POLICY BRIEF

AERC COLLABORATIVE RESEARCH CHINA - AFRICA PROJECT

ISSUE NUMBER 5| NOVEMBER 2010

# The Impact of China-Africa Trade Relations: The Case of Kenya

*Road construction in Nairobi, Kenya by Chinese contractors*

***By Joseph Onjala***

## Problem Investigated and the Issues

The increase in China's economic and political involvement in Africa is arguably the most momentous development on the continent today. One of the more contentious issues surrounding Sino-African relations involves trade. Although Africa and China have been trading with each other for centuries, the level and intensity of their trade relationship have increased dramatically since 2000. In the process, China has become a major destination for a range of African exports as well as an increasingly significant source of a wide range of manufactured goods imported by many African countries. The trends and patterns of trade between China and Africa suggest many possible impacts. On the one hand, Africa can take full advantage of the large size and the high growth rate of the Chinese economy, to diversify the direction and structure and increase the volume of its exports. On the other hand, Africa needs to respond to the import competition and falling prices, induced by Chinese exports of manufactured goods, which may not only displace exports in third country markets, but also decimate manufacturing production in domestic markets.

In response to the above research and policy issues, this research was conceived to undertake an in-depth analysis of the key features and patterns of the past, current and future evolution of the trading relations between Kenya and China. The specific objectives of this study are:

- Identification and analysis of the key features, patterns and developments in the main channels through which the impacts of the growth of China are transmitted to Kenya.
- Qualitative and quantitative evaluation of the nature, dimensions and magnitudes of the sector-specific and overall incidence of the impacts transmitted to Kenya over 1980-2007 or as far as the data will permit.
- Identification and analysis of the sector–specific opportunities and challenges faced by Kenya as a result of the impacts generated through the growth of and economic relationship with China.
- Provide scenario analysis of different "futures" in the evolution of the growth of China and the economic relationship with Kenya.
- Articulation and analysis of appropriate Kenya specific and sector –specific policy responses and overall development strategies for maximizing the benefits and confronting the challenges emanating from the economic relationship with China.

## Method of Analysis

### *Import trading patterns for Kenya and partners*

Kenya's structure of the import bill shows that the dominance of the EU as Kenya's import partner has been declining in the last 10 years while those of India and China have been rising gradually. On the other hand, import trading between Kenya and China has been rising rather rapidly, with China now becoming an important import partner. The import trading between Kenya and other East African countries have remained depressed over time as seen in Figure 1.

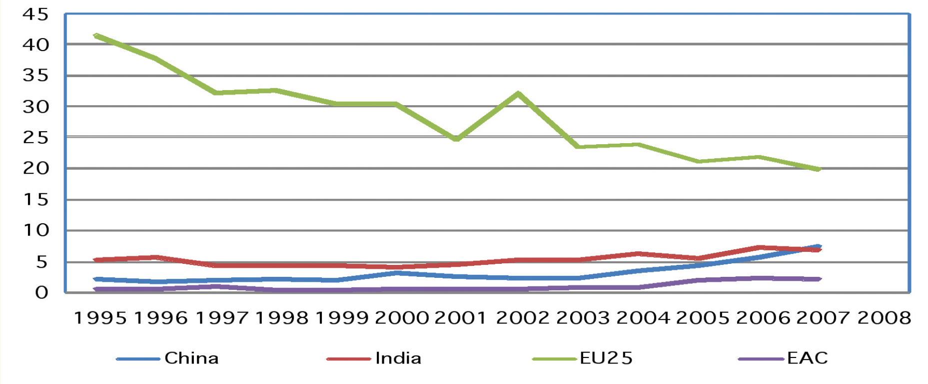
### *Trade balance for Kenya with China*

As shown below, the pattern of Kenya's trade balance with China is that of a rapidly growing deficit.

## Analysis of Trade Impacts

A widely adopted framework for analysis of trade impacts distinguishes among direct and indirect effects of trade relationships between developing countries and China. Direct

**Figure 1: Kenya Trading Partners as % income**




*Source: Calculated from Value/Quantity data from UN Comtrade database, March 2010.*

and indirect impacts are further divided into complementary (+) and competitive (-) effects. These are:

- Growth of exports to China (+): to the extent that the expanding Chinese economy offers a rapidly growing market opportunity, Kenya's export products that China imports stand to gain, if it is able to take advantage of the market opportunity.
- Welfare gains for consumers from cheaper manufacturing goods (+): Kenya's imports that China exports may gain to the extent that expanding Chinese exports are associated with falling prices. The potential trade-related gain takes the form of increasing welfare derived from the consumption of cheaper imported products.
- Increased competition from China for Kenyan exports to third markets (-): Kenya's export products that are the same or similar to those exported by China are likely to suffer a trade-related loss because they will face stiff export competition in third-country markets such as regional markets.

