Impact of Chinese Investments and Financing on Economic Growth and Inclusive Development in the Horn of Africa

by Ali Issa Abdi (PhD)
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Background

The Greater Horn of Africa consist of 8 countries in one of the African Union recognised Regional Economic Communities (RECs) in the continent. The HoA region possesses considerable advantages including its strategic location, the large size of landmass with ecological diversity and extended coastal lines, and youthful large population with diverse and rich cultural heritage, and vast agricultural and mineral resources. The region has about 7,000 Km of coastline and a population of about 275 million in as of 2018, according to the World Bank data. Average population density is relatively low, at 30 persons per square km, with considerable variations among the countries.

These represent tremendous opportunities for business investment ranging from agriculture & agro-processing; manufacturing, tourism, transportation and logistics; extraction of natural resources; and energy generation, transmission and distribution, to mention some. The region’s large population size and growth, with a youth bulge also offers an opportunity. The large youthful labor with adequate education and skills ensures a productive labor force, while it also increases pressure on the environment, the job market and social services delivery.

At the moment, the region is challenged by prevalent poverty, frequent droughts, insecurity in several countries, and high urban unemployment and rural underemployment, especially among the youth. The challenges faced include

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1 The Inter-Governmental Authority for Development (IGAD) region consists of Djibouti, Eritrea, Ethiopia, Kenya, Somalia, South Sudan, Sudan and Uganda.
2 Its coastline stretches from the Indian Ocean, Gulf of Aden and the Red Sea.
3 Compared to 65 per km2 in ECOWAS (the West African Regional Economic Community).
large numbers of internally displaced people and considerable out migration, partly driven by insecurity and droughts and partly by limited job opportunities failing to match the demands of the labor force. These are interrelated and interact with each other. Environmental degradation and natural hazards are becoming more acute owing to climate change. With a high proportion of the population dependent on rain-fed agriculture, the region is highly vulnerable to climate variability and adverse change.

There is a role for evidence-based policy, cooperation and action at both national and regional levels to minimize the risks and increase the likelihood of turning the challenges into opportunities. Effectively dealing with these would take economically, socially and environmentally sustainable economies that are equitable and inclusive.

The HoA economies have to be transformed. But, it has huge financing requirements that are largely beyond domestic capacities both at individual country level and collectively as a region. Faced with persistent and large saving-investment gap securing multilateral and bilateral funding and attracting FDI remains important for the sub region. Not only the size but also the type & flexibility, quality, distribution, and maturity and other terms & conditions of financing also matter.

Over the past two decades or so, China has emerged as a credible option not only as source of finance but also technology and know-how, entrepreneurship, relatively affordable equipment & machinery and intermediate inputs, capacity building support, as well as markets for Africa’s products. A recent study by McKinsey concluded:

In a matter of two decades, China has become Africa’s biggest economic partner. Across trade, investment, infrastructure financing, and aid, there is no other country with such depth and breadth of engagement in Africa. The Chinese “dragons”—firms of all sizes and sectors—are bringing capital investment, management know-how, and entrepreneurial energy to every corner of the continent—and in so doing, they are helping to accelerate the progress of Africa’s “lions,” as its economies are often referred to (McKinsey & Company, 2017).

The recent allocation of $60 billion 3-year funding for Africa under the Forum of China Africa Cooperation enhances China’s credibility as source of development finance. However, Chinese engagement in the continent has also attracted criticisms of sorts, ranging from outright labelling of China as merely seeking resources and cherry picking the benefits of exploiting market opportunities; blaming it for using the African continent to dump cheap products; and pushing financial terms that are getting countries highly
indebted. Unsubstantiated criticisms aside, the full extent of the opportunities and limitations of Chinese investment and financing, and its role and Impact on Economic Growth and Inclusive Development in the Horn of Africa (HoA) requires further review and study.

