

# Follow the Maritime Silk Road

*- Why China's Belt and Road has an East Africa focus.*

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*MARITIME ORDER IN THE INDIAN OCEAN*

*DEAKIN UNIVERSITY, APRIL 30-MAY 1, 2018*



# Introduction: Me, Econ, China and Africa

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## **1. Australian and British national**

- Not of the political “South”, but of the geographic ‘south’.

## **2. Learned Chinese and studied regional economics (BA/Bcom, Melb)**

## **3. MSc Development Economics (SOAS, London); then:**

- ODI Fellow (economist), Ministry of Finance Guyana (2004) and Sierra Leone (2005)
- Global Leadership Fellow, World Economic Forum (Geneva), 2005-07

## **4. PhD in Economics, Peking University (Chinese language program)**

- Thesis: China/Africa trade and economic geography study
- Spent year of research in Washington at World Bank

## **5. University of Melbourne (Jan 2015- March 2018).**

## **6. World Bank Beijing office, Short-term Consultant (April-June 2018)**

# Presentation Overview

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- 1. China's Contemporary Economic Challenges - and the BRI**
- 2. Why is Africa, and East Africa in particular, in focus?**
- 3. What Implications for Australia?**

# 1. China's economy and the BRI

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1.1 Contemporary economic challenges

1.2 Net FDI and Demographic transitions

1.3 China as 'old before rich'

1.4 Looking to new frontier 'young and poor' countries

1.5 New importance of foreign aid and development finance

1.6 Belt and Road

# 1.1 China's economy today

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## **China's economy is enormous, and slow(er)**

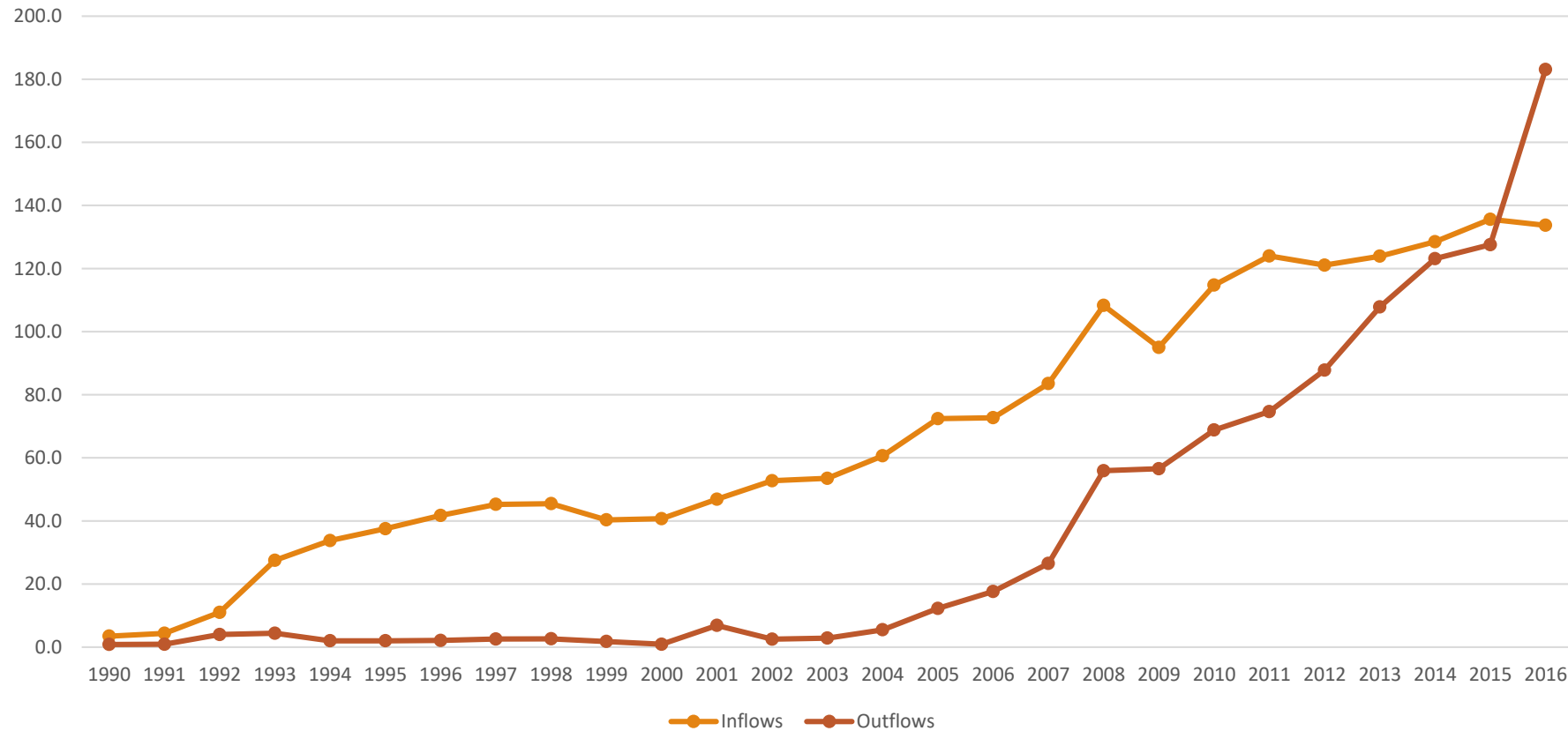
- USD11.9trn in 2017 (eg. Germany: 3.7trn) (growth of 6.9% last year)

## **But, structural imbalances**

- Fall in export demand following GFC
- Excessive heavy industrial capacity, esp. steel and infrastructure
  - Thanks to former labour and capital-intensive growth model
- In 2013 US\$4 trillion in foreign-exchange reserves earning <1%pa
  - Given then expected RMB appreciation against USD, the return in fact was negative
  - Long-term trend of rising outbound relative to inbound investment
- Second largest economy, but limited role re financial services or RMB
- Shifting away from energy and labour-intensive production



# 1.2 Foreseeable net FDI transition



China's outbound FDI was rising anyway.

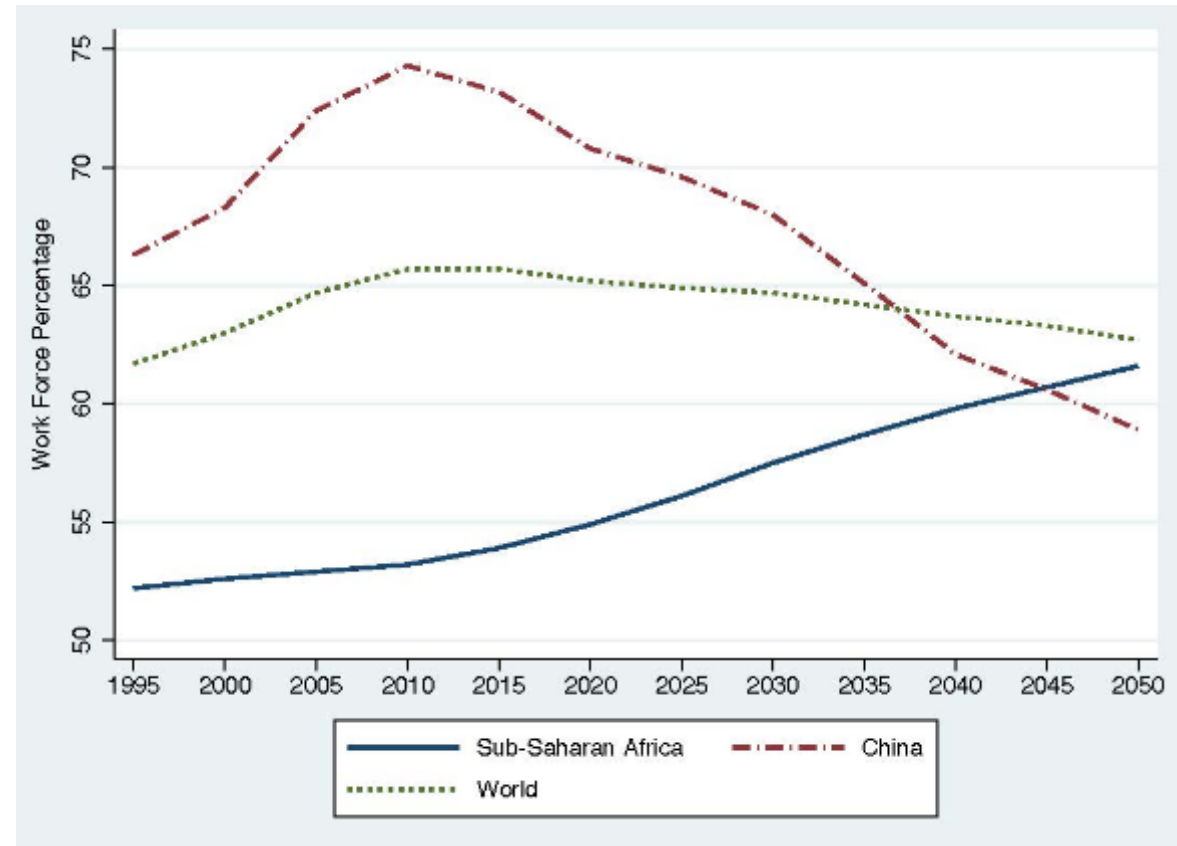
BRI as an umbrella plan under which to institutionalize outbound foreign direct investment from China.