Our study adopted a three – pronged analytical framework to capture both the direct and indirect impacts of China-Kenya trade relations. In our assessment of the above effects, we have analysed comparative advantage; export price similarity, and market penetration. Furthermore, in order to validate the welfare gains for consumers, we conducted a survey to learn about the welfare implications of various Chinese consumer products.

We have used secondary data, enterprise surveys and in-depth interviews of key informants/ stakeholders to capture the impacts. The main source of secondary data was the United Nations COMTRADE statistics. The data has been used to track trade between China, Kenya and the regional market (East African Community). The other sources of data included interviews and published information from international sources, Government Printers, Kenya National Bureau of Statistics, Ministry of Trade and Industry, Investment Promotion Centre, and Kenya Revenue Authority - Customs. The interviews targeted Chinese Embassy / Trade Mission, Kenya Association of Manufacturers (KAM), Ministry of Planning and National Development and other government departments such as Export Promotion Council. Other sources of data included the specific sectors importing Chinese products such as shops, business enterprises for example: footwear and headwear; textiles and clothing; batteries; office supplies; household electric appliances; industrial and agricultural tools; commodities for daily use; and building materials. Also covered are the sectors exporting products to China such as: hides and skins, sisal fibre, tea, fishery products, and scrap metals.

# Key Findings

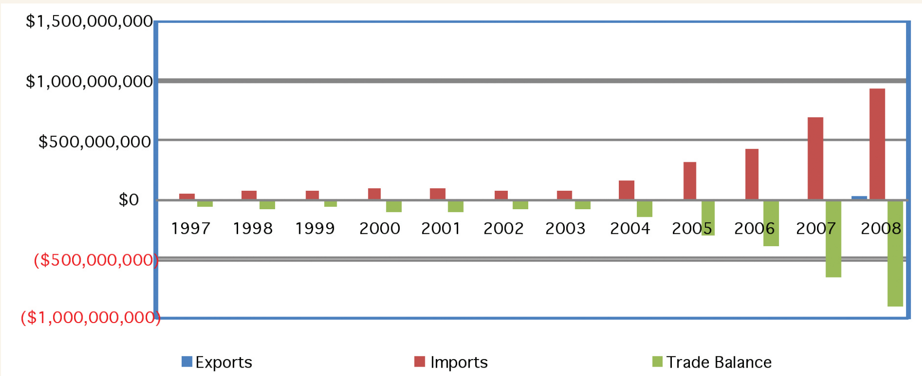
## *Trading patterns*

Kenya's exports to China are still small but growing gradually. The major exports are tea, leather, sisal fibre, fish, and scrap metal. An analysis of the trends and patterns of Kenya's exports growth to China suggests many impacts: Tea exports to China are still a small proportion of Kenya's total export market constituting less than 1%. China remains the leading sisal export market for Kenya. However, China takes only about 4% of the total export value. Kenya's sisal fibre is valued highly because of its quality and is an input in high quality carpets, special paper, etc, in Kenya. The sisal exports thus generate the highest benefit to the export destination.

In the leather subsector, Kenya's raw hides and skins (HS4101) exports to China rose from 6% ($357,482) of total hides exports in 2000 to 33% ($2,988,285) in 2005. In 2008, the proportion had declined to 10% ($55,876) following an imposition of levy on exports of raw hides and skins. Exports of leather of bovine or equine animals to China have increased in value but substantially declined as proportion of the total export value to the world. The proportion of sheep or lamb skin exports to China have been stable over the years. In 2000 the exports were valued at 37,693 (1% of total product exports) while in 2008 it had increased to $79,871. Exports of goat or kid skin leather to China have also experienced phenomenal growth both in terms of export value and proportion of total exports.

