study here explores how the two countries might collaborate to support African growth and poverty reduction, examining possible synergies among their respective policies. Specifically, it evaluates China–Africa, UK–Africa and China–UK–Africa economic engagement to craft a framework for future trilateral cooperation targeting poverty. Using this framework, it delves into the two cases of Kenya and South Africa, countries with distinct economic profiles but similar potential to harness trade for poverty reduction. Indeed, South Africa and Kenya have maintained their share of global exports, implying that both nations have seen their exports grow more quickly than those of the UK.

Divided into four main parts, the study first details how Chinese and UK bilateral relations in Africa have expanded to new modes of trilateral cooperation. It next builds a framework for future China–UK–Africa cooperation, highlighting China–UK complementarities in three areas central to the African poverty reduction agenda: infrastructure, agriculture and trade facilitation. It then presents the cases of Kenya and South Africa and examines their engagement with China and the UK across trade, investment and development assistance channels. It concludes with a discussion of opportunities for cooperation in the two case countries and provides recommendations for action.

1.1 From bilateral to trilateral cooperation in Africa

While possessing distinct historical experiences and trajectories, neither China nor the UK is a new entrant to economic cooperation on the African continent. Over the past 60 years, both countries have sought to strengthen their bilateral engagement with African countries across aid, trade and investment channels. Now, however, novel modes of trilateral cooperation are emerging as development partners begin to recognise complementarities and the potential for financial and technical collaboration (OECD 2016). The following sections explore past and present China–Africa, UK–Africa and China–UK–Africa engagement to construct an effective framework for enhancing future trilateral cooperation.

1.2 China–Africa cooperation

Following the founding of the People’s Republic of China in 1949, the Chinese government initiated various forms of economic cooperation with African countries. Drawing on its own domestic experience, it emphasised self-reliance, especially that achieved through agricultural development and food security. As such, in the new government’s first three decades, about 39 per cent of officially supported foreign development projects involved agriculture. From 1971 to 1975, China dispatched 670 agricultural experts to 25 African countries, where it invested US\$33m in irrigation, built numerous agricultural extension stations and encouraged the formation of cooperatives across the continent.

The 1980s and 1990s – the first two decades of the reform era – saw a significant decrease in China’s overseas development activities and a shift to a business-oriented model of assistance. Accordingly, China established joint ventures and introduced the household responsibility system abroad. It also began to promote multidimensional economic cooperation combining aid, trade and investment (Gu *et al.* 2015, 2016). After 2000, Chinese outbound development assistance began to grow again, with officially reported flows to Africa increasing steadily from a total of US\$17.3bn for 1950–2009 to approximately US\$7.5bn for 2010–12. Concurrently, the proportion of African disbursements within China’s total foreign assistance budget increased from 46 per cent in 2009 to 52 per cent in 2012 (State Council 2011, 2014).

Throughout its reform era engagement with Africa, China has consistently emphasised infrastructure-led growth and agricultural development. According to the UN’s *Economic Report on Africa 2012*, from 2001 to 2009, Chinese financial support for African infrastructure totalled US\$14bn (UNECA 2012: 118). The State Council’s second white paper on foreign aid reported that from 2010 to 2012, the country financed 86 economic infrastructure projects across the region. In the agricultural sector, China has constructed 14 demonstration centres in Africa, and begun the planning and implementation of another eight centres. Not unlike its Mao era development initiatives, the country has also dispatched numerous agricultural experts to Africa and trained more than 5,000 African agro-technicians (State Council 2014).

Operating in tandem with its outbound development assistance, China’s trade and investment in African countries has also expanded rapidly. According to China’s National Bureau of Statistics, the total value of trade in goods between China and Africa reached US\$221.7bn in 2014, an increase of US\$11.4bn year-on-year.¹ As for investment, Chinese foreign direct investment (FDI) stock in Africa totalled US\$32.4bn in 2014. Broadly speaking, strong economic complementarities between China and Africa – along with linkages between their respective phases of development – have stimulated trade and investment flows. While China has an absolute advantage in industrial products and some service products (e.g. engineering construction), Africa enjoys an absolute or comparative advantage in natural resources. As a consequence of this economic structure, African countries mainly export raw materials to China while importing Chinese industrial products and infrastructure services. China’s investment in the region follows a similar pattern, primarily focusing on engineering construction and raw materials.²

Key Chinese initiatives cross-cutting aid, trade and investment include the construction of six economic and trade cooperation zones, the establishment of the China–Africa Development Fund and the provision of large loans and credit lines to recipient governments. In 2007, China built its first economic and trade cooperation zone in Zambia, allowing China to gain experience in zone construction while promoting African trade and local employment. That same year, it launched the China–Africa Development Fund to support Chinese companies

¹ For sub-Saharan Africa, this figure is closer to US\$193.4bn.

² These particular trade and investment patterns are not exclusive to the China–Africa relationship; indeed, other international partners active in the region concentrate on the same sectors.

investing in Africa, particularly those focused on agriculture, manufacturing, infrastructure, and cultural industries.³ Meanwhile, from 2001 to 2010, the Export–Import Bank of China – the country’s official export credit agency – provided US\$67.2bn in loans to Africa, exceeding the World Bank’s US\$55bn to Africa for the same period (UNECA 2012: 118).

Despite continued emphasis on infrastructure, China’s engagement with Africa has evolved beyond the ‘hard’ sectors of development. A 2011 African Development Bank (AfDB) report observed that the China–Africa relationship had shifted from a relatively narrow focus on trade and investment to a broader consideration of development issues (Gu and Schiere 2011). Chinese experts likewise noted that China’s engagement on the continent has expanded into ‘soft’ areas of development, combining aid with trade and investment to target and reduce poverty more effectively (Gu 2009; Zhang 2013). During Chinese Premier Li Keqiang’s visit to Ethiopia in 2014, this shift in focus was apparent. Specifically, the Chinese Premier proposed the ‘461 Framework’ for a China–Africa strategic partnership, underscoring four key principles: equality, solidarity and mutual trust, inclusive development and innovative cooperation. According to the framework, China and Africa would pursue new projects in six areas: industry, finance, poverty reduction, ecological and environmental protection, humanity and cultural exchange, and peace and security. They would also continue to regard the Forum on China–Africa Cooperation as the one central platform for collective dialogue and practical cooperation (Australian Centre on China in the World 2014).

In sum, China has played a vital role in the acceleration of Africa’s economic growth. Chinese demand has fuelled a resource boom across Africa while its investment has targeted bottlenecks impeding development, especially in infrastructure (Dollar 2016). At the same time, China–Africa economic cooperation has helped change perceptions of the African continent, driving new wealth flows into the region. For African governments, China has afforded them an alternative to traditional bilateral and multilateral partners. Schmaljohann and Prizzon (2015) referred to the worldwide increase in donors and development mechanisms as indicative of an ‘age of choice’. From interviews with key stakeholders in six Asian and African countries, they found ‘developing country government officials welcomed more options for financing development, which for them outweighs the costs associated with greater fragmentation’ (2015: 8). Furthermore, they observed that for some recipient countries, the multi-donor landscape had enhanced their role in negotiating and managing development finance (*ibid.*).