Source: Johnston (2018) (data from UNCTAD, 2017).

# 1.3 Demographic transition

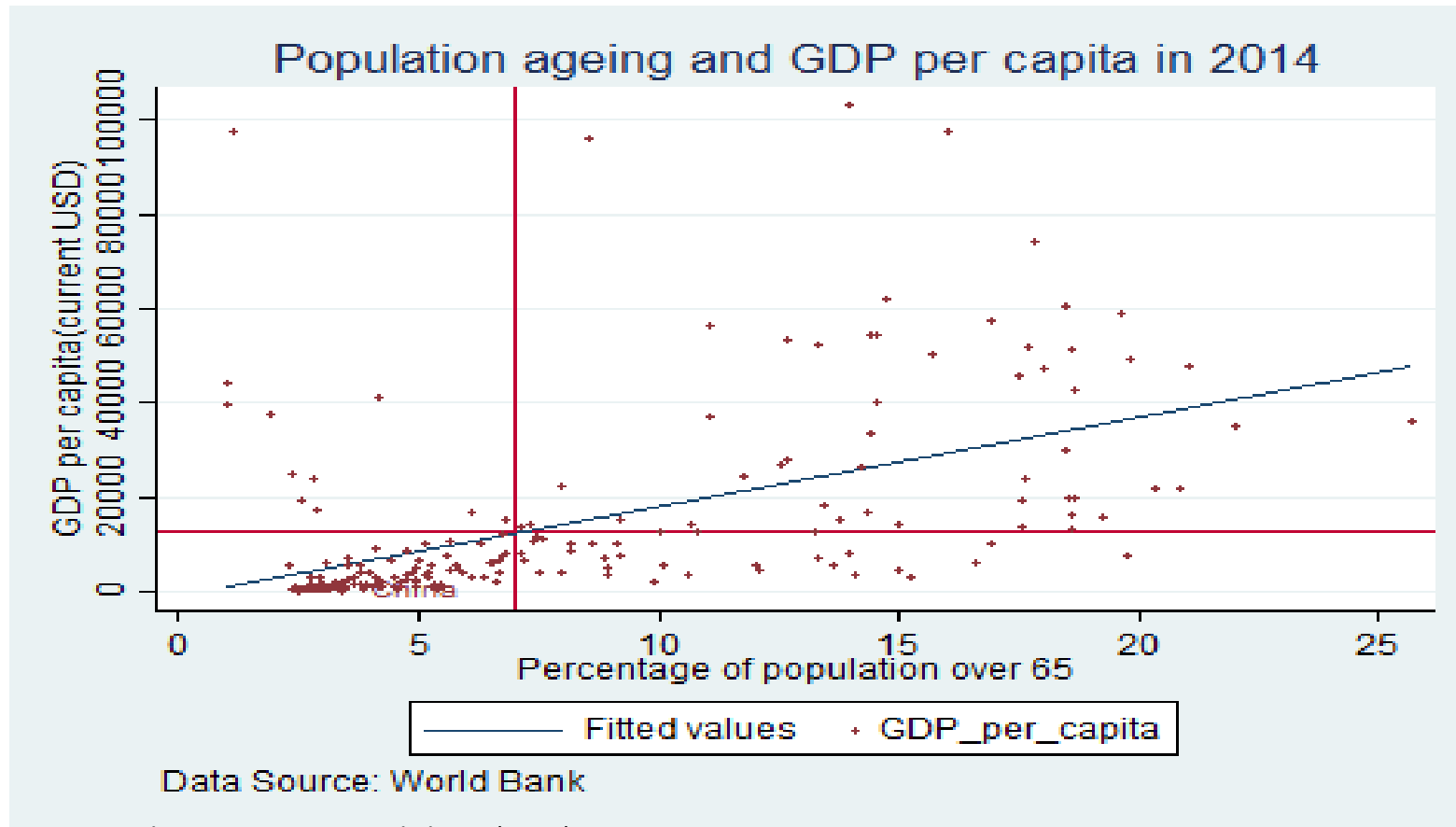
## = Loss of low-wage advantages

- Fertility rate below replacement level since around 1990
- China's revealed comparative advantage index for labour-intensive goods was 4.4, in 2003
- Workforce share population falling since around 2011
  - 100mns of old to provide for over coming decades
- New entrants better educated than retiring workers (old before rich)



Source: Johnston 2015b.

# 1.4 China is 'old before rich'



Source: Johnston, Liu, Yang and Zhang (2016).

Old =  
share of pop. >65yrs >7%

Rich =  
per capita income  
 $\geq$  USD12,475  
(high-income)



# 1.5 Demographic transition

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- China's 400mn millennials: "will not and cannot make the world's shirts. Innovation is the key to this young generation pushing China past the middle-income trap" (NY Post, 2018)

