

## 1. Introduction

### 1.1. Background of the study

China's first contact with Africa could be traced back to ancient times. In spite of the two regions being separated by vast distance, the first contact between China and Africa was on the parts of the Red Sea borders of the continent around the first Millennium A.D. (Gedion 2008). However, their relations were not official as in the second half of the 20th century. The early contacts of China with the Horn and especially with Ethiopia is of two factors: first, that the Chinese were importing rhinoceros from Abyssinia; second, there was a degree of phonetic similarity between Hough Chih (the then Chinese language) and Ge-eze (the then literary language of Ethiopia) (Addis Dilnesa, 2005:241). Diplomatic relations between Ethiopia and China began on 24 November 1971, when Emperor Haile Selassie visited China. (Monika, 2009:6-7). Ethiopia was among a number of nations who supported China's bid to join the UN in the same year. But during the period from 1974 – 85, their relation became strained due to Ethiopia's close alliance with USSR (Gedion 2008, Monika 2009)

In recent days the relations during and after the transitional government of Ethiopia have been strengthened as the Ethiopian Prime Minister visited China in 1995. The visit was reciprocated by the president of China who visited Ethiopia in 1997. Other high-level visits were also exchanged. Exchange of high-level visits consolidated the momentum. (Alemayehu 2008).

Ethiopia has been trading with various countries across the world. For a long period of time, its major trading partners both as destination of exports and origin of imports were the European countries for a long period of time. However, the trend seems taking another direction recently. According to Ethiopian Economics Association's (EEA) survey of 2009, The major trading partners of Ethiopia which were, in order of importance, Saudi Arabia, Germany, Italy, Djibouti, Japan, USA, UK, China in 1997/98 have changed in recent years. In 2006/07, for instance, the ranks of Ethiopia's

major trading partner countries have taken a different shape, (Ethiopian Economic Policy Research Institute 2008). China is coming from the bottom to top very rapidly. Bilateral Trade between China and Ethiopia was \$100 million. However, by 2007 trade volumes rose to \$860 million (Monika 2009). Export to china has increased to 15% of her total exports today which was none some five years ago i.e. from 2007 (Alemayehu 2008).

The Chinese engagement in Ethiopian economy has both challenges and opportunities for Ethiopia since both countries are more labor intensive in their nature. The challenges and opportunities according to (Alemayehu & Atnafu 2007) are as follows:

- i. Ethiopian infant industries which export labor intensive manufactures may face competition in the third market and
- ii. Local producers of labor intensive manufactures could be displaced from the local market.

And the opportunities are:-

- i. Domestic consumers are getting cheaper imports from china even though it's of low quality
- ii. The FDI that is taking place by Chinese investors (roads, railroads, big power plants etc)
- iii. Supply of cheaper machineries for producers.

As it's clearly stated in the foreign affairs and national security policy and strategy of the Federal Democratic Republic of Ethiopia, "Currently China has very good relation with Ethiopia." The document adds, "We should pay special attention to the strengthening of relations with China" (Ethiopian Foreign Policy Document, 2002:27). This indicates that the government of Ethiopia is paying special attention and giving weight to the relationship with China. This study tries to investigate if China is practically displacing the Ethiopian exports given both countries are labor intensive. Is china growing this fast at the expense of other countries like Ethiopia? Is the current market penetration power of China at the expense of other poor countries?

## 1.2. Statement of the problem

A study of Sino–Ethiopian relations is in many respects an anomaly within the growing literature on Sino–African relations. (Monika 2009) Although the bulk of scholarship has focused on China’s no-strings-attached (i.e. no political conditions) approach to doing business in Africa — especially in relation to unsavory regimes such as those in Zimbabwe and Sudan, or with resource rich/economically powerful countries such as Angola, Nigeria and South Africa — few efforts have been made to understand Chinese engagement with African countries that are neither viewed as especially ‘controversial’ regimes nor as economic powerhouses. (Monika 2009) This is surprising, as it is arguable that it is in these other less ‘significant’ countries that China has the potential to have the most impact. This creates a knowledge gap as Most of international studies revolve around China and the Latin American countries and Important African Countries either politically or economically (Alemayehu and Atnafu 2008). Therefore one may question the complementarities of the Chinese produced exports to the Ethiopians in the market. This research tries to fill this knowledge gap by empirical investigation of the bilateral relationship over periods of time and determining the significance of the displacement of Ethiopian exports.