These benefits notwithstanding, China’s engagement with Africa has faced several challenges, such as how to balance efficiency and quality in the pursuit of sustainable development (He 2011; Gu and Carty 2014). Within the literature, the main criticisms of China–Africa relations have included the lack of transparency in Chinese aid policy and its lack of focus on African democracy and good governance (Tull 2006; Hanauer and Morris 2014). Concerns also have been raised about Chinese economic activities using African resources and markets to achieve national objectives while crowding out local industries (Kaplinsky and Morris 2008; Kaplinsky, McCormick and Morris 2008; Jenkins and Edwards 2015). Others have cited China’s limited protections for the environment, labour rights and local livelihoods (Bosshard 2008; Lyons and Brown 2010; Otu-Tei 2014).

³ The China Development Bank – one of China’s three policy banks and its largest overseas lender – provided a total of US\$3bn in seed funding, attracting more than US\$1.6bn in Chinese FDI. In 2013, the fund formulated a plan to invest US\$2.83bn in 75 projects with the potential to draw an additional US\$15bn into Africa. A year later, during his visit to the African Union in Ethiopia, Chinese Premier Li Keqiang announced that the fund would receive an additional US\$2bn in financial support.

1.3 UK–Africa cooperation

As a former colonial power, the UK's engagement in Africa extends back 400 years and is now based on the shared history, language and culture that this interaction produced. At present, there are 18 Commonwealth nations in Africa, accounting for one third of the 54 countries on the continent. While the Commonwealth comprises a voluntary association of former British colonies and other countries shaped by the once-vast British Empire, it nonetheless represents an important link between the UK and Africa.⁴ This sustained relationship is evident across all forms of economic engagement, including trade, investment and development assistance.

In 2014, the UK exported US\$11.6bn in goods to sub-Saharan Africa, principally consisting of machinery and equipment, road vehicles and chemical products. Between 2004 and 2014, UK exports to the region grew by approximately 5.6 per cent year-on-year, with the top destinations including South Africa, Nigeria, Botswana, Angola, Kenya, Ghana and Senegal. In each of these nations, the UK enjoys a strong position among imported goods, maintaining a 4 to 5 per cent share of total imports (UNCTAD n.d.). This trade relationship has been further strengthened by the new set of Economic Partnership Agreements that the EU signed in 2014 with three of the region's major trading blocks (together representing 35 African countries). As for investment, UK FDI flows to sub-Saharan Africa registered US\$5.7bn in 2014, with total UK FDI stock amounting to US\$39.9bn that year (OECD n.d.).

UK development assistance, meanwhile, remained relatively stable from the early 1960s until 1999 when it began to increase rapidly – both in total quantity and in proportion to gross national income. In 2011, the UK Department for International Development (DFID) issued its *Action Plan for Africa 2011–2015*, further augmenting African aid and adjusting its focus to the region's poorest countries. In 2014, the UK disbursed approximately US\$3.7bn in net official development assistance (ODA) to sub-Saharan Africa, or 35 per cent of its total bilateral aid budget (OECD n.d.).

Compared with China, the UK has placed more emphasis on recipient countries' 'soft' sectors, devoting almost half of its development assistance budget to education, health and other social infrastructure; it also designated 41 per cent of its budget for multilateral aid in 2014 (OECD n.d.). Conversely, a much smaller proportion of UK development assistance is dedicated to those areas that China emphasises, namely, infrastructure and productive sectors; and China's multilateral aid comprises a mere 10 per cent of its budget (Kitano and Harada 2014). Aside from health and education, the UK's other target areas include civil society and government capacity building, fiscal support, technical cooperation, private sector support and security (OECD n.d.). In terms of this last area, the UK has developed a comprehensive global conflict prevention mechanism involving the UK Foreign and Commonwealth Office (FCO), DFID and the UK Ministry of Defence. From planning to operations and implementation, the programme has far-reaching influence in Africa (Zhang 2014).

Not unlike China–Africa engagement, UK–Africa policy is also evolving. First, the UK has sought to update its engagement framework and strengthen cooperation with the whole continent, especially southern Africa. Second, it has expanded its development programme to encompass a combination of aid, investment and cooperation, attempting to build a UK–Africa relationship based on equal rights and shared responsibilities. Third, it has begun to increase its official support for infrastructure and trade, perhaps an indication of China's influence on prevailing development models. Fourth, it has altered its approach to conditionality and discontinued previous practices of hard-selling democracy. Instead, it now stresses mutual partnership and ownership, strengthening aid to African countries that of

⁴ In addition to the Commonwealth, other key platforms for UK–Africa interaction include the Commission for Africa, EU–AU Summit, G8 Summit and the Extractive Industries Transparency Initiative.

their own accord have pursued reform and good governance. Finally, in an effort to remedy past weaknesses, it has expanded cooperation with other western partners in the form of administrative staff exchanges and capital support (Cargill 2011; FCO 2015).

1.4 China–UK–Africa cooperation

Although initially wary of China–Africa engagement, the UK has gradually realised that Chinese influence in Africa does not preclude its own role, or that of other countries, and indeed can offer complementarity for cooperation in supporting African development. There is now evidence that China and the UK have shifted away from independent and exclusive operations towards a mutual recognition of their respective roles, functions and policies in Africa (DFID 2014). In turn, Chinese and UK policy interactions in Africa have transformed into an important part of their bilateral relationship.

Over the past five years, China and the UK have used their bilateral relationship to coordinate policies in Africa. In February 2009, at the first China–UK Business Summit,⁵ the then British Prime Minister Gordon Brown and then Chinese Premier Wen Jiabao agreed on a plan for China–UK–Africa agricultural cooperation. The two countries now hold an annual high-level Dialogue on Africa, in which they exchange views on concrete measures to support African development and further their trilateral cooperation. In December 2013, British Prime Minister David Cameron attended the third China–UK Business Summit, which concluded with commitments from China and the UK to explore cooperation on infrastructure investment and construction in Africa.⁶

At the ministerial level, DFID and its Chinese counterparts have explored opportunities for collaboration in Africa. In 2011, DFID and China’s Ministry of Commerce signed a Memorandum of Understanding (MoU) to create a partnership to enhance development cooperation and achieve the Millennium Development Goals. That same year, in conjunction with the Congolese government and China, DFID helped develop environmental and social guidelines for new Chinese-financed highway projects. In 2014, DFID signed another MoU, this time with China Development Bank, for a partnership to promote economic growth and poverty reduction in Africa.

International and multilateral organisations have also served as a platform for China–UK–Africa cooperation. For example, through various World Bank mechanisms, such as the World Bank Trust Fund, DFID, the Export–Import Bank of China, Chinese Ministry of Finance, Chinese Ministry of Commerce, and Chinese companies have all cooperated on numerous small projects across Africa. DFID has also supported the World Wildlife Fund in its cooperation with Chinese government agencies, banks and companies to promote environmentally sustainable investment and trade with Africa (World Wildlife Fund 2011). During 2009 and 2010, the UK government, the Chinese Training Centre for Peacekeeping Civil Forces and the Kofi Annan International Training Centre for Peacekeeping together organised three training classes for African peacekeeping forces in China and Ghana (Hirono and Xu 2013). In addition, in 2009, the UK provided funding for a joint research group to study how African countries can utilise international aid effectively to enhance poverty reduction.⁷

⁵ The China–UK Business Summit is the highest-level platform for dialogue among Chinese and UK business circles.

