

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



*The multi-billion Tianli Chinese Development project of Riche Terre in Mauritius*

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## Introduction

This policy brief aims to provide an in-depth analysis of China-Mauritius trade relations and their impacts on the Mauritian economy. The accumulated evidence suggests that while the resource-abundant countries of sub-Saharan Africa will benefit from China's deepening trade relations with the continent, resource-poor countries, which, additionally, are in competition with China in export markets, will lose. Mauritius features prominently in the latter group, yet this study is premised on the argument that China can benefit, rather than hurt, this small island economy.

Chinese exports to Mauritius have more than doubled between 2000 and 2008, propelling China to the ranks of Mauritius' major trading partners. China is the third largest supplier to the Mauritian market but, at current trends, it will soon be competing for first place with the EU and India. Mauritius'

exports to China, on the other hand, have remained marginal. In 2007, China took in a negligible 0.2% of Mauritius' exports. Moreover, this share has fluctuated widely in recent years without showing any sign of a marked upward trend.

Perhaps the impact of China's economic rise has been most significant for Mauritian exports into third-country markets. The end of apparel quotas and the consequent surge in garment exports from China has competed out a number of African countries from developed-country markets, especially the USA. In Mauritius, a number of clothing firms closed in the run-up to January 1, 2005, leading to mass layoffs and a sharp dip in exports. Within one year – between 2004 and 2005 – the value of apparel exports declined by 27%. However, our study suggests that the Mauritian clothing industry has resisted the increased competition in third markets that Chinese apparel has entailed, and that China cannot be blamed for its decline before 2006.

China's trade impacts have produced gainers and losers. Consumers are the biggest gainers from cheap

Chinese imports. However, these gains are likely to be smaller after adjusting for the generally poorer quality and greater risk of Chinese products. On the other hand, import-competing producers, many of which are SMEs vying to establish a presence in the local market, have been most adversely affected by Chinese imports. It is important to assess the nature and extent of injury caused, and examine policy options for addressing these negative impacts.

## Objectives and Methods of Analysis

The key objectives of the study are:

1. To analyze the evolution of bilateral trade between Mauritius and China, and consider the factors driving such trade;
2. To identify the gainers and losers from Mauritius' increasing engagement with China, specifically to assess the gains to consumers due to cheap imports against the injury caused to local industry from greater competition;
3. To investigate the factors behind the low and declining level of Mauritius' exports to China and to examine policy options to avert the negative trend;
4. To articulate and analyze policies that Mauritius can use to optimize its trading relations with China with a view to making the most of emerging opportunities and addressing the challenges posed.

In pursuit of the above objectives, we adopt a variety of methodological approaches, each suited to the question at hand. More generally, our proposed methodology uses both macro-level and micro-level data and analysis.

We draw extensively on secondary

data to explain the low export penetration of Mauritian goods on Chinese markets and to examine the impact of Chinese dominance of the global apparel market on Mauritius' clothing exports to third markets.

We first consider three potential explanations for Mauritius' low levels of exports to China, namely, that: (a) Mauritius exports are not competitive enough to penetrate the Chinese market; (b) China does not need to import from Mauritius since it produces all that Mauritius exports; and (c) the Chinese market is relatively closed to Mauritian exports due to high trade barriers.

We investigate each of the above hypotheses using secondary data from UN COMTRADE. We compute a set of revealed comparative advantage (RCA) indices for Mauritius and China, and show how they have evolved over time. Given the inherent shortcoming of the RCA measure, we provide a complementary assessment based on an analysis of cost competitiveness factors. We also use the Export Similarity Index and the Trade Complementarities Index to shed light on the above hypotheses.

Secondly, we examine China's impact on Mauritius' apparel exports to third markets using both primary and secondary data. Using disaggregated data on clothing exports from UN COMTRADE, we analyze the product categories where Chinese competition has been most acute.

Our micro-level analysis relies on survey methods to extract primary data that shed light on several questions of interest. First, we draw on findings from a light survey of export enterprises potentially competing with China on Mauritius' traditional markets (the EU and, to a lesser extent, the US) to support our macroeconomic analysis of China's impact on Mauritius' apparel exports. Next, we interview key informants in the export sector, including export-support institutions such as Enterprise Mauritius (EM) and the Mauritius Exports Association (MEXA), to explore a fourth possible explanation for Mauritius' timid export penetration into the Chinese market – that Mauritian firms are not interested in exporting to China because the Chinese market is not as lucrative as existing markets. Thirdly, we undertake a consumer survey to gauge consumers' appreciation of Chinese products in terms of price, quality, reliability and safety, among others. The survey also

throws light on how consumers view locally produced goods relative to competing Chinese imports. Finally, we study the impact of Chinese imports on the domestic import-competing sector by means of a survey of enterprises, with a focus on SMEs, where the impact has arguably been more severe.