Although some relatively important studies have been done, the depth of treatment of issues lack important regional and country variations and are not contextualized. For example, some studies focus on countries that have been major recipients/destinations of Chinese finance/investment, and exclude countries that badly wanted to attract similar funding but haven’t or whose institutional or policy contexts would not allow them to replicate what the successful countries did to attract Chinese investment and finance. In this context, this assessment will focuses on the role of Chinese investment and finance in the HoA countries explicitly taking into account the development strategies and priorities of two diverse sets of recipient countries; those with high economic growth rates and broad good performance and the fragile states of the sub region.

Assessment of Chinese FDI in the HoA

The review of Chinese external financing and Foreign Direct Investment (FDI) in the HoA will focus on what the recipient countries (both government and private sector) have done to fully exploit the opportunities Chinese finance and investment offer while minimizing any undesired effects in order to enhance their economic growth and inclusive development potential. In particular, the cases of select successful countries and the fragile states and the requirements for undertaking country level efforts are examined to improve collaboration, attract finance under favorable terms & conditions, and encourage financial and investment flows in high priority uses that support the countries’ economic transformation.

The HoA region, includes two set of countries: the good performers and the fragile states. Thus, the region contains some of the fastest growing economies in Africa, which include the four countries of Djibouti, Ethiopia, Kenya, and Uganda. These countries in particular are very attractive to Chinese investments due to the geographical location of the region, and because of their economic growth potential, their growing consumer markets, cheap labor costs and abundance of natural resources. The real economic growth rates in these four countries averaged in the range of 5.3% to 7.6 % in 2017 and 2018.
Among the Greater HoA, the four countries termed good performers have received large inflows of Chinese investment and finance. Djibouti has been a major recipient of Chinese investment and projects financing, including the Doraleh Container terminal, the Doraleh multi-purpose port, the international free zone industrial parks operation, and rail and road projects linking the country with Ethiopia.

Also, a notable example is Ethiopia, the fifth largest recipient of Chinese Foreign Direct Investments (FDI) in Africa, which attracted billions of Chinese foreign loans and investments in ambitious infrastructure projects such as Ethio-Djibouti Railway, the Addis Ababa transit railway and ring road, modern storage facilities of Ethiopian airline, a number of inter-city road projects, and industrial parks development in many cities, to mention but a few.

Kenya is also among the top 10 countries in Africa benefiting from China’s investments and finance. China has financed a number of large scale infrastructure projects in Kenya, namely the construction of Nairobi - Thika Super Highway, Mombasa- Nairobi Standard Gauge Railway and Lake Turkana-Suswa power line transmission station.

Uganda has received sizable Chinese investment in the last decade plus. These investments include five industrial parks developed with Chinese investment; two large dams and hydropower plants, at Karuma and Isimba; three big road construction projects, including Kampala-Entebbe ’expressway; and development of oil fields in the Albertine Rift. There are major Chinese investments in agriculture, industry and tourism that have generated considerable employment in the country.

China’s presence in Djibouti, Ethiopia and the greater HoA is part of its Belt and Road Initiative (BRI) that forms part of its long term foreign and economic policy strategies to safeguard its vital diplomatic and trade interests in the wider Eastern Mediterranean region and gain unfettered access to European markets.

China’s emergence as world economy power and its development and foreign relations approach is generally perceived positively in many African countries. Some observers emphasize China’s diplomacy of non-interference, mutual respect and friendship with Africa together with its increased trade and investment as a sign that “China’s presence in Africa should be seen as that of a partner in economic development”. It is evident that China’s engagement in the HoA brought in much needed FDI and finance especially in economic infrastructure projects, which would otherwise be too costly for these developing countries and supported the region to grow their internal economic connectivity and generating new opportunities for jobs, economic growth and inclusive
development.

The main objectives of attracting Chinese investment by the more successful HoA countries were to strengthen their basic transport economic infrastructure, and power generation and distribution and generate higher sustainable growth. Also of considerable interest in these countries was to have access to high technology, increase employment, acquire know-how, increase foreign exchange earnings through exports generation, and to benefit from both backward and forward linkages of the productive chain.

The good performing countries have viewed China’s increased investment and financial support as a means to foster their enhanced inclusive development and poverty reduction for opening up these economies to international markets, and attaining sustainable transformation. More specifically, the cooperative win-win developments was envisaged to bring proportional benefits through trade flows, technology transfer, and integration in global value chains, which otherwise these countries would not have access to before entering into these new relations.