⁶ As a result of this summit, the China International Contractors Association (CHINCA) signed a memorandum of understanding with the British Institution of Civil Engineers (ICE).

⁷ The research group consisted of representatives from the OECD Development Assistance Committee and the Poverty Alleviation Centre of the State Council of China.

Box 1.1 Trilateral cooperation in African agriculture

In January 2010, at the first Africa–UK–China Conference on Agriculture and Fisheries in Beijing, meeting participants reached a consensus on the principles, priorities and mechanisms for trilateral cooperation. Two years later, at the second Africa–UK–China Conference on Agriculture and Fisheries, a new programme – Working in Partnership to Accelerate Agricultural Technology Transfer – was officially launched to help African countries improve agricultural production capabilities and address global food security challenges.⁸ The programme’s first two pilot projects were initiated in Malawi and Uganda with the hope that this innovative model could eventually provide valuable lessons for future trilateral cooperation among Chinese, UK and African partners targeting poverty (World Affairs 2014).

⁸ Marking the launch of this project, two documents were signed: a *Memorandum of Understanding on Cooperation on Transfer of Agricultural Technology among China, Britain, and Uganda* and a *Memorandum of Understanding on Cooperation on Transfer of Agricultural Technology among China, Britain, and Malawi*.

2 A framework for China–UK–Africa trilateral cooperation

Drawing on the past experiences of China–Africa, UK–Africa and China–UK–Africa engagement, this section presents a framework for trilateral cooperation targeting poverty. It first explores the advantages that this modality offers to participating development partners; it also points out some challenges. It then details priority areas for poverty reduction and the complementarities that China and the UK possess in each of these areas. Finally, it discusses potential platforms and mechanisms for operationalising this framework.

2.1 Trilateral cooperation: advantages and challenges

The triangular modality provides several advantages compared with other forms of development cooperation. It can provide international public goods more efficiently while reducing risk for large-scale projects, especially in countries marked by political unrest, poor investment environments and high default rates. It can also draw together the complementary capacities of disparate actors to leverage more resources than might have been possible within a bilateral partnership. For instance, emerging partners can contribute relevant strategies learned over the course of their own development. Established partners meanwhile can utilise their international cooperation experience, providing effective institutional frameworks and offering access to large global and local networks. In some cases, a partner might share a similar linguistic, cultural or historical background with the host government, lowering language barriers and preventing misunderstanding. In essence, triangular cooperation can foster inclusive horizontal relationships that facilitate mutual learning and accountability. It can also create regional synergies and positive spillovers into diplomatic and commercial relations.

Despite its many advantages, triangular cooperation must surmount the coordination and harmonisation issues that accompany any project with additional independent actors. Indeed, disparate development cooperation regimes, standards frameworks, conditionalities and stakeholder interests can result in higher transaction costs, asymmetrical information and coordination breakdowns with adverse development outcomes. At the same time, triangular cooperation does not automatically guarantee that beneficiaries set the agenda; established and emerging partners can still dominate negotiations, ultimately engendering unequal partnerships. As a relatively recent modality, triangular cooperation has produced a high volume of small-scale projects, raising additional concerns about fragmentation within the development community (Special Unit for South–South Cooperation, UNDP 2009).

2.2 Priority areas for poverty reduction cooperation in Africa

There are three priority areas for poverty reduction cooperation in Africa: infrastructure, agriculture and trade facilitation. Although many development programmes previously focused on the social side of poverty and on building human capacity, the rapid infrastructure-led growth of East Asia and subsequent reduction in impoverished populations has renewed interest in infrastructure as a key component of poverty alleviation. Indeed, inadequate power, transport, water and communication networks can hinder economic activity by increasing transaction costs, reducing productivity, impeding the movement of goods and preventing the creation of new markets (UN-HABITAT 2011). Africa currently faces severe shortages across all forms of infrastructure. In 2009, the African Infrastructure Country Diagnostic project reported that the whole of sub-Saharan Africa produced about the same amount of power as that of Spain, a country with one-eighteenth the population (AICD 2010: 5). As such, many African countries have prioritised infrastructure. According to the

African Union's *Programme for Infrastructure Development in Africa 2012–2040*, the continent will require more than US\$360bn in infrastructure investment (African Union 2010: 5). Domestic resources alone will not be able to meet this requirement; here, China and the UK can help fill the gap.

Specifically, China and the UK can mobilise their complementary capacities in infrastructure 'hardware' and 'software' to achieve high-standard outcomes. China enjoys a comparative advantage in the physical construction of infrastructure, offering low costs, skilled workers, mature technologies, substantial sector experience and abundant capital. Meanwhile, the UK possesses more experience in project design, professional skills support, technical personnel training, localisation of operations and management and corporate social responsibility. Together, China and the UK can call on leading enterprises in these fields to work jointly on infrastructure projects. They can also collaborate on regional infrastructure projects.⁹

The second priority area is agriculture. Across Africa, agriculture employs approximately half of the total labour force, and for the 64 per cent of the population who live in rural areas, it is their main source of income (World Economic Forum 2015: 37). Nevertheless, over the past 50 years, agricultural productivity has made limited gains. Africa's crop yields are among the lowest in the world, with cereal yields at one-half to one-third the global average. Consequently, the continent has become a net importer of food, importing US\$35bn in food products in 2014 (US\$25bn in staples alone). At about 1.7 times the value of exports, these agri-food imports have resulted in trade deficits and further inhibited the development of domestic and export-driven agricultural markets (NEPAD 2013: 29). Given this situation, it is clear that African agriculture presents both incredible potential for poverty reduction and serious challenges for raising productivity and ensuring food security.

Both China and the UK possess valuable experience in agricultural development. During China's early reform era, agricultural development played a central role in poverty reduction. Moreover, as the population grew and urbanised, the country managed to raise agricultural productivity and address food security concerns. As such, China offers relatively strong technical advantages in crop and plant cultivation, animal husbandry, horticulture and fisheries. For its part, the UK has accumulated abundant experience in the management of African aid projects, agricultural training, agricultural technology and farm management. So far, China and the UK have cooperated on agricultural technology transfer projects in Malawi and Uganda. They could consider expanding their cooperation into other African countries such as Ethiopia and Mozambique, both central to the UK development programme and home to China's agro-technology demonstration centres, effectively leveraging established resources.