China is not the traditional export destination for Kenya's scrap metal exports. In the last 10 years, however, the growth of Kenya's scrap metal

**Figure 2: Kenya Trade Balance with China (1997-2008)**




*Source: Calculated from Value/Quantity data from UN Comtrade database, March 2010.*

exports to China has been phenomenal. Copper export growth has risen more than aluminum exports. Kenya's fish exports to China have been subject to many fluctuations. Kenya's fisheries export products may be in high demand in China, and thus Kenya stands to gain from rising prices and increased export earnings. Nevertheless, prospects for expanding exports of fish fillets to China appear to be very low. This is primarily because of the constraints imposed by the local environmental conditions and lack of investments to ensure sustainability of the resource. The fisheries sector remains underdeveloped while the fishermen have remained impoverished.

Overall, the export trends and patterns of Kenya's major export products to China suggest that the trading relations have been beneficial to Kenya especially in affording the country participation in the international market and also in supporting economic activities through backward linkages (employment, and overall development). The export trading has been majorly on primary commodities some of which could be critical inputs in Kenya's own manufacturing sector.

Kenya's major imports from China comprise organic chemicals; pharmaceuticals products; knitted or crocheted fabric; footwear; ceramic products; iron and steel; electrical and electronic equipment; and vehicles other than railway. In terms of value, the leading imports are electrical and electronic equipment; followed by vehicles; iron and steel; knitted or crocheted fabric and ceramic products; in that sequence. Kenya also locally manufactures ceramic products, knitted or crocheted fabric and footwear, thus the imports from China are in direct competition with local manufacturing industries. Kenya's competitiveness in footwear is much lower than China; Kenya has a comparative disadvantage in knitted or crocheted fabrics while China has been able to gain a comparative advantage in the last 10 years. Kenya's trade with China presents an opportunity for a wide range of goods in the local market. However Kenya is one of the countries where counterfeit products are widely found in the market.

### *Perceptions of Consumers*

Despite the misgivings about the Kenya-China trading relations, perceptions of 400 consumers in Nairobi is generally positive on Chinese products.

- Perceptions of impacts of Chinese products tend to be similar across different consumer age and income groups.
- Most respondents indicate that they purchase or trade in Chinese products either occasionally or many times. Frequency of purchase is uniform across all income groups, suggesting that the products appeal to all segments of the market.
- Overall, Chinese electronics attract the largest market in Nairobi (and other parts of Kenya), followed by footwear and textiles. Electronics is purchased irrespective of the level of education.
- The footwear purchase decreases with the level of education in Kenya. Textiles are purchased by the largest proportion of primary, secondary and diploma holders. These observations might suggest that the more educated might be inclined to better quality and perhaps other more expensive brands of shoes.
- Most respondents perceive the products to be affordable, providing business opportunity, and providing a variety of products in the market. In addition, they also provide employment opportunities to Kenyans. Very few respondents think that there is loss of employment or business opportunities. Most respondents think that the goods are of inferior quality compared with other products.

### *International and regional Competitiveness*

The revealed comparative advantage (RCAs) – thus, competitive advantage – for various products in Kenya and China are relatively constant over time. Over the 10-year period, there are a few products where comparative advantage has been lost for Kenya and where advantage has been gained for China.

- China has a comparative advantage in the textiles, footwear and fabrics. On the other hand, Kenya has comparative advantage in the hides and skins products, and in sisal fibre, copper waste and scrap metal, and soap. It should therefore be expected that Kenya is able to export these products to China. Vice versa, a large part of the Chinese exports in Kenya and regional market comprise textiles and footwear.
- China's comparative advantage is increasing for soaps and paper products suggesting a possible threat for Kenya in the regional market. On the other hand, Kenya's comparative advantage is increasing for leather of bovine and sheep or lamb skin.
- The sector that has decreasing advantage for China is mainly in hides and skins. This is unlikely to impact on China in any way given that Kenya is a minor trader in the sector.
- Kenya's decreasing advantage in hides and skins could be attributed to recent government policy to deliberately discourage exports of raw hides and skins in order to protect the local tanneries and promote value addition.
- Even though comparative advantage is declining for some sectors in China, none of the sectors analysed with comparative advantage in the past have disadvantage at present. For Kenya, a number of sectors with advantage in the past, are having disadvantage at present (raw hides and skins and woven cotton).