*"Old Era"*

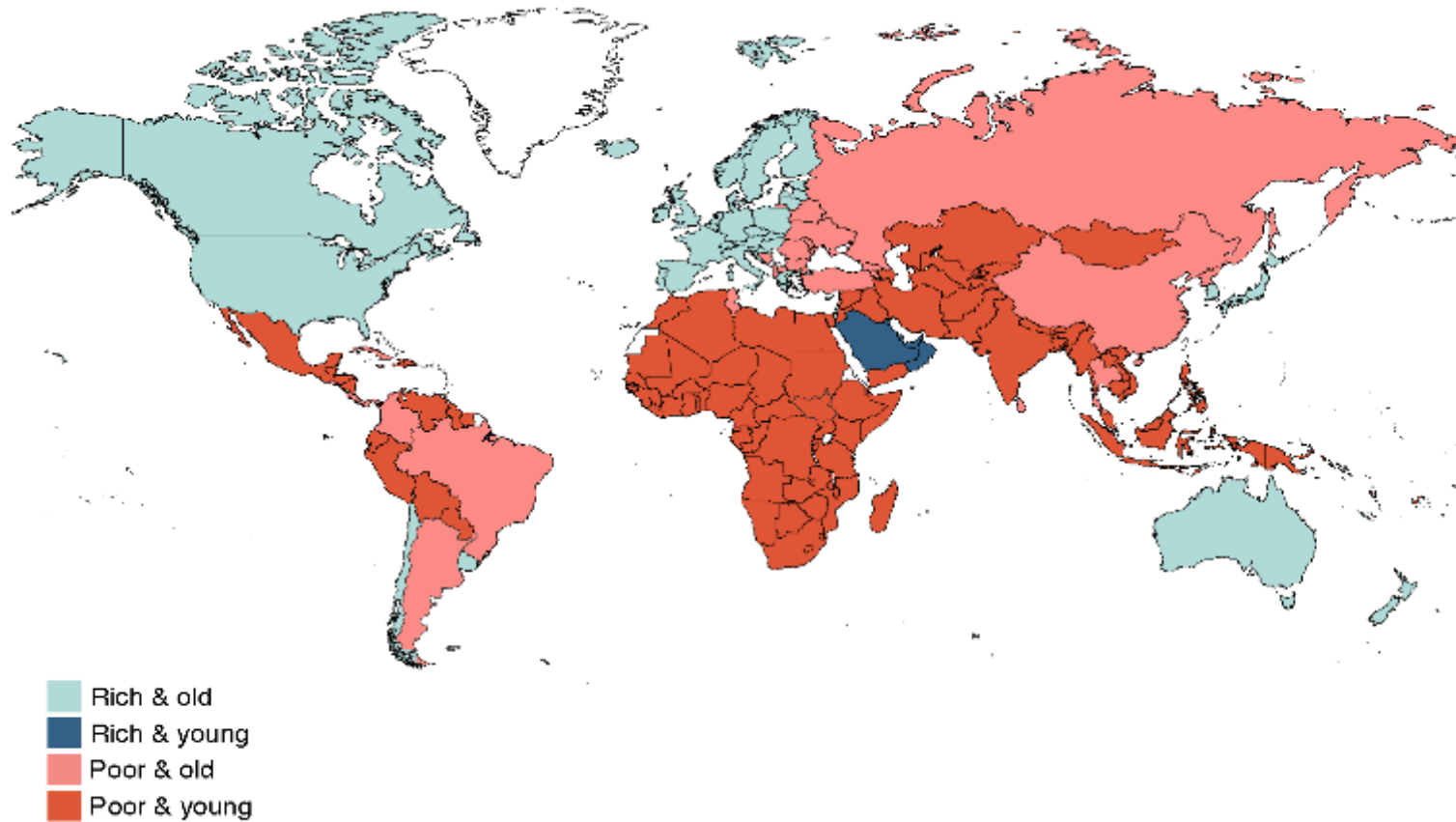


*"New Era"*



# 1.6 Demographic transition

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Countries by four economic-demography typologies:

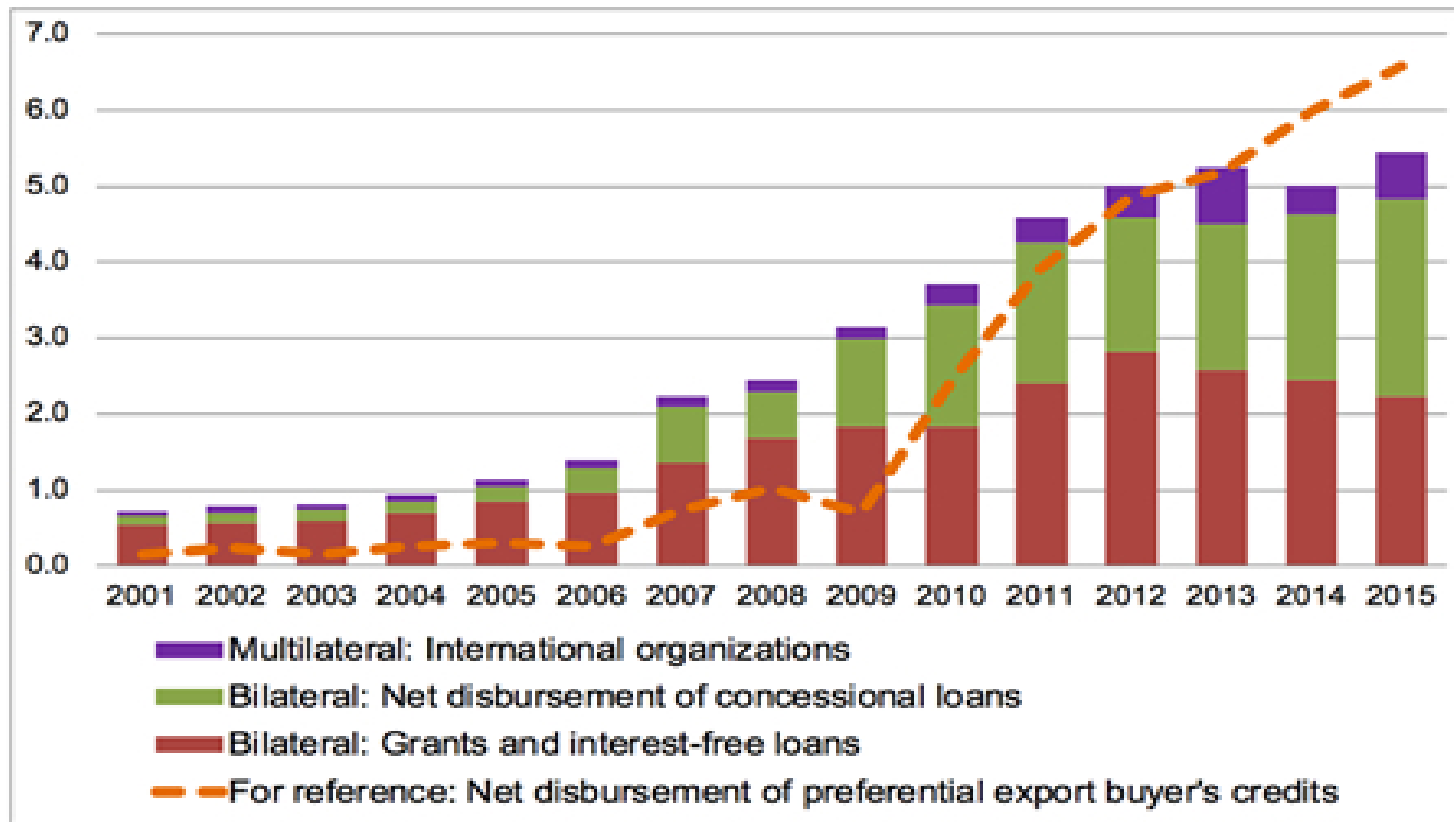
Old = share of pop. >65yrs >7%

Rich = per capita income  $\geq$  USD12,475 (high-income)

China is 'old' and seeking low-hanging fruit growth in younger lower-cost demographic frontiers (the places where shirts for export may be optimally now made)

See Johnston, Liu, Yang and Zhang (2016); Johnston (2017).

# 1.7 New importance of foreign aid



China has followed Japan, one of its earlier aid donors/lenders, in linking aid, trade and investment.

In 2015, was a donor equivalent in size to Holland.  
(Kitano, 2016)

Source: Kitano (2016), cited in Johnston and Rudyak (2017).

# 1.8 New development finance/aid institutions

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- In 2017 President Xi stated that China must “optimise the strategic layout” of its foreign aid (SCMP, 2017)
- In March 2018 a new foreign aid agency was launched, the **State International Development Cooperation Agency (SIDCA)**:
  - Answers to China’s highest executive, the State Council and ends MOFCOM/MFA fragmentation
  - Charged with enhancing the strategic planning and coordination of China’s foreign aid, including integration of China’s aid and the BRI.
  - Congruent with ‘foreign-aided’ investment plans of the BRI, Wang Xiaotao, a former Vice-Minister of the National Development and Reform Commission with deep experience of China’s outbound investment as the inaugural head of SIDCA (Sina, 2018).
- On top of AIIB, South-South Fund, New Development Bank, Silk Road Fund....

# 1.9 BRI from launch

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## ➤ Kazakhstan, Sept 2013:

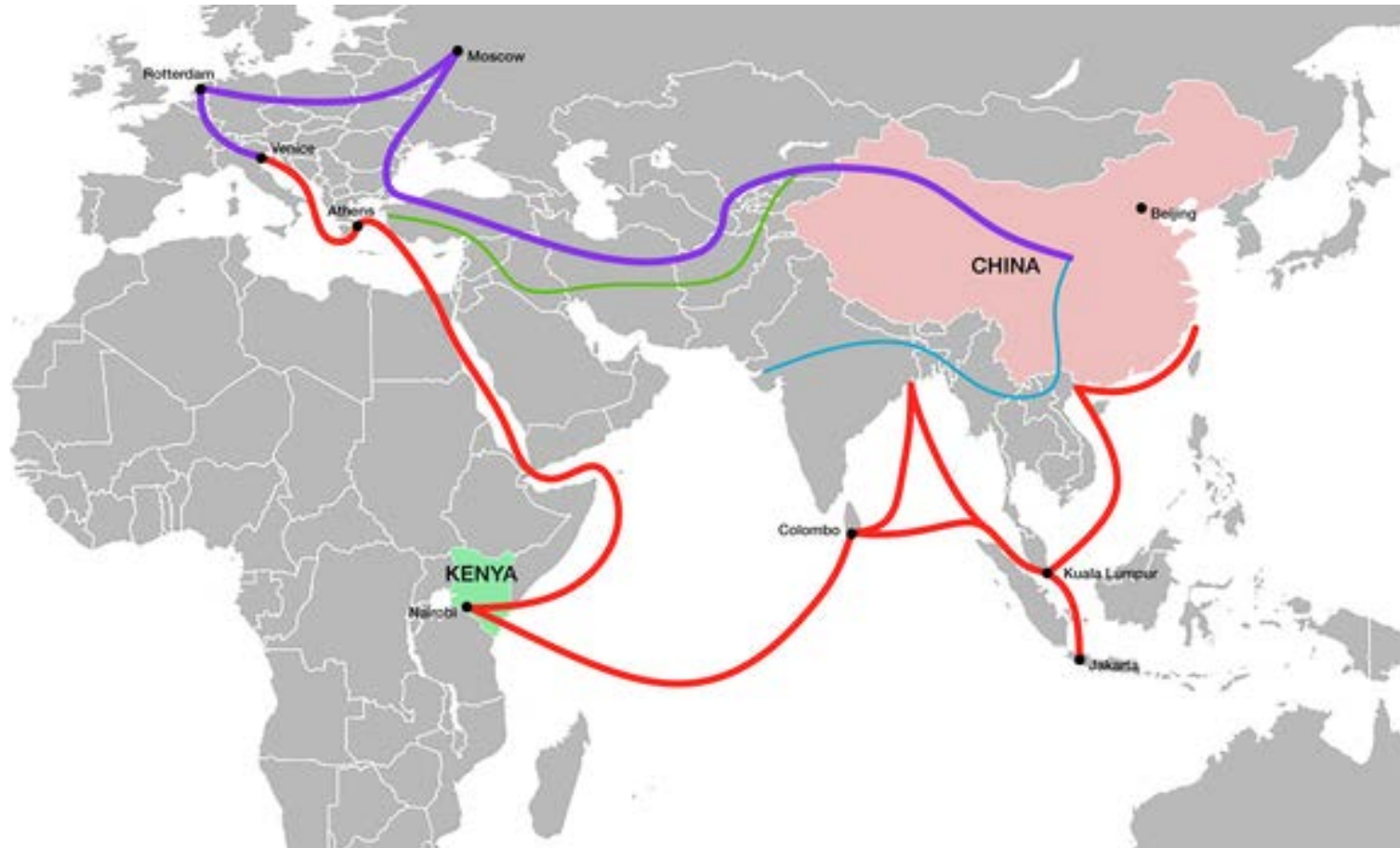
- Xi announced a “Silk Road Economic Belt”.
- Mentioned four areas of cooperation that this “Belt” would entail: 1) policy communication, 2) improved infrastructural connectivity, 3) trade promotion; 4) enhanced monetary circulation.

## ➤ Indonesia, Oct 2013:

- Xi proposed China-ASEAN nations partnership that would build a “Maritime Silk Road of the 21<sup>st</sup> century”.
- Noted China as ready to expand its practical cooperation with ASEAN countries:
  - ‘supply each other’s needs and complement each other’s strengths, with a view to jointly seizing opportunities and meeting challenges for the benefit of common development and prosperity’ (Xi, 2013).

# 1.10 Markets 'old' and 'new' (young)

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Belt (land):  
***“Markets Old”***  
(geopolitics and domestic inequality )

Road (sea):  
***“Markets New”***  
(economics)

Image source: author's own copyright.

# 1.11 BRI in words (2015)

Area of cooperation	Details
Strengthen policy communication	Communicate with each other on development strategies, and make plans and measures for regional cooperation through consultation
Improve road connectivity	To open up the transportation channel from the Pacific to the Baltic Sea, and to gradually form a transportation network that connects East Asia, West Asia, and South Asia
Promote trade facilitation	All parties should discuss issues concerning trade and investment facilitation
Enhance monetary circulation	All parties should promote the realization of exchange and settlement of local currency, increase the ability to fend off financial risks and make the region more economically competitive in the world
Strengthen people-to-people exchange	Strengthen people-to-people exchanges. All the parties should strengthen the friendly exchange between their people-to-people exchanges. All the parties should strengthen the friendly exchanges between their peoples to promote understanding and friendship with each other.



# 1.12 Experimental China-inclusive globalization

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## **A few thoughts:**

- Domestically “BRI” is a label via which difficult change can be introduced
- Internationally, is a label given to the process of accommodating China into the international order
  - From economics, to global norms, to people, to culture.

## **No roadmap for that process:**

- Probably fair to consider that process the outbound/globalization equivalent of the phrase that Deng Xiaoping used to summarize China’s ‘opening and reform’ process:
  - Crossing the river by feeling the/for stones.



## 2. Why is (East) Africa in focus?

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**2.1 China's supply meets Africa's demand?**

**2.2 Demography**

**2.3 History**

**2.4 Economic Geography**

**2.5 Institutions**

# 2.1 Economic complementarity

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## China:

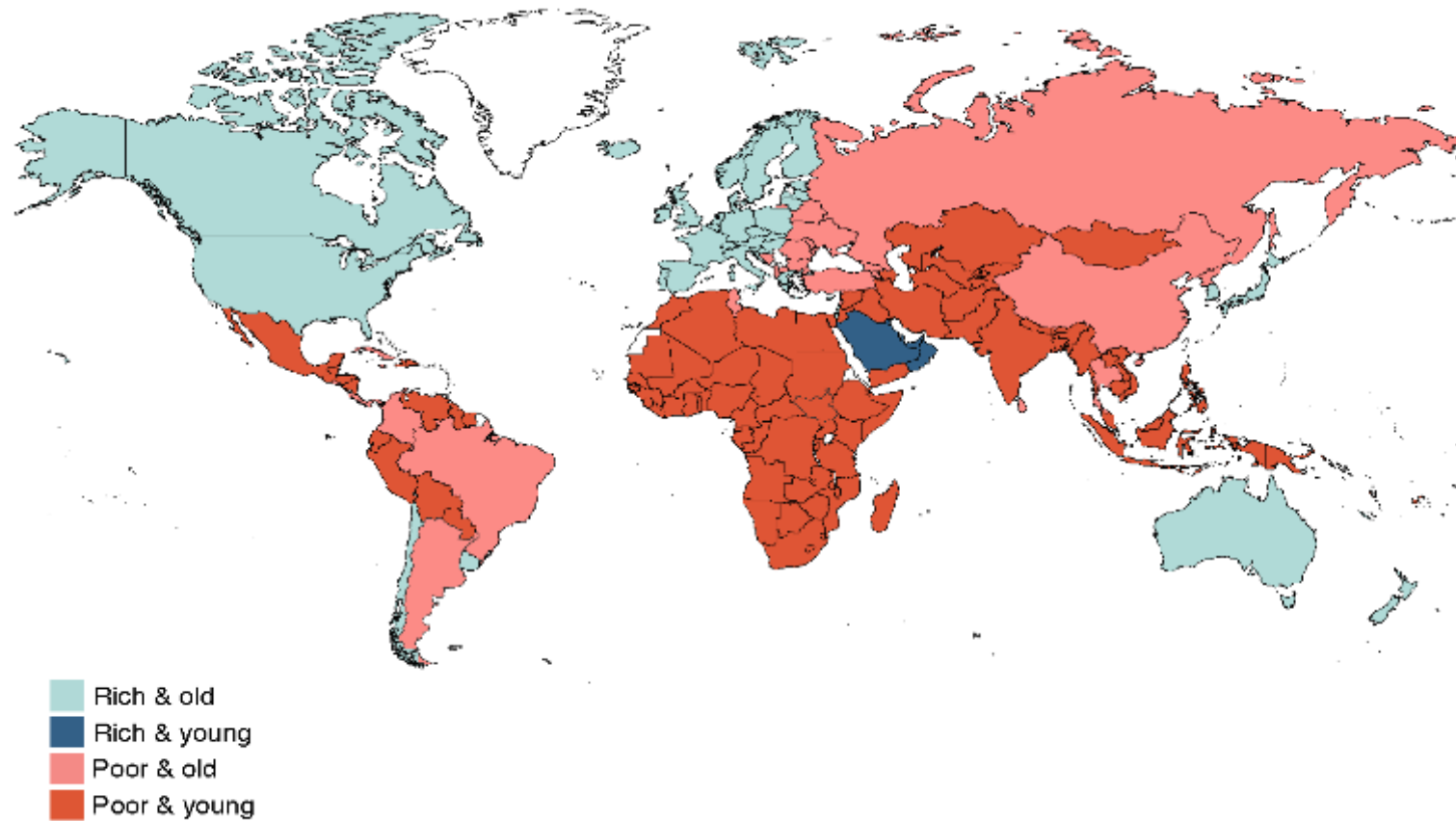
- Excess savings earning low return; excess industrial capacity; rapidly ageing population and diminishing low-wage advantages, etc.