The third priority area is trade facilitation. Recently, African countries have taken significant steps towards enhancing intra-regional trade and driving overall export-led growth. In June 2015, the continent's three major trading blocks (the Common Market for Eastern and Southern Africa (COMESA), the Southern Africa Development Community (SADC), and East African Community (EAC)) launched the Tripartite Free Trade Area, harmonising preferential trade schemes across 26 African countries in a concerted effort to promote regional integration. Negotiations are ongoing within the African Union for an even more comprehensive Continental Free Trade Area including all 54 African countries (UNCTAD 2015). Despite these achievements, Africa faces serious supply-side issues – particularly among poorer potential market players – related to inadequate infrastructure, low agricultural yields, limited domestic resources and other non-tariff barriers to trade (UNECA 2015). Recognising these constraints, both China and the UK have supported various trade facilitation programmes in Africa. One such programme is the WTO-led Aid for Trade (AfT)

⁹ In 2013, China reaffirmed its support of partnerships for Sino-African transnational and trans-regional infrastructure construction (State Council 2013).

initiative that mobilises concessional finance to reduce trade barriers in developing countries.¹⁰

With respect to trilateral cooperation on trade facilitation, it is important to note that China and the UK each offer competitive products to trade with Africa, and their trade partners seldom overlap. In other words, China–Africa trade does not create an obvious substitution effect on UK–Africa trade, thus providing a foundation for trade-related cooperation to reduce poverty. Specifically, China can contribute its policy and sector expertise in export-led growth and the penetration of global markets. Considering African trade’s intimate link with infrastructure and agriculture, many of the comparative advantages that China offers in these areas can be applied here as well, ultimately improving productive capacities and increasing export opportunities. The UK can complement this effort with its experience in building global value chains, particularly those focusing on EU markets.

2.3 Platforms and mechanisms

At least initially, China, the UK and African partners could utilise their high-level bilateral relationships to build a solid foundation for trilateral cooperation and ensure sufficient political will and ownership among all parties. In this pursuit, China and the UK could draft a Strategic Plan for China–UK Cooperation in Africa, setting out in broad terms mutually beneficial objectives, priority areas and implementation mechanisms. Later, a collaborative task force could be established to explore more specific opportunities for regional and country-level engagement. This task force should aim for maximum flexibility and work with existing agencies to avoid programme duplication. Actual mechanisms for trilateral cooperation likewise should reflect the variety of resources and tools available across aid, trade and investment channels – from aid for trade to project bonds and equity to co-financing vehicles to public–private partnerships.

¹⁰ At its 2005 Hong Kong Ministerial Conference, the World Trade Organization (WTO) launched the Aid for Trade (AfT) Initiative, subsequently setting up the Task Force on Aid for Trade in February 2006 to mobilise the initiative. Both China and the EU were among the 13 WTO members on the Task Force. According to the latest data, in 2013, the UK disbursed approximately US\$1.4bn in AfT, with about US\$692m for Africa. Most recently, in October 2015, it contributed £500,000 (US\$772,900) to assist developing countries in the implementation of the WTO’s Trade Facilitation Agreement (WTO 2015). For further discussion of AfT, see Section 3.4 of this Evidence Report.

3 The cases: Kenya and South Africa

The following section begins with an overview of recent economic trends and poverty reduction in Kenya and South Africa, comparing their performance with sub-Saharan Africa as a whole. It then details Chinese and UK engagement in the two case countries, focusing on activities in the areas of trade, investment and development assistance.

3.1 Economic performance and poverty reduction

It is clear that Kenya and South Africa occupy different development stages. Where Kenya's GDP per capita is about 83 per cent of the average for sub-Saharan Africa, the South African figure is more than three and a half times the regional average (see Table 3.1). Likewise, the two countries exhibit distinct economic structures. South Africa maintains a very small agricultural sector (similar to that in developed countries) while Kenyan agriculture constitutes almost one-third of the national economy, or roughly twice the average for sub-Saharan Africa. In South Africa, non-manufacturing industrial sectors (e.g. mining and extractive industries) play an important role – although still secondary to services, which dominate at 68 per cent of GDP. For Kenya, however, these two sectors still contribute well below the regional average.

These indicators notwithstanding, Kenya has outperformed both South Africa and sub-Saharan Africa in terms of GDP growth over the past five years. From 2010 to 2014, Kenya averaged about 6 per cent growth, recording a healthy rate of 5.3 per cent in 2014. By contrast, since 2008, South Africa has exhibited slower growth more or less comparable to developed nation rates but below average for sub-Saharan Africa (around 4 per cent), declining to 1.5 per cent in 2014. Resource endowments cannot explain the differences in recent economic performance between the two case countries. The China-led resource boom of the past 15 years should have boosted economic growth in resource-rich South Africa. Instead, South Africa has failed to keep pace with other resource-endowed countries on the continent, suggesting energy and iron ore prices might have been a factor. Structural problems related to income inequality, low-skilled labour, corruption and high unemployment also might have prevented South Africa from returning to the high growth rates that characterised the pre-recession period from 2002 to 2008. Contrary to this, Kenya enabled its strong recent growth mostly by an expansion in modern services and the subsequent increasing demand for traditional services. In total, 72 per cent of the increase in GDP between 2006 and 2013 came from the service sector (World Bank Group 2016).

Although Kenyan and sub-Saharan African exports contracted in 2013, it appears that these markets recovered over the following year. South Africa fared well comparatively, registering 4.6 per cent and 2.61 per cent growth in exports for 2013 and 2014, respectively. South Africa's more diversified export structure might have shielded the country from commodity price fluctuations, possibly explaining its better export performance. In terms of their current accounts, both countries presented significant deficits in 2014, with a particularly acute imbalance in Kenya. As developing countries under economic transformation, this is not necessarily an urgent problem but sustainable financing of these deficits will constitute a key policy challenge. As for inflation, in 2014, Kenya and South Africa exhibited almost equivalent consumer price increases of 6.88 per cent and 6.38 per cent, respectively; these figures are just slightly above that calculated for the whole of sub-Saharan Africa (4.39 per cent).

Table 3.1 Key economic indicators, 2014

Measure	Kenya	South Africa	sub-Saharan Africa
GDP (current US\$bn)	60.94	349.82	1,728.32
GDP growth (annual %)	5.33	1.52	4.24
GDP per capita, PPP (current international US\$)	2,954.08	13,046.21	3,568.63
GDP per capita growth (annual %)	2.58	-0.06	1.45
Agriculture, value added (% of GDP)	30.27	2.49	13.96
Industry, value added (% of GDP)	19.36	29.47	27.61
Manufacturing, value added (% of GDP)	11.11	13.29	10.95
Services, value added (% of GDP)	50.37	68.05	58.40
Exports of goods and services (annual % growth)	2.31	2.61	3.13
Current account balance (% of GDP)	-10.40	-5.46	-
Consumer price index (2010 = 100)	140.91	124.43	-
Population, total (millions)	44.86	54.00	974.32
Population growth (annual %)	2.64	1.58	2.74

Source: World Bank (2015).

Poverty reduction data for the two case countries and the region as a whole is very limited, primarily based on estimates using imperfect international poverty lines. Nonetheless, using the data available, it would appear that both case countries saw a reduction in the percentage of the population living on US\$1.90 a day, with a slightly larger decline in Kenya than in South Africa (see Table 3.2). Moreover, it would seem that the two countries have outperformed sub-Saharan Africa, in terms of both their total ratios and poverty reduction over time.

The reduction in South Africa's poverty gap is also notable, suggesting that by 2011 the average daily income of people under the threshold was just 4.9 per cent short of US\$1.90. More recent data for Kenya is not yet available; that said, 2005 data indicates a larger poverty gap than that calculated for South Africa. As for food deficits among the undernourished, South Africa exhibited better performance overall. Kenya also managed to improve the depth of the food deficit over the past ten years, but still lags behind the regional average.