### *China's impact on Kenya in the regional market*

- Kenya faces competitive price pressure from China in the regional market for manufacturing, especially textiles, clothing and footwear, and soap, potentially displacing the manufacturing exports of Kenya in Uganda and Tanzania.
- Kenya's global price competitiveness appear to be improving only in the hides and skins subsector; products that are not suited for regional markets. Kenya also seems to be more competitive in tea, leather, raw skins, aluminum waste and sisal.
- Kenya's prices are worsening for paper products, soap, and woven fabrics in the regional market. The price is improving in the regional market for tissue paper products.

## Policy Implications/ Lessons from the findings

## Policy Implications for:

### a) Domestic Market

- The availability of cheap Chinese products has been a welcome development for many consumers who find them affordable despite their poor quality. In a sense, this has been a source of relief from economic and political pressure.
- Kenya's trade with China also presents an opportunity for skills transfer and possibility of upgrading local enterprises. The extent of this possibility has been created by the leveraging of local enterprises in Kariobangi Cottage Industries on manufacturing of similar products.
- Exports of scrap metal to China represent a loss to the extent that the Kenyan manufacturing industries are denied the capacity to develop similar capabilities. Moreover, the demand for scrap in China has for sometime spurred vandalism in Kenya's local infrastructures such as power cables, and the railway lines which suffered the greatest impacts. Other scrap metals that have suffered include lead in battery manufacture.

The presence of substandard and counterfeit goods in the Kenyan market has adverse effects on the lives of unsuspecting consumers. The flooding of counterfeit products in the local market reduces the entry of genuine products, making fair competition impossible.

### b) Regional Integration

- Given the rapid penetration of Chinese manufactured exports to the East African market, prospects for Kenya's industrialization could be in jeopardy.
- Kenya could negotiate for protective measures within the trading bloc in order to deal with the threat of cheap imports from China.

### c) International trade

- China has a comparative advantage in the textiles, footwear and fabrics. On the other hand, Kenya has comparative advantage in the hides and skins products, and in addition, she has a comparative advantage in sisal fibre, copper waste and scrap, and soap. It should therefore be expected that Kenya is able to export these products to China. Vice versa, a large part of the Chinese exports in Kenya and regional market comprise textiles and footwear.

## Policy Recommendations

- Kenya should ban or impose heavy taxes on exports of scrap metal, especially those that contribute to vandalism or shortages of raw material for local industries. These should include copper and aluminum scrap.
- A common approach needs to be fostered by the East African Community in their trading engagements with China. In particular, since Kenya is likely to be the biggest loser, it should take a leading initiative to pursue the matter.
- Kenya needs to further exploit its competitive advantage in tea, leather and sisal exports to China. She could leverage for establishment of more Chinese value addition ventures locally. In the case of the leather industry, technology remains the biggest constraint to exploiting this niche.
- Similar to the case of tea exports, there is need for sisal producers and exporters to leverage for the establishment of value addition enterprises rather than continue in the path of primary exports to China.
- Indeed the expanding trade between China and the regional market in Eastern Africa provides a direct threat to the future viability of the economic integration for Kenya since the process is likely to erode many of the trading/manufacturing benefits envisaged during conception. This possible loss of market for Kenya needs to be addressed squarely by Kenya in the preferential trading regime.

AFRICAN ECONOMIC RESEARCH CONSORTIUM (AERC)
CONSORTIUM POUR LA RECHERCHE ECONOMIQUE EN AFRIQUE

The African Economic Research Consortium (AERC), established in 1988, is a public not-for-profit organization devoted to advanced policy research and training. The principal objective is to strengthen local capacity for conducting independent, rigorous inquiry into problems pertinent to the management of economies in sub-Saharan Africa. In response to special needs of the region, the AERC Research Programme has adopted a flexible approach to improve the technical skills of local researchers, allow for regional determination of research priorities, strengthen national institutions concerned with economic policy research, and facilitate closer ties between researchers and policy makers. The Training Programme augments the pool of economic researchers in sub-Saharan Africa by supporting graduate studies in economics, as well as improving the capacities of departments of economics in local public universities. AERC is supported by donor governments, private foundations and international organizations. Further information concerning AERC and its programmes can be obtained from:

The Executive Director
African Economic Research Consortium
Middle East Bank Towers, 3rd Floor
Milimani Road
Tel: (254-20) 273-4150 (pilot line) / 273-4157 / 273-4163
Fax: (254-20) 273-4173
Email: exec.dir@aercafrica.org
Website: www.aercafrica.org

www.aercafrica.org