Undoubtedly, Chinese investments and external financing in the well performing countries of the HoA have been indispensable part of their economies high and sustained economic growth achieved in recent years. Such investments have contributed to providing world class infrastructural development, injected much needed capital, introduced new technologies, modern management know-how, and enhanced demonstration effects into these economies.

The countries that have benefited from these Chinese investments have been in particular those that have synchronization their own national strategies with the sought out Chinese investments and external financing in such way as to have been committed to addressing the principal binding constraints on their national economic transformation. The productivity gains and spill over positive effects of these investments have permitted these good performing countries to leverage the contributions made by the Chinese direct foreign investment and external public financing.

The broad commentary of the policy makers in the region and few academic studies reviewed in this assessment demonstrated that the good performing countries in the HoA substantially benefited from the Chinese cooperative investments and financing. The Chinese investments in the HoA appear to be properly aligned with the South-South cooperative strategies and goals, of developing trade and investment linkages that are of mutual benefit to Africa and China.
Concerns Expressed on Impact of Chinese Investments and Financing

Some concerns expressed by academics and policy makers in the HOA and outside on the modalities of Chinese investment and finance flows into the region are worth noting. These exclude the run of the mill, politically motivated commentary and criticism of Chinese / Africa cooperation, which are espoused by “competing interests and expressed in hegemonic narratives”. But, such misguided narratives and fear-mongering commentary aside, there are objective and fact-based concerns on deficiencies noted with regard to the terms and conditions of Chinese investments and financing flows in the HoA (and elsewhere in the continent) that merit consideration and assessment, including the following:

(1) China is only interested in rich African countries with abundant resources. The concern among the academic community and the policy makers of fragile African economies is that the investment and financial resources from China to Africa further aggravate the disparities within the continent’s haves and have not’s. The top African country recipients of Chinese finance and investments are relatively the more developed countries and /or those that have proven minerals or hydrocarbons in abundance. According to those expressing this concern, the income disparities within the continent would further widen and unlike the model development of china itself will not contribute to considerable poverty reduction in the continent.

(2) The Fragile HoA economies do not benefit from access to Chinese investment and finance. The principal fragile economies in the HoA include Eritrea, Somalia, Sudan and South Sudan, largely on account of prolonged economic instability and often associated with insecurity attributed to inter-state or intra state conflicts. There has been some investments in the oil and gas sector in the Sudan and South Sudan by Chinese firms, but interest in other economic sectors in the fragile countries has been lacking. A case in point is the longstanding relationship of China with Somalia. Despite its diplomatic presence in Somalia since 1960, and evidence of Chinese aid to Somalia in many essential infrastructure projects between 1970—1990, Somali observers posit that China has not made any significant contribution to state recovery and reconstruction efforts in Somalia in the last 28 years of state fragility and ineffective state institutions. The evidence of fragility and ineffective institutional governance in Somalia clearly is a contributing factor to low engagement by China, but mutual benefits and joint cooperation could be explored at an early stage of recovery, as with some other bilateral engagements.
(3) Envisaged technology transfer of Chinese investments ought to be strengthened. Policy makers and academics have argued that success of considerable home grown technological progress in China in the last 3-4 decades will permit the well performing HoA countries to tap into this know-how and associated technology in a quick manner. The overwhelming evidence however is that most of the skilled labor and advanced equipment that built the base of China’s investment in Africa has remained in China and has not contributed to considerable transfer to HoA nations. A case in point is that most of the large investments in the railways industry in the HoA countries has not led to initiation of a heavy equipment manufacturing base that is essential for the sub region to develop and eventually meet its important transport requirements locally. It needs to be underlined that host countries will not be able to capture the technological transfer benefits associated with foreign direct investment until they achieve a certain threshold in terms of educational attainment, local technological capabilities, and viable industrial development, which should all be accelerated.