Table 3.2 Key poverty reduction indicators

Measure	Year	Kenya	South Africa	sub-Saharan Africa
Poverty headcount ratio at US\$1.90 a day (2011 PPP) (% of population)	2005	33.6	23.13**	51.2***
	2011	23.7*	16.56	45.1***
Poverty gap at US\$1.90 a day (2011 PPP) (%)	2005	11.7	7.23**	-
	2011		4.9	-
Depth of the food deficit (kilocalories per person per day)	2005	229	27	179.58
	2011	158	24	146.24
	2014	156	16	136.84

Note: * Kenya has not provided official poverty data since undertaking its last national household survey in 2005. Reddy and Lahoti (2015) provided a preliminary estimate of 23.7 per cent for Kenya's US\$1.90 a day (2011 PPP) poverty headcount ratio in 2012, cautioning that country-level data could be inaccurate. In their 2014 joint paper on Kenya's poverty reduction strategy, IMF and World Bank staff estimated that using the old threshold of US\$1.25 per day, Kenya's poverty headcount ratio had declined from about 47 per cent in 2005–06 to 39 per cent in 2012–13; ** 2006 World Bank data; *** Reddy and Lahoti (2015) also provided poverty headcount estimates for sub-Saharan Africa in 2005 and 2012 using the new US\$1.90 a day line (2011 PPP).

Source: World Bank (2015); Reddy and Lahoti (2015).

3.2 Chinese and UK trade

In the last decade, China's share of case country exports and imports has increased significantly. Between 2004 and 2014, merchandise exports to China increased more than eight-fold from South Africa and almost five-fold from Kenya (see Table 3.3). Nevertheless, China remained a relatively small market for Kenya. Over the same period, the UK's share of total exports declined by more than half from both Kenya and South Africa. These export trends are similar to the performance of China and the UK globally but the importance of the UK as a market for African exports has decreased dramatically. Import trends mirror that of exports: UK shares have fallen while Chinese shares have increased significantly to the point that for both case countries, China is their largest single source of imports.¹¹

As for trade structures, China and the UK import quite different bundles of products from South Africa and Kenya.¹² More generally, the trade concentration index¹³ shows that sub-Saharan African export structures to the world, the UK and China are much more concentrated than the import structures. The increased export concentration likely reflects increased volume demand from China and consequent increases in prices. Also noteworthy is that Kenya is relatively less successful at penetrating the Chinese market than South Africa or sub-Saharan Africa as a whole, perhaps as a result of trade policy obstacles. The next two sections will examine these trade trends for each case country.

¹¹ In South Africa, only the European Union – with its 28 member countries – surpasses China, with 27.8 per cent of total imports in 2014.

¹² These findings are based on the Finger Kreinin Index of structural similarity, which varies from 1 to zero where 1 implies 100 per cent overlap of commodity structure and zero implies completely independent export structures. An index of 0.2 thus can be interpreted as a 20 per cent commodity overlap.

¹³ The trade concentration index varies from zero to 1, with a higher index indicating more concentrated trade by commodity. For example, an index of 1 would signify only one product was traded. Conversely, the closer the index is to zero the more products are traded.

Table 3.3 Chinese and UK Merchandise Trade with Kenya and South Africa

Measure	Year	Kenya	South Africa	sub-Saharan Africa
Exports (US\$m)	2004	3,250	40,264*	152,327
	2014	7,037	90,612	402,971
Chinese share in exports (%)	2004	0.52	2.62	8.62
	2014	1.09	9.58	17.34
UK share in exports (%)	2004	12.01	10.47	6.73
	2014	5.79	3.82	3.20
Imports (US\$m)	2004	5,343	47,398	133,592
	2014	22,396	104,738	425,373
Chinese share in imports (%)	2004	6.53	6.23	7.42
	2014	22.02	14.99	19.19
UK share in imports (%)	2004	6.41	7.29	5.54
	2014	3.00	3.74	2.72
Structural similarity of exports to China with respect to the world	2012	0.23**	0.35	-
Similarity of structure of exports to China with respect to the UK	2012	0.22**	0.11	0.1143
Similarity of structure of exports to UK with respect to the world	2012	0.43**	0.37	-
Concentration of exports to China	2014	0.222*	0.471	0.613
Concentration of exports to the UK	2014	0.461*	0.364	0.481
Concentration of exports to the world	2014	0.194	0.119	0.392
Concentration of imports from China	2014	0.077*	0.115	0.065
Concentration of imports from the UK	2014	0.123*	0.125	0.100
Concentration of imports from the world	2014	0.147	0.152	0.086

Note: All import data and Kenyan exports reported by partner countries; South African and sub-Saharan African exports reported by origin; * UNCTAD estimates; ** 2010 data.

Source: UNCTAD (2016) via UNCTADStat, 'International trade in goods and services'; TRALAC via UN COMTRADE (2015).

3.2.1 South Africa

There is a high degree of product concentration in South African exports to China while South African imports from China are much more diversified. In 2014, South Africa's top ten exports to China accounted for 94 per cent of total exports to China while the top ten exports to the UK accounted for 85 per cent of total exports to UK (ITC n.d.). The top exported products are mostly those with zero Chinese Most Favoured Nation (MFN) status (except for wool). There are some manufactured products that South Africa successfully exports to the rest of the world but not to China. The top exports to the UK are mostly products with zero tariffs but also agricultural products with preferences from the EU Trade and Development Cooperation Agreement.

Many imports from China and the UK carry high South African MFN tariffs.¹⁴ Moreover, in some of the top imported products from the UK, where the South African MFN tariff is zero,

¹⁴ South African MFN tariffs fell sharply between 1996 and 2004, stabilising thereafter around a mean of 7.5 per cent (World Databank 2015).

the UK data does not show a global comparative advantage, perhaps due to tastes or non-tariff barriers favouring the UK. China, meanwhile, faces tariffs higher than those extended to the UK. On the top 20 imported products, the average tariff paid by China was 18.4 per cent, while the UK faced a minimal 1.3 per cent in 2014 (ITC n.d.).¹⁵ It is clear that China successfully exports products even where South African tariffs are particularly high (for instance, in textiles).

Product differentiation coupled with global product manufacturing and distribution chains is important in the China–UK–South African case. In recent years, the Trade and Development Cooperation Agreement has served as a key feature of South African–EU trade, and as a central component of the EU, the UK has likewise benefited from this agreement. Conversely, there are no tariff concessions to China, and on the contrary, South Africa placed quantitative restrictions on imports in several lines of textiles and clothing from China during 2007 and 2008, and then increased tariffs after this measure proved ineffective. While the quotas restricted Chinese imports, they encouraged trade from other import sources rather than stimulating South African domestic production (Centre for Chinese Studies 2009).