## 'Africa':

- Highest number and density of 'poor and young' countries
- Generally insufficient growth to raise per capita incomes (World Bank, 2017: 7).
- Lags other developing regions on virtually all dimensions of infrastructure performance (ibid).
  - Telecoms infrastructure improved dramatically since 1990, but road/rail lagged; road density declining over the two decades to 2011 (ibid).
  - Infrastructure gap estimated to slow region's growth by some 1.2 percentage points annually (World Bank, 2017: 71). Improving existing infrastructure would add a further 0.5 percentage points to growth (ibid).
- *Infrastructure combined with youthful demography could create massive market over next few decades, for Chinese (and other) goods, technology, etc.*

## 2.2 New 'young and poor' frontiers

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The 'young and poor' (ie, prospective low-wage demographic dividend returns of next few decades are along the Maritime Silk Road.

Source: Johnston, Liu, Yang and Zhang (2016).

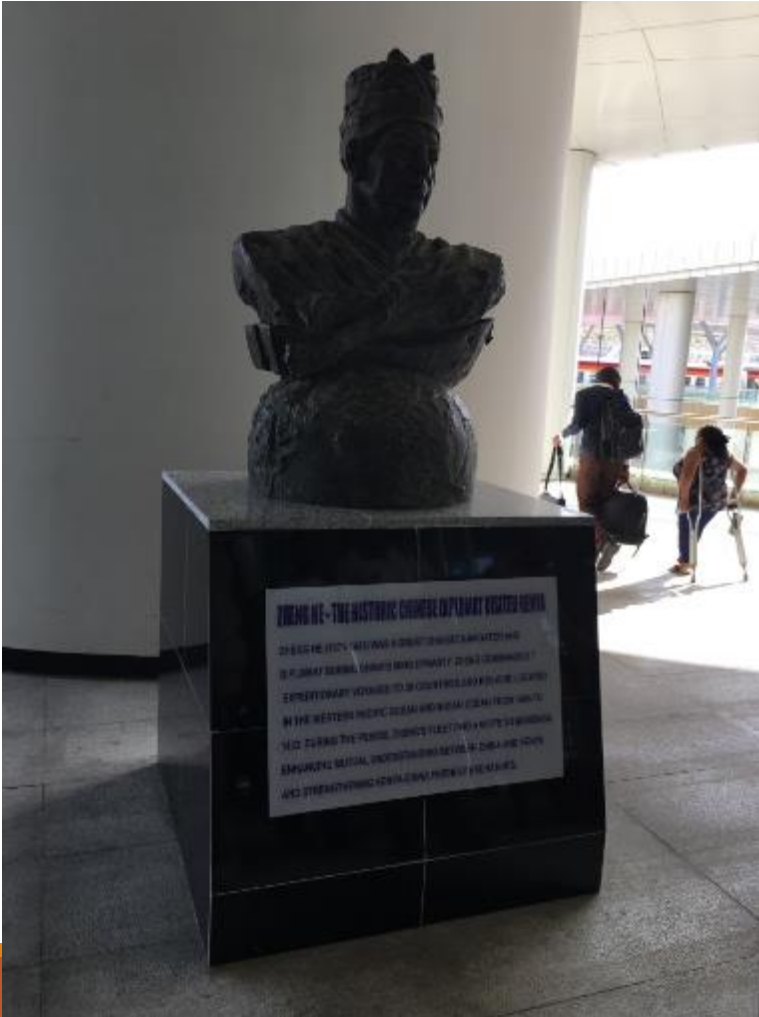
## 2.3 Historical significance re East Africa

Era	Periodisation
1500s-1949	<b><i>Maritime Silk Road</i></b>
	- Zheng He reaches East Africa (Lamu area of modern Kenya)
1950-1979	<b>Political Alliances</b>
	- Tanzam railway constructed
1979-1995	<b>Independent (economic) Worlds</b>
	- China focuses on crossing its own river by feeling the stones
1995-2012	<b>Interdependent (economic) Worlds</b>
	- China's need for commodities meets end of Apartheid and end of extreme macroeconomic volatility in SSA
2013-present	<b>Comprehensive Development</b>
	- In Tanzania in 2013, Xi calls for 'fast track of comprehensive development'

Jiang (2012); Wang, Y., Q. Xia and S. Jiang (2012); Johnston (2016a).

## 2.4 Zheng He returns to Kenya

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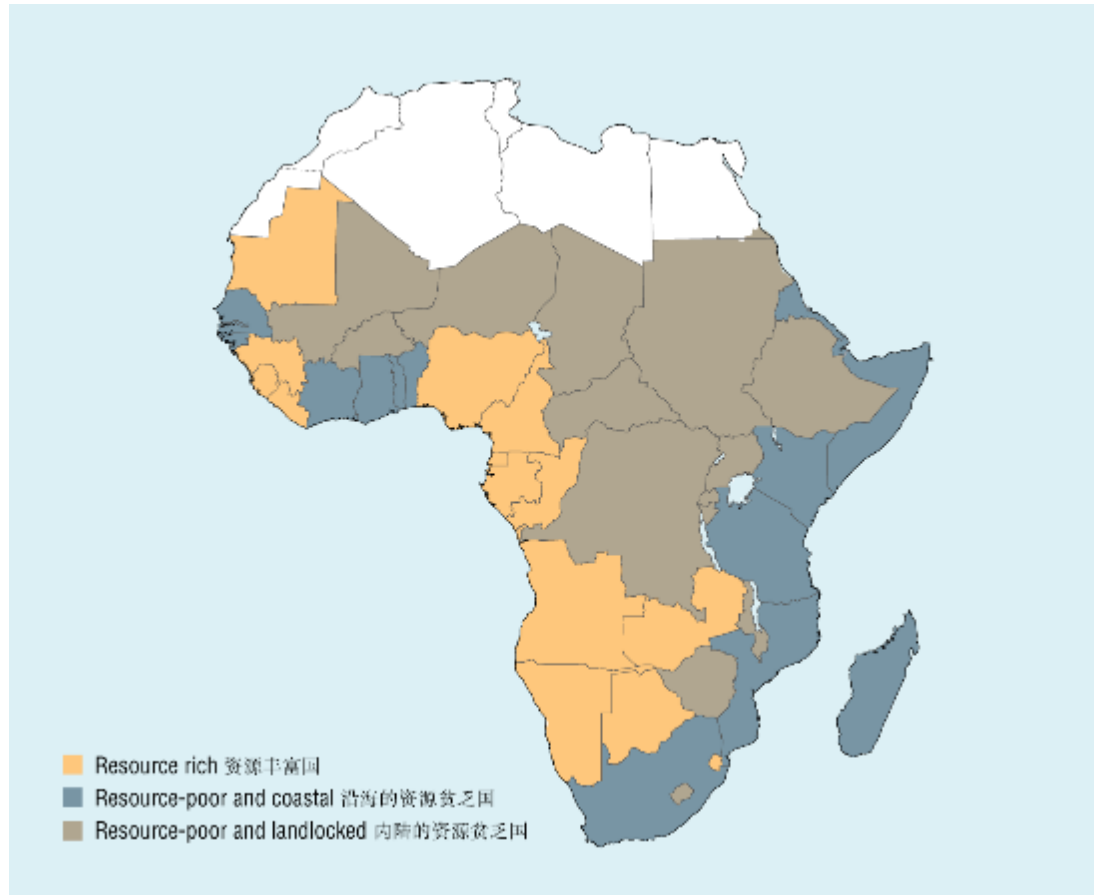


Zheng He commemorative statue at Standard Gauge Railway Mombasa terminal, Kenya:

*“Zheng He, the Historic Chinese Diplomat Visited Kenya*

*Zheng He (1371-1433) was a great Chinese navigator and diplomat during China’s Ming dynasty. Zheng commanded 7 expeditionary voyages to 30 countries and regions located in the Western Pacific Ocean and Indian Ocean from 1405 to 1433. During the period, Zheng’s fleet paid 4 visits to Mombasa, enhancing mutual understanding between China and Kenya and strengthening China-Kenya friendly exchange.”*

## 2.5 Economic Geography



Source: Johnston (2012).