## Key Findings

We summarize the key findings in terms of direct and indirect impacts.

### *Direct impacts: Imports*

Mauritius has witnessed a phenomenal growth in imports from China, a three-fold increase between 2000 and 2008, which has placed China into the enviable position of Mauritius' second largest source of imports, behind India. The bulk of imports have been in SITC categories 6, 7 and 8, more precisely in textile yarn and fabrics, machinery and transport equipment (motorcycles), and miscellaneous manufactured goods such as garments and toys. Cheap imports have certainly benefited consumers. But the poor quality or hazardous nature of Chinese products constitutes a potential loss to consumers.

A more significant loss arises from the injury that Chinese import competition has caused to the local industry in Mauritius. Our findings suggest that small firms and those in such sectors as garments, footwear and furniture have experienced a loss of market, and have consequently downsized. These firms cite lower prices and a favourable price-quality ratio as the key competitive pressures exerted by Chinese imports and attribute China's superior cost competitiveness to cheap labour and easy access to low-cost materials and inputs. Contrary to common belief, they indicate that manipulated currency is the least likely source of China's external competitiveness.

### *Direct impacts: Exports*

Mauritius has traditionally exported to the EU and the US. The EU absorbed over 70% of Mauritius' exports in 2008. The US market, which attracted over 20% percent of exports in 2000, has seen this share decline to 7.5% in 2008 in favour of the EU and regional markets. China absorbed less than a quarter of 1%

of Mauritius' exports in 2008. Exports have been virtually inexistent in all but a few products, including fish and fish preparations, tobacco and TV and radio transmitters.

We consider various potential explanations for this timid penetration of Mauritian goods in the Chinese market, and we do this using both macro-level analysis and discussion with experts. The first is that Mauritius' exports are not sufficiently competitive. Mauritius ranks low on the competitiveness scale as measured by the ILO's Competitive Industry Performance Index. Moreover, China exhibits revealed comparative advantages in a much broader range of products than Mauritius does. There are only two products – pearls and precious stones, and jewellery – in which Mauritius boasts a significant comparative advantage. Nevertheless, the scope to export these products to China is limited by the rather underdeveloped capacity to export of these sectors.

The second hypothesis we investigated is that low bilateral trade complementarities inhibits Mauritius' exports to China. The evidence in support of this hypothesis is compelling. Our calculations reveal, on the one hand, a relatively high degree of export similarity and low levels of trade complementarities, on the other. Together, these indices imply that Mauritius' prospects to export to China are rather dim, both because the two countries tend to export rather similar goods to third markets and because China's import needs and Mauritius' exports offer a poor match.

Next, we consider whether high trade barriers in China could be responsible for the marginal state of exports from Mauritius. We find that average tariffs on products of export interest to Mauritius are rather high, and, by all means, higher than in Mauritius' traditional markets (the EU), which offer duty-free access to made-in-Mauritius products. This finding constitutes a singular potent explanation for the lack of exporters' zeal to venture into the often-dreaded Chinese market. Interviews with key informants from the export sector echo such fears. The experts further argue that Mauritian exporters lack the competitiveness that the Chinese market demands. While some scope to export exists in such products as rum and spirits, pearls, precious stones and



jewellery, and fish and fish preparations, a dearth of market intelligence, a systemic skewed orientation towards industrial-country markets and an unhealthy sense of scepticism among prospective exporters make exporting to China unlikely in the short term.

Ironically, according to one informant, SMEs do not even entertain the idea of exporting to China since they lack the capacity to satisfy orders of the scale that the Chinese market may entail.

In conclusion, the whole body of evidence presented in this study points to bleak prospects for Mauritian exporters to enter the Chinese market in a significant manner. Worse, because most of the causes of this low export penetration are due to systemic factors – such as a lack of trade complementarities, poor export competitiveness, export market bias and an irrational fear of doing business in China – the current situation is unlikely to improve in the future in the absence of bold policy measures.

### ***Indirect impacts: Exports***

China's indirect impacts, that is, impacts on exports to third-country markets, have been much dreaded in Mauritius and elsewhere, prompting concerns about de-industrialization in Africa. In Mauritius, these fears have taken added significance by virtue of the economic importance of the clothing industry and the fact that China is reputed to be a mighty competitor in wearing apparel. Moreover, Mauritius exports to the same markets – Europe and the US – in which Chinese competition is known to be most acute.

Perhaps not surprisingly, then, China has been blamed for the decline of the Mauritian clothing industry between 2003 and 2005. Since this period coincided with the end of apparel quotas, which signalled the sweeping rise of China, it is easy to pin the fate of the Mauritian clothing industry on China's economic dominance. However, our analysis suggests that the real cause of the rapid decline in clothing exports was the mass exit of Hong Kong-based enterprises on learning that Mauritius had failed to obtain renewal of the third-country fabric derogation in September 2003. The fact that exports bounced back after 2005 to attain a historic peak in 2007 confirms that China could not be held responsible for the earlier setback. Our survey results provide further support

for this hypothesis. The larger firms in the clothing industry claim that China has hardly bothered them. In fact, these firms view China's economic emergence as a boon since they source their yarn and fabrics from China.