Under the current scenario, with the exception of transport equipment, China is consistently outperforming the UK in the South African market. Between 2004 and 2014, the value of South African imports from China grew from US\$2.95bn to US\$15.7bn, a more than five-fold increase. By contrast, imports from the UK barely increased from US\$3.45bn to US\$3.92bn over the same period. Total South African imports, meanwhile, grew at an annual rate of 12.1 per cent, just slightly lower than the country's annual export growth of 12.5 per cent. For manufacturing, China's share increased from 8.21 per cent to 22.08 per cent while conversely the UK's performance declined from 7.16 per cent to 4.12 per cent (UNCTAD n.d.). Unquestionably, China is a highly competitive player in the South African manufacturing market. Only in transport did the increase in UK imports outperform the Chinese equivalent, while in no sectors did South African exports to the world outperform the equivalent imports from the world.

3.2.2 Kenya

In 2014, China just barely made Kenya's list of top 20 export destinations, with Hong Kong and mainland China respectively ranking 18th and 19th. That said, from 2004 to 2014, its share of Kenyan exports doubled, albeit to 1 per cent. China, meanwhile, was the largest source of imports in 2014, with a share of 22 per cent and a total value of US\$4.9bn in 2014. In contrast, the UK has seen its share decline by half as both a destination of exports and an origin of imports for Kenya – despite modest increases in these trade flows between 2004 and 2014 from US\$390m to US\$408m and from US\$343m to US\$672m, respectively. At the broadest product classification level, Chinese and UK exports to Kenya are in line with the Kenyan import structure. As for Kenya's export market, there is some evidence of divergence between what it exports to China and what it exports to the world. Over time, the composition of exports to China and the UK has grown more similar. When compared with import composition, however, it is still very distinct. Indeed, the top five exports from Kenya to China were leather, coconut fibres, copper, ores and scrap plastics; the top five exports to the UK were black tea, cut flowers, legumes, fresh vegetables and perfume plants.¹⁶

Kenya has maintained high tariffs on the top 20 Chinese imports, which include electronic equipment, machinery, vehicles, clothing and furniture. The top 20 products imported from the UK – also led by vehicles, machinery and electrical equipment – entail lower tariffs. Kenyan exports likewise face substantially lower tariffs in the UK than they do in China. For example, on Kenya's chief exports (i.e. tea, cut flowers and food products), the UK and

¹⁵ For all imported products in 2014, China faced an average tariff of 10.5 per cent while the UK paid 3.1 per cent (ITC n.d.).

¹⁶ The UK does not import these products from China; at the same time, China maintains high tariffs on tea and fresh vegetables.

China maintain average MFN tariffs of 0 per cent and 10 to 13 per cent, respectively. The UK largely imports products within these key export markets. It also accounts for a significant share of Kenyan service exports (30 per cent), especially transportation and travel. China, on the other hand, largely focuses on ores, leather and copper, and to a lesser extent, imports tea, food and cut flowers (ITC n.d.).

3.3 Chinese and UK investment

Although South Africa enjoys approximately one-third of total FDI stock in sub-Saharan Africa, in terms of annual FDI flows it is now closely followed by Congo, Mozambique and Nigeria. In contrast, foreign investment in Kenya has been exceedingly low, both for flows and stock, with 0.9 per cent of total FDI stock for sub-Saharan Africa in 2014 (see Table 3.4).

For South Africa, the UK serves as the dominant investment partner, maintaining US\$21bn in 2012 FDI stock. China follows some way behind the US and Switzerland with nearly US\$4.8bn in 2012 FDI stock, or almost 26 per cent of its total FDI stock in sub-Saharan Africa. Using the EDGE FDI Database, Gelb (2014) reported that there were more than 2,000 foreign operations in South Africa, of which only 74 (or 3.7 per cent) were Chinese, and that there were more than 3,500 operations of South African firms offshore, with about 1 per cent in China. For Chinese stocks in South Africa, the Industrial and Commercial Bank of China's 20 per cent holding in Standard Bank was the largest single holding, followed by six Chinese companies with investments in mining and metal manufacturing. Conversely, in 2010, only four South African companies had holdings in China: Bidvest, Sappi, Sasol and Naspers (Gelb 2010).

Kenya receives a marginal share of Chinese and UK investment flows, perhaps reflecting the former's lack of natural resources relative to the rest of the continent. In 2012, Chinese FDI stock in Kenya amounted to a meagre US\$403m. While the UK stock position in Kenya is double its Chinese counterpart, it is a mere twenty-fifth of UK stock in South Africa. Compared with the UK, China has devoted a slightly higher – but still tiny – percentage of its total FDI stock to Kenya. The small difference in FDI distribution is also reflected at the regional level, with China designating approximately 3.5 per cent of its total 2012 FDI to sub-Saharan Africa while the UK contributed not quite 1.5 per cent.

Overall, China is rapidly increasing its investment presence in Africa. This trend notwithstanding, inbound investment figures for Kenya – an agriculture-based economy – do not indicate a large buying up of land resources (Bräutigam 2015). Likewise, Gelb's findings do not support the idea of a growing Chinese 'intrusion' into South African industrial capabilities (2010, 2014). Indeed, with annual flows and total stock 2.5 times their Chinese counterpart, the UK still represents the principal investor in the region.

Table 3.4 Comparing Chinese and UK FDI in Kenya and South Africa

Measure	Year	Kenya	South Africa	sub-Saharan Africa
Total FDI flows (US\$m)	2014	989	5,712	42,948
Total FDI stock (US\$m)	2014	4,370	145,384	492,791
Chinese FDI flows (US\$m)	2012	79	-815	2,152
UK FDI flows (US\$m)	2012	-9	8,036	7,437
Chinese FDI stock (US\$m)	2012	403	4,775	18,552
UK FDI stock (US\$m)	2012	841	21,189	45,719
Chinese FDI stock (% of China total)	2012	0.08	0.90	3.49
UK FDI stock (% of UK total)	2012	0.05	1.23	1.46
Chinese FDI stock (% of destination total)	2012	14	2.9	4.2
UK FDI stock (% of destination total)	2012	29.24	12.96	5.63

Source: UNCTAD via UNCTADStat, 'Foreign Direct Investment', 2015; UNCTAD, 'Bilateral FDI Statistics', 2014; OECD via OECD.Stat, 'FDI Flows and Positions by Partner Country', 2015.

3.4 Chinese and UK development assistance

Development assistance comprises one of the most challenging forms of international engagement to assess and compare across countries. It has taken donor countries, through the OECD Development Assistance Committee, many years to agree on a definition of what constitutes official development assistance and how to measure it. Meanwhile, China largely operates outside the OECD governance regime, compelling the development community to reconsider current definitions and criteria.

Until recently, the Chinese government did not publish development assistance data. In 2011, the State Council issued its first white paper on China's foreign aid, presenting only aggregate data covering all years up until 2009. The second white paper, published in 2014, represented a modest improvement in transparency; nonetheless, it again contained only aggregate data for 2010–12 and did not include any specific statistics at the country level. Further complicating the situation, Chinese classifications of foreign assistance differ from those of the Development Assistance Committee, rendering some official data ineligible for comparison. At present, most figures for China's development assistance are estimates.