## 1.3. Hypothesis

In this study we hypothesize that:

The highly industrialized and large scale Chinese exports are displacing Ethiopian exports from the markets.

## **1.4. Objectives of the study**

### **1.4.1. General objective**

The overall objective of this study is to examine the impact of China on the displacement of Ethiopian exports and if China is having this growing market penetration power at the expense of other countries like Ethiopia.

### **1.4.2. Specific objectives**

The specific objectives of the study are to:

- Evaluate the displacement of Ethiopian Exports in the market.
- Distinguish China's role in the displacement of the Exports of Ethiopia.
- Explore some additional factors of the displacement of the commodities.

## **1.5. Methodology of the study**

### **1.5.1. Data**

This study will employ totally a secondary data. Most of the data will be aggregated since it's on a country level. Data from: World Bank's World integrated trade solution (WITS). IMF's Direction of Trade Statistics. Ethiopian Central Statistical Authority (CSA), National Bank of Ethiopia (NBE) etc will be used.

### **1.5.2. Method**

The method that is going to be used to attain the stated objective is one of which most researchers used to measure bilateral trades between different countries, the popular gravity model.

The gravity model is widely used in international relations to evaluate the impact of treaties and alliances on trade, and it has been used to test the effectiveness of trade agreements and organizations. (Inmaculada 2003)

One of the good features of the gravity model is its empirical success. Even though some researchers say that it doesn't have deep rooted theoretical justification, it can answer some questions that the hypotheses rooted purer economic theories like the Heckscher-Ohlin (*which predict that trade patterns would be based on relative factor abundance*) models can't explain. (Alan 1998, Michael 2007, Zakir 2010). Wassily Leontief empirically found that the US, the most capital owned country in the world actually exports more in labor intensive industries. Which was to the opposite of the model (Leontief paradox). (Alan 1998)

The gravity model that will be employed on this particular study will have the popular gravity variables.

$$\ln Mijt = \beta_0 + \beta_1 \ln XCHit + \beta_2 \ln GDPit + \beta_3 \ln GDPjt + \beta_4 \ln Yit + \beta_5 \ln Yjt + \beta_6 \ln Dij + \beta_7 BORDij + \epsilon_{ij}$$

**Where:**

**Mijt** - Imports of country i from Ethiopia

**XCHit** – Chinese Export to country i

**GDPit** – Real GDP of importing country

**GDPjt** - Real GDP of Ethiopia

**Yit** - Real GDP Per capita of importing country

**Yjt** - Real GDP Per capita of Ethiopia

**D<sub>ij</sub>** – Distance between i and j

**BORD<sub>ij</sub>** – Binary dummy which is one if I and j share a land border, zero otherwise

**ε<sub>ij</sub>** – Error term

The coefficients corresponding to the variables **GDP<sub>it</sub>**, **GDP<sub>jt</sub>**, **Y<sub>it</sub>**, **Y<sub>jt</sub>** and **BORD<sub>ij</sub>** are expected to bear a positive sign while **D<sub>ij</sub>** is expected to be negative.

If Chinese exports displacement of other countries in the region is indeed the case, the coefficient of the variable **XCH<sub>it</sub>** should be negative and statistically significant.

## 1.6. Significance of the study

Very little is done on the impacts of the Chinese exports on the exports of African countries and specifically for the Ethiopian case. Even in Africa the study of bilateral trade relations focuses mainly on resource Abundant and strategically important countries. There are no studies undertaken on this topic in undergraduate level. This study can be used as a reference for further studies on this and other aspects of the bilateral relation. The study has also important policy implications.

## 1.7. Limitations of the study

The major limitation of this study is lack of complete and updated data of the countries. The Chinese also use different unit of account than that is conventionally accepted which leads to different interpretation by different scholars. The study should have incorporated large numbers of importing countries in order to capture the displacement effect clearly. But only few sample countries are used on the expense of the budget and time constraint. In addition, the unavailability of recent data are the limitations that need to be cited at this point.

## 1.8. Organization of the study

The rest of the paper is organized as follows; Chapter 2 covers the literature review; the estimations and analysis of the data are found in chapter 3; chapter 4 discusses the recommendations, followed, finally, by the conclusion.

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