### ***Indirect impacts: Investment-induced***

Some of the impacts of Chinese economic dominance through the trade channel have their roots in Chinese investments in Mauritius. For example, Chinese investments in yarn spinning have helped Mauritius reduce its import bills. In the same logic, the massive inflows of FDI towards the setting up of a Chinese special economic zone in Mauritius will generate significant exports to regional markets and beyond. However, the environmental impacts of the project and the risk of a Dutch disease-induced real appreciation of the rupee that could prove detrimental to Mauritius' fledgling exports should be watched.

### ***Policy implications***

China's net direct and indirect impacts via the trade channel on the Mauritian economy are generally mild. Nevertheless, our findings point to a number of areas where policy intervention can improve the impacts, both by minimizing the adverse effects and by maximizing the gains. We consider these policy implications in the same way as we discussed the impacts above.

### ***Imports***

Cheap imports from China, while benefiting consumers, have raised concerns over quality and potential health risks. There is wide agreement among consumers that Chinese products are generally of poorer quality. Yet they buy them because of the favourable price-quality trade-off that they offer. Consumers' complaints about quality should usually not call for any policy intervention in that quality is a means of product differentiation that is reflected in the product's price. However, where poor quality and lack of respect of norms threaten human life and welfare, urgent corrective measures are required. In Mauritius, these problems have come to the surface following a few, isolated life-threatening incidents involving toys and candy. In both cases, the products

were withdrawn from the market and, subsequently, directives were issued to importers to ensure that such products conform to certain norms. But these measures have served only as short-term palliatives. Import-competing producers have protested that the stringent norms and standards they have to comply with do not necessarily apply to imported products, and that these products are not subjected to any quality controls upon arrival in Mauritius. The policy implication is clear: protection of consumer health requires that norms and standards be enforced on imported products as they are on locally produced ones.

Several firms claim to have been adversely affected by the dramatic influx of cheap Chinese goods. These are mainly the small, import-competing firms in the garment, footwear, and furniture industries. However, while both the data and the survey suggest that these effects have been mild, the Federation of SMEs in Mauritius claims that small firms have been hit hard by fiercer import competition.

However, it appears that the policy of trade liberalization rather than Chinese competition as such is the main cause of the current plight of the SMEs. In the move towards a 'duty-free island', tariffs have been progressively reduced in a broad cross-section of industries, exposing such industries, and especially the small and vulnerable enterprises within them, to 'unfair' competition from cheap imports. For example, the applied MFN average tariff on furniture has gone down from 75.4% in 2001 to 14.3% in 2007. On wearing apparel and footwear, the tariff cut appears less drastic – from about 80% each to 35% and 51.2%, respectively – but this is only because some specific duties were reinstated on these products amid protests by local producers following the 2005 wave of tariff liberalization.

The government is well aware of the potential of SMEs to create jobs and generate wealth. In fact, this sector is regarded as the locomotive of growth in the next phase of industrialization. As such, the government has always been sympathetic to the concerns of SMEs and has proposed a number of policy measures in recent years to assist the sector, sometimes negating on its own previous policy commitments like in 2005. In the wake of the financial crisis

in 2008, the government proposed a Manufacturing Adjustment and SME Development Fund to assist SMEs to restructure and modernize with a view to improving their competitiveness and ensuring their long-term survival. Subsequently, the fund was transformed into the Saving Jobs and Recovery (SJR) Fund with a wider coverage of sectors and a significantly stepped up budgetary endowment. A larger range of services are proposed by the SJR Fund. For example, SMEs could benefit from consultancy services to help them prepare and submit financial restructuring plans to enable them to benefit from the Mechanism for Transitional Support. Moreover, the Mauritius Business Growth Scheme was set up to provide financing to SMEs to support their business growth on a cost-sharing basis. These schemes and services they offer are in addition to the SME Partnership Fund, set up in 2006 to provide equity capital to promising SMEs and other funds and programmes, including the National Endowment Foundation. By strengthening the capacity of SMEs to maintain a foothold on the local market, and facilitate their evolution into dynamic exporters to regional markets, these funds help local enterprises tackle China since Chinese competition presents the biggest challenge to the local industry.

However, local SMEs vehemently criticize the management of the various funds, which, they claim, have not benefited them. They argue that the conditions for acceding to the funds are too stringent, and crowd them out, to the benefit of larger firms. Moreover, they believe that the allocation of funds is not done in a fair, impartial and transparent manner. The Federation itself is more in favour of trade-related policy measures, such as quantitative restrictions, protective duties and control of norms.