### World Bank Commission on Growth (2008):

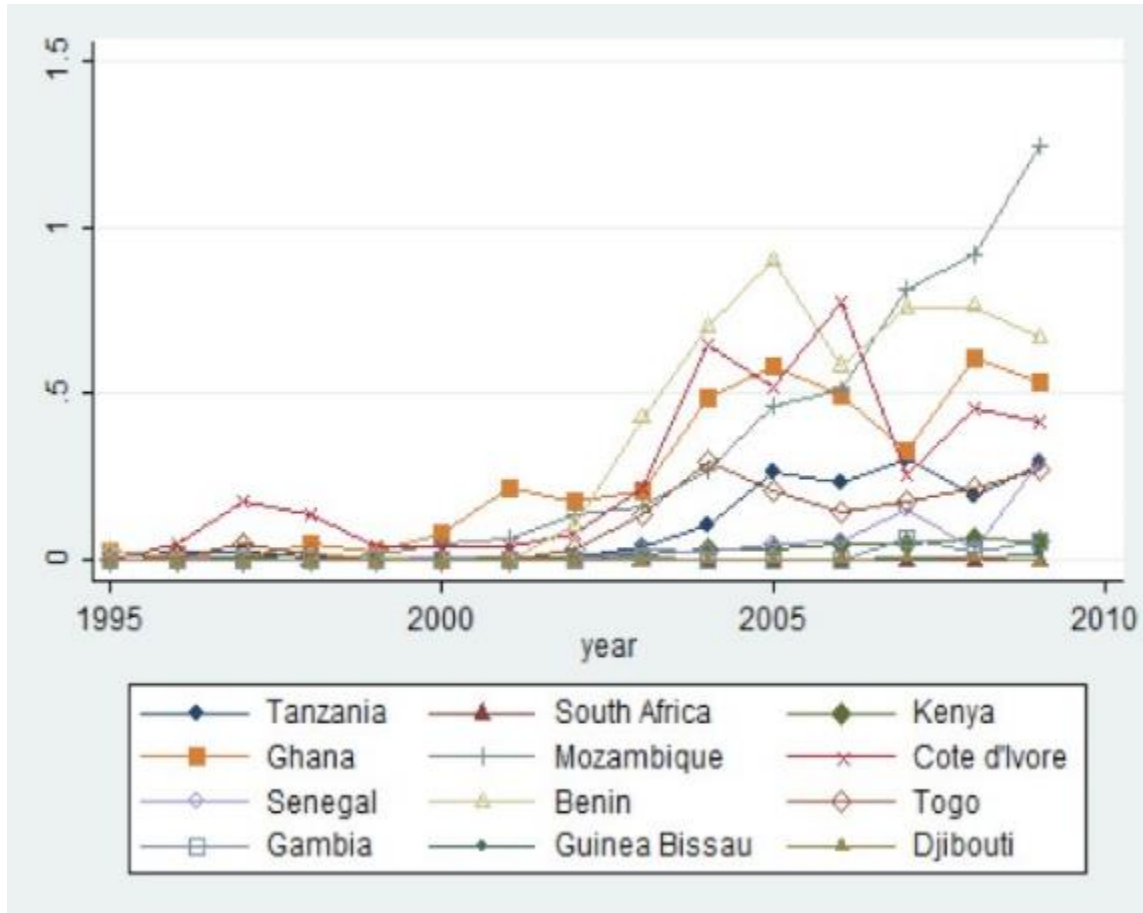
- Coastal-resource poor economies played key role in industrialisation in East Asia, Latin America..

### ➤ Sadly, sub-Saharan Africa's coastal-resource poor economies are:

- smaller geographically and in home market size than in East Asia
- further from international markets/value-chains
- poorly connected to neighbouring economies

*(Definition of 'resource-poor/rich' can change over time, but in general, these economies are concentrated in East Africa).*

## 2.6 East Africa: Economic Geography logic



### Gravity model of China's global imports (1995-2009) (Johnston, Morgan and Wang, 2015):

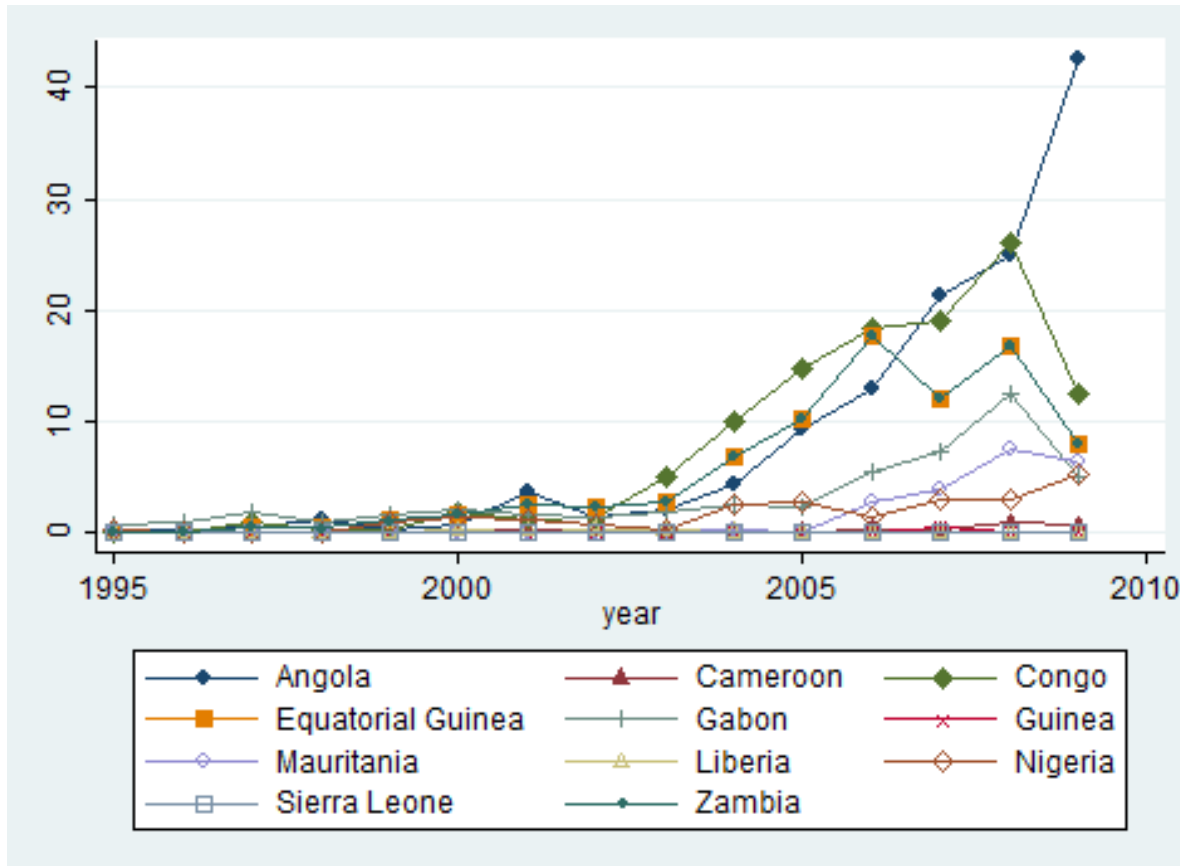
- < 1: observed value < predicted value ('under-trading')
- = 1: observed value = predicted value
- > 1: observed value > predicted value ('over-trading')

### Resource-poor coastal economies up to 2009 (year China became Africa's largest trading partner)

- were almost all trading below the predicted level: 'under-exporting' to China.
- lesser benefited from LDC trade preferences;
- lesser had access to earlier resource-based lending; etc.