Given these data limitations, it is therefore difficult to compare Chinese and UK engagement in Kenya and South Africa across all development assistance indicators. In general, China's officially reported development assistance to Africa has risen rapidly over the last decade, reaching US\$7.5bn for 2010–12; the proportion of total assistance dedicated to the continent has also increased, from 45.7 per cent in 2009 to 51.8 per cent in 2012 (State Council 2011, 2014). For its part, the UK disbursed approximately US\$10.4bn in gross ODA to Africa over that same three-year period.

At the country level, there is only UK data available for development assistance (see Table 3.5). In 2014, the UK provided Kenya with about US\$216m in gross ODA, making the African nation its 11th largest recipient worldwide.¹⁷ To South Africa, it provided US\$79m in gross ODA in 2014.¹⁸ For Kenya and South Africa, the UK ranked as the second and fourth largest sovereign donor, respectively. Of its total ODA to sub-Saharan Africa in 2014 (US\$4.2bn), the UK dedicated 5.1 per cent to Kenya and 1.9 per cent to South Africa. For that year,

¹⁷ In 2014, the UK's net ODA to Kenya was US\$222.3m.

¹⁸ In 2014, the UK's net ODA to South Africa was US\$29.7m.

Ethiopia, Nigeria and Sierra Leone served as the top three recipients of UK ODA in the region.

For this study, there exists another important development assistance metric to consider: Aid for Trade (AfT). As mentioned in the previous section, China has played a key role in the WTO's Aid for Trade Initiative. Furthermore, throughout its overseas activities, the country has consistently emphasised its support of trade-related assistance and other forms of development finance that crosscut trade, aid and investment. Based on China's 2014 white paper, a very rough estimate of total Chinese AfT to the world would be about an average of US\$2.4bn per year from 2010 to 2012.¹⁹ Concurrently, global AfT has been increasing, and at a rate faster than that of total ODA disbursements. Between 2006 and 2014, global AfT doubled from US\$21bn to US\$42.5bn; over the same period, total ODA registered a negligible increase from US\$227bn in 2006 to US\$228bn in 2014 (constant prices).²⁰ The growing AfT share in total ODA suggests development partners are shifting their focus to economic development and in particular, to the role of export-led growth. To some extent, this trend may have resulted from China's success in using export-led growth to help reduce poverty.

The UK likewise has seen its AfT rise as a proportion of ODA, from 3.2 per cent in 2006 to 8.6 per cent in 2014.²¹ In total, it provided approximately US\$1.6bn in AfT in 2014, with US\$614.3m designated for sub-Saharan Africa. As for the two case countries, in 2014, the UK contributed US\$49.1m in AfT to Kenya; to South Africa, it provided US\$45.2m. For that year, Kenya and South Africa respectively received 8 per cent and 7.4 per cent of total UK AfT in sub-Saharan Africa. While the two countries received similar amounts of UK AfT, the UK constituted a far greater share of South Africa's total AfT receipts (13.3 per cent); in 2014, it contributed just 4.9 per cent of Kenya's US\$1bn in AfT receipts. It is clear, however, that for both Kenya and South Africa, UK AfT comprises an important part of total UK development assistance. Indeed, almost a quarter of UK ODA to Kenya is AfT, and more than a half is AfT for South Africa.

¹⁹ According to the 2014 white paper, approximately 50.8 per cent of the total development assistance budget for 2010–2012 (US\$14.4bn) was devoted to economic infrastructure, agriculture and industry – the key categories of AfT. For China, economic infrastructure included transport and communications, broadcasting and telecommunications and power supply; agriculture included agricultural technology demonstration centres, irrigation and water conservancy and agricultural processing; and industry included light industry and textiles, building materials and chemical industry and machinery and electronics.

²⁰ In 2007, global ODA disbursements declined to US\$175bn. Comparing 2007 and 2014, global ODA registered a more significant increase of 30 per cent – albeit still lower than global AfT's increase of 85 per cent over that same period.

²¹ Within AfT, the UK has primarily focused on economic infrastructure in transport and storage, energy generation and supply, agricultural productive capacity and banking and financial services.

Table 3.5 Comparing UK and global gross ODA and AfT disbursements, 2014

Measure		Kenya	South Africa	sub-Saharan Africa	World
UK ODA	Constant 2013 US\$m	216	79	3,918	18,572
	Annual % growth, 2006–2014	9.4	-1.4	-3.6	5.3
UK AfT	Constant 2013 US\$m	49.1	45.2	614.3	1,622
	Annual % growth, 2006–2014	64.5	58.8	78.2	35.1
Global ODA	Constant 2013 US\$m	2,968	1,296	46,994	227,811
	Annual % growth, 2006–2014	16.8	4.6	-6.4	0.04
Global AfT	Constant 2013 US\$m	1,043	340	11,292	42,517
	Annual % growth, 2006–2014	46.8	31.9	15.7	12.8

Source: OECD via OECD.Stat, 'Aid (ODA) disbursements to countries and regions' and 'Creditor Reporting System', 2016.

4 Opportunities, challenges and recommendations

Considerable potential exists for China–UK cooperation to boost trade and in turn facilitate poverty reduction in Kenya and South Africa. Bringing together the study’s framework with the current situation of its case countries, this section explores opportunities for China–UK cooperation in linking South Africa into global value chains, expanding investment in Kenya, facilitating trade among all four economies and sharing information.

4.1 Linking South Africa into global value chains

When carefully considering local economic conditions and requirements, integration into global value chains can raise productivity, create jobs and promote structural transformation (AfDB, OECD and UNDP 2014). This is particularly true for African countries that manage to increase the domestic value added in their exports as a percentage of GDP (*ibid.*). In 2011, about 57 per cent of South African exports were connected to global value chains through either backward or forward participation, making the country the tenth most integrated in Africa (World Economic Forum 2015: 73).²² According to the 2014 *African Economic Outlook*, South Africa has transformed into a ‘headquarter economy’ in Southern Africa, playing a key intermediary role similar to that of Germany in Europe and the United States in North America. Between 1995 and 2011, South Africa’s use of intermediates imported from its neighbours increased nine-fold while regional use of South African intermediates increased five-fold (AfDB *et al.* 2014: 26). For products that reached their final destination within the local market, the country’s financial and business services exhibited the highest proportion of domestic value added, with almost 90 per cent in 2009 (OECD 2013: 2). Whether through logistics, communications, insurance, product design or marketing, the services sector has also contributed significantly to South African manufacturing, representing 30 per cent of value added in manufacturing exports in 2009 (*ibid.*).

For their part, the UK and China can encourage firms to exploit the potentially important role of South African services and suppliers in global value chains. Specifically, they can explore whether any outsourced processes can be relocated to South Africa. Concurrently, investors can notify South African suppliers of outsourcing opportunities so that the latter can bid for the services and products in which they maintain a comparative advantage. That said, China and the UK should also consider opportunities in low-skilled activities, not just those industries where South Africa has a comparative advantage such as mining services.

South Africa’s key obstacles to building global value chains are primarily internal: low-skilled workers dependent on the informal economy need to be brought into more formal employment, a process even more important than the restoration of high-end manufacturing exports. An increase in ‘value added’ industrial exports from South Africa may require domestic policy interventions to stimulate job creation favouring low-skilled labour, at least initially. In the long run, enhancing skills will be a key challenge (AfDB *et al.* 2014: 161). There are products that South Africa – like Kenya – exports to the rest of the world, notably automotive products to the EU and Japan, but not to China. It is worth exploring opportunities for South African exports to China while ensuring that trade barriers do not harm domestic firms’ insertion into global value chains by increasing the costs of imported intermediates.