(4) There is inadequate consideration for environmental consequences. The terms and conditions of China’s negotiation tactics of offering loans to HoA are reported to lack adequate consideration of all relevant matters, and are limited in transparency and accountability with regard to adverse externalities. Observers point to inadequate and at times an overall lack of robust feasibility studies, cost–benefit analysis and environmental impact assessments on Chinese FDI in big infrastructure projects prior to loan agreements. The projects execution are conducted with the no external supervision, but with the entire processes from inception, technical and financial appraisals, engineering and construction, and final approval performed in house.

(5) The risks of non-sustainable debt accumulation should be avoided for vulnerable economies. Some HoA countries have accumulated high levels of public debts attributable partially to Chinese loans, raising the question of how such loans may ultimately be repaid, at what cost, and what sacrifices the governments’ may have to make to repay these loans. Some observers consider the accumulation of such large debts as unwise and unsustainable on the part of the HoA countries and African governments at large. It is the responsibility of governments to ensure that the borrowed funds are used for productive investments that generate additional productive capacity, to add to foreign exchange earnings and add value to debt service payments. Both the lending and borrowing countries should maintain caution, and ensure debt obligations would not lead to default and debt crisis--certainly they would both share the blame if projects considered “vanity” expenditures lead a country to quick and early debt
distress. Responsible policy makers in the HoA countries (and elsewhere) should be wary and vigilant that access to funding and its terms and conditions should be based on capacity of a country to maintain debt sustainability, in the long run.

(6) HoA countries could benefit from Chinese FDI in economic infrastructure projects of all sorts, in energy production and distribution, and in the manufacturing sector. Nevertheless they must learn from the concerns and shortcomings of past Chinese investment and financing flows in this sub region and other countries around the globe, particularly the need to establish formal, transparent, mutually beneficial trade and economic cooperation agreements, taking into account the impact of the investment in the local economy, environment, job creation and labor conditions, immigration and technology development.

Conclusions

The purpose of this policy note is to explore the important economic relationship that has developed between China and select countries in the Horn of Africa sub region, as it relates to the impact of Chinese investment and financing on economic growth and sustainable development in these countries. The evident conclusion of this assessment is that the relevant HoA countries benefited considerably from the FDI and the financing flows that they received in terms of the improved economic infrastructure and its impact on economic growth. In particular, the countries that properly utilized the Chinese financing and FDI as an integral part of their strategic growth transformation plans have achieved considerable success in their development efforts.

The China and Horn of Africa economic relationship and associated trade linkage is assessed as important for both parties, and as positively contributing to the economic transformation of the sub region. Accordingly, such linkages are envisaged to endure, provided that the objective concerns expressed by the policy makers and unbiased academics are addressed forthwith to enhance the efficacy and effectiveness of the investments and financing flows to the countries of the HoA, and by extension to other similar situations in Africa.

The principal concerns to be addressed to enhance the impact of Chinese investments and financing for growth and sustainable development are that (i) China policy makers and corporations should not only engage with the better performers, but also with the fragile economies that have yet to benefit from access to Chinese investment and finance, so as to have more comprehensive impact on inclusive and sustainable development in the sub region; (ii) envisaged technology transfer of Chinese investments is modest and should be
strengthened; and (iii) the risks of non-sustainable debt accumulation should be avoided for and by the vulnerable economies.

Table 1  Top recipients of Chinese Foreign Direct Investment in Africa, (USD Millions) in 2017

<table>
<thead>
<tr>
<th>Country Name</th>
<th>2017</th>
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<tbody>
<tr>
<td>South Africa</td>
<td>7,473</td>
</tr>
<tr>
<td>Congo, Dem. Rep.</td>
<td>3,884</td>
</tr>
<tr>
<td>Zambia</td>
<td>2,963</td>
</tr>
<tr>
<td>Nigeria</td>
<td>2,862</td>
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<tr>
<td>Angola</td>
<td>2,260</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>1,976</td>
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<tr>
<td>Algeria</td>
<td>1,834</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>1,748</td>
</tr>
<tr>
<td>Ghana</td>
<td>1,575</td>
</tr>
<tr>
<td>Kenya</td>
<td>1,544</td>
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