In other words, the under the earlier growth model, China's Africa ties were not optimal helpful to African development.

## 2.7 Resource-rich comparison



**China's merchandise exports and capital-intensive growth drove its massive demand for commodities:**

- Resource-rich Africa benefited increased demand a terms-of-trade boost
- Resource-poor Africa suffered a diminished terms-of-Trade

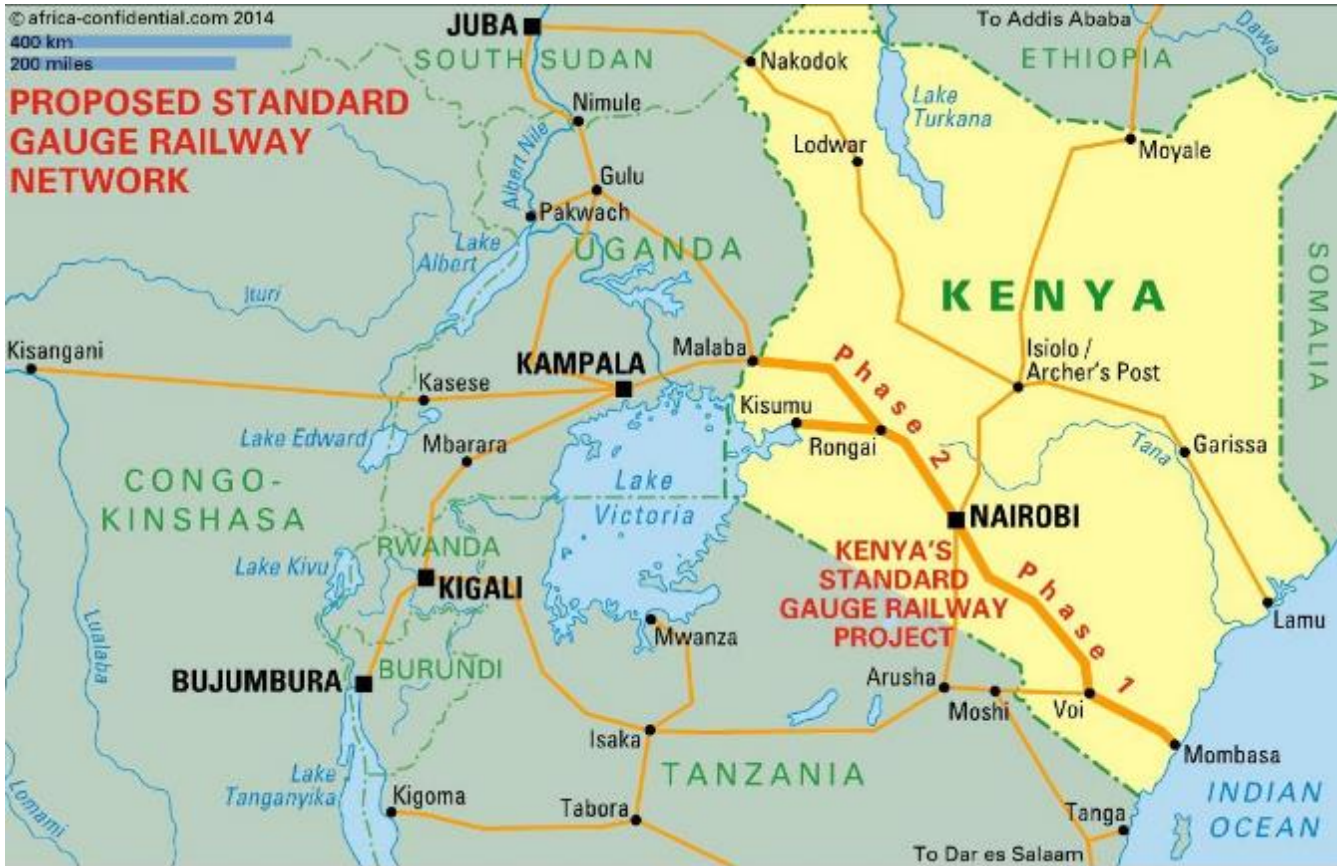
**But: China's new growth model:**

- Shifts economy away from energy-intensive production
- Rising labour costs and falling export demand combine to reduce demand for commodities
- Greater outbound investment and financial internationalization.

Source: Johnston, Morgan and Wang (2015).



## 2.8 Under 'BRI': Kenya in focus

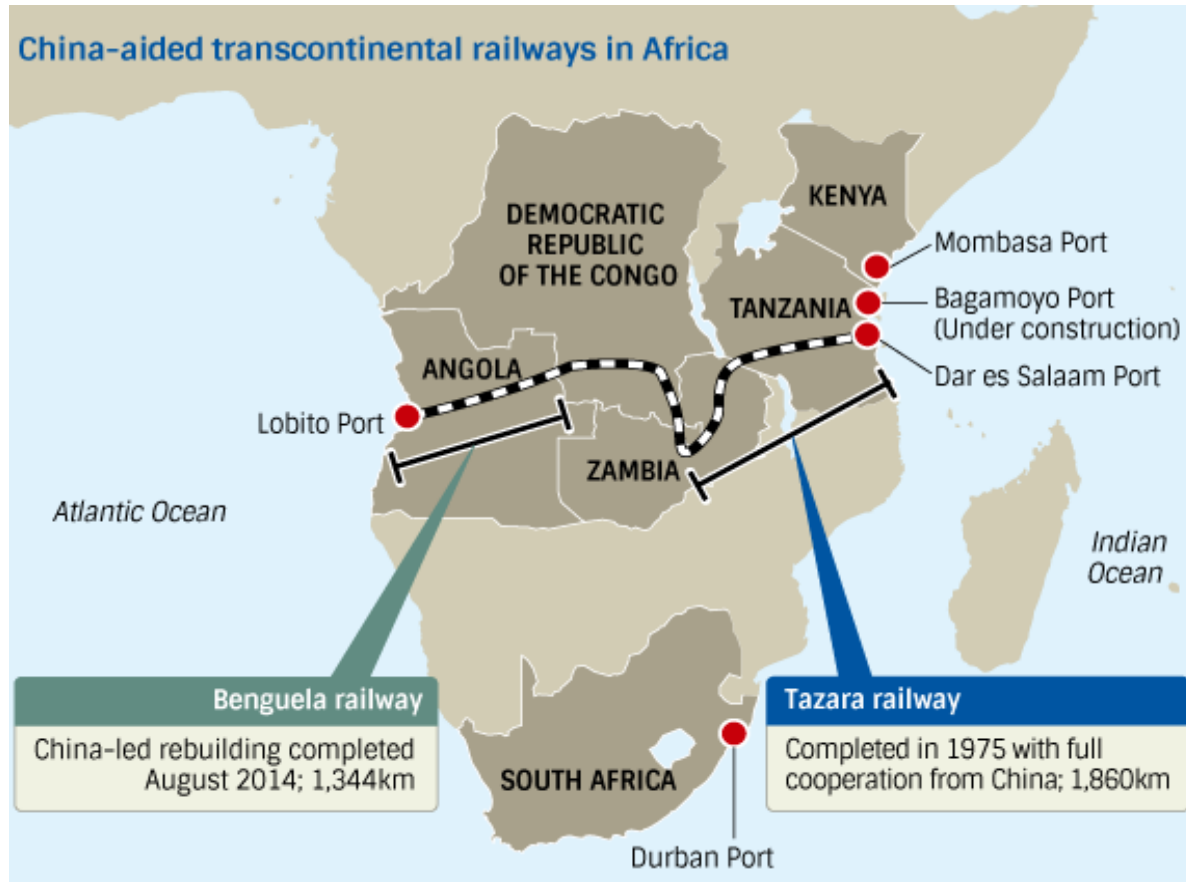


## Standard Gauge Railway (SGR)

➤ **May help to ease East/Central African economic geography constraints?**

- Linking up ports with landlocked economies to facilitate trade and regional integration.
- Helping to create value-chain clusters in Mombasa, etc.
- Kenya as “Jiangsu” and Tanzania as “Zhejiang”?
- But debt risks, etc.
- Are African economies as ready as China?