²² In 2011, the African continent represented 2.2 per cent of global value-added trade. Albeit small, this share has expanded by 60 per cent since 1995. In relative terms, just over 50 per cent of the continent’s total exports exhibited forward or backward linkages, making Africa the third most integrated region in global value chains behind Europe and Southeast Asia (World Economic Forum 2015: 73).

4.2 Expanding investment in Kenya

At present, South Africa serves as the continent's top destination for UK and Chinese FDI, with a combined total of US\$26bn compared to Kenya's US\$1.2bn in 2012. Nevertheless, Kenya exhibits modest growth and investment potential across a range of industries. For the most part, China and the UK have invested in different sectors of the Kenyan economy. While China concentrates on road and telecommunications infrastructure, the UK primarily supports the financial and professional services sector with more minor investments in renewable energy, education and aviation.

Given the significant demand for infrastructure construction and real estate in Kenya, these sectors could serve as an important area for collaboration among Chinese and UK firms. For large infrastructure projects, Chinese construction could be paired with British financial services to lower risk, attract capital and ultimately improve the overall investment environment. Indeed, for many Chinese firms in Kenya, infrastructure development has been a key determinant of a favourable business environment. In terms of infrastructure finance, China and the UK could cooperate through a variety of investment vehicles such as project bonds, project equity, joint contracting and co-financing.

The importance of infrastructure notwithstanding, it is crucial to stimulate investment in other sectors of the economy, particularly those sectors where additional scope for local sourcing can be found. Here, China has sought to support agricultural development and manufacturing. For its part, the UK could locate new opportunities for partnership in professional and financial services and lend its expertise in these sectors. To attract additional investment, Kenya faces some major obstacles. According to a survey conducted by CUTS Nairobi, Chinese firms' principal concern was corruption, while UK firms enumerated other issues, including taxation, energy costs and the rules and regulations governing business in Kenya.²³ For both countries' firms, security and acts of terrorism were also a major challenge. To help address this latter concern, the UK could consider expanding the Kenyan programmes it has implemented under the Building Stability Overseas Strategy. Together with Chinese and Kenyan partners, it could also organise joint trainings for peacekeeping forces similar to those held in Ghana.

4.3 Boosting trade and lowering barriers

Kenya is relatively less successful at penetrating the Chinese market than South Africa or sub-Saharan Africa as a whole, perhaps as a result of trade policy obstacles. Over the past decade, Kenyan exports have not increased in concert with the sharp rise in Chinese imports and non-resource investments. China is not importing much from Kenya, but is importing products from the rest of the world that also appear in Kenya's top 20 exports. Many Kenyan competitors receive preferences in China under the duty free treatment for least developed countries. Kenya faces MFN tariffs in coffee, tea, flowers and legumes while some of its African and Asian competitors benefit from preferential trade regimes. China could consider Kenya for similar GSP-type preferences,²⁴ even though such a decision could erode preferences for exporters in least developed countries. At the same time, the country's links with the UK remain strong but static. For the foreseeable future, the East African Community–EU Economic Partnership Agreement will serve as the foundation for UK–Kenyan trade relations. Nevertheless, potential implementation issues exist related to EU non-tariff barriers to trade and EU export subsidies, notably in agricultural trade.

Reducing non-tariff barriers to trade among the four partner countries could generate positive impacts for local livelihoods. Using World Bank data, Jensen and Sandrey (2015) simulated

²³ In 2015, Transparency International's Corruption Perceptions Index ranked Kenya 139 out of 168 in terms of how corrupt the public sector is believed to be by surveyed businesses and experts.

²⁴ GSP refers to the Generalised System of Preferences that exempts least developed WTO member countries from MFN tariffs. Least developed countries contribute a minor proportion of Chinese imports in coffee, flowers and vegetables.

50 and 20 per cent reductions in trade barriers and found welfare-enhancing effects for all partners – especially for South Africa and Kenya. The reductions also contributed to increases in exports, imports and employment opportunities. During the simulation, changes to trade barriers were made in isolation of any reductions to tariffs, infrastructural blockages and service-related business costs. If included, these three factors would likely have been additive to the current results and possibly of a greater level (Jensen and Sandrey 2015). In light of this simulation exercise, China and the UK should pursue further studies assessing whether there are significant non-tariff barriers in their respective markets for Kenya and South Africa.²⁵ The two countries could subsequently establish consultation mechanisms dedicated to trade barriers adversely affecting Kenyan and South African exporters. In addition, taking a long-term view, they could jointly conduct feasibility studies of Free Trade Agreements demonstrating a clear focus on development benefits.

As noted earlier, Kenyan and South African export success will depend to a large extent on improving local infrastructure, increasing agricultural productivity and building global value chains. China and the UK could consider cooperation on Aid for Trade initiatives in these areas. They could also work together to help Kenya and South Africa adapt to international standards and rules, improving their customs, tax, inspection and quarantine facilities. Furthermore, they could cooperate on regional trade integration projects, skilled worker training and the construction of economic and trade cooperation zones.

With regard to agricultural productivity, they could establish a China–UK–Africa policy research taskforce on agriculture and rural development. This has the potential to strengthen the training of skilled agricultural workers, help to set up specialised regional training centres and conduct food processing and agricultural commerce training. China and the UK could strengthen the popularisation of certain agricultural techniques and transfer technology to Kenya to help improve the level of agricultural mechanisation and agricultural machinery production as well as increase access to agricultural inputs such as fertiliser, pesticides, etc. They could also enhance agricultural infrastructure, improve the trading capacity of agricultural products, cultivate agricultural markets, help accelerate production times and reduce costs.

4.4 Sharing information and enhancing transparency

Across all of the opportunities described here, China and the UK should seek open dialogue and transparency. The UK has adopted an open and transparent strategy for development support, such that data on official flows to Kenya and South Africa is readily available online. Chinese data and information is much more limited, potentially complicating coordination efforts and placing undue burden on host governments to ensure transparency.

In the context of China–UK–Africa cooperation, it is thus essential to establish regular communication and share information among key stakeholders. At the government level, DFID, the UK Department of Trade and Industry and China’s Ministry of Commerce could set up a strategic platform for dialogue, hosting roundtable meetings periodically. These agencies could consider sharing less sensitive material for publication, such as Memoranda of Understanding with African partners. In addition to official communication, expert and academic exchange could enhance mutual understanding, increase transparency and create research synergies. Chinese, UK and African experts could hold seminars on major policy issues, such as on growth, competitiveness, innovation, cooperation and development as well as conduct joint research on novel methods for achieving poverty reduction in Africa. Collaborative research initiatives could be pursued in the fields of food and agriculture, physical and social infrastructure, trade, sustainable urbanisation, natural resource management and technology transfer.

²⁵ An earlier study identified significant sanitary and phytosanitary regulations and other barriers into China for South Africa (Sandrey *et al.* 2008).

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