The use of quotas is prohibited by the WTO but can be permitted as a temporary safeguard measure if the applicant could provide evidence of injury sustained by local industry as a result of excessive imports. Alternatively, the importing country can use countervailing duties in an attempt to offset the price advantage of the exporting country. However, Mauritius has never given recourse to these measures, probably because their use entails costly legal battles at the

WTO. Nevertheless, Mauritius disposes of significant tariff waters in most products, which means that it can raise import duties in affected sectors without violating any WTO regulation. And indeed, protective duties were raised in 2006, and have been maintained since.

While putting up higher tariff barriers in the face of stiffer import competition is an easy and tempting option, it should be avoided at all costs in Mauritius. The country has embarked on a policy of openness pushed to its limits. Trade liberalization has been a long and ongoing process, and it has proved sustainable over the years. Reversals of trade liberalization have occurred only once (in 2006) since the government is aware that backtracking will send the wrong signals to the international community. We are inclined to support the government's position. Inefficient firms should not be tolerated. Instead, we are in favour of control of product quality to ensure that Chinese imports conform to basic norms of health and safety. This requirement will raise the product's price, bringing it closer to the prices of locally produced goods, giving SME some breathing space.

The extent of damage to local industry due to competition from China is, at present, relatively small. However, at the current pace of growth of Chinese imports, it is foreseeable that local firms will be exposed to even fiercer competition from China. Perhaps, once the threat to local SMEs reaches a critical level, the government could call on Beijing to consider voluntary restraints on its exports to Mauritius much along the lines of South Africa's recent move. The advantage of VERs is that they can be negotiated diplomatically, and provide mutual gains to both the exporter and the importing country. China would pocket the rents arising from the export quota while Mauritian firms would enjoy protection from the disruptive effects of cheap imports. On the downside, consumers in Mauritius would lose big, but, in the logic of Olson's collective action, they are unlikely to put up resistance to the VER.

### **Exports**

Mauritius' exports to China have remained marginal over the years and have been concentrated in a few products, such as telecommunication equipment, tobacco and fish. This

situation is due to various systemic causes, including a lack of trade complementarities and poor export competitiveness. Fear of the Chinese market, often accentuated by a dearth of market intelligence and an exclusive focus on traditional, industrial-country markets, also prevents prospective exporters from exploring China. The government can do little to address the systemic causes of low export penetration. However, policy intervention in other areas can help, considering that there exists a number of products in which Mauritian exporters can carve a niche in the Chinese market.

First, there is a need to shift focus away from traditional markets. The recent financial crisis clearly illustrated the dangers of dependence on a few markets. Moreover, the erosion of preferences in the European market and the emergence of some regional markets means that in Mauritius, some degree of export diversification is already under way. The government should jump on the bandwagon and invest more significantly in market development. Funding participation in trade fairs in China, providing links with prospective buyers for value added products like rum and spirits, jewellery and fashion clothing and, more generally, promoting China as a potential market for Mauritian products can go a long way towards breaking the ice.

Second, it is high time the Mauritius considers a bilateral trade agreement with China. As mentioned earlier, such an agreement is in the offing, and Mauritius will surely push for it. However, China is unlikely to heed a trade treaty with Mauritius since it is clearly not in its economic interests. Mauritius should use its diplomatic arsenal to impress on the Chinese the need to rectify the huge trade surpluses in favour of China by opening up their market to Mauritian products. A trade agreement, with preferential market access, appears as the best strategy to offer Mauritian SMEs a chance to get a foothold in the Chinese market. Mauritian negotiators can use several potent arguments to justify the trade agreement: cultural (strong historical ties with China), political (Mauritius' support of the One China policy) and economic (the need to reduce bilateral trade deficits, the upcoming Chinese SEZ in Mauritius, existing agreements on investment and double taxation). A

trade agreement with China will have the blessing of a broad cross-section of economic agents in Mauritius, including firms importing consumer goods, raw materials and inputs as well as prospective exporters to China. Import-competing firms in Mauritius have little more to lose since MFN tariffs are already low, and, in any case, Mauritius may opt to exclude certain sensitive sectors.

Concerning China's impacts on Mauritius exports to third markets, we have noted that China was not the cause of the temporary decline of clothing exporters during 2003-2005. Most of the large apparel exporters can compete effectively with China on these

markets since they produce in the high end of the market, where competition is less ruthless, have solid comparative advantages in specific products and have a reputation as reliable suppliers offering a full-package delivery. The government, through the various funds and facilities it has put to the disposal of the business community, should see to it that Mauritian firms remain competitive as cost pressures keep up. Ultimately, the firms themselves are the best defenders of their interest; the government is merely a facilitator. Barring a few exceptions, the Mauritian government has fully lived up to this role.



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