## 2.9 BRI: Tanzania and Bagamoyo ports



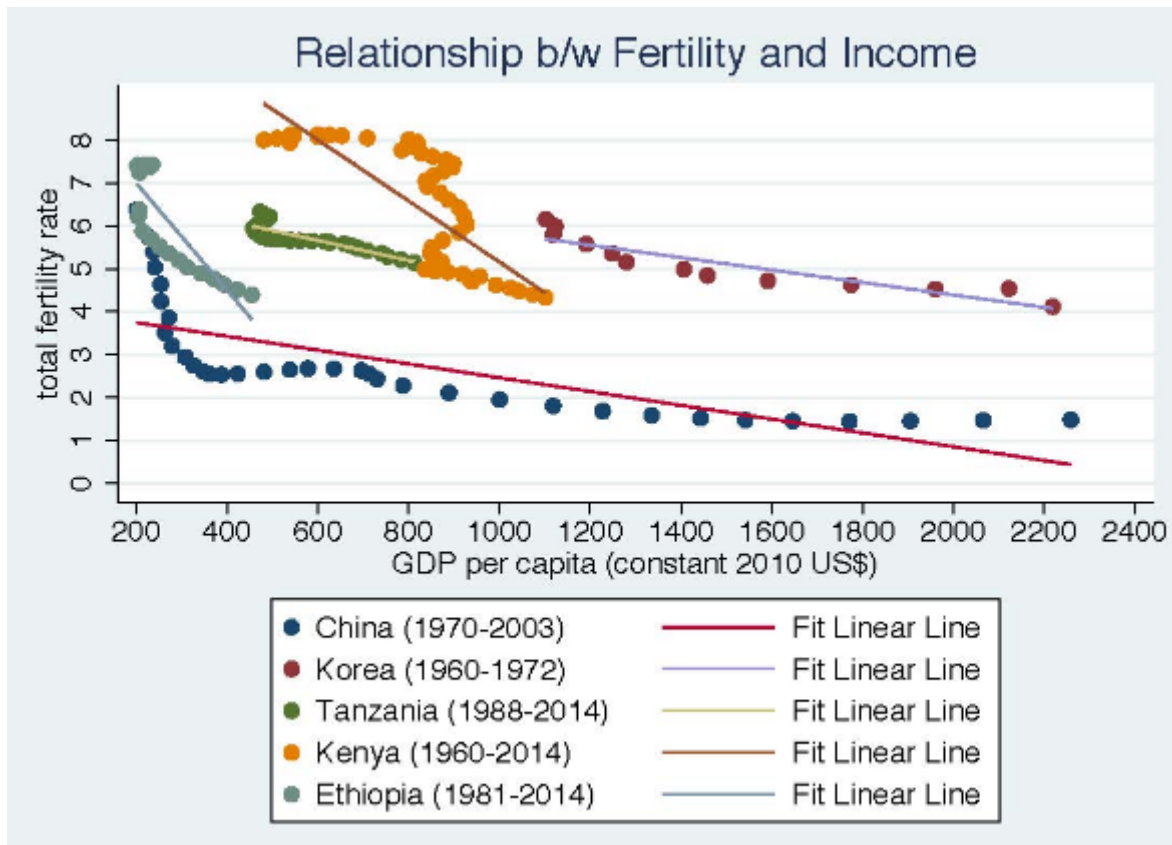
Source: The Nikkei.

## 2.10 Bagamoyo Port and SEZ

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- **US11bn port project jointly funded by Oman's State General Reserve Fund and China Merchants Holdings International**
- **Port will be biggest in East and Central Africa:**
  - 20mn containers/pa capacity
  - 75km from Dar es Salaam and 10km from Bagamoyo town
  - Think Guangdong and Shenzhen
- **Alongside, Bagamoyo Special Economic Zone:**
  - Attract about 700 industries to become a strategic investment zone in East Africa.
  - East Africa's leading shipping and logistics centre
  - Regional railway connectivity planned.

## 2.11a Long-run prospects



Garnaut, Johnston and Hang (in progress).

Controlling for per capita income, it appears that the Kenya, Tanzania and Ethiopia fertility rates are lower than were South Korea's, but not China's.

But will the TFR fall to replacement level or below, or find an equilibrium at 3-4 children per woman?

- This will decide the demographic dividend potential, or Malthusian trap (extreme); and size of investor return.

## 2.11b Long run prospects

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Table: Share of population >65%.

	1970	1980	1990	2000	2010	2016
China	3.8	4.7	5.7	6.9	8.4	10.1
Sub-Saharan Africa	2.9	3.0	3.0	3.0	3.0	3.1
Euro area	11.9	13.5	14.1	16.3	18.4	20.2
Pre-demographic dividend	2.9	2.9	2.9	2.9	2.8	2.8
Early-demographic dividend	3.5	3.7	3.8	4.4	5.0	5.5
Late-demographic dividend	4.5	5.4	6.0	7.2	8.5	10.0
Post-demographic dividend	10.1	11.7	12.7	14.3	16.3	18.4

Data source: World Bank, World Development Indicators (2018).

**China holds an annual Population and Development Conference with Africa countries, since 2017.**

**China has launched a Population and Development Research Centre, in Nairobi.**

## 2.12 Institutions

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➤ **Language:**

- English is widely-spoken in East Africa, and is the most-spoken second-language in China

➤ **Developmental baseline:**

- East African economies have a lower-density of LDCs, and thus have comparatively sound education and health baseline

➤ **East African regional integration agenda:**

- Steady advance of East African Community regional integration agenda
- Tripartite free-trade area discussions

➤ **Interesting historical reference for Germany**

- Tanzania's Bagamoyo, a potential massive industrial zone of tomorrow, was capital of German East Africa (Oman is involved in financing).

# 3.1 Implications for Australia

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- **Stimulus for economic activity to Indian Ocean region west of Australia**
  - Mostly former Commonwealth countries
- **Direct opportunities**
  - Public finance and financial services training
  - Youthful populations needing education and services opportunity development over coming decades
  - Potentially massive opportunity for mining companies and mining-related services
  - Evolution of greater 'south' opportunities in medicine, science, industry
- **Political economy partnerships akin to APEC (?)**
  - IORA (Indian Ocean Rim Organization) to become the APEC of the 21<sup>st</sup> century?
  - Diversification of interests akin to strengths of middle power country

See also Johnston, L. (2015b). [China, Australia and the African Frontier](#), *Pursuit*, University of Melbourne (10/15)



## 3.2 Risks for Australia

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- **Australia had geographic advantage with East Asia, but less so re Indian Ocean**
  - On other than, fewer services sector constraints re languages at least
  - Maybe important to get head start in more open economies, eg. Mauritius.
- **India, most populous nation in Indian Ocean and power of tomorrow is already appearing to seek to use Mozambique's coal the way China used Brazil's coal, but this time Australia is "Brazil".**
- China etc finding alternative suppliers re gas, minerals, etc.
- Political risks: Pakistan/India tensions; militarization; cheating cricketers
- **On the one hand, Australian society understands Commonwealth nations better; on the other, it's a whole new region to become acquainted with**
  - "But we've only just started to get our heads around Asia" (2014)
- BRI itself is very dynamic.



## 3.3 NB: BRI is also bigger than economics

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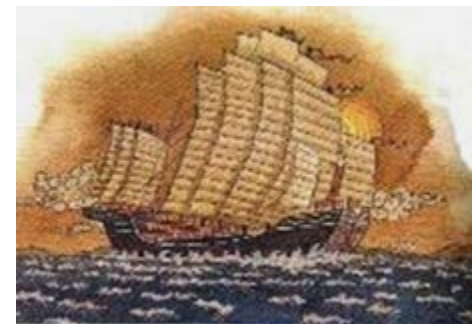
- **Historians hold breadth of views on the Ming Dynasty fleets;**
- **Security scholars worry re dual-use of port investments**
- **Political scholars focus on implications for governance and democracy**
  - Unknown if "BRI courts" are more about reforming Chinese or international law
  - Similarly, "BRI" is an important tool for central governance in China too.
- **Macroeconomists worry about debt crises and role of dollar**
- **Entrepreneurs say only Chinese companies benefit.**
- **Environmentalists worry that China is exporting its dirty industries to Africa**
  - Less an issue under new growth model

# We're all feeling for stones now.

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Are any of them golden? Which ones?

Who gets what share of the gold? etc. etc.



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